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NOTES

THE IMPOSITION OF NEW YORK CITY'S WATER AND SEWER RENTS ON NON-PROFIT INSTITUTIONS

I. Introduction

Nonprofit institutions established for religious, educational, or charitable purposes have long enjoyed immunity from real property taxation.¹ In New York, these institutions are protected by the state constitution.² State law further exempts these institutions from service charges, special *ad valorem* levies, and special assessments.³ Such charges are imposed on non-exempt real property by municipalities to defray the cost of specific services and improvements⁴ and are deemed to be taxes. It is well established that local charges for the use of water and sewer services are not taxes⁵ and

1. See generally Bennett, *Real Property Tax Exemptions of Non-Profit Organizations*, 16 CLEV.-MAR. L. REV. 150 (1967); Curtiss, *Tax Exemption of Educational Property in New York*, 52 CORNELL L.Q. 551 (1967) [hereinafter cited as *Tax Exemption of Educational Property in New York*]; Ginsberg, *The Real Property Tax Exemption of Non-Profit Organizations: A Perspective*, 53 TEMP. L.Q. 291 (1980); Note, *New York's Real Property Tax Exemptions for Religious, Education, and Charitable Institutions: A Critical Examination*, 44 ALB. L. REV. 488 (1980) [hereinafter cited as *New York's Real Property Tax Exemptions*]; Note, *Exemption of Educational, Philanthropic, and Religious Institutions from State Real Property Taxes*, 64 HARV. L. REV. 288 (1950); Note, *Real Property Tax Exemption of Churches*, 29 ST. JOHN'S L. REV. 121 (1954); Note, *Alternatives to University Property Tax Exemption*, 83 YALE L.J. 181 (1973).

2. N.Y. CONST. art. XVI, § 1. This constitutionally mandated exemption is codified in New York's Real Property Tax Law, N.Y. REAL PROP. TAX LAW § 421 (McKinney 1972). Although there are numerous groups of property exempt from taxation, this Note is concerned only with nonprofit institutions which are exempt.

3. N.Y. REAL PROP. TAX LAW §§ 102 (13-a), (14), (15), 440, 448 (McKinney 1972); § 498(d) (McKinney Supp. 1980-1981) (exempting religious, charitable, educational, hospital or cemetery associations from the payment of service charges).

4. *Id.* § 420(1). It has been consistently held, for example, that the property tax exemption institutions are similarly exempt from the payment of local charges for fire protection. See *State Univ. v. Patterson*, 42 A.D.2d 328, 346 N.Y.S.2d 888 (3d Dep't 1973); *New York Tel. Co. v. Common Council*, 43 Misc. 2d 668, 252 N.Y.S.2d 126 (Sup. Ct. 1964), *aff'd*, 25 A.D.2d 682, 269 N.Y.S.2d 692 (2d Dep't 1966); *Rector of Christ Church v. Town of Eastchester*, 197 Misc. 943, 99 N.Y.S.2d 991 (Sup. Ct. 1950).

5. See *Robertson v. Zimmerman*, 268 N.Y. 52, 196 N.E. 740 (1935); *New York Univ. v. American Book Co.*, 197 N.Y. 294, 90 N.E. 819 (1910); *Silkman v. Board of Water Comm'rs*,

therefore do not fall under the constitutional umbrella of tax exemption.

Historically, state and local laws have enabled virtually all non-profit institutions in New York City to avoid payment of water and sewer rents. Due to the critical need in New York City for additional revenues, many of these institutions no longer enjoy exemptions.

This Note will examine the nature of New York City's water and sewer rents and exemptions. First, this Note will discuss the method by which New York City charges for water and sewer services. Second, it will examine the case law that establishes the liability of nonprofit institutions for the payment of water and sewer rents. Third, it will examine the exemptions from water and sewer rents extended to nonprofit organizations in New York City. Until 1980, given the widespread practice of granting exemptions to nonprofit institutions, there were few challenges to the validity of New York City's water and sewer rents. In light of the recent cancellation of exemptions, this Note will discuss possible arguments which nonprofit institutions might use to challenge New York City's water and sewer rents.

II. New York City's Water and Sewer Rents: Implementation of the Charge

State and local governments perform certain "governmental functions" essential to their ability to administer the law and provide public services.⁶ The provision of water and sewer services by a city to its citizens has been held to be a "governmental function" carried out for the benefit of the general public.⁷ Indeed, New York state law empowers cities to supply, regulate, and sell water to its citizens⁸ and to construct, maintain and operate sewer systems.⁹ In

152 N.Y. 327, 46 N.E. 612 (1897); *Brass v. Rathbone*, 153 N.Y. 435, 47 N.E. 905 (1897). See also notes 23 and 28 *infra*.

6. See *National League of Cities v. Usery*, 426 U.S. 833 (1976). In a partial list of activities which it deemed to be essential or traditional governmental functions of state or local governments, the Supreme Court included fire prevention, police protection, sanitation, public health, and parks and recreation. *Id.* at 851.

7. *Parsons Constr. Corp. v. City of New York*, 163 Misc. 932, 940, 298 N.Y.S. 276, 285 (Mun. Ct. 1937). See also *Puckett v. City of Muldraugh*, 403 S.W.2d 252 (Ky. 1966); *Henry B. Byors & Sons v. Board of Water Comm'rs*, 358 Mass. 354, 264 N.E.2d 657 (1970); *Uhler v. City of Olympia*, 87 Wash. 1, 151 P. 117 (1915).

8. N.Y. GEN. CITY LAW art. 2-A, § 20 (2), (7) (McKinney 1968 and Supp. 1980). See also

return for furnishing these services, cities are entitled to compensation fixed by law.¹⁰

In New York City, the compensation for providing water to city residents is determined either by metering¹¹ or by a uniform annual charge or annual flat rate.¹² Unlike metering, the flat rate does not measure actual water consumption but adopts a schedule to approximate use. The schedule takes into consideration such factors as the frontage of the building,¹³ and the number of floors and apartments in the building.¹⁴ This method of assessment, nev-

People *ex rel.* City of New York v. Queens County Water Co. 232 N.Y. 277, 282, 133 N.E. 889, 891 (1922); City of New York v. Jamaica Water Supply Co., 226 N.Y. 572, 123 N.E. 859 (1919).

9. N.Y. GEN. CITY LAW art. 2-A, § 20(2), (7) (McKinney 1968 & Supp. 1980). See also GEN. MUN. LAW art. 14F §§ 450-54 (McKinney 1968 & Supp. 1980).

10. City of New York v. Psaty & Fuhrman, Inc., 166 Misc. 938, 939, 3 N.Y.S.2d 230, 232 (Mun. Ct. 1938) ("The city is entitled to be paid for water that it supplies to anyone."); Parsons Constr. Corp. v. City of New York, 163 Misc. 932, 940, 298 N.Y.S. 276, 285 (Mun. Ct. 1937). See also N.Y. GEN. CITY LAW art. 2-A § 20 (7-a) (McKinney 1968) (which empowers a city to sell and convey the water supply to a water authority, a county water district, or a joint water works system, and if the proceeds exceed the cost of the facilities (including principal and interest on indebtedness) these excess funds may be used for any purpose).

11. N.Y.C. ADMIN. CODE ch. 30 § 734(4)-1.0 (1977).

12. N.Y.C. CHARTER ch. 57 § 1403(a)(1)(d) (McKinney Supp. 1980-1981).

13. "Frontage" means the front width of a building. Board of Estimate Res. (Cal. No. 89), § 1(B), adopted June 12, 1980. The frontage rate is fixed as follows:

Section I(B) — Frontage Rents.

The annual frontage rents on premises wholly or partly unmetered shall be as follows:

Front Width of Building	One Story	
16 feet and under	[\$21.00]	\$24.15
Over 16 feet to 18 feet	[26.25]	30.19
Over 18 feet to 20 feet	[31.50]	36.23
Over 20 feet to 22½ feet	[36.75]	42.26
Over 22½ feet to 25 feet	[42.00]	48.30
Over 25 feet to 30 feet	[52.50]	60.38
Over 30 feet to 37½ feet	[63.00]	72.45
Over 37½ feet to 50 feet	[73.50]	84.53

Id. (new rates in italics).

14. For each additional story [\$5.25] \$6.04 per annum shall be added; and for each addition (10) feet or part thereof above fifty (50) feet in front width of building, [\$10.50] \$12.08 shall be added.

