IOLTA LOST THE BATTLE BUT HAS NOT LOST THE WAR

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INTRODUCTION

Since its inception, the Interest on Lawyer & Trust Accounts ("IOLTA") program has come under serious attack on both ideological and constitutional levels. The purpose of the program is to fund legal aid programs through interest earned on client deposits in attorney trust accounts. Opponents of the program argue that IOLTA violates the Takings Clause[1] of the Fifth Amendment as well as the First Amendment right of freedom of speech.[2]

In resolving these issues, both clients and attorneys have called upon courts to determine whether the client has a recognizable property interest in the funds generated by the IOLTA program. The First and Eleventh Circuits of the Court of Appeals found that the client had no recognizable property interest; therefore, the Fifth and First Amendment challenges to IOLTA failed.[3] In 1996, contrary to previous rulings, the Fifth Circuit held that the client did have a recognizable property interest.[4] The Texas Supreme Court Justices (who authorized the IOLTA program) and the Texas Equal Access to Justice Foundation appealed the Fifth Circuit's holding to the U.S. Supreme Court, which finally resolved the issue by affirming the Fifth Circuit's decision.[5] However, the Court remanded the case to the district court to determine whether a "taking" had actually occurred.[6]

This Note attempts to resolve the issues surrounding the constitutionality of the IOLTA program. Part I of this Note will survey the historical development and purpose of the IOTLA program. Parts II and III will discuss the cases challenging IOLTA. Part IV will analyze relevant cases that question whether the IOLTA program "takes" clients' property in terms of the Fifth Amendment. Finally, Part V of this Note will evaluate the argument that IOLTA violates a client's First Amendment right of freedom of speech.

I. HISTORY AND PURPOSE OF THE IOLTA PROGRAM

In the 1960s, a number of f countries developed programs in which clients'

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1. U.S. CONST. amend V states "nor shall private property be taken for public use, without just compensation."

2. U.S. CONST. amend I.

3. *See* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962 (1st Cir. 1993); Cone v. State Bar of Fla., 819 F.2d 1002 (11th Cir. 1987).

4. *See* Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996 (5th Cir. 1996).

5. *See* Phillips v. Washington Legal Found., 524 U.S. 156 (1998).

6. *See id.* at 172.

trust funds were invested to fund public legal programs.[7] Until 1980, United States' federal law did not allow the development of these types of programs, just as federal law did not permit banks to pay interest to "demand accounts."[8] Attorneys are required to establish these demand accounts and to place client trust funds into them.[9] Yet, client funds could not earn interest if placed in an attorney's trust account.[10] However, in 1980, Congress passed legislation creating accounts entitled Negotiable Order of Withdrawal accounts ("NOW" accounts) that operate as interest-bearing checking accounts, provided that none of the funds in the account belong to a for-profit corporation.[11] By passing this legislation, Congress made possible the development of the system in the United States for funding legal aid, like those systems already established in foreign jurisdictions.[12]

How does IOLTA work? If a client won $2000 in a court case, the lawyer would be obligated to place these funds along with funds from other clients into his trust account. (Over one month, the $2000 deposit would generate $3.30 in interest at an annual percentage rate in a money market savings account.)[13] The interest earned from the combined deposits in the IOLTA account is then funneled into that state's foundation or agency responsible for overseeing the IOLTA program. That agency then turns the money over to organizations that provide legal aid to the poor.[14]

Not all clients' funds should be placed in an IOLTA account. There are some individual client funds which are either large enough in amount or are held for such a significant length of time that they should be kept separate from the funds of other clients because they are capable of producing a significant amount of income for that client if placed in a separate trust account.[15] However, those

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7. *See generally* Taylor S. Boone, *A Source of Revenue for the Improvement of Legal Services, Part I: An Analysis of the Plans in Foreign Countries and Florida Allowing the Use of Clients' Funds Held by Attorneys in Non-Interest-Bearing Trust Accounts to Support Programs of the Organized Bar*, 10 ST. MARY'S L.J. 539 (1982). These countries include Australia, Canada, and South Africa. *See id*. at 542.

8. Trust accounts are called "demand accounts" because of the duty of the lawyer to place clients' funds into "a trust account that permits withdrawal on demand." *Washington Legal Found.*, 94 F.3d at 998.

9. *See* Gerald A. Gordon, Note and Comment, *IOTA & Professional Responsibility in the Shadow of* Washington Legal Foundation v. Texas Equal Access to Justice Foundation, 6 J.L. & POL'Y 699, 703 (1998).

10. *See id*. at 704.

11. *See* 12 U.S.C. § 1832 (1994).

12. *See* Gordon, *supra* note 9, at 709.

13. *See* Clara G. Herrera, *State Legal-Aid Program Faces High Court Test*, AUSTIN AM.-STATESMAN, Jan. 13, 1998, at B1.

14. *See* Gordon, *supra* note 9, at 706-07.

15. *See* Betsy Borden Johnson, Comment, '*With Liberty and Justice for All' IOLTA in Texas—The Texas Equal Access to Justice System*, 37 BAYLOR L. REV. 725, 726 (1985); *see also* Anthony J. Frates, *Trust Funds: To Separate or Not to Separate*, 21 No. 6 LAW PRAC. MGMT. 28

client funds which are nominal in amount or are held for such a short length of time that they cannot earn interest are commingled with other client funds of the same class and placed into a trust account. The interest earned on these types of funds goes into the IOLTA program.[16]

There are three types of IOLTA programs: mandatory, opt-out, and voluntary.[17] In a mandatory program, "the state requires that all lawyers' trust funds earn interest either for the client or for the specified IOLTA organizations to which contributions are made."[18] In an "opt-out" program, "lawyers [may] exclude themselves during an annual opt-out period if they do not [wish to] participate in IOLTA."[19] Finally, in a voluntary program, a non-participating attorney "may [still] impute short-term and nominal amounts to non-interest bearing [checking] accounts," while participating attorneys would open their IOLTA account and inform their local bar association that they have done so.[20]

After Congress passed the "NOW" legislation and IRS clearances were granted, two other obstacles existed for states to overcome before they could use IOLTA as a means of funding legal aid in the United States. First, traditional tax rules stood in the way of developing IOLTA programs because "clients would be taxed on the interest income whether or not they actually received" such income.[21] In response to this problem, "states applied for IRS clearances . . . that allow a client to avoid reporting the interest as part of gross income."[22] The IRS generally granted these clearances, but only if the states stipulated that client consent was unnecessary and was to be avoided.[23] "Giving the client power [to] direct[ing] the interest generated [by an IOLTA fund] would trigger the assignment of income doctrine, . . . subjecting the client to tax on the interest."[24] Therefore, attorneys were given exclusive decision-making power by the agencies governing the IOLTA program as to whether to place funds in IOLTA

(1995).

16. *See* Johnson, *supra* note 15, at 726.

17. *See* Brent Salmons, *IOLTAS: Good Work or Good Riddance?*, 11 GEO. J. LEGAL ETHICS 259, 262 (1998). "Twenty-seven states have mandatory programs, eighteen states and the District of Columbia have opt-out programs, and five states have voluntary programs." *Id.* at n.33.

18. Risa I. Sackmary, Comment, *IOLTA's Last Obstacle:* Washington Legal Found. v. Bar Found.*'s Faulty Analysis of Attorneys' First Amendment Rights*, 2 J.L. & POL'Y 187, 192 (1994). *See generally* Rachael Scovill Worthington, *IOTA–Overcoming Its Current Obstacles*, 18 STETSON L. REV. 415 (1989).

19. Sackmary, *supra* note 18, at 192.

20. *Id*.

21. Salmons, *supra* note 17, at 261.

22. *Id*.

23. *See id*.

24. *Id*.; *see also* Helvering v. Horst, 311 U.S. 112, 118 (1940) (describing the assignment of income doctrine as, "[t]he power to dispose of income is the equivalent of ownership to it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it.").

accounts.[25]

The final obstacle to implementing IOLTA programs in the United States was an ethical question. Canon 9 of the Model Code of Professional Responsibility governs the establishment and management of interest bearing attorney trust accounts.[26] Disciplinary Rule 9-102 prohibits an attorney from profiting from his clients' funds.[27] In the late 1970s, the Florida Supreme Court considered the ethical implications of the IOLTA program in light of this rule.[28] The court held that this rule did not prohibit attorneys from investing clients' funds in a special trust account governed by a specific trust document if strict accounting procedures were imposed on such accounts.[29]

The American Bar Association ("ABA") Committee on Ethics and Professional Responsibility issued a formal opinion on the ethical implications of IOLTA in response to the concerns of members of various state bars.[30] The ABA agreed with the Florida Supreme Court that participation in an IOLTA program does not violate an attorney's ethical obligations.[31] In fact, the ABA found that participation in IOLTA was consistent with an attorney's ethical obligations to assist in improving the legal system.[32]

As these issues were resolved, states began to develop IOLTA programs to fund public legal aid. Florida was the first to develop an IOLTA program in 1981, and the other 49 states as well as the District of Columbia have since adopted this program.[33] Florida's IOLTA concept spread rapidly because of the

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25. *See* Salmons, *supra* note 17, at 261.

26. MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 9 (1999) states, "A lawyer should avoid even the appearance of impropriety, . . . and therefore commingling of funds should be avoided." *See also* MODEL RULES OF PROFESSIONAL CONDUCT R. 1.15 (1999).

27. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 9-102 (1999).

28. *See In re* Interest on Trust Accounts, 356 So.2d 799, 800-01 (Fla. 1978). Florida was attempting to establish an IOTLA program at this time.

29. *See id*. at 801.

30. *See* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 348 (1982); *see also* Kristin A. Dulong, Note, *Exploring the Fifth Dimension: IOLTA, Professional Responsibility, and the Takings Clause*, 31 SUFFOLK U. L. REV. 91 (1997).

31. *See* Dulong, *supra* note 30, at 101.

32. *See* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 348; MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 8 (1999); Dulong, *supra* note 30, at 101.

33. *See* ALA. RULE PROF. CONDUCT 1.15(g) (1999); ALASKA RULE PROF. CONDUCT 1.15(d) (1999); ARIZ. SUP. CT. RULE 44(c)(2) (1999); ARK. MODEL RULES OF PROF. CONDUCT 1.15(d)(2) (1998); CAL. BUS. & PROF. CODE § 6211(a) (1999); COLO. RULES OF PROF. CONDUCT 1.15(d) (1999); CONN. RULE PROF. CONDUCT 1.15(d) (1998); DEL. LAWYERS' RULE PROF. CONDUCT 1.15(h) (1999); D.C. RULE PROF. CONDUCT 1.15(e) (1999); FLA. BAR RULE 5-1.1 (1999); GA. CODE PROF. RESP. RULE 3-109, DR 9-102(c)(2) (1998); HAW. SUP. CT. RULE 11 (1999); IDAHO RULE PROF. CONDUCT 1.15(d) (1999); ILL. RULE PROF. CONDUCT 1.15(d) (1999); IOWA CODE PROF. RESP. FOR LAWYERS DR 9-102(A) (1999); KAN. MODEL RULE PROF. CONDUCT 1.15(d)(3) (1999); KY. SUP. CT. RULE 3.830 (1999); LA. RULE PROF. CONDUCT 1.15(d) (1999); ME. CODE PROF. RESP. 3.6(e)(4) (1999); MD. BUS. OCCUPATION & PROF. CODE ANN. § 10-303 (1998); MASS. SUP. CT.

drastic need in the 1980s to improve America's legal services for the indigent.[34]

The purpose of the IOLTA program is to fund legal aid for those who are unable to afford legal representation. In 1997, the program generated over $100 million dollars nationwide, making it the second highest provider of legal aid to the poor.[35] An estimated 1.7 million people benefit from legal aid made possible by the IOLTA program.[36] Generally, funds generated by the IOLTA program are used to litigate civil matters such as wrongful eviction from homes, claims of disabled children, and domestic violence issues.[37] IOLTA funds are also used for educational purposes such as educating elementary and secondary school children in Oklahoma about the legal system.[38] Funds are given to law schools to enhance opportunities for underrepresented minorities and to finance law

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RULE 1.15(d) (1999); MICH. RULE PROF. CONDUCT 1.15(d) (1999); MINN. RULE PROF. CONDUCT 1.15(d) (1999); MISS. RULE PROF. CONDUCT 1.15(d) (1999); MO. RULE PROF. CONDUCT 1.15(d) (1999); MONT. RULE PROF. CONDUCT 1.18(b) (1999); NEB. SUP. CT. TRUST ACCT. RULES 1-8 (1998); NEV. SUP. CT. RULE 217 (1998); Petition of New Hampshire Bar Assn., 122 N.H. 971, 453 A.2d 1258 (1982); N.J. RULES GEN. APPLICATION 1:28A-2(a)(1) (1999); N.M. RULE PROF. CONDUCT 16-115(D) (1998); N.Y JUD. LAW § 497 (1999); N.C. RULE PROF. CONDUCT 1.15-3 (1998); N.D. RULE PROF. CONDUCT 1.15(d)(1) (1999); OHIO REV. CODE ANN. § 4705.09(A)(1) (1999); OKLA. RULE PROF. CONDUCT 1.15(d) (1999); OR. CODE PROF. RESP. DR 9-101(D)(2) (1999); PA. RULE PROF. CONDUCT 1.15(d) (1999) and PA. RULE DISCIPLINARY ENFORCEMENT 601(d) (1999); R.I. RULE PROF. CONDUCT 1.15(d) (1999); S.C. APP. CT. RULE 412 (1988); S.D. RULE PROF. CONDUCT 1.15(d)(4) (1999); TENN. CODE PROF. RESP. DR 9-102(C)(2) (1999); TEX. ST. BAR R., art. XI, § 5(A); *In re* Interest on Lawyers' Trust Accounts, 672 P.2d 406 (Utah 1983); VA. SUP. CT. RULES, pt. 6, § 4, para. 20 (1998); VT. CODE PROF. RESP. DR 9-103 (1998); WASH. RULE PROF. CONDUCT 1.14(c)(1) (1998); W. VA. RULE PROF. CONDUCT 1.15(d) (1999); WIS. SUP. CT. RULES 13.04, 20:1.15 (1999); WYO. RULE PROF. CONDUCT 1.15(II) (1998). Indiana's program has been authorized but is not yet operational. *See* IND. RULE PROF. CONDUCT 1.15(d) (1999).

34. *See* Sackmary, *supra* note 18, at 190.

35. *See* Herrera, *supra* note 13, at B1. The Federal government's Legal Services Corporation is the highest provider of legal aid in the U.S., and in the 1998 budget, Congress approved $300 million for the program, a $17 million increase over last year. However, ABA President Phillip S. Anderson stated, "[T]his increase still leaves the program woefully underfunded; only 20 percent of the legal needs of the poor in this country are being met." *Congress Approves $300 mil for Legal Services Corp.*, PR NEWSWIRES, Oct. 21, 1998.

36. *See* James Kilpatrick, *OK, Scooping Up Interest Was Wrong but $2.19 Isn't Enough to Cause Clients Any Harm*, CHARLESTON GAZETTE & DAILY MAIL, June 26, 1998, at 4A. In Texas the IOLTA program distributed more than 5 million dollars in legal aid. *See* Scott Ozmun & Susan Burton, *Program Supports Legal Aid for All*, AUSTIN AM. –STATESMAN, July 3, 1998, at A15. In 1998, $5.7 million in Washington's IOLTA program was distributed to programs that served more than 100,000 people who needed legal aid. *See* Susan Gilmore, *Ruling Puts Legal Aid in Jeopardy*, SEATTLE TIMES, June 17, 1998, at B3.

37. *See* Ozmun & Burton, *supra* note 36, at A15.

38. *See* Leigh Jones, *Ruling Endangers Legal Aid, Law Related Education Programs*, THE JOURNAL RECORD, July 23, 1998, *available in* 1998 WL 11955605.

school clinics.[39] Additionally, IOLTA funds have also been used to litigate issues involving gay rights[40] and to provide legal aid to poor immigrants trying to come to the United States.[41] However, the use of IOTLA funds for litigation surrounding those causes has triggered opposition to the program.[42]

Extensive debate exists on the subject of whether the program violates the Takings Clause of the Fifth Amendment and the First Amendment right of freedom of speech. Several courts have addressed the takings issue while the issue of freedom of speech has taken a backseat.[43] Opponents of the IOLTA program contend that the interest belongs to the clients and that lawyers are making decisions about how to spend money that is not theirs.[44] Some opponents argue that IOTLA is unconstitutional because it compels clients to support programs of the bar foundations' choosing.[45] IOLTA supporters argue that IOLTA is not a taking because "individually the money is not enough to warrant an interest-bearing account, but pooled together, the interest" generated on clients' funds becomes significant.[46] IOLTA's supporters also argue it is the duty of lawyers and the government to support legal aid funding for those who cannot afford it.[47]

II. THE CIRCUIT SPLIT

A. The First and Eleventh Circuits Hold That a Client Had No Recognizable Property Interest

The Eleventh Circuit Court of Appeals heard the first major challenge to the IOLTA program in *Cone v. State Bar of Florida*.[48] In *Cone*, a client of a law firm did not receive part of a settlement owed to her, totaling $13.75. This amount inadvertently remained in her attorney's trust account for almost fourteen years before an attorney in the firm discovered the error. From 1981 to 1984, subject to Florida's IOTA program, the attorney placed her funds in an interest bearing

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39. *See* Bob Ackerman, Editorial, *Pennywise Complaint Pound Foolish Interest Follows Principles, but Motive for Suing over Lawyer's Trust Accounts Is Unprincipled Attack on the Poor*, PORTLAND OREGONIAN, June 24, 1998, at B11.

40. *See* Don Feder, Editorial, *Court Will Rule on IOLTA Scam*, BOSTON HERALD, Jan. 7, 1998, at 19.

41. *See* Herrera, *supra* note 13, at B1.

42. *See id*.

43. The only court to address the First Amendment issue was the First Circuit in *Washington Legal Foundation v. Massachusetts Bar Foundation*, 993 F.2d 962, 976-77 (1st Cir. 1993).

44. *See* Dan Chern, *Why Mandatory IOTLAS Should Be Eliminated*, 4 TEX. WESLEYAN L. REV. 123, 137-39 (1997).

