
COMMENTS

JUST COMPENSATION FOR ZERO IS ZERO: THE SUPREME COURT’S DECISION IN *BROWN V. LEGAL FOUNDATION OF WASHINGTON* KEPT IOLTA PROGRAMS EXACTLY WHERE THEY BELONG

I. INTRODUCTION

The Supreme Court granted certiorari in *Washington Legal Foundation v. Legal Foundation of Washington*—later renamed *Brown v. Legal Foundation of Washington*¹—to determine whether a state’s use of interest earned on an Interest on Lawyer’s Trust Account (IOLTA) is a taking under the Fifth Amendment.² In light of the Supreme Court’s decision in *Phillips v. Washington Legal Foundation*,³ which held that the interest earned on funds in an IOLTA account is “private property” of the owner of the principal,⁴ a circuit split developed as to whether a state’s use of interest earned in an IOLTA account to fund legal programs violated the Takings Clause of the Fifth Amendment. The Ninth Circuit in *Washington Legal Foundation v. Legal Foundation of Washington*⁵ found no taking and

1. 123 S. Ct. 1406 (2003).

2. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835, 841 (9th Cir. 2001), *cert. granted*, 536 U.S. 903 (2002), *aff’d sub nom. Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003); see also Tim O’Brien, *No Loss, No Foul: Skimming of Clients’ Interest Isn’t a Fifth Amendment Taking, Court Rules, Since Without IOLTA, There Would Be No Interest to Skim*, 171 N.J.L.J. 1151 (2003) (stating that *Brown v. Legal Foundation of Washington* upheld the IOLTA program in Washington, but that it will apply to IOLTA programs in every state).

3. 524 U.S. 156 (1998).

4. *Id.* at 156.

5. 271 F.3d 835 (9th Cir. 2001).

the Fifth Circuit in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*,⁶ on a remand from *Phillips*, found a taking.⁷ As a result, *Brown v. Legal Foundation of Washington* presented the Supreme Court with many unanswered legal issues.⁸

This case gave the Court an opportunity to clarify the line between when the per se and ad hoc analyses are appropriate to use in takings cases.⁹ The *Brown* Court also had the chance to decide when and how the Takings Clause applies to money and other personal property, as opposed to real property.¹⁰ The Court's decision in *Brown* profoundly affected the course of future takings clause litigation and the use of IOLTA interest.¹¹ The Court's decision demonstrates that attorneys and legal services corporations are able to use the Takings Clause to seek out an additional way to attack burdensome governmental regulations.¹² The petitioners, as property owners, were left frustrated, because they had limited remedies against what they perceived as an injustice.¹³

Part II of this Comment will discuss the history and uses of IOLTA programs, including the lawyer's role in IOLTA as part of ethical responsibilities and the use of IOLTA interest to fund legal services within the states. Part II also examines the mechanics of Negotiable Order of Withdrawal accounts and how the interest earned on these accounts is used to fund legal services via IOLTA programs. Finally, Part II illustrates the strictness of IOLTA regulations and consequences for violations of those regulations. Part III will discuss the Fifth Amendment's Takings Clause jurisprudence and the Supreme Court's interpretation of the Takings Clause. This Part also includes the purpose of the Takings Clause, the requirements of a takings claim, and relevant cases that have added to takings jurisprudence. Part IV is an examination of relevant Supreme Court takings cases involving IOLTA programs and concludes with the Court's most recent decision in *Brown v. Legal Foundation of Washington*. Lastly, Part V will discuss the leading alternatives to IOLTA programs that still need to be seriously considered and possibly implemented because IOLTA programs are still open to challenge under the First Amendment.¹⁴ This

6. 270 F.3d 180 (5th Cir. 2001).

7. *See id.* at 180; *Phillips*, 524 U.S. at 157.

8. *See generally* *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003).

9. *See* Michael J. Collins, *Do State IOLTA Programs Constitute Illegal Takings of Client Property?*, PREVIEW U.S. SUP. CT. CAS., Nov. 29, 2002, at 164.

10. *See id.*

11. *See id.*

12. *See generally* *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003).

13. *See id.*

14. *See id.* at 1415, 1428 (Kennedy, J., dissenting); *see also* Robert G. Seidenstein, *N.J. Legal Services Weathers Nail-Biter as IOLTA is Upheld*, N. J. L.: WKLY. NEWSPAPER

Comment concludes by agreeing with the Court's holding in *Brown* that using the interest earned on principal deposited in an IOLTA account to fund legal services for the poor is not a taking under the Supreme Court's present takings jurisprudence. Therefore, the current system should remain intact. It is important to be aware, however, that there are other viable alternatives that could be implemented if IOLTA programs are attacked again in the future.

II. HISTORY AND USES OF IOLTA

A. A Lawyer's Role in Ethical Responsibilities as Part of IOLTA Programs and States' Use of IOLTA Interest to Fund Legal Services

As a general matter, IOLTA accounts grew out of an insight that intricacies in the banking system would produce funds for a worthy social cause, specifically legal assistance to the poor, without any noticeable financial sacrifice to anyone.¹⁵ IOLTA accounts were initially created to help lawyers fulfill the duties placed upon them by the code of ethical responsibilities governing the legal profession.¹⁶ One of these responsibilities includes placing clients' funds in bank accounts that are separate from those of the attorney.¹⁷ This includes keeping a strict accounting to ensure that lawyers' funds are in no way commingled with that of their clients.¹⁸ This responsibility cannot be taken lightly, since the Model Rules of Professional Conduct instruct that it is a fiduciary duty to

(Mar. 31, 2003) (discussing Justice Kennedy's dissent in *Brown* that IOLTA programs could be considered compelled speech).

15. See Donald L. Beschle, *The Supreme Court's IOLTA Decision: Of Dogs, Mangers, and the Ghost of Mrs. Frothingham*, 30 SETON HALL L. REV. 846, 848 (2000).

16. See Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d 835, 841 (9th Cir. 2001). A few of the many ethical duties imposed on lawyers are loyalties to the client, representing clients zealously, protecting their legal rights, and safeguarding client property. See *id.* at 841-42; see also MODEL RULES OF PROF'L CONDUCT R. 1.15 (2003).

17. See MODEL RULES OF PROF'L CONDUCT R. 1.15 (2003).

18. See Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d at 842. Since 1908, ethical requirements have dictated that "money of the client or collected for the client . . . should be reported and accounted for promptly, and should not under any circumstances be commingled with his own or be used by him." *Id.* (citing CANONS OF PROF'L ETHICS Canon 11 (1933)). The most recent rules state that a lawyer, who has client property in his possession in connection with representation, has to hold the property in a separate account, which is in no way connected to the lawyer's own property. See MODEL RULES OF PROF'L CONDUCT R. 1.15(a) (2003). The account is maintained in the state where the lawyer's office is located and complete records of the account must be kept by the lawyer for at least five years after termination of the representation. See *id.*

hold the property of clients with great care.¹⁹ Today, lawyers in all fifty states are held to this strict standard.²⁰

Before the IOLTA scheme existed, lawyers complied with their ethical obligations by placing client funds in a separate bank account, generally in non-interest bearing, federally insured checking accounts.²¹ This type of account was used in order to ensure the funds were available to attorneys on demand.²² However, because of the mechanics of these types of accounts, the bank essentially received a windfall by holding the funds.²³ The bank would not only use the funds as an interest-free loan and keep all derived income, but it would also charge the lawyer, as the holder of the account, service fees to maintain the account.²⁴ Only when a large sum of money was being held for a long period of time, was it placed in an interest-bearing account.²⁵ In this situation, clients were responsible for any bank or attorney charges associated with accounting for this interest.²⁶ Therefore, client funds were not treated the same as other funds because funds held for a relatively short period of time did not earn any interest, while those held for a longer time did.²⁷

These client trust accounts did not remain interest-free for long because Congress passed the Consumer Checking Account Equity Act in 1980.²⁸ The Act authorized federally insured banks to pay interest on certain demand accounts, such as the checking accounts where attorneys placed client funds.²⁹ The new demand accounts that paid interest were called

19. See MODEL RULES OF PROF'L CONDUCT R. 1.15 cmt.1 (2003).

20. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 842. For example, California's professional responsibility rules mandate that all funds held for the benefit of clients by an attorney shall be deposited in a client trust account and that no funds of the lawyer can be deposited in the same account. See PAUL W. VAPNEK ET AL., CAL. PRAC. GUIDE PROF. RESP. Ch. 9 § B (2002). The funds may be held in either an IOLTA or a non-IOLTA, depending on whether the funds are "nominal" in amount and the length of time they will remain in the account. See *id.* § B(1)(a), (1)(b).

21. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 842.

22. See *id.*

23. See *id.*

24. See *id.*

25. See *id.* Historically, client funds that were only to be held for a short period of time were kept in non-interest bearing accounts along with other clients' funds. See RONALD D. ROTUNDA, LEGAL ETHICS: THE LAWYER'S DESKBOOK ON PROFESSIONAL RESPONSIBILITY §16-6 (2002). Due to the administrative difficulty of apportioning to each client his share of the interest in these multi-client accounts, non-interest bearing accounts were encouraged. See *id.*

26. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 842.

27. See *id.*

28. See *id.*; see also 12 U.S.C. § 1832 (2000).

29. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 842.

Negotiable Order of Withdrawal (NOW) accounts.³⁰ “NOW accounts are strictly regulated” and can only consist of funds held not-for-profit by individuals or organizations.³¹

The introduction of NOW accounts came at the right time because states were in need of a new source of legal funding.³² Traditionally, states received funding for legal services from attorneys as a result of the legal profession’s ethical responsibility to provide a certain amount of legal assistance to those who cannot afford it.³³ Bar associations and attorneys also helped support individuals and organizations that provided legal services.³⁴ However, much of the funding the states received came from the Legal Services Corporation, a federally funded corporation which gave direct grants to local attorneys who provided legal services to the poor.³⁵ Unfortunately, Congress dealt a hard blow to the Legal Services Corporation in 1981, when it restricted the Corporation’s scope and budget, resulting in states and their bar associations searching for new ways to secure legal funding.³⁶

As a result, states began using NOW accounts to conveniently serve the dual purpose of separating client funds from those of attorneys,³⁷ and using the interest earned on those accounts to help fund legal services.³⁸ In practice, the states took the money earned on the combined deposits made on behalf of clients and used it to fund legal services for the indigent at no cost to the owner of the principal.³⁹ IOLTA programs, based on the interest

30. *See id.*

31. *Id.* NOW accounts “must ‘consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, political, or other similar purposes and which is not operated for profit.’” *Id.* However, the Federal Reserve Board allows for-profit organizations, such as corporations and partnerships, to place funds in NOW accounts so long as the funds are held pursuant to a program under which charitable organizations have the exclusive right to interest earned on the account. *See id.*

32. *See id.* at 843.

33. *See id.* All attorneys bear the ethical responsibility of representing indigent clients or working to make the legal system accessible to those who cannot afford it. *See id.* As a result, bar associations recommend a certain number of hours each year to be designated by the attorney for pro bono services. *See id.* For example, the American Bar Association recommends that “[a] lawyer should aspire to render at least (50) hours of pro bono publico legal services per year.” MODEL RULES OF PROF’L CONDUCT R. 6.1 (2003).

34. *See Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 843.

35. *See id.*

36. *See id.*

37. *See* MODEL RULES OF PROF’L CONDUCT R. 1.15(a) (2003).

38. *See Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 843.