All rear buildings on any lot or lots with front buildings thereon, shall pay an annual frontage rate of [\$26.25] \$30.19 for each twenty-five (25) front, or fraction thereof, but this provision shall not apply to buildings erected on corner lots, each of

ertheless, has long been accepted by the city and upheld by New York courts.¹⁵ The meter and flat rates are fixed by the Commissioner of the Department of Environmental Protection subject to the approval of the Board of Estimate.¹⁶ By law, "all places in which water is furnished for business consumption" must be metered;¹⁷ other buildings are not so required¹⁸ and may opt for the flat rate.

Any owners of real property who use the city's sewer system must compensate the city in the form of sewer rents.¹⁹ The sewer rent is fixed at one-third of the property's water rent.²⁰ Funds realized from such rents may be used to defray the costs of construction of sewers, including interest on debts, and the costs of operation, maintenance, and repair of sewage treatment and disposal works.²¹

which building shall pay the regular rates as stated in the foregoing subdivision.

The apportionment of the regular frontage rates upon buildings shall be on the basis that but one family is to occupy same, and for each additional family or apartment [\$5.25] \$6.04 per year shall be charged.

Id. Additional fees are changed for miscellaneous items such as baths and toilets. *Id.* § 2(1)-(55).

15. *Grace Inst. v. Clark*, 35 A.D.2d 368, 371, 316 N.Y.S.2d 670, 672 (1st Dep't 1970); *Hennessey v. Volkening*, 22 N.Y.S. 528, 530, 533 (Super. Ct. N.Y.C. 1893).

16. N.Y.C. CHARTER ch. 57 § 1403 (a)(1)(d) (McKinney Supp. 1980-1981). As of July 1, 1980, the meter rate was 52.5¢ per 100 cubic feet of water consumed. Board of Estimate Res. (Cal. No. 89), § 3(a) adopted June 12, 1980.

17. N.Y.C. ADMIN. CODE ch. 30, § 734(4)-1.0 (1977), authorizes the New York City Commissioner of Water Supply, Gas and Electricity to order the installation of metering "in any or all stores, workshops, hotels, lodging houses, factories, office buildings, and public edifices, at wharves, ferry houses, and stables, and in all places in which water is furnished for business consumption." *Id.*

18. *Id.* But see Carmody, *Stern Seeks Apartment-House Water Meters*, N.Y. Times, Jan. 12, 1981, at B5, col. 1 (concerning proposed legislation to require metering in apartment buildings and multiple dwellings in order to reduce city water consumption). The Administrative Code does provide that a multiple dwelling may be required to be metered by resolution of the Board of Estimate or by local law, N.Y.C. ADMIN. CODE § 734(4)-1.0 (1977), or because of repeated waste of water violations. *Id.* § 734(4)-4.1 (1977).

19. N.Y. GEN. CITY LAW art 2-A § 20 (26) (McKinney 1968), authorizes a city to establish a scale of rents by metering or by a flat rate based on number and kind of plumbing fixtures connected with the sewer system or number of persons served by the system or by a local legislative body on any equitable basis.

20. N.Y.C. ADMIN. CODE § 683 a4-9.0 (b)(2) (1977) (as amended by Pub. L. No. 32 which raised the sewer rent from one-quarter of the water rent to one-third; the increase applies to all sewer rent billings on and after July 1980. 1980 N.Y. Laws ch. 32).

21. N.Y. GEN. MUN. LAW art. 14-F § 453 (McKinney 1974).

III. Liability of Tax-Exempt Institutions for Water and Sewer Rents

New York courts have long held that municipal levies for water and sewer services are not "taxes." In 1897, the New York Court of Appeals in *Silkman v. Board of Water Commissioners*²² ruled that a water rent charged by a public corporation for actual consumption of water was a payment pursuant to a contractual obligation and not a tax.²³ The court distinguished between "rents" paid for a specific quantity of water consumed and a "tax" paid for the potential benefit to the property owner from the existence of water in the city.²⁴ The court in *Silkman* noted that in the case of "rents" the property owner pays only for what he uses, while a "tax" is paid regardless of use.²⁵ A water rent arises from a contract, express or implied,²⁶ between a municipal seller and a private con-

22. 152 N.Y. 327, 46 N.E. 612 (1897). In *Silkman*, a property owner challenged an increase in water rates which was implemented without notice. The court of appeals held:

We are of the opinion that, under these circumstances, the water rents charged the plaintiffs were not in the nature of taxes, but were rents established for water actually used and supplied to him under an express contract that he would pay for it at the rates established by the defendant [the Board of Water Commissioners of the City of Yonkers], and, therefore, he is not entitled to either enjoin the defendant from collecting them, or to recover any portion of them paid under protest.

Id. at 331-32, 46 N.E. at 613. See also *Town Bd. v. City of Poughkeepsie*, 22 A.D.2d 270, 255 N.Y.S.2d 549 (2d Dep't 1964) (holding under *Silkman* that pursuant to a water contract, a municipality may change rates without notice to the buyer).

23. 152 N.Y. at 331, 46 N.E. at 613. *Accord*, *New York Univ. v. American Book Co.*, 197 N.Y. 294, 90 N.E. 819 (1910); *YMCA v. Rochester Pure Water Dist.*, 44 A.D.2d 219, 354 N.Y.S.2d 201 (4th Dep't 1974), *aff'd*, 37 N.Y.2d 371, 334 N.E.2d 586, 372 N.Y.S.2d 633 (1975); *Rupersam Realty Corp. v. Larpeg Realty Corp.*, 253 A.D. 695, 3 N.Y.S.2d 840 (2d Dep't 1938); *Dunbar v. City of New York*, 177 A.D. 647, 164 N.Y.S. 519 (1st Dep't 1917), *aff'd*, 223 N.Y. 597, 119 N.E. 1039 (1918), *aff'd*, 251 U.S. 516 (1920); *Emerson v. Plastronics, Inc. v. City of New York*, 82 Misc. 2d 770, 772, 370 N.Y.S.2d 366, 368 (Sup. Ct. 1975); *City of New York v. Idlewild Beach Co.*, 182 Misc. 205, 43 N.Y.S.2d 567 (County Ct. 1943).

24. 152 N.Y. at 330, 46 N.E. at 613.

25. The court in *Silkman* noted that a tax would be levied against a vacant lot, whereas, a water rent would not. *Id.* See also, *New York Univ. v. American Book Co.*, 197 N.Y. 294, 297, 90 N.E. 819, 820 (1910); *Parsons Constr. Corp. v. City of New York*, 163 Misc. 932, 298 N.Y.S. 276 (Mun. Ct. 1937), in which the same distinction was made concerning a flat-rate water charge.

26. In *Silkman*, the contract was held to be express, because the plaintiff had specifically requested that he be supplied with water, subject to the rates, rules and regulations of the board of water commissioners. 152 N.Y. at 331, 46 N.E. at 613. In *Brass v. Rathbone*, 153 N.Y. 435, 440-41, 47 N.E. 905, 907 (1897), the plaintiff had made no such request and the court, applying the principle established in *Silkman*, upheld the water rent on the basis of an implied contract.

sumer, for the provision of water at rates set by the seller.²⁷

The *Silkman* principle has been extended to the imposition of sewer rents,²⁸ especially where the rents are fixed at a percentage of the water rent,²⁹ which is the practice in New York City. The amount of water usage determines the amount of sewer usage.³⁰ Courts have understandably held that a sewer rent is as valid as a water rent.³¹

Unlike water and sewer rents, service charges, special *ad valorem* levies and special assessments from which charitable, religious and educational institutions are exempt by state law,³² are in the nature of taxes, not contractual obligations.³³ These charges are levied according to a percentage of the rate of tax assessed on real property,³⁴ not according to use. Charges for water and sewer

27. *New York Univ. v. American Book Co.* 197 N.Y. at 297, 90 N.E. at 820; *Silkman v. Board of Water Comm'rs*, 152 N.Y. at 331-32, 46 N.E. at 613.

28. See *Robertson v. Zimmermann*, 268 N.Y. 52, 64, 196 N.E. 740, 744-45 (1935); *Battista v. Board of Estimate*, 51 Misc. 2d 962, 966-67, 274 N.Y.S.2d 729, 733-34 (Sup. Ct. 1966), *aff'd*, 27 A.D.2d 986 (2d Dep't 1967); *L.X. Corp. v. City of New York*, 201 Misc. 400, 115 N.Y.S.2d 120 (Sup. Ct. 1952), *aff'd*, 281 A.D. 860, 119 N.Y.S. 917 (1st Dep't 1953).