45. *See* Jones, *supra* note 38; *see also* Dulong, *supra* note 30.

46. Jones, *supra* note 38.

47. *See id*.

48. 819 F.2d 1002 (11th Cir. 1987).

account.[49] When the firm discovered its error in 1984, it returned the principal amount to the client. During those three years, her principal generated $2.25 in interest, and pursuant to IOTA, the firm gave the interest to the Florida Bar Foundation.[50] The client sued the Bar Foundation to recover the interest her principal had earned.

The Eleventh Circuit held that "[t]o demonstrate a constitutionally cognizable property interest [the client] must show that she had a specific and legitimate 'claim of entitlement'" to the interest generated by her principal in her attorney's IOTA account.[51] The court affirmed the district court's finding that the client did not have a claim of entitlement in the interest due to "the economics of running an interest-producing demand accounts [] and the restrictions that federal banking law places upon [those types of] accounts."[52]

The client's funds could not have been placed in its own interest bearing account because $13.75 would not meet the minimum balance requirements.[53] Even if the client's principal could have been placed in such an account, the administrative costs of the account would significantly exceed any interest earned.[54] Thus, the court reasoned that "[s]tanding alone, [the plaintiff's funds] in the IOTA account could not earn" any interest.[55] However, "by combining [these types of] deposits, interest income has been created which was not within the legitimate expectations of the owner of any one of the principal amounts."[56]

The client relied solely on the authority of the Supreme Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[57] to support her contention that she had a right to the interest her principal generated.[58] In *Webb's*, the Court found unconstitutional a Florida statute which declared that interest earned on interpleader funds deposited with the county court were the property of the county clerk.[59] The *Cone* court distinguished *Webb's* by stating that the funds in *Webb's* did give rise to a legitimate claim of entitlement because they were sufficient enough in amount to generate interest by themselves and were held for a sufficient period of time.[60] The court found that "[t]he district court in this case correctly concluded that 'the crucial distinction is not the amount of interest earned, but that the circumstances [in *Webb's*] led to a legitimate expectation of

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49. *See id*. at 1004 (Florida's IOLTA program is entitled "Interest on Trust Accounts" or "IOTA.")

50. *See id.*

51. *Id*.

52. *Id*. at 1005.

53. *See id*. at 1006.

54. *See id*.

55. *Id.* at 1007.

56. *Id*.

57. 449 U.S. 155 (1980).

58. *See Cone*, 819 F. 2d at 1006.

59. *See Webb's*, 449 U.S. at 164-65. In *Webb's*, the plaintiff's principal earned over $100,000 while in the possession of the county clerk. *See id*. at 158.

60. *See Cone*, 819 F. 2d at 1007.

interest exclusive of administrative costs and expenses.'"[61] The court, in finding that the client did not have a recognizable property interest, held that the IOTA program does not violate the Takings Clause of the Fifth Amendment.[62]

Five years later, the First Circuit Court of Appeals addressed a challenge to the IOLTA program. In *Washington Legal Foundation v. Massachusetts Bar Foundation*,[63] the numerous plaintiffs alleged "that they had been deprived, under the color of state law, of their rights secured by the First, Fifth, and Fourteenth Amendments of the Constitution by operation of the Massachusetts IOLTA program."[64]

The court stated that "[t]o make a cognizable claim of a taking in violation of the Fifth Amendment, the plaintiffs must first show that they possess a recognized property interest."[65] The court noted that "[n]ot all asserted property interests are constitutionally protected . . . as 'a mere unilateral expectation or an abstract need is not a property interest entitled to protection.'"[66] In determining whether or not a client had a recognizable property interest, the court focused on the issues of "the character of the governmental action" involved and the economic interference to the client.[67]

The plaintiffs argued that the character of the governmental action in this case was "a physical invasion of their beneficial interests in their funds held in IOLTA accounts" because IOLTA borrows their principal to generate interest to fund the IOLTA program.[68] The plaintiffs claimed a physical invasion in the intangible property rights of the right to control and exclude others from the property.[69]

The court noted previous Supreme Court holdings recognizing that a taking is more obvious if the government action involved is a physical invasion.[70] The court found no physical invasion because "the IOLTA program leaves the deposited funds [of the client] untouched [and] always available to the client[]."[71] Therefore, the plaintiffs did not have a property right to the interest earned on their funds held in the IOLTA accounts.[72]

In discussing the plaintiffs' claim of economic interference, the court cited the principal that "[g]overnmental action through regulation of the use of private

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61. *Id*. (quoting Cone v. Florida Bar, 626 F. Supp. 132, 136 n.7 (M.D. Fla. 1985), *aff'd*, 819 F.2d at 1002).

62. *See id*.

63. 993 F.2d 962 (1st Cir. 1993).

64. *Id*. at 969.

65. *Id*. at 973.

66. *Id*. (quoting *Webb's*, 449 U.S. 155, 161 (1980)).

67. *Id*. at 974 (quoting Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 225 (1986)).

68. *Id*. at 974-75.

69. *See id*. at 976.

70. *See id*. at 975 (citing Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978)).

71. *Id.* at 976.

72. *See id*.

property does not cause a taking unless the interference is significant."[73] The plaintiffs argued that the IOLTA program interfered with their rights to exclude others and control their property.[74] The court found that there were no economic interests in those property rights claimed by the plaintiffs.[75] The court reasoned that those rights had no economic benefit for the plaintiffs because there were no "investment-backed expectations" in those property rights.[76] The court stated that in the recognized "bundle of property rights," the plaintiffs could claim a "thin strand" at best.[77] "At least where an owner possesses a full 'bundle' of property rights, the destruction of one 'strand' of the bundle is not a taking, because the aggregate must be viewed in its entirety."[78] Weighing all of these factors, the court found that the IOLTA program did not involve a taking.[79]

The plaintiffs also argued that their First Amendment right of freedom of speech was violated by the IOLTA program because IOLTA compels attorneys and their clients to "participate in the IOLTA program and [therefore,] support lobbying and litigation for ideological and political causes."[80] The court held that the district court also properly dismissed this claim because the IOLTA program did not involve compelled speech or constitutionally protected speech.[81] The court stated that the interest generated by the funds deposited in IOLTA is not the client's property because the client "has not been compelled by the IOLTA Rule to contribute [his] money to the IOLTA program."[82] Therefore, he has "not been compelled by the IOLTA Rule to join, affirm, support or subsidize ideological expression of IOLTA recipient organizations in any way."[83]

B. The Fifth Circuit Takes a Different Approach—Recognizing the Client's Property Interest

In *Washington Legal Foundation v. Texas Equal Access to Justice Foundation* ("WLF"),[84] the District Court for the Western District of Texas held that the plaintiffs did not have a recognizable property interest in the funds generated by Texas' IOLTA program.[85] The Fifth Circuit Court of Appeals

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73. *Id*. (citing Andrus v. Allard, 444 U.S. 51, 66-67 (1979)).
74. *See id*.
75. *See id*.
76. *Id.*
77. *Id*.
78. *Id*. (quoting *Andrus*, 444 U.S. at 65-66.)
79. *See id*.
80. *Id*.
81. *See id*.
82. *Id.* at 980.
83. *Id*.
84. 873 F. Supp. 1 (W.D. Texas 1995), *aff'd in part, vacated in part, and rev'd in part*, 94 F.3d 966 (5th Cir. 1996), *and aff'd sub. nom* Phillips v. Washington Legal Found., 524 U.S. 156 (1997).
85. *See id.*

reversed the district court and found that the Constitution protected a recognizable property interest.[86] In so holding, the court cited Texas' observation of the "rule that 'interest follows principal,' which recognizes that interest earned on a deposit of principal belongs to the owner of the principal."[87]

The Fifth Circuit's analysis focused on the decision of the Supreme Court in *Webb's*.[88] Disagreeing with the Eleventh Circuit's analysis in *Cone* that the situation in *Webb's* was distinguishable from the IOLTA program, the Fifth Circuit held that *Webb's*

> creates a rule that is independent of the amount or value of interest at issue, holding that a property interest existed in the accrued interest simply because "[t]he earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property."[89]

The court found that a property interest attaches at the moment that the interest accrues.[90] Also, the court noted that IOLTA programs became possible only upon an IRS ruling whereby "clients would not be taxed on the interest earned on their deposits in IOLTA accounts provided that they had no choice but to participate in the program."[91]

The court remanded the case to the district court to determine whether a taking had occurred, noting that the plaintiffs had to "demonstrate that the taking was against the will of the owner" and that "a similar showing would also likely be necessary to prevail on the First Amendment claim."[92] The petitioners, including the Justices of the Texas Supreme Court and the Texas Equal Access to Justice Foundation, appealed and the U.S. Supreme Court granted certiorari.[93] The Supreme Court affirmed the Fifth Circuit's holding that a client has a recognizable property interest and remanded the issue of whether a taking occurred.[94] However, two Justices wrote persuasive dissenting opinions,[95] which could affect the outcome of the remaining issues to be determined in the case.

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86. *See* Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996 (5th Cir. 1996), *aff'd sub. nom Phillips*, 524 U.S. at 156.

87. *Id.* at 1000.

