Florida Law Review

Volume 36 | Issue 4 Article 3

September 1984

Interest on Lawyers' Trust Account Programs: Do They "Take" "Property" of the Client?

Peter M. Siegel

INTEREST ON LAWYERS' TRUST ACCOUNT PROGRAMS: DO THEY "TAKE" "PROPERTY" OF THE CLIENT?

PETER M. SIEGEL*

I. INTRODUCTION

The interest on lawyers' trust account programs (herein collectively referred to as "IOLTA" programs) all operate on the premise that client trust funds constitute an unused economic resource which

*Attorney, Florida Justice Institute. B.S. 1962, University of New Hampshire, LL.B. 1965, Rutgers, The State University of New Jersey, Newark. Research and writing of this article was supported by funds granted to the Florida Justice Institute by the Legal Services Corporation and the Ford Foundation to support the National IOLTA Clearinghouse. The author is also counsel for the Amici Curiae participants supporting the State Bar of California in litigation challenging California's IOLTA program.

may be mobilized to generate income to improve the delivery of legal services to the poor.[1] The IOLTA programs authorize attorneys to pool nominal or short term client trust funds, which before IOLTA were deposited in interest-free checking accounts, and deposit them in NOW or Super NOW checking accounts. The interest generated from these accounts is then used to support legal services to the poor and to fund other law-related public purposes. If there are no constitutional impediments to using client funds in this fashion, IOLTA constitutes a significant new source of revenue for these legal services.

The critical constitutional question raised by IOLTA programs is whether using clients' monies, which lawyers hold in aggregated trust accounts, to produce income for public services constitutes a taking without just compensation contrary to the dictates of the fifth amendment.[2] Those who question the constitutionality of IOLTA contend the owner of a fund possesses a vested property right to the earnings of that fund.[3] They argue, relying on *Webb's Fabulous Pharmacies, Inc. v. Beckwith*,[4] that a state's action in appropriating

---

1. IOLTA Programs, as of May 1, 1985, have been approved in 35 states and the District of Columbia and rejected in four. Initial petitions seeking the adoption of IOLTA programs are pending before six state supreme courts. IOLTA UPDATE, National IOLTA Clearinghouse, vol. 2, no. 4 (Winter 1985) [hereinafter cited as IOLTA UPDATE]. IOLTA programs began in Australia and have spread to many countries with a common law heritage. Their history and operation is explained in England & Carlisle, *History of Interest on Trust Accounts Program*, 56 FLA. B.J. 101 (1982). *See also* Gonser, Almond & Ziegler, *Financing Public Services Activities With Interest-Bearing Attorney Trust Accounts*, 15 IDAHO L. REV. 219 (1979) (discussion of the problems in development of Idaho's public service program for the legal profession with a comparison to Florida's plan); Special Project, *Interest on Lawyers' Trust Accounts: A Proposal For Wisconsin*, 66 MARQ. L. REV. 835 (1983) (the Florida Bar's program is considered in conjunction with the IOLTA proposal for Wisconsin and the constitutional issues raised in implementing such a proposal); Note, *Minnesota's New Interest on Lawyer Trust Accounts Program*, 67 MINN. L. REV. 1286 (1983) (exploring the background and mechanics of the IOLTA concept with a discussion of the constitutional, tax and fiduciary issues raised); Comment, *A Source of Revenue for the Improvement of Legal Services, Part I: An Analysis of the Plans in Foreign Countries and Florida Allowing the Use of Clients' Funds Held by Attorneys in Non-Interest-Bearing Trust Accounts to Support Programs of the Organized Bar*, 10 ST. MARY'S L.J. 539 (1979).

2. "[N]or shall private property be taken for public use, without just compensation." U.S. CONST. amend. V (applicable to the states through the fourteenth amendment). Chicago, B. & Q. R.R. v. Chicago, 166 U.S. 226, 238-41 (1897).

3. *See* Baker & Wood, *"Taking" A Constitutional Look at The State Bar of Texas Proposal to Collect Interest on Attorney-Client Trust Accounts*, 14 TEX. TECH L. REV. 327, 357 (1983); Comment, *A Critique of Interest on Lawyers' Trust Accounts Programs*, 44 LA. L. REV. 999 (1984).

4. 449 U.S. 155 (1980). The *Webb's* opinion held unconstitutional on fifth amendment grounds a Florida statute which permitted counties to invest interpleader funds and retain the income generated as public revenues. FLA. STAT. § 28.33 (1977). In addition, counties charged a separate, percentage fee based on the dollar amount of the funds deposited in court. *Id.* § 28.24(14). The result reached in *Webb's* is intuitively correct. Moreover, it is consistent with

the earnings of the fund for its own purposes, notwithstanding the economic realities or desirability of the public purposes served, constitutes a taking. Those who find no fifth amendment violation argue no property is taken because IOLTA "creates income" which would never, under any set of circumstances, accrue to the benefit of the client.[5] Moreover, even if a client possesses a property interest in the earnings potential of his nominal or short term deposits, IOLTA supporters argue the potential for income is so attenuated that shifting the income to public use does not constitute a taking for purposes of the fifth amendment.[6]

The goal of this article is to show the fifth amendment poses no barrier to the implementation of IOLTA programs. Principles of both property and taking law demonstrate the client's claim to the income is not valid. The client lacks a property interest, as the term "property" is interpreted for purposes of the fifth amendment. Moreover,

---

prior case law. *See* Morton Grove Park Dist. v. American Nat'l Bank & Trust Co., 78 Ill. 2d 353, 399 N.E.2d 1295 (1980). Both Coudert v. United States, 175 U.S. 178 (1899) and Branch v. United States, 100 U.S. (10 Otto.) 673 (1879), held, as a matter of statutory construction, that monies paid into court during contested litigation did not, thereby, become public monies. United States v. Minnesota Mut. Inv. Co., 271 U.S. 212 (1925), held, also as a matter of statutory construction, that the interest on funds paid into court belonged to the owner of the fund. Constitutional claims were neither raised nor considered. *See* Annot., 15 A.L.R.2d 473 (1951). The acceptance of *Webb's* is evident from the lack of legal literature devoted directly to that case. Only one brief comment was found at 67 A.B.A. J. 212 (1981). *But see* Chatham & Phenix Nat'l Bank v. Guaranty Trust Co., 256 F. 90 (2d Cir.), *cert. denied,* 250 U.S. 642 (1919), reaching the same result that the Florida Supreme Court reached in Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951 (Fla. 1979), *rev'd,* 449 U.S. 155 (1980). Of course, *Webb's* features prominently in the literature devoted to IOLTA. In response to *Webb's,* Florida amended the offending statute to provide that the county retain 10% of the interest income as a "reasonable investment management fee," while still charging the percentage fee for accepting the deposit. FLA. STAT. § 28.33 (1983). The amended statute has not been challenged.

5. *In re* Interest on Trust Accounts, 402 So. 2d 389, 395 (Fla. 1981).

6. A truly client-voluntary program does not implicate the fifth amendment. None of the currently existing programs, however, are client-voluntary. Instead, of the 36 approved IOLTA programs, 6 are attorney-mandatory and 30 are attorney-voluntary. IOLTA UPDATE, *supra* note 1. Mandatory programs require that all attorneys with trust accounts deposit all their clients' nominal or short-term funds in an IOLTA account. Voluntary programs allow lawyers to choose whether to participate in an IOLTA program. A lawyer who chooses to participate in a voluntary program, however, must deposit all nominal or short-term client funds into an IOLTA account. The reason programs cannot be client-voluntary lies in the assignment of income doctrine and rulings of the Internal Revenue Service. The rulings state that if a client who deposited nominal or short-term funds could exercise any control over the placement or use of those funds, the earnings would be deemed income to the client who, if qualified, could take a charitable deduction. Rev. Rul. 81-209, 1981 C.B. 16. *See* England & Carlisle, *supra* note 1; Middlebrooks, *The Interest on Trust Account Program, Mechanics of Its Operation,* 56 FLA. B.J. 115 (1982). The adverse tax consequences, as well as the added administrative costs that would result if IOLTA generated income was deemed income of the client, would make the program impracticable. For fifth amendment purposes there is no difference between mandatory and voluntary programs. In both, the client is compelled to participate. *See* Baker & Wood, *supra* note 3, at 337-39.

even if a property interest is assumed, no taking occurs. This paper will begin with a brief look at the premise of IOLTA. Then, to provide a foundation for the discussion of both property and taking concepts, Section III will examine the evolution of laws concerning the ability of individuals to place funds at interest and the ability of individuals to earn interest on bank deposits.