29. *Battista v. Board of Estimate*, 51 Misc. 2d at 963, 274 N.Y.S.2d at 730; *L.X. Corp. v. City of New York*, 201 Misc. at 401, 115 N.Y.S. at 121.

30. It is fair to assume that sewage use is affected and determined by water use. New York City's water charge is levied according to use; the sewer charge is levied at a fraction of the water charge and therefore the amount of the sewer charge is similarly determined by use. See, e.g., *L.X. Corp. v. City of New York*, 201 Misc. 400, 115 N.Y.S.2d 120 (Sup. Ct. 1952), *aff'd*, 281 A.D. 860, 119 N.Y.S.2d 917 (1st Dep't 1953).

31. See note 28 *supra*.

32. N.Y. REAL PROP. TAX LAW §§ 102, (13-a), (14), (15), 490, 498(d) (McKinney 1972 and Supp. 1980-1981). See also *Rupersam Realty Corp. v. Larpeg Realty Corp.*, 253 A.D. 695, 696, 3 N.Y.S.2d 840, 841 (2d Dep't 1938) ("when water rents are incurred by a consumer such rents are not classified as taxes or assessments"). Special *ad valorem* levies, special assessments and service charges would be imposed in addition to rents for water and sewer use for special improvements or services. See N.Y. REAL PROP TAX LAW §§ 490, 498 (McKinney 1972).

33. See, e.g., OP. COUNSEL S.B.E.A. No. 32, construing the New York Real Property Tax Law § 102(13-a) and § 498: "[t]his section is concerned with charges that are in the nature of a tax, not contractual obligations." N.Y. REAL PROP. TAX LAW § 102(14) (McKinney 1972), defines a special *ad valorem* levy as "a charge imposed upon benefited real property in the same manner and at the same time as taxes." In *Y.M.C.A. v. Rochester Pure Water Dist.*, 44 A.D.2d 219, 354 N.Y.S.2d 201 (4th Dep't 1974), *aff'd*, 37 N.Y.2d 371, 334 N.E.2d 586, 372 N.Y.S.2d 633 (1975), the Fourth Department and the court of appeals distinguished a charge for water and sewer services, which was characterized as a "user charge," from special assessments and *ad valorem* levies. 44 A.D.2d at 223, 354 N.Y.S.2d at 204, 37 N.Y.2d at 376-77, 334 N.E.2d at 589, 372 N.Y.S.2d at 636-37.

34. See N.Y. REAL PROP. TAX LAW §§ 102 (14), (15), 498(a) (McKinney 1972).

services are not "taxes" but are akin to the rates charged by a public utility service,³⁵ like electricity or gas, from which tax-exempt institutions are not automatically exempt.³⁶

IV. Exemptions from Water and Sewer Rents

Tax-exempt institutions located in New York City have, at various times, received exemptions from local water and sewer rents. The first state exemption was granted in 1887, when the state legislature enacted chapter 696 of the Laws of New York, prospectively exempting hospitals, orphan asylums and homes for the aged from the payment of water rents to the City of New York.³⁷ These organizations likewise were released from any outstanding unpaid water rents.³⁸ By 1970, the Act had been amended twelve times³⁹

35. See *Battista v. Board of Estimate*, 51 Misc. 2d at 967, 274 N.Y.S.2d at 734. See also *YMCA v. Rochester Pure Water Dist.*, 44 A.D.2d at 224, 354 N.Y.S.2d at 206.

36. See 11 OP. N.Y. COMP. 19 (1955) ("Tax exempt properties are not exempt from payment of water rents . . ." 35 OP. N.Y. COMP. 353 (1979) ("The real property of schools, churches, and cemeteries is exempt from taxes but subject to sewer rents. . .").

37. "AN ACT to provide hospitals, orphan asylums and other charitable institutions in the City of New York with water and remitting assessments therefore." This exemption applied to then existing institutions and any established in the future. 1887 N.Y. Laws, ch. 696. Some observations may be made concerning the rationale for exempting nonprofit institutions in New York City from water and sewer charges. First, that the Act applies only to New York City may be explained by the state's long-standing policy of treating the city differently from the state for the purposes of real property tax assessment. See *Matter of Colt Indus., Inc.*, N.Y.L.J., June 4, 1980, at 10, cols. 2-6, at 11, col. 1 (Sup. Ct.). Indeed, it appears that nonprofit institutions outside New York City have not received water and sewer exemptions. See, e.g., *First Baptist Church v. Vogal*, 23 Misc. 31, 197 N.Y.S.2d 951 (Sup. Ct. 1960) (holding that although the First Baptist Church of Long Beach was exempt from real property taxes, it was not exempt from the City of Long Beach's water and sewer charge). *Id.* at 31-32, 197 N.Y.S.2d at 952.

As to why the exemption was granted, it is fair to assume that the same reasons for exempting nonprofit institutions from property taxes — for example, because they provide beneficial services to the public which the state might otherwise have to provide — convinced the legislature to grant water and sewer exemptions. For an indication of the policy behind granting property tax exemptions see N.Y.S. CONSTITUTIONAL CONVENTION OF 1938, 2 REVISED RECORD 1109 (1938) (remarks of John Godfrey Saxe, member of the Subcommittee on Taxation and Finance of the N.Y.S. Constitutional Convention Committee) ("[Exemption] has been the policy of the State because these religious and educational and charitable institutions perform a social function which otherwise might have to be taken care of by the State." *Id.*) See also *New York's Real Property Tax Exemptions*, *supra* note 1, at 502-04; *Tax Exemption of Educational Property in New York*, *supra* note 1, at 552-54; text accompanying notes 115-116 *infra*.

38. 1887 N.Y. Laws ch. 676 § 1.

39. 1970 N.Y. Laws ch. 167; 1957 N.Y. Laws ch. 433; 1921 N.Y. Laws ch. 607; 1913 N.Y. Laws ch. 226; 1911 N.Y. Laws ch. 686; 1907 N.Y. Laws ch. 135; 1906 N.Y. Laws ch. 440; 1902

to exempt thirteen additional classes of nonprofit organizations from payment of water charges.⁴⁰ It also reserved to the Mayor of the City of New York the power to cancel some of these exemptions by executive order.⁴¹

One class of tax-exempt property, however, was never included in the Act's exemption: property owned by parochial and private schools.⁴² These educational institutions, nevertheless, have avoided payment of water rents by virtue of the New York City Administrative Code.⁴³ Although the Code does not grant an exemption by right to any class of property owners, it does allow the Board of Estimate, acting in its own discretion, to remit or cancel

N.Y. Laws ch. 605; 1896 N.Y. Laws ch. 852; 1895 N.Y. Laws ch. 459; 1894 N.Y. Laws ch. 672; 1890 N.Y. Laws ch. 492.

40. The amendments to Chapter 696 exempted the following institutions from the payment of water charges:

Dispensaries, houses or homes for the reformation, protection or shelter of females, day nurseries . . . non-profit organizations furnishing volunteer aid to the sick and wounded of armies, etc., industrial homes, institutions for medical research owned by a charitable corporation, public baths, free school societies, free circulating libraries, veteran firemen's associations, social settlements, religious corporations used exclusively as a place of public workshop, and associations of honorably discharged soldiers, sailors, or marines, devoted exclusively to patriotic and charitable purposes. 1970 N.Y. Laws, ch. 167.

41. 1970 N.Y. Laws ch. 167. The statute provided that the mayor could only cancel exemptions of institutions eligible to receive reimbursements from federal, state or local governments. For example, hospitals and nursing homes which provide hospital and health-related services to needy persons receive state and federal reimbursements pursuant to N.Y. PUB. HEALTH LAW § 2807 (McKinney 1974); N.Y. INS. LAW § 250 (McKinney 1966) (Blue Cross-Blue Shield); 42 U.S.C. § 1396 (1976) (Medicaid). *Cf.*, Long Island College Hosp. v. Whalen, 68 A.D.2d 274-77, 416 N.Y.S.2d 841, 844 (3d Dep't 1979) (holding that legal fees incurred in litigation against the state are costs "reasonably related to the efficient production of hospital services" and therefore merit reimbursement under N.Y. PUB. HEALTH LAW § 2807 (McKinney 1974) and 42 U.S.C. § 1396a (1976)).

