Found Money: IOLTA, *Brown v. Legal Foundation of Washington*, and the Taking of Property without the Payment of Compensation

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Introduction

When James Madison drafted the Fifth Amendment, he included the "takings" clause, which provides that "private property [shall not] be taken for public use, without just compensation." Madison included this provision because he believed that property rights are a part of human rights. In an essay published after the states ratified the Bill of Rights, Madison explained:

> If there be a government then which prides itself in maintaining the inviolability of property; which provides that none shall be taken directly even for public use without indemnification to the owner, and yet directly violates the property which individuals have in their opinions, their religion, their persons, and their faculties; nay more, which indirectly violates their property, in their actual possessions, in the labor that acquires their daily subsistence, and in the hallowed remnant of time which ought to relieve their fatigues . . . such a government is not a pattern for the United States.[1]

Nearly two centuries later, Justice Stewart, speaking for the Court, echoed this theme, citing John Locke and Blackstone, two intellectual ancestors of Madison:

> [T]he dichotomy between personal liberties and property rights is a false one. Property does not have rights. People

[1] *Property*, Nat'l Gazette, Mar. 27, 1792, reprinted in 14 JAMES MADISON, THE PAPERS OF JAMES MADISON 266 (1983), quoted in Douglas W. Kmiec, *The Jurisprudence of Takings: The Original Understanding of the Taking Clause Is Neither Weak nor Obtuse*, COLUM. L. REV. 1630, 1661, n. 161 (1988).

> have rights. The right to enjoy property without unlawful deprivation, no less than the right to speak or the right to travel, is in truth a ''personal'' right, whether the ''property'' in question be a welfare check, a home, or a savings account. In fact, a fundamental interdependence exists between the personal right to liberty and the personal right in property. Neither could have meaning without the other.[2]

Initially, the takings clause applied only to the federal government. But, because a person's right to property is fundamental, the Court held that this clause applies to the states as well.[3]

The framers wanted limits on the power of government to use the people's money, and the takings clause is one of those limits. It provides a check on the government: the clause gives government the power to take a person's property, *if* the government (a) takes it for ''public use,'' and (b) pays ''just compensation.'' For example, if the government wants to build a road through my house, it can take my property, but first it must pay the fair market price for the land that it requires.[4] The purpose of the takings clause is ''to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.''[5] Thus, if the government wants the road badly enough so that it is willing to pay the market price for my land, the takings clause poses no roadblock.[6]

[2] Lynch v. Household Finance Corp., 405 U.S. 538, 552 (1972), citing, *inter alia*, JOHN LOCKE, OF CIVIL GOVERNMENT 82–85 (1924); JOHN ADAMS, A DEFENCE OF THE CONSTITUTIONS OF GOVERNMENT OF THE UNITED STATES OF AMERICA, in F. COKER, DEMOCRACY, LIBERTY, AND PROPERTY 121–32 (1942); and 1 WILLIAM BLACKSTONE, COMMENTARIES, *138–140.

[3] Chicago, B. & Q.R. Co. v. City of Chicago, 166 U.S. 226 (1897) (a state court judgment, although authorized by statute, that takes private property for public use without compensation, lacks due process of law. When the state court affirms such a judgment, it denies a right secured by the federal constitution).

[4] Roger Pilon, *Freedom, Responsibility, and the Constitution: On Recovering Our Founding Principles*, 68 NOTRE DAME L. REV. 507, 542–43 (1993).

[5] Armstrong v. United States, 364 U.S. 40, 49 (1960). *See also* Steven J. Eagle, *The Development of Property Rights in America and the Property Rights Movement*, 1 GEORGETOWN J. OF L. & PUBLIC POLICY 77 (2002).

[6] Ronald D. Rotunda, *The Impairments Clause and the Corporation*, 55 BROOKLYN L. REV. 809 (1989).

How is the government to determine what it must pay for the property it has taken? The Supreme Court tackled this takings issue in *Brown v. Legal Foundation of Washington.*[7] The issue in *Brown*[8] is, ultimately, this takings issue. The Court had to decide what the government owed, that is, what it had to pay, for property that the Washington State Supreme Court had taken. It is important to understand that all nine justices conceded that property had been "taken," but the five-person majority, surprisingly, found that the state government had to pay nothing for this property, although it was worth millions of dollars to the government.

Brown is a relatively short opinion that is much more complex than it first appears.[9] It is written so that lower courts could read it very narrowly, substantially limiting its applicability and growth. Granted, lower courts may ignore the caveats written throughout this opinion and simply see it as a green light for state courts and legislatures to "take," without compensation, the interest that grows out of the principal. But, the Court gives us many reasons why this case should be read narrowly, with the majority conceding that the government cannot take the principal (which belongs to the owners of that principal) unless it pays just compensation, and cannot even take the interest, except under the peculiar facts of this case.

The Court upheld the constitutionality of what is called "Interest on Lawyers' Trust Accounts" (IOLTA). The state court of Washington, by court rule, took the interest from these trust fund accounts. All nine justices agreed that what the state court had ordered was a "taking" of property. As Justice Stevens, for the Court, bluntly acknowledged, quoting an earlier decision, "the interest earned in the IOLTA accounts 'is the private property of the owner of the principal.' "[10] But then, five members concluded that the value of the money was worth zero to the owners of the principal out of which

[7] 123 S.Ct. 1406 (2003).

[8] 123 S.Ct. 1406 (2003).

[9] It could have been even more complex. Originally, the name of the case was "Washington Legal Foundation v. Legal Foundation of Washington," but a procedural ruling changed the name of the petitioner. *See* 123 S.Ct. at 1415 and n. 4. *See also* Brief of Petitioner, in Washington Legal Foundation v. Legal Foundation of Washington, 2002 WL 1974400 (Appellate Brief), (U.S. Pet. Brief Aug 22, 2002) (NO. 01-1325).

[10] Brown v. Legal Foundation of Washington, 123 S.Ct. 1406, 1419 (2003).

the interest grew, so, the majority concluded, the compensation that the state owed these people was also ''zero.''