88. *See id*. at 1000-02. Recall that *Webb's* involved the Florida statute which declared that any interest earned on interpleader funds was the property of the county clerk, which the Court struck down as unconstitutional. *See* Webb's Fabulous Pharm., Inc. v. Beckwith, 449 U.S. 155 (1980).

89. *Texas Equal Access to Justice Found*., 94 F.3d at 1002 (quoting *Webb's*, 449 U.S. at 164).

90. *See id.* at 1003.

91. *Id*. (citing Rev. Rul. 81-209, 1981-2 C.B. 17).

92. *Id*. at 1004 (citing Vee v. City of Escondido, 503 U.S. 519, 527 (1992)).

93. *See* Phillips v. Washington Legal Found., 524 U.S. 156 (1998). The Honorable Thomas R. Phillips is a Justice on the Texas Supreme Court and a petitioner in this case along with the other Texas Supreme Court Justices and the Texas Equal Access to Justice Foundation.

94. *See id.* at 172.

95. *See id*. at 172 (Souter, J., dissenting), 179 (Breyer, J., dissenting).

II. THE *PHILLIPS* DECISION

A. The Majority's Approach

Five justices on the Supreme Court held that the clients did have a recognizable property interest and that the interest income generated by funds held in IOLTA accounts is the private property of the owner of the principal.[96] The Court noted that "existing rules or understandings that stem from an independent source such as state law" determine the existence of a property interest.[97] Discussing its holding in *Webb's*, the Court stated, "earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property."[98] The Court also noted "a State may not sidestep the Takings Clause by disavowing traditional property interests long recognized under state law."[99]

The Court held that any interest earned attaches as a property right due to the ownership of the underlying principal, "regardless of whether the owner of the principal has a constitutionally cognizable interest in the *anticipated* generation of interest by his funds. . . ."[100] The Court rejected the petitioners' argument that the interest could not be private property because if no IOLTA program existed, the money would not generate net income on its own.[101] Citing its holding in *Loretto v. Teleprompter Manhattan CATV Corp.*,[102] the Court stated that even though a physical item may lack a positive or economic value does not mean that it is not property.[103] In *Loretto*, the Court held that while the infringement on the property right arguably increased the market value of the property, it was still a taking of that property interest.[104] Property is more than an economic value.[105]

The Court found that "[w]hile the interest income at issue here may have no economically realizable value to its owner, possession, control, and disposition are nonetheless valuable rights that inhere in the property."[106] The Court

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96. *See id*. Chief Justice Rehnquist authored the majority opinion and the four concurring justices were Justice O'Connor, Justice Scalia, Justice Kennedy, and Justice Thomas. *See id.* at 158.

97. *Id*. at 164 (quoting Board of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972)).

98. *Id*. at 167 (quoting Webb's Fabulous Pharm., Inc. v. Beckwith, 449 U.S. 155, 164 (1980)).

99. *Id*. (citing Lucas v. South Carolina Costal Council, 505 U.S. 1003, 1029 (1992); *Webb's*, 449 U.S. at 163-64).

100. *Id*. at 168.

101. *See id*. at 169.

102. 458 U.S. 419 (1982).

103. *See Phillips*, 524 U.S. at 169.

104. *See Loretto*, 458 U.S. at 438 n.15.

105. *See Phillips*, 524 U.S. at 170 (citing *Loretto*, 458 U.S. at 435).

106. *Id*. (citing Hodel v. Irving, 481 U.S. 704, 715 (1987)).

disagreed with the petitioners' argument "that 'private property' is not implicated by the IOLTA program because the interest income generated by funds held in IOLTA is 'government-created value.'"[107] Interest income is not the outcome of "increased efficiency, economies of scale, or pooling of funds by the government"[108] and the government does not create the value; the respondents' funds do.[109] The Court did not consider the issues of whether the funds had been "taken by the State" or if any "just compensation" was due to the respondents and remanded those issues to the district court.[110]

B. The Dissenting Opinions

Justice Souter and Justice Breyer each wrote dissenting opinions in *Phillips*. All four dissenting justices joined in both opinions.[111] Justice Souter declined to join in the Court's holding because he felt that, under Texas law, deciding just the issue of whether a client has a recognizable property interest in the income generated by the IOLTA program was an abstract decision that might ultimately have no significance in resolving the real issue of whether IOLTA violates the Takings Clause of the Fifth Amendment.[112]

Justice Souter stated that the Court should have decided the issues of whether a taking had occurred and whether the government owed any just compensation to the respondents.[113] He suggested that the IOLTA program does not violate the Takings Clause because there "is no apparent economic impact."[114] He also noted that any required compensation should be measured against, not the government's gain, but the claimant's loss.[115]

In his dissenting opinion, Justice Breyer disagreed with the majority's holding that the client had a recognizable property interest in the funds generated by the IOLTA program.[116] He noted that "they [the Court's previous holdings] have not said that the Constitution forces 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."[117] Justice Breyer distinguishes the court's holding in

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107. *Id*. (quoting Brief for United States at 51 (No. 96-1578)).

108. *Id.*

109. *See id*. at 171.

110. *Id*. at 172.

111. *See id*. at 172, 179. Justice Souter's dissent was joined by Justice Stevens, Justice Ginsburg, and Justice Breyer. The same Justices, along with Justice Souter, joined in Justice Breyer's dissent.

112. *See id*. at 172 (Souter, J., dissenting).

113. *See id.* at 175.

114. *Id*. at 176. He also noted that a claimant could not reasonably expect to obtain net interest. *See id.*

115. *See id*. at 177.

116. *See id*. at 180 (Breyer, J., dissenting).

117. *Id*. at 181.

Webb's by stating that the principal in that case would have earned interest without state intervention, but federal law, in the absence of the IOLTA program, would prevent the client's principal from earning any interest.[118]

The IOLTA program suffered a loss in *Phillips* as the majority determined that a client does have a recognizable property right in the interest generated by the program.[119] While the program and its supporters lost this battle, the war rages on. The *Phillips* decision, in the long run, could have very little effect on the program. If the takings issue is ultimately resolved in IOLTA's favor, as Justice Souter suggested,[120] IOLTA will emerge victorious and continue to operate to provide legal aid to those who cannot afford legal counsel.

C. The District Court's Decision

On remand from the United States Supreme Court, the District Court of the Western District of Texas determined that the IOLTA program does not violate the Takings Clause of the Fifth Amendment.[121] The District Court found that the crux of the case rested on the issue of just compensation because the Takings Clause "does not prohibit the taking of private property" but prohibits such taking without just compensation.[122] The court found that the client did not suffer a compensable loss because just compensation is determined not by what the taker has gained but what the owner has lost,[123] and in the absence of the IOLTA program, the interest generated by a client's principal would possess no economically realizable value.[124]

The court also addressed the issue of whether a taking had occurred even though it found that the issue was of little importance because there was no identifiable compensable loss. The Court determined that an "ad hoc" takings analysis should be applied and used the test announced in *Penn Central*.[125] Applying this test, the court concluded that IOLTA does not violate the Takings Clause because the economic impact of the regulation on the client "is nill."[126] Although IOLTA won this round of the battle, the war rages on as the District court's ruling was appealed to the Fifth Circuit Court of Appeals.[127]

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118. *See id*. at 182.

119. *See id*. at 172.

120. *Id*. at 176 (Souter, J., dissenting).

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

122. *Id*. at 637

123. *See id.* at 637-38.

124. *See id.* at 643.

125. *Id.* at 646 (citing Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978)).

126. *Id.* The *Penn Central* test is discussed in greater detail, *infra* Part IV.

127. *See* Margaret Graham Tebo, *An Ok for IOLTA*, A.B.A. J., May 2000, at 84.

IV. DOES IOLTA VIOLATE THE TAKINGS CLAUSE?

A. General "Takings" Principles

The "Takings Clause" is enumerated in the Fifth Amendment of the Constitution and provides, "nor shall private property be taken for public use, without just compensation."[128] The Fourteenth Amendment makes the Takings Clause applicable to the states.[129] There are generally two types of takings cases: those cases analyzed under the principles established by the Court in *Penn Central Transportation Co. v. City of New York*[130] and per se takings.[131]

Takings that do not involve a permanent, physical occupation of the claimant's property or that do not deprive the claimant of all of the property's economic and productive value, should be analyzed by the principles elucidated in *Penn Central*.[132] Per se takings are those where there is a permanent, physical occupation of the property or where the government has deprived the claimant of all of the property's economic or productive use.[133] In analyzing a takings question, the threshold inquiry is whether the taking is a per se taking or whether it should be analyzed by the principles set forth in *Penn Central*.

Finally, the Constitution prohibits not all takings, but only those that occur without "just compensation."[134] The Court has stated that just compensation requires that "[t]he owner is to be put in as good position pecuniarily as he would have occupied if his property had not been taken."[135]

B. Examining IOLTA Under Penn Central's Test

In *Penn Central Transportation Co. v. City of New York*, [136] the Court established the following factors in evaluating a takings claim: 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."[137]

In its opinion in *Washington Legal Foundation v. Massachusetts Bar Foundation*,[138] the First Circuit, in dicta, examined IOLTA under the *Penn Central* test. After finding that the plaintiffs could not establish a tangible

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128. U.S. CONST. amend. V.