42. Chapter 696, as amended, exempts "free schools" from water and sewer charges. 1970 N.Y. Laws ch. 167. Prior to the mayor's Executive Order of Feb. 13, 1980, *see* note 51 *infra* and accompanying text, it was an unwritten policy of the Department of Water Register to treat schools charging tuition of less than \$30 per month as free schools, thereby exempting them. The term "free school" has since been narrowly construed to mean only those schools which charge no tuition. Information provided by the New York City Department of Environmental Protection to the author (Feb. 23, 1981).

43. N.Y.C. ADMIN. CODE ch. 5, § 93d-9.0 (McKinney 1976). An application must be filed by the organization seeking cancellation and approved by the City Comptroller. Cancellations were regularly made on behalf of educational institutions. *See* Basler, *Catholics and Jews Assail Water Fees at Schools*, N.Y. Times, Apr. 30, 1980, at B1, col. 1; Quindlen, *New York Abolishes Free Water and Cry is Heard Around the World*, N.Y. Times, Jan. 21, 1980, at A1, col. 2.

payment of water rents to any property owner it deems worthy.⁴⁴

The cancellation of water rents requires the unanimous approval of the Board of Estimate.⁴⁵ In 1978, Mayor Edward I. Koch and City Council President Carol Bellamy, as members of the Board, began to vote consistently against any cancellations.⁴⁶ By 1980, all of the city's 400 Catholic schools, 200 Jewish schools, and all other "private" schools, colleges and universities whose water bills had been customarily cancelled in prior years were no longer excused from the payment of water rents.⁴⁷ According to the mayor, the "City's desperate fiscal plight" justified his action.⁴⁸

Consistent with this policy,⁴⁹ the mayor exercised the power granted to him in 1970 by the legislature,⁵⁰ and cancelled whatever exemptions he could. Accordingly, on February 13, 1980, Mayor Koch issued an executive order requiring a number of tax-exempt organizations to pay water rents.⁵¹ Because the Administrative Code provides that any real property entitled to an exemption from the payment of water rents will be similarly exempted from the payment of sewer rents,⁵² the order effectively cancelled both.

44. An organization could, of course, withhold payment until the Board formally cancelled the unpaid charges. The lien placed upon the property for non-payment, N.Y.C. ADMIN. CODE ch. 5 § 93d-9.0 (1976), would be removed by the Board's resolution. The organization would have effectively received an exemption, not a remittance.

45. N.Y.C. ADMIN. CODE ch. 5 § 93d-9.0 (McKinney 1976).

46. Information furnished by the New York City Board of Estimate, Office of the Secretary (Feb. 18, 1981). On Sept. 28, 1978, the mayor and the city council president initially voted against cancellation of any water and sewer payments that were due as of July 1, 1978.

47. Basler, *Catholics and Jews Assail Water Fees at Schools*, N.Y. Times, Apr. 30, 1980, at B1, col. 1.

48. See A. Quindlen, *New York Abolishes Free Water and Cry is Heard Around the World*, N.Y. Times, Jan. 21, 1980, at A16, col. 5.

49. See letter from Franklin Havelick, Special Advisor to the Mayor, to the author (Feb. 4, 1981) (on file with *Fordham Urban Law Journal*), stating that "the Mayor's policy has been to maximize revenues to the City and to eliminate inequitable exemptions." *Id.*

50. 1970 N.Y. Laws, ch. 167.

51. Office of the Mayor, The City of New York, Exec. Order No. 43 (1980). Pursuant to 1970 N.Y. Laws ch. 167, this order applied only to organizations eligible to receive reimbursement from either federal, state or city governments. Thus, the order cancelled exemptions previously enjoyed by hospitals and nursing homes. See note 41 *supra*.

52. N.Y.C. ADMIN. CODE ch. 28 § 683(a)4-9.0(4) (McKinney 1977). See, e.g., *Society of the N.Y. Hospital v. D'Angelo*, N.Y.L.J., May 13, 1963, at 15, col. 5 (Sup. Ct.) (hospitals exempt from water rents pursuant to 1957 N.Y. Laws ch. 433 are similarly exempt from sewer rents); *Associated YM-YWHA's of Greater New York, Inc. v. D'Angelo*, 38 Misc. 2d 1082, 239 N.Y.S.2d 722 (Sup. Ct. 1963) (community center exempt from sewer rents by

The mayor's decision was not taken lightly by the institutions affected. A number of religious and educational institutions lobbied for aid from the state legislature.⁵³ Most of the lobbyists represented small parochial and private schools which did not fall within the scope of chapter 696, and had to depend on the Board of Estimate to cancel their water and sewer bills.⁵⁴ They argued that the reversal of the customary policy of cancellation would compel them either to reduce school services or to pass on the added charges in the form of higher tuition.⁵⁵ And parents, it was insisted, were already struggling to meet tuition costs and might have to remove their children from parochial or private schools if tuitions were raised.⁵⁶ A movement away from these educational institutions, one might argue, would not only deprive children of a sought-after education, but might threaten the continued survival of these institutions, and overburden the public school system.⁵⁷

In June of 1980, the state legislature amended chapter 696⁵⁸ to include the non-public primary and secondary schools owned by tax-exempt entities which had not previously been covered by the Act.⁵⁹ This amendment also granted a full exemption to all institutions covered by chapter 696 whose annual rents were less than \$5,000, and a fifty percent exemption to those whose annual rents exceeded \$5,000 but were less than \$10,000.⁶⁰ Those institutions

virtue of exemption from water rents).

53. Basler, *Catholics and Jews Assail Water Rents at Schools*, N.Y. Times, Apr. 30, 1980, at B1, col. 1. These organizations included the Archdiocese of New York, Agudath Israel of America, and the Brooklyn Diocese.

54. *Id.*

55. Basler, *A Private-School Victory over Water and Sewer Fee*, N.Y. Times, June 17, 1980, at B1, col. 2.

56. *Id.*

57. Similar arguments have been advanced in support of extending state aid to parochial schools. In the late 1960's, there was considerable debate concerning the repeal of Article II, § 3 of the New York State Constitution, commonly called the "Blaine Amendment," which contained a general prohibition against public aid to parochial schools. Proponents of the amendments' repeal argued that without a public subsidy, secular schools would be forced to close and the public schools would have to absorb the additional students at the taxpayers' expense. See Remarks of State Comptroller Arthur Levitt (Apr. 17, 1967), reprinted in OFFICE OF LEGISLATIVE RESEARCH, *Church and State in Education (The So-Called Blaine Amendment)* at 17-18 (June 18, 1967); Press Release of Msgr. Edgar P. McCarren (May 15, 1967). *Id.* at 18.

58. 1980 N.Y. Laws ch. 893.

59. *Id.* § 1.

60. *Id.* § 2b.

whose rents exceeded \$10,000 were not exempt and were required to pay full water and sewer charges.⁶¹ The mayor retained the power to cancel the exemptions of institutions eligible for reimbursement.⁶²

Thus, the June, 1980 amendment accomplished a dual purpose. On the one hand, it exempted small schools up to the twelfth grade which might be financially unable to absorb payment of water and sewer fees. On the other hand, it withdrew the exemption from able larger nonprofit institutions. No exemption was extended to colleges or universities.⁶³

V. Possible Challenges to New York City's Water and Sewer Rents

A. Equal Protection

The legislature's recent amendment classifies nonprofit institutions according to the amount of water they use and establishes varying rates of payment according to these classifications. Users of up to \$5,000 worth of water are exempt from water and sewer charges; users of between \$5,000 and \$10,000 must pay for one-half of the water they use; users of over \$10,000 receive no exemption.⁶⁴ Arguably such a classification discriminates against larger nonprofit institutions whose water consumption is substantial and denies them the equal protection of the laws.⁶⁵

Although it is well settled that a water charge must not be discriminatory,⁶⁶ this does not mean that a governmental entity may

61. *Id.* Chapter 893 was amended in an extraordinary session of the Senate and Assembly on Nov. 19, 1980, providing that the legislation would take effect on Jan. 1, 1981 and that the partial and full water and sewer payments were due as of Sept. 1, 1981.

62. 1980 N.Y. Laws ch. 893 § 1. *See note 41 supra.*

63. The city has filed a complaint against New York University alleging nonpayment of outstanding water and sewer rents. *City of New York v. New York Univ.*, No. 40837/81 (Sup. Ct.) (motion for summary judgment, filed Feb. 19, 1981).