Yet the Washington State Court and other IOLTA jurisdictions did not collect zero from IOLTA accounts. Washington IOLTA accounts generate between $2.5 and $4.0 million per year.[11] In the year 2000 alone, IOLTA programs throughout the United States generated more than $148 million through interest on nominal or short-term client funds.[12] By 2001, the figure had grown to more than $200 million.[13] The states treated this money as free money or found money, something akin to money you might find on the street corner: it just comes, like manna from heaven; one does not have to earn it. In this case, the state court collects this money without the necessity of imposing a tax, which is the normal way that the government ''earns'' money. The state court, in its view, created something out of nothing, a feat unrivaled since Genesis.

Before we turn to the decision, we must discuss the complicated historical and legal background.

The Historical Road Leading to IOLTA

IOLTA accounts are a relatively recent phenomenon made possible by a series of changes in trust law and tax law provisions.

As a matter of trust law, the general rule has long been that lawyers, who are fiduciaries of their clients, must not mix up, blend, or ''commingle'' their funds with their clients' funds.[14] Sometimes a client will have the lawyer hold a great deal of money in trust, and the lawyer will put that money in a trust fund established in that client's name. It is not necessary, however, that the lawyers establish a separate named trust account for each client. Lawyers typically combine small accounts from each client when the amounts from each client are small. These funds are usually held for only a

[11] Brief of Petitioners, Washington Legal Foundation v. Legal Foundation of Washington, 2002 WL 1974400 (Appellate Brief), (U.S. Pet. Brief, Aug 22, 2002)(NO. 01-1325), at 4.

[12] AMERICAN BAR ASSOCIATION, COMMISSION ON INTEREST ON LAWYERS' TRUST ACCOUNTS, IOLTA HANDBOOK 5 (2001).

[13] AMERICAN BAR ASSOCIATION, COMMISSION ON INTEREST ON LAWYERS' TRUST ACCOUNTS, IOLTA HANDBOOK 98, 208 (2002 update).

[14] *See* RONALD D. ROTUNDA, LEGAL ETHICS: THE LAWYER'S DESKBOOK ON PROFESSIONAL RESPONSIBILITY §16-1 (ABA-West Group, 2nd ed. 2002).

short time, and the amount only becomes substantial when all of the clients' deposits are aggregated.

Although the funds of each client are normally mingled together with the funds of other clients, there are records to detail what is each client's share of the pooled trust account.[15] In addition, these trust funds may not be commingled with the lawyer's personal funds.[16]

When lawyers establish trust funds for their clients, they traditionally place those funds in noninterest bearing accounts. First, the law governing lawyers' trust fund accounts forbids commingling and requires safekeeping and accounting; customarily, it does not require investing. IOLTA, as discussed below, requires that the funds be invested. In some unusual circumstances, trust law might require that funds be invested, but this rule does not apply when the trustee is merely under a duty to safeguard money, not to invest it.[17] Many lawyers' trust fund accounts fall in that category. In addition, before the advent of computers, it was administratively difficult to calculate how much interest should be assigned to a particular client when the funds were held for a short time and combined with the funds of other clients.

And then there was federal law. Until 1980, federal law did not allow federally insured banks to pay interest on checking accounts. If a lawyer held a large sum in trust for his client, he normally would place these funds in an interest-bearing savings account because the interest generated outweighed the inconvenience of not having the lack of immediate access to the fund via check-writing capabilities. But if the client's funds were small or only held for a short time,

[15] ABA Model Rule 1.15, Comment 1, advises that monies of clients or third persons should be kept "in one or more trust accounts. Separate trust accounts may be warranted when administering estate monies or acting in similar fiduciary capacities." The ABA Model Rules of Professional Conduct are not law but are "model" rules. The ABA urges state courts to adopt them as law governing the lawyers within the jurisdiction and most state courts have done that. *See* RONALD D. ROTUNDA, LEGAL ETHICS: THE LAWYER'S DESKBOOK ON PROFESSIONAL RESPONSIBILITY § 1.5.5.4 (ABA-West Group, 2nd ed. 2002).

[16] *See, e.g.,* Cincinnati Bar Association v. Stidham, 87 Ohio St.3d 455, 721 N.E.2d 977 (2000) (two year suspension on lawyer who, *inter alia*, delayed filing a matter for over a year, collected fees in probate matters before getting court permission, and wrote personal checks against his IOLTA account).

[17] 2 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS, §§ 180.3, 181 (3d ed. 1967).

the lawyer would pool this money with funds from other clients and put them in a single federally insured trust checking account, due to administrative convenience and ready access to the funds by check. Federal law prohibited federally insured banks and savings and loans from paying interest on these checking accounts.[18]

When Congress finally changed the law in 1980, it relaxed this prohibition on interest but did not eliminate it. Congress authorized federally insured banks to pay interest on a limited category of demand deposits referred to as negotiable order of withdrawal accounts or ''NOW accounts.''[19] The regulation governing NOW accounts allows the banks to pay interest on ''deposits made by individuals and charitable organizations, but does not include those made by for-profit corporations or partnerships unless the deposits are made pursuant to a program under which charitable organizations have 'the exclusive right to the interest.'''[20] So, if lawyers pooled their clients' money held for safekeeping into one account, that account could be accessed by checking, and also earn interest as long as charitable programs have the exclusive right to the interest. Yet, the ethical rules governing lawyers required (until the advent of IOLTA) that any interest earned be given to the client under the age-old doctrine that interest on principal belongs to the owner of the principal.

If trust funds are placed in interest-bearing accounts, then, under standard trust rules, any interest would have to be credited to each client.[21] Under normal trust rules, the interest generated from the funds becomes the property of the client, not of the lawyer, because the client owns the principal from which the interest accrues. The general rule is that interest follows the principal. Consequently, the legal ethics rules provided that the lawyer could not use the interest earned on client funds to defray the lawyer's own operating expenses (such as bank handling fees, accounting costs, recordkeeping and

[18] *See* 12 U.S.C. §§ 371a, 1464(b)(1)(B), 1828(g).

[19] 12 U.S.C. § 1832, 87 Stat. 342.

[20] *Legal Foundation*, 123 S.Ct. at 1411 and n. 1, quoting Donald Middlebrooks, *The Interest on Trust Accounts Program: Mechanics of Its Operation*, 56 FLA. B.J. 115, 117 (1982) (Letter from Federal Reserve Board General Counsel Michael Bradfield to Donald Middlebrooks, Oct. 15, 1981).

