

--- N.Y.S.2d ---, 2012 WL 1537570 (N.Y.A.D. 3 Dept.), 2012 N.Y. Slip Op. 03499  
(Cite as: **2012 WL 1537570 (N.Y.A.D. 3 Dept.)**)

Supreme Court, Appellate Division, Third Department,  
New York.

In the Matter of **HOMESTEAD FUNDING CORPORATION**, Appellant,

v.

**STATE of New York BANKING DEPARTMENT**  
et al., Respondents.

May 3, 2012.

**Background:** Mortgage bank brought a combined proceeding pursuant to article 78 and an action for declaratory judgment, seeking review of the Banking Department's determination imposing an annual general assessment upon mortgage bank. The Supreme Court, Albany County, McDonough, J., dismissed proceeding. Mortgage bank appealed.

**Holdings:** The Supreme Court, Appellate Division, McCarthy, J., held that:

(1) annual general assessment imposed on mortgage bank was a fee, not an unconstitutional tax;

(2) Banking Department's determination of mortgage bank's annual general assessment was not arbitrary or capricious; but

(3) Banking Department created new rule by implementing policy of including mortgage banks' secondary income for purposes of calculating assessment, and thus assessment on mortgage bank under new policy was unenforceable for Department's failure to promulgate new policy as a formal rule.

Reversed.

West Headnotes

**[1] Banks and Banking 52** 🔑

[52](#) Banks and Banking

Annual general assessment that Banking Department imposed on mortgage bank was a fee, not an unconstitutional tax; the purpose of the assessments was to recover the Department's expenses related to regulating banks from the banks that were regulated, not to raise revenue for the support of government generally. [McKinney's Const. Art. 16, § 1](#);

[Banking Law § 17\(2\)](#).

**[2] Banks and Banking 52** 🔑

[52](#) Banks and Banking

The annual general assessment that the Banking Department charges mortgage banks to cover the Department's costs of overseeing such entities does not constitute an unconstitutional tax. [Banking Law § 17\(2\)](#); [McKinney's Const. Art. 16, § 1](#).

**[3] Taxation 371** 🔑

[371](#) Taxation

A "tax" is a charge imposed upon citizens to defray the costs of government services and operations generally, whereas a "fee" is a charge, imposed upon certain citizens or entities who use particular services of or obtain benefits from a particular governmental program or agency, to defray the costs of those services or benefits.

**[4] Taxation 371** 🔑

[371](#) Taxation

One legitimate purpose of fees is to make an agency self-sustaining so that its operations are paid for by those who use that agency rather than by the public at large through general tax revenues.

**[5] Declaratory Judgment 118A** 🔑

[118A](#) Declaratory Judgment

Trial court in declaratory judgment action is required to declare the rights of the parties one way or the other. [McKinney's CPLR 3001](#).

**[6] Banks and Banking 52** 🔑

[52](#) Banks and Banking

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Banking Department's determination of mortgage bank's annual general assessment was not arbitrary or capricious; assessment properly included expenses by ancillary divisions that Department incurred indirectly in connection with supervision of mortgage banks, assessment did not treat mortgage bank differently from other similarly situated entities, as Department applied same formula to all mortgage banks, and assessment calculation reasonably included mortgage bank's income from mortgage servicing and secondary market activities, which was indirectly related to mortgage bank's license. [McKinney's Banking Law § 17\(2\)](#).

## **[7] Banks and Banking 52**

### [52](#) Banks and Banking

Banking Department is statutorily authorized to recoup, from the licensed entities paying the general assessments imposed by the Department, the expenses by ancillary divisions, such as legal services, consumer services, and information technology, that are incurred by the Department indirectly in connection with the supervision of the licensed entities. [Banking Law § 17\(a\)](#).

## **[8] Administrative Law and Procedure 15A**

### [15A](#) Administrative Law and Procedure

Agency's blanket requirements and fixed standards that are to be generally applied in the future, regardless of individual circumstances, are rules subject to the State Administrative Procedure Act's rule-making procedures. [McKinney's State Administrative Procedure Act §§ 102\(2\)\(a\)\(i\), 102\(2\)\(b\)\(iv\)](#).

## **[9] Banks and Banking 52**

### [52](#) Banks and Banking

Banking Department created new rule by implementing policy of including mortgage banks' secondary market income and income from servicing activities as gross income for purposes of calculating mortgage banks' annual general assessment, and thus assessment on mortgage bank under new policy was unenforceable for Department's failure to promulgate new policy as a formal rule; Department did more

than explain methodology or interpret already existing policy, instead, Department created expansive new definition of income that rigidly applied to all mortgage banks when assessments were determined. [Banking Law § 17\(2\)](#); [McKinney's State Administrative Procedure Act §§ 102\(2\)\(a\)\(i\), 102\(2\)\(b\)\(iv\)](#).