64. 1980 N.Y. Laws ch. 893 § 2b.

65. *See* U.S. CONST. amend. XIV § 1; N.Y. CONST. art. I § 11.

66. *Town Bd. v. City of Poughkeepsie*, 22 A.D.2d 270, 273, 255 N.Y.S.2d 549, 552 (2d Dep't 1964); *Weiskopf v. City of Saratoga Springs*, 244 A.D. 417, 422, 279 N.Y.S. 878, 883 (3d Dep't 1935), *rev'd on other grounds*, 269 N.Y. 634, 200 N.E. 33 (1936); *People v. Albion Waterworks Co.*, 140 A.D. 646, 649, 125 N.Y.S. 589, 591 (4th Dep't 1910). This principle is equally well established in other states. *See, e.g., Water Works Bd. v. White*, 281 Ala. 357, 202 So. 2d 721 (1967); *Western Heights Land Corp. v. City of Fort Collins*, 146 Colo. 464, 362 P.2d 155 (1961); *Conner v. City of Elmhurst*, 28 Ill. 2d 221, 190 N.E.2d 760 (1963); *Seltzer v. Sterling Twp.*, 371 Mich. 214, 123 N.W.2d 722 (1963); *City of Clifton v. Passaic*

not charge different consumers different rates.⁶⁷ It has been held that absolute uniformity is not required⁶⁸ as long as the classifications are not arbitrary or unjust.⁶⁹ Variances in rates must have a "rational basis" and must be "fair and equal" to similarly situated properties,⁷⁰ that is, classification is proper as long as there is "uniformity within the class."⁷¹

Since water and sewer rents are not taxes, the legislature is not constitutionally bound to exempt any nonprofit institutions from

Valley Water Comm'n, 59 N.J. Super. 87, 157 A.2d 151 (Super. Ct. 1960).

67. *Town Bd. v. City of Poughkeepsie*, 22 A.D.2d at 273, 255 N.Y.S.2d at 552. See *People v. Albion Waterworks Co.*, 140 A.D. at 649, 125 N.Y.S. at 591 ("the defendant may supply water to the public school buildings or to charitable institutions without charge, and not be properly subject to the accusation of undue preference to these institutions"); *Silkman v. Water Comm'rs*, 152 N.Y. 327, 332, 46 N.E. 612, 613 (1897) (that a water rent imposes a lower rate on heavy users than on light users does not render it discriminatory).

68. *Town Bd. v. City of Poughkeepsie*, 22 A.D.2d at 273, 255 N.Y.S.2d at 552. The state's power to classify water users, e.g., *Weiskopf v. City of Saratoga Springs*, 244 A.D. at 422, 279 N.Y.S. at 883, follows from the long-standing principle that a state may classify taxpayers. See, e.g., *Swiss Oil v. Shanks*, 273 U.S. 407, 413 (1927) (the fourteenth amendment does not require uniformity of taxation); *Northwestern Life Ins. Co. v. Wisconsin*, 247 U.S. 132, 138-39 (1918) ("That the State is not because of the Fourteenth Amendment required to tax all property alike, and may classify the subjects selected for taxation, is too well established to require citation of the many cases in this court which have so held."); *People ex rel. Hatch v. Reardon*, 184 N.Y. 431, 445, 77 N.E. 970, 974 (1906) ("The legislature has power to classify as it sees fit by imposing a heavy burden on one class of property and no burden at all upon others. . . . The power of taxation necessarily involves the right of selection, which is without limitation, provided all persons in the same situation are treated alike and the tax [sic] imposed equally upon all property of the class to which it belongs.").

69. See *Central School Dist. No. 1 v. Village of Schoharie*, 42 A.D.2d 1008, 348 N.Y.S.2d 212 (3d Dep't 1973) (holding that a water and sewer rate which applied only to schools was purely arbitrary and thus discriminatory); *Town Bd. v. City of Poughkeepsie*, 22 A.D.2d at 273, 255 N.Y.S.2d at 552; *Weiskopf v. City of Saratoga Springs*, 244 A.D. at 421, 422, 279 N.Y.S. at 882; *Silkman v. Board of Water Comm'rs*, 152 N.Y. at 332, 46 N.E. at 613. In tax cases, the standard has been held to be whether the classification is arbitrary or capricious. See, e.g., *Allied Stores v. Bowers*, 358 U.S. 522, 528 (1959) (a classification is not arbitrary nor capricious if a "state of facts reasonably can be conceived that would sustain it"); *Shapiro v. City of New York*, 32 N.Y.2d 96, 107, 296 N.E. 230, 237, 343 N.Y.S.2d 323, 332, *appeal dismissed*, 414 U.S. 804 (1973) (tax classification imposing greater tax on self-employed persons than salaried employees was not arbitrary nor capricious and therefore valid).

70. *Town Bd. v. City of Poughkeepsie*, 22 A.D.2d at 273, 255 N.Y.S.2d at 552. *Weiskopf v. City of Saratoga Springs*, 244 A.D. at 421, 422, 279 N.Y.S. at 882.

71. *Id.* Cf. *City of Rochester v. Rochester Gas & Elec. Corp.*, 233 N.Y. 39, 48, 134 N.E. 828, 831 (1922) (concerning rates set by a municipal gas corporation). "Varying charges are not prohibited always and everywhere, but only varying charges for like services in substantially similar circumstances or conditions." *Id.*

their payment.⁷² The legislature's exception in the case of small nonprofit institutions is based on the presumption that the existence of these institutions may be threatened by the imposition of water and sewer rents. The legislature assumes, however, that all larger nonprofit institutions are able to pay water and sewer rents without threat of extinction.

While the exemptions are uniformly applied within the user classes designated by the legislature, the classification is based on a presumption which may be subject to constitutional challenge.⁷³ A larger institution in the non-exempt class may be able to establish that the payment of water and sewer rents subjects it to economic hardship.⁷⁴ If at the same time there are small institutions which are exempt notwithstanding their ability to pay the rents, a larger institution may persuasively argue that the classifications are unreasonable.⁷⁵

72. See notes 23-36 and accompanying text *supra*. The New York State Constitution only exempts nonprofit institutions from real property taxes. See note 2 *supra* and accompanying text.

73. The New York Court of Appeals, however, has long held that in construing the constitutionality of a state statute there is "an exceedingly strong presumption of constitutionality." *Lighthouse Shores v. Town of Islip*, 41 N.Y.2d 7, 11, 359 N.E.2d 337, 341, 390 N.Y.S.2d 827, 830 (1976); *Van Berkel v. Power*, 16 N.Y.2d 37, 40, 209 N.E.2d 539, 540, 261 N.Y.S.2d 876, 878 (1965) ("This presumption is accompanied by another as to the statute: that the Legislature has investigated and found the existence of a situation showing or indicating the need for or desirability of the legislation."); *Defiance Milk Prods. Co. v. Du Mond*, 309 N.Y. 537, 540-41, 132 N.E.2d 829, 830 (1956). The presumption is rebuttable, but only as a last resort, upon a showing that "the statute has no reasonable basis at all," will the court strike down the statute as unconstitutional. *Id.*

74. In light of such proof the legislation would appear to be "underinclusive" because it doesn't exempt all institutions that are unable to pay the water and sewer rents. See generally L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 997-98 (1978). Although the Supreme Court has invalidated underinclusive legislation where it was shown to be unconstitutionally arbitrary, see, e.g., *O'Brien v. Skinner*, 414 U.S. 524 (1974), it has sustained underinclusive legislation in the absence of such a showing. See, e.g., *Railway Express Agency, Inc. v. New York*, 336 U.S. 106, 110 (1949) ("[i]t is no requirement of equal protection that all evils of the same genus be eradicated or none at all"); accord, *Bussey v. Harris*, 611 F.2d 1001, 1006 (5th Cir. 1980) ("[u]nderinclusion that is not irrational does not violate the fifth amendment").

