SCHOOL OF LAW
TEXAS A&M UNIVERSITY

Texas Wesleyan Law Review

Volume 4 | Issue 1 Article 7

10-1-1997

Why Mandatory IOLTAs Should be Eliminated

Dan Chern

Follow this and additional works at: https://scholarship.law.tamu.edu/txwes-lr

Recommended Citation

Dan Chern, *Why Mandatory IOLTAs Should be Eliminated*, 4 Tex. Wesleyan L. Rev. 123 (1997).
Available at: https://doi.org/10.37419/TWLR.V4.I1.5

This Comment is brought to you for free and open access by Texas A&M Law Scholarship. It has been accepted for inclusion in Texas Wesleyan Law Review by an authorized editor of Texas A&M Law Scholarship. For more information, please contact aretteen@law.tamu.edu.

WHY MANDATORY IOLTAS SHOULD BE ELIMINATED

INTRODUCTION

The state's ability to find new ways to take the money of its citizens should never be underestimated. One of the more curious methods of state sponsored fund-raising (Read: taxes) comes from a program entitled Interest on Lawyers Trust Accounts ("IOLTA"). The IOLTA, in addition to being a tool for the funding of legal services to the indigent and procuring various government benefits for the needy,[1] also provides legal services for death-row inmates who wish to continue their appeals as well as helping secure political asylum for those seeking entry into the United States.[2] In the fourteen year period between 1981 to 1995, IOLTAs generated almost $945 million nationwide.[3] Texas alone, last year, collected over $10 million for such uses.

The collection of this money was not a result of any controversial legislation; nor did the Governor expend political capital in raising the money. Instead, the Texas Supreme Court mandated[4] that attorneys deposit their clients' funds into interest-bearing demand accounts.[5]

Forty-nine states, including Texas, have implemented the IOLTA program.[6] This program requires attorneys to deposit money given to them by clients into interest-bearing accounts. The deposited money must either be nominal in amount or held for a short term. Under the various state bar rules of conduct, the attorney is required to decide what constitutes "nominal" or "short term".[7] Once the money has been classified as such, IOLTA mandates placing the money into an interest-bearing, demand account. All interest earned on the pooled money is then turned over to an organization (created either by the

1. *See* TEX. GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11, § 4(B)(C) (Vernon 1995).

2. *See* Frances A. McMorris, *Ruling May Undermine Programs that Fund Legal Services for Poor*, WALL ST. J., Sept. 30, 1996, at B12.

3. *See id.*

4. *See* TEX. GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11, § 2 (Vernon 1995).

5. LAWRENCE S. WRIGHT & WILLIAM L. SILBER, PRINCIPLES OF MONEY, BANKING AND FINANCIAL MARKETS 15-16 (7th ed. 1991). Interest-bearing demand accounts are those accounts where a bank pays interest to the account; such interest is normally calculated by multiplying a pre-determined rate by the size of the principal and the amount of time that principal is left in the account. Thus, if the current annual interest rate is 5%, the principal is $1000 and the account is open for 6 months, the interest would be figured in the following way: (0.05 x 1000) x 0.5. To say that an account is a "demand" account means simply that the owner of the principal may claim the money at any time without suffering monetary penalties. *See id.*

6. *See In re* Indiana State Bar Ass'n's Petition to Authorize a Program Governing Interest on Lawyer's Trust Accounts, 550 N.E.2d 311, 311-13 (Ind. 1990).

7. *See* TEX. GOV'T CODE ANN. tit. 2, subtit. G, app. A, art. 11, § 5(A) (Vernon 1995).

DOI: https://doi.org/10.37419/TWLR.V4.I1.5

state judiciary or the state bar),[8] that in turn distributes the money to various petitioning groups[9] that seek to provide legal services to the indigent, secure government benefits for the same (such as Social Security and Aid for Dependent Children), as well as provide money to other non-profit causes.[10]

Attorneys, clients, and various public-interest groups, most notably the Washington Legal Foundation, a conservative think tank, have challenged the constitutionality of the IOLTA program. Specifically, challenging the program as an unconstitutional "taking" under the Fifth Amendment.[11] These various groups assert the use of the money is both unauthorized and uncompensated. This Comment's primary topic is centered on a threshold issue for a takings claim: whether a client's property right attaches to interest earned on principal—principal that the state requires an attorney place into an interest-bearing account. As of this writing, three federal circuits[12] have dealt with this threshold issue.

The First and Eleventh Circuits have held that clients have no property right in interest earned through the IOLTA program. Contrary to both holdings, the Fifth Circuit found that clients do have a property right in this interest. Indeed, the Fifth Circuit's opinion consists almost entirely of a critique of these two contrary holdings. Curiously, all three circuits rely on the same United States Supreme Court case, *Webb's Fabulous Pharmacies, Inc. v. Beckwith*.[13] This Comment concludes that the Fifth Circuit correctly applied *Webb's* in holding that the owner of principal has a property right in the interest earned on that principal.