With this background established, the precise constitutional question will be defined and broken down into its two component parts, the property issue and the taking issue. Section V will then examine the property issue from two different perspectives. The first perspective explores whether a definition of property, qua property, can be usefully applied to the IOLTA controversy. The discussion concludes the attempt to develop a definition of the word "property" for application to novel or unique circumstances fails absent an accepted normative theory of property. Thus, competing claims cannot be resolved by using a definitional exercise. The second perspective examines the concept of property as embodied in the entitlement doctrine of *Board of Regents of State Colleges v. Roth*[7] and concludes IOLTA works a constitutionally permissible change in the attorney-client trust relationship. Finally, after assuming the existence of a property interest, Section VI explores whether IOLTA's impact on that interest constitutes a taking. After briefly noting the historical evolution of taking law, current doctrine is explored in two ways. First, several alternative approaches which scholars of various persuasions have suggested are identified and applied. Second, the Supreme Court's current multifactor analysis is examined and applied. Section VI concludes, in the absence of a per se rule, the complete lack of injury suffered by clients negates any claim of taking.

II. The IOLTA Premise

Attorneys frequently receive funds from or on behalf of their clients. Prior to IOLTA, most of these funds were deposited in aggregated, interest-free checking accounts.[8] This procedure was adopted because the typical deposit was either so small, or expected to be held for so short a period of time, that it could not be invested productively for the benefit of the client.[9] The lack of income-earning

7. Board of Regents of State Colleges v. Roth, 408 U.S. 564 (1972).

8. Demand deposits were used so that the attorney could return the client's money immediately upon request. Model Code of Professional Responsibility DR 9-102(B)(4) (1980).

9. Not all client funds were held in demand accounts. Larger amounts, or amounts likely to be held for long periods of time, were frequently placed in interest-bearing accounts. Placing client money in an interest-bearing account was primarily a business decision by the attorney and client, although the attorney's ethical and fiduciary responsibilities were implicated. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 348, 68 A.B.A. J. 1502 (1982)

capacity resulted from four factors: (1) charges imposed by financial institutions, particularly on small accounts; (2) administrative costs incurred by the lawyer; (3) trust account requirements imposed by the Code of Professional Responsibility; and, (4) banking law restrictions.

Both attorneys and financial institutions incur a wide range of expenses in opening, disbursing, and closing client trust accounts. Financial institutions, in addition to the cost of interest paid, incur a variety of administrative expenses for each depositor's account. These costs lead to service charges, minimum balance requirements, and other rules designed to diminish the cost of small accounts.[10] Lawyers incur an even wider range of costs in administering their trust accounts.[11] Given these basic costs, lawyers do not place their clients' funds at interest unless the amount of the funds, or the time period the funds are expected to be held, provides clear economic justification for doing so.[12] Instead, the normal focus is on safekeep-

---

[hereinafter cited as ABA Formal Op. 348].

10. Although the information is dated, one study placed the breakeven point for NOW accounts at $1000.00. D. CRANE & M. RILEY, NOW ACCOUNTS: STRATEGIES FOR FINANCIAL INSTITUTIONS 80 (1978).

A $1000 breakeven point is consistent with current banking practice. The NCNB National Bank of Tampa, for example, imposes a monthly maintenance fee of $5.00 and a transaction fee of $.25 for each item for each NOW account, unless the account maintains a minimum balance of $1000, or an average monthly balance of $2500. Affidavit from NCNB National Bank filed in Glaeser v. The Florida Bar, No. 84-1345-Civ-T-13 (M.D. Fla. filed Oct. 11, 1984) (challenging Florida's path-breaking 1981 IOLTA program on fifth amendment grounds).

11. These costs include:

> 1. The time needed, presumably that of the lawyer and client, to determine whether investment is warranted.
>
> 2. The time necessary to obtain the client's social security or tax identification number and other relevant information required for such investments.
>
> 3. The time necessary, probably of support staff, to open a separate account for the client whose funds are to be invested.
>
> 4. The cost of internal law firm bookkeeping, on a periodic basis, to account for client earnings.
>
> 5. The cost of preparing and furnishing IRS Form 1099, either by the financial institution or the lawyer.
>
> 6. The time necessary to close the account, a task more complicated than the simple drawing of a check when client funds are kept in an aggregated, interest-free account.

REPORT TO THE BD. OF GOVERNORS, ABA TASK FORCE AND ADVISORY BD. ON INTEREST ON LAWYER TRUST ACCOUNTS, 22-24 (July 1982) [hereinafter cited ABA TASK FORCE REPORT]. *See also* ABA Formal Op. 348, *supra* note 9, at 1503. The possible future availability of sub-accounting may reduce, but cannot eliminate, the administrative costs that banks and attorneys incur. Some clients will also incur transaction costs if separate investment accounts are opened. IOLTA proponents have not taken those costs into account.

12. ABA Formal Op. 348, *supra* note 9, at 1503. Established by a time and motion study which concluded the transaction costs incurred by attorneys in opening individual client trust accounts equaled or exceeded $50.00, the Maryland IOLTA statute adopts a $50.00 safe harbor guideline. MD. ANN. CODE art. 10, § 44(a)(2) (1982). *See* Machen, *I-O-L-T-A "What Is It/How*

ing, accounting, and delivery on demand.[13]

The lawyer's cost problem is compounded by the ABA Model Code of Professional Responsibility. The expectation lawyers will absorb the transaction costs incurred is inherent in the Code's treatment of client trust accounts. Thus, the Code has been interpreted to bar a lawyer from placing funds at interest and utilizing the interest earned to defray the costs of administration.[14] The Constitution, however, does not impose such a bar. This approach is consistent with the usual rule that a trustee is entitled to recover the expenses of administering the trust.[15] If customary trust rules are applied, a client would have no legal claim to interest earned where the interest earned did not exceed the administrative costs incurred. IOLTA is premised on these rules.

In addition to economic realities, banking law restrictions in force prior to 1981 generally barred the payment of interest on demand accounts.[16] Accordingly, the typical client was neither penalized nor benefited when his funds were deposited in an attorney's trust ac-

---

Does It Work?", 1983 MD. B.J. 6, 9.

The table below shows the amount of principal and length of time necessary to generate interest revenue in excess of the $50.00 Maryland benchmark:

Principal Deposit	Number of Days Required to Generate $50.00 of Interest at 5¼% Compounded Daily
$ 500	654
1,000	335
2,000	169
5,000	69
10,000	34
20,000	17
30,000	12

ABA TASK FORCE REPORT, *supra* note 11, at 24. Although little empirical evidence is currently available, it seems likely that a very substantial portion of client trust funds will earn less than the guideline amount.

13. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 9-102 (1980). *See* Mathewson v. Davis, 191 Ill. 391, 61 N.E. 68 (1901) (there is no duty to invest money held, but only to pay over money to another entitled to receive it); ABA Formal Op. 348, *supra* note 9 (lawyers must neither misuse a client's funds nor impede prompt delivery).

14. An attorney cannot personally benefit from any earnings generated by his trust account, even to the extent of using the earnings to offset bank service charges. *E.g.*, ABA Comm. on Ethics & Professional Responsibility, Informal Op. 545 (1962); ABA Comm. on Ethics & Professional Responsibility, Informal Op. 991 (1967).

15. *See* 3 A. SCOTT, THE LAW OF TRUSTS §§ 242, 244 (3d ed. 1967 & Supp. 1983). In Jamaica Sav. Bank v. Lefkowitz, 390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975), the court, while rejecting a fifth amendment challenge to a state statute requiring interest be paid on mortgage escrows, held it would be improper to require a custodian of funds to absorb administrative costs.

16. *See* 12 U.S.C. § 371a (1976). Some exceptions to this ban did exist, however, such as in the northeastern states where NOW accounts were authorized as early as 1972. *See infra* notes 92-96 and accompanying text.

count because the funds generally either came from an interest-free account, were nominal, or were to be held for a short period of time. Conversely, the commercial banks and attorneys benefited from this system. The commercial bank received a significant economic benefit from its interest-free use of clients' money. The individual attorney, in turn, benefited by way of reduced cost banking services, lower cost loans, and other free or reduced cost services.[17] The nationwide authorization of NOW accounts, effective December 31, 1980, however, permitted lawyers participating in IOLTA programs to convert their aggregated trust accounts from interest-free checking accounts to interest-paying NOW accounts. The economic benefits gained from harnessing attorney trust funds were reallocated from financial institutions to the public.[18] Neither the client's nor the attorney's relationship to the attorney trust account is altered because the funds are deposited in an IOLTA account. The only difference is that an unused economic resource is put to work in the public interest at no cost to either attorney or client.[19] An understanding of the nature of the client's right in the interest earned by his funds calls for a more

17. The use of IOLTA accounts prevents attorneys from benefiting from their trust accounts. Banks considered the interest-free trust account a "compensating balance" for which they extended to lawyers a variety of indirect benefits. The ethical propriety of using a trust account for such purposes is doubtful, but has never been directly addressed by an A.B.A. Ethics Opinion, or by a state decision. Philadelphia Bar Ass'n Ethics Op. 80-57 (1980) opined that a law firm could ethically agree to maintain all its accounts, including its trust account, in a particular bank in return for lower cost bank services, so long as the firm did not compromise its obligation to invest client monies for the benefit of the client where appropriate. *But cf.* Meyer v. Meyer, 106 Miss. 638, 64 So. 420 (1914), holding that where a trustee deposited trust funds in a bank, pursuant to an agreement that in return for the deposit the bank would make an interest-free loan to the trustee, the trustee was to be surcharged with the amount of interest he saved.