75. Evidence of this nature would indicate that the legislation is "overinclusive" because it exempts institutions that would not suffer any hardship if required to pay water and sewer rents. See generally TRIBE, *supra* note 74, at 999. Although "overinclusive" is generally less suspect than "underinclusive" legislation, the Supreme Court has invalidated legislation that combines both. *Id.* at n.20 (citing *Rinaldi v. Yeager*, 384 U.S. 305, 310 (1966) ("By imposing a financial obligation only upon inmates of institutions, the statute inevitably burdens many whose appeals, though unsuccessful, were not frivolous, and leaves untouched

B. Unreasonable User Charge

Water and sewer rents, to the extent that they are based on use, are not taxes.⁷⁶ Recent decisions have categorized water and sewer rents as "user charges."⁷⁷ The Supreme Court has defined a user charge as a charge "designed only to make the user of . . . facilities pay a reasonable fee to help defray the costs of their construction and maintenance."⁷⁸ Examples of user charges include airport departure fees⁷⁹ and bridge tolls.⁸⁰ The mere label "user charge," however, does not necessarily preclude a finding that the charge is a tax, if it is unreasonable, that is, wholly unrelated to the costs of the services provided.⁸¹

1. *New York City's Operating Costs and Revenues*

In the 1980 fiscal year, the city's operating costs (personnel, maintenance and repairs) in providing water and sewer services were \$150,170,000.⁸² Debt service on outstanding water and sewer related debt amounted to \$240,550,000.⁸³ In the same year, the city collected \$231,252,230 from water and sewer rents and charges.⁸⁴ If

many whose appeals may have been frivolous indeed.")). The recent water and sewer legislation, it may be argued, is such a combination of "underinclusive" and "overinclusive" classifications because it requires large but financially unsound institutions to pay the rents, while exempting smaller but financially able institutions. See notes 60, 61 *supra* and accompanying text.

76. See notes 22-36 *supra* and accompanying text.

77. *YMCA v. Rochester Pure Water Dist.*, 44 A.D.2d 219, 354 N.Y.S.2d 201 (4th Dep't 1974), *aff'd*, 37 N.Y.2d 371, 334 N.E.2d 586, 372 N.Y.S.2d 633 (1975).

78. *Evansville-Vandeburgh Airport v. Delta Airlines*, 405 U.S. 707, 714 (1972).

79. *Id.* at 714.

80. See generally *Automobile Club v. Cox*, 592 F.2d 658 (2d Cir. 1979); *Clarksburg-Columbus Short Route Bus Co. v. Woodring*, 89 F.2d 788 (D.C. Cir.), *remanded for dismissal as moot*, 302 U.S. 658 (1937); *City of Burlington v. Turner*, 336 F. Supp. 594 (S.D. Iowa 1972), *modified and aff'd*, 471 F.2d 120 (8th Cir. 1973).

81. See e.g., *State Univ. v. Patterson*, 42 A.D.2d 328, 346 N.Y.S.2d 888 (3d Dep't 1973) where the court invalidated a charge for water use for fire protection holding that it was a tax because there was no relation between the amount of the charge and the amount of the water consumed.

82. Estimate provided by New York City Comptroller's Office (Jan. 7, 1981).

83. *Id.*

84. CITY OF NEW YORK, COMPREHENSIVE ANNUAL REPORT OF THE COMPTROLLER FOR THE FISCAL YEAR ENDED JUNE 30, 1980 54. This figure includes water rents based on frontage — current and arrears; water rents by meter — current and arrears; sewer service charges — current and arrears; interest on sewer charges — current and arrears; sewer rent meter — arrears; interest on late water charge; interest on sewer arrears paid.

debt service is considered an operating cost, it appears that the city's water and sewer operations function at a deficit. The deficit was covered with funds realized from real estate taxes.⁸⁵

An argument might be made that because water and sewer rents and charges exceeded the operating costs by more than 80 million dollars, the city realized an unreasonable profit. This argument will succeed only if debt service is not considered to be a cost reasonably incurred by the city in providing water and sewer services.⁸⁶ It is difficult to argue, however, that debt repayment is not an operating cost because it represents capital spent and owed in providing water supply and sewage.

(a) *Debt Service*

It is well established under both state and federal law that debt service is a reasonable cost in fixing the rate of a water and sewer or "user charge."⁸⁷ In New York, the factors used to determine the reasonableness of water and sewer rates include the cost of construction, maintenance and improvements.⁸⁸ In addition, it is statutorily prescribed that a municipality's water and sewer related debt may be considered in determining the rate base of the water and sewer charge.⁸⁹ In bridge toll cases, federal courts have consid-

85. Information provided by New York City Comptroller's Office (Jan. 7, 1981); Official Statement of the City of New York, Relating to \$175,000,000 Series B General Obligation Revenue Anticipation Notes, Dec. 13, 1979, at 69. The city is empowered to raise a "debt service levy" from general real estate taxes to cover all of its annual indebtedness. The amount that the city may raise through the debt service levy is unlimited. *Id.* N.Y. ENVIR. CONSERV. LAW § 17-1907 (1)(l) (McKinney 1973), defines debt service as "such amounts as shall be required to be paid annually to amortize obligations (both principal and interest) issued in order to finance the capital cost of an eligible project." *Id.*

86. Money is fungible, however, and its source is immaterial. *See, e.g.,* Evansville-Vandeburgh Airport v. Delta Airlines, 405 U.S. at 720 (whether revenues from an airport departure user fee are expressly earmarked for airport use is immaterial).

87. *See generally* N.Y. GEN. MUN. LAW § 453(2) (McKinney 1974); City of Burlington v. Turner, 336 F. Supp. 594 (S.D. Iowa 1972), *modified and aff'd*, 471 F.2d 120 (8th Cir. 1973); YMCA v. Rochester Pure Water Dist., 44 A.D.2d at 222, 354 N.Y.S.2d at 204.

88. YMCA v. Rochester Pure Water Dist., 44 A.D.2d at 222, 354 N.Y.S.2d at 204. *See also* N.Y. GEN. MUN. LAW § 453(1) (McKinney 1974).

89. N.Y. GEN. MUN. LAW § 453(2) (McKinney 1974); YMCA v. Rochester Pure Water Dist., 44 A.D.2d at 222, 354 N.Y.S.2d at 205; 10 OP. N.Y. COMP. 50 (1954). It is well established that debt repayment is considered to be an operating cost in determining rates for municipal water and sewer services. *See generally* County of Bergen v. Board of Pub. Util. Comm'rs, 137 N.J. Super. 448, 349 A.2d 537 (Super. Ct. 1975); Shirk v. City of Lancaster, 313 Pa. 158, 169 A. 557 (1933); King County Water Dist. No. 75 v. Seattle, 89 Wash. 2d 890,

ered the reasonable cost factors in fixing a user charge.⁹⁰ In those cases, even the most restrictive interpretations of what constitutes a reasonable rate of return would include debt service as an operating cost.⁹¹ If debt service is a reasonable factor in determining user charges, the revenues collected by New York City do not even meet its costs in providing water and sewer services.

The Supreme Court in *Evansville-Vandeburgh Airport v. Delta Airlines* held that for a user charge to be valid, the amount of the charge must have a reasonable relation to the costs incurred in providing the services.⁹² In *Evansville*, which sustained a state imposed airport departure fee, no evidence was advanced to prove that the fees collected would exceed the airport's operating costs.⁹³ Under *Evansville*, New York City's water and sewer rents appear to satisfy the criteria for a valid user charge.

(b) *Fair Return*

Even in the unlikely event that nonprofit institutions succeed in proving that the city realizes a profit from its water and sewer rents because debt service should be excluded⁹⁴ from the city's op-

577 P.2d 567 (1978); McQUILLIN, 12 MUNICIPAL CORPORATIONS § 35.37f, at 490 (3d ed. 1970); YOKLEY, 3 MUNICIPAL CORPORATIONS § 503 at 217 n.89.2 (1980 Supp.).

90. See note 80 *supra*.

91. See *City of Burlington v. Turner*, 336 F. Supp. 594 (S.D. Iowa 1972), *modified and aff'd*, 471 F.2d 120 (8th Cir. 1973). In *Burlington*, the Federal Highway Administrator had rejected a toll increase which produced a profit subsequently used by Burlington to finance salary raises for policemen and firemen. The district court rejected the Administrator's determination that a "reasonable and just" rate must be limited to bridge costs including an allowance for debt payment and effectively sustained the profit-producing toll. The court of appeals, however, modified the decision, noting that "[t]he method Burlington used in setting tolls was based primarily on its financial needs, unrelated to the bridge, and is no more reasonable or just than the determination made by the Administrator. . . ." 471 F.2d at 123. The court remanded the proceeding to the Administrator directing that he consider "a reasonable return on invested capital" in determining a "reasonable and just" rate. The Eighth Circuit reasoned: "[t]he added factor of reasonable return on invested capital should result in tolls less than those set by Burlington, but may result in tolls greater than those prescribed by the Administrator." *Id.*

New York City's water and sewer rents are readily distinguishable from the City of Burlington's toll. New York's charges are fixed to produce only the amount necessary to cover operating costs and debt repayment. In fact, the revenues realized do not even cover these costs. See notes 83-85 *supra* and accompanying text.

