Real Estate Development Advisory: Massachusetts Court Rules that an I/I "Fee" for Sewer Connections Is Actually an Illegal Tax

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More than $670,000 has been returned to developers of new properties in Saugus, thanks to a recent decision by the Massachusetts Superior Court. In *Denver Street LLC v. Town of Saugus,* the court ruled that the Town of Saugus had imposed an unlawful tax on new developers.

The decision dealt with the Town's attempt to finance its state-mandated infiltration and inflow (I/I) reduction process. I/I includes groundwater and other extraneous water that enters a sewer system through defective pipes, illegal connections, manhole covers, and the like. I/I increases the volume of liquid in a sewer system, which can lead to sewer overflows.

In April 2005, after repeated sewer overflows into the Saugus River, the Town entered into an administrative consent order with the Massachusetts Department of Environmental Protection in which the Town agreed to reduce its rate of I/I. The Town then began requiring any person seeking a new connection to the sewer system to pay the Town an amount equal to 10 times the project's proposed wastewater flow, multiplied by $3.00—known as the I/I Reduction Contribution (I/I Contribution).

In a 35-page decision, the *Denver Street* court addressed the main issue in the case: whether the I/I Contribution constituted a tax or a fee. The court recognized that a municipality lacks the power to tax, unless that power is expressly granted by the Massachusetts legislature. However, municipalities are permitted to charge reasonable fees for specific services. Because the legislature had not granted the Town the power to tax, the I/I Contribution payments would be unlawful if they were deemed to constitute a tax rather than a fee.

As distinguished from taxes, fees typically are:

1. charged in exchange for a particular government service which benefits the party paying the fee in a manner not shared by other members of society
2. paid by choice
3. collected not to raise general revenues, but to compensate the governmental entity for providing the services.

The court analyzed each of these three factors.

In exploring the first of these traits, the court noted that if a town service benefits only a few residents, the cost of that service should not be paid in the form of a town-wide tax, but should

be funded by fees paid by the service beneficiaries. In *Denver Street*, the Town argued that the benefit the new user obtained was permission to connect to the sewer system. Yet the court concluded that the Town's I/I reduction efforts were intended primarily to fund repairs to the dilapidated existing system, which benefited those already connected to it; reduction in I/I would eventually prevent sewage from flooding into basements and discharging into environmentally sensitive areas. Therefore, the court concluded the first factor indicated that the I/I Contribution was tax-like due to the widespread benefits of I/I reduction.

The court quickly accepted the I/I Contribution as fee-like under the second factor because the Plaintiffs did not dispute the I/I Contribution's voluntariness.

With respect to the third factor, the court concluded that the I/I Contribution was tax-like because of how it was calculated and how it was used. The court was troubled by the Town's use of $100,000 of its collected I/I Contributions to repair a sewer pump rather than reduce I/I; this suggested that the Town was raising general revenues rather than charging for services rendered to the developers, and therefore indicated that the I/I Contribution was a tax. The court also commented that requiring new users to pay for I/I reduction gallon-for-gallon might be reasonable, but multiplying that gallonage by 10 overcompensated the Town for its I/I reduction "service."

The court's bottom line was that the new users did not create the I/I problem and, therefore, placing financial responsibility for the repair of the existing infrastructure on so few, when the principal benefit was enjoyed by so many, would be unjust. For these reasons, the court concluded that the I/I Contribution constituted an unlawful tax, and it ordered the Town to return the I/I Contribution payments to the Plaintiffs.

Earlier this month, the Town appealed the *Denver Street* decision. But even the trial court decision may prove influential, because it is a thorough analysis of an increasingly common municipal "fee" and because its analysis resembles that of a 15-year-old Massachusetts Appeals Court case on the same topic. Issues raised by the *Denver Street* decision include:

- Will the *Denver Street* decision make developers more likely to challenge I/I Contribution rules?
- Could municipalities adjust their I/I Contribution rules to make them more fee-like? For example, will towns adopt the suggestion that it could be reasonable to require developers to pay on a gallon-for-gallon basis, as opposed to the ten-to-one ratio, for new wastewater flow? Some towns now employ a four-to-one ratio; will courts find that ratio to be reasonable?
- Will the *Denver Street* decision cause municipalities to move away from asking new sewer users for a financial I/I Contribution, and toward requiring new users instead to do the actual work of removing I/I from the sewer system?

Another case concerning the tax/fee distinction, this one about municipal fees for burial certificates, was recently argued before the state's highest court. The Supreme Judicial Court's decision in that case, expected this summer, will probably provide additional guidance.

The litigators and real estate and environmental lawyers in Mintz Levin's multi-disciplinary Real Estate and Land Use Litigation team will be closely watching developments in this area.

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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