18. The impact of the reallocation is limited by the realities of banking industry competition. Before NOW accounts, only commercial banks (and saving banks), but not savings and loan associations, could offer checking accounts. Federal law barred the payment of interest on checking accounts, thereby granting commercial banks the interest-free use of depositors' funds. The shifting of a lawyer's trust account from a demand account to a NOW account causes the commercial bank to incur interest expense it was not previously paying. That financial impact is tempered by the competition from savings and loan associations, which expect to pay interest on all their deposits. To savings and loan associations, the advent of NOW accounts provides a way for them to compete with commercial banks in attracting money previously kept in demand accounts. The impact on commercial banks produced by changes in the banking industry is substantial; IOLTA plays a very small role.

19. IOLTA may serve one other useful purpose. It reminds attorneys that funds which can be productively invested for the benefit of the client should be so invested. Particularly in states where participation in IOLTA is mandatory for all attorneys (Arizona, California, Iowa, Minnesota, Ohio and Washington, IOLTA UPDATE, *supra* note 1), attorneys must determine whether to invest client funds for the benefit of the client or deposit the funds in the IOLTA account. It is likely that because attorneys are forced to consider the investment potential of all client funds they hold, more funds will be invested. In voluntary states, the impact will likely be less.

in-depth look at the history of interest.

III. The Right of a Fund to Earn Interest Income

This section traces the historical development of an individual's ability to place funds at interest. The tracing serves four broad purposes. First, it identifies the descriptive elements that can be utilized as part of a definitional exercise which attempts to answer the threshold property question. Second, it identifies the positive rules of law necessary to apply the "reliance and expectation" theory developed in *Roth* for determining the existence of a legitimate claim of entitlement. Third, it furnishes the foundation for assessing the validity of the change in attorney trust accounting law implicit in IOLTA. Finally, it provides a factual basis for applying the relevant criteria of the multifactor balancing test.

The intuitive claim of IOLTA opponents cannot be dismissed as groundless. The general rule is that interest becomes part of the invested fund which produced the income. Thus, the earnings of a fund are usually deemed a mere incident of ownership of the fund itself so that an eminent domain provision "applies to the earnings in the same manner, and with the same force, as it applies to the principal."[20] This rule is frequently applied in situations where private funds are entrusted to public officials.[21] For example, funds deposited

20. McMillan v. Robeson County, 262 N.C. 413, 417, 137 S.E.2d 105, 108 (1964). The clearest expression of the duty to distribute occurs in *McMillan,* where the court clerk was required to distribute $9,842.82 in interest to 1368 account holders, several of whose accounts contained less than one dollar in principal and few of whose accounts contained substantial sums. In ordering distribution, the court said: "It is manifest from the foregoing summary that allocation of the earnings which have occurred on the funds paid to the Clerk will present problems in accounting, but that fact does not justify depriving the owners of the funds of their share of the earnings." *Id.* at 415, 137 S.E.2d at 108.

When IOLTA was first proposed in North Carolina, the Chief Justice of the North Carolina Supreme Court declined to approve, relying on *McMillan, Webb's,* and the argument that IOLTA would interfere with the fiduciary relationship between attorney and client. Letter from Joseph Branch, Chief Justice, North Carolina Supreme Court, to Mr. John W. Campbell, President, North Carolina State Bar (Apr. 13, 1982). Thereafter, the Bar modified its proposal by requiring notice to the client that his funds would be deposited in an IOLTA account, although the client was not given a veto power over his lawyer's decision, and on June 23, 1983, the Chief Justice approved the proposal.

21. The usual rule is set forth in Bordy v. Smith, 150 Neb. 272, 278, 34 N.W.2d 331, 335 (1948), to wit:

> The clerk suggests that a decision to the effect that the interest money belongs to the beneficial owners would present serious difficulties in determining who are such owners and in computing how much each would be entitled to receive. Such difficulties, if actually present, would be of no benefit to the clerk because the interest goes with the principal to the owners thereof and no difficulty in determining such owners and their proportionate share thereof would entitle the clerk to keep such funds.

Id. See Annot., 5 A.L.R.2d 257 (1949).

in court, such as in interpleader actions, should be invested where feasible.[22] The income generated, if any, belongs to the party adjudged entitled to the fund.[23] Conversely, if no interest is actually earned, the prevailing party is not entitled to recover interest as part of its judgment.[24]

The rule that earnings follow principal does not, however, generally place the holder of a fund under a duty to invest the money on the owner's behalf.[25] As between private parties, such as when mortgage escrows for taxes and insurance are involved, the majority view holds the mortgagee need not pay interest[26] unless an applicable statute requires otherwise.[27] A lawyer is usually under no duty to invest the ordinary client trust account deposit because its short-term nature makes such action impractical.[28] If the fund does earn interest, however, that interest "is always said to be an accretion to or an increment to the fund earning it and unless lawfully separated from the fund"[29] it becomes a part of the principal.[30] Whether IOLTA "lawfully separates" interest from principal is, of course, the question under discussion. To answer this question, scrutiny of the historic right to interest is useful.

An essential element of property is said to be the "right to income" produced as a result of the property's use. It is not always true, however, that an essential characteristic of property ownership is the legal ability to earn income where the income takes the form of interest.[31] At common law, in fact, it was unlawful to recover interest

22. Prudential Ins. Co. of Am. v. King, 308 F. Supp. 1143 (W.D. Mo. 1969).

23. Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. at 155; James Talcott, Inc. v. Allahabad Bank, Ltd., 444 F.2d 451 (5th Cir.), *cert. denied*, 404 U.S. 940 (1971); First Constr. Co. v. Tri-South Mortg. Investors, 308 N.W.2d 298 (Minn. 1981).

24. Nebben v. Kosmalski, 307 Minn. 211, 239 N.W.2d 234 (1976).

25. Bassett v. Kinney, 24 Conn. 267 (1855); Everglade Cypress Co. v. Tunnicliffe, 107 Fla. 675, 148 So. 192 (1933); Clay v. McCabe, 56 A.D.2d 747, 392 N.Y.S.2d 29 (1977). Where the holder is a trustee, the trust property should be made productive where feasible. 2 A. SCOTT, *supra* note 15, § 181.

26. Brooks v. Valley Nat'l Bank, 113 Ariz. 169, 548 P.2d 1166 (1976); Kronisch v. Howard Sav. Inst., 161 N.J. Super. 592, 392 A.2d 178 (App. Div. 1978). *Contra* Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 281 Or. 533, 577 P.2d 477, *cert. denied*, 439 U.S. 1051 (1978).

27. Jamaica Sav. Bank v. Lefkowitz, 390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975).

28. ABA Formal Op. 348, *supra* note 9.

29. Heck & Paetow Claim Serv. v. Heck, 93 Wis. 2d 349, 357, 286 N.W.2d 831, 835 (1980).

30. *See, e.g.*, Alfred v. Esser, 91 Colo. 466, 15 P.2d 714 (1932); Kiernan v. Cleland, 47 Idaho 200, 273 P. 938 (1929); Toop v. Palmer, 108 Neb. 850, 189 N.W. 394 (1922); Southern Or. Co. v. Gage, 100 Or. 424, 197 P. 276 (1921); Des Moines Mut. Hail & Cyclone Ins. Ass'n v. Steen, 43 N.D. 298, 175 N.W. 195 (1919). The generality of this rule did not, however, bar implementation of IOLTA programs in Idaho, Nebraska, Oregon and Colorado.

31. The terms interest and usury were generally considered synonymous until the eighteenth century. E. JOHNSON, AMERICAN ECONOMIC THOUGHT IN THE SEVENTEENTH CENTURY 213

on money loaned.[32] The prohibition ascribed to the common law is attributable to a long history of religious and moral debate, only a small part of which will be traced here.[33] This common law bar stemmed from the biblical prohibition found in Deuteronomy that "thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury."[34] The biblical prohibition furnished fertile grounds for moral debate in medieval Europe. The Church condemned usury in any form.[35] Nevertheless, lending at interest has been present throughout recorded history.[36] At the time of the German Reformation, "the radical preachers declared interest charges, usury, and in some cases even private property, to be anti-Mosaical and unchristian."[37] The conservatives, led by Luther, argued that Mosaic law was obsolete and that the New Testament was not meant to govern civil affairs. Usury, under this theory, was neither prohibited nor permitted; it was simply no business of the Church. Regulation of interest was solely a matter for the civil government.[38]

Overcoming religiously based opposition to usury was vital if the newly emerging capitalist system was to continue to develop.[39] Calvin was the first to "exploit the ambivalence of the Deuteronomic passage" to establish that lending at interest was proper.[40] His leadership paved the way for "merchants, lawyers, and other spokesmen of the business community" to take the initiative in removing the burdensome medieval doctrine of usury.[41] By 1650, the "traditionalist forces had been thoroughly routed in Protestant lands."[42]

England first allowed lending at interest in 1545 at the rate of ten percent.[43] In the face of a storm of moral and religious opposition,[44]

(1961). The terms will be used interchangeably throughout this section.