I. An Explication of Relevant Cases

A. Webb's Fabulous Pharmacies, Inc. v. Beckwith

The *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[14] case found its way to the United States Supreme Court on an appeal from a Florida Supreme Court ruling.[15] Eckerd, the appellant, purchased the assets

8. *See id.* § 3(A).
9. *See id.* § 4(G). This section requires that any organization receiving funds must provide "reports as to the actual use of funds and for audit of the reports." *Id.*
10. *See id.* § 4(F).
11. These organizations have also challenged IOLTA on the basis of First Amendment violations. For a full discussion of First Amendment issues, as they relate to mandatory IOLTAs, see Risa I. Sackmary, Comment, *IOLTA's Last Obstacle: Washington Legal Foundation v. Massachusetts Bar Foundation's Faulty Analysis of Attorney's First Amendment Rights*, 2 J.L. & POL'Y 187 (1994).
12. *See* Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996 (5th Cir. 1996); Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962 (1st Cir. 1993); Cone v. State Bar of Florida, 819 F.2d 1002 (11th Cir. 1987).
13. 449 U.S. 155 (1980).
14. 449 U.S. 155 (1980).
15. *See* Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951 (Fla. 1979), *rev'd*, 449 U.S. 155 (1980). The Florida Supreme Court reasoned that "the statute

of Webb's Fabulous Pharmacies ("Webb's") for $1.8 million. At the closing, Eckerd discovered Webb's debts were greater than the purchase price. Seeking state statutory protection from Webb's creditors, Eckerd tendered the purchase price to the Circuit Court of Seminole County, Florida, interpleading both Webb's and its creditors as defendants.[16] Florida law requires not only that the $1.8 million be delivered to the court clerk but also that it be deposited in an interest-bearing account.[17] In addition to receiving the interest from monies tendered to the court, Florida law also directs the court clerk to deduct a fee for "services rendered."[18]

Approximately one year after the tender of money into the court, the circuit court appointed a receiver for Webb's. The receiver then petitioned the court for the interest that had accrued on the $1.8 million. The interest retained by the court clerk amounted to more than $100,000.[19] The receiver moved to have the interest returned to it for the purpose of paying creditors.[20] The court clerk refused. The circuit court found for the receiver and ordered the clerk to transfer the interest.[21] The clerk appealed to the Florida District Court of Appeal, maintaining that the interest, under Florida law, belonged to the court.[22] The District Court of Appeal transferred the case to the Florida Supreme Court.[23] The Florida Supreme Court held for the court clerk.[24] The receiver and creditors subsequently appealed to the United States Supreme Court.

---

takes only what it creates." *Id.* at 953. This "creation" occurs when the funds are deposited with the court clerk. The court reasons that the funds, at the time they are deposited, are no longer private property. *See id.* at 952 (citing Money v. State *ex rel.* Florida First Nat'l Bank, 206 So. 2d 436 (Fla. Dist. Ct. App. 1968); FLA. STAT. ANN. § 219.01(2) (West 1977). The statute the court refers to, Florida Statute § 28.33, directs the court clerk to deposit any money received in its (the court's) registry into interest-bearing certificates. *See id.* The statute goes on to say, "all interest accruing from moneys deposited shall be deemed income of the office of the clerk of the circuit court investing such moneys and shall be deposited in the same account as are other fees and commissions of the clerk's office." *Id.*

16. *See Webb's*, 449 U.S. at 157.

17. *See* FLA. STAT. ANN. § 28.33 (West 1977).

18. *See id.* § 28.24.

19. *See Webb's*, 449 U.S. at 158.

20. *See id.*

21. *See id.*

22. *See id.*

23. *See id.*

24. *See* Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951, 953 (Fla. 1979), *rev'd*, 449 U.S. 155 (1980). The Florida Supreme Court reasoned that the interest earned is created by the relevant state statute. This creation of wealth occurs, according to the court, when private money is deposited with the court clerk. Once deposited, the money may then be considered public money. As public money, any interest earned on it may be used for the "benefit of all the people." *Id.*

The Court began by stating the purpose of its analysis: whether the "second exaction"[25]—the keeping of the interest—amounted to a taking.[26] In order to make such a determination, the Court began its investigation as to whether there was a property right in the earned interest, reasoning that where there is no property, there can be no taking.

The Court recognized that the principal was private property, and as the appellees noted, the Constitution is not the creator of private property or property rights. Rather, the boundaries of property rights are created by an "independent source such as state law."[27] The Court then set boundaries of its own to the creation of property rights by saying that "a mere unilateral expectation or an abstract need is not a property interest entitled to protection."[28]

The Court stated the principal was held for the "ultimate benefit of Webb's creditors, not for the benefit of the court and not for the benefit of the county."[29] Thus, those creditors had more than a "unilateral expectation" to the principal.

Once Eckerd deposited the purchase price for the assets of Webb's with the state court, and interplead not only Webb's, but also Webb's creditors, those creditors had a state-created property interest in the fund (the principal). The Court reasoned that as the creditors' expectations were not merely unilateral, those creditors had a "state-created property right to their respective portions of the fund[,]"[30] the initial principal and the earned interest. The property interest was not, however, an immediate one. The creditors had no right to the fund when it was initially deposited by Eckerd. Instead, the creditors would (and did) have to wait for the court-appointed receiver to distribute the fund.[31]

The relationship between when a property right is created in interest earned on principal and whether a party has a claim in the interest earned on that principal was discussed by the Court:

> That lack of immediate right, however, does not automatically bar a claimant ultimately determined to be entitled to all or a share of the fund from claiming a proper share of the interest, *the fruit of the fund's use*, that is realized in the interim. To be sure, § 28.33 establishes as a matter of Florida law that interest is to be earned on deposited funds. But the State's having mandated the accrual of

25. The first exacting came from the Florida statute authorizing the court clerk to deduct pre-determined fees for the holding of money. *See id.* at 952.

26. *See Webb's*, 449 U.S. at 160.

27. *Id.* at 161 (quoting Board of Regents v. Roth, 408 U.S. 564, 577 (1972)).