[21] ABA Formal Opinion 348 (July 23, 1982).

notification expenses) unless the lawyer had ''the specific and informed consent of the client.''[22]

The response of the states was to change the law governing lawyers. The federal law governing NOW accounts changed in 1980. A year later, Florida became the first state to create an IOLTA program.[23] The Washington State Court created its IOLTA program by court order in 1984.[24] Now, every state in the union, plus the District of Colombia, has an IOLTA program. These programs, at a minimum, require lawyers to create accounts that earn interest and to give that interest to the charity that the state court stipulates. Many programs, like Washington State, are mandatory: the lawyer must deposit certain funds in IOLTA accounts.

In 1980, when Congress allowed interest to be paid on demand deposits for NOW accounts, it still prohibited for-profit corporations and partnerships from earning interest on demand deposits.[25] The Federal Reserve Board, however, later ruled that such funds could be held in NOW accounts *if* the funds were held in trust pursuant to which charitable organizations had the ''exclusive right to the interest.''[26] Further, the Internal Revenue Service ruled that it would not attribute the interest earned from such accounts to the income of the individual clients if they had no control over the decision to place the funds in the IOLTA account and did not designate who would receive the interest generated by the account.[27] A leading ABA Formal Opinion also approved IOLTA programs as permissible under the rules of ethics.[28]

[22] ABA Formal Opinion 348 (July 23, 1982). This principle is not new. ABA Informal Opinion 545 (1962) (lawyer may not keep interest earned on trust account even though it was ''quite difficult to allocate'' interest to particular clients, unless clients specifically authorize this action); ABA Informal Opinion 991 (1967) (law firm may not use interest earned on savings account to defray expenses of handling agency account unless clients specifically consent).

[23] The IOLTA concept originated in several Canadian provinces and British Commonwealth countries, THOMAS D. MORGAN & RONALD D. ROTUNDA, PROBLEMS AND MATERIALS ON PROFESSIONAL RESPONSIBILITY 574 (Foundation Press, 8th ed. 2003).

[24] The rule may be found at 101 Wn.2d 1242 (1984).

[25] 12 U.S.C.A. § 1832.

[26] *See* Donald Middlebrooks, *The Interest on Trust Accounts Program: Mechanics of Its Operations*, 56 FLA. BAR J. 115, 117 (Feb. 1982).

[27] *See* Revenue Ruling 81-209, 1981-2 Cum. Bull. 16; Revenue Ruling 87-2, 1987-1 Cum. Bull. 18.

[28] ABA Formal Opinion 348 (July 23, 1982).

Armed with this change in the law, bar associations and courts sought to capture this interest from the banks, and to use the money to fund various public service projects, such as legal services programs and similar pro bono activities. The shorthand word for all these programs is often called IOLTA.

The Legal Road Leading to IOLTA

The law governing the taking of property is complex, but one only need to understand three important points to comprehend *Brown.*

The first important point is that the government must pay for property that it takes by physical possession. But the Supreme Court has strayed from this principle and given the government a great deal of leeway in regulating property if it does not occupy the property. Zoning rules that limit the height of buildings are a typical example. In these cases, the Court does not require compensation unless the regulation is unusually excessive. For constitutional purposes, taking by regulation is different than taking by physical possession.

For example, *Penn Central Transportation Co. v. New York*[29] upheld state law that authorized the Landmark Preservation Commission to designate certain property as a ''landmark.'' If such designation was upheld after judicial review, the landmark was subject to various restrictions, such as requiring that any proposed alterations to the building's external appearance have the prior approval of the commission. Penn Central claimed that the commission's refusal to allow it to build a multistory office building above the Grand Central Terminal was an unconstitutional ''taking.'' Justice Brennan, for the divided Court, held that there was no taking, and said that a ''taking'' is more readily found ''when the interference with property can be characterized as a physical invasion by government, than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good.''[30]

If there is, instead of a regulation, a physical intrusion, even a minor one, the normal rule is for the Court to find a ''taking'' and require compensation. Consider *Loretto v. Teleprompter Manhattan CATV Corp*.[31] Justice Thurgood Marshall, speaking for the Court,

[29] 438 U.S. 104 (1978).

[30] 438 U.S. at 124 (internal citation omitted).

[31] 458 U.S. 419 (1982).

described the issue as whether "a minor but permanent physical occupation of an owner's property authorized by government" is a "taking" of property for which just compensation is due."[32] New York law provides that a landlord must permit a cable television company to install its cable facilities on his property. In this case, the cable was about one-half inch in diameter, and its installation occupied a small portion of the appellant's roof and the side of her building. In addition, the cable and boxes in that case occupied only about one-eighth of a cubic foot of space on the roof of the appellant's Manhattan apartment building. The intrusion was minor and on the outside of the building. Nonetheless, Justice Marshall found a taking. This holding is part of a long judicial tradition. Thus, *Butler v. Frontier Telephone Co.*[33] held that an ejectment action would lie if a telephone wire was strung across the plaintiff's property without touching the soil.

Second, it is important to realize that the Court has held, as a constitutional matter, that interest is property that belongs to whoever owns the principal to which the interest has attached. The leading case is *Webb's Fabulous Pharmacies, Inc. v. Beckwith*,[34] where the Court found a taking of property when a Florida county took the interest earned on an interpleader fund while the fund was temporarily held by the county court. The value of the property taken was the interest that the county took.[35] Justice Blackmun, for the Court, ruled that neither the Florida Legislature by statute, nor the Florida courts by judicial decree, could accomplish this result by characterizing or deeming the principal of the deposited fund as "public money." The Court also rejected the argument that "the statute takes only what it creates."[36] Justice Blackmun, after citing

[32] 458 U.S. at 421.

[33] 186 N.Y. 486, 79 N.E. 716 (1906).

[34] 449 U.S. 155, 159 (1980) citing Chicago, Burlington & Quincy R.R. Co. v. Chicago, 166 U.S. 226 (1897).

[35] The general rule is that, when the government takes physical possession of money or property that otherwise would accrue to the benefit of a private person, the private person's claim for just compensation is established unless the government can demonstrate that its action in fact constituted only a regulation of the property use, or payment of an amount lawfully owed to the government. Because a state statute authorized a separate clerk's fee for services rendered, the taking of the interest could not be justified as payment of an obligation to the government.