32. National Bank v. Mechanics' Nat'l Bank, 94 U.S. (4 Otto.) 437 (1877).

33. For a more extensive development of the topic, see J. NOONAN, JR., THE SCHOLASTIC ANALYSIS OF USURY (1957); F. RYAN, USURY AND USURY LAWS (1924); T. WILSON, A DISCOURSE UPON USURY (1963) (first published in 1572, with an historical introduction by R.H. Tawney).

34. *Deuteronomy* 23:19 (King James). The earliest known written usury law is contained in the Hammurabi Code, dating to 1750 B.C. Special Project, *Interest Rates and the Law: A History of Usury,* 1981 ARIZ. ST. L.J. 61, 66-67 [hereinafter cited as *Interest Rates*]. The Code is said to have permitted interest at 20% on loans of silver and 33% on loans of grain. *Id.*

35. B. NELSON, THE IDEA OF USURY, FROM TRIBAL BROTHERHOOD TO UNIVERSAL OTHERHOOD (1949).

36. *Interest Rates, supra* note 34, at 73.

37. B. NELSON, *supra* note 35, at xix.

38. *Id.*

39. *Id.* at xx.

40. *Id.* at 73.

41. *Id.* at 82.

42. *Id.* at 95.

43. A Bill Against Usury, 37 Hen. 8, ch. 9 (1545).

44. *Interest Rates, supra* note 34, at 81.

the authorization was repealed seven years later.[45] This prohibition lasted only eighteen years. In 1570, the taking of interest was legalized[46] and was never again banned. Henceforth, the issue would not be whether interest could be charged, but rather how much could be charged.

Although religious thought no longer abhored usury, it never abandoned the proposition that rates of interest should be controlled to prevent exploitation. Luther declared that "interest which does not exceed 4 or 5 percent is not immoral."[47] Calvin argued that taking interest was not improper so long as the rate was not oppressive.[48] Interest rates were regulated downward in 1624,[49] 1660,[50] and again in 1713.[51] While John Locke, writing in 1691, advocated free trade in money, he never doubted the power of the state to regulate the rate. In fact, he supported legal limits to protect the inexperienced against "extortion and oppression."[52] Regulation continued to be the rule, although opposed by Bentham,[53] Blackstone[54] and

---

45. 5 & 6 Edw. 6, ch. 20 (1552).

46. An Act Against Usury, 13 Eliz. 1, ch. 8 (1570).

47. *Interest Rates, supra* note 34, at 78.

48. *Id.* at 78-79.

49. An Act Against Usury, 21 Jac. 1, ch. 17 (1623) (reducing the rate to 8%).

50. An Act for the Refraining the Taking of Excessive Usury, 12 Car. 2, ch. 13 (1660) (reducing the rate to 6%).

51. An Act to Reduce the Rate of Interest Without Any Prejudice to Parliamentary Securities, 12 Anne., stat. 2 ch. 16 (1713) (reducing the rate to 5%).

52. F. RYAN, *supra* note 33, at 47. Locke insisted:

> [T]hat the "price of the hire of money" cannot be regulated, that lowering the rate of interest by law would destroy trade, ruin "widows and orphans," and inspire general perjury, . . . would enrich only bankers, [who] . . . with the money of the "ignorant and the lazy in their hands . . . are always skillful enough to get interest above the legal."

B. NELSON, *supra* note 35, at 98.

53. Bentham, *Letters in Defense of Usury* (1781), *reprinted in* 3 WORKS OF JEREMY BENTHAM 1-29 (J. Bowring ed., reprint 1962). Bentham said:

> In a word, the proposition I have been accustomed to lay down to myself on this subject is the following one, viz. that *no man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered with a view to his advantage, from making such bargain, in the way of obtaining money, as he sees fit: nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to.*

Id. at 4 (emphasis in original). Bentham also argued the laws regulating interest rates could do nothing but cause mischief. *Id.*, vol. VI, at 9. For a fuller development of Bentham's position, see *Interest Rates, supra* note 34, at 83-84.

54. Blackstone argued that the total prohibition of usury was the work of the "Dark Ages," the time of "Monkish superstitutions and civil tyranny," when "commerce was at its lowest ebb." 2 W. BLACKSTONE, COMMENTARIES, *107-08, *quoted in* B. NELSON, *supra* note 35, at 108.

others.[55]

The tradition of interest rate regulation carried over to colonial America.[56] By the eighteenth century, all of the colonies had adopted laws regulating interest rates.[57] Following the Revolution, the new states used these laws as models.[58] Regulation, in one form or another, has continued to be the general pattern to date.

The inherited history of usury quickly led American courts to conclude that the "right to recover interest upon the loan or forebearance of money" was purely statutory.[59] State courts have continued to adhere to that view,[60] although the federal rule, in the absence of statute, permits the recovery of interest as the dictates of equity require.[61] Between private parties, interest is purely a matter of contract.[62] Indeed, in the absence of statute or contract, banks have no obligation to pay interest on deposits.[63]

While the rules authorizing both loans at interest and the recovery of interest in judicial proceedings have constantly expanded, until recently the same could not be said of the rules authorizing interest on bank deposits. The modern institution of banking can be traced to the founding of the Bank of England in 1694.[64] From the earliest period, the regulation of banking activities was deemed of utmost

---

55. H. SPIEGEL, THE GROWTH OF ECONOMIC THOUGHT 256 (1983). Not until 1854, long after the American Revolution, did England repeal its usury laws. Usury Law Repeal Act, 1854, 17 & 18 Vict., ch. 90.

56. The usury question was no longer a moral issue to the American colonists because the last absolute prohibition against usury was removed during the reign of Elizabeth in 1571. E. JOHNSON, *supra* note 31, at 213-19.

57. *Interest Rates, supra* note 34, at 85.

58. Every state regulated interest rates by the middle of the nineteenth century. *Id.*

59. Frazer, Executor v. Boss, 66 Ind. 1 (1879).

60. *See, e.g.,* Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1913); City of Detroit v. Detroit Police Officers, 408 Mich. 410, 294 N.W.2d 68 (1980); McManus v. Burrows, 280 Mo. 327, 217 S.W. 512 (1919). For a contrary view, see Coleman v. Commins, 77 Cal. 548, 20 P. 77 (1888), where the Court reversed the rule and held that the bar of usury was solely statutory. Therefore, in the absence of statute, any rate, no matter how high, was lawful.

61. *See, e.g.,* Rodgers v. United States, 332 U.S. 371 (1947); Billings v. United States, 232 U.S. 261 (1914); Young v. Godbe, 82 U.S. (15 Wall.) 562 (1873). Although no statute is required where the United States seeks recovery, the converse is not true. Richerson v. Jones, 551 F.2d 918 (3d Cir. 1977).

62. Lakefront Realty Corp. v. Lorenz, 19 Ill. 2d 415, 167 N.E.2d 236 (1960).

63. Jones v. Mallory, 22 Conn. 386 (1853). *See* 5A MICHIE ON BANKS AND BANKING § 94 (1973 & Supp. 1983). The positive law may also deny recovery, even as to pre-existing contractual agreements, because it is only by way of positive law that interest may be recovered. A law of that nature will not be deemed to impair a contract, nor will it be considered a deprivation of property. *E.g.,* Missouri & Arkansas Lumber & Mining Co. v. Greenwood Dist. of Sebastian County, Ark., 249 U.S. 170 (1919); Morley v. Lake Shore & M.S. Ry., 146 U.S. 162 (1892). Harmanson v. Wilson, 11 F. Cas. 541 (1877), held that the long history of interest rate regulation authorized the legislature to freely modify, as it deemed in the public interest, laws relating to the recovery of interest on a debt.

64. J. KNOX, A HISTORY OF BANKING IN THE UNITED STATES 4 (1900).

importance.[65]

Banking developed slowly in colonial America. There were no banks as we know them today prior to 1780.[66] Unlike the Bank of England, a central bank with important commercial functions and which paid interest on deposits from the beginning,[67] the early American banks were established for the purpose of providing "safe depositories for the funds of capitalists."[68] Beginning in 1781, however, banks in the modern sense were established in ever increasing numbers.[69] By 1786, bank deposits played an important role in the economy.[70] Still, the suggestion in 1810 that the First Bank of the United States pay interest on government deposits was considered a radical departure.[71] Even as late as 1834, it was thought the purpose of making a bank deposit was for safekeeping.[72]

Although the terminology differed, the earliest banks accepted

---

65. *Id.*

66. B. HAMMOND, BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR 4 (1957). Hammond describes early banking:

> In the 18th century American "banks" were known in three different senses. First, the word was used of corporate institutions — the Bank of England, for example — of which, however, there were none in America till 1782. Second, it was used of an issue of bills of credit by a colonial government: Rhode Island, for example, might emit "a bank of L40,000." This use became obsolete before the century ended. Third, it was used of an association of private persons who issued their own bills of credit.