129. U.S. CONST. amend. XIV. The Fourteenth Amendment states, "nor shall any State deprive any person of life, liberty, or property, without due process of law. . ."

130. 438 U.S. 104 (1978).

131. *See* Kevin H. Douglas, Note, *IOLTAs Unmasked: Legal Aid Programs' Funding Results in Taking of Clients' Property*, 50 VAND. L. REV. 1297, 1322-23 (1997).

132. *See id*. at 1323.

133. *See id*. at 1322-23.

134. U.S. CONST. amend. V.

135. United States v. Miller, 317 U.S. 369, 373 (1943).

136. 438 U.S. 104 (1978).

137. *Id*. at 124 (quoting Goldblatt v. Hempstead, 369 U.S. 590, 594 (1962)).

138. 993 F.2d 962 (1st Cir. 1993).

property interest,[139] the court stated that IOLTA does not constitute a taking even if the plaintiffs could show that they had a property interest in the funds generated by IOLTA.[140]

The court gave no weight in the plaintiff's argument that the governmental action through IOLTA effected a physical invasion of their property rights.[141] The court considered the economic impact on the plaintiffs and "the extent to which the regulation has interfered with distinct investment-backed expectations."[142] The court found that the plaintiffs had not claimed that property rights involving economic interests had been interfered with and that there were no "investment-backed" expectations in the rights (rights to control) claimed by the plaintiffs.[143] The court held:

> Under the IOLTA Rule, the plaintiffs retain the right to possess, use and dispose of the principal sum deposited in IOLTA accounts. "At least where an owner possesses a full 'bundle' of property rights, the destruction of one 'strand' of the bundle is not a taking, because the aggregate must be viewed in its entirety."[144]

The court stated that the IOLTA rule does not bring about a taking of the plaintiffs' property.[145]

In *Phillips v. Washington Legal Foundation*,[146] the Court held, in a 5-4 opinion that under Texas law, the interest income generated by funds held in IOLTA accounts is the private property of the owner of the principle for the purposes of the Takings Clause.[147] Justice Souter, dissenting in the opinion, disagreed with not only the holding of the majority, but also the fact that the majority did not determine whether the IOLTA program "takes" the client's property.[148]

In discussing the issue of whether IOLTA unconstitutionally takes the client's property, Justice Souter discussed the principles announced in *Penn Central* stating "[h]ere it is enough to note the possible significance of the facts that there is no physical occupation or seizure of tangible property. . . ."[149] Justice Souter also found that there is no apparent economic impact on the client because the client would have no net interest for himself, with or without IOLTA.[150] "[T]he facts present neither anything resembling an investment nor

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139. *See id*. at 974.
140. *See id*.
141. *See id*. at 975-76.
142. *Id*. (quoting Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 275 (1986)).
143. *Id*.
144. *Id*. (quoting Andrus v. Allard, 444 U.S. 51, 65-66 (1979)).
145. *See id*.
146. 524 U.S. 156 (1998).
147. *See id*. at 172.
148. *See id*. (Souter, J., dissenting).
149. *Id*. at 176.
150. *See id*.

. . . any apparent basis for reasonably expecting to obtain net interest."[151] Justice Souter concluded that an application of the *Penn Central* test to IOLTA would likely find that the program does not violate the Takings Clause.[152]

If the IOLTA program is analyzed under the *Penn Central* test, it appears that no taking has occurred. First, there is no economic impact on the claimant nor has the IOLTA program interfered with any distinct investment based expectations. If an attorney were to place all client funds in separate trust accounts for each client, in the majority of instances, the client's funds would earn no interest because any administrative costs on such accounts would be higher than any interest earned. Thus, no net interest would be earned on the account. In addition, after a client wins a judgment, generally they do not expect that the money will be invested or earn interest in the short amount of time that it will be held in the attorney's trust account. Finally, without the IOLTA program, attorney trust accounts could not be set up under current law to earn any interest.

Therefore, if the IOLTA program were analyzed under the *Penn Central* test, as Justice Souter[153] and the First Circuit[154] suggested, it does not appear that the government has taken any recognizable property interest, even though the Supreme Court found that the client does have a property interest in funds generated by IOLTA. However, some argue that the IOLTA program should be analyzed as a per se taking.[155] In those cases, it is more difficult for the government to demonstrate that a taking has not occurred.[156]

C. Per Se Takings and IOLTA

In *Lucas v. South Carolina Coastal Council*,[157] the Supreme Court found "at least two discrete categories of regulatory action as compensable without case-specific inquiry into the public interest advanced in support of the restraint."[158] In cases where the government regulation allows a permanent, physical invasion of privately owned property or where the "regulation denies all economically beneficial or productive use of land" a "per se" taking can be found.[159]

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151. *Id.*

152. *See id*.

153. *See id*.

154. *See* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 976 (1st Cir. 1993).

155. *See* Douglas, *supra* note 131, at 1325.

156. *See id*.

157. 505 U.S. 1003 (1992).

158. *Id*. at 1015.

159. *Id*. at 1015-16. "As we have said on numerous occasions, the Fifth Amendment is violated when land-use regulation 'does not substantially advance legitimate state interests or denies an owner economically viable use of his land.'" *Id*. at 1016 (quoting Agins v. City of Tiburon, 447 U.S. 255, 260 (1980)). However, the Court recognizes a narrow exception where the government may "affect property values by regulation without incurring an obligation to compensate" if acting

It is arguable that the Fifth Circuit's ruling in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*[160] demonstrates that the court felt that the state's action under the IOLTA program should be analyzed as a per se taking.[161] In its instruction on remand to the district court, the Fifth Circuit stated that the district court should find a taking if the plaintiffs "demonstrate that the taking was against the will of the property owner."[162] "Thus, the Texas Equal Access court made the analytical jump from holding that clients possessed a property interest in IOLTA income to concluding . . . that, absent client consent, Texas's IOLTA resulted in a taking."[163] The court's based its conclusion on its comparison of the IOLTA program to the Supreme Court's findings in *Loretto* and *Webb's*.[164]

1. A Discussion of Per Se Takings Cases.—Although the court did not agree with them, the plaintiffs in *Massachusetts Bar* claimed that IOLTA causes a physical taking like those found in *Kaiser Aetna v. United States*,[165] *Loretto v. Teleprompter Manhattan CATV Corp.*,[166] and *Webb's Fabulous Pharmacy, Inc. v. Beckwith*.[167] These cases involved per se takings.[168]

In *Kaiser*, the Court found a taking where the government imposed a navigational servitude requiring that owners of a private marina, who had connected their private marina to the Pacific Ocean, allow a right of access to the public.[169] The Court found that the government's action constituted a physical invasion of the owner's private property by the public and was an unconstitutional taking of the marina owner's right to exclude others from their private property.[170] In *Loretto*, a government regulation required private property owners to allow conduits for cable television to be fastened to their buildings even where the property owners did not subscribe to cable television.[171] The Court found that the regulation authorized a physical occupation, although a small one, of the plaintiff's private property, which was unconstitutional without compensation.[172]

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within the State's police power. *Id*. at 1023.

160. 94 F. 3d 996 (1996).

161. *See* Douglas, *supra* note 131, at 1325.

162. *Texas Equal Access to Justice Found.*, 94 F.3d at 1004.

163. Douglas, *supra* note 131, at 1325.

164. *See id*.

165. 444 U.S. 164 (1979).

166. 458 U.S. 419 (1982).

167. 449 U.S. 155 (1980).

168. Some have argued that *Webb's* does not involve a "per se taking" because in *Webb's* the Court stated that the state could retain the claimants' interest to the extent the exaction constitutes a fee for services rendered. *See* Peter M. Siegel, *Interest on Lawyers' Trust Account Programs: Do They "Take" "Property" of the Client?*, 36 U. FLA. L. REV. 674, 746 (1984).

169. *See Kaiser*, 444 U.S. at 178-80.

170. *See id*. at 180.

171. *See Loretto*, 458 U.S. at 422-24.

172. *See id*. at 441.

As discussed in Part II, *Webb's* involved a Florida statute which allowed a county to take the interest accruing on an interpleader fund.[173] In *Webb's*, the plaintiff deposited nearly $2 million into the interpleader fund, from which the clerk withdrew over $9000 as his fee which was permitted by the statute.[174] The money deposited into the fund earned over $100,000 in interest that the clerk kept.[175] The Court held that there was no sufficient justification for the county to take the interest on interpleaded funds, the private property of the claimants, when the county was already receiving fees for costs related to holding the funds.[176] The Court found that the Florida statute permitted "a taking violative of the Fifth and Fourteenth Amendments."[177]

The Court in *Webb's* never stated explicitly that it was applying the per se takings rule. In fact, some argue that the per se takings rule is only applicable to the state's confiscation of real estate, not money.[178] In *Webb's*, the Court indicated that Florida may have been able to justify retaining the claimant's interest if retaining that interest was "reasonably related to the costs of using the courts."[179] Here the Court's language would indicate that it did not consider Florida's action to be a per se taking.[180]

However, the Court in *Webb's* emphasized that Florida's action amounted to a "forced contribution" to the government, unrelated to the costs of using the courts.[181] The Court also stated that Florida's action was analogous to the state's action in *United States v. Causby*[182] in which the Court found an unconstitutional taking where the government utilized air space above the claimant's land as part of a flight plan for military aircraft, thus destroying the use of the land as a chicken farm.[183] By comparing *Webb's* to *Causby*, it appears that the Court was saying Florida's confiscation of the claimants' interest proceeds should be treated like the government's appropriation of the claimant's real estate in *Causby*, which constitutes a per se taking.[184]

2. The Application of the Per Se Takings Rule to IOLTA.—Webb's is perhaps the takings case that is most closely analogous to the IOLTA program

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173. *See* Webb's Fabulous Pharm., Inc. v. Beckwith, 449 U.S. 155, 155-56 (1980).