[36] 449 U.S. at 158.

a long series of both state and federal court opinions, said, for a unanimous Court: ''The usual and general rule is that any interest on an interpleaded and deposited fund follows the principal and is to be allocated to those who are ultimately to be the owners of that principal.''[37]

Finally, it is important to understand that five years before it decided *Brown*, the Court issued its opinion in *Phillips v. Washington Legal Foundation*.[38] *Phillips* was the first Supreme Court case to ask whether state IOLTA plans constitute an unconstitutional taking of client funds. Under the Texas IOLTA program at issue in that case, an attorney who received client funds was required to deposit them in a separate, interest-bearing, account if he or she determined that the funds ''could not reasonably be expected to earn interest for the client'' or the interest that might be earned ''is not likely to be sufficient to offset the cost of establishing and maintaining the account, service charges, accounting costs and tax reporting costs which would be incurred in attempting to obtain the interest.''

The respondents in *Phillips* alleged that the Texas IOLTA program constituted a ''taking'' under the Fifth Amendment. The Court said that the question before it was narrow. The Court assumed that a lawyer was required to put funds into an IOLTA account only if the interest generated on the funds would be insufficient to offset bank service charges and accounting for the interest. The issue was whether the interest was nevertheless ''property'' of the lawyer or client so that the takings clause could apply. The Court held that the interest on client funds held in IOLTA accounts is property of the client for purposes of the takings clause of the Fifth Amendment.

Chief Justice Rehnquist, for the Court (5 to 4), adhered to the ''interest follows principal'' rule[39] and held that the interest on a client's funds in a lawyer's hands is ''property'' of the client even if bank charges would mean the client could never spend it. For example, the Court said, rental income would be the property of the owner of a building even if collecting the rent cost more than

[37] 449 U.S. at 162.

[38] 524 U.S. 156 (1998).

[39] This common law rule dates back hundreds of years. *See, e.g.,* Beckford v. Tobin, 1 Ves. Sen. 308, 310, 27 Eng. Rep. 1049, 1051 (Ch. 1749): ''[I]nterest shall follow the principal, as the shadow the body.''

the tenant had paid. The Court concluded that there is no traditional property law principal that allows the owners of funds temporarily deposited in an attorney's trust account to be deprived of the interest the funds generate.[40]

Although the decision in *Phillips* is narrow,[41] it raised significant constitutional doubt about the ultimate viability of IOLTA plans.

Then came *Brown*.

The Legal Road Leading to IOLTA

Brown v. Legal Foundation of Washington,[42] like ancient Gaul, may be divided into three parts.

In the first part, all nine justices agree that what the Washington State Court did was equivalent to a physical taking of the property rather than a regulatory taking in which the rules governing when compensation is due tend to be ad hoc.

On one level, this conclusion is unremarkable because the principal earned interest and the state took the interest. This is as much a physical intrusion as in *Teleprompter*. After *Phillips v. Washington Legal Foundation* it was clear that the interest on client funds held in IOLTA accounts is the property of the client for purposes of the takings clause. Nonetheless, the respondents, amici, and the lower court all argued that the ad hoc regulatory taking cases, such as *Penn Central Transportation Co. v. New York City*, should govern this taking.

Significantly, the Court rejected that argument and explicitly applied the per se rule of physical intrusions. There is a taking when IOLTA rules take the interest on clients' trust fund accounts and that taking is equivalent to a physical intrusion. The majority emphasizes:

[40] Because the questions had not been decided below, the Court left for another day whether the IOLTA program constituted an unconstitutional taking of the clients' property and what, if any, compensation might be due. 118 S.Ct. at 1934.

[41] Souter, J. (joined by Breyer, Stevens, & Ginsburg, JJ.) and Breyer, J. (joined by Stevens, Souter, & Ginsburg, JJ.) filed dissenting opinions in *Phillips*. They argued that the Court had reached out unnecessarily to decide an abstract issue, and that it could only properly decide the property issue in light of the issues that were not before the Court. They also believed, however, that it was meaningless to talk of "taking" or calling "property" an asset that had no practical value to the client. Under pre-existing federal law, the client's principal could not generate interest (because federal law prohibits for-profit corporations and partnerships from earning interest on demand deposits unless the interest is earned in an IOLTA account).

[42] 123 S.Ct. 1406 (2003).

''As was made clear in *Phillips*, the interest earned in the IOLTA accounts 'is the ''private property'' of the owner of the principal.' If this is so, the transfer of the interest to the Foundation here seems more akin to the occupation of a small amount of rooftop space in *Loretto*.''[43]

In the second part of *Brown*, the Court decided that the property had been taken for a ''public use.'' Normally, the Court has not imposed a very high hurdle on the ''public use'' restriction and this case is no exception.

Before *Brown*, the leading modern case defining the scope of the public use limitation is the unanimous 1954 Supreme Court decision in *Berman v. Parker*.[44] This case involved the constitutionality of the 1945 District of Columbia Redevelopment Act. Under section 2 of that Act, Congress declared it the policy of the United States to eliminate all substandard housing in Washington, D.C., because such areas were ''injurious to the public health, safety, morals, and welfare.'' The Act also created the District of Columbia Redevelopment Land Agency and granted that agency the power to assemble real property for the redevelopment of blighted areas of the city through the exercise of eminent domain. After assembling the necessary real estate, Congress authorized the Agency to lease or sell portions of the land to private parties upon an agreement that the purchasers would carry out the redevelopment plan.

The appellants in *Berman* owned property within the redevelopment area upon which a department store was located. They argued that their property could not constitutionally be taken for the project because the property was commercial and not residential or slum housing; and, by condemning the property for sale to a private agency for redevelopment, the land was being redeveloped for a private and not a public use as required by the Fifth Amendment. The Supreme Court, in an opinion by Justice Douglas, disagreed and upheld the use of the eminent domain power.

Berman does not treat the ''public use'' requirement as much of a constraint. Under that case, once the legislature has declared a

[43] 123 S.Ct. at 1419 (internal citations omitted).