39. *See id.* By pooling client deposits that were too small individually, or held for too short a period of time to generate any net positive interest, a state was able to secure a large

generated from NOW accounts, have been implemented by all fifty states and the District of Columbia.⁴⁰ Florida was the first to implement the program in 1981.⁴¹ For example, the Texas IOLTA program dictates that funds deposited in an IOLTA account are to be paid to the Texas Equal Access to Justice Foundation, which is a non-profit corporation that distributes funds to non-profit organizations whose mission is the delivery of legal services to people with low incomes.⁴²

B. The Strictness of IOLTA Accounts and Consequences for Its Misuse

Attorneys are held to strict standards in the legal profession due to the fiduciary duties they owe to their clients.⁴³ As a result of these duties, lawyers must use precise care in handling their clients' funds.⁴⁴ The funds must be kept in a separate account and in no way commingled with the lawyer's personal or business accounts; nor may the lawyer's own funds be deposited in the client funds account.⁴⁵ Because they seek to enforce this duty, state IOLTA rules are also strict. For example, California's rules dictate that attorneys must place client funds that are "nominal" or held for a "short period of time"⁴⁶ in at least one interest-bearing demand trust account with interest paid at least quarterly to the California State Bar.⁴⁷

source of funding for legal services. *See id.*

40. *See Phillips v. Wash. Legal Found.*, 524 U.S. 156, 159 n.1 (1998) (noting that Indiana was the last state to institute an IOLTA program); IND. RULES OF PROF'L CONDUCT R. 1.15(d) (2003).

41. *See Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835, 843 (9th Cir. 2001). The interest in an IOLTA account, which is paid into a special fund to support legal programs, is authorized by a state's supreme court. *See MODEL RULES OF PROF'L CONDUCT R. 1.15(a)* (2003) (discussing interest bearing accounts).

42. *See Phillips*, 524 U.S. at 162.

43. *See MODEL RULES OF PROF'L CONDUCT R. 1.15(a)* (2003) (describing a lawyer's fiduciary obligation).

44. *See id.* at R. 1.15 cmt.1 (stating that a lawyer should hold property of others with the care required of a professional fiduciary).

45. *See id.* "All property that is property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property. . . ." *Id.*

46. *See VAPNEK ET AL.*, *supra* note 20, § B(1)(a)(3). Funds are defined as "nominal" or held for a "short time" if it is not practical to segregate the funds to earn income for the client's benefit, considering the income the funds could earn or the costs involved in earning or accounting for any such income. *See id.*

47. *See id.* at § B(1)(a). IOLTA accounts provide many advantages to attorneys. *See id.* This includes cost savings that result from a state's bar paying the regular maintenance charges on IOLTA accounts and attorneys not having to apportion or account for interest because the interest is paid to the state's bar. *See id.*

Client funds that are more than “nominal” in amount or that will be deposited for more than a “short time” are to be placed in interest-bearing bank accounts with interest payable to the client.⁴⁸

Furthermore, misappropriating client funds is the most egregious breach of the fiduciary duty and generally results in disbarment.⁴⁹ Misappropriation of funds usually occurs when an attorney uses client funds that have been commingled with his or her own funds and/or makes unauthorized use of trust account funds.⁵⁰ If a lawyer does commingle his or her funds with those of a client, the attorney’s creditors could attach the client’s property as a result of the commingling.⁵¹ The seriousness of the anti-commingling rule is evinced by the fact that a violation of the rule is a strict liability, or *mala prohibita*, offense.⁵²

Two cases demonstrate the consequences of misappropriating client funds. In *Butler County Bar Ass’n v. Turner*,⁵³ the attorney was suspended from the practice of law for six months for failing to deposit his clients’ funds in the proper account and failing to promptly pay his clients the funds to which they were entitled.⁵⁴ Specifically, the attorney cashed client retainer checks and put them in a lockbox, thereby failing to place them in the appropriate trust account.⁵⁵ He was found to have violated disciplinary rule DR 9-102(A), which states that “a lawyer shall deposit client funds in

48. *See id.* § B(1)(b). The client whose funds are neither nominal nor held for a short period of time has three choices for what to do with his or her funds. *See id.* § B(1)(b)(1)(a). The client can direct the funds to be deposited in: (1) an IOLTA account (with interest payable to the state bar); (2) an interest bearing non-IOLTA account where the client earns any interest generated from the funds; (3) or a non-interest bearing, non-IOLTA account where neither the client, nor the state bar, will earn interest. *See id.*

49. *See* MODEL RULES OF PROF’L CONDUCT R. 1.15(a) (2003) (describing a lawyer’s fiduciary obligation).

50. *See id.* (discussing misappropriation and conversion).

51. *See id.* (protecting client funds from lawyer’s creditors); *see also In re Anonymous*, 698 N.E.2d 808, 809 (Ind. 1998) (commingling of lawyer and client funds would subject client to the risk of creditors attaching the client’s property along with that of the lawyer).

52. *See* MODEL RULES OF PROF’L CONDUCT R. 1.15(a) (2003) (indicating that intent or lack of harm to client is not relevant). Because a violation of the anti-commingling rule is a strict liability offense, a lawyer cannot defend against this violation by stating that he did not intentionally commingle the funds, or that the client was not harmed as a result of mixing the funds. *See id.* A lawyer may not avoid responsibility for misappropriation by claiming that the conversion of funds was inadvertent or that he intended to repay the funds. *See id.* Therefore, there are no circumstances in which an attorney can ever justify the deliberate misuse of client funds for the lawyer’s personal benefit. *See id.*

53. 729 N.E.2d 347 (Ohio 2000).

54. *See id.*

55. *See id.* at 348.

an identifiable bank account in which funds of the lawyer are not deposited.”⁵⁶ Additionally, in *In re Mel Dahl*,⁵⁷ the attorney was disbarred for using client funds held in an IOLTA account for personal purposes, lying to his clients about the status of their funds, and attempting to bill his clients for services he did not perform.⁵⁸ These cases serve as examples of how seriously attorneys must take their fiduciary responsibility to assure the proper management of client funds, attorney funds, and IOLTA accounts.

III. THE FIFTH AMENDMENT’S TAKINGS CLAUSE JURISPRUDENCE AND INTERPRETATIONS

A. Origins and Purpose of the Takings Clause

The Court acknowledged the importance of property rights inherently protected by the Takings Clause as far back as 1798.⁵⁹ In *Calder v. Bull*, the Court condemned government confiscation and transfer of one person’s property to another as violating the natural law principles upon which the Constitution was founded.⁶⁰ Notwithstanding this, the Takings Clause does justify some confiscation of property through the long recognized power of eminent domain,⁶¹ and has been interpreted to mean that in “some cases the necessities of the government must override the rights of private ownership, and compel the surrender of specific private property to the public use.”⁶² Under this rationale, the general idea developed that “[i]f the

56. *Id.* at 348. Even though the attorney’s actions were not motivated by dishonesty or selfishness, but caused by physical and psychological problems, the court suspended him from practice for six months. *See id.* This suspension was conditioned upon him establishing an IOLTA account, continuing and completing treatment for a sleep disorder, completing six hours of continuing legal education relating to ethics, professionalism, and law office management, entering into a mentor relationship with an attorney, and reimbursing his clients for the improperly held funds. *See id.* at 347-48.

57. 709 N.E.2d 1117 (Mass. 1999).

58. *See id.* at 1118.

59. *See Calder v. Bull*, 3 U.S. (3 Dall.) 386 (1798) (reversing a probate court decision that upheld a Connecticut law disallowing inheritance and recognizing property rights as a principle of social compact and personal liberty).

60. *See id.* at 392.

61. *See* THOMAS M. COOLEY, THE GENERAL PRINCIPLES OF CONSTITUTIONAL LAW IN THE UNITED STATES OF AMERICA 363 (3d ed. 1898). Cooley defines eminent domain as the “lawful authority which exists in every sovereignty to control and regulate those rights of a public nature which pertain to its citizens in common, and to appropriate and control individual property for the public benefit, as the public safety, necessity, convenience, or welfare may demand.” *Id.* at 363-64.

62. *Id.* at 363.

government takes away a person's property to benefit society, then society should pay" in the form of compensation.⁶³

Moreover, the Supreme Court has articulated the Takings Clause to bar the government from forcing some people alone to bear the public burdens, which, in all fairness, should be borne by the public as a whole.⁶⁴ This concept of fairness is apparent in government taxation because it takes property from citizens for public use.⁶⁵ However, the exercise of eminent domain takes something very different from that taken by taxation because it seizes a particular part of a citizen's property and uses it to fulfill a specific government need.⁶⁶ Accordingly, this type of appropriation is not proper without compensation.⁶⁷

B. Requirements of a Takings Claim

Under the Fifth Amendment's Takings Clause, there are three ways to constitute a taking. The first is through eminent domain, which is the taking of private property for public use when the government pays compensation for what it has taken.⁶⁸ The second is through physical invasion by the government, again, when compensation is due.⁶⁹ The third type of taking occurs when a government regulation restricts the property to the point that the owner is totally deprived of all economically viable use of the property.⁷⁰ To prove a taking has occurred, generally four elements must be shown.⁷¹ First, the object claimed to have been taken must be a property interest.⁷² Second, the court must determine whether a "taking" of the

63. See ERWIN CHEMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 616 (2d ed. 2002).

64. See *Armstrong v. United States*, 364 U.S. 40, 49 (1960) (holding that lienholders should receive just compensation because of property loss).

65. See COOLEY, *supra* note 61, at 365. Taxation takes property from citizens under the general rules of apportionment and uniformity, so each citizen contributes his or her fair share and is compensated in the form of benefits from the government. See *id.*

66. See *id.*

67. See *id.* at 375; see also CHEMERINSKY, *supra* note 63, at 638.

68. See U.S. CONST. amend. V. The Fifth Amendment prohibits the government from taking "private property . . . for public use, without just compensation." *Id.*; see also *supra* Part III.A.

69. See generally *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982).

70. See generally *Lucas v. S.C. Coastal Council*, 505 U.S. 1003 (1992).

71. See CHEMERINSKY, *supra* note 63, at 615-16.

72. See *id.* at 616 (providing that state law principles will determine whether the object is a property interest); see also *Bd. of Regents of State Colleges v. Roth*, 408 U.S. 564, 578 (1972) (holding that respondent teacher had no property interest in an expired contract).

property interest has occurred.⁷³ Third, if a taking is found, the court will determine whether the taking was for public use.⁷⁴ Finally, the court must inquire into whether just compensation has been paid or is due.⁷⁵

C. The Takings Clause and Supreme Court Interpretations

The Takings Clause of the Fifth Amendment is incorporated into the Due Process Clause of the Fourteenth Amendment and thus applies to the states as well as to the federal government.⁷⁶ Early takings cases sought to determine the point at which a government act that regulates property, but falls short of divesting the owner of his title to the property, will qualify as a taking and thus require compensation under the Takings Clause.⁷⁷ Even though the Takings Clause is applicable to both personal and real property, most of the Supreme Court's takings cases have dealt with real property.⁷⁸ As a result, the standards developed by the Court concerning the Takings Clause have emerged primarily from real property.⁷⁹

Traditionally, a taking was limited to situations where the government expropriated property or physically occupied it, but the landmark case of *Pennsylvania Coal Co. v. Mahon*⁸⁰ held a taking could also be found if a regulation concerning the use of property went "too far."⁸¹ The regulation in *Pennsylvania Coal* prevented mining companies from excavating coal that acted to support the surface estate; thus the Court had to decide whether this regulation acted as a taking.⁸² The Court did find a taking and reasoned that, "[w]hen [a regulation] reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act."⁸³ The Court was quick to note, however, that compensation is not owed to every person whose property value decreased because of a government action.⁸⁴ Therefore, this early Supreme Court jurisprudence resulted in the notion that something less than fully

73. See CHEMERINSKY, *supra* note 63, at 615.

74. See *id.* at 505. For the court to find a "public use," the taking must be "rationally related to a conceivable public purpose." *Id.* This inquiry is almost always satisfied because the term is defined broadly by the Supreme Court. See *id.*

75. See *id.*

76. See *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

77. See Beschle, *supra* note 15, at 857.

78. See *id.*

79. See *id.* at 857-58.

80. 260 U.S. 393 (1922).

