

RETHINKING FEES AND TAXES IN LIGHT OF THE NEW YORK CITY HEALTH CARE SECURITY ACT

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Lack of health insurance is an acute problem in New York City,¹ particularly among the low-wage community.² The city contains nearly one million low-wage workers and family members who lack health insurance throughout the year.³ These individuals incur considerable and inefficient health care costs, and the city frequently bears the weight of these costs. Together, New York City taxpayers and health care providers spend \$466 million per year caring for this population, through either public insurance or un-

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1. New York City's experience with lack of health insurance, while particularly acute, is consistent with a nationwide trend towards greater numbers of uninsured workers. Eighty-one million eight-hundred thousand Americans were without health insurance for some part of the period of 2002 through 2003, including one out of every three citizens under the age of sixty-five. KATHLEEN STOLL & KIM JONES, *FAMILIES USA, ONE IN THREE: NON-ELDERLY AMERICANS WITHOUT HEALTH INSURANCE, 2002–2003* at 3 (2004), http://www.familiesusa.org/assets/pdfs/82million_uninsured_report6fdc.pdf. Four out of five of those uninsured Americans were in families connected to the workforce (either employed or actively looking for employment). *Id.* at 5. Over the most recent period for which data is available (2002–2003), the total number of year-long uninsured Americans increased by 1.2 million. CARMEN DENAVAS-WALT, BERNADETTE D. PROCTOR & ROBERT J. MILLS, U.S. DEP'T OF COMMERCE, *INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2003* at 14 (2004), www.census.gov/prod/2004pubs/p60-226.pdf.

2. One measure of low-wage has been offered by Sherry Glied at Columbia, who defines low-wage as \$11/hour or less, which is 125% of the federal poverty level for a family of four with a full-time, full-year worker. Sherry Glied & Bisundev Mahato, *Health Insurance and Expenditures Among Low-Wage Workers in New York City 2* (Columbia Center for the Health of Urban Minorities Access to Care Core: Working Paper No. 1), *available at* <http://nyhealthcaresecurity.org/docs/Glied.pdf>.

3. *Id.* at 1.

compensated care.⁴ The city and the state have put forward numerous policy initiatives to attempt to insure fully this population, including expansions of the state's Medicare program, New York State's Healthy New York program,⁵ and New York City's Health Pass purchasing alliance.⁶ Despite these efforts, the problem of uninsured working individuals has proven intractable. Nearly half of all New York City low-wage workers remain uninsured.⁷

In 2004, the New York City Council responded by proposing the Health Care Security Act⁸ (HCSA), a health insurance bill modeled on a pay-or-play⁹ proposal passed in 2003 by California.¹⁰ The HCSA was designed to target employers in select industries, requiring them either to provide health insurance to their employees or to pay into a city fund that would provide employees with health benefits.¹¹ The bill promised both to prevent further loss of

4. *Id.* at 2.

5. New York State's Healthy New York program provides employers and uninsured workers access to low cost health insurance, provided they meet a set of enrollment criteria related to previous insurance coverage and income. Within New York county, the cheapest family plan available to an individual, with no drug coverage, is \$5671.44/year. 2005 HEALTHY NY RATES BY COUNTY, <http://www.ins.state.ny.us/website2/hny/rates/html/hnynewyo.htm> (last visited Feb. 18, 2006).

6. New York City's HealthPass makes health insurance available to small businesses with less than fifty employees, offering a range of plans among which employees can choose. HEALTHPASS: FREEDOM OF CHOICE FOR SMALL BUSINESSES, <http://www.healthpass.com> (last visited Feb. 14, 2006).

7. Glied & Mahato, *supra* note 2, at 1. Although Medicaid does cover a substantial portion of the low-income population, it is limited by "stringent income eligibility standards." Carolyn V. Juárez, Note, *Liberty, Justice, and Insurance for All: Re-Imagining the Employment-Based Health Insurance System*, 37 U. MICH. J.L. REFORM 881, 888 (2004). For instance, the current cap on income for a single individual to qualify for Medicaid in New York is \$667/month, which correlates to a full-time job paying less than the current minimum wage. NEW YORK STATE DEP'T OF HEALTH, MEDICAID, http://www.health.state.ny.us/health_care/medicaid/index.htm#money (last visited Feb. 18, 2006).

8. New York, N.Y., Local Law (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

9. The label "pay-or-play" comes from the structure of the program, which requires employers to either "pay" into a city plan, or "play" by providing health benefits independently.

10. S.B. 2, 2003-04 Sen., Reg. Sess. ch. 673 (Cal. 2003) (repealed 2004). The California bill was passed in 2003 and would have gone into effect in 2006. In 2004, however, it was repealed by referendum. See *infra* text accompanying notes 43-52.

11. The assumption built into the HCSA is that it would be preferable to have employer-provided insurance than to seek to make it easier for employees to buy insurance for themselves. There are several bases for this assumption. First, there is evidence that employers are able to use their market leverage to insist upon improved quality of care from insurers, while simultaneously demanding lower

coverage for insured employees and to extend coverage to workers who do not currently receive health insurance, without transferring this burden to the city's taxpayers at large.

The proposed Act operated principally through the pay-or-play fee,¹² which took advantage of a perceived gap in ERISA (Employee Retirement Income Security Act of 1974) pre-emption of state health insurance coverage legislation.¹³ Critically, however, the

prices. See Juárez, *supra* note 7, at 894–95; FAMILIES USA, A TIME-TESTED APPROACH TO EXPANDING HEALTH COVERAGE FOR WORKERS: HAWAII'S PREPAID HEALTH CARE ACT 4 (2004), <http://www.familiesusa.org/assets/pdfs/Hawaii.pdf>. Employer-based coverage also mitigates the effects of adverse risk selection, as:

[t]he pools exist for reasons independent of the demand for coverage, so insurers can safely assume that the group's future medical expenses will approximate the group's recent experience, allowing the insurer to assess the overall group's average risk simply by observing its claims experience . . . rather than assessing each individual member's risk.

Juárez, *supra* note 7, at 895 (internal quotations omitted). Finally, employed individuals tend to be healthier than the broader population, and hence tend to be cheaper to cover. *Id.* at 896.

Statistics on health-care costs bear out these arguments. Recent studies have determined that low-wage workers tend to utilize less health-care expenditures than the average citizen and that the average low-wage worker in New York tends to expend around \$1532.59 in health care a year. Glied & Mahato, *supra* note 2, at 4. Despite this relatively low average cost of care, the cheapest government-subsidized plan available to an uninsured individual in 2005 cost \$1922.52, without covering drug expenditures. 2005 HEALTHY NY RATES BY COUNTY, <http://www.ins.state.ny.us/website2/hny/rates/html/hnynewyo.htm> (on file with NYU Annual Survey of American Law). A properly diversified risk pool should be able to beat this price without government subsidy.

12. In both the California and New York City manifestations, the pay-or-play fee was structured as a charge on all employers for the hours worked by their employees, with a credit given to those employers who currently spend money on health insurance.

13. Under the precedent of *Standard Oil Co. of California v. Aghalud*, a state plan which mandated health insurance coverage would be pre-empted by ERISA, the federal statute governing employee benefit plans. 442 F. Supp. 695 (N.D. Cal. 1977), *aff'd*, 633 F.2d 760 (9th Cir. 1980), *aff'd mem.*, 454 U.S. 801 (1981). See *infra* text accompanying notes 33–42. However, recent Supreme Court precedent has relaxed ERISA preemption and established a newer doctrine that state laws which impose only an “indirect economic effect” on the costs of plans are not pre-empted. See *N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 662 (1995). See *infra* text accompanying note 37. Thus, proponents of the New York City HCSA argue that the bill will not be pre-empted by ERISA, as it offers businesses an economic option for complying, namely paying the fee. See Paul K. Sonn & Chitra Aiyar, *NYC Health Care Security Act: Leveling the Playing Field for Responsible Businesses* 10 (Brennan Center for Justice at NYU School of Law, Working Paper, 2004). Although I will examine the ERISA implications of pay-or-play in explaining the particular form of the New York City HCSA, legal analysis of this ERISA issue is beyond the scope of this Note. I would refer the

constitutionality of the pay-or-play fee remained contested. Opponents of the HCSA argued that like all pay-or-play fees, the charge¹⁴ was not a fee at all, but a tax on employers to provide for a city-wide medical insurance program. This distinction was significant, as the City Council does not have authorization from the state legislature to impose taxes.¹⁵ For that reason, the bill's opponents argued that the entire HCSA was rendered unconstitutional.¹⁶ The legality of the HCSA turned on whether the pay-or-play charge was properly characterized as a fee or a tax.

Although such uncertainty about the basic powers of the City Council may seem unusual, the reality is that the difficulty of distinguishing between fees and taxes is a frequent problem for both city councils and state legislatures. The fee-tax issue has arisen in New York in recent years in a wide variety of regulatory contexts, including land use regulation,¹⁷ insurance regulation,¹⁸ and low-income housing regulation.¹⁹ New York courts have overturned charges on the grounds that they create taxes masquerading as fees, using an inconsistent variety of factors and tests to make the distinction. Uncertainty in the area of fiscal powers not only creates difficulty for

reader to the wide body of literature on this subject. *See generally* Stephen F. Befort & Christopher J. Kopka, *The Sounds of Silence: The Libertarian Ethos of ERISA Preemption*, 52 FLA. L. REV. 1 (2000); Karen A. Jordan, *Travelers Insurance: New Support for the Argument to Restrain ERISA Pre-emption*, 13 YALE J. ON REG. 255 (1996); Edward A. Zelinsky, *Travelers, Reasoned Textualism, and the New Jurisprudence of ERISA Preemption*, 21 CARDOZO L. REV. 807 (1999).

14. Due to the nature of the inquiry which determines whether a legislative imposition is a fee or a tax, use of the label "fee" when discussing abstract legislative assessments prior to judicial determination would only complicate the discussion. Therefore, to avoid the construction "the fee is constitutional because it is a fee," when I refer to a legislative imposition either in the abstract or prior to judicial review, I will use the term "charge," creating the more acceptable construction, "the charge is constitutional because it is a fee."

15. N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(8) (1994). Under New York Municipal Home Rule Law, the power to tax is not granted to municipalities. *See infra* text accompanying note 78.

16. Under its home-rule powers, the New York City Council is authorized to assess fees for regulatory purposes, but not to levy taxes without prior approval from the state legislature. N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(9-a) (1994). *See infra* text accompanying notes 74–78.

17. *See* Albany Area Builders Ass'n v. Town of Guilderland, 534 N.Y.S.2d 791 (App. Div. 1988) (impact fees).

18. *See* Health Servs. Med. Corp. of Cent. N.Y. v. Chassin, 668 N.Y.S.2d 1006 (Sup. Ct. 1998) (HMO assessments).

19. *See* Seawall Assocs. v. City of New York, 534 N.Y.S.2d 958 (App. Div. 1988) (single-room occupancy restrictions).

city councils and legislatures, but in fact could be entirely avoided with a more focused jurisprudence.

Ultimately, this legal uncertainty was fatal to the pay-or-play structure. The final version of the HCSA passed by the New York City Council retracted the pay-or-play model, and replaced it with a civil fine.²⁰ This change has several deleterious effects on the HCSA. The change from a regulatory program to a civil fine heightens the conflict between the city and the regulated entities, possibly decreasing the voluntary compliance necessary for a successful program. The regulatory fine structure is also more likely to be pre-empted by ERISA, possibly undermining the entire regulatory scheme. In the case of the HCSA, unfocused jurisprudence on fees and taxes may have undermined a popular legislative program.

This result is all the more lamentable because a perfectly workable test could be created for distinguishing between fees and taxes, and in fact such a test has served as the backdrop for much of the judicial meandering in this area. A two-factor test was proposed over one hundred years ago by the United States Supreme Court,²¹ focusing on intent and revenue use. A return to that venerable precedent would add a great deal of organization to this area and give much better guidance to legislatures and city councils in carrying out their duties. If courts emphasized intent and revenue use in their analysis of the fee-tax distinction, the pay-or-play structure of the original HCSA would have been constitutional because it relied on a fee rather than a tax.

This Note will begin, in Section I, by examining the original version of the New York City Health Care Security Act which included the pay-or-play structure, including its historical precursors and its administrative structure, with an eye to examining why the city considered a pay-or-play structure for this local law. Section II will examine the legal doctrine distinguishing fees and taxes and argue that a simplification through a return to the *Head Money* test would give better direction for legislative action. Section III will return to the HCSA and explain how the two-factor *Head Money* test would apply to the HCSA's pay-or-play scheme. Finally, in the Epilogue and Conclusion, I will examine how the lack of a clear test led to the rejection of the pay-or-play model, and the lessons we should take from this episode for more general fee-tax jurisprudence.

20. New York, N.Y., Local Law No. 468-A (Aug. 9, 2005) (proposed) (on file with NYU Annual Survey of American Law).

21. *Head Money Cases*, 112 U.S. 580, 595–96 (1884).