174. *See id*. at 156-57. The plaintiffs did not object to the clerk's statutory fee. *See id*. at 158.

175. *See id*. at 158.

176. *See id*. at 163-64.

177. *Id*. at 165.

178. For example, the Takings Clause does not prevent the government from compelling people to surrender their money under the taxing power. *See* Thomas E. Baker & Robert E. Wood, Jr., *"Taking" a Constitutional Look at the State Bar of Texas Proposal to Collect Interest on Attorney-Client Trust Accounts*, 14 TEX. TECH. L. REV. 327, 350 (1983).

179. *Webb's*, 449 U.S. at 163.

180. *See* Siegel, *supra* note 168, at 746.

181. *Webb's*, 449 U.S. at 163.

182. 328 U.S. 256 (1946).

183. *See id*. at 265.

184. *See* Douglas, *supra* note 131, at 1326-27.

because both cases involve interests generated when the claimant's principal is in the hands of a state actor. Also similar to the IOLTA program, a state actor took that interest in *Webb's*. If the property interest that a claimant has in the interest generated by the IOLTA program is an economic one, like the property interest in *Webb's*, then most likely the claimant would prevail on his claim that the government action constitutes a taking. It is very difficult for the government to prevail when a per se taking is involved.

However, unlike *Webb's*, the claimant's principal without the IOLTA program would not generate any net interest on its own.[185] While the *Phillips* Court determined that the claimants did have a property right in the interest generated, their decision was based primarily on the common-law notion that "interest follows principle."[186] Without the IOLTA program existence, an interest to follow the claimants' principle would not exist.[187] No argument made contends that the IOLTA program has taken the claimants' principle. It appears that, while the claimants have a property right in the funds generated by IOLTA, this right cannot be an economic one because without IOLTA their principle deposit would not generate any interest.

The majority opinion in *Phillips* recognized that "[w]hile the interest income at issue here may have no economically realizable value to its owner, possession, control, and disposition are nonetheless valuable rights that inhere in the property."[188] If the property right a claimant has is not an economic one, but merely the rights of control and possession, then the IOLTA program should not be analyzed under the "per se" taking standard. The property interest that claimants have in the funds generated by IOLTA are intangible property rights and would not fit into the category of per se takings discussed above. As such, the IOLTA program should be considered under the *Penn Central* test, which would not result in an unconstitutional taking because there is no apparent economic impact on the client. However, if a per se taking could be established with regard to the IOLTA program, the court would need to address the issue of just compensation.

As discussed above, the courts have yet to determine the issue of whether or not the IOLTA program constitutes a taking of the claimant's property. In order to prevail in a takings claim, the claimant must be able to establish not only that the government took private property, but also that the government took the property without just compensation and that just compensation is owed to the claimant. Although unlikely, in the event that a court were to decide that the

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185. Both dissenting opinions in *Phillips* recognized and discussed this distinction between the IOTLA program and *Webb's*. *See* Phillips v. Washington Legal Found., 524 U.S. 156, 172 (Souter, J., dissenting), 179 (Breyer, J., dissenting).

186. *Id.* at 163-64.

187. This is quite unlike the facts in *Webb's* where the claimant's principle was substantial enough to earn interest on its own and where the Florida government took over $100,000 of the interest generated by the claimant's principle deposit. *See* Webb's Fabulous Pharm., Inc. v. Beckwith, 449 U.S. 155, 158 (1980).

188. *Phillips*, 524 U.S. at 170 (citing Hodel v. Irving, 481 U.S. 704, 715 (1987)).

government did take the claimant's property, the claimant would still have to address the issue of just compensation.

D. Just Compensation

In his dissenting opinion in *Phillips*, Justice Souter noted, "for as we [the Court] have repeatedly said its [the Fifth Amendment] Takings Clause does nothing to bar the government from taking property, but only from taking it without just compensation."[189] Just compensation is described by the Court as "the full monetary equivalent of the property taken."[190] To determine the amount of just compensation owed if the regulation is found to amount to a taking, the court should attempt to place a claimant "in as good a position pecuniarily as if his property had not been taken."[191]

To determine what remedy would place a claimant in a position as if the taking had not occurred, a court would "look to the claimant's putative property interest as it was or would have been enjoyed in the absence of IOLTA, and consequently would measure any required compensation by the claimant's loss, not by the government's gain."[192]

In *Loretto*, the Court found a taking where the value of the property increased as a result of the government regulation, but unlike IOLTA, that case dealt solely with a physical occupation of private property.[193] "[A]s to the just compensation requirement, the client's inability to earn net interest outside IOLTA, due to the unchallenged federal and state regulations, raises serious questions about entitlement to any compensation."[194]

To find that an unconstitutional taking has occurred, a court must find a failure to "justly compensate" the claimant. If just compensation is available to the claimant, then there is no violation of the Constitution.[195] Without the IOLTA program, there would be no net interest generated on the claimants' principle held in the attorney's trust account. Net interest is only created when

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189. *Id*. at 177 (Souter, J., dissenting). *See generally* First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304, 315 (1987); Williamson County Reg'l Planning Comm'n v. Hamilton Bank, 473 U.S. 172, 194 (1985).

190. *Phillips*, 524 U.S. at 177 (Souter, J., dissenting) (quoting United States v. Reynolds, 397 U.S. 14, 16 (1970)).

191. United States v. 564.54 Acres Land, 441 U.S. 506, 510 (1979) (quoting Olson v. U.S., 292 U.S. 246, 255 (1934)). *See generally* Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1949).

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

193. *See id*. In discussing the *Loretto* Court's decision, Justice Souter further distinguished the case from the IOLTA program by stating, "it [Loretto] rested on no finding that value had actually been enhanced, and it held nothing about the legal consequences of an actual finding that enhancement had occurred." *Id*. *See also* Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 437 n.15 (1982).

194. *Phillips*, 524 U.S. at 176-77 (Souter, J., dissenting).

195. *See* U.S. CONST. amend. V.

multiple clients' deposits are placed together in an attorney's trust account. Only then is the generated interest sufficient to overcome any administrative charges. The claimants' property interest, even if taken by the government, would not constitute an unconstitutional taking because no just compensation would be available to them.

The IOLTA program could win the takings war with two arguments. If the property interest in IOLTA is not economic, but instead involves only those interests of control and possession, then the program would be analyzed under the *Penn Central* test. As noted above, by analyzing IOLTA under that test, it is unlikely that a court would find that a taking occurred because no apparent economic impact on the claimant exists.

However, if a court determines that the property right in IOLTA is an economic one, under a per se takings analysis, a court could find that IOLTA is a taking of a recognizable property interest. Therefore, the issue becomes, what just compensation is owed to the claimants? Here, no just compensation would be due to the claimants because without the IOLTA program, a client's funds would generate no interest on their own. If no just compensation is available to the claimants, then the taking is not unconstitutional and the IOLTA program will continue to function.

In addition to violating the Takings Clause, some argue the IOLTA also violates the First Amendment right of freedom of speech. After the Supreme Court's ruling in *Phillips*, those who oppose IOLTA have even greater ammunition for their argument that the program violates the First Amendment. As such, IOLTA must survive another battle.

V. IOLTA AND THE FIRST AMENDMENT

A. General First Amendment Principles

The First Amendment of the United States Constitution states, "Congress shall make no law . . . abridging the freedom of speech, or of the press. . . ."[196] The First Amendment protects not only the right to speak but also the right not to speak.[197] The Supreme Court has held that "[t]he right to speak and the right to refrain from speaking are complementary components of the broader concept of 'individual freedom of mind.'"[198]

In some instances, plaintiffs in litigation against the IOLTA program claimed that their First Amendment rights were violated, although this issue often takes a backseat to the takings issues discussed above.[199] Plaintiffs argued that the

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196. U.S. CONST. amend. I.

197. *See* Roberts v. United States Jaycees, 468 U.S. 609, 623 (1984); *see also* Wooley v. Maynard, 430 U.S. 705 (1977).

198. *Wooley*, 430 U.S. at 714 (quoting West Virginia State Bd. of Educ. v. Barnette, 319 U.S. 624, 633 (1943)).