28. *Id.*

29. *Id.*

30. *Id.*

31. *See id.*

> interest does not mean the State or its designate is entitled to assume ownership of the interest.[32]

What then would justify the State (or one of its designees) from "assuming ownership of interest?" The Court answers indirectly by saying it has allowed the adjusting of "benefits and burdens of economic life to promote the common good."[33] The government may be allowed to promote its interests through denying "the property owner of some beneficial use of his property or . . . restrict the owner's full exploitation of the property, if such public action is justified as promoting the general welfare."[34]

In *Webb's*, the Court further said that the shouldering of such "public burdens" should often be borne "in all fairness and justice" by the "public as a whole."[35] The State, however, sought to enhance its general revenues, "not reasonably related to the costs of using the courts,"[36] through a "forced contribution."[37] This "forced contribution" was exacted at the expense of the primary beneficiary of the fund, the creditors, by keeping the interest earned on that fund.

The Florida Supreme Court had reasoned that since the court clerk would have no authority to invest the funds without the relevant state statute,[38] those funds, because of this statute, temporarily assumed the status of public money.[39] The United States Supreme Court rejected that reasoning, and stated:

> The earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property. The state statute has the practical effect of appropriating for the county the value of the use of the fund for the period in which it is held in the registry.[40]

The characterization of the fund (principal) as "public money" is not sufficient to justify public use of the interest earned on the fund.[41] Thus, the Court implied that it would be willing to allow the state to deny the owner of the principal the full exploitation of the principal if the state could show that such a denial would (1) promote the general welfare, and (2) that such promotion should not in "fairness and jus-

32. *Id.* at 162 (emphasis added). The "right" the Court speaks of is the right to claim ownership in the funds being held by the court clerk. The claim is not immediate as the receiver was not free to distribute any funds to the creditor prior to the resolution of any and all claims. *See id.* at 161.

33. *Id.* at 163 (quoting Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978)).

34. *Id.*

35. *Id.* (quoting Armstrong v. United States, 364 U.S. 40, 49 (1960)).

36. *Id.*

37. *Id.*

38. *See* FLA. STAT. ANN. § 28.33 (West 1977).

39. *See* Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951, 952 (Fla. 1979), *rev'd*, 449 U.S. 155 (1980). *See also* Money v. State *ex rel.* Florida First Nat'l Bank, 206 So. 2d 436, 438 (Fla. Dist. Ct. App. 1968).

40. *Webb's*, 449 U.S. at 164.

41. *See id.*

tice" be borne exclusively by some members of the public (the owners of principal) but instead by the "public as a whole."[42]

Almost seven years after *Webb's* holding, the Eleventh Circuit addressed the issue of whether a property interest attaches to interest earned on principle. For reasons that will be made clear later in this paper, the Eleventh Circuit disregarded the basic thrust of the Supreme Court's holding in *Webb's*.

B. Cone v. State Bar of Florida

The Eleventh Circuit, in *Cone v. State Bar of Florida*,[43] found that a program in Florida similar to IOLTAs was valid. In February 1969, a client paid a fee deposit of $100 to a Florida law firm.[44] The firm deposited the money in a non-interest bearing trust account.[45] The firm's representation of this client ended in 1970.[46] The firm, however, inadvertently failed to remit the remaining $13.75 to the client until September 1984.[47] Prior to this return, the Florida Supreme Court approved an Interest On Trust Account ("IOTA") program.[48] As the court observed, this program "authorized, but did not require" placement of "nominal or short term funds into pooled, interest-bearing accounts[.]"[49] The interest was turned over to the Florida Bar Foundation where the money was distributed to various charitable purposes.[50]

In the three years that the $13.75 remained in an IOTA, $2.25 in interest was generated.[51] The law firm, having discovered its error, returned the $13.75, but deposited the interest with the Florida Bar Foundation (the designated receiver for the IOTA program). The client filed suit claiming the appropriation of interest earned on her principal and that of other similarly situated clients constituted an improper taking in violation of the Fifth and Fourteenth Amendments.[52]

The majority pointed out that in order for a person to have a constitutionally protected property interest, that person must have a "specific and legitimate 'claim of entitlement.'"[53] Further, such claim of entitlement must be based on "positive rules of substantive law or mu-

42. *Id.* at 163.
43. 819 F.2d 1002 (11th Cir. 1987).
44. *See id.* at 1003.
45. *See id.* at 1003-04.
46. *See id.* at 1004.
47. *See id.*
48. *See id.*
49. *Id.*
50. *See id.*
51. *See id.*
52. *See Cone*, 819 F.2d at 1004.
53. *Id.* (citing Board of Regents v. Roth, 408 U.S. 564, 577 (1972)).

tually explicit understandings."[54] The lower court held that the plaintiff could not show such a claim.[55] The appellate court agreed with the lower court, stating the $13.75 was insufficient to produce interest net of expenses.[56] A combination of three factors acted to keep the $13.75 from earning interest net of expenses: (1) Florida's ethical requirements that forbid commingling of attorney and client funds, (2) the economics of running an interest-bearing demand account, and (3) the federal restrictions on who may utilize interest-producing demand accounts.[57] While there are numerous federal banking regulations concerning what are and are not appropriate accounts for various groups of consumers, the relevant law here[58] does not permit partnerships to maintain interest bearing checking accounts (the law firm in this case was a partnership). The Negotiable Order of Withdrawal ("NOW") accounts permit banks to maintain interest-bearing checking accounts. The NOW account was created by federal law in the early 1980s.[59] The court reasoned that if the principal could never earn interest, the client could not have an expectation or claim of entitlement to any interest.[60]

Cone distinguished the *Webb's* decision by emphasizing that the Florida county in *Webb's* sought to use the net value of the fund[61] during the time the fund was held in the registry. Here, however, there was no "net value" on the $13.75. That is, under current banking law, coupled with the cost of maintaining an interest-bearing demand account, there could be no net gain to the owner of the principal.[62] The court further reasoned that it is only through the IOTA and the pooling of such short-term or nominal funds that interest net of expenses could be generated. An individual client, with such a short-term or nominal fund would, therefore, have no legitimate expectation of property.[63]

---

54. *Id.* (citing Perry v. Indermann, 408 U.S. 593, 601-02 (1972)).