I.
THE NEW YORK CITY HEALTH CARE
SECURITY ACT

A. *Predecessors to the Bill*

Although there have been numerous state-level attempts to expand health care coverage in recent years,²² two in particular have laid the foundation for the New York City HCSA. The first, Hawaii's Prepaid Health Care Act,²³ was passed in the mid-1970s and mandated employer-provided health insurance for all medium-sized and larger businesses within the state. The legislation led to Hawaii having one of the highest rates of health insurance in the country.²⁴ The second, California's S.B. 2,²⁵ was a pay-or-play bill enacted recently in California, and although it was repealed by a referendum, its structure inspired the original version of the New York City bill.

i. Hawaii's Prepaid Health Care Act

Hawaii's Prepaid Health Care Act went into effect in June 1974 and requires almost all employers to provide their employees with prepaid health insurance. With few exceptions, all employees who work at least twenty hours a week and do not have another source of health insurance must be covered by their employers' plans.²⁶ The Act regulates insurance plans by requiring that they meet minimum benefit standards²⁷ and requires individual employees to con-

22. A notable example is Tennessee's TennCare program, which extends the state's Medicare program to all uninsured individuals who are not eligible for employer-sponsored health insurance. See Sidney D. Watson, *Medicaid Physician Participation: Patients, Poverty, and Physician Self-Interest*, 21 AM. J.L. & MED. 191, 202-10 (1995). To control costs under this system, the state contracts with various private managed care organizations and allows the enrollees to choose among the managed care plans offered within their geographical area. The program succeeded in reducing the uninsured population in Tennessee by almost 50%. *Id.* at 209. In order to implement the program, however, Tennessee was required to obtain a waiver of Medicaid requirements. 42 U.S.C. § 1315(a) (1988).

23. Hawaii Prepaid Health Care Act of 1974, HAW. REV. STAT. § 393-1-51 (1993).

24. Hawaii is one of eight states to achieve 90% health insurance coverage over the last three-year period. DENAVAS-WALT ET AL., *supra* note 1, at 25. At its peak, Hawaii achieved coverage of 98% of the population. FAMILIES USA, *supra* note 11, at 1.

25. S.B. 2, 2003-04 Sen., Reg. Sess. ch. 673 (Cal. 2003) (repealed 2004).

26. HAW. REV. STAT. § 393-11 (1993).

27. Under the Hawaii Act, an employer-sponsored plan will satisfy the state's requirements if it provides for "health care benefits equal to, or medically reasonably substitutable for, the benefits provided by prepaid health plans of the same

tribute up to 1.5% of their monthly wage towards the insurance.²⁸ As a result of the Prepaid Health Care Act, 86.2% of Hawaii's employers offer health insurance, the highest rate of employer-provided health insurance in the country.²⁹

The health and economic effects of the plan on Hawaii have been stunning. Along with greatly increased rates of health insurance coverage,³⁰ Hawaii leads the country in a broad range of health factors and has the highest life expectancy in the U.S.³¹ In addition, perhaps due to the increased usage of primary and preventive care among a population that is largely insured or due to bargaining by employers who are forced to pay for coverage, "the cost of employer-sponsored health coverage in Hawaii is among the lowest in the country."³²

Not long after its passage, however, Hawaii's Prepaid Health Care Act encountered legal difficulties. In *Standard Oil Co. v. Ag-*

type . . . which have the largest numbers of subscribers in the State." HAW. REV. STAT. § 393-7(a) (1993). In addition to this rather general requirement, the Act gives a non-exclusive list of specific benefit types a plan must cover, including maternity and substance abuse coverage. HAW. REV. STAT. § 393-7(c) (1993).

28. HAW. REV. STAT. § 393-13 (1993).

29. KAISER FAMILY FOUNDATION, 50 STATE COMPARISONS: PERCENT OF PRIVATE SECTOR ESTABLISHMENTS THAT OFFER HEALTH INSURANCE TO EMPLOYEES, 2003, <http://www.statehealthfacts.org/cgi-bin/healthfacts.cgi?action=compare&category=health+Coverage+%26+Uninsured&subcategory=private+Sector+Coverage&topic=percent+of+Firms+Offering+Coverage> (last visited Feb. 18, 2006). The percentage of employers offering health insurance is 30 percentage points higher in Hawaii than in the rest of the nation (86.2% compared to 56.2% nationally). *Id.*

30. Hawaii experienced a significant rise in health insurance coverage immediately following passage of the Act and by the end of 1977, 98.2% of the population was covered by some form of health insurance, a rise of almost 3%. Michael G. Pfefferkorn, Comment, *Federal Preemption of State Mandated Health Insurance Programs Under ERISA—The Hawaii Prepaid Health Care Act In Perspective*, 8 ST. LOUIS U. PUB. L. REV. 339, 363 (1989). There is also evidence that some employees who had insurance prior to the passage of the Act saw their benefit package increase. *Id.* at 363–64.

31. *See id.* at 363–67; HAWAII HEALTH INFORMATION CORPORATION, HEALTH TRENDS IN HAWAII: HEALTH STATUS—LIFE EXPECTANCY, <http://www.healthtrends.org> (last visited Feb. 18, 2006).

32. FAMILIES USA, *supra* note 11, at 4. As of 2003, only one state (North Dakota) had cheaper employment-based single coverage health insurance than Hawaii, and in thirty-nine states coverage was at least 10% more expensive than in Hawaii. KAISER FAMILY FOUNDATION, AVERAGE ANNUAL COST OF EMPLOYMENT-BASED HEALTH INSURANCE FOR SINGLE COVERAGE, 2003, <http://www.statehealthfacts.org> (last visited Feb. 18, 2006). Employment-based single coverage health insurance in Hawaii cost only 87% of the national average. *Id.*

salud,³³ the Act was struck down as pre-empted by ERISA, the broad federal statute regulating employee benefit plans that was passed three months after the Prepaid Health Care Act.³⁴ ERISA contains very broad pre-emption language, indicating that all state laws which “relate to any employee benefit plan” are to be pre-empted.³⁵ The court found that the statute clearly pre-empts “laws relating to benefits of employee benefit plans,” despite the fact that ERISA provides no substantive regulation of the benefits provided by health insurance plans.³⁶ If Hawaii needed respite from the harsh constraints of ERISA, its remedy was “not in this Court but in Congress.”³⁷

Hawaii’s congressional delegation went to work, and Hawaii’s Act was saved by an ERISA exemption approved by Congress.³⁸ However, this exception applied exclusively to Hawaii’s plan³⁹ and

33. 442 F. Supp. 695 (N.D. Cal. 1977), *aff’d*, 633 F.2d 760 (9th Cir. 1980), *aff’d mem.*, 454 U.S. 801 (1981).

34. ERISA laid down federal standards for all employee benefit plans, including substantive standards for pension plans, and procedural standards for pension and welfare plans, which include health benefit plans. 29 U.S.C. §§1001–1381 (2000).

35. 29 U.S.C. § 1144(a) (2000).

36. *Agsalud*, 442 F. Supp. at 706–07.

37. *Id.* at 711. There is some evidence that the judicial doctrine on ERISA pre-emption may be moving away from the *Agsalud* decision. ERISA’s statutory preemption language, “the provisions of this subchapter and subchapter III shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan,” was initially interpreted very broadly to preclude almost any state regulation of employee benefits. 29 U.S.C. § 1144(a) (2000); *see generally* Edward A. Zelinsky, *Travelers, Reasoned Textualism, and the New Jurisprudence of ERISA Preemption*, 21 *CARDOZO L. REV.* 807, 815–27 (1999). A recent line of Supreme Court cases has narrowed ERISA pre-emption, and while another state’s attempt to institute Hawaii’s Prepaid Health Care Act would likely be pre-empted by the *Agsalud* precedent, there does appear to be some uncertainty today about the full reach of ERISA pre-emption. *See generally* Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., 519 U.S. 316 (1997); *De Buono v. Nysa-Ila Med. & Clinical Servs. Fund*, 520 U.S. 806 (1997); *N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995). *See also* Befort & Kopka, *supra* note 13, at 23–26.

38. 29 U.S.C. § 1144(b)(5)(A) (2000) (exempting HAW. REV. STAT. §§ 393-1–51 (1993) from the preemption provisions of ERISA).

39. Included among Congress’s amendments exempting Hawaii from ERISA was an explicit statement that “[t]he amendment made by this section shall not be considered a precedent with respect to extending such amendment to any other State law.” Amendments To Employee Retirement Income Security Act Of 1974, Pub. L. No. 97-473, § 301(b), 96 Stat. 2612 (1983). Commentators note that Hawaii’s efforts evidenced the “strength of the interests that had coalesced to protect ERISA preemption and made plain the stakes of any effort to change it.” Fernando R. Laguarda, Note, *Federalism Myth: States as Laboratories of Health Care Re-*

thus prevented the Prepaid Health Care Act from serving as a “model for national reform.”⁴⁰ Even more importantly, Hawaii’s ERISA exemption applied only to the Act as originally passed in 1974, and thus Hawaii has been unable to update the Prepaid Health Care Act to deal with modern health care issues, such as rapidly rising costs.⁴¹ It is thus conceivable that the impressive economic and health gains in Hawaii could have been even more exemplary with reasonable legislative and regulatory adjustments.

Although Hawaii’s model cannot be exported to other states, the state’s success suggests certain lessons. Most importantly, increased health insurance coverage can yield better health care outcomes and may even reduce the cost of insurance for individuals. Significantly, Hawaii’s businesses are not overwhelmingly opposed to the Prepaid Health Care Act,⁴² so the political challenge of implementing a plan to expand employer-based coverage may not be insurmountable.

ii. California’s Health Insurance Act of 2003, S.B. 2

Hawaii’s lessons may have inspired California’s recent attempt to enact pay-or-play legislation. California, in 2003, found itself in a health insurance crisis, with the nation’s fourth highest rate of uninsurance, 18.7%,⁴³ and an annual taxpayers’ tab of 4.6 billion dollars in medical care for the uninsured.⁴⁴ As a response to this problem, the state passed the California Health Insurance Act of 2003, hoping to expand employer-provided health insurance coverage while avoiding ERISA pre-emption.⁴⁵ At the time of its passage,

form, 82 GEO. L.J. 159, 182 (1993) (citing Daniel M. Fox & Daniel C. Schaffer, *Health Policy and ERISA: Interest Groups and Semipreemption*, 14 J. HEALTH POL. POL’Y & L. 239, 246 (1989)). It is also noteworthy that Hawaii’s exemption is not prospective, and only maintains the Hawaii Act as it existed prior to the passage of ERISA, as further evidence that Congress wanted to avoid state tinkering with employee benefit laws. Despite considerable legislative efforts, Hawaii has been unable to expand its exemption to modify the Hawaii Prepaid Health Care Act. *Id.* at 179. While a debate over the various arguments for and against ERISA preemption of state health-benefit laws is beyond the scope of this Note, New York’s HCSA is very unlikely to receive an ERISA exemption from Congress.

40. Laguarda, *supra* note 39, at 179.

41. *See id.* at 183–85; Leon E. Irish & Harrison J. Cohen, *ERISA Preemption: Judicial Flexibility and Statutory Rigidity*, 19 U. MICH. J.L. REFORM 109, 150–52 (1985); FAMILIES USA, *supra* note 11, at 2.

42. *See* FAMILIES USA, *supra* note 11, at 4.

43. DENAVAS-WALT ET AL., *supra* note 1, at 25.

44. Eric Schlosser, *Super-Sized Deception From Fast-Food Giants*, L.A. TIMES, Oct. 24, 2004, at M5.

45. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 (Cal. 2003) (repealed 2004).

the California Health Insurance Act of 2003 was expected to extend health insurance to an additional one million Californians over the course of several years.⁴⁶

The Act established a pay-or-play program in which employers would pay a charge into the State Health Purchasing Program, which would purchase health benefits for their employees, although they could obtain a credit against that charge by providing health benefits independently.⁴⁷ The level of the charge was to be set by the Managed Risk Medical Insurance Board, and the minimum level of coverage to obtain a credit would vary with the size of the employer, with large employers held to higher standards than smaller employers.⁴⁸ Employees would also contribute to the pay-or-play charge, although their contribution was capped at 20% of the charge.⁴⁹ The effect on businesses that were already providing health insurance was expected to be quite small.⁵⁰ Any existing plan that was collectively bargained or that met the standards of the

46. FAMILIES USA, AN INNOVATIVE APPROACH TO PROTECTING AND EXPANDING HEALTH COVERAGE FOR WORKERS: CALIFORNIA'S SB 2, 1 (2004), <http://www.familiesusa.org/assets/pdfs/California-rev.pdf>. The California Act was to be implemented in phases, with the fee for large employers being implemented in 2006, and the fees for medium and small employers being implemented in later years. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 § 2120.1 (Cal. 2003) (repealed 2004).

47. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 (Cal. 2003) (repealed 2004). The pay-or-play fee, a rather odd administrative structure for an attempted mandate of employer-based health insurance, is an attempted end-run around the *Agsalud* precedent, described *supra* text accompanying notes 36–39. As described above, a state law that mandated that employers provide health insurance would surely be pre-empted under *Agsalud*. However, the Supreme Court, in its *Travelers* decision, suggested that some state assessments that affect employers' ERISA plans impose only "indirect economic effect[s]," and thus escape preemption. *N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 659 (1995). The argument for the pay-or-play legislation is that employers are only required to pay a fee and then are left with the independent choice of whether to provide their employees with health insurance. The legislation's drafters suggest that this fee only creates an economic incentive to purchase insurance and does not actually force any particular choices on an employer. The legality of such a maneuver has never been tested, although some commentators suggest it may still be pre-empted. See Jordan, *supra* note 13, at 294–95.

48. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 §§ 2120.1, 2140.1 (Cal. 2003) (repealed 2004).

49. *Id.* § 2150.

50. The Act did require large employers, with more than two hundred workers, to provide coverage for dependents. *Id.* This additional burden might have posed a challenge to multi-state employers with existing plans that did not provide dependent coverage.

Taft-Hartley Act or ERISA would have qualified for a full credit against the charge.⁵¹

Although the California Act was narrowly repealed by referendum in November 2004,⁵² it had already become the model for New York City's HCSA before its repeal.