81. *Id.* at 415; see also CHEMERINSKY, *supra* note 63, at 621.

82. See *Pa. Coal Co.*, 260 U.S. at 412-13.

83. *Id.* at 413.

84. See *id.*

divesting an owner of title to his property could constitute a taking, while also establishing that government regulations that diminish the value of property might not be considered takings depending on how “far” they go.⁸⁵

The Court built on *Pennsylvania Coal’s* holding in *Penn Central Transportation Co. v. New York City*,⁸⁶ where it developed a specific inquiry, based on a case-by-case, or ad hoc, analysis for determining if a government regulation goes too far.⁸⁷ In that case, the Court will inquire into (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with investment-backed expectations; and (3) the character of the governmental action.⁸⁸

Then in *Keystone Bituminous Coal Ass’n v. DeBenedictis*,⁸⁹ the Supreme Court expounded upon the balancing test of *Penn Central* to “compare the value [of what] has been taken from the property with the value that remains in the property” when considering whether a regulatory taking has occurred.⁹⁰ Even though the overall test developed by *Penn Central* and *Keystone Bituminous* resulted in some inconsistency in application,⁹¹ it has established important takings principles to add to the Court’s analysis in these types of cases.⁹² Therefore, adding to the three factors derived from *Penn Central*, the Supreme Court opinions establish what is important to analyze in a takings case: the extent to which a government regulation diminishes the value of the property; the extent and nature of the benefit that the regulation provides to the community; and regulations that resemble a common law action to abate a nuisance are less likely to be a taking.⁹³ Additionally, as a final question in the takings analysis, the Court must inquire if the property owner who lost value from the regulation also shares in the benefits the regulation provides to the community as a whole.⁹⁴ Although the test developed seems authoritative, it remains

85. *See id.* at 413-15 (holding that a regulation was a taking, even though there was no transfer of a property interest). The Court also held that a state may prohibit an owner from a noxious use of his property if it inflicts injury on the community, thus adversely affecting public health and safety, without a duty to pay the owners compensation for their losses. *See id.*; *see also* *Mugler v. Kansas*, 123 U.S. 623, 669 (1887).

86. 438 U.S. 104 (1978).

87. *See id.* at 124.

88. *See id.*

89. 480 U.S. 470 (1987).

90. *Id.* at 497.

91. *See* Beschle, *supra* note 15, at 858 n.77. “[I]n later cases both the Court’s majority and dissenting opinions could cite the same cases for their conclusions.” *Id.* at 858.

92. *See id.*

93. *See Keystone Bituminous*, 480 U.S. at 491-92, 497.

94. *See id.* at 491. The Court stated that “one of the State’s primary ways of

“unclear which if any of these factors is the most important, [and] it also is often difficult to assess a single factor without considerable ambiguity.”⁹⁵

For example, the plaintiffs in *Penn Central* claimed a taking as a result of a regulation prohibiting them from building skywards on top of New York’s Grand Central Station.⁹⁶ They argued that the regulation effectively diminished the value of their airspace rights to nil because it took 100% of those airspace rights in the property.⁹⁷ In applying the ad hoc test, the government and the Court looked at the regulations from a completely different view.⁹⁸ Both argued that the effect the regulations had on airspace rights had barely any impact on the owners’ overall rights, claiming for example that airspace was just one stick in the bundle of property rights possessed by the owner.⁹⁹ Therefore, the plaintiffs looked narrowly at a particular right that was being “taken,” while the Court viewed the airspace rights as part of the larger property rights.¹⁰⁰

Along those same lines, the plaintiffs in *Keystone Bituminous* argued that a regulation requiring coal companies with certain mining rights in the land to leave a small percentage of coal in the ground in order to protect surface property owners from subsidence of the property constituted a taking of 100% of the coal that was left in the ground for the companies to mine.¹⁰¹ Again, taking a different view, the government and the Court supported the idea that the percentage of coal the statute required to be left in the ground was miniscule compared to all the coal in the ground left to be mined.¹⁰²

Causing much confusion and jurisprudential uncertainty, the regulation at issue in *Keystone Bituminous* was very similar to a coal statute in *Pennsylvania Coal* that did rise to the level of a taking.¹⁰³ The Court in *Pennsylvania Coal* reasoned that the regulation in that case was a total

preserving the public [wealth] is restricting the uses . . . [of] property.” *Id.* Even though individuals may be restricted on the uses of their property, they also “benefit greatly from the restrictions that are placed on others.” *Id.*

95. Beschle, *supra* note 15, at 859.

96. *See Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 104 (1978).

97. *See id.* at 130.

98. *See id.* at 131 (holding that the historic preservation statute that limited the use of airspace was not a taking).

99. *See id.* at 130-31. The Court held there was no taking because the plaintiffs still had the ability to use the rest of their property, as well as transferable development rights. *See id.* at 105, 137.

100. *See id.* at 130-31.

101. *See Keystone Bituminous*, 480 U.S. at 498.

102. *See id.* at 498-99 (holding that the regulation was therefore not a taking).

103. *See Beschle, supra* note 15, at 859-60; *see also supra* notes 80-83 and accompanying text.

taking of the owner coal companies' support estate because it only conferred benefits on a few private homeowners.¹⁰⁴ Therefore, in that case the Court looked to only one right in the owner's bundle of rights and found a taking because the total support estate was affected.¹⁰⁵ The Court reasoned, in contrast, that the regulation in *Keystone Bituminous* was not a taking for two reasons.¹⁰⁶ First, the regulation was only a minor interference with the property owner's entire bundle of rights, specifically the rights in the subterranean coal; and second, the regulation provided benefits to the entire community, unlike in *Pennsylvania Coal*.¹⁰⁷ Therefore, *Keystone Bituminous* and *Pennsylvania Coal* add to the Court's takings jurisprudence by illustrating the common questions and different ways of viewing a takings claim based upon a government regulation that "falls short of the classic situation involving eminent domain."¹⁰⁸

The next important case shedding light on the question of when a government regulation becomes a taking is *Lucas v. South Carolina Coastal Council*,¹⁰⁹ in which the Supreme Court held that a regulation rendering property valueless¹¹⁰ and of no use to the owner (usually meaning not worth more than the taxes on the property) always requires compensation.¹¹¹ In this situation, compensation is commanded regardless of how little or how much the regulation pursues a common societal goal.¹¹² Unfortunately, *Lucas* and cases decided thereafter center around regulations that reduce the value of the property to the owner, and, therefore, shed little light on the issue of takings involving IOLTA programs because they "do not reduce the value of the owner's property."¹¹³ In fact, IOLTA programs potentially increase the value of the owner's property, or principal funds, but do not take anything away as real property regulations do.¹¹⁴ Therefore, the big question with takings claims

104. See Beschle, *supra* note 15, at 860 n.90 (stating that "a source of damage to such a house is not a public nuisance, even if similar damage is inflicted on others in different places" (quoting *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922))).

105. See *Pa. Coal Co.*, 260 U.S. at 414.

106. See *Keystone Bituminous*, 480 U.S. at 498-502.

107. See *id.*

108. Beschle, *supra* note 15, at 860.

109. 505 U.S. 1003 (1992).

110. See *id.* at 1015. A regulation that renders the property valueless is one that deprives the owner of all economically viable use of the land. See *id.* at 1027.

111. See *id.* at 1015. A regulation "goes too far" and results in a taking when no productive or economically beneficial use of land is permitted. See *id.* at 1016.

112. See *id.* at 1015.

113. Beschle, *supra* note 15, at 861.

114. See *id.*; see also *supra* notes 37-42 and accompanying text. For example, if an attorney puts \$10,000 of a client's funds into a state mandated IOLTA account, the interest

involving IOLTA is whether a taking can occur when neither the title is transferred nor the value of the property is reduced.¹¹⁵

The case that came the closest to answering this question was *Loretto v. Teleprompter Manhattan CATV Corp.*,¹¹⁶ where the Court held that a permanent physical occupation, however minor, would always constitute a taking.¹¹⁷ The Court reasoned that “constitutional protection for the rights of private property cannot be made to depend on the size of the area permanently occupied.”¹¹⁸ The victory, however, was not worth the battle because on remand the New York landlords received one dollar in compensation—exactly what the statute already provided.¹¹⁹

Nonetheless, *Loretto* does aid in the development of the per se test for a taking,¹²⁰ which is one of the two alternative tests the Court uses in takings cases, the other being the ad hoc test.¹²¹ The per se test stands for the proposition that even a de minimus, or almost valueless, appropriation of property can result in a taking.¹²² This test, however, has been limited to

earned on the \$10,000 will only operate to increase the value of the original funds, but will not result in the funds being worth less than \$10,000 because the bank must pay a percentage of the principal to the lender in exchange for use of the money. *See* BLACK’S LAW DICTIONARY 818 (7th ed. 1999) (defining interest rate).

115. *See* Beschle, *supra* note 15, at 861.

116. 458 U.S. 419 (1982); *see also* Phillips v. Wash. Legal Found., 524 U.S. 156, 169-70 (1998) (citing *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 437 (1982)).

117. *See Loretto*, 458 U.S. at 432. In *Loretto*, a New York statute required landlords to allow the installation of cable television in their buildings and prohibited them from demanding payment for this use of their property in excess of one dollar. *See id.* at 423-24. The installation consisted of a half-inch wire running from the roof of the building and two cable boxes placed on the roof. *See id.* at 422. In reality, the wires and boxes only occupied about one-eighth of a cubic foot of space on the roof of the landlord’s building. *See id.*

118. *Id.* at 436-37.

119. *See id.* at 434-35.

120. *See Loretto*, 458 U.S. at 432. A per se taking occurs when there is a “permanent physical occupation of private property by the government or a government regulation which allows someone other than the property owner to have permanent physical occupation of a definable part of a piece of property.” JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW 484 (6th ed. 2000). As found in *Lucas*, a per se taking can also occur when the entire value of the land is diminished, thus when the owner is stripped of *all* economically beneficial use of his property. *See id.* at 480. In the case where the property value is “completely eliminated,” the government can only defend its taking of the property by showing that the owner took the property subject to the regulations. *Id.*

121. *See supra* notes 86-88 and accompanying text.

122. *See generally* *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). *See* David L. Callies & J. David Breemer, *The Right to Exclude Others From Private Property: A Fundamental Constitutional Right*, 3 WASH. U. J.L. & POL’Y 39, 42 (2000).

permanent *physical* occupations of real property.¹²³ So, what rules can be taken from *Pennsylvania Coal, Keystone Bituminous Coal Co., Penn Central, and Loretto*?

