

Is ‘Interest’ on Unclaimed Property A Constitutional Requirement?

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In this article, the authors discuss unclaimed property laws and the substantial windfall they can create for states.

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Every state has unclaimed property laws requiring holders of presumed abandoned property to report and turn over that property to the state. One important purpose of these laws is to place unclaimed property with the state, which, in contrast to private holders, is expected to be a better custodian and more likely to reunite owners with their lost or forgotten property. These laws dissuade private holders from silently keeping property owned by others for personal gain and allow states to put otherwise idle property to use for state purposes.

A less altruistic reason for state unclaimed property laws is that most property turned over to the states is never reunited with its true owners. Thus, unclaimed property can create a substantial

windfall for a state because states can often use unclaimed property while holding it as a custodian for its owner. For several states, unclaimed property is an important part of their fiscal forecasting and is viewed (at least behind closed doors) as an annual revenue line item for the state. This inflow of new unclaimed property is used by states to close budget gaps, pay down state pension deficits, and for other purposes. These are not necessarily bad uses of idle property. However, viewing unclaimed property as “free” money creates opportunities for abuse.

For instance, several states have shortened their statutory dormancy periods for when property must be treated as unclaimed and turned over to the state. These statutory changes are often made under the guise of protecting the property owners — that is, the earlier property is reported to the state, the better the chance that it will be reunited with its owner. However, a shortened dormancy period also results in an increase in the amount of unclaimed property reported and remitted to the state. A shortened dormancy period, coupled with antiquated and often minimal notification requirements (for example, newspaper publication), also “raises important due process concerns” under the due process clause of the 14th Amendment.¹

States are motivated to liquidate noncash property that cannot readily be used for state purposes. For example, most states, after some period, will convert corporate stock into cash that can be used by the state. Although this benefits the state (that is, it can more readily use the cash), and arguably protects the property owner from market downturns, property owners can lose out on significant stock value appreciation and dividend

¹*Taylor v. Yee*, 136 S. Ct. 929, 930 (2016).

income and may possibly face tax consequences from such sales.

Another potential area for significant maladministration is a state's authority (perceived or statutory) to estimate unclaimed property owed to the state. Estimations are commonly performed by third-party, contingent-fee auditors, who project large amounts of unremitted unclaimed property for periods for which the holder retains insufficient records. One significant reason that this area is ripe for manipulation is because estimated unclaimed property is not tied to any true owner. Consequently, this property will never be claimed by anyone and is purely a revenue item for the state. This encourages states and their contingent-fee auditors to be particularly aggressive in the scope of their audits and in the interpretation and enforcement of unclaimed property laws.

Unclaimed property laws provide an important and necessary function. However, as states struggle to close budget deficits without raising taxes, unclaimed property enforcement is likely to become increasingly important. Accordingly, it is not surprising that unclaimed property enforcement may become less about protecting the interests of owners and more about raising revenue. This change in focus could lead to abuse, including unlawful takings of property under the U.S. Constitution. One way to potentially curb this abuse is for states to pay interest to claimants for the use of their unclaimed property while it is held by the state. This is not only good public policy, but, as discussed below, might be a constitutional requirement.

Are States Constitutionally Required to Pay Interest?

Contrary to the notion that states are acting to protect owners' rights when they take custody of unclaimed property, many states take the position that they are allowed to use that property without payment of interest to the owner, thereby allowing the states to benefit from a steady flow of interest-free "loans." For the reasons discussed above, it is questionable whether encouraging states to take more unclaimed property into custody for longer periods of time, by allowing them to treat unclaimed property as an interest-free loan, is good policy. However, regardless of the policy

concerns, not paying interest on unclaimed property may also run afoul of the takings clause of the Constitution.

The takings clause,² as applied to the states through the 14th Amendment, instructs that no state shall take "private property . . . for public use, without just compensation." To establish a "taking," a claimant must show that:

- it has a property interest protected by the Fifth Amendment;
- the government took the property interest;
- the property interest was taken for public use; and
- just compensation was not paid.³

Any compensation due under the takings clause is to be "measured by the property owner's loss rather than the government's gain."⁴

The argument for states paying interest to unclaimed property owners is that a state's use or retention of property owned by another is a taking requiring compensation in the form of interest. Or, as explained by the U.S. Court of Appeals for the Seventh Circuit in *Cerajeski v. Zoeller*, "If you own an apple tree, you own the apples."⁵ Thus, not only should the property be returned to its owner, but also the fruits of the property while held by the state. The argument against paying interest is that property owners should not be compensated for neglecting their property through the payment of interest.