B. *The New York City Health Care Security Act*

New York City's HCSA was initially designed around the same pay-or-play charge and credits enforcement structure as the California Act. The level of the New York City charge was to be determined by the comptroller based on the cost of providing benefits for a worker and his family through the city's health program, and then assessed on the employer on a prorated hourly basis.⁵³ Unlike in California, however, where a credit could be obtained by an employer who possessed an existing employee benefits plan, under the HCSA the amount of credit was tied to the employer's expenditures

51. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 § 2160.1 (Cal. 2003) (repealed 2004).

52. Cal. Referendum, Prop. 72 (passed Nov. 2, 2004). The proposition to repeal the California Health Insurance Act was led by the "state's corporate community," and in particular was spearheaded by the current California governor, Arnold Schwarzenegger. Marc Lifsher, *State's Businesses Are Given a Lift by Voters; Companies, with the Governor's Help, Win on Referendums about Health Insurance and Limits on Lawsuits*, L.A. TIMES, Nov. 4, 2004, at C1. The proposition's backers argued that the California Act would hurt small businesses, and lead to outsourcing of jobs from California. *See id.* Proposition backers raised over 13.3 million dollars to support the repeal of the Act, with "the bulk coming from fast-food chains and department stores." *California Measure Requiring Business to Pay Bulk of Workers' Healthcare Fails*, HEALTH INS. L. WEEKLY, Dec. 26, 2004, at 50. The proposition passed by a margin of 50.9% to 49.1%, a difference of around 200,000 votes. *Id.*

Some California state legislators have responded to the defeat by proposing individual health care mandates, where individuals would be required to purchase coverage for themselves. Jordan Rau, *Mandatory Health Insurance Is Urged: Requiring All in the State to Carry Coverage Would Address Healthcare Crisis, Backers Argue. Critics Say Subsidies for the Poor Would Be Needed*, L.A. TIMES, Dec. 15, 2004, at B1. Supporters of an individual mandate maintain that it would be more politically feasible, as it would not face resistance from business groups. *Id.* While this may make political sense, the high cost of individual health insurance would undoubtedly require significant government subsidies to allow poor individuals to afford health insurance. The fiscal burden would likely be higher under an individual mandate system than a business mandate system, as there is no pooling of risk. Regardless, some form of health insurance mandates remains on the state legislative agenda in California. *Id.*

53. New York, N.Y., Local Law § 22-506(c)(2)(iv) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

on health care services.⁵⁴ Whereas in California, the presence of an employer-sponsored plan could exempt an employer from the charge entirely, in New York City an employer was entitled to a credit against the charge only for the amount of the employer's health care expenditures on behalf of its employees.⁵⁵ Under the New York City Plan, there was no provision for part of this charge to be paid by employees.⁵⁶

Initially, the New York City HCSA would have applied to five industries: building services, groceries, hotels, industrial laundries, and construction.⁵⁷ These industries were chosen due to employer support and as a means of testing the pay-or-play model with two important considerations in mind. First, these are all industries in

54. The bill's drafters chose this formulation of the pay-or-play credit over the California formulation (in which employers with ERISA plans are entirely exempted) to avoid the "reference to" branch of ERISA preemption doctrine, as established in *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 96–97 (1983). In that case the Supreme Court ruled that a state law "relates to" an employee benefit plan, and is thus preempted under ERISA, 29 U.S.C. §1144(a), when it "has a connection with or reference to such a plan." 463 U.S. at 96–97. "Connection with" and "reference to" have been held to be two different prongs of ERISA preemption analysis, with the latter the far more formalistic of the two. *See Dist. of Columbia v. Greater Washington Bd. of Trade*, 506 U.S. 125, 130–31 (1992). A state law is held to make "reference to" an employee benefit plan when it specifically refers to an ERISA plan, and can be pre-empted solely on that basis. *See id.* ("[The Act] specifically refers to welfare benefit plans regulated by ERISA and on that basis alone is pre-empted . . . any state law imposing requirements by reference to [ERISA plans] must yield to ERISA."). Thus, by avoiding any reference to ERISA plans the drafters of the New York City HCSA hoped to avoid the formalistic "reference to" prong, and instead be judged under the "connection with" prong, which has been softened in recent years. *See, e.g., N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995).

55. New York, N.Y., Local Law § 22-506(f)(2) (2005) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law). As "prevailing health care expenditure[s]" are defined by the act as "the amount of health care expenditure[s] customarily made on behalf of full-time workers and their families," the city expects that most employers who provide health benefits would be completely exempted from the fee. *Id.* §22-506(b)(16). Nonetheless, it remains possible that an employer with an ERISA plan paying slightly less than prevailing benefits may owe a reduced fee to the city. The proposed law does allow for a collective-bargaining exception, although only for employers who are signatories to collective bargaining agreements that provide "prevailing health care expenditures." Such employers could have a complete credit against the fee once their CBAs are approved by the city comptroller. *Id.* § 22-506(j).

56. Presumably the cost of the pay-or-play fee, and the benefits of health care for workers, will lead to lowered salaries, and thus employees should receive some of the burden of the fee.

57. New York, N.Y., Local Law § 22-506(b)(5) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

which nearly 50% or more of the existing employers already provide health insurance, demonstrating the feasibility of health insurance coverage within the industries and the importance of maintaining the insurance coverage for those workers who currently receive it.⁵⁸ Second, all five industries are in the service sector and provide jobs that must be performed locally. Whenever local employee benefit regulations are passed, there are worries that the burden on employers will lead to job flight, and so the limitation to necessarily local industries would have allowed the effects of the pay-or-play model to be tested before it was applied to less geographically-limited industries, such as manufacturing.

In New York, as in California, the charges received through the HCSA were to be used to fund a Health Care Security Program to provide health benefits for those workers within the five industries whose employers did not provide employer-sponsored health insurance.⁵⁹ Unlike in California, however, the HCSA specifically provided that not all employees who had charges paid on their behalf would necessarily be entitled to receive services under the program.⁶⁰ Instead, the administering agency was to establish eligibility procedures based “in part on need-based criteria” to be developed by the agency.⁶¹ While there were several justifications for not having the charge create a quid pro quo obligation for the city, one motivation could have been the desire to avoid an unfunded city liability that could put a drain on general city funds. The resulting Health Care Security Program would have provided benefits similar to those provided to city employees, and there was to be no premium or deductible to those employees provided benefits.⁶²

C. *The Policy behind the New York Health Care Security Act*

Proponents of both versions of the HCSA argued it would serve three useful policy goals. First, a higher rate of health insurance coverage could yield significant economic benefits for the city. The HCSA would have increased the number of working individuals

58. Sonn & Aiyar, *supra* note 13, at 4. Despite this considerable coverage, there remain 126,720 uninsured workers and their dependents in these industries, so the immediate effect of the bill on insurance coverage rates in the city would have been pronounced. *Id.* at 13.

59. New York, N.Y., Local Law § 22-506(c) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

60. *Id.* § 22-506(c)(3).

61. *Id.*

62. *Id.* §§ 22-506(d)(1)-(2) (2005).

who are covered by health insurance, both by stemming the tide of insurance loss and by extending health insurance to an additional 126,000 New Yorkers.⁶³ Research has shown that a higher rate of insurance leads to a more efficient use of health care among a population, as more individuals are able to obtain preventive treatment, thereby reducing costly hospital visits.⁶⁴ In addition, early access to preventive treatment often stems more serious illnesses that may result in a loss of productivity among workers.⁶⁵

Second, the bill would have leveled the playing field for those businesses that do provide health insurance. This leveling would have prevented a race to the bottom in which businesses are forced to abandon such programs when they are undersold by businesses that do not provide health insurance. This could have led to an exodus of skilled workers from industries which did not offer health insurance, as they would have been drawn to industries where health insurance benefits were available. The proponents of the bill maintain that responsible employers seeking to avoid a race to the bottom were the primary political constituency behind the HCSA, as these employers would find themselves unable to maintain benefits for their employees if faced with “Wal-Mart model” competitive practices.⁶⁶

Finally, proponents could have argued that the bill would have remedied a hole in the state’s public health insurance platform. New York State, working in conjunction with New York City, has several programs designed to make health insurance available for

63. Sonn & Aiyar, *supra* note 13, at 13.

64. Uninsured individuals are “often unable to obtain care when they first experience health problems and when management or alleviation of the problem could be achieved with less expensive intervention.” Nancy MacNeil, Comment, *Employer Mandated Health Insurance: A Solution for the Working Uninsured?*, 24 J. HEALTH & HOSP. L. 337, 337 (1991). Studies cited by the General Accounting Office found that “the uninsured rely more heavily than the rest of the population on hospitals for ambulatory services and as a regular source of care.” GENERAL ACCOUNTING OFFICE, GAO/HRD-89-45, HEALTH INSURANCE: AN OVERVIEW OF THE WORKING UNINSURED 35 (1989).

65. Among hospitals with a high percentage of uninsured patients, patients “typically present more complex and acute health problems, and require multiple medical treatments with more intense services.” GENERAL ACCOUNTING OFFICE, *supra* note 64, at 37.

66. See Alexandra Marks, *Businesses Warm to “Pay or Play” Healthcare*, CHRISTIAN SCI. MONITOR, Sep. 29, 2004, at 2. The “Wal-Mart model” refers to the phenomenon of large retailers relying on taxpayers to subsidize the cost of maintaining their workforce. Recent studies have reported that taxpayers subsidize \$20.5 million worth of medical care yearly for Wal-Mart in California alone, and that a single 200-person Wal-Mart store costs federal taxpayers an estimated \$420,750/year. Sonn & Aiyar, *supra* note 13, at 6.

purchase for small businesses.⁶⁷ On the federal level, Medicaid is designed to provide health insurance to the indigent and unemployed. Despite these programs, the city has noticed a growing problem of lack of health insurance among those workers employed by large employers, a community not covered by the current major health care regulations.⁶⁸ Arguably, society should not be subsidizing the medical care costs of larger employers, who presumably can afford to cover their own employees' medical costs. The proponents of the HCSA believe that this is particularly true in the industries that they have proposed to cover, in light of the fact that half or more of businesses in those sectors currently provide health insurance.⁶⁹ Proponents argued that large employers abuse the safety net by offloading their medical bills to the taxpayers or to insured individuals.⁷⁰ Either the pay-or-play model or the civil fine model could deter that behavior by shifting the cost back to the large employers directly.

These proposals also offered the possibility of targeting the current gap in health insurance coverage without overturning the entire health insurance system. Critics of society-wide solutions to the health insurance problem often argue that if the state provided an adequate substitute for health insurance, the result would be a decline in employer-provided health insurance as employers shifted their employees into the state program.⁷¹ An approach targeting employers prevents the substitution effect and allows for variation in health insurance while maintaining the responsibility of employers.

Against these policy arguments, critics of the New York program leveled several arguments. Incorporating a critique frequently used against employment regulation, they argued that the New York program would hurt industry and employees by forcing

67. New York State's Healthy New York Program and the New York City HealthPass initiative both are geared towards the small business population. See *supra* text accompanying notes 5–6; HEALTHPASS: FREEDOM OF CHOICE FOR SMALL BUSINESSES, *supra* note 6.

68. HEALTHPASS: FREEDOM OF CHOICE FOR SMALL BUSINESSES, *supra* note 6.

69. Sonn & Aiyar, *supra* note 13, at 4.

70. The GAO concluded that “[h]ealth care services provided to the uninsured are paid for directly—out of pocket by the uninsured themselves and by public funds and philanthropy—and indirectly—through cost-shifting to those people with health insurance or the ability to pay.” GENERAL ACCOUNTING OFFICE, *supra* note 64, at 38. Although some portion of these costs are absorbed by the patients themselves, a great deal of the costs are offloaded onto society through either higher taxes or higher premiums for those individuals who have insurance.

71. See Rau, *supra* note 52.

employers to reduce their workforce.⁷² All employee benefit regulations increase the cost of labor, and at the margins, employers may be forced to reduce payroll. Some employers may have been forced out of business by this regulation, although this seems unlikely given the high rate of employer-provided insurance already prevalent in these industries.

As a second argument against the bill, opponents could have argued that the bill would have had a disproportionate effect on small businesses. The bill's sponsor responded to these arguments by citing the bill's clear attempts to limit the HCSA to larger employers,⁷³ although it is possible that some small businesses might slip through the protections. Although it appears that the City Council is now willing to work with the employer community to ensure that only large employers are targeted, that willingness might change once the program has begun.

Finally, opponents of the HCSA are likely to have argued that the city's health insurance plan required more comprehensive regulation across a broader section of industries and with cooperation from state and federal authorities. The argument could have continued that targeted regulation would not have adequately addressed the lack of health insurance in the city, as skilled workers who would have likely been able to secure benefits regardless may have been drawn into these industries, forcing unskilled workers to move to other industries, where insurance coverage remains sparse.

Having made the broader argument that the city level was not the appropriate forum for health care regulation, however, opponents of the bill risked making the perfect the enemy of the good. While comprehensive regulation at the state or federal level across all industries might have been preferred, this hardly seems a reason

72. See, e.g., Lifsher, *supra* note 52; SAMUEL ESTREICHER & MICHAEL C. HARPER, CASES AND MATERIALS ON EMPLOYMENT LAW 623 (2004). Although typically an additional economic response to employment regulation is that it may lead to job flight, as discussed above, the geographical nature of the industries covered in this bill makes it less likely that the regulation would lead to an exodus of jobs from the city.

73. In the HCSA's definition section, it clearly seeks to limit the bill to larger employers. E.g., New York, N.Y., Local Law § 22-506(b)(2) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law) ("'Building Service Employer' means any entity that employs persons performing building service . . . in connection with any commercial or industrial building of 100,000 square feet or more or any residential building of 50 or more units."); *Id.* § 22-506(b)(9) ("'Grocery Employer' means any entity . . . that . . . employs more than 35 employees in any calendar year, or (ii) that contains 10,000 square feet or more of floor space for the sale of food for . . . off-site consumption.").

to reject useful regulation where implementation was possible. Congress and the New York state legislature have not shown themselves able to tackle the pressing issue of lack of health insurance coverage in this country. The wait for federal or state leadership on this issue may be long and disappointing.