Generally, the Supreme Court agrees that deprivation of all, or most, of something will constitute a taking, while only being deprived of *some* of something may not result in a taking.¹²⁴ However, it is hard to determine what the “something” is.¹²⁵ Is it 100% of the coal in the ground that cannot be mined because of the statute, or is it a small percentage of coal that cannot be mined when compared to all the coal left in the ground to mine?¹²⁶ Depending on which way one analyzes the question, each view sounds correct.¹²⁷

The two ways of looking at the same situation and arguing if there has been a taking come from the “bundle of sticks” analogy that is used to describe property in legal terms.¹²⁸ The “bundle” is a collective set of rights the owner of property possesses.¹²⁹ However, the takings cases do not unravel the questions of whether this “bundle” can actually be separated into distinct parts nor of how much each “stick” is worth.¹³⁰ Specifically, “if one portion of the bundle, or one ‘stick’ in the bundle, is taken away or severely limited by a regulation, is this a deprivation of 100%” of the “stick,” or merely a small portion of the bundle?¹³¹ The Court’s takings jurisprudence leaves this question unanswered.

Another key element found in traditional property concepts, and relevant to IOLTA programs, is the fundamental right to exclude others from using one’s property.¹³² This right is part of the bundle of rights an owner

123. See Callies & Breemer, *supra* note 122, at 42. In *Loretto*, the New York statute essentially granted the cable operators a traditional easement, which does not present the legal system with a problem when the owner claims a right to sue. See *id.*

124. See generally *Lucas v. S.C. Coastal Council*, 505 U.S. 1003 (1992) (holding that a regulation that takes away all practical use of one’s property is a taking); see also *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104 (1978) (holding that a regulation that takes a limited part of the property’s value is not a taking).

125. See Beschle, *supra* note 15, at 863.

126. See *Keystone Bituminous Coal Ass’n v. DeBenedictis*, 480 U.S. 470, 498-502 (1987); *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 414 (1922); see also *supra* notes 89-92 and accompanying text.

127. See Beschle, *supra* note 15, at 863.

128. See *id.*

129. See *id.* at 863-64.

130. See *id.*

131. Beschle, *supra* note 15, at 864.

132. See J. David Breemer, Comment, *IOLTA in the New Millennium: Slowly Sinking Under the Weight of the Takings Clause*, 23 U. HAW. L. REV. 221, 242 (2000). “There is nothing which so generally strikes the imagination . . . as the right of property; or that sole and despotic dominion which one man claims and exercises over the external *things* of this

possesses in property and a restriction on it could amount to a taking.¹³³ For example, in *Kaiser Aetna v. United States*, the Court held that the right to exclude is within the category of interests the government cannot take without compensation.¹³⁴ The Court regarded this right as one of the most essential sticks in the bundle.¹³⁵ The Court further characterized the situation in *Kaiser Aetna* as not one where the government was merely exercising its regulatory power so as to cause an insubstantial devaluation of the petitioners' property rights, but rather an imposition resulting in an actual physical invasion of private property.¹³⁶

However, even when the right to exclude is restricted by physical occupation, it may not necessarily be a taking. For example, common law trespass can be a public or private necessity that may justify an individual's entry upon the lands of another.¹³⁷ Thus, "an owner must expect to find the absoluteness of his property rights curtailed by the organs of society, for the promotion of the best interests of others"¹³⁸ Therefore, along this same reasoning, the Court had little trouble acknowledging that a regulation on the use of property is not as severe as a physical occupation.¹³⁹ It could also be argued that even if the taking of IOLTA interest were akin to a physical invasion, the interest earned on IOLTA accounts could arguably and justifiably be redirected to the state to assist the indigent with legal services without resulting in a constitutional violation, provided that the owner of the property suffered no loss.

Therefore, by the Court hinging its analysis upon physical invasion

world, in total exclusion of the right of any other individual in the universe." *Id.* at 242 n.182 (quoting 2 BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 2 (1766)). "[A] key element of the concept of property has been the right not merely to possess and use something, but the right to exclude others." Beschle, *supra* note 15, at 864.

133. See *Callies & Breemer*, *supra* note 122, at 41-43; see also *Pruneyard Shopping Ctr. v. Robins*, 447 U.S. 74, 75 (1980). Even though it did not find a taking, the Court stated that, "the 'right to exclude others' is so essential to the use or economic value of [the] property that the state-authorized limitation of it amounted to a taking." *Id.* at 75 (quoting *Kaiser Aetna v. United States*, 444 U.S. 164, 179-80 (1979)).

134. See *Kaiser Aetna*, 444 U.S. at 179-80. In *Kaiser Aetna*, the government required that a private waterway in Hawaii be opened to the public. See *id.* The waterway's construction had cost the owners a substantial amount of money as it required the digging of a channel to connect their pond with the Pacific Ocean. See *id.* The Court said that this was a taking because the government had transformed private property into public property by allowing the public to use the waterway. See *id.*

135. See *id.*

136. See *id.* at 180.

137. See *State v. Shack*, 277 A.2d 369, 373 (N.J. 1971) (holding that a farmer did not have the right to exclude trespassers from his land).

138. *Id.* (citation omitted).

139. See *Callies & Breemer*, *supra* note 122, at 42-43.

versus a regulation on the use of property, what has emerged from these cases is that the right to exclude is intertwined with other elements of the “bundle” of property rights, such as the right to its use by the owner or the right to alienate.¹⁴⁰ However, the Supreme Court in *Brown v. Legal Foundation of Washington*, did not discuss the traditional right to exclude or the property owner’s bundle of rights, nor did it characterize IOLTA programs as a restriction on the use of property.¹⁴¹ In fact, the Court praised the overwhelming success of IOLTA programs and qualified them as serving a public purpose.¹⁴²

D. Phillips v. Washington Legal Foundation

Important to the Court’s newest takings decision in *Brown v. Legal Foundation of Washington* was a 1998 Supreme Court case, which “presented a situation in which the right to exclude was . . . independent of other property rights and . . . also independent of any decline in the value of . . . private property, either actual or potential.”¹⁴³ In *Phillips v. Washington Legal Foundation*,¹⁴⁴ the Court held that the interest earned on client funds held in IOLTA accounts is the private property of the client for Takings Clause purposes.¹⁴⁵ Essentially, the Court held that this private property interest, although relatively small and of little use to the owner, represents the right to exclude others from using that money to fund legal programs.¹⁴⁶

Although the case presented three distinct issues implicated by a takings claim,¹⁴⁷ the Court only reached the question of whether the interest possessed by the plaintiffs amounted to a property interest.¹⁴⁸ Therefore, in reaching its decision, the Supreme Court did not directly address the Fifth Amendment Takings challenge, but only the underlying property interest, leaving the questions of a taking and compensation for remand to the Fifth Circuit Court of Appeals.¹⁴⁹ The Court in *Phillips* reiterated that the

140. See *id.* at 44-45.

141. See *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406, 1409-10, 1417-19 (2003).

142. See *id.* at 1417.

143. Beschle, *supra* note 15, at 867.

144. 524 U.S. 156 (1998).

145. See *id.* at 172.

146. See Beschle, *supra* note 15, at 867.

147. These are: “whether the interest asserted by the plaintiff is property, whether the government has taken that property, and whether the plaintiff has been denied just compensation for the taking.” *Phillips*, 524 U.S. at 172 (Souter, J., dissenting).

148. See *id.*

149. See *id.* The Court only addressed the property question because the question granted certiorari was “whether ‘interest earned on client trust funds held by lawyers in IOLTA accounts [is] a property interest of the client or lawyer, cognizable under the . . .

Constitution protects, rather than creates, property interests because the existence of a property interest is determined by existing rules and understandings emerging from independent sources, such as state law.¹⁵⁰ Relying on the general rule that “interest follows principal,” the court reasoned that the funds held in an IOLTA account, that would not generate interest on their own if placed in a separate account, were private property of the client.¹⁵¹

This long standing “interest follows principal” general rule was articulated in *Webb’s Fabulous Pharmacies, Inc. v. Beckwith*,¹⁵² in which the Court addressed a Florida statute that provided for interest accruing on an interpleader fund deposited in the registry of the court to become income of the clerk’s office of the circuit court.¹⁵³ In that case, the clerk retained more than \$100,000 in interest income generated from the funds deposited by the plaintiffs.¹⁵⁴ The Court held that under the narrow circumstances of *Webb’s Fabulous Pharmacies*, the statute designating the clerk as the beneficiary of the interest violated the Takings Clause.¹⁵⁵ It reasoned that a state may not transform private property into public property without compensation simply by legislatively abrogating the traditional rule that earnings of a fund are incidents of ownership of the fund itself and are property, just as the fund itself is property.¹⁵⁶ In other words, a state may not use a statute to disavow traditional property interests that have long been recognized by state law.¹⁵⁷

Because the Court in *Phillips* cited *Webb’s Fabulous Pharmacies* to restate the general rule that interest follows principal, the petitioners in *Phillips* were therefore unable to cite an exception to this rule.¹⁵⁸ They

Fifth Amendmen[t].” *Id.* at 164 n.4 (alterations in original). Unfortunately, because the takings and just compensation issues were not presented by the petitioners, the Court could not address them. *See id.* Therefore, it was only a matter of time before they were presented in *Brown v. Legal Found. of Wash.*, decided March 26, 2003. *See generally* Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d 835 (9th Cir. 2001), *cert. granted*, 536 U.S. 903 (2002), *aff’d sub nom.* Brown v. Legal Found. of Wash., 123 S. Ct. 1406 (2003).

150. *See* CHEMERINSKY, *supra* note 63, at 536-37; *see also Phillips*, 524 U.S. at 164.

151. *See Phillips*, 524 U.S. at 167, 172. The notion that interest follows principal has a firm basis in traditional property law principles. *See id.* at 167. It permits an owner of a sum of money to distribute the interest income generated by the principal to a designated beneficiary or otherwise dispose of all or part of the interest as he or she sees fit. *See id.*

152. 449 U.S. 155 (1980).

153. *See id.* at 155.

154. *See id.* at 160.

155. *See id.* at 164-65.

156. *See id.* at 164.

157. *See Phillips v. Wash. Legal Found.*, 524 U.S. 156, 167 (1998).

158. *See id.*

could not point to any background principles of property law leading to the conclusion that the owner of funds temporarily deposited in an IOLTA account may be deprived of the interest generated by that account.¹⁵⁹

Many important issues that were presented in *Phillips* laid the framework for the Court's analysis in *Brown*. First, the *Phillips* Court rejected the petitioners' argument that interest income from an IOLTA account transferred to the state's legal aid program is not private property because it could not reasonably be expected to generate interest income on its own.¹⁶⁰ The Court made the clear distinction that just because funds deposited in an IOLTA account may not generate *net* interest, they nevertheless are capable of generating interest, and this interest is private property.¹⁶¹ Accordingly, the *Phillips* Court reasoned that a physical invasion is not deemed to lack the characterization of "property" merely because it lacks positive economic or market value.¹⁶² As an example, the Court identified the cable equipment placed on the plaintiff's property by the cable company in *Loretto*.¹⁶³ Even though the cable equipment increased the market value of the plaintiff's property, the Court held that the plaintiff's property right was infringed upon, thus articulating the Court's long standing recognition that property is more than economic value.¹⁶⁴ The Court also recognized that even though the interest income from an IOLTA account considered in *Phillips* has no economically recognizable value to the owner, possession, control, and disposition of the interest are still valuable rights bound up with the property.¹⁶⁵

The second and third issues addressed by the Court in *Brown* are found in the dissenting opinions of Justice Souter and Justice Breyer in *Phillips*.¹⁶⁶ They address the takings and just compensation issues the

159. *See id.* at 167-68.

160. *See id.* at 169.