55. *See id.* at 1005-07.

56. *See id.* at 1006. "Interest net of expenses" is a technical way of saying that an account has earned more money through interest than that same account was charged with various administrative fees. For example, if a bank were to charge an account holder $10 a year for maintaining an account and that same account, during that same year, earned $15 in interest, the account holder would have earned $5 on that account: interest net of expenses.

57. *See id.* at 1005.

58. *See* 12 C.F.R. § 217.157 (1980).

59. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1832 (1980).

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

61. *See id.* (The "net value of the fund" refers to the proceeds (the interest) earned on the principal while it was held by the county clerk.).

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

63. *See id.*

C. Washington Legal Foundation v. Massachusetts Bar Foundation

In 1989, the Massachusetts Supreme Court, in *Washington Legal Foundation v. Massachusetts Bar Foundation*,[64] converted the IOLTA program from a voluntary to a mandatory one, as long as a client's funds were nominal in amount or to be held for a short period of time.[65] The court pointed out that earlier banking laws, coupled with ethical obligations of lawyers to maintain a client's funds in such a way that those funds are immediately available for the client, prevented such pooled trust accounts from ever accruing interest.[66] The court recognized that the principal was private property and "must be returned to the clients at their request."[67] The clients sought protection of the use of their principal by drawing analogies to the protection afforded real property; that is, the plaintiffs sought to exclude others from the beneficial use of their funds while deposited in an interest-bearing account.[68]

The court analyzed the plaintiffs' takings claim by looking at the following three factors: "'(1) "the 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.'"[69] The court stated that the government may "adjust rights and economic interests among people for the public good, as long as the government does not force 'some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'"[70]

The court reasoned that, unlike *Webb's*, the plaintiffs made no claim of ownership on the interest earned from their respective principal.[71] Instead, the plaintiffs asserted that the property interest in the principal should permit them to exclude the government from making a beneficial use of that property.[72] The plaintiffs sought protection by pointing to an analogy the *Webb's* Court makes: In *Webb's*, the Supreme Court pointed out that the plaintiffs had a cognizable and therefore "protectable" property right in the interest earned on the fund deposited with the court. That is, the interest existed and was being held by the court. The *Webb's* Court likened the county's use of

64. 993 F.2d 962 (1st Cir. 1993).

65. *See id.* at 980.

66. *See id.* at 968. With the advent of the NOW account, such interest-bearing accounts became possible. *See id.*

67. *See id.* at 973.

68. *See id.* at 974.

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

70. *Id.* (quoting Armstrong v. United States, 364 U.S. 40, 49 (1960)).

71. *See id.* at 975-76.

72. *See id.* at 975.

the fund to generate interest to the government's use of a private citizen's air space.[73]

Here, the court reasoned, no such analogy could be found. As the plaintiffs claimed no property right in the earned interest, the right of exclusion was an intangible right. Intangible rights, the court stated, were not afforded the same protection(s) afforded real property. As such, the plaintiff's analogy to *Webb's* was unfounded.[74] The only interference the plaintiffs could assert then was interference with the principal.

The interference, to constitute a taking, must be significant.[75] As the principal was always available to the client, there was no interference with the clients' property interest.[76] Further, with no interference with the fund itself, and no expectation of interest, the client had no "investment-backed" expectations.[77] Under these circumstances, the clients had no economic interest in the funds in question. As such, they were not in a position to argue that they should be allowed to exclude others in order to protect their economic interest.[78]

D. Washington Legal Foundation v. Texas Equal Access to Justice Foundation

In 1988, the Texas Supreme Court in *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*,[79] like the Massachusetts Bar, made participation in the IOLTA program mandatory.[80] Such accounts were created to hold the pooled funds of clients whose money was either nominal in amount or to be held for a short time. While in the account, the pooled money collected interest. The interest was then turned over to the Texas Equal Access to Justice Foundation ("TEAJF").[81]

Like both *Cone* and *Massachusetts Bar Foundation*, the defenders of the IOLTA program (the defendants) argued that the interest was created by current banking regulations and current ethical guidelines of the legal profession.[82] The defendants further argued that IOLTA provides the (legal) collection of interest, and that without such a program, no interest would exist.[83]

73. *See* Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 163-64 (1980) (citing United States v. Causby, 328 U.S. 256 (1946)).
74. *See Massachusetts Bar Found.*, 993 F.2d at 976.
75. *See id.* (citing Andrus v. Allard, 444 U.S. 51, 66-67 (1979)).
76. *See id.*
77. *See id.*
78. *See id.*
79. 94 F.3d 996 (5th Cir. 1996).
80. *See id.* at 999. *See also Massachusetts Bar Found.*, 993 F.2d at 968.
81. *See Washington Legal Found.*, 94 F.3d at 998.
82. *See id.* at 1000.
83. *See id.*

Unlike both *Cone* and *Massachusetts Bar Foundation*, the Fifth Circuit disagreed with the defendants and found instead that the clients have a cognizable property right in the interest earned from their principal.[84] The court reasoned that, like *Webb's*, the principal was held for the ultimate benefit of the client;[85] that the interest was the "fruit" of the principal and that "simply because the state ordered the placement of interpleaded funds into an interest-bearing account does not mean that the state can assert ownership of that interest."[86]