D. The Authority of the New York City Council to Adopt the Original HCSA

As examined above, the centerpiece of the original Health Care Security Act was the pay-or-play charge. The power of the city to levy this charge was crucial to the success of the Act.

New York City's power to assess fees is broad. Under its home-rule powers, the city has the authority to adopt laws relating to the "protection, order, conduct, safety, health and well-being" of its citizens⁷⁴ and "to adopt local laws providing for the regulation or licensing of occupations or businesses."⁷⁵ These municipal home-rule powers are to be "liberally construed."⁷⁶ When the city regulates pursuant to these powers, it is authorized to enact laws relating to the "fixing, levy, collection and administration of local government rentals, charges, rates or fees, penalties, and rates of interest thereon, liens on local property in connection therewith and charges thereon."⁷⁷ New York City, therefore, would not need state enabling legislation to impose a fee on businesses.

74. N.Y. CONST. art. IX, § 2(c)(ii)(10). The grant of home-rule authority from the New York Constitution explicitly grants the city authority to promote the health of citizens by regulating business. See *People v. Cook*, 312 N.E.2d 452, 455 (N.Y. 1974). In *Cook*, New York City used its home-rule powers to regulate cigarettes by requiring "retailers to maintain a difference in price between brands that have a higher tar and nicotine content and those which have a lower tar and nicotine content." *Id.* at 454. The Court held that as long as the enactment is related to the power to promote health, the city's police powers have only two limitations: "(1) the city may not exercise its police power by adopting a local law which is inconsistent with constitutional or other general law; and (2) the city may not exercise its police power over health to the extent that the Legislature shall restrict the adoption of such local law." *Id.* at 455. The Court found that the nicotine differential was reasonably related to health, and both the other criteria were met, thus the regulation was a valid exercise of the city's home-rule powers. *Id.* at 456, 459. For the HCSA, the New York state legislature has created no restrictions on the power of the city to enact a health insurance plan. The pay-or-play charge would thus have been a valid exercise of the city's police power so long as the charge met the first *Cook* criteria, constitutionality.

75. N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(12) (1994).

76. N.Y. CONST. art IX, § 3(c).

77. N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(9-a) (1994).

By contrast, New York City's right to tax is very limited. The city has the right to levy and administer non-property taxes only when they are "authorized by the [state] legislature," and these taxes must be "consistent with laws enacted by the legislature."⁷⁸ Without authorization from Albany, the city would not have been able to invoke its taxation powers to enact pay-or-play legislation.

So long as the legislation was to be enacted by the city council, the pay-or-play charge's status as a fee or a tax was central to its constitutionality.⁷⁹

II.

THE CONSTITUTIONALITY OF THE PAY-OR-PLAY ASSESSMENT ON EMPLOYERS

The distinction between taxes and fees comes up in a variety of legal settings. It arises in cases involving entities exempt from taxation,⁸⁰ state and federal constitutional limits on taxation,⁸¹ the Fed-

78. N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(8) (1994).

79. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 (Cal. 2003) (repealed 2004) faced a similar fee-tax issue, as California's Proposition 13 changed the California constitution to require that all taxes be passed by a two-thirds majority of both houses. CAL. CONST. art. XIII-A, § 3. S.B. 2, 2003–04 Sen., Reg. Sess. ch. 673 (Cal. 2003) (repealed 2004), while it passed both houses of California's legislature, did not receive a two-thirds majority and thus would have been unconstitutional as a tax.

80. *See, e.g.*, Health Servs. Med. Corp. of Cent. N.Y. v. Chassin, 668 N.Y.S.2d 1006, 1009 (Sup. Ct. 1998) (non-profit tax-exempt HMO arguing that an increase in mandated hospital payments was a disguised tax); Emerson Coll. v. City of Boston, 462 N.E.2d 1098, 1100–01 (Mass. 1984) (tax-exempt educational institution arguing that a charge for fire protection was actually a tax).

81. *See, e.g.*, Bolt v. City of Lansing, 587 N.W.2d 264, 266 (Mich. 1998) (considering challenge to storm water service charge under Michigan's Headlee Amendment, which requires all taxes to be approved by a vote of the people); Covell v. City of Seattle, 905 P.2d 324, 326 (Wash. 1995) (considering claim that a street utility charge violated the uniformity requirement of the Washington constitution); United States v. Maine, 524 F. Supp. 1056, 1057–58 (D. Me. 1981) (federal government suing to enjoin Maine from enforcing consumer protection fees against federal credit unions, relying on the Supremacy Clause of the Constitution); Massachusetts v. United States, 435 U.S. 444, 446 (1978) (state suing to enjoin federal government from collecting an aircraft tax on state-owned aircraft, citing the implied immunity of state government from federal taxation). Cases involving constitutional challenges to fees are arising more often recently due to the prevalence of anti-tax measures such as the Headlee Amendment and California's Proposition 13, which greatly constrain the ability of state and local legislatures to raise taxes. As a result, legislatures are often turning to regulatory fee systems as opposed to funding programs from the general state taxes, and these new systems are often accused of being taxes disguised as fees. *See* Richard Briffault, Foreword, *The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 RUTGERS L.J. 907, 950–52 (2003).

eral Tax Injunction Act,⁸² and local government initiatives.⁸³ A judicial finding that a legislative assessment is a “fee,” or other non-tax designation, is a determination that the assessment should not be subject to the applicable limits on taxation.⁸⁴ Distinguishing whether legislative charges are taxes or fees is a matter of common-law precedent,⁸⁵ as the term “tax” is rarely defined in constitutions or statutes. Perhaps due to this constitutional and statutory silence, courts are not overly deferential to legislative labels in this area. As many courts have noted, while the legislature may choose to label a charge as either a tax or a fee, the ultimate determination must be made by courts based on the properties of the measure.⁸⁶ As the

82. *See, e.g., Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 132 (4th Cir. 2000) (waste-removal companies challenging West Virginia’s waste removal fee as an unconstitutional violation of the commerce clause; court held that the fee was in fact a tax, and thus the court lacked subject matter jurisdiction to decide the substantive claim due to the Federal Tax Injunction Act (FTIA), which prevents district courts from interfering with state taxes where a “plain, speedy and efficient remedy may be had in the courts of such State”); *Tramel v. Schrader*, 505 F.2d 1310, 1316 (5th Cir. 1975) (holding that suit to enjoin the collection of street improvement assessments by the City of Dallas was barred by the FTIA, as the assessments were taxes for the purposes of the act). The fee-tax issues in FTIA cases are on slightly different footing than the fee-tax issues presented by state constitutional law challenges, as the federal courts have recognized that the FTIA demands a broad reading of tax to accomplish the Congressional purposes behind the act, one of which is “the desire to end the use of the federal courts to disrupt the collection of local revenues.” *Id.*

83. Cities and smaller municipalities often have no independent taxation power without state approval, and thus must rely on the police power to generate revenue. *See Jenad, Inc. v. Vill. of Scarsdale*, 218 N.E.2d 673, 674 (N.Y. 1966), *partially abrogated on other grounds by Dolan v. City of Tigard*, 512 U.S. 374 (1994) (plaintiff arguing that a fee levied by the village on a developer in lieu of developer allotting park land was in fact a tax, which the village did not have the authority to levy); *Contractors & Builders Ass’n v. City of Dunedin*, 329 So. 2d 314, 317 (Fla. 1976) (plaintiff arguing that water and sewer impact fees were taxes, which the city could not constitutionally impose without enabling legislation).

84. *See generally* Briffault, *supra* note 81, at 932–37. “State courts have exempted a host of special assessments, fees, and charges from tax limitations. These decisions grow out of, but often expand, the longstanding judicial determination that fees, charges, and assessments are not taxes because they lack the hallmarks of taxation—coercion and potential for retribution.” *Id.* at 934.

85. *See id.* at 934 (“the longstanding judicial determination that fees, charges, and special assessments are not taxes”); Laurie Reynolds, *Taxes, Fees, Assessments, Dues, and the “Get What You Pay For” Model of Local Government*, 56 FLA. L. REV. 373, 409 (2004) (“As a legal matter, courts have traditionally identified three requirements for valid fees.”) (emphasis added).

86. *See, e.g., Valero*, 205 F.3d at 134 (“[T]he nomenclature provided to the charge at issue is not material as the inquiry focuses on explicit factual circumstances that transcend the literal meaning of the terminology”); *Sinclair Paint Co. v. State Bd. of Equalization*, 937 P.2d 1350, 1353 (Cal. 1997) (“[W]hether imposi-

next section will document, however, New York courts have not been very consistent in this determination.

A. *Judicial Confusion: New York Common Law Distinction Between Taxes and Fees*

Looking at other states for persuasive precedent, several states have developed multi-factor tests for distinguishing taxes from fees.⁸⁷ Although the tests are rarely the same, the factors they have considered include:

- (1) the purpose of the charge, or legislative intent;⁸⁸
- (2) the revenue's ultimate use;⁸⁹
- (3) proportionality of the charge to the benefit received or detriment caused by the payer;⁹⁰

tions are 'taxes' or 'fees' is a question of law for the appellate courts to decide on independent review of the facts"); *Joslin v. Regan*, 406 N.Y.S.2d 938, 941 (App. Div. 1978) ("[T]he label attached to an assessment is not dispositive of its true nature"). See also *Dawson v. Kentucky Distilleries & Warehouse Co.*, 255 U.S. 288, 292-93 (1921); *Franklin Soc. for Home Bldg. & Sav. v. Bennett*, 24 N.E.2d 854, 857 (N.Y. 1939).

87. See *Emerson Coll. v. City of Boston*, 462 N.E.2d 1098, 1105 (Mass. 1984) ("[Fees] are charged in exchange for a particular governmental service which benefits the party paying the fee in a manner 'not shared by other members of society'; they are paid by choice . . . and the charges are collected not to raise revenues but to compensate the governmental entity providing the services for its expenses."). *Bolt v. City of Lansing*, 587 N.W.2d 264, 269 (Mich. 1998) ("[A] 'fee' is 'exchanged for a service rendered or a benefit conferred, and some reasonable relationship exists between the amount of the fee and the value of the service or benefit.'"); *Covell v. City of Seattle*, 905 P.2d 324, 327 (Wash. 1995) ("Whether a charge imposed by a governmental entity is a tax or a regulatory fee depends on three factors . . . [(1)] whether . . . the primary purpose of the charges is to raise revenue, rather than to regulate . . . [(2)] whether the money collected must be allocated only to the authorized regulatory purpose . . . [(3)] whether there is a direct relationship between the fee charged and the service received by those who pay the fee . . ."). Additionally, the *Bolt* court articulated "three primary criteria": a fee "must serve a regulatory purpose rather than a revenue-raising purpose," "must be proportionate to the necessary costs of the service," and must be voluntary. *Bolt*, 587 N.W.2d at 269.

88. See, e.g., *Covell*, 905 P.2d at 327 (whether the primary purpose of the charges "is to raise revenue, rather than to regulate"); *Bolt*, 587 N.W.2d at 269 (a "fee must serve a regulatory purpose rather than a revenue-raising purpose").

89. See, e.g., *Emerson Coll.*, 462 N.E.2d at 1105 ("[T]he charges are collected not to raise revenues but to compensate the governmental entity providing the services for its expenses"); *Covell*, 905 P.2d at 327 ("whether the money collected must be allocated only to the authorized regulatory purpose").

90. See, e.g., *Bolt*, 587 N.W.2d at 269 (a fee "must be proportionate to the necessary costs of the service"); *Covell*, 905 P.2d at 327 ("whether there is a direct relationship between the fee charged and the service received by those who pay the fee").

(4) a requirement of a particularized benefit/deterrence for the payer;⁹¹ and

(5) the voluntariness of the charge.⁹²

While each of these state tests can be critiqued, at the very least they share the commendable attribute of giving some degree of guidance to the state legislature and city councils in enacting charges. On the contrary, New York courts have never specifically established a multi-factor test, instead focusing on “legislative intent.”⁹³ As a result, New York courts have applied, rather haphazardly, all of the above criteria at one time or another, with a dizzying array of results.⁹⁴ They have stated alternately that the central issue is “legislative intent,”⁹⁵ the “visitation of the costs of special services upon the one who derives a *benefit*,”⁹⁶ or that “the amount charged cannot be greater than a sum reasonably necessary to cover the costs,”⁹⁷ often without examining the other issues in their analysis. The cost of this case-specific jurisprudence has been legislative confusion, as it can often be difficult to know in advance whether any particular charge will be rendered a fee or a tax.

New York courts generally encounter the fee-tax distinction in the context of state constitutional limits on taxation.⁹⁸ As a result, they should develop a distinguishing test that serves the policy of properly limiting taxation without unnecessarily complicating the legislative task or providing arbitrary hurdles. The remainder of

91. *See, e.g., Emerson College*, 462 N.E.2d at 1105 (fees “are charged in exchange for a particular governmental service which benefits the party paying the fee in a manner ‘not shared by other members of society’”).

92. *See, e.g., id.* (fees “are paid by choice”); *Bolt*, 587 N.W.2d at 269.

93. *See Am. Sugar Ref. Co. of N.Y. v. Waterfront Comm’n*, 432 N.E.2d 578, 584 (N.Y. 1982); *Torsoe Bros. Constr. Corp. v. Vill. of Monroe*, 375 N.Y.S.2d 612, 616–17 (App. Div. 1975); *Health Servs. Med. Corp. of Cent. N.Y. v. Chassin*, 668 N.Y.S.2d 1006, 1009 (Sup. Ct. 1998); *Radio Common Carriers of N.Y. v. State*, 601 N.Y.S.2d 513, 515 (Sup. Ct. 1993); *Hanson v. Griffiths*, 124 N.Y.S.2d 473, 476 (Sup. Ct. 1953).