There is a split among the circuits as to whether the payment of interest on unclaimed property is required under the takings clause. For example, the Seventh Circuit in *Goldberg v. Frerichs, Treasurer of Illinois*,⁶ recently affirmed its own earlier rulings that owners of property taken into custody under Illinois's unclaimed property laws are entitled to receive interest on their property from the state. The court reasoned that under the takings clause, the property owner is entitled to the time value of money, even if the property was not earning interest in the hands of the owner. Thus, a state's requirement to pay

²U.S. Constitution, Amend. V.

³See *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1000 (1984).

⁴*Brown v. Legal Foundation of Washington*, 538 U.S. 216, 235-36 (2003).

⁵735 F.3d 577, 580 (2013).

⁶No. 18-2432 (7th Cir. Jan. 2, 2019).

interest is not limited to property that was earning interest before being turned over to the state, as held by the district court.⁷

However, the Third Circuit reached a different conclusion in *Simon v. Weismann*.⁸ In *Simon*, the court held that a state is not required to pay interest on unclaimed property, because the property owner has abandoned its property, and thus has no rights in interest generated from the property. In support of its decision, the court cited to the U.S. Supreme Court's decision in *Texaco v. Short*,⁹ which although not a state unclaimed property law case, stands for the proposition that a property owner is not required to be compensated for its own neglect. In *Texaco*, the issue was whether compensation was required for severed mineral interests that automatically reverted to the current surface owner if not used for 20 years.

State courts have also entertained the issue with mixed results. In *Hall v. State*,¹⁰ the Supreme Court of Minnesota held that the state is required to pay interest only to owners of interest-bearing accounts. In differentiating interest-bearing accounts from non-interest-bearing accounts, the court reasoned that if property was not earning interest in the hands of the owner, the property owner has no loss and no right to require payment of interest. In *Sogg v. Zurz*,¹¹ the Ohio Supreme Court held that the state is required to pay interest on unclaimed property under Ohio's unclaimed property laws, because the property is not "abandoned, forfeited or escheated" to the state, and therefore requires just compensation under Ohio's constitution.

However, in other states, courts have held that interest is not due on unclaimed property. For instance, in *Cwik v. Giannoulis*,¹² the Illinois Supreme Court held that interest does not have to be paid to owners of unclaimed property, citing *Texaco* as the basis for its decision. The Illinois

Supreme Court also held that the legislature was within its rights to declare that "only an incident of ownership" is taken by the state (that is, the owner's right to interest), and that the state should be able to keep this interest as a "limited lapse or divestment," and as compensation for its custodial services.¹³

The U.S. Court of Appeals for the Ninth Circuit reached a similar decision in *Suever v. Connell*,¹⁴ holding that under *Texaco*, there is no taking when a property owner abandons its property and forfeits any rights to interest earned by that property. In *Smolow v. Hafer*, the Pennsylvania Supreme Court held that "it strains common sense to suggest that the Commonwealth is obligated to pay interest to a negligent owner, who has presumably ignored his property for several years."¹⁵

Based on the foregoing, there is a question under the takings clause regarding whether states are required to pay interest on unclaimed property and, if so, whether interest is required to be paid on all unclaimed property or only for such property that was generating interest for its owner before being turned over to the state. Given the split among federal and state courts, there is a good possibility that the U.S. Supreme Court may consider this issue of interest and the larger issue of whether states are meeting the notice requirements of the due process clause of the 14th Amendment.

Should the Supreme Court consider this issue, it will be especially telling to see how states defend their position. Will they be forthright and admit to the revenue-generating aspect of unclaimed property laws? Or will they instead attempt to present their retention of interest as an effort to protect the interests of the same property whose claims they are denying? Either way, states should be direct with the public as to their unclaimed property agendas and put safeguards in place to protect and justly compensate owners (and the holders) of such property. This is not only good public policy, but possibly also a constitutional requirement. ■

⁷ See also the Seventh Circuit's similar decisions in *Kolton v. Frerichs*, 869 F.3d 532, 539 (7th Cir. 2017); and *Cerajesi v. Zoeller*, 735 F.3d 577 (7th Cir. 2013).

⁸ 301 Fed. Appx. 107 (3rd Cir. 2008).

⁹ 454 U.S. 516 (1982).

¹⁰ 908 N.W.2d 345 (2018).

¹¹ 905 N.E.2d 187 (2009).

¹² 930 N.E.2d 990 (2010).

¹³ *Cwik* at 930 N.E.2d at 996-998; see also *Cwik v. Topinka*, 905 N.E.2d 300 (Ill. App. Ct. 2009).

¹⁴ 579 F.3d 1047 (9th Cir. 2009).

¹⁵ 959 A.2d 298, 303 (Pa. 2008).