The court went on to attack both the Eleventh and First Circuits' reasoning. The Eleventh Circuit, the court asserted, found *Webb's* to be inapposite due to the size of the money involved.[87] The court then pointed to the Eleventh Circuit's discussion of "legitimate expectation."[88] With no possibility of earning interest net of expenses, there could be no expectation of interest. By implication, the Eleventh Circuit found that the value (or size) of property determines whether a person had a cognizable, "protectable" interest in that property.[89] The Fifth Circuit continued its analysis by pointing out that interest accrues to principal prior to any deduction of service fees.[90] Once the interest accrues, a property interest attaches, regardless of what fees a bank might then charge.[91] In addition, the very rule which made the IOLTA program possible confounds the reasoning of *Cone*: In response to attorneys concerned about their clients' tax liability on earned-interest, the IRS issued a ruling[92] that if clients have control over earned interest, those clients are liable for the tax on that interest.[93] In response to this interpretive ruling, Texas, as well as the other participating states, created "an IOLTA monopoly, reserving all the IOLTA interest proceeds for itself and requiring all of its attorneys to participate in the program."[94] Such a monopoly removes not only any control the client has over the interest but also any tax liability the client might face with the earning of interest. To show the potential inconsistencies that these facts, coupled with the holding of *Cone*, would lead to, the court posited the existence of private charities setting up their own IOLTA programs, whereby people with nominal or

---

84. *See id.* at 1004.
85. *See id.* at 1000.
86. *Id.* at 1001.
87. *See Washington Legal Found.*, 94 F.3d at 1001. In *Webb's*, the earned interest amounted to over $100,000, unlike the Eleventh Circuit's $2.25 earned interest. *See* Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 157 (1980).
88. *See Washington Legal Found.*, 94 F.3d at 1002.
89. *See id.*
90. *See id.* at 1003. "As a result, a property interest attaches the moment that the interest accrues, from which the bank then deducts its charges from the depositor's account." *Id.*
91. *See id.*
92. *See* Rev. Rul. 81-209, 1981-2 C.B. 17.
93. *See Washington Legal Found.*, 94 F.3d at 1002.
94. *Id.* at 1003.

short-term funds could choose the charity to which their funds would go. Under such a scenario, the *Cone* court would say that, based on size, there is no property interest, while at the same time the IRS ruling would require the donating party to pay taxes on that which is not a property interest.[95] The client would then be left in the curious position of owing taxes on that in which he had no property interest. Such a result is not merely inequitable and unjust, it is simply bad legal reasoning.

II. An Analysis of Relevant Cases

A. *The Failure of the First and Eleventh Circuits in Their Reading and Application of* Webb's Pharmacies

For *Cone* and *Massachusetts Bar Foundation*, the value of property determines whether or not a property right attaches. In both cases, the courts held the clients did not have a legitimate expectation of property. The reasoning supporting this conclusion was the money in question could not have earned interest *above* administrative costs without being pooled with money from other clients. This *argument from net value*[96] demands that principal yield profit, net profit, in order for the owner of the principal to have a legitimate expectation of property rights in any use of the principal. Thus, if principal standing on its own could yield no net profit due to the costs of maintaining such an account at the current interest rate and administrative costs, the owner of the principal could never have an expectation of property. Such an argument relegates the foundation of property rights to an issue of banking regulations, finance, and accounting.[97]

Should the interest rates increase from day one of the owner's deposit of principal to day two, what was an unrecognizable, unprotectable property right would suddenly be recognizable and protected. An increase in the interest rate would potentially leave more interest than the administrative costs would have subtracted away, thus leaving net value in the fund. Under the First and Eleventh Circuits' reasoning, such a result would create a "legitimate expectation" to the

95. *See id.*

96. This author has, for ease of reference, coined this term. The argument from net value, as utilized by the First and Eleventh Circuits, demands that a person's money be used profitably for that person to assert a property interest over that money. *See generally* Cone v. State Bar of Florida, 819 F.2d 1002, 1006 (11th Cir. 1987) (noting that administrative costs and bank charges associated with an interest-bearing account would exceed the interest generated by the appellant's $13.75 deposit); *Massachusetts Bar Found.*, 993 F.2d 962, 976 (1st Cir. 1993) ("The property rights claimed by the plaintiffs do not involve clients' economic interests . . . . [C]lients would not otherwise be entitled to interest earned on pooled accounts . . . . [T]here are no 'investment-backed' expectations in the claimed rights of clients . . . under these circumstances.").

97. The Fifth Circuit adds to this list the "fickle tax code." *See Washington Legal Found.*, 94 F.3d at 1004 n.47.

interest. Should the fees a bank charges for account management decrease over some period of time, what was once a non-existent property right would turn into a legitimate expectation of property. Are the daily fluctuations of interest and the ever-changing bank regulations controlling factors determining when an owner may hope for legal protection of property? The United States Supreme Court has held that property rights are the creation of state substantive law.[98] The supporters of IOLTA offer no reason why this should change.

The argument from net value also relies on the specific rule of professional ethics, current banking regulations,[99] and a current IRS interpretive rule.[100] First, attorneys are permitted to pool clients' money together but may not commingle their own money with the clients' money. Second, federal banking regulations noted above permit the payment of interest on demand accounts only for individuals or non-profit business; in short, for-profit business are not entitled to these interest bearing demand accounts. Third, the IRS interpretive ruling noted above has deemed owners' of principal to be tax exempt when they have no control over the interest.

The argument from net value surveys these three regulations and declares that, because of these state/federal-mandated rules, no client (whose principal is either nominal in amount or to be held for a short-term period) could ever expect to earn interest.[101] Specifically, the first two combine, the argument goes, to say that since this nominal or short term principal can only be combined with other clients' nominal or short term interest, no individual client could expect to earn interest—net of expenses. Further, since the pooling of the clients' funds were mandated by the state, and not by any agreement between the clients, the state is the only entity entitled to the interest.