Id. Checking accounts were non-existent. *Id.* at 9-10.

67. J. KNOX, *supra* note 64, at 4.

68. I F. REDLICH, THE MOLDING OF AMERICAN BANKING: MEN AND IDEAS 13-14 (Johnson Reprint 1968). Redlich notes that, for the most part, banks did not *charge* a fee for this service, although for a few years between 1784 and 1815 The Massachusetts Bank did charge depositors a small fee payable at withdrawal. *Id.* at 15. Prior to 1815, only one bank paid interest on deposits. Redlich notes, "[i]t would hardly have occurred to the average bank director to pay such interest. Providing a safe place of deposit for capitalists was considered one of the main functions of banks, and the question was whether or not banks should charge a fee for such service." *Id.* at 52.

69. B. HAMMOND, *supra* note 66, at 71-72. By 1800, 29 banks were in existence. *Id.* at 144. The number steadily increased. In 1811, there were 88 banks and by 1816 there were 246 banks. C. GOLEMBE & D. HOLLAND, FEDERAL REGULATION OF BANKING 4 (1981). All the existing banks were state-chartered, the federal government not yet having created the dual banking system we know today.

70. B. HAMMOND, *supra* note 66, at 81 (interest was not paid on deposits). *See* I F. REDLICH, *supra* note 68, at 14. The payment of interest on deposits was first introduced in 1807 by the Farmers' Bank of Maryland. It paid 4% on deposits held for at least six months and 3% on demand deposits. Farmers' Bank was the exception; most banks did not pay interest prior to 1825. J. KNOX, *supra* note 64, at 480. *See also* D. DEWEY, STATE BANKING BEFORE THE CIVIL WAR 215 (1910) (for the proposition that a bank could not refuse to pay interest on government deposits without violating their charter); I E. KEYES, A HISTORY OF SAVINGS BANKS IN THE UNITED STATES, FROM THEIR INCEPTION IN 1816 DOWN TO 1874 328 (1876) (for the belief that allowing interest on money deposited would be a great public accommodation and benefit).

71. I F. REDLICH, *supra* note 68, at 14 n.103.

72. *Id.* at 13 n.99.

both time and demand deposits. In the east coast commercial centers, checks were in common usage before 1800.[73] By 1816, demand deposits accounted for nearly half of all deposits, a figure which continued to rise.[74] Ten years later it was common for banks to pay interest on time deposits, but not on demand deposits.[75]

As the banking industry evolved, competition for deposits grew. To attract new deposits, the payment of interest on demand deposits became widespread.[76] Due to the financial panic of 1857, however, forty-two New York City banks agreed among themselves to cease paying interest.[77] Banks outside of New York City soon followed suit.[78] The pressure of new competition after the Civil War, however, resulted in the resumption of interest payments.[79] By 1884, the payment of interest on demand deposits had become almost universal among banks.[80]

Throughout this developmental period, banking was heavily regulated.[81] The federal government's involvement in banking began with

---

73. *Id.* at 15.

74. *Id.* at 50.

75. *Id.* at 53.

76. *Id.* vol. II, at 6. Before 1840, it was unusual for interest to be paid on demand deposits of individuals, although interest was often paid on demand deposits of other banks, corporations, and governmental entities. *Id.* at 53. Today, of course, the rule is reversed. *See infra* note 97.

77. I F. REDLICH, *supra* note 68, at 7. By 1860, virtually all New York City banks had stopped paying interest on deposits. A. COX, REGULATION OF INTEREST RATES ON BANK DEPOSITS 3 (1966).

78. I F. REDLICH, *supra* note 68, at 7.

79. *Id.*

80. J. KNOX, *supra* note 64, at 187. Certificates of deposit were in common usage. Early withdrawal resulted in the forfeiture of all interest. *Id.* Connecticut, in 1854, adopted the first law limiting the amount of interest that could be paid on deposits. Although state regulation was pervasive, it was not, in general, concerned with whether, or how much, interest should be paid on deposits. A. Cox, *supra* note 77, at 2. Before 1863, there were no nationally chartered banks other than the First and Second Banks of the United States. Regulation, therefore, was almost entirely a matter of state law. C. GOLEMBE & D. HOLLAND, *supra* note 69, at 3.

81. The early years of the republic are often spoken of as if the era were one of *laissez faire* in which governmental authority refrained from interference in business and benevolently left it a free field. Nothing of the sort was true of banking. Legislators hesitated about the kinds of conditions under which banking should be permitted but never about the propriety and need for imposing conditions. To begin with, Hamilton and the Federalists closely restricted banking as a quasi-state monopoly at a time when the opposition would have permitted no banking at all. The issue was between prohibition and state control, with no thought of free enterprise. . . . The impression was general that the exercise of the banking function without express authorization from the sovereign power was improper, if not impractical, and that legislatures had the obligation to legislate for it with all the detail they chose.

B. HAMMOND, *supra* note 66, at 185-86. In 1852, there were no banks in the states of Arkansas, California, Florida, Illinois, Iowa, and Texas, then constituting 7 out of 31 states, or in the territories of Minnesota and Oregon, as well as the District of Columbia. *Id.* at 605. *See also* G.

the creation of the First Bank of the United States in 1791 and the later establishment of the Second Bank in 1816.[82] After the demise of the Second Bank in 1836, the federal government did not actively return to banking until adoption of the National Currency Act of 1863.[83] This Act, for the first time, made provisions for the federal chartering of banks.[84] A year later, the National Bank Act of 1864 revised the chartering authority and created a federal regulatory authority, the Office of the Comptroller of the Currency.[85] Like their state counterparts, the creators of the national banking system were not concerned with whether interest should be paid on deposits.[86] The National Bank Act of 1864 did not even address the issue. Periodically, after financial crises in 1873, 1884, 1893 and during World War One, proposals to eliminate interest on deposits were made, but never adopted.[87]

The bank failures of the Great Depression resulted in a complete overhaul of banking law and far more extensive federal regulation. Section 11(b) of the Banking Act of 1933 barred commercial banks from paying interest on demand deposits and authorized the Federal Reserve Board to limit, by regulation, the rate of interest payable on time and savings deposits.[88] This regulatory scheme, adopted in 1933,

---

BARNETT, STATE BANK AND TRUST COMPANIES SINCE THE PASSAGE OF THE NATIONAL BANK ACT 144-81 (National Monetary Commission 1911) (A.M. Kelley reprint 1969) (for a discussion of the development of state bank supervision); C. GOLEMBE & D. HOLLAND, *supra* note 69, at 3 (for the premise that banks are subject to the oldest and most pervasive system of regulation with the states, as opposed to federal government, almost completely regulating banking for the first 75 years); W. SUMNER, A HISTORY OF BANKING IN THE UNITED STATES (1896) (for a complete history of banking in the United States from 1630 to 1895).

82. C. GOLEMBE & D. HOLLAND, *supra* note 69, at 3.

83. 12 Stat. 665 (1863).

84. C. GOLEMBE & D. HOLLAND, *supra* note 69, at 5.

85. 13 Stat. 99 (1864). The Act was originally entitled "An Act to provide a National Currency, secured by a Pledge of United States Bonds, and to provide for the Circulation and Redemption thereof." *Id.* The Act was retitled in 1874. 18 Stat. 123. *See* Levin, *In Search of the National Bank Act,* 97 BANKING L.J. 741, 742-43 (1980).

86. A. Cox, *supra* note 77, at 4.

87. *Id.* at 4-9.

88. Banking Act of 1933, ch. 89, § 11(b), Pub. L. No. 66, 48 Stat. 181 (1933). That section, codified at 12 U.S.C. § 371a (1976), provided in relevant part that: "No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand." The Banking Act of 1935, Pub. L. No. 305, 49 Stat. 702 (1935), authorized the Federal Deposit Insurance Corporation (F.D.I.C.) to regulate interest rates of insured, nonmember banks. Other legislation had the effect of regulating interest rates for savings and loan associations and other types of financial institutions. Both the Federal Reserve Board, in its Regulation Q, 12 C.F.R. § 217 (1984), and the F.D.I.C. have maintained interest rate regulations for over forty years. In Steingut v. Guaranty Trust Co., 161 F.2d 571 (2d Cir.), *cert. denied,* 332 U.S. 753, 807 (1947), the court held that § 11(b) required financial institutions to stop paying interest on pre-1933 demand deposits, even where the interest was being paid pursuant to an express contract between the bank and the depositor.

remained relatively unchanged for forty years.[89]

The new regulatory scheme severely limited the ability of depositors to earn interest. Some slippage was inevitable, however, because of definitional problems associated with the three types of available accounts, "demand," "time" and "savings." No depositor was entitled to interest on a demand account. Savings deposits, defined as money belonging to individuals or to non-profit institutions operated for religious, charitable or similar purposes left on deposit thirty days or more, were permitted to earn interest. Corporate funds could earn interest only if placed in time deposits.[90] Efforts to circumvent interest limitations were common.[91] The real revolution, however, was yet to come.