161. *See id.* The Texas IOLTA rule at issue in this case required "client funds held by an attorney [to] be deposited in an IOLTA account 'if the interest [that] might be earned'" on the funds was "insufficient to offset the 'cost of establishing and maintaining the account, [the] service charges, [and the] accounting costs and tax reporting costs which would be incurred in attempting to obtain the interest on such funds for the client.'" *Id.* (quoting Tex. IOLTA R. 6).

162. *See id.*

163. *See Phillips v. Wash. Legal Found.*, 524 U.S. 156, 169-70 (1998); *see also supra* notes 116-19 and accompanying text.

164. *See Phillips*, 524 U.S. at 170.

165. *See id.* The Court defines property rights as "a reasonable expectation to continued receipt of a benefit" and, therefore, more than economic value. CHEMERINSKY, *supra* note 63, at 537.

166. In all, four Justices dissented in *Phillips*—Souter, Stevens, Breyer, and Ginsburg. *See Phillips*, 524 U.S. at 172, 179 (Souter, J., and Breyer, J., dissenting).

majority did not consider.¹⁶⁷ In his dissent, Justice Souter directs the lower court, in deciding a takings claim, to consider via an ad hoc, factual inquiry whether the government has gone “too far” with IOLTA regulations.¹⁶⁸ The lower court had to specifically consider the nature of the government’s action, its economic impact, and the degree of any interference with the reasonable, investment-backed expectations of the owner.¹⁶⁹

Based on the facts of *Phillips*, Justice Souter found the IOLTA program in Texas did not result in a physical occupation or seizure of tangible property.¹⁷⁰ He based his rationale on the fact that there was no economic impact on the plaintiff clients because they would not have any net interest to possess without, or even with, the IOLTA program.¹⁷¹ Furthermore, plaintiffs had no investment-backed expectations of receiving any net interest from the funds deposited in the IOLTA account for the same reason there was no economic impact.¹⁷²

In considering the compensation requirement of the takings claim, Justice Souter doubted plaintiffs were due any compensation on remand.¹⁷³ It is important to note that just compensation is defined as the full monetary equivalent of the property taken and is measured by what the client or claimant lost, not by what the government or the public gained.¹⁷⁴ Therefore, Justice Souter found it important that the claimants lost nothing because without the IOLTA program, their principal would not have generated any net interest income whatsoever.¹⁷⁵ Justice Breyer’s opinion furthers this notion by stating the claimants could not be deprived of any property right because such a right would not exist if it were not for the existence of the IOLTA program, because without it, the claimants would not have any interest.¹⁷⁶ He rationalized that the most that could have been taken was “[their] right to keep [their] principal sterile, a right to prevent the principal from being put to productive use by others.”¹⁷⁷ Accordingly,

167. *See id.* at 176 (Souter, J., dissenting); *see also supra* notes 147-48 and accompanying text.

168. *See Phillips*, 524 U.S. at 176 (Souter, J., dissenting). The ad hoc inquiry was first laid out in *Penn Central*. *See Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978); *see also supra* notes 83-86 and accompanying text.

169. *See Phillips*, 524 U.S. at 176 (Souter, J., dissenting).

170. *See id.*

171. *See id.*

172. *See id.*

173. *See id.* at 176-77.

174. *See id.* at 177.

175. *See Phillips*, 524 U.S. at 177 (Souter, J., dissenting).

176. *See id.* at 181 (Breyer, J., dissenting).

177. *Id.* The Constitution does not force a state to confer upon the owner of property—that produces no value—ownership of the fruits of that property, which exist only after the

on this reasoning both the Justices found that no compensation would be due.¹⁷⁸

IV. LOWER COURT DECISIONS INVOLVING IOLTA CHALLENGES

On the remand of *Phillips*, the District Court used the ad hoc analysis and found neither a taking nor any compensation due.¹⁷⁹ This decision was then appealed to the Court of Appeals for the Fifth Circuit in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, which found a taking had occurred, but no compensation was due using the per se method.¹⁸⁰ The appeals court used the *per se* method of analysis for the takings claim because the Supreme Court in *Phillips* had relied upon *Loretto* and *Webb's Fabulous Pharmacies*, both of which used the per se method.¹⁸¹ In its decision to find a taking, the appeals court cited *Webb's Fabulous Pharmacies* to illustrate the distinction between a permissive upholding of governmental action that denies a property owner full use of his property when that action promotes the general welfare, and an action where the government not only adjusts the benefits and burdens of economic life to promote the common good, but does so by a forced contribution to governmental revenues.¹⁸² The court characterized the interest being "taken" in this case as a permanent physical occupation by the government requiring compensation "no matter how minute the intrusion, and no matter how weighty the public purpose behind it."¹⁸³

The court further stated that the per se test does not only apply to government appropriations of real property, but it also applies to property such as interest generated from an IOLTA account, where it is permanently

government lawfully intervenes with the property. *See id.*

178. *See id.*

179. *See Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 86 F. Supp. 2d 624, 647 (W.D. Tex. 2000).

180. *See Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 270 F.3d 180, 180, 188, 195 (5th Cir. 2001); *see also supra* notes 116-22 and accompanying text.

181. *See Tex. Equal Access to Justice Found.*, 270 F.3d at 186; *see also Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980).

182. *See Tex. Equal Access to Justice Found.*, 270 F.3d at 186. The court notes that a forced contribution occurs where petitioners' interest was deemed property of the clerk of the court by statute, and when the interest "taken" bears no reasonable relation to the costs of using and managing that interest. *See id.* (citing *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155). In other words, the "taking" of the interest amounts to confiscation of a client's interest income when it cannot arguably be a fee for services rendered by the state. *See id.* at 187.

183. *Id.* at 187. The per se analysis does not require a case-specific inquiry into the public interests advanced by the regulation and almost always results in compensation being due. *See id.*; *see also Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1015 (1992).

invaded by the government.¹⁸⁴ Therefore, even though the IOLTA interest had little or no economic value to the appellant client (because it could not be earned without the IOLTA program), the right to possess, control, and dispose of the interest was held to be “taken.”¹⁸⁵ The taking of this right was held to be a taking per se because the state permanently appropriated the IOLTA interest income (which *Phillips* held to be private property of the client) against the appellant’s will.¹⁸⁶

The court reached this decision by stating that a “taking” is distinct from “just compensation.”¹⁸⁷ The court said compensation is only to be considered after a taking is found, with the extent of the taking being one factor in determining how much compensation is due, not whether there is a taking.¹⁸⁸ Upon this rationale, the court said the taking of interest in this case was not contingent on whether the client would have had any net interest, despite the IOLTA program.¹⁸⁹ The mere fact that interest is being earned and that this interest is private property of the client was enough to satisfy the court’s holding that a taking occurred.¹⁹⁰ Interestingly, the court also found that retroactive compensation for the interest earned in the IOLTA account could not be recovered; only prospective relief (declaratory or injunctive) was available to appellants.¹⁹¹

184. See *Tex. Equal Access to Justice Found.*, 270 F.3d at 187-88. For example, in *Phillips* the Court held that the government may not seize rents received by a landlord merely because it can prove the costs incurred in collecting the rents exceeds the amount actually collected. See *id.* (citing *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 170 (1998)).

185. *Tex. Equal Access to Justice Found.*, 270 F.3d at 188-89.

186. See *id.* at 188. The interest earned was taken against the appellant client’s will because he had no choice whether to participate in the IOLTA program. See *id.* Participation of attorneys in the Texas IOLTA program is mandatory, and therefore clients cannot avoid the appropriation of their interest by selecting an attorney that chooses not to participate. See *id.*

187. *Id.* at 189.

188. See *id.*

189. See *id.* at 189 n.10. The related costs of managing an IOLTA program are what prevent net interest from being realized. See *id.* By finding a per se taking the court disregards the fact that net interest could not be earned without the IOLTA program. See *id.* at 188-89, 189 n.10. Cf. *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003) (holding that although there was a taking for public use, no compensation was due because there was no net loss to the clients).

190. See *Tex. Equal Access to Justice Found.*, 270 F.3d at 188-89, 189 n.10.

191. See *id.* at 189, 194. The Fifth Circuit Court of Appeals affirmed the District Court’s ruling that the Eleventh Amendment bars any claims for monetary reimbursement of the earned interest the court held to belong to the client in this case. See *id.* at 189. The court stated that injunctive and declaratory relief is ordinarily available through federal statutes that allow “individuals threatened with a taking to seek a declaration of the constitutionality of the disputed governmental action before potentially uncompensable damages are sustained.” *Id.* at 193 (citations omitted). In most instances, plaintiffs are only allowed to

However, Justice Wiener, the dissenting justice in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, presents a much clearer and more accurate analysis of the takings claim as it applies in this case.¹⁹² He correctly argues that by its literal terms, the Fifth Amendment Takings Clause can be violated only by governmental failure to pay just compensation.¹⁹³ The Fifth Amendment does not prohibit a taking; it only prohibits a taking without just compensation.¹⁹⁴ Therefore, the Takings Clause does not proscribe the taking of private property, but only places a condition on the exercise of that power.¹⁹⁵ Thus, even if the IOLTA program involved a taking of property, it does not violate the appellants' constitutional rights because the appellants' suffered no loss, thereby placing the just compensation for zero at zero.¹⁹⁶

Furthermore, in order to prove a violation of the Takings Clause, a three-part inquiry must be satisfied.¹⁹⁷ The plaintiff must prove that "(1) property (2) has been taken for public use (3) without just compensation."¹⁹⁸ The appellants and the majority in this case only satisfied the first two elements, and the majority's analysis only included the first two elements, resulting in the inquiry being only two-thirds satisfied and the crux of the case resting on the issue of just compensation (of which none exists).¹⁹⁹ The IOLTA program is unlike the classic takings problem of fairness, in which an individual or small group is singled out to bear a burden that should be

seek post-deprivation remedy for harms to property because the Supreme Court believes a federal remedy is unnecessary if the state provides adequate procedures for redress. *See* CHEMERINSKY, *supra* note 63, at 532. Therefore, the Fifth Amendment does not require just compensation to be paid in advance of, or even at the same time as the taking—all that is required is that a "reasonable, certain and adequate provision for obtaining compensation exist at the time of the taking." *Tex. Equal Access to Justice Found.*, 270 F.3d at 191. Because the IOLTA program does not contain a compensation provision, appellants could not obtain restitution compensation. *See id.* at 194. Therefore, appellants were only allowed to ask for declaratory and injunctive relief along with the takings claim. *See id.*

192. *See Tex. Equal Access to Justice Found.*, 270 F.3d at 195 (Wiener, J., dissenting).

193. *See id.*

194. *See id.* at 189, 195.

195. *See id.* at 189.

196. *See id.* at 196 (Wiener, J., dissenting). "Only takings without 'just compensation' infringe [upon the Fifth] Amendment." *Suitum v. Tahoe Reg'l Planning Agency*, 520 U.S. 725, 734 (1997). The Fifth Amendment is "designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." *First English Evangelical Lutheran Church of Glendale v. Los Angeles County, Cal.*, 482 U.S. 304, 315 (1987).

197. *See Tex. Equal Access to Justice Found.*, 270 F.3d at 197 (Wiener, J., dissenting).