[44] 348 U.S. 26 (1954), discussed further in 2 RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 15.13 (''The 'Public Use' Limitation'') (West Group, 3rd ed., 1999).

condemnation to be for a public use, the role of the courts is an extremely narrow one. However, Justice Stevens, speaking for the *Brown* majority, seems to loosen those already loose restrictions when he appears to adopt a different test:

> [The public use] condition is unquestionably satisfied. If the State had imposed a special tax, or perhaps a system of user fees, to generate the funds to finance the legal services supported by the Foundation, there would be no question as to the legitimacy of the use of the public's money. The fact that public funds might pay the legal fees of a lawyer representing a tenant in a dispute with a landlord who was compelled to contribute to the program would not undermine the public character of the ''use'' of the funds. Provided that she receives just compensation for the taking of her property, 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. Even if there may be occasional misuses of IOLTA funds, the overall, dramatic success of these programs in serving the compelling interest in providing legal services to literally millions of needy Americans certainly qualifies the Foundation's distribution of these funds as a ''public use'' within the meaning of the Fifth Amendment.[45]

The Court analogizes the state court's ethics rule setting up the IOLTA program to a tax. It is a tax, of sorts, because it takes away money (the interest on the IOLTA accounts) that would, but for the IOLTA program, go to the holders of the principal—the clients of the lawyers. Conversely, if the law did not allow interest to be earned, or if the lawyers holding the funds had placed them in a non-interest-bearing account, the banks would have captured this interest. In any event, before the IOLTA program, private parties earned the interest and after the program the state captured that interest. The effect of IOLTA is to allow the Washington Supreme Court to do what, normally, only the state legislature can do: impose a tax. Instead of a democratically elected legislature enacting a tax, the state court imposes its functional equivalent by enacting a rule of ethics governing lawyers. The rule, however, unlike most ethics rules, does not apply to conflicts of interest, or the attorney-client

[45] 123 S.Ct. at 1417 (footnote omitted).

privilege, or the assorted other matters that make up the bulk of the court's rules or rationales governing lawyers.

Justice Scalia's dissent, joined by Chief Justice Rehnquist and Justices Kennedy and Thomas, objected to Stevens's "ruminations" on the public use prong of the takings clause. The Court, Scalia wrote, appeared to be creating a new test that was even less restrictive than the broad public-use test employed since *Berman v. Parker*.

The Court said, "If the State had imposed a special tax, or perhaps a system of user fees, to generate the funds to finance the legal services supported by the Foundation, there would be no question as to the legitimacy of the use of the public's money." Scalia rejected this tax analogy. It—

> reduces the "public use" requirement to a negligible impediment indeed, since I am unaware of *any* use to which state taxes cannot constitutionally be devoted. The money thus derived may be given to the poor, or to the rich, or (insofar as the Federal Constitution is concerned) to the girl-friend of the retiring governor. Taxes and user fees, since they are not "takings," are simply not subject to the "public use" requirement, and so their constitutional legitimacy is entirely irrelevant to the existence *vel non* of a public use.[46]

It is difficult to know what to make of Stevens's effort to analogize the public-use limitation to the taxing power. On the one hand, the majority does not tell us that any case would come out differently under this new approach. It does not even argue that it is adopting a new approach. On the other hand, the Court did talk about the public-use issue. This is one of the instances in which lower courts might see this case as broadening the power of states to take property for "public use." Yet, the Court does not purport to overrule any case or even question the reasoning of any of its prior decisions relating to the already-relaxed public-use requirement. None of the parties briefed, or even raised, the public-use issue, nor was it part of the question presented to the Court for review. In a real sense, Stevens's discussion is dictum. No one argued that the IOLTA program failed the public-use test. Given the context in which the discussion is presented, it seems likely that this leg of the case will have no growing power.

[46] 123 S.Ct. at 1423, n. 2 (Scalia, J., dissenting), citing United States v. Sperry Corp., 493 U.S. 52, 63 (1989).

Then there is the third part of *Brown*. This portion of the case relates to the issue of how one values the property that the state court has taken. All nine justices agreed that the property has been taken. None of the nine justices disputed the issue of whether the taking is for a public use. What is left then is the final issue: how does one measure ''just compensation''?

Before this case, the short answer was that the compensation is the fair market value of the property taken at the time of the taking. The Court in *Brown* repeated Justice Holmes' oft-quoted dictum that the test is ''what the owner lost, not what the taker has gained.''[47] Holmes was known for his pithy statements, but the actual statement is not quite as pithy as the above quotation suggests:

> But the Constitution does not require a disregard of the mode of ownership,—of the state of the title. It does not require a parcel of land to be valued as an unencumbered whole when it is not held as an unencumbered whole. It merely requires that an owner of property taken should be paid for what is taken from him. It deals with persons, not with tracts of land. And the question is, What has the owner lost? not, What has the taker gained? We regard it as entirely plain that the petitioners were not entitled, as matter of law, to have the damages estimated *as if* the land was the sole property of one owner, and therefore are not entitled to $60,000 under their agreement.[48]

In context, Holmes meant that the taker only has to pay the fair market value of the land (the typical item that is taken), even if the particular parcel of land is very crucial to the plans of the taker—for example, if the farm that the state takes is crucial because it allows the state to avoid a more costly alternative for that leg of the highway that the state is constructing, the state does not have to pay more than the fair market value of the farm as farmland simply because the state wants to use that farmland to construct a crucial bridge for a crucial route in the road.[49]

[47] Boston Chamber of Commerce v. Boston, 217 U.S. 189, 195 (1910).

[48] 217 U.S. at 195 (emphasis added).

[49] Holmes' introduction to the *Boston Chamber of Commerce* case shows that the factual background of this case is a bit more complex than the hypothetical in the text. In spite of this factual complexity, the principle is the same. Holmes said:

> This is a petition for the assessment of damages caused by the laying out of a public street over 2,955 square feet of land at the apex of a triangle between India street and Central Wharf street, in Boston, the latter being a private way between Milk street and Atlantic

A long series of prior Supreme Court cases have summarized "just compensation" as the "market value of the property at the time of the taking."[50] This statement reflects how commentators recapitulated the general rule before this decision: "Here the courts normally look to the market value of the property that has been taken."[51]

In determining what the market value is, the court will look to the value of the property as if land were applied to its "highest and