In June of 1972, the Consumers Savings Bank of Worcester, Massachusetts, offered the first savings accounts that permitted a "Negotiable Order of Withdrawal" (NOW accounts).[92] Three months later, similar accounts were offered in New Hampshire.[93] Congress quickly confirmed the authority of financial institutions in those two states to

89. The federal government has the power to regulate all aspects of the banking industry. *E.g.*, Deitrick v. Greaney, 309 U.S. 190 (1949); Dillingham v. McLaughlin, 264 U.S. 370 (1924); Cook County Nat'l Bank v. United States, 107 U.S. 445 (1882). The government's power to control interest rates has never been directly challenged. The early case of Munn v. Illinois, 94 U.S. (4 Otto.) 113 (1877), which upheld the regulation of rates charged by warehousemen as a valid exercise of the police power, adequately disposes of any such attack. United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 329 (1963), assumed, without discussion, the validity of § 11(b). Lower court decisions make the same assumption. For example, Federal Deposit Ins. Corp. v. Sumner Fin. Corp., 451 F.2d 898 (5th Cir. 1971), upheld, without analysis or discussion, F.D.I.C. regulations limiting interest rates and controlling interest rate advertising. Gearheart v. Federal Reserve Bank, 516 F.2d 353 (6th Cir.), *cert. denied*, 423 U.S. 927 (1975), upheld the interest rate differential of Regulation Q, 12 C.F.R. § 217.7, dependent on the size of a certificate of deposit. Frouge Corp. v. Chase Manhattan Bank (Nat'l Ass'n), 426 F. Supp. 794 (S.D.N.Y. 1976), held that it was improper for a bank to pay interest on a business checking account. The states have similarly broad regulatory powers. Noble State Bank v. Haskell, 219 U.S. 104 (1911), upheld, against a fifth amendment taking claim, a state law requiring banks to contribute to a "Depositors' Guaranty Fund," a precursor of the F.D.I.C. The Court so held, at least in part, on the basis that because the state could take the entire business of banking under its control it surely could regulate a lesser matter. *Id.* at 113. State court decisions are similar. *See, e.g.*, Holland v. Nakdimen, 177 Ark. 920, 9 S.W.2d 307 (1928) (upholding a limitation of 4% on interest payments on deposits); Hoeffler v. American Sav. Bank, 47 N.Y.S.2d 327 (N.Y. Sup. Ct. Special Term), *aff'd*, 268 A.D. 766, 50 N.Y.S.2d 166 (N.Y. App. Div.), *appeal denied*, 293 N.Y. 935 (1944) (sustaining a law barring savings banks from paying interest on deposits in excess of $7,500.00).

90. Board of Governors, Federal Reserve System, *Annual Report* 64 (1935). Current regulation is found at 12 C.F.R. § 217.135 (1984). *See* A. Cox, *supra* note 77, at 26-27.

91. A. Cox, *supra* note 77, at 26.

92. D. CRANE & M. RILEY, *supra* note 10, at 3. These "check-equivalent" devices were quickly upheld by the Supreme Judicial Court of Massachusetts. Consumers Sav. Bank v. Commissioner of Banks, 361 Mass. 717, 282 N.E.2d 416 (1972).

93. D. CRANE & M. RILEY, *supra* note 10, at 3.

offer NOW accounts.[94] Three years later, the authorization was extended to all six New England states.[95] The popularity of what, to the general public, was simply an interest paying checking account spread quickly and became a nationwide phenomenon as of December 31, 1980.[96] NOW accounts are not available to all depositors. Instead, NOW accounts must consist "solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit," or of funds belonging to public entities.[97] NOW

94. Pub. L. No. 93-100, § 2, 87 Stat. 342 (1973) (repealed 1980). Financial institutions in other states were barred from allowing "the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties." *Id.*

95. Pub. L. No. 94-222, § 2, 90 Stat. 197 (1976), *amended by* 12 U.S.C. § 1832(a) (1982). New York was added in 1978, Pub. L. No. 95-630, tit. XIII, § 1301, 92 Stat. 3712 (1978), *amended by* 12 U.S.C. § 1832(a) (1982), and New Jersey in 1979, Pub. L. No. 96-161, tit. I, § 106, 93 Stat. 1235 (1979), *amended by* 12 U.S.C. § 1832(a) (1982).

96. The Consumer Checking Account Equity Act of 1980, Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 146 (1980), codified at 12 U.S.C. § 1832(a) (1982). Other provisions of the Act are codified primarily at 12 U.S.C. §§ 3501-3524 (1982). Section 12 U.S.C. § 3502(a) (1982), delegates to a Depository Institutions Deregulation Committee (D.I.D.C.) the authority to "prescribe rules governing the payment of interest . . . and the establishment of classes of accounts." Section 204, 12 U.S.C. § 3503(a) (1982), states that limitations will cease as soon as economic conditions render it feasible, but not later than March 31, 1986. In 1982, the Thrift Institutions Restructuring Act, Title III of the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 327, 96 Stat. 1501 (codified at 12 U.S.C. § 3503(c) (1982)), authorized financial institutions to compete with the interest rates offered by money market mutual funds. The D.I.D.C. then created the Money Market Deposit Account (M.M.D.A.). 47 Fed. Reg. 53710 (Nov. 29, 1982). M.M.D.A.'s are available to all depositors. Preauthorized transfers are limited to a maximum of six per month, however, three of which can be by "check, draft or similar device drawn by the depositor to third parties." 12 C.F.R. § 1204.122 (1984). The development of the M.M.D.A. resulted in the creation of the Super NOW account, pursuant to the D.I.D.C.'s authority to create classes of accounts, granted by § 203(a). *See* 47 Fed. Reg. 56320 (Dec. 16, 1982), *cited in* 12 C.F.R. § 1204.122 (1984). The NOW account interest rate is limited to 5¼%. Super NOW accounts are identical to NOW accounts, except for an unregulated interest rate in return for opening and average balance requirements. 12 C.F.R. § 1204.108 (1984).

97. 12 U.S.C. § 1832(a)(2) (1982). The categories of depositors eligible to hold NOW and Super NOW accounts include:

1. Individuals, both privately and as sole proprietors.
2. Fiduciaries, provided the entire beneficial interest belongs to an individual.
3. Pension funds, escrow accounts, security deposits, and the like, provided the entire beneficial interest belongs to an individual.
4. Nonprofit organizations operated primarily for religious, philanthropic, charitable, educational or other similar purposes.
5. Organizations described in section 501(c)(3) through (13) and (19) of the Internal Revenue Code.
6. Homeowners and condominium owners associations.
7. Governmental entities.

Ineligible categories of depositors include:

accounts furnish the only basis for interest-paying checking accounts. NOW account ownership restrictions, however, bar all profit-making clients, other than sole proprietors, from utilizing NOW accounts.

In short, both economic and banking barriers prevent a client's nominal or short-term deposits from being made productive for the client. The first barrier, the transaction costs incurred by attorneys and financial institutions, was noted earlier.[98] The second barrier, considered in this section, consists of the long history of restrictions on the ability of bank customers to earn interest on checking accounts. This barrier includes the current NOW account ownership restrictions, which prevent all profit-making clients, other than sole proprietors, from utilizing NOW accounts. The unique character of the IOLTA program rests in part on its ability to overcome both barriers. The economic barrier is overcome because the aggregate, as an aggregate, can produce income net of expenses. Additionally, by providing that income produced by a NOW account be paid to a nonprofit charitable corporation or a public entity, the banking barrier is overcome.[99] Therefore, it is accurate to say that without IOLTA there would be no interest income in the first place.

---

1. All organizations, of whatever form, operated for profit, including corporations, partnerships, associations, business trusts, etc.
2. Credit unions.
3. Mutual insurance companies.
4. Crop financing organizations.
5. Political organizations.
6. Prepaid legal services plans.

12 C.F.R. § 217.157 (1984). The Federal Deposit Insurance Corporation's similar regulation for insured banks is found at *id.* § 329.103; the Federal Home Loan Bank Board's for savings and loan associations at *id.* § 526.1(a)(1). The history of the restriction is discussed in Schley, *Restrictions on Ownership on NOW Accounts,* 99 BANKING L.J. 196, 201-06 (1982). Corporations can earn interest on their bank deposits if they do not use negotiable instruments as the method of withdrawal. *Id.* Otero Sav. & Loan Ass'n v. Federal Home Loan Bank, 665 F.2d 279 (10th Cir. 1981), prohibited a savings and loan association from evading NOW account ownership restrictions by using a "check-in" account, which consisted of an interest bearing savings account and a zero balance checking account into which funds were transferred to cover checks as presented. In American Bankers Ass'n v. Connell, 686 F.2d 953 (D.C. Cir. 1979), the court struck down regulations which authorized Automatic Fund Transfer schemes designed to achieve the same end, as being an "indirect device" to pay interest on demand deposits, and thus barred by 12 U.S.C. § 371a (1976). Congress then amended the section to permit automatic withdrawal accounts so long as the deposits consist "only of funds in which the entire beneficial interest is held by one or more individuals." Act of Dec. 28, 1979, Pub. L. No. 96-191, tit. I, § 101(a), 93 Stat. 1233 (1979), effective from Dec. 31, 1979 to Mar. 31, 1980, *extended by* The Consumer Checking Account Equity Act, Pub. L. No. 96-221, tit. III, § 302(a), 94 Stat. 145, 145-46 (1980).