198. *Id.*

199. *See id.* at 198.

borne by the public as a whole.²⁰⁰ The Takings Clause was not intended to take over the role of the people in deciding what social programs are appropriate, and is not understood to be a substantive or absolute limit on the government's power to act, but more of a conditional limitation on that power.²⁰¹

By the majority's partial use of the per se method of analysis, it ignored the specific factual findings of this case.²⁰² Therefore, the correct analysis must include an inquiry into the amount of compensation due.²⁰³ How can the Fifth Amendment be violated when no compensation is due? The appellants have a zero loss and therefore zero compensation is due.²⁰⁴ Therefore, by using the per se method to find a taking, the majority in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation* stopped short of a full analysis of all the facts of this case and allowed a taking to be found when the appellants were not put in a worse position than they would be without the IOLTA program.²⁰⁵ This analysis results in a loss to the only group affected by the IOLTA program that is able to sustain a loss—those who receive the legal funding generated by the interest earned on IOLTA accounts.

The next case involving the constitutionality of IOLTA was presented to the Ninth Circuit Court of Appeals in *Washington Legal Foundation v. Legal Foundation of Washington*,²⁰⁶ in which the court used the ad hoc analysis and found no taking and that no compensation was owed to the appellants.²⁰⁷ The appellants in *Washington Legal Foundation v. Legal Foundation of Washington* were not clients whose funds were held in attorney IOLTA accounts like those in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, but those whose funds were

200. See Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 123-24 (1978).

201. See *Tex. Equal Access to Justice Found.*, 270 F.3d at 202-03 (Wiener, J., dissenting).

202. See *id.* at 198.

203. See *id.*

204. See *id.*

205. See *id.* At trial, the plaintiffs were unable to prove a loss using three different accounting methods: the clients' funds "could not earn net interest if placed in a non-IOLTA pooled account with funds of a law firm's other clients"; they could not show "that their funds could earn net interest in a sub-account [because of] the costs associated with such accounts; and [they] failed to prove they could gain a 'net benefit' from their funds even if they could not earn net interest on them." *Id.*

206. 271 F.3d 835 (9th Cir. 2001).

207. See *id.* at 857, 864. The Ninth Circuit Court of Appeals was quick to embrace the *Phillips* decision by stating that, in its prior decision in this case (decided before *Phillips*), it had overlooked the Supreme Court's view that, due to the fungible nature of money, as opposed to real or personal property, it cannot be physically appropriated away from any interest earned on the principle. See *id.* at 846.

held by title and escrow companies via a Limited Practice Officer (LPO), “a state-licensed non lawyer who is permitted by the state to ‘select, prepare, and complete the appropriate legal documents incident to the closing of real estate and personal property transactions.’”²⁰⁸ However, the IOLTA rules apply to LPOs in the same way they apply to attorneys.²⁰⁹ Under Rule 12.1, client funds must be placed in an IOLTA account unless:

- (i) the parties to a real estate transaction enter a written agreement requesting an interest-bearing account and “specifying the manner of distribution of accumulated interest to the parties to the transaction;” (ii) the funds are deposited in “a separate interest-bearing trust account for a particular party to a real or personal property closing on which accumulated interest will be paid to that party;” or (iii) the funds are deposited in “a pooled interest-bearing trust account with subaccounting that will provide for computation of interest earned by each party’s funds and the payment thereof to the respective party.”²¹⁰

Following the Supreme Court’s holding in *Phillips*—that the interest earned on an IOLTA account is the property of the owners of the principal—the appeals court in *Washington Legal Foundation v. Legal Foundation of Washington* agreed with Justice Wiener’s dissent in the Fifth Circuit case involving IOLTA, *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*,²¹¹ that the Fifth Amendment cannot be violated when no compensation is due.²¹² Essentially, the Ninth Circuit Court of Appeals answered the question that *Phillips* left open: whether a taking has occurred when a state IOLTA program “enables otherwise barren principal to earn a net positive interest for the benefit of funding legal service for the poor.”²¹³

208. *Id.* at 844 (citing Wash. Admission to Practice R. 12). “The position of LPO was created in 1983 in response to a Washington Supreme Court decision holding that laypersons performing [real estate closing and personal property transaction documents] were engaged in the unauthorized practice of law.” *Id.* (citation omitted). The IOLTA rule, Admission to Practice Rule 12, did not apply to LPOs until 1995. *See id.* Although escrow and title companies, like attorneys, hold client deposits in separate trust funds, they have never been able to take advantage of interest-bearing NOW accounts, partly because these companies handle transactions on behalf of for-profit corporations for which funds cannot be legally deposited in NOW accounts. *See id.* at 844-45. Therefore, “even if the IOLTA rules did not exist and the principal would generate net interest,” the principal would not be allowed to do so. *Id.* at 845.

209. *See id.* at 844, 857.

210. *Id.* at 844 (citing Wash. Admission to Practice R. 12.1(c)(2)).

211. 270 F.3d 180 (5th Cir. 2001).

212. *See* Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d at 851; *see also supra* notes 192-96 and accompanying text.

213. *See* Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d at 853-54.

Before determining whether a taking had occurred, the court had to define the nature of the property interest being affected by the IOLTA program.²¹⁴ Citing *Phillips*, the court found the interest attached “as a property right incident to ownership of the underlying principal” and that “without the principal, there would be no interest and therefore no property right in that interest.”²¹⁵ The court then stated that the ad hoc analysis used in *Penn Central* is the proper test to use in this case because the per se method used in *Loretto* is not typically used outside the context of real property and is an inadequate method to use when the property in question is money.²¹⁶ Money is unlike real property because it is fungible, the court reasoned.²¹⁷ Therefore, it would be artificial to view a “taken” interest (money) as a physical appropriation of property.²¹⁸ The court further relied on the ad hoc analysis used in *Webb’s Fabulous Pharmacies*, as well as the Supreme Court’s reliance on *Webb’s Fabulous Pharmacies* in *Phillips*, to reach the conclusion that the ad hoc method was the appropriate test to be used in the case at bar.²¹⁹ Moreover, the circumstances of this case would seem to present the very situation for which the *Penn Central* ad hoc analysis was designed: government interference arising from a public program, like IOLTA, that adjusts the benefits and burdens of economic life to promote health, safety, morals, or general welfare.²²⁰ “The Takings Clause was never intended to replace the role of the people in determining which social programs are appropriate and has not been understood to be a substantive or absolute limit on the government’s power to act”²²¹ Therefore, the Clause operates as a conditional limitation which permits the government to take so long as it pays the charge.²²²

Furthermore, under *pre-Brown* precedent, the per se method seemed like

214. See *id.* at 854.

215. *Id.* (citing *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 168 (1998)).

216. See *id.* at 854-55. However, the Court in *Brown v. Legal Foundation of Washington*, decided March 26, 2003, took the unprecedented step of using the per se takings analysis in the context of money by holding that a state’s use of IOLTA interest is more akin to a per se taking. See *Brown v. Legal Found. of Wash.*, 538 U.S. 216 (2003); see also *infra* notes 269-72 and accompanying text.

217. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 854.

218. See *id.* In *United States v. Sperry Corp.*, the Court distinguishes between money, which is not subject to the per se doctrine because it is fungible, and real or personal property. 493 U.S. 52, 62 n.9 (1989); see also *Nixon v. United States*, 978 F.2d 1269, 1285 (D.C. Cir. 1992).

219. See *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 855.

220. See *id.*; see also *supra* notes 86-94 and accompanying text (discussing the ad hoc rule).

221. *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 856 (citations omitted).

222. See *id.*

the incorrect method of analysis to use in determining if the IOLTA interest was “taken,” primarily because the banking industry is the backdrop for IOLTA interest, and because IOLTA is highly regulated and does not involve real property.²²³ “[I]ndividuals should expect that their commercial transactions, including their bank deposits, will be regulated.”²²⁴ Therefore, because of “the monetary nature of the property in question, the public nature of the IOLTA program, [and] the highly-regulated nature of the banking industry,” the ad hoc approach would seem to be the appropriate analysis for this type of takings claim.²²⁵ This test would therefore be used to determine if the IOLTA program is “reasonably necessary to the effectuation of a substantial public purpose.”²²⁶ Only then may the IOLTA regulations adjust the rights of individuals for the benefit of the public.²²⁷

Therefore, in applying the ad hoc analysis to the takings claim, the Ninth Circuit Court of Appeals examined the IOLTA program to determine whether the regulation went “too far” so that it forced “some people alone to bear the public burdens, which should be borne by the public as a whole.”²²⁸ When using this analysis, the Supreme Court will look at three factors: (1) “[t]he economic impact of the regulation on the claimant;” (2) “the extent to which the regulation has interfered with distinct investment-backed expectations;” and (3) “the character of the governmental action.”²²⁹ As to the first factor, there is no negative economic impact on the appellants resulting from the IOLTA program because no interest would be earned on their principal if it were not for the program.²³⁰

The only economic impact resulting from the IOLTA program and interest earned on the principal in an IOLTA account is a positive one for legal service organizations, law firms, and indigent clients because before

223. *See id.* “Because of ‘the State’s traditionally high degree of control over commercial dealings,’ . . . the principles of takings law that apply to real property do not apply in the same manner to statutes imposing monetary liability.” *Id.* (citations omitted). For example, “even though taxes ‘take’ money from individuals or businesses, assessments of that kind are not treated as *per se* takings under the Fifth Amendment.” *Id.* (citations omitted).

224. *Id.* Unlike in the banking industry, “property law [protects] an owner’s expectations that he will be . . . undisturbed . . . in [the] possession of his property.” *Id.* (citations omitted).

225. *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835, 857 (9th Cir. 2001).

226. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 127 (1978); *see also* *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 857.

227. *See* *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 857.

228. *Id.* (citations omitted).

229. *Penn Cent. Transp. Co.*, 438 U.S. at 124; *see also* *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 857; *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 176 (1998) (Souter, J., dissenting).

230. *See* *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 857.

the existence of the program, these funds did not earn interest.²³¹ After the enactment of the program, the same funds could earn interest via other non-IOLTA interest-bearing accounts, or if they were not placed here, through an IOLTA account.²³² Therefore, the IOLTA program maintains the status quo by producing interest, but certainly does not take anything away from legal clients.²³³

Furthermore, the only way for a possible taking of the appellants' interest to occur would be for an LPO to incorrectly place a client's principal in an IOLTA account when it would have actually generated interest on its own in a separate account.²³⁴ However, in such a scenario, the "taking" would be a direct result of the LPO's violation of the IOLTA rules, and therefore, it could not be attributable to state action and cannot implicate the Takings Clause.²³⁵ As the majority stated in *Phillips*, the right to possession, disposition, and control of any theoretical interest on a client's principal is a valuable property right, even if the interest generated has no economically realizable value.²³⁶ However, these rights cannot be "taken" by the state via the IOLTA program because these rights would not exist if it were not for the program.²³⁷ These rights are not *affected* by IOLTA, they are *created* by it; and without it, there is no value to these rights at all.²³⁸ Therefore, the court concluded the appellants suffered no direct economic impact as a result of the IOLTA program using the interest earned on their principal to fund legal services.²³⁹

Regarding the second element of the ad hoc inquiry, any interest earned on a client's principal while in an IOLTA account cannot effect a taking

231. *See id.*; *see also infra* note 251 (discussing how appellants have lost nothing and are due no compensation).

232. *See* Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d at 857.

233. *See id.* at 857-58.

234. *See id.* at 858.

235. *See id.*

236. *See* Phillips v. Wash. Legal Found., 524 U.S. 156, 170 (1998).

237. *See* Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d at 858.

238. *See id.* at 858, 863-64. Without the program, a positive net interest would have neither been received nor controlled. *See id.* at 863.