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> avenue, laid out by the same order, as part of the same street. The chamber of commerce had a building at the base of the triangle, and owned the fee of the land taken. The Central Wharf & Wet Dock Corporation, which owned other land abutting on the new street, had an easement of way, light, and air over the land in question, and the Boston Five Cents Savings Bank held a mortgage on the same, subject to the easement. These three were the only parties having any interests in the land. They filed an agreement in the case that the damages might be assessed in a lump sum, the city of Boston refusing to assent, and they contended that it was their right, as matter of law, under the Massachusetts statute, Rev. Laws chap. 48, §§ 20-22, and the 14th Amendment, to recover the full value of the land taken, considered as an unrestricted fee. The city, on the other hand, offered to show that the restriction being of great value to the Central Wharf & Wet Dock Corporation, the damage to the market value of the estate of the chamber of commerce was little or nothing, and contended that the damages must be assessed according to the condition of the title at act date of the order laying out the street. It contended that the jury could consider the improbability of the easement being released, as it might affect the mind of a possible purchaser of the servient estate, and that the dominant owner could recover nothing, as it lost nothing by the superposition of a public easement upon its own. The parties agreed that if the petitioners were right, the damages should be assessed at $60,000, without interest; but, if the city was right, they should be $5,000.

217 U.S. at 193.

[50] *See, e.g.,* United States v. 50 Acres of Land, 469 U.S. 24, 29 (1984) (holding that just compensation is "market value of the property at the time of the taking"), *see also* Olson v. United States, 292 U.S. 246, 255 (1934); Kirby Forest Industries, Inc. v. United States, 467 U.S. 1, 10 (1984); United States v. 564.54 Acres of Monroe and Pike County Land, 441 U.S. 506, 511, (1979); Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 474 (1973); United States v. Commodities Trading Corp., 339 U.S. 121, 130 (1950); United States v. New River Collieries Co., 262 U.S. 341, 344 (1923).

[51] 2 RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE § 15.14 (West Group, 3rd ed., 1999), at p. 752. *Accord, e.g.*, Note, *Valuation of Conrail Under the Fifth Amendment*, 90 HARV. L. REV. 596, 598 (1977).

best'' use. The highest and best use of a piece of property is determined by the value of the property in light of its present and potential uses if those uses can be anticipated with reasonable certainty.[52]

The majority in *Brown*, however, rejects the market value test. It quotes the short form of Holmes's dictum and language from several other cases that did not discuss the issue before the Court. For example, Stevens quotes Frankfurter's statement that an owner's nonpecuniary losses attributable to ''his unique need for property or idiosyncratic attachment to it,'' are not compensable,[53] a noncontroversial statement that is not relevant to the facts of *Brown*.

Stevens, in a weak effort to muster support, even relies on language in a dissent. Quoting the dissent from a 1940 case, Stevens says that it stands for the proposition that the government should pay ''not for what it gets but for what the owner loses.''[54] The dissent, of course, is the part of a decision in which one is least likely to find the holding.

[52]Super–Power Co. v. Sommers, 352 Ill. 610, 618, 186 N.E. 476, 479 (1933). The market value test is not, however, a definitive test. *See* United States v. Fuller, 409 U.S. 488 (1973), which stated that the overall standard is governed by basic equitable principles of fairness. *Fuller* held that the government as a condemnor was not required to pay for elements of the property's market value that the government had created by granting the landowner a revocable permit to graze his animals on adjoining Federal lands. The Court also does not use market value if it is too difficult to ascertain, or if paying of market value would result in ''manifest injustice'' to the owner or the public. *See also* United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950).

The Court explained this matter further in Kirby Forest Industries, Inc. v. United States, 467 U.S. 1, 10 n.15 (1984). Note that even here the Court reaffirmed the fair market value measure:

> We have acknowledged that, in some cases, this standard fails fully to indemnify the owner for his loss. Particularly when property has some special value to its owner because of its adaptability to his particular use, the fair-market-value measure does not make the owner whole. United States v. 564.54 Acres of Land, 441 U.S. 506, 511–12 (1979). We are willing to tolerate such occasional inequity because of the difficulty of assessing the value an individual places upon a particular piece of property and because of the need for a clear, easily administrable rule governing the measure of ''just compensation.''

[53]123 S.Ct. at 1419, quoting Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1940).

[54]*See* 123 S.Ct. at 1419, quoting Kimball Laundry, 338 U.S. 1, 23 (1940) (Douglas, J., dissenting), stating that the government should pay ''not for what it gets but for what the owner loses.''

Stevens then announces that just compensation should be "measured by the property owner's loss rather than the government's gain. This conclusion is supported by consistent and unambiguous holdings in our cases."[55] But are these prior cases really so clear? Their fact patterns do not match the present case, the language that Stevens quotes does not come from holdings, and there is abundant Supreme Court precedent that adopts a different rule—that the proper measurement of just compensation is the market value of the property taken on the date it is appropriated.[56] His statement that these earlier cases are both consistent and unambiguous is unconvincing.

In any event, given the Court's statement of the rule—just compensation is the market value of what the taker receives, not what the property owner has lost—the final question is, what has the property owner lost? One would think that the measure of loss should be easy: if the IOLTA account turns over one million dollars in interest to the state, then the various property owners who own the principal from which that interest came would have suffered the loss of one million dollars and the market value of what the taker receives or the property owner loses is the same. But the *Brown* rule is not that simple.

Stevens concluded that the owners of the money deposited in the IOLTA accounts—the owners of the money that draws interest that is taken by the state—have suffered *no* loss. Remember that Washington IOLTA accounts generate between $2.5 and $4.0 million per year of interest, and that, nationwide, these accounts in 2001 generated more than $200 million in interest payments.[57] We should remember that Stevens also concluded that the state has engaged

[55] 123 S.Ct. at 1419.

[56] *See, e.g.,* United States v. 50 Acres of Land, 469 U.S. 24, 29 (1984); Olson v. United States, 292 U.S. 246, 255 (1934); Kirby Forest Industries, Inc. v. United States, 467 U.S. 1, 10 (1984); United States v. 564.54 Acres of Monroe and Pike County Land, 441 U.S. 506, 511, (1979); Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 474 (1973); United States v. Commodities Trading Corp., 339 U.S. 121, 130 (1950); United States v. New River Collieries Co., 262 U.S. 341, 344 (1923).