The IRS ruling, the argument continues, allows the state to declare itself the sole receiver of the interest—thereby avoiding any tax liability to the client. The net result of this IRS ruling is to point to another instance of the owner's lack of property right in any interest derived from their principal. Since the IRS does not require the owner of principal to pay taxes on the interest earned from their principal, then

98. *See* Board of Regents v. Roth, 408 U.S. 564, 577 (1972).

99. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1832(a)(2) (1989). This Act permits NOW accounts to "consist of commingled funds belonging to numerous individuals or non-profit organizations or both." Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996, 998 (5th Cir. 1996).

100. *See* Rev. Rul. 81-209, 1981-2 C.B. 16. This ruling states that individual clients are exempt from paying taxes on interest from IOLTAs.

101. In *Cone*, *Massachusetts Bar Foundation*, and *Washington Legal Foundation*, the supporters of IOLTAs have asserted that the state is only taking that which it has created. For ease of discussion, this Comment refers to the supporters of IOLTAs collectively.

they (the clients) have no property right in the interest—under the unstated premises of that which is not taxed can not be property.[102]

What such reasoning amounts to—and what the defendants in *Washington Legal Foundation* asserted—is that the state has earned this interest; that the owner of principal could not have earned *any* interest, and that the owner may not come in after such an earning and demand a share in that which they did not create. To support such reasoning, both *Cone*[103] and *Massachusetts Bar Foundation*[104] assert the deposits of a client's principal in an interest-bearing account and the state's use of that interest, are not covered in *Webb's*. Whether the supporters of the IOLTA program admit it or not, the unwillingness to see *Webb's* as controlling could come only by considering whether the principal earned interest above the cost(s) of maintaining that principal in an interest-bearing account.

Yet *Webb's* states that a statute requiring placing money in an interest-bearing account does not provide any basis for the state claiming a right to that interest.[105] Neither *Cone* nor *Massachusetts Bar Foundation* offers any reasoning why a *combination* of statutes and rules should provide the state with such a right where a statute alone would not. Yet both circuit decisions held that such a right is established through the net value argument.

Webb's, however, explicitly stated that "the state statute has the practical effect of appropriating for the county the value of the use of the fund for the period in which it is held in the registry."[106]

Both circuits found themselves exempt from this statement since the statute and rules that led to the IOLTA program permit only nominal amounts of money to be pooled together. It is this requirement, the pooling of monies, that these circuits relied on to set them free of a Supreme Court ruling. Both circuits argued that since the state required pooling of money, the state may demand the result of such pooling, with the added caveat that had it not been for such statutes and rules, there would be no interest. The same, however, may be said of *Webb's*: A state statute required the court clerk to deposit money turned over to the court in an interest-bearing account *and* for the clerk to then turn the interest over to the county. Without such a requirement, there would have been no accrued interest in *Webb's*.

102. IOLTA supporters would no doubt agree that a person would have a recognizable property interest in various sources of non-taxable income. The absence of a tax would not be justification for denying someone the right to bring suit in protection of municipal bonds, or income realized from the sale of a home.

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

104. *See Massachusetts Bar Found.*, 993 F.2d at 975.

105. *See* Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 162 (1980). "To be sure, § 28.33 establishes as a matter of Florida law that interest is to be earned on deposited funds. But the State's having mandated the accrual of interest does not mean the State or its designate is entitled to assume ownership of the interest." *Id.*

106. *Id.* at 164.

Neither circuit provided a reason why such a statutory requirement should not be cited as a justification for the state keeping that interest; had it not been for the relevant statute, the principal would have never been deposited, and the interest would never have been earned.

B. *Where Ownership and Statutes Collide*

That the supporters of IOLTA can point to a combination of statutes and rules that require the pooling of client money is irrelevant to an analysis of whether the owner of principal has a property interest in any money created by that principal. As *Webb's* points out, where a person is entitled to a portion of principal, that person is also entitled to "a proper share of the interest."[107] Nowhere in the Supreme Court's analysis is the amount of principal that a person may be entitled to relevant in determining if that person has an interest in proceeds generated from that principal. Yet *Cone* states, "the crucial distinction is not the amount of interest earned, but that the circumstances led to a legitimate expectation of interest exclusive of administrative costs and expenses."[108] The circumstances *Cone* speaks of are the statute that required the court clerk to place money into an interest-bearing account, and the amount of interest that would accrue to the deposited fund.[109] While the *Cone* court claims to be unconcerned with the amount of interest earned, it approvingly cites the lower court's holding that the use of a client's money that had "no net value" could have no property interest for that client.[110] In other words, had the principal been greater, the client would have had a property right in the earned interest. Contrary to what the court says, it effectively established a *de minimis* standard in dealing with a Fifth Amendment taking. The *Cone* court missed the United States Supreme Court's central point in *Webb's*: Interest does not exist without principal.[111] Further, compelling people to pool their money together does not alter this essential economic fact.[112]

Cone also dismissed any similarities between *Webb's* reliance on *United States v. Causby*[113] and the IOLTA program. *Webb's* found *Causby* analogous to the facts before it since "*Causby* emphasized that

---

107. *Id.* at 162.
108. Cone v. State Bar of Florida, 819 F.2d 1002, 1007 (11th Cir. 1987).
109. *See id.*
110. *See id.*
111. *See Webb's*, 449 U.S. at 162.
112. *See id.*
113. 328 U.S. 256 (1946). The Court reasoned that over-flights by U.S. aircraft constituted a taking of property. The government maintained that as the over-flights did not destroy the value of the land, there was no taking. The Supreme Court disagreed, saying, "The path of glide for airplanes might reduce a valuable factory site to grazing land, an orchard to a vegetable patch, a residential section to a wheat field. Some value would remain. But the use of the airspace immediately above the land would limit the utility of the land and cause a diminution in its value." *Id.* at 1006.