Whiteman, Osterman & Hanna, L.L.P., Albany ([John J. Henry](#) of counsel), for appellant.

Eric T. Schneiderman, Attorney General, Albany ([Victor Paladino](#) of counsel), for respondents.

Before: [MERCURE](#), J.P., [LAHTINEN](#), [SPAIN](#), [McCARTHY](#) and [GARRY](#), JJ.

McCARTHY, J.

\*1 Appeal from a judgment of the Supreme Court (McDonough, J.), entered October 4, 2011 in Albany County, which dismissed petitioner's application, in a combined proceeding pursuant to CPLR article 78 and action for declaratory judgment, to review a determination of respondent Banking Department imposing an annual general assessment upon petitioner.

Petitioner is a mortgage bank conducting the business of originating mortgage loans in New York. As such, petitioner is licensed and regulated by respondent Banking Department.<sup>FN1</sup> Pursuant to the Banking Law, the Department charges mortgage banks an annual general assessment to cover the cost of its operations associated with overseeing such entities (*see* [Banking Law § 17](#) [2]).<sup>FN2</sup> Mortgage banks must annually file a report with the Department setting forth their income from the previous year, which the Department uses to calculate the annual general assessments. Beginning with the 2010–2011 fiscal year, mortgage banks were instructed to include not only mortgage loan origination income, but also income from secondary market sales of mortgages and mortgage loan servicing activities. This resulted in a significant increase in petitioner's reported income and, correspondingly, a significant increase in petitioner's annual general assessment for fiscal year 2010–2011.

Petitioner objected to the determination of its annual general assessment. When the Department upheld the assessment, petitioner commenced this combined proceeding pursuant to CPLR article 78

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and action for declaratory judgment challenging the determination. After joinder of issue, Supreme Court dismissed the petition. Petitioner appeals.

[1][2][3][4][5] The annual general assessment does not constitute an unconstitutional tax (see N.Y. Const. art XVI, § 1). A tax is a charge imposed upon citizens to defray the costs of government services and operations generally, whereas a fee is a charge, imposed upon certain citizens or entities who use particular services of or obtain benefits from a particular governmental program or agency, to defray the costs of those services or benefits (see Matter of Walton v. New York State Dept. of Correctional Servs., 13 N.Y.3d 475, 485 [2009]; New York Tel. Co. v. City of Amsterdam, 200 A.D.2d 315, 318 [1994]). One legitimate purpose of fees is to make an agency self-sustaining so that its operations are paid for by those who use that agency rather than by the public at large through general tax revenues (see Matter of Joslin v. Regan, 63 A.D.2d 466, 470 [1978], *aff'd* 48 N.Y.2d 746 [1979]). The annual general assessments here were a fee, not a tax, because the purpose of the assessments was to recover the Department's expenses related to regulating banks from the banks that are regulated, "not to raise revenue for the support of government generally" (American Assn. of Bioanalysts v. Axelrod, 106 A.D.2d 53, 56 [1985], *appeal dismissed* 65 N.Y.2d 847 [1985]; see Matter of Joslin v. Regan, 63 A.D.2d at 470–471, 406 N.Y.S.2d 938).<sup>FN3</sup>

\*2 [6][7] The determination of petitioner's annual general assessment was not arbitrary or capricious. The statute provides that "[a]ll general expenses, including in addition to the direct costs of personal service, the cost of maintenance and operation ... and all other direct or indirect costs, incurred in connection with the supervision of any person or entity licensed [or] registered ... pursuant to this chapter shall be charged to and paid by them in such proportions as the superintendent [of Banking] shall deem just and reasonable" (Banking Law § 17[2]). Contrary to petitioner's argument, expenses by ancillary divisions, such as legal services, consumer services and information technology, are incurred by the Department indirectly in connection with the supervision of licensed entities, including mortgage banks (*compare* Matter of Joslin v. Regan, 63 A.D.2d at 470–472, 406 N.Y.S.2d 938). Thus, the statute permits the Department to recoup those expenses from the banks paying

assessments.

Petitioner was not treated differently from other similarly situated entities. The same formula was applied to all mortgage banks. Depository institutions are not similarly situated, as they are subject to federal regulations, federal deposit insurance requirements and equity capital maintenance levels that are not applicable to mortgage banks (see Bower Assoc. v. Town of Pleasant Val., 2 N.Y.3d 617, 632 [2004]). The Department rationally determined that, considering these differences, it was appropriate to apply a different assessment methodology to depository institutions than the one applied to mortgage banks. Although the Department had not previously included income from mortgage servicing and secondary market activities for purposes of calculating the annual general assessment, it was reasonable to include that income because it is indirectly related to a mortgage bank's license, and failing to include this income could allow banks to structure transactions so as to avoid paying fees to the Department.