199. *See* Washington Legal Found. v. Massachusetts Bar, 993 F. 2d 962, 976 (1993). In *Cone v. State Bar of Florida*, 819 F.2d 1002 (11th Cir. 1987), this issue was not litigated. In

IOLTA program compels lawyers, and therefore clients, to participate in the program, thus forcing them to support lobbying and litigation for ideological and political causes.[200]

B. The First Circuit Applies First Amendment Jurisprudence to IOLTA

One of the only courts thus far to discuss the issue of whether the IOLTA program violates the First Amendment was the First Circuit in *Massachusetts Bar*.[201] The court stated that the most obvious violation of the First Amendment, when dealing with compelled speech, occurs when individuals are forced to make a direct affirmation of belief.[202] The First Circuit found that the IOLTA program "does not compel the plaintiffs to display, affirm or distribute ideologies or expression allegedly advocated by the IOLTA program or its recipient organizations."[203] Therefore, the court determined that direct compelled speech was not an issue in the case.[204] However, the court recognized that compelled financial support of an organization entering into expressive activities might also encumber First Amendment rights.[205] The Supreme Court has found that compelled financial support of organizations, such as bar associations and unions, burdens First Amendment rights when such funds are used to support political or ideological activities.[206] The *Massachusetts Bar* court stated that the following issues were dispositive in addressing the plaintiffs' First Amendment claims:

> [1)] whether the IOLTA Rule burdens protected speech by forcing expression through compelled support of organizations espousing ideologies or engaging in political activities. [2)] If so, we will strictly

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Washington Legal Foundation v. Texas Equal Access to Justice Foundation, 94 F.3d 996, 1004 (1996), *rev'd sub nom*, *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998), the Fifth Circuit remanded the First Amendment issue to the District Court, but the Supreme Court did not mention the First Amendment issue in its opinion.

200. *See Massachusetts Bar*, 993 F. 2d at 976.

201. *See id*.

202. *See id.* at 977; *see also Barnette*, 319 U.S. at 633 ("[T]he compulsory flag salute and pledge requires affirmation of a belief and an attitude of mind. . . .").

203. *Massachusetts Bar*, 993 F.2d at 977.

204. *See id*.

205. *See id*.

206. *See id.*; *see also* Lehnert v. Ferris Faculty Ass'n, 500 U.S. 507 (1991) (sanctioning union expenditures of dues on expenses not expressly authorized by statute and for national affiliate activities that benefitted local union members); Keller v. State Bar of Cal., 496 U.S. 1 (1990) (finding that the use of compulsory bar membership dues to finance political activities, such as lobbying governmental agencies, with which members disagreed, violated First Amendment Rights.). *But see* Board of Regents of Univ. of Wisc. v. Southworth, 120 S. Ct. 1346 (2000) (holding that the First Amendment permits a public university to charge its students an activity fee used to fund extracurricular student speech and finding that an optional or refund system is not a constitutional requirement).

> scrutinize the IOLTA program to determine whether the IOLTA Rule serves compelling state interests through means which are narrowly tailored and germane to state interests.[207]

The court found that the IOLTA program was compulsory as to both attorneys and clients.[208] The Massachusetts IOLTA Rule, a mandatory program, obligates lawyers to deposit client funds that meet certain specifications into IOLTA accounts.[209] The plaintiff's attorneys claimed that avoiding the IOLTA Rule would significantly limit their practice of law and have a negative affect upon their livelihood.[210] The court accepted these allegations as true and agreed that an attorney's practice of law would be limited if they refused to represent client's whose funds would be mandatorily placed in IOLTA accounts.[211] As to the client-plaintiffs, the court stated, "[a]lthough the IOLTA Rule does not directly regulate clients, its effect is compulsory because lawyers generally deposit appropriate funds from clients into IOLTA accounts without the knowledge or consent of their clients."[212]

While that issue was resolved in favor of the plaintiffs, the court found that the IOLTA program did not compel speech by the plaintiffs.[213] The plaintiffs argued that they were required to finance the IOLTA program's recipient organizations in the same manner that bar association and union members have been compelled to support political and ideological activities through fees and dues, which the Supreme Court has found unconstitutional.[214] The First Circuit found this argument unpersuasive because, unlike the cases relied upon by the plaintiffs, it could not find a significant connection between these plaintiffs and the IOLTA program such that it was reasonably understood that the plaintiffs are supporting a message promulgated by organizations receiving funds from IOLTA.[215] To affect First Amendment rights, this nexus must be present.[216] The court found that the plaintiffs "have not been compelled by the IOLTA Rule to join, affirm, support, or subsidize ideological expression of IOLTA recipient

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207. *Massachusetts Bar*, 933 F.2d at 977.

208. *See id*. at 978.

209. *See id*. For a discussion of mandatory, opt-out, and voluntary programs and the types of client funds that may be placed in IOLTA accounts, see *supra* Part I.

210. *See Massachusetts Bar*, 933 F.2d at 977.

211. *See id*.

212. *Id*.

213. *See id*. at 980.

214. *See id*. at 978-79; *see also* Keller v. State Bar of Cal., 496 U.S. 1, 14 (1990); Abood v. Detroit Bd. of Educ., 431 U.S. 209, 222 (1977) (Non-union teachers were compelled to pay a service charge to the union that negotiated their collective bargaining agreement. The teachers claimed that their service charge was used to express political opinions and support candidates that they did not support. The Court held that this was compelled speech and violated the First Amendment.)

215. *See Massachusetts Bar*, 993 F.2d at 979.

216. *See id*.

organizations in any way."[217] After resolving this issue, the court did not consider it necessary to determine whether the IOLTA program serves a compelling state interest.[218]

C. Analyzing IOLTA as a Possible Violation of the First Amendment After Phillips

1. The Connection Between Claimants and the Recipient Organizations.— Even the *Massachusetts Bar* court agreed that clients subject to a mandatory IOTLA program are compelled to support IOLTA and its recipient organizations.[219] Once the court makes this determination, the issue then becomes whether the "connection" between clients and the recipient organizations that IOLTA supports is such that clients "reasonably understand that they are supporting the message propagated by the recipient organizations."[220] IOLTA does not engage in any political or ideological activities, but simply funds organizations, that, at times, support litigation associated with political or ideological causes.[221]

In *Carrol v. Blinken*,[222] university students disagreed with a university policy that forced them to pay mandatory student association fees. The students opposed paying the dues because the association made contributions to an interest group whose political activities the students found objectionable.[223] The defendants argued that the connection between the students and the interest group was too attenuated because the student fee supported over 100 groups and was paid by thousands of students in some of its brochures.[224] However, the Second Circuit did not agree with this argument because the interest group in question stated in some brochures that it represented all fee paying students.[225] Also, the court felt that outsiders could feasiblely link the students with "at least some causes pursued by student organizations, especially when those causes are furthered off campus."[226] The court concluded that a tight relationship between the plaintiffs and the financial beneficiary was not required.[227]

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217. *Id*. at 980. The court based part of its conclusion on its finding that the plaintiffs did not have a property interest in the funds generated by IOLTA. *See id*. Since the Supreme Court's holding in *Phillips*, this assumption is no longer correct. The fact that the claimants now have a recognized property interest will be addressed as to the First Amendment claims, *infra*.

218. *See id*.

219. *See id*. at 978.

220. *Id*. at 979.

221. *See supra* notes 38-39, 41 and accompanying text.

222. 957 F.2d 991 (2d Cir. 1992).

223. *See id*. at 993-94.

224. *See id*. at 998.

225. *See id*.

226. *Id*.

227. *See id*. at 998-99.

In *Keller v. State Bar of California*,[228] attorneys had to pay membership dues to the state bar as a condition of practicing law in California.[229] The bar used these dues for self-regulatory functions, but also to lobby the legislature and other government agencies, file amicus curiae briefs in pending cases, and fund other activities to which the plaintiffs objected.[230] The Court held that the State Bar's use of compulsory fees to finance political and ideological activities violated the plaintiffs First Amendment rights when such fees were not used for the purpose of regulating the legal profession or improving the quality of legal services.[231]

In *Hays County Guardian v. Supple*,[232] a case similar to *Carrol*, students had to pay fees that essentially conscripted the students into membership with a public interest group that the some students found offensive.[233] Unlike *Carrol*, the court rejected the students' First Amendment claims. The Fifth Circuit found that the association's fees were justified because they enhanced the overall exchange of information, ideas, and opinions on the campuses.[234]

The IOLTA program is distinguishable from cases where plaintiffs claim that compelled payment of mandatory dues to fund groups that support ideological or political causes violates their First Amendment Rights. Neither clients nor attorneys are forced to join IOTLA recipient organizations. While the courts may not require a "tight connection" between those objecting to the fee and the organization being funded,[235] the connection between those funding IOLTA, clients, and IOLTA recipient organizations is tenuous. There is no direct connection between attorneys or clients and IOLTA recipient organizations because the agency that distributes IOLTA funds is an intermediary between those two groups.

In comparing the IOLTA program to the facts in *Carrol* and *Keller*, significant differences exist. In *Carrol*, the organization supporting objectionable political causes specified in their materials that they represented all of the students who paid fees.[236] In *Keller*, there is an obvious connection between state bar activities and the attorneys supporting those activities with mandatory dues.[237] However, with IOLTA, a client probably could not determine whether the interest generated from his principle deposit went to an objectionable recipient organization. Numerous organizations receive IOLTA funds. Furthermore, it may not be clear that IOLTA funds have been used to support objectionable organizations.