[57] Brief of Petitioners, Washington Legal Foundation v. Legal Foundation of Washington, 2002 WL 1974400 (Appellate Brief), (U.S. Pet. Brief, Aug 22, 2002) (NO. 01-1325), at 4; AMERICAN BAR ASSOCIATION, COMMISSION ON INTEREST ON LAWYERS' TRUST ACCOUNTS, IOLTA HANDBOOK 98, 208 (2002 update).

in a per se taking of these interest payments.[58] How can one conclude that the owners of the principal from which the interest was taken have suffered zero loss?

Stevens answers by making a factual assumption on the way he believes that law firms conduct business. Because of this factual assumption, a future court can interpret this case to apply to IOLTA accounts as they operate in the present and not as they must operate in the near future. Let us examine this factual assumption about the way law firms engage in business or administer IOLTA accounts. Stevens quotes a hypothetical factual scenario presented in the lower court:

> Suppose $2,000 is deposited into a lawyer's trust account paying 5% and stays there for two days. It earns about $.55, probably well under the cost of a stamp and envelope, along with clerical expenses, needed to send the $.55 to the client. In that case, the client's financial loss from the taking, if a reasonable charge is made for the administrative expense, is nothing. The fair market value of a right to receive $.55 by spending perhaps $5.00 to receive it would be nothing.[59]

That is not the way one would expect a law firm to do business. Let us say that the client's interest amounted to fifty-five cents. The law firm would not cut a check for that amount and mail it. When the next billing cycle came around, the law firm would merely deduct fifty-five cents from the amount that the client owed the law firm. The cost of rebating the fifty-five cents to the client is zero in administrative expense. When you deposit money in a NOW account, and the bank tells you that you earned fifty-five cents in interest that month, it also does not send you a check. This would only impose unnecessary administrative expenses that would eat up the minor interest that an account earns, particularly in the present day when checking accounts pay less than one-half percent interest. The bank just adds the miniscule amount of interest, such

[58] 123 S.Ct. at 1419 (internal citations omitted).

[59] Brown v. Legal Foundation of Washington, 123 S.Ct. 1406, 1420 (2003), *quoting* Washington Legal Foundation v. Legal Foundation of Washington, 271 F.3d 835, 833 (9th Cir. 2001) (Judge Kleinfeld, dissenting), affirmed in part, vacated in part, and remanded in, Washington Legal Foundation v. Legal Foundation of Washington, 271 F.3d 835 (9th Cir. 2001), affirmed, Brown v. Legal Foundation of Washington, 123 S.Ct. 1406 (2003).

as fifty-five cents, to your account. Given modern computers, the marginal cost of calculating and rebating the interest for one month on an account that varies in amount from day to day is zero.

Stevens presents a slightly different hypothetical fact situation immediately after the one I have just quoted. He also quotes from the Ninth Circuit opinion:

> On the other hand, suppose, hypothetically, that the amount deposited into the trust account is $30,000, and it stays there for 6 days. The client's loss here would be about $29.59 if he does not get the interest, which may well exceed the reasonable administrative expense of paying it to him out of a common fund. It is hard to see how just compensation could be zero in this hypothetical taking, even though it would be in the $2,000 for 2 days hypothetical taking. It may be that the difference between what a pooled fund earns, and what the individual clients and escrow companies lose, adds up to enough to sustain a valuable IOLTA program while not depriving any of the clients and customers of just compensation for the takings. This is a practical question entirely undeveloped on this record. We leave it for the parties to consider during the remedial phase of this litigation.[60]

Stevens rejected the idea that a remand is necessary because of the way he characterizes the IOLTA program. His description is lengthy, and he repeats it in different phraseology several times. In short, he concludes that, by definition, if the client could earn interest, then the lawyer should not deposit the funds in the IOLTA account, and if the lawyer did deposit funds, the lawyer would be liable to the client for the interest. There are several features of the Washington State IOLTA plan that Stevens regards as crucial and that he therefore discusses and reiterates several times in his opinion.

First: "*All* client funds paid to any Washington lawyer or law firm must be deposited in identifiable interest-bearing trust accounts separate from any accounts containing non-trust money of the lawyer or law firm. The program is mandatory for all Washington lawyers."[61] This provision, alone, raises no takings issue. It simply requires lawyers to keep the clients' funds in interest-bearing

[60] 123 S.Ct. at 1420 (footnote omitted), *quoting Brown,* 271 F.3d at 893.

[61] 123 S.Ct. at 1413.

accounts. It says nothing about what accounts the lawyer uses. That provision comes next.

Second:

> The new rule provides for two kinds of interest-bearing trust accounts. The first type of account bears interest to be paid, net of any transaction costs, to the client. This type of account may be in the form of either separate accounts for each client or a single pooled account with subaccounting to determine how much interest is earned for each client. The second type of account is a pooled interest-bearing account with the interest to be paid directly by the financial institution to the Legal Foundation of Washington (hereinafter the Foundation), a nonprofit entity [that the Washington Supreme Court established by court rule.][62]

Thus, says Stevens, there is no taking of principal (as opposed to interest on that principal) when the client's money is put in an interest-bearing account because the client still owns the principal. If the client's funds are too small to justify its own account, the Washington Supreme Court rule allows funds from various clients to be pooled into one account and earn interest for the various clients.

That leads us to the third point and the crucial issue: When must the lawyer put the client's money in a pooled fund to earn interest for the various clients and when must it be paid to the Legal Foundation of Washington?

On that point, Stevens quotes again from the court rule:

> Determining whether client funds should be deposited in accounts bearing interest for the benefit of the client or the Foundation is left to the discretion of each lawyer, but the new rule specifies that the lawyer shall base his decision *solely* on whether the funds could be invested to provide a positive net return to the client. This determination is made by considering several enumerated factors: the amount of interest the funds would earn during the period they are expected to be deposited, the cost of establishing and administering the account, and the capability of financial institutions to calculate and pay interest to individual clients.[63]

[62] 123 S.Ct. at 1413.

[63] 123 S.Ct. at 1413–14 (emphasis added).