[8][9] Nevertheless, the Department's definition of income constitutes a rule that must be formally promulgated. A rule is defined as "the whole or part of each agency statement, regulation or code of general applicability that implements or applies law, or prescribes a fee charged by or paid to an agency or the procedure or practice requirements of any agency" (State Administrative Procedure Act § 102[2][a][i]). The definition excludes "forms and instructions, interpretive statements and statements of general policy which in themselves have no legal effect but are merely explanatory" (State Administrative Procedure Act § 102[2][b][iv]). Blanket requirements and fixed standards that are to be generally applied in the future, regardless of individual circumstances, are rules subject to the State Administrative Procedure Act's rule-making procedures (see Matter of Alca Indus. v. Delaney, 92 N.Y.2d 775, 778 [1999]; Matter of Schwartzfigure v. Hartnett, 83 N.Y.2d 296, 301 [1994]; Matter of Home Care Assn. of N.Y. State v. Dowling, 218 A.D.2d 126, 128 [1996]).

\*3 Petitioner only asserted that the Department created a rule when it implemented its new policy of including secondary market income and income from servicing activities as gross income for purposes of calculating a mortgage bank's annual general assess-

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ment. Petitioner did not challenge, as an unpromulgated rule, the Department's overall formula or methodology used to calculate annual general assessments; the Department has apparently been applying that methodology for years to determine the annual general assessments for petitioner and others without challenge.<sup>FN4</sup> [Banking Law § 17\(2\)](#) contains broad authority for the Department to charge fees to banks, but does not contain any specific methodology or definitions. By redefining income, the Department did more than just explain part of its methodology or interpret the policy as it already existed; the Department crafted a new aspect of the policy and declared what is considered income for all mortgage banks when they calculate their annual general assessments (see [Matter of SLS Residential, Inc. v. New York State Off. of Mental Health](#), 67 A.D.3d 813, 816 [2009], *lv denied* 14 N.Y.3d 713 [2010]; [Matter of HMI Mech. Sys. v. McGowan](#), 277 A.D.2d 657, 658 [2000], *lv denied* 96 N.Y.2d 705 [2001]; compare [Lewis v. New York State Dept. of Civ. Serv.](#), 60 A.D.3d 216, 224 [2009], *affd* 13 N.Y.3d 358 [2009]; [Matter of Pharmacists Socy. of State of N.Y., Inc. v. Pataki](#), 58 A.D.3d 924, 926–927 [2009], *lv denied* 12 N.Y.3d 710 [2009] ). The Department created an expansive definition of income, required all mortgage banks to annually report their income based upon that definition, and rigidly applied the definition across-the-board to calculate annual general assessments for all mortgage banks. It is undisputed that the Department did not follow the procedures for making and filing a rule when it established this definition (see [State Administrative Procedure Act §§ 202, 203](#); see also [N.Y. Const. art IV, § 8](#)). As no rule was properly promulgated, the assessment based on this definition cannot be enforced, it must be annulled and the Department must determine petitioner's 2010–2011 annual general assessment based on a properly promulgated rule or upon petitioner's individual facts and circumstances (see [Matter of Schwartzfigure v. Hartnett](#), 83 N.Y.2d at 302, 610 N.Y.S.2d 125, 632 N.E.2d 434).

ORDERED that the judgment is reversed, on the law, without costs, petition granted to the extent that respondent Banking Department's 2010–2011 annual general assessment of petitioner is annulled, it is declared that the Banking Department's methodology for determining the annual general assessment for mortgage banks is not arbitrary or capricious and does not result in an unconstitutional tax, and matter remitted to respondents for further proceedings not

inconsistent with this Court's decision.

[MERCURE](#), J.P., [LAHTINEN](#), [SPAIN](#) and GARRY, JJ., concur.

[FN1](#). The Banking Department and the Insurance Department merged to form the Department of Financial Services, effective October 3, 2011 (see [Financial Services Law § 102](#); L 2011, ch 62, pt A, § 1).

[FN2](#). Due to the merger of the Banking Department and Insurance Department and the enactment of the Financial Services Law, the Banking Law was repealed, effective April 1, 2012 (see L 2011, ch 62, pt A, § 1).

[FN3](#). Because petitioner sought a declaratory judgment, Supreme Court was required to declare the rights of the parties one way or the other (see [CPLR 3001](#); [Stonegate Family Holdings, Inc. v. Revolutionary Trails, Inc., Boy Scouts of Am.](#), 73 A.D.3d 1257, 1262 [2010], *lv denied* 15 N.Y.3d 715 [2010] ). We will therefore issue a declaration in respondents' favor.

[FN4](#). Based on the limited nature of petitioner's challenge, we do not express an opinion on whether the overall methodology constitutes a rule under the State Administrative Procedure Act.

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