239. *See id.* at 858. The appellants argued that they suffered an economic impact from the loss of earning credits that were awarded by the bank to title and escrow companies once the IOLTA program was implemented. *See id.* Before IOLTA, companies received these credits to offset the transactional and administrative costs of maintaining accounts at a bank. *See id.* The appellants alleged that because the companies no longer received these credits after IOLTA was implemented, they charged their clients more to make up for the loss, and thus their real estate transaction costs increased. *See id.* The court discounted this argument first, because these earning credits were incentive payments to escrow companies, not their customers, and second, because the appellants could not prove the cost of the loss of these credits was passed on to them through increased fees. *See id.*

because the regulation did not interfere with any distinct investment-backed expectations.²⁴⁰ Thus, “[g]overnmental action through regulation of the use of private property does not cause a taking unless the interference is significant.”²⁴¹ There is no significant interference because clients whose principal could not otherwise earn interest outside the IOLTA program cannot possibly expect to earn any net interest on their principal.²⁴² Therefore, they have no investment-backed expectations either.²⁴³

Lastly, the court inquired into the character of the governmental action involved in *Washington Legal Foundation v. Legal Foundation of Washington* by stating the IOLTA rules are regulations rather than a physical invasion of the use of property.²⁴⁴ The appeals court viewed the governmental action within the context of the heavily regulated banking industry and held that IOLTA regulations are not out of character for either the commercial banking industry or the legal profession.²⁴⁵ Viewing IOLTA regulations as unobtrusive, the court found appellants were not “singled out to bear a burden that should be borne by the public as a whole.”²⁴⁶ Therefore, the court found the IOLTA rules “just and fair” and not effectuating a taking of the appellants’ property.²⁴⁷

In summary, after using the ad hoc analysis to find no taking, the court’s inquiry could stop there and find that the IOLTA program does not violate the Takings Clause.²⁴⁸ A thorough analysis, however, reveals that even if the court were to find a taking, the Fifth Amendment would not be violated since no compensation is due to the owners of the principal.²⁴⁹ Because “just compensation” must put the owner in as good a position as if the property had not been taken, proper compensation is the value of what has been lost, not what the taker gained.²⁵⁰ Applying this general rule, it is easily determined that owners of principal lying in an IOLTA account have

240. *See id.* at 860.

241. *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d 962, 976 (1st Cir. 1993) (citing *Andrus v. Allard*, 444 U.S. 51, 66-67 (1979)).

242. *See Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 860.

243. *See id.*

244. *See id.* at 861.

245. *See id.*

246. *Id.*

247. *See id.* “The Takings Clause does not prevent the government from being able to regulate how people use their property but limits that ability to what is ‘just and fair.’” *Id.* (quoting *Andrus v. Allard*, 444 U.S. 51, 66-67 (1979)).

248. *See Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 861.

249. *See id.* “[T]he Fifth Amendment only protects against a taking without compensation.” *Id.*

250. *See id.* at 862.

lost nothing.²⁵¹ They cannot seek compensation based upon the value of what a regulation creates; Takings Clause jurisprudence has never “force[d] a State to confer, upon the owner of property that cannot produce anything of value for him, ownership of the fruits of that property should that property be rendered fertile through the government’s lawful intervention.”²⁵² All the appellants might have lost is the ability to place their principal in a non-interest bearing checking account and thus let their principal lie fallow.²⁵³ Any theoretical rights of control and disposition of the interest are valueless without the IOLTA scheme and those rights will “never come to fruition on [their] own because without IOLTA there is no interest.”²⁵⁴

V. BROWN V. LEGAL FOUNDATION OF WASHINGTON

In *Brown*, the Court addressed the issue of whether the IOLTA program in that case could constitute a taking under the per se and/or ad hoc methods of analysis.²⁵⁵ In doing so, the Court made sure to extend the inquiry into the amount of compensation due so as to not make the mistake the majority made in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*.²⁵⁶ In that case, the Court of Appeals for the Fifth Circuit made the mistake of finding a taking without addressing the issue of compensation.²⁵⁷

Before addressing compensation, however, the *Brown* Court had to decide what type of taking, if any, the case involved.²⁵⁸ This resulted in the Court carefully drawing a distinction between a physical taking and a regulatory taking, saying the plain language of the Constitution requires payment of compensation “whenever the government acquires private property for a public purpose, whether the acquisition is the result of a condemnation proceeding or a physical appropriation. But the Constitution

251. *See id.* Because appellants would not have been able to earn any net interest if their funds were not placed in an IOLTA, they have lost nothing and are not due compensation. *See id.* Due to the amount of the principal, banking regulations, and the practice of escrow and title companies, their principal would have been placed in a non-interest bearing account if it were not for the IOLTA program. *See id.*

252. *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 181 (1998).

253. *See Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 863. Because it is fallow, it is characterized as having large potential value, but is left unused. *See WEBSTER’S THIRD NEW INT’L DICTIONARY* 819 (1986) (defining fallow).

254. *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d at 863-64.

255. *See Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406, 1418-19 (2003).

256. *See id.* at 1409-10; *see also supra* notes 197-99 and accompanying text.

257. *See Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 270 F.3d 180, 198 (5th Cir. 2001) (Wiener, J., dissenting).

258. *See Brown*, 123 S. Ct. at 1417.

contains no comparable reference to regulations that prohibit a property owner from making certain uses of her private property.”²⁵⁹ Furthermore, in its analysis, the Court reiterated its longstanding jurisprudence with respect to physical takings, stating that it is “as old as the Republic and, for the most part, involves the straightforward application of *per se* rules.”²⁶⁰ Here, the Court was quick to note that compensation is required for a physical taking “no matter how small” the occupation is.²⁶¹

In contrast, regulatory takings jurisprudence is more recent and involves an ad hoc, factual inquiry allowing examination and weighing of all the relevant circumstances involved in the takings claim.²⁶² Unlike a physical taking, when a regulatory taking is involved, compensation is not automatically due because “complex factual assessments of the purposes and economic effects of government actions[]” must be examined before compensation can be due.²⁶³ Keeping in mind this legal precedent, the Court began to address the two separate challenges brought by the petitioners: (1) the requirement that their funds be placed in an IOLTA account; and (2) the subsequent transfer to the legal services corporation whatever interest was thereafter earned on that principal.²⁶⁴

First, the Court gave careful examination to the possibility of an ad hoc taking based upon the petitioners’ first challenge.²⁶⁵ The Court said that the transfer of the *principal* into an IOLTA account could be viewed as a regulatory taking which would necessitate an ad hoc inquiry.²⁶⁶ Under this test, however, the transfer of the principal would not affect a taking because “the transaction had no adverse economic impact on the petitioners and did not interfere with any investment-backed expectation[s]” they may have had.²⁶⁷ Next, the Court focused on petitioners’ second challenge and determined that the transfer of interest earned on a client’s principal in an IOLTA account to a state’s legal services corporation was a *per se* taking.²⁶⁸ This holding, the Court reasoned, was consistent with the Court’s previous decisions in *Phillips* and *Loretto*.²⁶⁹ The Court stated this transfer was “like[] the kind of ‘*per se*’ taking that occurred in *Loretto v.*

259. *Id.* (quoting *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978)).

260. *Id.*

261. *Id.* at 1418.

262. *See id.* at 1417-18.

263. *Id.* at 1418.

264. *See Brown*, 123 S. Ct. at 1418.

265. *See id.*

266. *See id.*

267. *Id.*

268. *See id.* at 1418-19.

269. *See id.* at 1419.

Teleprompter Manhattan CATV Corp.” where there was a small physical occupation of rooftop space by the cable television company.²⁷⁰ *Loretto* was also consistent with the holding in *Phillips* that interest earned in an IOLTA account is the private property of the owner of the principal.²⁷¹

Second, after finding a per se taking, the Court had to examine the important question of whether compensation was due and, if so, how much.²⁷² Again, the Court reiterated its longstanding precedent that just compensation as required by the Fifth Amendment is measured by the “property owner’s loss rather than the government’s gain.”²⁷³ Because the technicalities of the IOLTA program require pooling of principal funds that would not otherwise generate net interest on their own,²⁷⁴ the Court found that compensation was not due on either nonpecuniary or pecuniary loss grounds.²⁷⁵ The petitioners lost on a nonpecuniary loss theory because any special or unique attachment a property owner has to his property is treated as part of the burden of citizenship in society and is not compensable.²⁷⁶ On the pecuniary loss theory, the Court stated that any compensation due would be measured by the owner’s net loss, which in this case was zero.²⁷⁷ Therefore, the placing of petitioners’ funds into an IOLTA account did not amount to a constitutional violation when they were not compensated.²⁷⁸ Most importantly, *Brown* presented a situation where a per se taking was found, but since the owner had lost nothing, zero compensation was due.

VI. PROTECTIONS FOR AND ALTERNATIVES TO IOLTA PROGRAMS

The Fifth Amendment issue may have been resolved, but a First Amendment attack on IOLTA programs is just around the corner. In addition to a Fifth Amendment challenge, the petitioners in *Brown* alleged that by transferring their interest earned in an IOLTA account to fund legal services, their First Amendment rights were violated.²⁷⁹ Keeping in mind these and other future challenges, there are alternatives to the present

270. *Brown*, 123 S. Ct. at 1418-19.

271. *See id.* at 1419 (citations omitted).

272. *See id.*

273. *Id.*

274. *See supra* notes 39-48 and accompanying text (discussing the operation of IOLTA programs); *see also Brown*, 123 S. Ct. at 1420 n.10.

275. *See Brown*, 123 S. Ct. at 1419-20.

276. *See id.*

277. *See id.* at 1419-20.

278. *See id.* at 1421.

279. *See id.* at 1415. However, the Court may have foreclosed a First Amendment challenge, stating that “a conscientious pacifist has no standing to object to the government’s decision to use the property she formerly owned for the production of munitions.” *Id.* at 1417. *But see* Seidenstein, *supra* note 14, at 39.

IOLTA program that may quiet its critics.

The first is a voluntary IOLTA program where the client consents to participate in the program.²⁸⁰ It is nothing more than a disclaimer on the attorney-client fee agreement directing a client's interest to be donated to groups who benefit from the current IOLTA program.²⁸¹ Coupled with this solution is the possibility of obtaining an IRS ruling exempting IOLTA interest from income so clients will be able to donate the interest earned on their funds held in an IOLTA account without being taxed on that interest.²⁸² The second alternative is a client waiver,²⁸³ which seems like the best alternative because the client will be able to avoid the unfavorable tax consequences of the consent alternative. Needless to say, these alternatives must pass muster with the Court's holding in *Brown*.²⁸⁴

The consent option would allow states to continue using the interest earned on IOLTA accounts to fund legal services, but clients would have to voluntarily consent to the appropriation of their money.²⁸⁵ In fact, Model Rule 1.15(d) states:

Except . . . by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.²⁸⁶

By this language, consensual client participation in an IOLTA program is possible.²⁸⁷

By giving clients the choice of how to manage their funds, clients are faced with three choices.²⁸⁸ First, clients could place their money in a traditional trust account, where no interest or taxes are paid, which would essentially give the bank a free loan.²⁸⁹ Second, the money could be invested in order to generate interest for the client and the client would be

280. See *infra* notes 286-97 and accompanying text (discussing consent).

281. See *infra* notes 286-97 and accompanying text.

282. See *infra* notes 293-308 and accompanying text (discussing the IRS ruling).

283. See *infra* notes 309-15 and accompanying text (discussing waiver).

284. See *generally* *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003).

285. This could be done by adding a clause in the attorney-client fee agreement. See VAPNEK & TUFT, *supra* note 20, § B(1)(a)(2)(a) (practice pointer).