Government had not 'merely destroyed property [but was] using a part of it for the flight of its planes.'"[114] The government's *use* of property, not merely its destruction, is what *Webb's* emphasized,[115] while *Cone* insisted that the high court said the opposite.[116] Appellants were correct, under both *Causby* and *Webb's* reliance on *Causby*, that the government may not make (an uncompensated) *use* of private property.

The IOLTA programs make use of private property in a fashion prohibited by both Supreme Court holdings in *Causby* and *Webb's*. Once the state requires attorneys to deposit money in an interest-bearing account, any further requirement by the state that it take the interest is a use of that money. The IOLTA program treats not merely money but ownership of money as if it was of a fungible quality. That is, since one piece of money is interchangeable with another, the control of that money is equally interchangeable; and since the owner of one of those pieces of money had no legitimate expectation of interest, neither do the owners, *en mass*. For the supporters of IOLTA, forcing clients to pool their money relieves them of ownership of that money. The argument seems to find some magical quality in herding clients into a financial collective: If you (the owner) cannot tell which $20 bill is yours, you may not claim control over any of the $20 bills. The Fifth Circuit appropriately characterizes the supporters of IOLTA's argument as a modern day alchemists. "The alchemists failed because the necessary ingredients for their magic did not exist in historical times: the combinations of attorney's client funds and anomalies in modern banking regulations"[117] is the magic formula for turning lead into gold. While *Cone* and *Massachusetts Bar Foundation* treat the principal as being pooled they both seem to treat the ownership as being laid out side-by-side in some abstract juxtaposition of ownerships. That is, money may be combined but rights of ownership may not.

When monies from individual clients are combined, the owners of the principal become the owners *in toto* of the fund. Any use of that fund is a use of all the property—property that has discreet, distinct owners. As *Webb's* points out, the lack of an immediate right does not automatically bar the parties from claiming ownership over the "fruit

114. *Webb's*, 449 U.S. at 164 (alteration in original).

115. *See id.*

116. *Cone*, 819 F.2d at 1007 n.9. The *Cone* court believes that the destruction of property (a chicken farmer's inability to raise chickens because of aircraft noise) is central to the holding in *Causby*. *See id.* Yet *Causby* explicitly states that the taking does not occur because of any "incidental damages." *See Causby*, 328 U.S. at 262. This author does not mean to assert that the Court did not speak of a destruction of the use of the land. Rather, the salient point is that the government's actions lessened the value, i.e., the potential uses the owner could make of the land.

117. Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996, 1000 (5th Cir. 1996).

of the funds use."[118] The cause(s) of a delay in an "immediate claim" is irrelevant in determining whether a property interest exists. Similarly, prior to the withdrawal of a client's individual principal, that client may not have an immediate right to the interest his principal helped to create. Yet, once the principal is withdrawn, the client is not automatically barred from "claiming a proper share of the interest."[119] *Cone* and *Massachusetts Bar Foundation* have erroneously held otherwise.

C. *A Lack of Consistency*

The supporters of IOLTAs will undoubtably continue to push their forced charity on other professions as well. Perhaps the payment of insurance may become a source of funds for other IOLTA-like programs. An individual normally pays an insurance premium at the beginning of a month or some other pre-determined period. Such a premium "carries" that person through to the end of the month. A monthly insurance premium of $100 amounts to a person paying $3.33 a day. The insurance company, in effect, "deducts" this $3.33 every day from its customer's payment of $100. This daily deduction leaves a balance that provides the insurance company with an interest-free loan. Under the logic of the IOLTA program, insurance companies should be compelled to place these funds into an interest-bearing account. Once a given amount of interest has accrued, such proceeds might then be turned over to an organization that disperses such funds to those unable to afford medical care. Such funds could be used for remedial check-ups and vaccinations. Should such funds be used for abortions or other controversial medical procedures, the supporters of IOLTA might tell us that those who deposited the money (the customers of the insurance companies) had no legitimate expectation of interest from such money. Further, since the principal is still being used to finance the customer's insurance needs, the customer's property (the fund) and the insurance coverage are not being destroyed. Since there is no destruction of this property *and* the customer had no expectation of earned interest, the customer may not seek compensation for the use of his fund, regardless of either how much, or how little, money is generated from the customers' fund or how disagreeable the use of such money may be to a particular customer.

We could of course apply this logic to any field where people do not have the same access to goods and/or services as others. Those who lack auto insurance might be provided with such insurance by compelling the auto insurance industry to combine such money into interest-bearing accounts. Such an application would create (or at least further) a class division made up of those who provide and those who

118. *See Webb's*, 449 U.S. at 162.
119. *See id.*

receive. Of course, the incentive to actually pay for one's own product/service would be greatly reduced.

The supporters of IOLTAs apparently see nothing wrong with such logic. The use of another's money presents no problem to those who see ownership as some sort of ephemeral concept that loosely hovers over an object. They see no loss of money to either lawyers, clients, or banks through such programs. For these individuals, ownership may be shifted from one person or group (the clients) to any other person or group (the TEAJF) without consent of the *original* owners and without the necessity of trade between the group who provides the benefit and the group who receives the benefit. The IOLTA supporters would perhaps respond by asserting that the "contributing" group has, in fact, provided nothing; the various banking regulations have done the real work. Yet if all the capital, however great or modest in amount, were removed from these IOLTAs, all the banking regulations now in existence would not produce one cent of revenue for these programs. Such matters will probably not deter those who seek to be virtuous with other people's money.