92. *Evansville-Vandeburgh Airport v. Delta Airlines*, 405 U.S. at 719-20.

93. *Id.* at 720.

94. The argument could be made that because debt service is paid out of real estate taxes and not water and sewer revenues, debt service cannot fairly be considered an operat-

erating costs, the profit still might be sustained as a "fair return."

New York state law allows a local government to receive a fair return on its water supply system. The state constitution provides:

No local government shall be prohibited by the legislature (1) from making a fair return on the value of the property used and useful in its operation of a gas, electric or water public utility service, over and above costs of operation and maintenance and necessary and proper reserves. . . .⁹⁵

Similarly, federal bridge toll cases have sustained toll revenues which exceed operating costs. The reasonable standard for fixing bridge toll rates has been held to be flexible, encompassing "multi-factorial circumstances."⁹⁶ Additionally, the Second Circuit has held that a user may be required "to pay more than a fair return."⁹⁷

In order to determine what constitutes a fair return on the city's water and sewer systems, the difference between revenues collected and operating costs must be compared to the city's investment in the water and sewer systems.⁹⁸ Presently, the city has invested approximately \$1.7 billion in its water system.⁹⁹ Comparing only the

ing cost in determining water and sewer rates.

95. N.Y. CONST. art. IX § 1(f). See *Battista v. Board of Estimate*, 51 Misc. 2d 962, 968, 274 N.Y.S.2d 729, 735 (Sup. Ct. 1966), *aff'd*, 27 A.D.2d 986 (1st Dep't 1967) ("the 'reasonable standard' consists of such rate-making procedures as is not proscribed by the limitations contained in article IX"). See also N.Y. GEN. MUN. LAW § 94 (McKinney 1974), which allows the city to receive a "fair return on its water charges."

96. *City of Burlington v. Turner*, 336 F. Supp. at 604.

97. *Automobile Club v. Cox*, 592 F.2d 658, 669 (2d Cir. 1979). In *Automobile Club*, the Second Circuit approved a toll increase levied by the Port Authority to finance new mass transit projects. In determining that the increase yielded only a "reasonable rate of return" and was therefore permissible, the Federal Highway Administrator had considered not only the four bridges to which the toll applied, but also the Holland and Lincoln Tunnels, bus terminals at the Manhattan ends of the Lincoln Tunnel, the George Washington Bridge, and the PATH trains. The Administrator's rationale was that the existence of alternate facilities prevented congestion of any one facility and the court held that this was not arbitrary or capricious. *Id.* at 669, 673.

98. See *e.g.*, *Wholesale Laundry Bd. of Trade, Inc. v. City of New York*, 64 Misc. 2d 567, 569, 315 N.Y.S.2d 715, 717 (Sup. Ct. 1970).

99. The city's fixed investment in water supply and wastewater treatment systems is \$1,696,799,000 less depreciation of \$510,044,000. COMPREHENSIVE ANNUAL REPORT OF THE COMPTROLLER FOR THE FISCAL YEAR ENDED JUNE 30, 1980 17. In addition, the city has invested approximately \$500,000,000 on a third water tunnel to supply water to its inhabitants. Information furnished by the New York City Department of Environmental Protection, Feb. 23, 1981:

city's investment in its water system¹⁰⁰ to the \$80 million difference between the operating costs and revenues from both the water and sewer systems (excluding debt service), it is clear that the city does not receive an unreasonable return.¹⁰¹ Furthermore, under the state constitution, the city may use its return on its water system for any "lawful purpose."¹⁰²

C. The Flat Rate is a Tax

It may be argued that the city's flat rate water and sewer charge, because it does not precisely measure actual water use, is not a true user charge but a tax. Although there is no question that metering accurately measures actual water consumption, the flat rate charge may not.¹⁰³

Nevertheless, the flat rate charge has long been held a reasonably approximate formula for measuring actual use.¹⁰⁴ In *Evansville*, the Court required only that a user fee "reflect a fair, if imperfect approximation of the use of the facilities for whose benefit

100. Figures for the city's investment in its sewer system are presently not available. Information supplied by the New York City Office of Comptroller (Feb. 23, 1981).

101. In *Wholesale Laundry Bd. of Trade, Inc. v. City of New York*, 64 Misc. 2d at 569, 315 N.Y.S.2d at 717, the city's investment in its water supply system was \$1,385.5 million, its operating costs were \$110 million and it received revenues of \$186 million. The court held that the \$76 million excess, or 5.5% return on its investment, was a "fair return" within the meaning of Article IX, § 1(f) of the New York State Constitution. It should be noted that in *Wholesale Laundry*, the city's revenues exceeded its operating costs, while in 1980 it did not. See notes 82-85 *supra* and accompanying text.

102. N.Y. CONST. art. IX § 1(f) (McKinney 1969). Analogously, the Court in *Evansville* held: "Yet so long as the funds received by local authorities under the statute are not shown to exceed airport costs, it is immaterial whether those funds are expressly earmarked for airport use." 405 U.S. at 720. With respect to sewer rents, however, it appears that the city may be somewhat restricted in its use of sewer rent revenues. N.Y. GEN. MUN. LAW § 453 (McKinney 1974), provides that such revenues may be used only for the repayment of operating, maintenance and repair costs, including payment of sewer related debt, and costs for the construction of sewage treatment and disposal plants. *Id.* Considering that the city derives no profit from its water and sewer operations, see notes 82-85 *supra* and accompanying text, it is doubtful that sewer rent revenues are used for any purposes other than those prescribed by the statute.

103. See text accompanying notes 12-15 *supra*.

104. *Grace Instit. v. Clark*, 35 A.D.2d at 371, 316 N.Y.S.2d at 672; *Hennessey v. Volkening*, 22 N.Y.S. at 530, 533. Other jurisdictions have upheld flat rate water and sewer charges. See, e.g., *Glendale Estates, Inc. v. Mayor and City Council*, 222 Ga. 610, 151 S.E.2d 143 (1966); *Wagner v. City of Rock Island*, 146 Ill. 139, 34 N.E. 545 (1893); *Carson v. Sewerage Comm'rs*, 175 Mass. 242, 56 N.E. 1, *aff'd* 182 U.S. 398 (1900); *Town of Port Orchard v. Kitsap*, 19 Wash. 2d 59, 141 P.2d 150 (1943).

they are imposed."¹⁰⁵ Furthermore, a number of Supreme Court cases have sustained flat rate highway tolls as valid user charges so long as they were not excessive.¹⁰⁶ The city's flat rate water charge should be sustained as a reasonable user charge, because there is no indication that it is excessive.¹⁰⁷

In 1910, the New York Court of Appeals in *New York University v. American Book*,¹⁰⁸ indicated that a uniform rate for the supply of water was a tax.¹⁰⁹ The optional nature¹¹⁰ of the flat rate

105. *Evansville-Vandeburgh Airport v. Delta Airlines*, 405 U.S. at 717. In *Capital Greyhound Lines v. Brice*, 339 U.S. 542 (1950), the Court, in sustaining a flat highway toll which admittedly did not reflect actual mileage travelled, stated that a user charge "should be judged by its result, not its formula, and must stand unless proven to be unreasonable in amount for the privilege granted." *Id.* at 545.

106. *Capital Greyhound Lines v. Brice*, 339 U.S. 542 (1950); *Aero Mayflower Transit Co. v. Board of R.R. Comm'rs*, 332 U.S. 495 (1947); *Morf v. Bingaman*, 298 U.S. 407 (1936); *Aero Mayflower Transit Co. v. Georgia Pub. Serv. Comm'n*, 295 U.S. 285 (1935). The Supreme Court has upheld highway tolls which were based on a variety of factors: *Dixie Ohio Express Co. v. State Rev. Comm'n*, 306 U.S. 72 (1939) (manufacturer's rated capacity and weight of trailers); *Hicklin v. Coney*, 290 U.S. 169 (1933) (carrying capacity); *Continental Baking Co. v. Woodring*, 286 U.S. 352 (1932) (gross ton mileage); *Interstate Buses Corp. v. Blodgett*, 276 U.S. 245 (1928) (mileage within the state); *Clark v. Poor*, 274 U.S. 554 (1927) (number and capacity of vehicles); *Kane v. New Jersey*, 242 U.S. 160 (1916) (horsepower); *Hendrick v. Maryland*, 235 U.S. 610 (1915).