94. *See generally Health Servs. Med. Corp.*, 668 N.Y.S.2d at 1009–10 (discussing New York precedent in the fee-tax area and cataloguing independent precedents directing courts to examine legislative intent, particularized benefit, proportionality, and revenue’s ultimate use).

95. *Am. Sugar Ref. Co.*, 432 N.E.2d at 584.

96. *Jewish Reconstr. Synagogue of the N. Shore, Inc. v. Vill. of Roslyn Harbor*, 352 N.E.2d 115, 117 (N.Y. 1976).

97. *Torsoe Bros. Constr. Corp.*, 375 N.Y.S.2d at 616–17.

98. *See, e.g., Jenad, Inc. v. Vill. of Scarsdale*, 218 N.E.2d 673, 675–76 (N.Y. 1966); *N.Y. Tel. Co. v. City of Amsterdam*, 613 N.Y.S.2d 993, 995 (App. Div. 1994) (examining a city fee in relation to the constitutional prohibition of unauthorized taxation by cities); *Torsoe Bros. Constr. Co.*, 375 N.Y.S.2d at 614; *Health Servs. Med. Corp.*, 668 N.Y.S.2d at 1008 (examining a fee assessed on a tax-exempt HMO).

this section will demonstrate that New York could reach such a test by focusing on two sources that its courts have cited with approval, the *Head Money Cases*⁹⁹ and *San Juan Cellular*.¹⁰⁰

B. *The Head Money Criteria*

The seminal Supreme Court cases on the fee-tax distinction are the 1884 *Head Money Cases*, in which the Supreme Court first encountered a regulatory fee and laid down two basic characteristics that distinguish such a fee from a tax.¹⁰¹ The cases arose from challenges to a Congressional “Act to Regulate Immigration,” which levied a fifty-cent charge on any non-citizens who entered the United States on a vessel from a foreign port.¹⁰² The plaintiffs argued, *inter alia*, that Congress did not have the authority to levy this charge under any explicit power granted in the Constitution.¹⁰³ The Court held that “the true answer to all these objections is that the power exercised in this instance is *not the taxing power*. The burden imposed on the ship owner by this statute is the mere incident of *the regulation of commerce . . .*”¹⁰⁴ The Court then laid out two characteristics which distinguish the *Head Money* charge from a tax. First, the provisions of the Act to Regulate Immigration “are aptly designed to mitigate the evils inherent in the business of bringing foreigners to this country,” and thus demonstrate regulatory rather than revenue-generating intent.¹⁰⁵ Second, the money collected by the Act “is appropriated in advance to the uses of the statute, and does not go to the general support of the government,” which demonstrates that Congress is using the money collected solely to achieve the regulatory ends.¹⁰⁶ The court concluded that as the Constitution grants Congress broad use of its police power, the statute was a valid exercise of that power, and thus the charge was a regulatory fee rather than a tax.¹⁰⁷

99. 112 U.S. 580 (1884).

100. *San Juan Cellular Tel. Co. v. Pub. Serv. Comm’n*, 967 F.2d 683 (1st Cir. 1992).

101. 112 U.S. 580 (1884).

102. *Id.* at 589-90.

103. *See id.* at 591.

104. *Id.* at 595 (emphasis added).

105. *Id.*

106. *Id.* at 596.

107. It might be argued that the fee/tax distinction is merely a legal fiction, a judicial creation to exempt certain types of preferred legislative actions from the constraints on taxation, without actually revealing any salient differences between the underlying charges. This argument has never really gained traction, however, in that there are certain charges that are universally agreed to be fees. Examples

Although the criteria developed by the *Head Money* court have remained persuasive precedent throughout the past-century,¹⁰⁸ these criteria have recently been reaffirmed in the much-cited *San Juan Cellular* decision by then-First Circuit Chief Judge Breyer in 1992.¹⁰⁹ In that case, the FCC had licensed two cellular telephone companies, a private firm and a government-owned firm, to provide cellular service in Puerto Rico.¹¹⁰ Puerto Rico's regulatory commission approved the two companies, but sought to impose a "periodic fee" equal to three percent of gross revenue on solely the private firm.¹¹¹ When the private firm sought to challenge the charge as discriminatory, Puerto Rico asserted that the charge was protected as a tax under the Butler Act,¹¹² which serves as a Tax Injunction Act for the Commonwealth of Puerto Rico. The First Circuit rejected the Commonwealth's characterization of the charge as a tax, and in the process laid out a more developed version of the *Head Money* test for distinguishing between fees and taxes.¹¹³

The *San Juan Cellular* test directs courts to look first at legislative intent and sketched out a spectrum for fees and taxes.¹¹⁴ The paradigmatic tax "raises money, contributed to a general fund, and spent for the benefit of the entire community."¹¹⁵ The paradig-

would include user fees, such as payments for publicly-provided water service, regulatory cleanup fees, such as fees for toxic waste sites, or more generic filing fees, courthouse fees, and judicial fees. Where a particular actor has imposed a direct cost on the government, it has never seriously been contended that the imposition of the cost upon the actor would constitute a tax. *See, e.g.,* Fox v. Kern, 12 N.Y.S.2d 561, 563 (Sup. Ct. 1939) ("Where . . . special service is required, a fee may properly be charged of the one whose needs require it instead of loading the expense therefor upon the taxpayer at large."). The difficulty of the fee/tax distinction has always been encountered in those charges which fit neatly into neither the fee basket, as not clearly in response to a direct cost on the government, nor the tax basket, as not clearly for the generation of public revenue. It is towards the classification of these intermediate charges that this Note is directed.

108. *See, e.g.,* Am. Sugar Ref. Co. of N.Y. v. Waterfront Comm'n, 432 N.E.2d 578, 585 (N.Y. 1982) (relying on the *Head Money* cases in determining that the payment by steamship companies of the Waterfront Commission's expenses was a fee, not a tax.)

109. *San Juan Cellular Tel. Co. v. Pub. Serv. Comm'n*, 967 F.2d 683, 685 (1st Cir. 1992).

110. *Id.* at 684.

111. *Id.*

112. The Butler Act forbids Federal district courts from "restraining the assessment or collection of any tax imposed by the laws of Puerto Rico" where a plain, speedy, and efficient remedy is available in the Commonwealth's courts. 48 U.S.C. § 872 (2000); *Carrier Corp. v. Perez*, 677 F.2d 162, 164 (1st Cir. 1982).

113. *San Juan Cellular Tel. Co.*, 967 F.2d at 685–86.

114. *Id.*

115. *Id.*

matic regulatory fee “serve[s] regulatory purposes” by “deliberately discouraging particular conduct by making it more expensive,” or by “raising money placed in a special fund to help defray the agency’s regulation-related expenses.”¹¹⁶ Where the intent inquiry was inconclusive, the *San Juan Cellular* court directed courts to emphasize a second factor, the “revenue’s ultimate use.”¹¹⁷ Where the funds collected provide a “general benefit to the public,” the underlying charge is a tax;¹¹⁸ where the funds provide “more narrow benefits to regulated companies” or defray the “costs of regulation,” the charge should be considered a fee.¹¹⁹

Applying this test to the facts at bar, the *San Juan Cellular* court emphasized that the charge was assessed in the course of the regulation of cellular telephone service and that the funds received through the periodic charge were earmarked specifically for the expenses of the commission.¹²⁰ Therefore, the periodic charge was a fee.

Taken together, the *Head Money Cases* and *San Juan Cellular* suggest a two-pronged test for distinguishing fees and taxes. I will describe these two factors as (1) a “legislative intent to regulate” and (2) the “revenue’s ultimate use.” A closer look at each of them will demonstrate why they should be the central factors.

1. Legislative Intent

New York courts looking at the distinction between fees and taxes will at times base their decision on “legislative intent.”¹²¹ When New York courts focus in on intent, they generally look to the purpose of the statute in question. If the charge is “exacted for revenue purposes or to offset the cost of general governmental

116. *Id.*

117. *Id.*

118. *Id.* As examples of general benefits to the public, the court cited “highway construction, a general type of public expenditure” and “a city-assessed public utility franchise fee,” as the franchise fee “was treated as part of the city’s general revenue.” *Id.* (internal quotations omitted).

119. *Id.* As examples of more narrow benefits, the court cited the *Head Money* charge, which was tailored to the regulation related expenses of the immigration act, and a Public Utilities Commission assessment which helped “defray the cost of performing the regulatory duties” of the Commission. *Id.* at 686 (internal quotations omitted).

120. *Id.* The expenses which the court cited included, “specialized investigations and studies . . . the hiring of professional and expert services and the acquisition of the equipment needed for the operations provided by law for the Commission.” *Id.*

121. *Am. Sugar Ref. Co. of N.Y. v. Waterfront Comm’n*, 432 N.E.2d 578, 584 (N.Y. 1982).

functions,” it is generally held to be a tax.¹²² If the charge is “enacted principally as an integral part of the regulation of an activity and to cover the cost of regulation,”¹²³ it is considered a fee. Stated more simply, where an assessment is “intended to regulate rather than generate revenue it is not a tax.”¹²⁴ The first question New York courts ask appears direct: Did the legislative body intend to regulate or to generate revenue?

Despite its seeming directness, this formulation of a legislative-intent analysis is inadequate. As commentators have noted, all charges generate revenue, and in some publicized cases local governments have seized on regulatory fees as a mechanism to cover the costs of all governmental services.¹²⁵ In other settings, such as municipal water utilities, a charge which clearly has no purpose other than to raise revenue is not thereby a tax.¹²⁶

A deeper legislative-intent analysis must thresh out why the government sought to raise money.¹²⁷ If the money was to be raised and then “spent for the benefit of the entire community,”¹²⁸ then the measure was likely motivated by revenue incentives, and thus a tax. On the other hand, if the levy serves regulatory ends, perhaps by “deliberately discouraging certain conduct by making it more expensive,” or by defraying “regulation-related expenses,” then the measure is likely a fee.¹²⁹

The legislative-intent prong is a powerful tool to distinguish fees and taxes because it measures a central feature of a fiscal system: the relationship between the source of revenue and the resulting government spending. The most notable feature of a tax is that

122. *Health Servs. Med. Corp. of Cent. N.Y. v. Chassin*, 668 N.Y.S.2d 1006, 1009–10 (Sup. Ct. 1998) (citing *N.Y. Tel. Co. v. City of Amsterdam*, 613 N.Y.S.2d 993, 995 (App. Div. 1994)); *Joslin v. Regan*, 406 N.Y.S.2d 938, 941 (App. Div. 1978); *Radio Common Carriers of N.Y., Inc. v. State*, 601 N.Y.S.2d 513, 515–16 (Sup. Ct. 1993)) (internal quotations omitted).

123. *Id.*

124. *Colonial Life Ins. Co. of Am. v. Curiale*, 617 N.Y.S.2d 377, 380 (App. Div. 1994).

125. *See Reynolds*, *supra* note 85, at 412–13 (describing a North Carolina town which established twenty-two new user fees, each linked to substantive “regulatory services,” in what may have been “blatant attempts to generate revenue in the face of anti-tax limitations”). *See also* Hugh D. Spitzer, *Taxes vs. Fees: A Curious Confusion*, 38 GONZ. L. REV. 335, 352 (2002/03).

126. Spitzer, *supra* note 125, at 352.

127. *Id.* at 354 (The “court failed to observe that the key question is not whether a charge is to raise money, but to raise money *for what?*”).

128. *San Juan Cellular Tel. Co. v. Pub. Serv. Comm’n*, 967 F.2d 683, 685 (1st Cir. 1992).

129. *Id.*

there “is no connection between the person who bears the burden of a tax dollar and who determines how to spend tax revenue.”¹³⁰ Because of this lack of connection, taxation presents problems of “coercion and potential for retribution”¹³¹ that justify the imposition of statutory or constitutional constraints on taxation powers.¹³² By contrast, fees “crucially depend on the relationship between the payer and the purpose for which the revenue raised will be spent.”¹³³ Because of the connection between revenue source and revenue output, fees are exempted from the requirements of taxation.¹³⁴

A legislative-intent analysis adequately measures the connection between revenue source and revenue output, in a way that is consistent with the court’s institutional competence. As will be explored further below in the sections examining the proportionality and particularized-benefit tests, courts are often not well-suited to determine the precise level of benefits a given regulation will provide, or whether the benefits or deterrence value of the charge is proportionate to the cost to the charge-payer. While in an individual case a court might determine that a particular charge is overly burdensome of the charge-payer’s rights, across a broader population these issues turn on legislative fact-finding and policy decisions, which are outside the province of the courts.¹³⁵ Where

130. Spitzer, *supra* note 125, at 338. *See also* Reynolds, *supra* note 85, at 379 (“[T]axes are levied without consideration of whether the individual taxpayer will benefit from the services funded by the tax.”).

131. Briffault, *supra* note 81, at 934.

132. *See id.* at 927–28 (cataloguing the types of constraints on taxation that are contained in state constitutions). “More than half the state constitutions include some substantive or procedural limitation on the level of state or local taxing or the level of spending funded by own-source revenues.” *Id.* at 928.

133. Reynolds, *supra* note 85, at 380. *Cf.* Spitzer, *supra* note 125, at 352 (“Properly understood, *regulatory fees* are charges to cover the cost of the state’s use of its regulatory powers which can be allocated to those who are either voluntarily or involuntarily receiving special attention from government regulators.”)