D. *A Lack of Justification*

The justification offered for such use is *need*, the need of whatever group currently enjoys the political spotlight.[120] The use of need as a justification would seem to suggest a certain intellectual bankruptcy in finding any justifiable basis for such programs. All persons have various needs. If the supporters of IOLTAs believe an organizing principal of American law is, or should be, the providing of such needs through the uncompensated use of other people's money, let them stand up and say as much.

Of course, the investigation of ethical formulations begins to exceed the scope of this paper. Presumably, this is true of the various articles, and commentators supporting the IOLTAs.[121] Yet, the introduction of such issues into this area would provide both sides a more explicit and cogent statement of where they believe the law currently is and where it should be going. Yet, the act of naming the principle(s) one stands

120. *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 (1985). *See also* Kenneth Paul Kreider, Note, *Florida's IOLTA Program Does Not "Take" Client Property For Public Use:* Cone v. State Bar of Florida, *819 F.2d 1002 (11th Cir.), cert. denied, 108 S. Ct. 268* (1987), 57 U. CIN. L. REV. 369 (1988) (discussing the reasoning used by the courts and legislatures of states that have adopted IOLTA programs to resolve problematic issues of banking regulations, taxation and ethics when authorizing the program as a source of legal aid funds for the public good).

121. *See generally* Kreider, *supra* note 120, at 372-74 (discussing how prior to the implementation of the program in states that have adopted IOLTA programs, issues raising concerns about the ethical ramifications of lawyers participating in the IOLTA program had to be resolved).

on can prove difficult, if not dangerous: Not only does it expose one's true intentions, it also demands greater intellectual rigor in the defense of one's position.

The lack of an explicit justification in these various papers may be explained for a variety of reasons. The most favorable would be that an absence of this sort of discussion may be attributed to a desire for academic rigor. Thus, that which does not, directly or indirectly, refer to specific statutes, cases, or other papers should not be discussed, at least not at any length. Instead, these discussions focus solely on legal reasoning, never referencing the ethical/jurisprudential principles on which legal reasoning ultimately depends.

A less favorable explanation, however, for such an absence might be attributable to a disregard for those fields of inquiry (jurisprudence, ethics and political philosophy) that make the legal field possible. Such a disregard may suggest a number of different beliefs held by the supporters of IOLTAs. One such belief might be the lack of necessity to discuss such matters. That is, the supporters of IOLTAs may believe the various ethical points have been conceded by those who seek to abolish IOLTAs. If this is the case, the responsibility for the absence of such a discussion falls on those who seek to defend the property rights of those who have been compelled to contribute to the IOLTAs. Indeed, an article that takes up the defense of clients forced to pay into the IOLTA, seems to have open disdain for the attempted use of political philosophy and ethics in this on-going debate.[122] Such an attitude will only serve to encourage the supporters of IOLTAs.

Leaving all moral pronouncements to the supporters of IOLTAs implies the lack of a moral position for those who seek to end the IOLTA programs. Instead, those who wish to end IOLTAs should counter the ethical arguments of supporters of the IOLTA programs. This will not cause a degeneration of the debate. Rather, it will demand, of both sides, a rigorous and strict method of legal reasoning that shows itself to be in accord with the principles on which it relies. Without reference to such principles, opportunities for legal gamesmanship will arise.

CONCLUSION

The IOLTA program seeks to distinguish between the owners of principal and the owners of interest earned on that principal. In defending such a distinction, the First and Eleventh Circuits have created an inappropriate and unsupportable position: the net value argument. In so doing, both federal circuits have ignored a key

122. *See* Charles E. Rounds, Jr., *Social Investing, IOLTA and the Law of Trusts: The Settlor's Case Against the Political Use of Charitable and Client Funds*, 22 LOY. U. CHI. L.J. 163, 166 (1990).

Supreme Court ruling. Consistency, as well as fairness, requires all federal circuits to align themselves with *Webb's*.

At a minimum, the IOLTA programs should be switched from mandatory to voluntary participation. A voluntary program would keep attorneys from the uncomfortable, if not unethical,[123] position of using a client's money in a manner not in accordance with the client's wishes. Further, the attorney would no longer be a collector of revenue for the state. Placing the attorney in such a role will likely result in greater regulation by the state (via the state bar) of the legal profession. The attorney who does decide to participate in the IOLTA program will undoubtably incur costs greater than when the program was mandatory. Such an attorney may lose clients who do not wish their money to be used by the state. If the attorney opts to have both participating and non-participating clients, such an attorney will face increased cost and headaches from the various accounting issues that will likely arise. What bears pointing out is that the attorney and the client will be in a position to determine their own economic fate. The IOLTA programs, to a limited extent, deny such economic self-determination.

More importantly, the client's use of an attorney, and presumably the court system, would not leave the client helpless before the state. One normally consults an attorney for the protection of one's rights and interests, not their further abridgment. Should the program be ordered to adopt (in some cases, re-adopt) voluntary participation, attorneys should be required to disclose to clients whether they intend to participate in such a program. The attorneys would be in a position to follow not only their own political dictates but also their own economic self-interest. The clients, the owners of principal, would then be in a position to exercise control over their own money—a control they should have never been denied.

Dan Chern

123. *See* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.15 (1997) (setting forth rules for keeping a client's property, making it unethical to commingle the client's and attorney's property, and to deliver any funds to the client as directed by the client, with exceptions as stated in the law).