98. *See supra* text accompanying notes 8-15.

99. Because the recipient of the IOLTA-generated interest is considered the beneficial owner, the use of NOW accounts by the law firm is permissible. Middlebrooks, *The Interest on Trust Accounts Program, Mechanics of Its Operation,* 56 FLA. B.J. 115 (1982).

IV. Identification of the Constitutional Challenge

Moving past rhetoric to a definition of the precise fifth amendment issues IOLTA raises is difficult. Such an analysis requires an examination of two of the four core concepts of the takings clause.[100] The threshold issue is whether IOLTA deprives a client of any "property." If that question is answered affirmatively, the second issue, whether the client's property is "taken" as that term is understood in fifth amendment jurisprudence, must be examined. Unfortunately, neither proponents nor critics of IOLTA have engaged in a rigorous and searching examination of the fifth amendment issues at stake. This article's discussion of the policies and doctrine underlying the issues serves to highlight the difficulty in resolving the conflict.

Twenty-five state supreme courts have adopted IOLTA programs without formal opinion.[101] Four state supreme courts have refused to

---

100. "Public use" and "just compensation" limitations imposed by the fifth amendment are not implicated. Even IOLTA's harshest critics concede that providing legal services to the poor is a "public use" within the meaning of the taking clause. Baker & Wood, *supra* note 3, at 365. Hawaii Housing Auth. v. Midkiff, 104 S. Ct. 2321 (1984), confirms that the police power and the fifth amendment's public use limitation are coextensive. "Just compensation," the measure of damages, is applicable only if IOLTA is a taking. Deciding that IOLTA is a taking ends the program because no IOLTA program can provide for just compensation.

101. IOLTA UPDATE, *supra* note 1. In five states, IOLTA programs have been established by legislation: California, The Funds for the Provision of Legal Services to the Indigent Act, CAL. BUS. & PROF. CODE §§ 6210-6228 (West 1981); Maryland, MD. ANN. CODE art. 10, §§ 44-45.0 (1982); New York, N.Y. JUD. LAW § 497 (McKinney 1983); Connecticut, 1984 Conn. Acts 84-537 (Reg. Sess.); Ohio, Amended Substitute Senate Bill No. 219, effective Jan. 8, 1985. Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984), *appeal denied,* No. 4 Civ. 31635 (Cal. May 2, 1985), decided after completion of this article, rejected all parts of an attack on California's mandatory IOLTA program. The plaintiffs in that action alleged that the California program violated the fifth amendment's taking clause, was void for vagueness because it failed to adequately specify how to determine whether a client's funds were nominal or short-term, violated the equal protection clause because clients without trust fund deposits did not have to participate in financing legal aid, and worked a denial of the right to counsel. In rejecting the taking claim, the court emphasized the total lack of loss to the client, cited the statement in Hooker v. Burr, 194 U.S. 415, 419 (1904), that if a claimant is "not injured to the extent of a penny . . ., his abstract rights are unimportant." *Id.,* slip. op. at 13, and held that "[s]o long as the principal is secure, not diminished and is not economically capable of generating net income through deposits or investments legally available for lawyers' trust funds . . ." there is no taking. *Id.* slip. op. at 16.

Iowa's mandatory program has just been made the subject of a unique challenge. IOLTA objectors have petitioned for the issuance of a writ of certiorari directed to the Iowa Supreme Court's rule-making order of December 28, 1984. Ronwin v. Supreme Court of Iowa, *cert. denied,* 53 U.S.L.W. 3807 (U.S. May 14, 1985).

One challenge to an IOLTA program is pending. Florida's voluntary program is being challenged in Glaeser v. The Florida Bar, No. 84-1345 (M.D. Fla. filed Oct. 11, 1984). Plaintiff there alleges that Florida's program constitutes a taking of property without due process of law, conversion, and breach of fiduciary duty. A preliminary injunction was denied on November 16, 1984. Glaeser v. The Florida Bar, No. 84-1345 (M.D. Fla. Nov. 16, 1984) (order denying preliminary injunction), *appeal dismissed as moot,* No. 84-3796 (11th Cir. May 28, 1985).

approve IOLTA programs.[102] The supreme courts of Arkansas,[103] Florida,[104] Minnesota,[105] New Hampshire,[106] Utah,[107] and Washington[108] have expressly held IOLTA does not violate the fifth amendment because IOLTA *creates* income rather than takes property belonging to the client. The reported decisions adopting IOLTA programs do little more than declare that IOLTA-generated income is not the property of the client. Having declared the absence of a property interest, none of the decisions examine the taking issue.[109] For analytical purposes, IOLTA is unique, fitting into no obvious legal pigeonhole. Neither *Webb's* nor any other decision of the United States Supreme Court demands the conclusion that IOLTA is or is not a taking.

A. The Property Issue Identified

An analysis of the property issue cannot start with a declaration that the earnings from a fund are the property of the fund owner.[110] Nor is it adequate to state "that no client is compelled to part with 'property' by reason of a state directive, since the program creates income where there had been none before, and the income thus created would never benefit the client under any set of circum-

102. IOLTA UPDATE, *supra* note 1. None of the rejections rest explicitly on fifth amendment grounds.

103. *In re* Arkansas Bar Ass'n: Petition to Authorize a Program Governing Interest on Lawyers' Trust Accts., 283 Ark. 252, 675 S.W.2d 355 (1984), *overruling, In re* Interest on Lawyers' Trust Accts., 279 Ark. 84, 648 S.W.2d 48 (1983).

104. *In re* Interest on Trust Accts., 402 So. 2d 389 (Fla. 1981).

105. Petition of Minnesota State Bar Ass'n, 332 N.W.2d 151 (Minn. 1982).

106. Petition of New Hampshire Bar Ass'n, 122 N.H. 971, 453 A.2d 1258 (1982).

107. *In re* Interest on Lawyers' Trust Accts., 672 P.2d 406 (Utah 1983).

108. *In re* Adoption of Amendments to CPR DR 9-102 IOLTA, No. 25700-A-351, slip op. Wash. (June 19, 1984).

109. The California decision, *supra* note 101, accepted the "generalized claims that clients have property rights in their money," Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984), *appeal denied,* No. 4 Civ. 31635 (Cal. May 2, 1985), but found that the IOLTA programs use of the income generated by those funds did not constitute a taking.

110. Baker & Wood, *supra* note 3, at 357, fall into this error, assuming that IOLTA "does not create the right to recover interest income from client trust funds." Their pronouncement ignores the difference between net and gross income and thus ignores the essential characteristic of nominal or short-term deposits that provides the foundation for the IOLTA concept. The discussion of the client's "inchoate right to income" as property, in Comment, *supra* note 3, at 1009-11, similarly ignores the unique factual circumstances under which IOLTA operates. To affirm, or deny, that someone has a "right" is merely to announce a conclusion that a court will, or will not, grant relief. The conclusion, however, "provides no reason whatever *why* such relief should," or should not, be granted. Van Alstyne, *The Demise of the Right-Privilege Distinction in Constitutional Law,* 81 HARV. L. REV. 1439, 1459 (1968) (emphasis in original). *See* United States v. Willow River Power Co., 324 U.S. 499, 502-03 (1945). *See also* Holmes, *Natural Law,* 32 HARV. L. REV. 40, 42 (1918) (for a jurisprudential discussion of a legal right as the basis of a prophecy).

stances."[111] The initial burden IOLTA critics must meet is to define the specific property, the specific "legitimate claim of entitlement," that IOLTA allegedly takes.[112] In order to fully understand the flaw in the IOLTA critics' reasoning, it is necessary to compare the requirements of the IOLTA programs with the requirements of the prior law regulating attorney trust accounts. IOLTA does not alter the traditional pattern. The attorney's duty to place client monies in secure, available-on-demand accounts is not changed. IOLTA expressly preserves, if not strengthens, the attorney's obligation to place client trust funds in interest-bearing accounts when the attorney and the attorney's client conclude the funds can produce income net of transaction costs. The only real change IOLTA makes is requiring banks, which previously enjoyed the "free" use of clients' nominal or short-term deposits, to pay interest.