134. *See* Briffault, *supra* note 81, at 934 (“[S]tate courts have exempted a host of special assessments, fees, and charges from tax limitations. These decisions grow out of . . . the longstanding judicial determination that fees, charges, and assessments are not taxes because they lack the hallmarks of taxation . . .”).

135. A similar situation in which courts embroil themselves in the review of legislative fiscal decisions is while examining state taxes under the Dormant Commerce Clause. The Supreme Court has stated that, “no State may discriminate against interstate commerce by enacting a tax which provides a competitive advantage to local business.” *Am. Trucking Ass’n v. Scheiner*, 483 U.S. 266, 269 (1987). However, policing the line of in-state favoritism “embroils the courts in detailed accounting controversies of the kind that, in other contexts, the Court has held beyond judicial competence.” David A. Super, *Rethinking Fiscal Federalism*, 118

courts have shown themselves adept is in the determination of whether a particular charge has been tailored to a regulatory purpose, and whether that charge has been assessed primarily to accomplish that purpose.¹³⁶ By focusing on this legislative-intent analysis, courts can limit legislative authority to dodge tax limitations without unduly restricting the range of valid regulatory options.

2. The “Revenue’s Ultimate Use”

After making a determination that the legislature or city council has tailored a charge to a regulatory purpose, it remains to be shown that the funds raised are actually spent for that purpose. The Supreme Court addressed this issue in the *Head Money Cases* when it noted that “[t]he money thus raised . . . is apportioned in advance to the uses of the statute, and does not go to the general support of the government.”¹³⁷ Modern courts have imported this factor into their analysis, by emphasizing the “revenue’s ultimate use.”¹³⁸ The second question courts should ask is nearly as direct as the first: will the funds collected actually be spent regulating?

A good analysis of this factor was presented in *Health Services Medical Corp. v. Chassin*, a recent decision in New York determining

HARV. L. REV. 2546, 2602 (2005). Courts are forced “either to undertake the almost impossible task of determining when business activity’s marginal costs to state and local governments exceed the taxes being levied, or to force states to allow those businesses to exploit them.” *Id.* at 2603. These comments apply almost word-for-word to the efforts to use proportionality or particularized-benefit tests to distinguish between fees and taxes.

136. *Compare* *Am. Sugar Ref. Co. of N.Y. v. Waterfront Comm’n*, 432 N.E.2d 578, 585 (N.Y. 1982) (“The benefits to the industry—elimination of the evils in employment and employment practices and the adverse effect of those practices on the commerce of the port . . . are persuasive evidence of a legislative intent to correct the evils referred to by a program the cost of which was to be related to gross payroll payments because the new waterfront program would in major part redound to the benefit of employers.”), *with* *N.Y. Tel. Co. v. City of Amsterdam*, 613 N.Y.S.2d 993, 995–96 (App. Div. 1994) (“[T]he record reveals that the ‘fee’ sought to be imposed by defendant is being exacted for revenue purposes . . . defendant has not controverted the assertion that the moneys garnered under the ordinance will be deposited into defendant’s general fund, and it is apparent from a review of defendant’s Common Council meeting minutes that the ordinance is in fact a revenue-raising measure.”).

137. 112 U.S. 580, 596 (1884).

138. *San Juan Cellular Tel. Co. v. Pub. Serv. Comm’n*, 967 F.2d 683, 685 (1st Cir. 1992). *See also* *Health Servs. Med. Corp. of Cent. N.Y. v. Chassin*, 668 N.Y.S.2d 1006, 1010 (Sup. Ct. 1998) (“Where the legislation has both regulatory and revenue raising aspects, emphasis is placed on ‘the revenue’s ultimate use’”).

the constitutionality of state legislation regulating hospitals.¹³⁹ A non-profit health maintenance organization, which was exempt from taxation, took issue with a statute that sought to increase the payments from HMOs to hospitals, arguing that the increased payments were in fact an unconstitutional tax.¹⁴⁰ The statute linked the increase in HMO payments to regulatory goals involving Medicare enrollment.¹⁴¹ The plaintiff's evidence showed that the statute would raise thirty-one million dollars in revenue, and that the expense of administering the funds should not exceed two hundred thousand dollars.¹⁴² Of the over-charge, only one million dollars were earmarked for medical industry development, the remainder to enter general revenue.¹⁴³ The court found that while the statute served regulatory ends, the revenue raised clearly bore no relationship to the costs of regulating, and the revenue's ultimate use was for "the common welfare."¹⁴⁴ Thus while the statute might have been regulatory, the exaction only served to generate revenue, and was therefore a tax.¹⁴⁵

The court in *Health Services*, without citing the *Head Money* decisions, applied a nearly identical test. Once it established that the legislature intended to use its police powers, the court concluded that it had nonetheless used its fiscal powers by requiring an assessment that would fund general state services.¹⁴⁶ Conceptually, the court severed the charge from the remainder of the legislation and analyzed whether the resulting proceeds were used for a regulatory purpose.¹⁴⁷ With a simple two-step test, the court arrived at an appropriate result.

The importance of this prong of the analysis is not merely in ensuring that the legislature or city council has lived up to its word by properly segregating the money collected through a fee. Looking to the revenue's ultimate use distinguishes a regulation accompanied by a tax from a regulatory fee. Any tax may serve regulatory purposes. An example is a tax on alcohol, which serves the regula-

139. *Health Services Med. Corp.*, 668 N.Y.S.2d 1006 (Sup. Ct. 1998).

140. *Id.* at 1008.

141. *Id.* at 1009.

142. *Id.*

143. *Id.*

144. *Id.* at 1010.

145. *Id.* at 1009–10.

146. *Id.*

147. See *Radio Common Carriers of N.Y., Inc. v. State*, 601 N.Y.S.2d 513, 515 (Sup. Ct. 1993) (“[A] fee is enacted principally as an integral part of the regulation of an activity and to cover the cost of regulation.”); *Am. Trucking Ass'ns. v. O'Neill*, 522 F. Supp. 49, 54 (D.Conn. 1981).

tory function of decreasing consumption of a good deemed to have a deleterious effect on society, but which simultaneously funds any number of government projects. What distinguishes a regulatory fee is the connection between those who pay the fee and the use of the funds,¹⁴⁸ and thus courts must determine how the proceeds are spent.

An example of a situation where the “revenue’s ultimate use” prong would differentiate between regulation plus taxation and regulatory fees is in judicial review of impact fees, the constitutionality of which has confronted many state courts.¹⁴⁹ The regulatory concept behind impact fees is that those who create additional burdens on city or county local finances should compensate the locality, and that by placing a fee on growth the city or county can prevent excessive development. In New York, *City of Buffalo v. Stevenson*¹⁵⁰ and *Albany Area Builders Ass’n v. Town of Guilderland*¹⁵¹ addressed this issue. In *City of Buffalo*, the court confronted a street opening charge imposed on any developer before he could open a street for development. The court found that the charge served to regulate the expansion of city streets, and that the moneys were set apart to “meet the expenses necessarily or possibly attendant” upon the opening of streets.¹⁵² Although the court did not use the term “revenue’s ultimate use,” the revenue directly served the developer who paid the charge and protected the city against expenses generated by the developer, and thus the court held that the charge was a fee.¹⁵³ By comparison, in *Albany Area Builders Ass’n*, the court confronted a transportation impact fee that levied a charge for road improvement on any developer who improved land so as to “generate additional traffic.”¹⁵⁴ Although the regulatory purpose in *Albany* was very similar to the purpose in *City of Buffalo*, the revenue raised in *Albany* was to go to the improvement of roads throughout the town of Albany. The court found that the charge imposed “the expense of highway improvements upon a small group of home buyers even though the benefit of such improvement is enjoyed by

148. See *supra* notes 110–118 and accompanying text.

149. See Richard J. Gallogly, *Opening the Door for Boston’s Poor: Will “Linkage” Survive Judicial Review?*, 14 B.C. ENVTL. AFF. L. REV. 447, 457 (1987) (“[V]ery few judicial decisions speak to the legality of a program similar to the one in Boston.”). See also Pamina Ewing, Note, *Impact Fees in Pennsylvania: Requiring Land Developers to Bear Development-Related Costs*, 50 U. PITT. L. REV. 1101, 1102 (1989).

150. 100 N.E. 798 (N.Y. 1913).

151. 534 N.Y.S.2d 791 (App. Div. 1988).

152. 100 N.E. at 800.

153. *Id.*

154. 534 N.Y.S.2d at 792.

the public generally”¹⁵⁵ The revenue was ultimately spent not on the expenses generated by the individual payers, but on the expenses of society generally.¹⁵⁶ The court thus correctly found the transportation impact fee to be a tax. In distinguishing these cases, the “revenue’s ultimate use” prong was useful in determining whether the funds generated through regulation were properly applied to the regulatory ends.

As a test to distinguish fees and taxes, I propose that courts look to two principal factors: (1) a legislative intent to regulate, and (2) the revenue’s ultimate use. These two tests provide a workable format for courts to examine legislative enactments and restrict the unconstitutional use of fees. By comparison, several other commonly-used factors have not proved workable.

C. Other Criteria

Despite the simplicity and directness of the *Head Money/San Juan Cellular* criteria, courts both in New York and elsewhere have turned to several other factors in their fee-tax analysis. As listed above, these have included (1) proportionality, (2) a particular benefit, and (3) “voluntariness.” With each additional criterion, the burdens on the regulatory powers of legislative bodies grow heavier, and thus before the police powers are constrained, courts should demonstrate that these factors improve the analysis. Rather than contributing any additional content to the fee/tax distinction, these further factors merely serve as arbitrary judicially-imposed hurdles for legislative enactments.

1. Proportionality

Many courts, both in New York and elsewhere, have stated a requirement for fees that “the amount charged cannot be greater than a sum reasonably necessary to cover the costs of [regulation].”¹⁵⁷ Other courts have focused not on the cost of regulation, but on the “service received by those who pay the fee or . . . the burden produced by the fee payer,”¹⁵⁸ thus focusing on the perceived “value” of the regulation to the fee payer. Under either con-

155. *Id.* at 795.

156. *Id.* at 794–95.

157. *Torsoe Bros. Constr. Corp. v. Vill. of Monroe*, 375 N.Y.S.2d 612, 617 (App. Div. 1975). *See also Bolt v. City of Lansing*, 587 N.W.2d 264, 269 (Mich. 1998); *Health Servs. Med. Corp. of Cent. N.Y. v. Chassin*, 668 N.Y.S.2d 1006, 1010 (Sup. Ct. 1998).

158. *Covell v. City of Seattle*, 905 P.2d 324, 327 (Wash. 1995). *See also Sinclair Paint Co. v. State Bd. of Equalization*, 937 P.2d 1350, 1353–54 (Cal. 1997); *St.*

struction, the notion is of proportionality: a fee should be levied in proportion to the needs of regulation, and not be “unreasonable, discriminatory nor oppressive.”¹⁵⁹ A proportionality criterion fails to add anything to the fee/tax distinction, however, both because the criterion is not administratively useful for the courts and because it represents a misunderstanding of the difference between fees and taxes.

In examining the utility of a “proportionality” criterion, we must begin by asking if courts are merely applying a rational basis version of proportionality. If courts are merely inquiring as to whether the rate of the charge is arbitrary or capricious, this factor is not likely to invalidate many otherwise valid fees.¹⁶⁰ A cursory review of the case law demonstrates that in cases where a charge is found to be disproportional, examination of the *Head Money* factors would suffice to invalidate the charge. Sometimes when a charge bears no reasonable relationship with the service/benefit provided, it is a sign that the charge serves no regulatory purpose whatsoever, and would thus fail the “legislative intent” test.¹⁶¹ More often, though, when the rate of a regulatory charge is disproportionately high, the excess funds are typically earmarked for general fiscal purposes, thereby failing the “revenue’s ultimate use” test.¹⁶² In most situations, then, a weak “proportionality” factor does not expand the analysis.

Where courts have attempted to enforce a strong “proportionality” requirement, in some areas they have found it practically un-

Johns County v. Ne. Fla. Builders Ass’n, 583 So. 2d 635, 637 (Fla. 1991); *Bolt*, 587 N.W.2d at 269.

159. *Jewish Reconstr. Synagogue of the North Shore, Inc. v. Vill. of Roslyn Harbor*, 352 N.E.2d 115, 119 (N.Y. 1976).

160. *See, e.g., Seawall Assocs. v. City of New York*, 534 N.Y.S.2d 958, 968 (App. Div. 1988) (upholding a very significant fee for conversion of housing on a cursory review of the legislative justification for the rate, and a finding that the plaintiffs had presented “no persuasive evidence . . . that said sum is arbitrary or capricious”).

161. *See Covell*, 905 P.2d at 328–29 (invalidating a street utility charge which served no regulatory purpose, and was calculated based on the per month limit for residential charges).

162. *See Bolt*, 587 N.W.2d at 270 (invalidating a storm-water service charge where the fee was not proportional to the service because the fee was calculated to pay off a “public improvement designed to provide a long-term benefit to the city and all its citizens”); *Health Servs. Med. Corp.*, 668 N.Y.S.2d at 1010 (invalidating a medical services fee which bore “no relationship to the cost of regulation,” but where the revenue’s ultimate use was for the common welfare); *Torsoe Bros. Constr. Corp.*, 375 N.Y.S.2d at 616–17 (invalidating a tap-in fee which was “greater than a sum reasonably necessary to cover the costs of issuance” when the excess money was used to pay down a bond issue).

workable. In relating the history of special assessments,¹⁶³ Stephen Diamond reports that initially, assessments were assigned according to a “precise calculation, wherever possible, of the benefit received by each lot from any given public expenditure.”¹⁶⁴ Over time they began to be apportioned by “general formula,”¹⁶⁵ and eventually they were assigned “in spite of the possibility that any individual assessee might not have been benefited by one or another part of the improvement.”¹⁶⁶ Diamond reports that courts initially attempted to impose a constitutional requirement of proportionality, but eventually scaled back review to cases where the assessment clearly represented abuse.¹⁶⁷ The trouble courts faced in requiring proportionality was that accuracy in benefit calculation was “administratively impractical and technically impossible.”¹⁶⁸ As a result, a court could either invalidate all assessments, a difficult proposition in the face of their clear acceptance by society, or accept that the precise benefits to the individual would often be only roughly related to the assessment.