In other words, Stevens says, if the funds could earn ''net interest'' for the client, the money must be deposited in a *non*-IOLTA fund—even if it is a pooled fund—where the interest inures to the benefit of the client. At another point he quotes from the state court opinion creating IOLTA: ''Can the client's money be invested so that it will produce a net benefit for the client? *If so, the attorney must invest it to earn interest for the client*. Only if the money cannot earn net interest for the client is the money to go into an IOLTA account.''[64] Later he reemphasizes the same point, where he explained that the state court said that—

> *as cost-effective subaccounting services become available*, making it possible to earn net interest for clients on increasingly smaller amounts held for increasingly shorter periods of time, more trust money will have to be invested for the clients' benefit under the new rule. *The rule is therefore self-adjusting and is adequately designed to accommodate changes in banking technology* without running afoul of the state or federal constitutions.[65]

To reemphasize the fact that the Court assumes that the clients had lost no money, Stevens quotes the lower court, which found, as a factual matter, that the clients could not have made any net returns from their investments.[66] Because of certain procedural rulings, Stevens limited his discussion to ''the claims asserted by petitioners Allen Brown and Greg Hayes.''[67] He quoted from the trial transcript to show that Brown, one of the individual plaintiffs, ''did not claim that he would have received any interest if the IOLTA Rules had not been in place.''[68] With respect to both litigants, Stevens admitted that ''the facts are not crystal clear,'' but it ''seems'' that the petitioners' funds generated some interest that was paid to IOLTA. Stevens assumed the ''net interest'' was zero and that therefore, as ''a factual matter,'' the clients' net interest was zero.[69]

[64] *Id.* at 1414 (emphasis added).

[65] *Id.* at 1415 (emphasis added).

[66] 123 S.Ct. at 1416.

[67] *Id.* at 1415.

[68] *Id.* at 1416 & n.5.

[69] *Id.* at 1416.

Stevens is always speaking of "net interest," and he seems to assume that the cost of refunding the money to the client, when the money may be less than one dollar, is prohibitive, or an administrative nightmare.[70] No; it is only the cost of subtracting the twenty-five cents from the client's bill, and the marginal cost of doing that is also zero because, to the computer, once it goes about figuring out the bill, there is no extra effort for it to add or subtract twenty-five cents from the client's bill.

The petitioners also argued that the lawyers may inadvertently place clients funds in an IOLTA account instead of a pooled account from which the client can earn some interest. Stevens's response is that if funds are inadvertently deposited, the lawyer will have violated the requirements of IOLTA and will be liable in tort to the client.[71]

There is another reason to read this case quite narrowly. In addition to the qualifying remarks that pepper his opinion, Stevens does not purport to overrule any prior decision. Instead, he constantly emphasizes that the clients' net interest gain was zero, and that, if the net interest were higher than zero, the money belongs to the clients according to the Washington Court rules. Finally, if the lawyer inadvertently gives this money to IOLTA instead of to the client, the lawyer will be liable to the client for damages. The net interest to the client is always zero, "whenever the Washington law is obeyed,"[72] because the Washington law requires that client funds that generate net interest—that is, interest after subtracting the cost of administration—must be given to the client. "IOLTA funds are only those funds that cannot, under any circumstances, earn net interest (after deducting transaction and administrative costs and bank fees) for the client."[73]

[70] *Id.* at 1420. In the twenty-first century computers engage in complicated mathematical computations with lightning speed. Once the law firm buys the computer program, the marginal cost to the firm is zero. The cost of refunding the money, even if the refund is twenty-five cents, is not the cost of a postage stamp—that is what Stevens appeared to have assumed earlier.

[71] 123 S.Ct. at 1421.

[72] *Id.* at 1421.

[73] *Id.* 1421 n.10 (internal quotation marks omitted, quoting Washington IOLTA adoption order).

Conclusion

When one looks closely at this case, there is much less than meets the eye. On one level, many commentators may argue that *Brown* gives the green light to IOLTA programs to take the interest earned from private clients' funds and pay no compensation for that interest. Perhaps one or more members of the five-person majority would embrace that view of the law, but that is not what the language of the majority conveys.

Stevens turned this case into one that invites further dispute in IOLTA matters. Computer programs already exist that allow banks to compute interest on money left in NOW accounts for very short periods of time. Although computers are very good for playing solitaire or watching movies on DVD, they were, after all, originally designed to compute. And, the marginal cost of their computing is zero, just like the marginal, out-of-pocket cost of my typing this sentence on the computer is zero. Typing the sentence on a computer uses no paper and no ink.

The future should see more suits over IOLTA accounts. First, the Court did not approve any IOLTA programs that lack the limiting language found in the Washington program. That language demands that ''IOLTA funds are only those funds that *cannot, under any circumstances*, earn *net* interest (after deducting transaction and administrative costs and bank fees) for the client.''—a phrase that Justice Stevens quotes with emphasis added *twice* in his opinion.[74]

Second, if the cost of apportioning the interest from a pooled account, after deducting transaction and administrative costs and bank fees is zero, *Brown* holds that the IOLTA program is invalid, because that interest then belongs to the client. The marginal cost of apportioning the interest among the various accounts all deposited in a pooled interest account is either zero or soon will be zero. Bank fees will be more than zero, but they have to be apportioned over all the accounts deposited in a pool interest account. We know that Washington IOLTA accounts generate between \$2.5 and \$4.0 million per year. We can safely assume that the bank fees on IOLTA are substantially less than the \$4 million in interest generated by these accounts.

[74] *Id.* at 1414; 123 S.Ct. at 1420.

There is another reason that we should expect to see more IOLTA suits in court. The petitioners in this case raised not only a takings issue but a free speech issue. The Court did not reach that question, but Justice Kennedy's separate dissent noted:

> Had the State, with the help of Congress, not acted in violation of its constitutional responsibilities by taking for itself property which all concede to be that of the client, the free market might have created various and diverse funds for pooling small interest amounts. These funds would have allowed the true owners of the property the option to express views and policies of their own choosing. Instead, as these programs stand today, the true owner cannot even opt out of the State's monopoly.
>
> The First Amendment consequences of the State's action have not been addressed in this case, but the potential for a serious violation is there. Today's holding, then, is doubly unfortunate. One constitutional violation (the taking of property) likely will lead to another (compelled speech). These matters may have to come before the Court in due course.[75]

The *Brown* case did not end the litigation over IOLTA. Like its predecessor, *Phillips*, the case is written narrowly and suggests that five or more members of the Court would not approve an IOLTA program that did not, as a legal and factual matter, contain all the caveats found in the majority opinion.

[75] *Id*. at 1428 (Kenney, J., dissenting) (internal citations omitted).