107. A flat rate water charge was held to be a tax in *State Univ. v. Patterson*, 42 A.D.2d 328, 346 N.Y.S.2d 888 (3d Dep't 1973), but the nature of that charge is readily distinguishable from the charge under discussion here. In *Patterson*, the charge was for water stored in public sprinkler systems and hydrants for the purpose of fire protection and was imposed in addition to a metered charge; property owners paid the fire protection charge regardless of whether they actually used the water. *Id.* at 328, 346 N.Y.S.2d at 888. New York City's flat rate charge is imposed in lieu of water metering, note 18 *supra* and accompanying text, and is imposed for general usage.

108. 197 N.Y. 294, 90 N.E. 819 (1910).

109. The City of New York pursuant to its charter, N.Y.C. CHARTER § 473, is authorized to adopt either of two distinct methods of compensating or reimbursing itself for furnishing water to its inhabitants. The first is by the exercise of the power of taxation; the second, by sale. By the section cited the board of aldermen is authorized to establish a uniform scale of rates and charges for supplying water to different classes of buildings in the city with reference to their dimensions, value, exposure, use, etc. *The rates so imposed must be paid regardless of the quantity of water used, or whether any water is used. Such a rate is a tax. . . .*

Id. at 297, 90 N.E. at 820. The court relied on earlier cases, in *Re Trustees of Union College*, 129 N.Y. 308, 29 N.E. 460 (1891), *Remsen v. Wheeler*, 105 N.Y. 573, 12 N.E. 460 (1887) which held that a flat rate imposed on a vacant lot was a tax. *But see Mahler v. Comm'r of Internal Revenue*, 119 F.2d 829, 873, *cert. denied*, 314 U.S. 660 (2d Cir. 1941) (distinguishing *American Book* and holding that payment of a flat rate water rent was not tax deductible).

110. See text accompanying notes 17-18 *supra*.

presently charged by the city, however, distinguishes it from a tax.¹¹¹ Tax-exempt entities eligible to pay the flat rate may opt to have their water consumption metered.¹¹² Metering, however, for two reasons may be more expensive than the flat rate. First, each institution must bear the expense of installing a meter¹¹³ and second, because metering represents the actual amount of water consumed it may be more expensive.¹¹⁴ Thus the city's flat rate provides an option which enables tax-exempt institutions to avoid the more costly method of metering. It therefore appears unlikely that this option will be construed as a tax.

VI. Conclusion

It is commonly accepted that nonprofit institutions render an important service to the community. Consequently, they are subsidized by exemption from real property taxation. It does not follow,

111. *Cf.* *Central Savings Bank v. City of New York*, 279 N.Y., 266, 280, 18 N.E. 2d 151, 156 (1938) (“[a] tax is a forced charge levied by the state upon persons or property. It operates *in invitum* and is in no way dependent upon the will or contract, express or implied, of the persons taxed.” *Id.*); E. SELIGMAN, *The Development of Taxation*, in *ESSAYS IN TAXATION* 1 (1921), for a discussion of the evolution from “voluntary” payments to “compulsory” taxes: “Thus the fees and tolls change into taxes . . . ; thus the ‘evil duties’ and the excises grow apace; thus the payments become veritable ‘impositions.’ In other words, the community enters upon the stage of indirect taxation.” *Id.* at 4.

112. *See* notes 17-18 *supra* and accompanying text. *See also* *Almaras v. City of Hattiesburg*, 180 So. 392, 395 (Sup. Ct. 1938) holding that where a property owner elected to pay by meter instead of the flat rate, he became liable for the payment of the meter rate notwithstanding that the flat rate was lower.

113. N.Y.C. ADMIN. CODE ch. 30 § 734 (4)-1.0(b) (1974), requires that the cost of meter installation be borne by the property owner. *Id.* Although the cost of meter installation may vary according to the size of an institution, the cost for schools has been estimated at a minimum of \$2,000 and an average of \$4,000. Basler, *Catholics and Jews Assail Water Fees at Schools*, N.Y. Times, Apr. 30, 1980, at B1, col. 1. Institutions with the alternative of paying by meter or flat rate might argue that since they must bear the costs of metering, they essentially are compelled to choose the less expensive flat rate. It is immaterial, however, that the costs of meter installation must be paid by the property owners rather than the city. If the city bore the metering costs, such costs would be “reasonably related to the provision of the services,” *see* text accompanying note 92 *supra*, and as the city's operating costs increased, so would the rate of the water and sewer charge. *See* notes 82-92 *supra* and accompanying text.

114. *See, e.g.*, Carmody, *Stern Seeks Apartment — House Water Meters*, N.Y. Times, Jan. 12, 1981, at B5, col. 2 (concerning proposed legislation to require metering in residential apartment buildings and multiple dwellings: “The City now charges a flat fee for water, based on the frontage of a building plus the number of floors and apartments. *This means that identical buildings might have the same water bill even if one used twice as much water as the other.*” *Id.*) (emphasis added).

however, that this subsidy should extend to water and sewer rents.

The arguments in favor of extending this subsidy are the same as those which gave rise to the real property tax exemption.¹¹⁵ The general benefits conferred on society by nonprofit institutions are apparent.¹¹⁶ Equally important are the economic benefits, which may include the enhancement of the value of other property in the area, the creation of employment opportunities which in turn generate revenue, and the provision of services which the state otherwise would be compelled to provide. Perhaps the most convincing argument stems from the fear that these institutions may be financially unable to survive without such a subsidy.

The arguments against extension of the subsidy cannot be overlooked. Exemptions reduce a municipality's fiscal capacity to render essential services to its citizens and they burden those who do pay taxes with a disproportionate share of the cost of municipal government. These arguments are most persuasive at a time when essential services are seriously decreasing because of fiscal constraints. Under the circumstances, it is not surprising that an across-the-board exemption from water and sewer rents has not been granted to all nonprofit institutions in New York City. A limited exemption, however, has been granted by the state legislature to nonprofit institutions whose water use is limited.

The state legislature's approach appears eminently sensible. It protects the small institutions whose existence may be threatened if forced to pay water and sewer rents; it offers no such protection to larger institutions whose existence is presumed not to be threatened. Should that presumption prove incorrect,¹¹⁷ the consti-

115. See generally Ginsberg, *The Real Property Tax Exemption of Non-Profit Organizations: A Perspective*, 53 *TEMPLE L.Q.* 291 (1980); Note, *New York's Real Property Tax Exemption for Religious, Educational and Charitable Institutions: A Critical Examination*, 44 *ALB. L. REV.* 488 (1980).

116. See e.g., *Diocese of Rochester v. Planning Bd.*, 1 N.Y.2d 508, 136 N.E.2d 827, 154 N.Y.S.2d 849 (1956) ("Churches and schools are more important than local taxes, and it is in furtherance of the general welfare to exclude such institutions from taxation." *Id.* at 524-25, 136 N.E.2d at 836, 154 N.Y.S.2d at 861).

117. It is well settled that tax exemptions are to be construed against those seeking the exemption. *Association of the Bar v. Lewisohn*, 34 N.Y.2d 143, 153, 313 N.E.2d 30, 35, 356 N.Y.S.2d 555, 561 (1974); *Community Gen. Hosp. v. Town of Onondaga*, 80 Misc. 2d 96, 362 N.Y.S.2d 375 (Sup. Ct. 1974); *City of Lackawanna v. State Bd. of Equal. and Assessment*, 16 N.Y.2d 222, 212 N.E.2d 42, 264 N.Y.S.2d 528 (1965). In light of this established policy to restrict exemptions, nonprofit institutions exempt from property taxes may have a heavy

tutionality of the legislation may be questioned. The Board of Estimate, however, retains the power to cancel rents due on a case-by-case basis. Board of Estimate cancellations would provide a convenient alternative to protracted litigation over the constitutionality of the 1980 legislation.

In sum, the 1980 legislation accomodates the conflicting needs of our society: it affords across-the-board protection to the weakest institutions without any showing of dire need, while enabling the city to collect sorely needed revenues from the larger ones.

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