In reviewing regulation, a proportionality requirement greatly complicates the judicial decision. The situation is only that much worse outside the realm of special assessments, where the government benefit to the individual may be more tenuous than a concrete improvement to land. Depending on the regulatory scheme, it is generally very difficult to particularize the benefits of regulation for any individual fee payer,¹⁶⁹ even assuming that both parties can agree on the actual benefit.¹⁷⁰ Legislators are left legislating in

163. A special assessment, as described by Stephen Diamond, attempts to assess the cost of a government improvement to private property on the possessor of the property through a charge, rather than pay for such improvements out of general government revenues. Stephen Diamond, *The Death and Transfiguration of Benefit Taxation: Special Assessments in Nineteenth-Century America*, 12 J. LEGAL STUD. 201, 201 (1983).

164. *Id.* at 202.

165. *Id.*

166. *Id.* at 236 n.152.

167. *Id.* at 202.

168. *Id.* at 239.

169. See *Nat'l Cable Television Ass'n v. Fed. Commc'ns Comm'n*, 554 F.2d 1094, 1105 (D.C. Cir. 1976) (“This is not to say that the Commission must calculate the exact cost of servicing each individual; that would be an all but impossible task.”); *Emerson Coll. v. City of Boston*, 462 N.E.2d 1098, 1105–06 (Mass. 1984).

170. See Patric O'Brien, Comment, *The Bizarre Journey of Impact Fees in Massachusetts: From the “Foothills of Confusion” Around the “Mountains of Ignorance” and Up Into the “Castle in the Air”—Will “Rhyme” and “Reason” Ever Be Rescued?*, 35 NEW ENG. L. REV. 511, 554–55 (2001) (arguing the court erred in overturning an educational impact fee on a residential association by describing the benefit as improved education, rather than improved marketability and sales appeal of the homes).

the dark, unaware of whether a particular charge will be upheld until a court weighs in on the particular benefits to a plaintiff.

More fundamentally, though, a “proportionality” requirement misunderstands the distinction between a fee and a tax. If a charge is set too high because it raises money for general public purposes, then it is properly considered a tax. If a charge serves regulatory purposes and raises money solely for the regulation at issue but is disproportionate to the benefits provided, then it is simply set too high.¹⁷¹ Miscomputation of a regulatory charge does not necessarily render the charge a tax.¹⁷² Lack of proportionality may weigh in as evidence that a charge is not truly an exercise of the police power, but a strict requirement of proportionality serves only to complicate the judicial determination and possibly invalidate legitimate fees that have simply been poorly set.

2. Particularized Benefits for Fee Payers

Closely related to the notion of proportionality is a requirement of many courts, including those of New York, that a fee be visited upon one who receives a special benefit not shared by the general population.¹⁷³ At a general level, the use of this factor harkens back to the general distinction between taxes and fees discussed under “legislative intent”: “taxes are burdens of a pecuniary nature imposed generally upon individuals or property for defraying the cost of governmental functions, while, on the other hand, charges are sustainable as fees where they are imposed upon a person to defray or help defray the cost of particular services ren-

171. Spitzer, *supra* note 125, at 348 (“[T]he fact that a particular user charge exceeds the user’s fair share does not automatically convert that charge into a tax If a user charge is too high, it is just too high.”).

172. Note that in the *Chassin* case, a deciding factor was that “the amount generated by the differential was not to be paid to the hospital to cover its expenses, but instead was to end up in the general fund of the State.” *Health Servs. Med. Corp. of Cent. N.Y. v. Chassin*, 668 N.Y.S.2d 1006, 1009 (Sup. Ct. 1998). The court was persuaded not by the fact that the charge generated additional income, but instead by the fact that the additional income was earmarked for purposes unrelated to the underlying regulation.

173. See *Jewish Reconst. Synagogue of the N. Shore, Inc. v. Vill. of Roslyn Harbor*, 352 N.E.2d 115, 117 (N.Y. 1976) (“[T]he justification which underlies fee structures has most often been expressed as a visitation of the costs of special services upon the one who derives a *benefit* from them.”); *Emerson Coll.*, 462 N.E.2d at 1105–06 (“Fees are legitimate to the extent that the services for which they are imposed are sufficiently particularized as to justify distribution of the costs among a limited group (the ‘users,’ or beneficiaries, of the services), rather than the general public.”).

dered for his account.”¹⁷⁴ When applying a “particularized benefit” requirement, courts search for evidence that the charge serves a regulatory purpose for the individual and is not merely subsidizing governmental programs for the larger society.

In this light, a weak requirement of a particularized benefit is nothing more than a requirement that the charge have a regulatory purpose—a restatement of the legislative intent factor. For a charge to serve a regulatory function, the payer must either receive some benefit justifying the charge or be deterred in some behavior she would otherwise pursue. Regardless of whether the broader statute has a regulatory function, if there is no particularized benefit/deterrence to the individual payer, the charge will also serve no regulatory purpose and thus be a tax.

There may, however, be a stronger notion at issue in a “particularized benefit” requirement: that the benefits provided by a fee must not accrue to the general population. If so, this represents a flawed and potentially dangerous understanding of the purpose of regulation. Initially, it is questionable whether legislative action could legitimately focus on granting benefits solely to private individuals, without some positive externalities for the broader society.¹⁷⁵ In addition, a requirement that the revenue generated by fees benefit only the fee payer generates a quid pro quo requirement, what Laurie Reynolds describes as a “get what you pay for” model of government.¹⁷⁶ The effect of a quid pro quo model for government is profoundly anti-democratic, as it replaces a “one person, one vote” principle of government with a “one dollar, one vote” principle.¹⁷⁷ The city’s home rule and regulatory powers are not predicated on maintaining the economic status quo, but on ensuring the “protection, order, conduct, safety, health and well-being” of its citizens.¹⁷⁸ Regulations that seek to achieve these ends will undoubtedly benefit its citizens more broadly, but that does not render all regulatory fees taxes. A requirement that a charge have a particularized regulatory effect on the payer ensures that fee techniques are used for suitable purposes. A requirement of segregated benefits solely for the private payer unjustifiably burdens the regulatory process.

174. *Hanson v. Griffiths*, 124 N.Y.S.2d 473, 476 (Sup. Ct. 1953).

175. It is also worth asking whether it would be possible to create regulation that would not indirectly benefit some segment of the broader society.

176. See Reynolds, *supra* note 85, at 376.

177. See *id.* at 375–77.

178. N.Y. CONST. art. IX, § 2(c)(ii)(10).

In making the weaker determination, a focus on the requirement of a legislative intent to regulate the particular individual, rather than on the special benefit to the payer, saves courts the difficulty of analyzing the particularized benefits. Just as the value of a service can be difficult to calculate, it can also be very difficult to determine whether benefits are particularized to an individual.¹⁷⁹ Courts are left wide discretion to adopt either a very broad or very narrow reading of “benefit” and thus uphold or invalidate a statute on that basis.¹⁸⁰ Legislators are again operating in the dark, without proper guidance. Where the legislative body has established that the charge serves a valid regulatory function as applied to the particular payer, the addition of a requirement of “particularized benefits” is merely a judicial roadblock.

3. Voluntariness

Some courts attempt to distinguish taxes from fees by describing the latter as being paid “voluntarily,”¹⁸¹ although this particular factor has rarely been applied in New York.¹⁸² This criterion presumably evolved from traditional fee-for-services arrangements with the government, through which a user could reduce his fee by consuming less of the service. In the regulatory context, a voluntari-

179. See *Home Builders & Contractors Ass’n v. Bd. of County Comm’rs*, 446 So. 2d 140, 143 (Fla. Dist. Ct. App. 1983) (“It is difficult to envision any capital improvement for parks, sewers, drainage, roads, or whatever, which would not in some measure benefit members of the community who do not reside in or utilize the new development.”).

180. Compare *St. Johns County v. Ne. Fla. Builders Ass’n*, 583 So. 2d 635, 638–39 (Fla. 1991) (upholding an educational impact fee) (“It may be that some of the units will never house children. However, the county has determined that for every one hundred units that are built, forty-four new students will require education at a public school. The St. Johns County impact fee is designed to provide the capacity to serve the educational needs of all one hundred dwelling units.”), with *Emerson Coll. v. City of Boston*, 462 N.E.2d 1098, 1105–06 (Mass. 1984) (invalidating a fire protection impact fee) (“The benefits of ‘augmented’ fire protection are not limited to the owners of AFSA buildings. The capacity to extinguish a fire in any particular building safeguards not only the private property interests of the owner, but also the safety of the building’s occupants as well as that of surrounding buildings and their occupants.”).

181. See *Nat’l Cable Television Assn., Inc.*, 415 U.S. 336, 340–41 (“A fee, however, is incident to a voluntary act.”); *Emerson College*, 462 N.E.2d at 1105 (fees “are paid by choice, in that the party paying the fee has the option of not utilizing the governmental service and thereby avoiding the charge”); *Bolt v. City of Lansing*, 587 N.W.2d 264, 269 (Mich. 1998).

182. See *Seawall Assocs. v. City of New York*, 523 N.Y.S.2d 353, 359 (Sup. Ct. 1987), *rev’d on other grounds*, 534 N.Y.S.2d 958 (App. Div. 1988) (“Moreover, the fee is a voluntary means to escape the regulatory scheme.”).

ness criterion is less suitable, as the local government has generally chosen to regulate an activity because of the externalities imposed by the fee payer on the broader society.¹⁸³ Arguing that a payer has “voluntarily” incurred a charge by engaging in the externality-producing activity is a short step away from arguing that a payer has “voluntarily” incurred the charge by choosing to live in the jurisdiction. It is hardly surprising, then, that many courts who have addressed the issue have dropped the voluntary criterion from the fee/tax distinction.¹⁸⁴

Where the regulatory powers of a legislative body are broad, it is not clear why the voluntariness of an assessment should affect its legality. If a legislature or city council is acting under its police power, the results need not be voluntarily incurred by the populace. Presumably, the police power was added to the state constitution to give the legislature and city councils the power to regulate without individual consent. In this context, a voluntariness standard either effectively prevents regulation or is content-free boilerplate.

D. A Two-Prong Test for New York

I propose, then, that New York courts adopt a two-prong test to distinguish fees and taxes in order to provide better guidance to the legislature and city councils about the range of their fiscal powers and to provide greater consistency in judicial decisions. As a first prong, courts should analyze whether the legislature or city council intended that a particular charge serve a regulatory function, and whether the charge was “enacted principally as an integral part of the regulation of an activity and to cover the cost of regulation.” As

183. See Reynolds, *supra* note 85, at 412:

Though some courts have tried to massage the voluntariness standard as applied to regulatory fees, concluding that the payer has voluntarily undertaken the activity being assessed by the fee, the definition is stretched to its logical limits when the court concludes that a fee is voluntary because the individual complainant can avoid the fee by ceasing to engage in the activity being assessed.

Cf. John A. Henning, Jr., *Mitigating Price Effects with a Housing Linkage Fee*, 78 CAL. L. REV. 721, 723 (1990) (“A more productive judicial approach would be to determine whether an exaction effectively reduces or eliminates an externality that a development would otherwise impose on the public.”).

184. See *Paramount Film Distrib. Corp. v. State*, 285 N.E.2d 695, 697 (N.Y. 1972) (“[A]ll taxes and fees in a sense are paid ‘involuntarily.’”); O’Brien, *supra* note 170, at 563 (“Massachusetts law is well settled that fees are not taxes even though they must be paid in order that a right may be enjoyed.”) (internal quotations omitted); Reynolds, *supra* note 85, at 412.

a second prong, courts should analyze the “revenue’s ultimate use” and determine that the funds raised are spent either on benefits which accrue to the payer or the remedy of social ills caused by the payer and are not spent on the general needs of the broader society. With such a determination, courts can ensure that there is a connection between the fee-payer and the use of the funds, the hallmark of a fee system. Courts will also avoid overly burdening legislative actors with possibly unattainable requirements such as precise proportionality or particularized benefits, which embrace only a highly circumscribed and discredited theory of local finance. This test will be judicially feasible and capable of uniform application.

III. ANALYSIS OF THE PAY-OR-PLAY CHARGE.

As a demonstration of how the *Head Money* test should be applied, we can look to the pay-or-play version of the New York City HCSA.

A. *Legislative Intent*

The centerpiece of a legislative-intent analysis must be an examination of the purpose of the charge. As was stated in the HCSA, the city council intended to assess a fee in certain service industries in order to establish a city program to provide health care for workers in those industries whose employers do not provide such care.¹⁸⁵

Although the law was designed to raise revenue for a new city program, the charge and resulting program would have had three clear regulatory effects. First, the law would have leveled the playing field for those employers who provide health insurance by eliminating the economic pressures on employers to “abandon their long-standing commitment to providing employer-paid care.”¹⁸⁶ Second, the law would have reduced the negative externalities imposed on the city by employers who fail to provide health benefits by forcing all employers in these industries to internalize the costs of health care for their workers.¹⁸⁷ Finally, the law would have re-

185. New York, N.Y., Local Law § 22-506 (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

186. *Id.* §1.