286. MODEL RULES OF PROF'L CONDUCT R. 1.15(d) (2003).

287. See Jason Lacey, Note, *IOLTA Programs and Professional Responsibility: Dealing with the Aftermath of Phillips v. Washington Legal Foundation*, 47 U. KAN. L. REV. 911, 931 (1999).

288. See Brent Salmons, *IOLTAs: Good Work or Good Riddance?*, 11 GEO. J. LEGAL ETHICS 259, 272 (1998).

289. See *id.*

taxed on that interest as income, but chances are, those funds would not realize a net positive value from the interest due to bank fees.²⁹⁰ The third choice is the IOLTA choice, where the client is paid no interest, is not taxed, and the interest goes directly to fund legal services for the poor.²⁹¹ This last choice is clearly the best choice because it cures the defects of the other choices and is constitutional: banks are not receiving a free loan; clients are not paying bank fees to produce what will ultimately be a negative value; and people who cannot afford legal services, but need them, receive help at no one's expense.

There is a slight downfall to the consent option, however, because clients would now have dominion and control over the disposition of their property, and therefore the IRS would be able to tax their contributions as income.²⁹² This, in turn, could discourage participation in what would be known as the "voluntary" IOLTA program which is based upon client consent.²⁹³ With the current IOLTA program, clients are not taxed on the interest earned on their principal because IRS Revenue Ruling 81-209 specifically excludes interest "generated by IOLTA accounts from clients' income."²⁹⁴ The crux of the Revenue Ruling is a complete abrogation of any rights the client could have to control disposition over the interest.²⁹⁵ If

290. *See id.*

291. *See id.*

292. *See* Breemer, *supra* note 132, at 245.

293. *See id.*

294. Rev. Rul. 81-209, 1981-2 C.B. 17. The Revenue Ruling states that:

no client may individually elect whether to participate in the program. If the attorney elects to participate in the program, the attorney must do so with respect to nominal and short-term advances of all clients The program bars clients from receiving the benefit of any interest earned on the commingled advances; and, because of their fiduciary responsibility to their clients with respect to any advances, it is illegal for the attorneys to receive any benefit from the interest earned on the commingled advances. Furthermore, under the program, clients cannot compel attorneys to invest the advances on the clients' behalf.

Id.; *see also* Lacey, *supra* note 287, at 931.

295. *See* Lacey, *supra* note 287, at 931. During oral arguments in *Brown v. Legal Foundation of Washington*, Justice O'Connor asked whether the Takings Clause problem could be solved by adding an explanatory clause in the attorney-client agreement that would give clients the option to *not* have their interest go to an IOLTA program. *See* Tony Mauro, *Remarks by Thomas Alter Argument: Justice's Words Shape Debate in First Amendment Case. Plus, Court Considers IOLTA, Punitive Damages*, LEGAL TIMES, Dec. 16, 2002, at 7. Justice Ginsburg correctly interjected, however, that this would cause clients that have control over their interest to include it as part of income and would be subjected to tax laws even if they *did not* want their money to help IOLTA beneficiaries. *See id.*; *see also* Frank Newton, *IOLTA's Final Fate: A Firsthand Account of the U.S. Supreme Court Oral Arguments*, TEXAS LAWYER, Dec. 23, 2002, at 70.

the IOLTA program becomes voluntary, thus enabling clients to exercise control over their interest, this “income” will no longer be exempt from federal income tax by the IRS.²⁹⁶ In order to cure this problem, a ruling from the IRS would be needed to exempt the interest from taxable income.²⁹⁷ Critics of a new tax ruling would be silenced because “[i]n theory, the IRS would suffer no revenue loss because only clients with funds that traditionally would have been subject to IOLTA programs would be given the option to participate[.]” in the voluntary program.²⁹⁸ Thus, because the IRS presently gains nothing from funds placed in IOLTA accounts, it would not forgo any revenue by allowing an exemption for the voluntary program.²⁹⁹

However, Congress is not likely to be receptive to changing current Revenue Ruling 81-209 to exempt IOLTA interest because of the rationale behind the original exemption of IOLTA interest from income taxation.³⁰⁰ In order to comply with the IRS’s concern of possible tax-avoidance schemes by clients—which could develop because of IOLTA programs—advocates of the program structured it so that clients could not control the interest earned on their funds.³⁰¹ For this reason, it is unlikely that the IRS would extend the current Revenue Ruling to exempt interest earned on IOLTA funds under a *consensual* program.³⁰²

Nevertheless, in reality any minimal amount taxable to clients because of their contributions under a consensual program, does not outweigh the heavy ideological opposition the program may face if IOLTA participation becomes voluntary.³⁰³ Because clients will not have theoretical control over their interest, many will oppose “donating” their money to fund legal services for certain groups whose views they do not agree with.³⁰⁴ One way

296. See Lacey *supra* note 287, at 931. Although some clients would be able to take a deduction for a charitable contribution in the amount of the interest generated by their funds, not all clients would be able to do this because some would have already taken the maximum amount of deductions allowable due to their other charitable contributions. See *id.* at 932.

297. See *id.* at 932. This ruling, argues Frank Newton, Dean of Texas Tech University School of Law, would be like the “Thanksgiving turkey” exception that allows an employer to give an employee a gift, such as a turkey, with no requirement that the employee report the value of the gift as income on his tax return. See Mary Alice Robbins, *IOLTA Ruling Leaves Lawyers in a Quandry*, LEGAL INTELLIGENCER, Oct. 23, 2001, at 4.

298. Lacey, *supra* note 287, at 932.

299. See *id.*

300. See *id.* at 932-33.

301. See *id.* at 933.

302. See *id.*

303. See Breemer, *supra* note 132, at 245.

304. See *id.* This argument, however, has First Amendment implications and is beyond

to cure this problem is to include a diverse group of beneficiaries in the pool of IOLTA interest recipients;³⁰⁵ or, if this option is unsatisfactory to clients, they could select their own beneficiary.³⁰⁶ Therefore, in order to avoid tax ramifications to clients, the hassle of approaching an unsympathetic Congress to change existing regulations, or gabbling with clients' ideologies, the current IOLTA program is realistically the best choice.³⁰⁷

Another alternative to the IOLTA program is a client waiver or interest waiver agreement.³⁰⁸ This alternative is a crafty way to subvert the shortcomings of the consent alternative discussed above.³⁰⁹ In operation, this option will allow the lawyer to notify a client that his or her nominal, or short-term, funds will be placed in an IOLTA account.³¹⁰ The client would then be required to sign an "interest waiver" along with the traditional attorney-client employment contract.³¹¹ The waiver would explain that the funds have the potential to generate interest and also that the client has a property right in that interest, but by signing the waiver the client has relinquished that property right.³¹² Because this alternative does not seek client consent to participate in the IOLTA program, clients would not be subject to income tax under IRS Revenue Ruling 81-209.³¹³ Essentially, the lawyer retains the right to decide whether to participate in the IOLTA program and the waiver is an agreement between the lawyer and the client stating that the client will not seek to obtain any interest generated.³¹⁴ Therefore, the client waiver option silences those who still feel IOLTA programs are a "taking" under the Fifth Amendment because this option relinquishes any property rights the client possesses.³¹⁵

the scope of this Comment.

305. *See id.* at 245-46.

306. *See id.* at 245.

307. In fact, prior to Texas' mandatory IOLTA program, the state had a voluntary program, but raised substantially less funds. *See Robbins, supra* note 297, at 6.

308. *See* James D. Anderson, Note, *The Future of IOLTA: Solutions to Fifth Amendment Takings Challenges Against IOLTA Programs*, 1999 U. ILL. L. REV. 717, 747 (1999).

309. *See supra* notes 285-96 and accompanying text.

310. *See* Anderson, *supra* note 308, at 747.

311. *See id.*

312. *See id.*

313. *See id.*

314. *See id.*

315. *See* *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406, 1421 (2003). *But see* *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 172 (1998) (holding that interest income generated by funds held in IOLTA accounts is the private property of the owner of the principal).

Lastly, and on a more aspirational level, for those clients who, despite the Court's holding in *Brown*, still argue for "just compensation" under the Takings Clause regarding the monetary value of the interest earned on their principal, they can theoretically receive substantially more "compensation" just by contributing to IOLTA from the start. Their "just compensation" is the services they will receive if they ever find themselves, or someone they know, indigent and in need of legal representation. The value of services they will receive will far outweigh the cost of any interest they had to forego because of a "donation" to the IOLTA program.

VII. CONCLUSION

IOLTA programs and ethical responsibilities go hand in hand to benefit everyone involved in the legal system. The Model Rules of Professional Conduct make it a fiduciary duty to separate the attorney's funds from the funds belonging to their clients, established by a strict anti-commingling rule.³¹⁶ Out of this ethical responsibility grew a very pragmatic way to fund legal services for the poor through the creation of IOLTA programs. The interest earned on lawyer's trust accounts, or an IOLTA account, is a vital source of funding for legal services in every state and occurs at no detriment or cost to the owner of the principal that generates the funds.

However, recent court decisions have challenged IOLTA programs as violating the Takings Clause of the Fifth Amendment, claiming that because clients have a property interest in their principal, they also have one in any interest generated on those funds.³¹⁷ Without reaching the specific takings issues, including whether compensation is due, the Supreme Court held in *Phillips v. Washington Legal Foundation* that clients do in fact have a recognizable private property interest in the interest generated from their funds held in IOLTA accounts.³¹⁸ Picking up where the Supreme Court left off, the Fifth and the Ninth Circuits were able to reach the takings issue in cases before them, but each reaching the opposite result.³¹⁹ As a result of the split decisions, the Supreme Court granted certiorari in *Brown v. Legal Foundation of Washington* to

316. See MODEL RULES OF PROF'L CONDUCT R. 1.15.

317. See generally *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003); *Phillips v. Wash. Legal Found.*, 524 U.S. 156 (1998); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980); *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835 (9th Cir. 2001); *Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 270 F.3d 180 (5th Cir. 2001).

318. See *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 172 (1998).

319. Compare *Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 270 F.3d 180 (5th Cir. 2001) (holding that the IOLTA program is a per se taking under the Takings Clause), with *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835 (9th Cir. 2001) (holding that the IOLTA program is not a taking because no compensation is due).

determine whether the use of the interest earned on IOLTA accounts violates the Takings Clause of the Fifth Amendment.³²⁰ The Court decided in *Brown* that there was no constitutional violation under the Takings Clause because without the IOLTA program there would be no interest to claim.³²¹

Bolstered by the Court's decision in *Brown*, this Comment stands for the proposition that using the interest earned on these accounts to fund legal services for the poor results in absolutely no loss of value to the owners of the principal funds. In fact, IOLTA programs create value out of otherwise barren funds to serve a legitimate and weighty public need. Therefore, under the Supreme Court's takings jurisprudence, even if clients do have a property interest in the interest generated from the accounts, they are not due compensation because without the IOLTA program no property would exist that could be "taken." Furthermore, even if a taking is found per se, no just compensation is due even under the literal language of the Takings Clause. Despite this, states and their legal service corporations must be ready to secure alternative funding for legal services if IOLTA programs are challenged on other grounds, such as the First Amendment. In that case, legal services corporations must be ready to implement the several viable alternatives addressed in Part VI of this Comment.

Dawn M. Beauchesne

320. See generally *Brown v. Legal Found. of Wash.*, 123 S. Ct. 1406 (2003).

321. See *id.* at 1421.