

Justices' Minn. Takings Ruling May Have Broad Impact

By **Emily Ladd and Gregory Nowak** (June 13, 2023)

On May 25, the U.S. Supreme Court issued a decision in *Tyler v. Hennepin County*, Minnesota, holding that state tax foreclosures violate the takings clause of the U.S. Constitution when they provide "no opportunity for the taxpayer to recover the excess value" beyond the amount of taxes owed.[1]

This is an important win for taxpayers nationwide. It also resolves a conflict among the U.S. circuit courts regarding the legality of such a strict foreclosure.

Prior litigation on the matter in Michigan resulted in a flood of class action litigation as well as legislation that created new strict deadlines for claiming excess proceeds. Class actions may arise in other states, and those states may follow suit and enact new legislation imposing deadlines on claims for any excess proceeds.

The facts in *Tyler* were simple. In 2010, an elderly taxpayer moved out of her Minneapolis condominium and into a senior community.

After that time, no one paid the taxes on the condominium, leading to accumulation of approximately \$15,000 in unpaid taxes, interest and penalties. The county seized and sold the condominium for \$40,000. In addition to the \$15,000 in taxes and other charges owed, the county also kept the \$25,000 surplus in accordance with Minnesota law.

Tyler argued that the failure to return the surplus constituted an improper taking under the U.S. Constitution, and the Supreme Court agreed.

In its opinion in *Tyler*, the Supreme Court briefly reviewed and distinguished a prior case where it had found no takings violation. That case, *New York v. Chapman Docks Co.*, decided by a New York state appeals court in 1956, involved taxpayers who asserted that the government had improperly kept the surplus proceeds from a foreclosure sale.

The difference, however, is that the New York foreclosure process provided taxpayers with an opportunity to recover any surplus proceeds; the taxpayers involved simply had not taken advantage of it.

The Supreme Court held that the taxpayers' forfeiture of their rights to a surplus did not result in a takings violation. That distinguished *Tyler* because Minnesota law provided no avenue for taxpayers to claim the surplus.

The court's decision resolved a split between the U.S. Courts of Appeals for the Sixth and Eighth Circuits.

The Sixth Circuit's decision in *Hall v. Meisner* last year created an irreconcilable split with decisions of the Eighth Circuit in *Tyler* and the Nebraska Supreme Court in *Continental Resources v. Fair*.



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A unanimous Eighth Circuit held that there was no takings clause claim. Rather than examine the common law history back to Magna Charta as did the Sixth Circuit, the Eighth Circuit "look[ed] to Minnesota law to determine whether Tyler has a property interest in surplus equity."^[2]

Like the Eighth Circuit, the Nebraska Supreme Court in *Fair* began with the court's admonition that "the existence of a property interest [under the takings clause] is determined by reference to existing rules or understandings that stem from an independent source such as state law."^[3]

Fair maintained that several "Nebraska statutes and a provision in the state constitution ... recognize a property interest in the equity of his property."^[4] But "[t]hese general provisions," the court held, "do not recognize a property interest in the surplus equity value of property after a tax certificate has been sold, the redemption period has expired, and a tax deed is requested and issued."^[5]

The *Tyler* decision also follows a number of Michigan cases, including *Rafaeli LLC v. Oakland County* in 2020, *Proctor v. Saginaw County* in 2022, and *Hall*, which foreshadowed the court's decision to take up this issue.

Nuances may also exist in the laws of other states as they did in Michigan, such as what happens if a governmental entity has the option to withdraw a foreclosed property from the foreclosure sale and take title, so no auction proceeds are generated. States will need to grapple with these issues as a result of this decision.

On July 17, 2020, the Michigan Supreme Court held in *Rafaeli* that the retention of excess tax foreclosure proceeds by county treasurers from tax auctions constitutes "an unconstitutional taking without just compensation" in violation of the Michigan Constitution.^[6]

The *Rafaeli* court found that the provisions of the General Property Tax Act conflicted with the Michigan Constitution's takings clause, which mirrors the takings clause of the U.S. Constitution, and that the remedy for a government taking is just compensation for the value of the property taken.

The court found that the property taken was the surplus proceeds from the tax foreclosure sales, and that therefore the taxpayers were entitled to those proceeds as just compensation.