187. *Id.* The legislative findings argue that employers who are not providing health insurance are receiving a quasi-subsidy from tax payers and the city, who are forced to cover at least the emergency health care costs of those employees who are not covered. *See id.*

duced employee turnover and improved employers' ability to attract high-quality workers by guaranteeing health insurance to the workers in these industries.¹⁸⁸ Research has shown that a lack of access to employer-paid health care will cause highly qualified workers to leave jobs in industries that do not offer it.¹⁸⁹ A race to the bottom in which New York City employers could no longer provide health care might result in a less qualified workforce for these industries.¹⁹⁰

Courts in New York have been willing to interpret "legislative intent to regulate" broadly in similar circumstances. In *American Sugar Refining Co. v. Waterfront Commission of New York Harbor*, the court examined a plan which would assess charges on steamship companies to provide for the Waterfront Commission's costs in regulating port employees.¹⁹¹ The court found that the purpose of the bill was "elimination of the evils in employment and employment practices and the adverse effect of those practices on the commerce of the port," and that imposing the costs of regulation on employers was appropriate as the program would "in major part redound to the benefit of employers."¹⁹² As the bill sought to regulate an industry to the benefit of that industry, an assessment of the costs of regulation on the employers was upheld as a fee.

New York courts have also upheld similar fee arrangements outside the employment context. In *Jenad, Inc. v. Village of Scarsdale*,

188. *Id.* In California, Jack-in-the-Box restaurants recently started offering franchise-wide health insurance benefits, as part of an effort to reduce employee turnover, and attract better employees. Sarah Skidmore, *Jack Puts Health Plan on Employees' Menu: Company Develops Program to Cut Turnover in its Hourly Workforce*, SAN DIEGO UNION-TRIBUNE, Dec. 16, 2004, at C1.

189. See New York, N.Y., Local Law § 1 (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

190. Of course, some argue from examples like Jack-in-the-Box, discussed *supra* note 188, that private employers can handle their own problems with turnover or attracting skilled workers, and that government should not intervene. However, to the extent that New York City has an interest in the health of its industries, the city has a valid interest in ensuring that New York City employers have a top-quality workforce.

191. *Am. Sugar Ref. Co. of N.Y. v. Waterfront Comm'n*, 432 N.E.2d 578, 579 (N.Y. 1982).

192. *Id.* at 585. The evils described by the court in *American Sugar* include "irregularity of employment, fear and insecurity, inadequate earnings, an unduly high accident rate . . . exploitation and extortion as the price of securing employment and a loss of respect for the law . . . [and] destruction of the dignity of an important segment of American labor." *Id.* at n.9. Although the evils sought to be remedied by the HCSA, the decline in workers' health insurance and the negative externalities of lack of health insurance on the city and on industry, are not precisely the same, they seem similar in kind to the evils discussed in *American Sugar*.

the court examined a program in which villages required developers to either provide recreational space within their developments, as allowed under village laws, or to pay an assessment per lot into a city fund to provide park space.¹⁹³ The court found that it was reasonably within the village's power to require a charge in lieu of dedicated land, and the charge was not a tax as it was used for the same regulatory purposes.¹⁹⁴ *City of Buffalo v. Stevenson* concerned a city's imposition of a charge on anyone opening pavement for a street or alleyway.¹⁹⁵ The court held that the "power to regulate the use of the streets implied the power to do all such things, or to impose all such reasonable conditions, in relation to their use, as would tend to the accomplishment of the municipal duty to provide for the general welfare and safety of the community."¹⁹⁶ Imposing a charge for the costs of "effective control and regulation of the use of the streets" was a "means of regulation and not of raising revenue."¹⁹⁷

Thus, New York courts have upheld charges on employers or other individuals to provide regulatory benefits as fees under a broad understanding of the legislative intent to regulate. This fits with the understanding of legislative intent developed above, contrasting targeted regulation of a narrow population with the generation of revenue for general state purposes. The pay-or-play legislation sought to regulate several targeted industries, and the charge was narrowly tailored to benefit those industries. Under the framework proposed above as the proper analysis for distinguishing fees from taxes, the original version of the New York City HCSA would meet the "legislative intent" standard for a fee.

B. *Revenue's Ultimate Use*

Under the normative framework this Note proposes, the second factor courts look at in distinguishing fees and taxes is whether the funds raised are segregated from general revenue, and thus spent on regulation of the payer rather than general state purposes. The pay-or-play legislation was carefully drafted to ensure that the funds generated by the charge would be used solely to provide benefits for workers in the targeted industries. The charge was to be set

193. 218 N.E.2d 673, 675 (N.Y. 1966).

194. *Id.* at 675–76.

195. 100 N.E. 798, 799 (N.Y. 1913).

196. *Id.* at 799–800.

197. *Id.* at 800.

“using reliable factual studies and statistics”¹⁹⁸ to determine “the cost to the city of providing or purchasing health care services for one enrolled employee and for the family of one enrolled employee.”¹⁹⁹ All collected funds not immediately spent on employee health benefits would have been placed in a “reserve fund to protect the program against operating at a deficit.”²⁰⁰ Thus, all funds collected under the pay-or-play charge were to be spent for the regulatory purpose, to provide health care within the covered industries and internalize health care externalities, and none would have gone to general revenues.²⁰¹ The pay-or-play legislation met the “revenue’s ultimate use” standard for a fee.

C. The New York City Health Care Security Act is Constitutional

The two most important criteria for fees were expressed by the Supreme Court in the *Head Money Cases*: a “legislative intent” to regulate and the “segregation of funds” for the costs of regulating.²⁰² Provided that the city council provides for the exaction as a regulatory measure, and the funds collected are not allocated to general purposes, the city council acts properly within its police powers and should not be subject to the additional constraints applicable to taxation. Although courts have developed numerous other standards for differentiation, those standards have not added content to the original criteria and only serve to confuse legislators as to the applicable standards or to unnecessarily complicate legislation.

Under the *Head Money* criteria, the pay-or-play charge would have been a valid regulatory fee. The intent of the city council was to regulate the covered industries within its home rule powers: the exaction was not primarily income-generating, but narrowly tailored to the regulation at hand. The resulting proceeds from the charge were to be allocated to the regulatory purposes and would not have supported general governmental functions. The pay-or-play provisions of the original HCSA were a valiant effort by the New York City Council to address the decline in employer-provided

198. New York, N.Y., Local Law § 22-506(c)(2)(i) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law). See *Jewish Reconstr. Synagogue of the N. Shore, Inc. v. Vill. of Roslyn Harbor*, 352 N.E.2d 115, 118 (N.Y. 1976) (“[F]ees also should be assessed or estimated on the basis of reliable factual studies or statistics.”) (internal quotations omitted).

199. New York, N.Y., Local Law § 22-506(c)(2)(iv) (Sept. 14, 2004) (proposed) (on file with the NYU Annual Survey of American Law).

200. *Id.*

201. *Id.*

202. *Head Money Cases*, 112 U.S. 580, 595–96 (1884).

health insurance rates within the city and should have been constitutionally acceptable.

IV. EPILOGUE

In the end, the constitutionality of the HCSA pay-or-play fee never reached the courts of New York, as the final version of the bill passed by the city council over the mayor's veto had excised the pay-or-play regime.²⁰³ The final bill instead creates a positive mandate that employers must spend an amount on health care at least equal to the prevailing rate in the industry²⁰⁴ and imposes a civil fine on violating employers equal to the amount of the shortfall.²⁰⁵ Conspicuously absent from the final bill is any involvement by the city in providing health insurance or health care coverage.

There are many possible motives for this legislative shift. The City Council may have been concerned about the ability of the city to provide health care coverage efficiently. Council members may have become convinced that the public sector is not an efficient provider of health services. The change may, however, have reflected legal worries about the constitutionality of the pay-or-play provisions. If proportionality or particularized benefits tests were applied to the pay-or-play fee, it might have been invalidated by the New York courts.²⁰⁶ Redrafting the measure as a civil fine potentially avoids this legal issue.²⁰⁷

From a policy perspective, the shift from a pay-or-play scheme to a civil fine structure has negative effects. The specter of a fine, even if non-criminal, may create more tension and resistance between employers and the city's administrators, as it will be hard to continue to argue that the city is protecting the interests of employ-

203. New York, N.Y., Local Law No. 468-A § 22-506 (Aug. 9, 2005) (proposed) (on file with NYU Annual Survey of American Law).

204. *Id.* § 22-506(c)(1)-(3).

205. *Id.* § 22-506 (2005)(e)(1) (2005).

206. As discussed, *supra* text accompanying notes 157–180, proportionality and particular benefits cases often turn on difficult and somewhat arbitrary determinations of what particular “benefits” the fee generates. In the case of the HCSA, the benefits generated for employers include a level-playing field, a reduction in competition, and a more qualified workforce. These intangible benefits may be difficult to value, rendering the bill susceptible to an argument that it does not apply sufficient particularized benefits to the fee payers.

207. As discussed, *supra* text accompanying notes 76–77, the City's power to regulate is broad, and would allow command-and-control style regulation to protect the health of citizens and regulate businesses. *See* N.Y. CONST. art. IX, § 2(c)(ii)(10); N.Y. MUN. HOME RULE LAW § 10(1)(ii)(a)(12)(1994).

ers who must pay a fine. Although the costs of monitoring may be attenuated given the small scope of the program, lack of compliance is more likely when employers do not receive benefits for their payments. Whistle-blowing from employees, although protected in the final statute,²⁰⁸ is also less likely given that employees are not guaranteed benefits once the employer is exposed. The city may well have exchanged costs of administering a health care program for the cost of monitoring and enforcing a health care mandate, at no clear gain to the city.

Even from a purely legal perspective, the change to a command and control structure does not universally improve the bill's legal prospects. The final bill is now more susceptible to an ERISA preemption challenge. A mandate enforced through civil fines can hardly be described as having merely an "indirect economic effect" on ERISA plans.²⁰⁹ Although the backers of the plan will argue that employers can meet the HCSA's requirements without creating ERISA plans, a realist critique of the HCSA might argue it is functionally indistinguishable from the Hawaii program invalidated in *Agsalud*.²¹⁰ If the HCSA's civil fine provisions are invalidated as preempted by ERISA, all the legislative effort will be for naught.

Ultimately, the city council's decision to abandon the pay-or-play model cannot be blamed on the courts. However, unclear precedents in this area provided a background to the city council's deliberations, influencing their final choices as to the bill's structure. As I argue above, the fee/tax precedents in New York are not unclear because of valid constitutional concerns, but instead because the fee/tax distinction has been incompletely theorized by New York courts. This judicial confusion distorts legislative decision-making, and may ultimately have undermined pay-or-play health care legislation in New York City.

V. CONCLUSION

Ultimately, the New York City Council rejected the pay-or-play health insurance model. Even so, other cities are already consider-

208. New York, N.Y., Local Law No. 468-A § 22-506(d) (Aug. 9, 2005) (proposed) (on file with NYU Annual Survey of American Law).

209. See *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 US 645, 658–62 (1995).

210. See *Standard Oil Co. of Cal. v. Agsalud*, 442 F. Supp. 695 (N.D. Cal. 1977). See *supra* text accompanying notes 13, 33–42.

ing similar pay-or-play legislation,²¹¹ and we can expect this trend to continue given the national crisis in health insurance and the budgetary crises of many states who must deal with the externalities of uninsured workers. In many of these localities, the legislative body will have to deal with the tax/fee issue in seeking to approve a pay-or-play measure.

In response to this growing legislative action, courts should reach a more sensible understanding of the distinction between fees and taxes and avoid imposing overly technical and confusing constraints on the legislative police power. Courts should concentrate on the two factors highlighted by the Supreme Court in its *Head Money* decision: a legislative intent to regulate and the segregation of funds for the regulatory purpose. By doing so they will send a clear signal to legislatures and city councils about where the acceptable limits of the police power lie. Armed with a clear judicial statement, when legislators confront lack of health insurance or the next social ill ripe for regulation, be it rising health care costs, depleted educational budgets, or urban renewal, they will be able to address the issue with the full extent of their regulatory power, without worrying that a long political struggle will only end in judicial defeat.

Furthermore, judicial clarity in the review of regulatory action is a valid goal in its own right. Apart from whether the resulting test serves the goals of de-regulation or governmental social policy, legislators and regulators who are unaware of the limits of their powers are often impotent to address societal challenges, wherever their personal ideology lies. Many of the same considerations that counsel for a clear test in the area of fiscal powers have also guided precedent in administrative law²¹² and constitutional law more generally. Unfocused balancing tests can create their own problems, of course, leaving too much room for judicial discretion and failing to emphasize which factors are of primary importance. But a clear, focused test can provide needed guidance to a legislature and clarity to a legal doctrine. Legislators who are aware of the boundaries of their powers are less likely to quarrel with judicial

211. San Francisco's Board of Supervisors is currently considering pay-or-play health care legislation within the city of San Francisco. See Supervisor Ammiano Calls for Plan to Provide Health Insurance to San Francisco's 38,000 Uninsured Workers and Protect Local Businesses From Unfair Competition, available at http://www.sfgov.org/site/bdsupvrs_page.asp?id=31395 (last visited Feb. 18, 2006).

212. See, e.g., *Chevron, U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 865-66 (1984); *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001).

pronouncements, and, in the end, better governance is likely to result.

State fiscal limitations are an understudied area of state constitutional law, as much of the academic focus in the past few decades has been on new federalism and state constitutional protections of civil liberties and substantive rights.²¹³ In the modern era of massive state budget deficits, however, state fiscal issues are re-emerging. Further development of state constitutional doctrine in the area of fiscal limitations would provide a better legal foundation for the inevitable expansion of state revenue collection. A clear delineation of the boundaries of state legislators' revenue powers would mark only the beginning of this development, but it is surely a useful place to start.

213. See Briffault, *supra* note 81, at 907.