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228. 496 U.S. 1 (1990).
229. *See id*. at 5.
230. *See id*.
231. *See id*. at 16.
232. 969 F.2d 111 (5th Cir. 1992).
233. *See id*. at 123.
234. *See id*.
235. Carrol v. Blinken, 957 F.2d 991, 998 (2d Cir. 1992).
236. *See id*. at 994.
237. *See* Keller v. State Bar of Cal., 496 U.S. 1, 5 (1990).

It is difficult to draw a reasonable connection between clients and recipient organizations to show that the client, through his compelled support, is actually endorsing the message promulgated by the recipient organization because no direct link exists. However, if a court finds a sufficient connection between clients and the recipient organizations, the court would then apply the test of strict scrutiny to determine if the IOTLA program serves a compelling state interest.[238]

2. Applying the Strict Scrutiny Test to IOLTA.—The Supreme Court has developed a balancing test to determine whether a First Amendment right is burdened by governmental action.[239] This test provides that a court make an inquiry as to whether the regulation in question serves a compelling state interest through means which are narrowly tailored to that state interest.[240]

IOLTA's goal is to provide legal aid to impoverished citizens, thus giving them access to the legal system that they otherwise could not afford.[241] IOLTA's opponents argue that "[t]he program burdens the First Amendment rights of citizens, who have no responsibility for the increased needs of legal services and who obtain no help from the IOLTA program."[242] Whether or not providing legal aid is a compelling state interest, the IOLTA program arguably may not qualify as "narrowly tailored" to meet that objective.

IOLTA's objectives can be achieved through less restrictive means.[243] Mandatory IOTLA programs are only one category of IOTLA programs that are functioning in the United States today.[244] The other two categories of IOLTA programs, opt-out and voluntary, would not burden the First Amendment rights of attorneys or clients because they would not be compelled by a state actor to support the program.[245] "Although mandatory IOLTA accounts earn more than both voluntary and 'opt-out' programs, the additional money which may be earned does not excuse the serious impingements on attorneys' First Amendment rights."[246]

Although unlikely, if a court found a reasonable connection between claimants and the IOLTA recipient organizations, the IOLTA program would most likely not survive the strict scrutiny test, as most regulations do not. However, if a court found that no such connection exists, the mandatory IOLTA programs would not violate the First Amendment of the Constitution even though the program implicates compelled speech.

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238. *See* Washington Legal Found. v. Massachusetts Bar, 993 F.2d 962, 976 (1993).

239. *See* Roberts v. United States Jaycees, 468 U.S. 609 (1984).

240. *See id*. at 623.

241. *See supra* notes 17-20 and accompanying text.

242. Terence E. Doherty, *The Constitutionality of IOLTA Accounts*, 19 WHITTIER L. REV. 487, 527 (1998).

243. *See id*.

244. *See supra* notes 17-20 and accompanying text.

245. *See* Sackmary, *supra* note 18, at 210.

246. *Id*.

D. The District Court's Decision in Washington Legal Foundation v. Texas Equal Access to Justice Foundation

Although neither the Fifth Circuit Court of Appeals nor the United States Supreme Court directly addressed the First Amendment challenge to IOLTA, on remand from the *Phillips* decision, the District Court for the Western District revisited the issue in its opinion in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*.[247] The district court found that the IOLTA program does not violate the First Amendment.[248] The plaintiff argued that the IOLTA program compelled him to speak in violation of the First Amendment. To establish this claim, a plaintiff has to show that he would be identified with a message he finds objectionable.[249] The court found that no specific message was dictated by the variety of legal services that are funded by the IOLTA program and the plaintiff failed to establish that he was being identified with expressive activities to which he objects.[250]

The plaintiff also argued that his First Amendment rights were violated because IOLTA compels him to financially support private organizations to which he objects.[251] A claim of compelled contribution requires the plaintiff to show that 1) there was an involuntary contribution; 2) the message supported by the involuntary contribution must be political or ideological; and 3) even when the message supported by the involuntary contribution is political or ideological, no First Amendment violation exists if the message supports the government's policy interests.[252]

The district court made an assumption that the plaintiff was required to involuntarily contribute to the IOLTA program.[253] The court stated that the concept of helping to ensure the availability of legal services to low income citizens is a non-controversial idea that does not qualify as a political or ideological activity. However, the use of IOLTA proceeds "in funding certain litigation could be ascribed certain political or ideological components and therefore potentially qualify as an expressive activity . . . ."[254]

Although the plaintiff met the first two requirements to establish a claim of compelled financial contribution, the court held that his First Amendment claims failed under this theory because the IOLTA program supports a core government function by providing access to the Texas justice system.[255] The court found that

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247. Washington Legal Found. v. Texas Equal Access to Justice Found., 86 F. Supp.2d 624 (W.D. Tex. 2000).

248. *See id.* at 636.

249. *See id*. at 633; *see also* Prune Yard Shopping Ctr. v. Robins, 447 U.S. 74, 87-88 (1980).

250. *See id.* at 633-34.

251. *See id.* at 634.

252. *See id.*; *see also* Abood v. Detroit Bd. of Educ., 431 U.S. 209 (1977); Keller v. State Bar of California, 496 U.S. 1 (1990).

253. *See Texas Equal Access to Justice Found.*, 86 F. Supp.2d at 635.

254. *Id.*

255. *See id.* at 635-36.

the sole purpose of the IOLTA program is to fund legal services for the poor, a core government interest, and therefore, the plaintiff's claim of compelled financial contribution failed.[256]

CONCLUSION

Proponents of mandatory IOLTA lost an important battle for the first time when the Supreme Court determined in *Phillips* that clients do have a property interest in the funds generated by the IOLTA programs.[257] While this decision dealt a blow to the IOLTA program, the program still has battles to fight, and should in the end, become the ultimate victor.

The prominent issue in litigation surrounding the IOLTA program is the idea that IOLTA violates the Takings Clause of the Fifth Amendment of the Constitution. The most important inquiry here is whether to apply to the program the standards developed in *Penn Central* or the per se takings rule. If the *Penn Central* test is applied to the IOLTA program, many agree that IOLTA would survive and would not be found to violate the Takings Clause because there is no apparent economic impact on the claimant. If the IOLTA program is examined under the per se takings rule, the question becomes more difficult to answer.

However, IOLTA would most likely not be scrutinized under the per se takings test. As the Supreme Court suggested in *Phillips*, the property rights that a client has in the interest generated by the IOLTA program might not be economic ones. Per se takings cannot involve the intangible property rights of control and possession that the Court suggested the clients might have. Also, in his dissent, Justice Souter mainly focused on applying IOLTA to the *Penn Central* test. Finally, a taking is not unconstitutional unless just compensation is unavailable to the claimant.2 Here, just compensation would not be available to the client because without the IOLTA program, the client's principle would earn no interest; therefore, there could be no taking of the client's property interest.

The secondary issue in IOLTA litigation revolves around First Amendment Rights. The First Circuit dismissed this issue in *Massachusetts Bar*. That court found that the IOLTA program did involve compelled speech, but the First Amendment was not violated because no reasonable connection existed between the plaintiffs and the recipient IOLTA organizations. The First Circuit's analysis of the issue is convincing; however, if a court were to find that there was a sufficient connection between the plaintiffs and the recipient organizations, the mandatory IOLTA program would likely fail the strict scrutiny standard in determining whether IOLTA serves a compelling state interest. The IOLTA program would fail because IOLTA may not qualify as "narrowly tailored" to serve a compelling state interest. Unfortunately, it might be possible, although hopefully unlikely, for a court to find mandatory IOLTA programs unconstitutional yet, mandatory programs are only one type of IOLTA program.

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256. *See id.* at 636.

257. Phillips v. Washington Legal Found., 524 U.S. 156, 160 (1998).

There are less restrictive means, such as enacting "opt-out" or voluntary programs, which would not violate the First Amendment because in these types of IOLTA programs there is no compelled speech.

The IOLTA program won another battle when on remand from the United States Supreme Court's decision in *Phillips*, the District Court for the Western District of Texas held that the IOLTA program does not violate either the Fifth Amendment Takings Clause or the First Amendment. The court found that the IOLTA program does not violate the Takings Clause because the client did not suffer a compensable loss and there is no apparent economic impact to the client. Also, IOLTA did not violate the First Amendment because the client could not prove that he was being identified with expressive activities to which he objected. Finally, although the client was financially compelled to support private organizations to which he objected, there was no First Amendment violation because the IOLTA program supports a core governmental function.

Courts should not find that the IOLTA program violates the Constitution. If IOLTA loses this war, the real loser will not be the program, but those people who are unable to afford legal counsel. If states lose this money, they will have to tighten the budgets for their legal aid programs and will not be able to reach as many people in need. The mandatory IOLTA programs in this country make it possible for many people to get the legal help that they need. While voluntary and "opt-out" IOLTA programs also generate a significant amount of funds for legal aid, they do not come close to the amount of funding that mandatory IOLTAs provide.

Realistically, the client loses nothing in the IOLTA program. If this program were not in place, his principle deposit would make no interest. Even with the IOLTA program, the client's deposit earns a minuscule amount of interest that only adds up to a significant when interest generated from all client funds is pooled together. With the program, the client receives nothing; without the program, he receives nothing. If mandatory IOLTA programs were found unconstitutional, those unable to afford legal counsel in this country would suffer a devastating setback.