In *Proctor*, a consolidated appeal of five putative class actions against a large number of counties, the state Court of Appeals rejected an effort to allow the recovery of such proceeds as a class action.

The court also held that the Michigan Supreme Court's 2020 *Rafaeli* decision applied retroactively and that the subsequent legislative fix, 2020 PA 256, MCL 211.78t(1), which created various procedural requirements for recovering excess proceeds, applied prospectively only.

Finally, the court also held that qualified immunity protected the government officials involved in the foreclosure process, while holding that under *Rafaeli*, taxpayers are entitled to recover both the excess proceeds and interest on those proceeds.

On Oct. 13, 2022, the Sixth Circuit in *Hall* held, consistent with *Rafaeli*, that the Fifth

Amendment's takings clause provides that private property shall not "be taken for public use, without just compensation."

The central issue in Hall was the same as that in *Rafaeli*: whether the state may cause owners of real estate to forfeit the entire value of their real property in satisfaction of delinquent property tax bills — particularly when the value of the real property far exceeds the amount of the tax debt and the homeowners receive nothing in exchange for the taking of the equity remaining in the property.

Hall involved a provision of Michigan law that allowed the local community to exclude the property from the tax foreclosure sale and acquire the delinquent property by payment of the delinquent tax amount.

The Hall court held that the federal Constitution "protects rather than creates property interests," which means that "the existence of a property interest," for purposes of whether one was taken, "is determined by reference to existing rules or understandings that stem from an independent source such as state law," according to the Supreme Court's 1998 decision in *Phillips v. Washington Legal Foundation*.^[7]

But the takings clause would be a dead letter if a state could simply exclude from its definition of property any interest that the state wished to take. To the contrary, rather, "a State may not sidestep the Takings Clause by disavowing traditional property interests long recognized under state law."^[8]

As a result, the Sixth Circuit determined that this practice violates the takings clause of the U.S. Constitution. It then remanded the case to ensure the lower court revises its position to be consistent with its findings.

Michigan law flatly contravened long-settled principles when it allowed Oakland County to take absolute title to the plaintiffs' homes as payment for their tax delinquencies.^[9]

By taking absolute title to the plaintiffs' property, the county took their equitable titles; and the county did so without a public foreclosure sale and without payment to the plaintiffs for the value of those titles.

The county's foreclosure of these properties was thus nothing less than a strict foreclosure — a practice that English courts had steadfastly prevented as far back as the 1600s and that American courts, not least Michigan ones, effectively eradicated as unconscionable and draconian some 200 years ago.^[10]

The county took the plaintiffs' equitable titles without paying for them simply because the Michigan General Property Tax Act said it could. Thus — by that ipse dixit — the act "sidestep[ped] the Takings Clause by disavowing traditional property interests long recognized under state law," to quote the Supreme Court in the *Phillips* case.^[11]

Approximately 20 states have statutes like the one at issue, which permit the forfeiture of all proceeds in tax foreclosure situations. With just under half of the country employing similar statutory language, the decision in *Tyler* may do more than just resolve the circuit split — it has the capacity to change well-established foreclosure laws across the country.

Given the number of states that have tax foreclosure mechanisms that don't pay the excess auction proceeds to the former owner, practitioners should look at the laws in their own

state to consider whether the Tyler decision gives rise to a new cause of action for recovery of those proceeds.

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[1] Tyler v. Hennepin Cnty., Minn., No. 22-166, 2023 WL 3632754 (U.S. May 25, 2023).

[2] Id. at 792.

[3] Id. at 324 (quoting Phillips, 524 U.S. at 164).

[4] Id. (citing Neb. Rev. Stat. § 76-101 (Reissue 2018), Neb. Rev. Stat. § 77-102 (Reissue 2018), Neb. Rev. Stat. § 40-101 (Reissue 2016), and Neb. Const. art I, § 25).

[5] Id. at 325.

[6] *Rafaeli, LLC v Oakland County*, 505 Mich. 429 , 952 N.W.2d 434 (2020).

[7] *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 164 (1998).

[8] Id. at 167.

[9] M.C.L. § 211.78k(6).

[10] *Lansing*, 9 Cow. at 355; *Resolution Trust Corp.*, 511 U.S. at 541.

[11] *Phillips*, 524 U.S. at 167.