Nothing has changed from the client's perspective. Client funds attorneys hold in trust continue to be the property of the client. If those funds are capable of producing income, the income produced, less the costs of producing that income,[113] is also the property of the client.[114] IOLTA does not affect these long established property rules. If client funds individually cannot produce income net of expenses, but can when pooled with other clients' funds, that net income is similarly the property of the client.[115] IOLTA does not affect this trust administration procedure. In neither circumstance, however, could a client successfully assert a property claim to that portion of

111. *In re* Interest on Trust Accts., 402 So. 2d at 395. The Florida court's rationale was adopted by the other courts which expressly considered the issue. *See supra* notes 103-08. The Florida Supreme Court distinguished *Webb's* on two grounds: that the income created would never benefit the client under any set of circumstances, and that the program was essentially voluntary because attorneys would not participate if their clients voiced strong objections. 402 So. 2d at 395. The second ground is mere guesswork and is simply not relevant for mandatory programs. *Webb's* can be distinguished for other, more relevant reasons, including the amount of interest in excess of $90,000, the compelled nature of the payment into court, the apparent double exaction, and the fact no police power rationale was offered to support the county's claim to the income. *See, e.g.*, ABA TASK FORCE REPORT *supra* note 11, at 7-11. If *Webb's* is not controlling, only half the equation has been answered. For if the differences cited are significant, they do not of themselves establish the absence of a taking.

112. Board of Regents of State Colleges v. Roth, 408 U.S. 564 (1972). The *Roth* entitlement test is equally applicable to fifth amendment claims where the issue is whether the claimant has a property right. Texaco, Inc. v. Short, 454 U.S. 516 (1982); Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980).

113. The trustee is entitled to reimbursement for the costs necessarily incurred to produce income, as well as the costs necessary to safeguard and administer the trust. 3 A. SCOTT, *supra* note 15, § 242.

114. The owner of a fund is properly deemed the owner of the net income. *Id.* vol. 2, § 182.

115. The use of common or pooled trust funds is described in Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950).

the gross income representing the expenses of producing the income. In short, deposits which would have earned the client nothing prior to IOLTA still earn the client nothing. Deposits which would have earned income for the client still do.

IOLTA takes advantage of the traditional trust rules, combines them with the realities of banking and attorney trust account requirements and, in effect, shifts the real but unitemized costs of producing the income from the trustee to the provision of legal services to the poor. Net income is possible only because IOLTA aggregates nominal or short-term deposits and pays the interest earned to a single beneficiary, thus avoiding the cost of individual accounting, administration and tax reporting. There is no reason in either fairness or logic why IOLTA's shift of income from banks to the providers of legal services should serve to grant the client a previously nonexistent property interest.

The assertion that the owner of a fund also owns any income the fund produces is the widest possible claim of right. If this is the applicable criterion, then IOLTA does deprive clients of property. Yet the claim to all income, *simplicter,* fails to recognize the cost of producing that income. Assume a slightly more than nominal or short-term trust fund. Upon creation of the fund, the trustee is entitled to recover his expenses as well as charge a fee for his services. The beneficiary is left with little or no income.[116] Moreover, if the trustee in good faith miscalculates the income-producing potential of the principle, the beneficiary might even be left with a negative balance, perhaps offset by invasion of the principal.[117]

The distinction between gross and net income serves to narrow the focus of the property claim. IOLTA proponents, in their constitutional calculus, impute the real but unitemized costs attorneys and financial institutions incur. By recognizing those real, albeit unallocated, costs IOLTA proponents correctly argue clients suffer absolutely no loss. Nevertheless, the claim that "IOLTA creates income" is too broad. Nominal or short-term deposits can produce income. What they cannot produce is income net of expenses. What IOLTA provides, therefore, is a mechanism for the creation of net income in a situation where only the intervention of IOLTA makes the creation of net income possible.

The rule of law enunciated in *Webb's,* that the "earnings of a fund are incidents of ownership of the fund itself and are property just as the fund itself is property,"[118] properly understood, is limited

116. 3 A. SCOTT, *supra* note 15, §§ 242, 244.
117. *Id.* § 233.
118. 449 U.S. at 164.

to the net income generated by the fund. That reading of *Webb's* is manifest from the Court's discussion of the right to charge a fee for services, or perhaps retain the interest income when that is the only fee charged. Moreover, limiting the Court's holding to the net income produced by the fund is fully consistent with the usual trust rule that the beneficiary is only entitled to the net income. The property claim must be evaluated in the context of these long established rules.

For analytical purposes, IOLTA is best viewed as a modification of trust administration principles allowing recognition of the real but unitemized costs of administering attorney trust accounts. In that light, the specific property question is whether the owner of a fund which cannot by itself produce income net of expenses is entitled to a proportionate share of the gross income produced by pooling his fund with other funds which also could not, on their own, produce income net of expenses. Clearly, the owner does not suffer any loss because his funds individually could not produce income net of expenses. The absence of loss, however, does not alone establish the absence of a property interest.

The validity of the modification depends on whether the traditional rules of property law support the assertion of the right to *all* the income. The validity of the modification is difficult to discern by reference to the law of trusts alone. It can, however, be answered more broadly by reference to economic realities, banking law restrictions on the income-producing ability of deposits and the inherent nature of attorney trust accounts. The combination of factors which prevents nominal or short-term funds from producing income net of expenses casts doubt on the critics' claim to a constitutionally protected entitlement to *all* the income. In light of the unique circumstances posed by IOLTA, the "determinative question is whether . . . [the client] holds such a legitimate claim of entitlement [to the income] that the Constitution, rather than the political branches, must define the procedures attending its removal."[119] In the absence of positive rules of law or mutually explicit understandings sufficient to satisfy the expectation and reliance theory employed in *Roth,*[120] the modification of trust law worked by IOLTA does not offend the fifth amendment.

B. The Taking Issue Identified

The taking aspect may furnish IOLTA proponents stronger sup-

119. O'Bannon v. Town Court Nursing Center, 447 U.S. 773, 796 (1980) (Blackmun, J., concurring).
120. 408 U.S. 564 (1972).

port for their claim that IOLTA does not impair fifth amendment rights. IOLTA critics contend that if the client's funds are used to produce income, and the income is not distributed to the client because of an IOLTA program, then property of the client has been taken. The contrary position, that IOLTA creates income that would never benefit the client under any set of circumstances, is remarkably similar to the rationale of the Florida Supreme Court which the United States Supreme Court rejected in *Webb's*.[121] Nevertheless, while the rationale is similar, the factual circumstances are very different.

The relevant facts of *Webb's* and IOLTA are not analogous. Perhaps the most important distinction is that the *Webb's* fund, $1.8 million held for more than a year,[122] was neither nominal nor short-term. Economic reality compelled the conclusion that the *Webb's* fund should be invested. By its very nature, the interest the *Webb's* fund earned was clearly the property of someone other than the county. Conversely, the inherent inability of nominal or short-term funds to generate positive income compels the conclusion that nominal or short-term client deposits should not be invested. The threshold ability of the two funds to generate income is of critical importance. Unlike the *Webb's* fund, the individual components of the IOLTA fund are inherently incapable of producing significant income. The client, no matter what he does, can never earn income net of expenses on a nominal or short-term trust fund deposit. IOLTA, by aggregating nominal or short-term deposits and eliminating most transaction costs, truly has created income where income previously could not exist. Under no set of circumstances does the owner of a nominal or short-term trust fund deposit have the ability to earn positive interest. This intrinsic factor, not the IOLTA program, deprives the nominal or short-term deposit of any income-producing potential.

Moreover, the interest generated by a nominal or short-term deposit is, in real economic terms, less than the cost incurred by the attorney-trustee to administer the deposit. The customary trust relationship permits the trustee to recover both the costs of administering the trust and a fee for services rendered. The premise behind IOLTA is that the income generated because of IOLTA does not exceed and is essentially the equivalent of those charges. Therefore, the attorney would, in fact, seem to have the greater claim to the earnings.[123]

121. Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951 (Fla. 1979), *rev'd*, 449 U.S. 155 (1980).

122. 449 U.S. at 159.

123. Absent rules regulating the conduct of attorneys, the client and attorney could ex-

The *Webb's* holding is also limited to "the narrow circumstances" where the government, in addition to retaining the interest income, also receives a fee "for services rendered." The Court expressed "no view as to the constitutionality of a statute that prescribes a county's retention of interest earned, where the interest would be the only return to the county for services it renders."[124] Unlike the interpleader fund in *Webb's,* an individual client's nominal or short-term funds have no ability to produce income net of expenses. To award IOLTA-generated income to the client is to award the client a windfall. The differences between the IOLTA and *Webb's* situations are sufficiently great to permit the conclusion that *Webb's* is not controlling. Nevertheless, the superficial similarity compels an examination of whether IOLTA's use of client trust deposits "takes" any legitimate claim of entitlement from a client, just as the uncertainty in application of a definition of property compels closer scrutiny of the property issue.

V. THE PROPERTY ISSUE ANALYZED

A. The Descriptive Approach to Defining Property

This section explores whether the competing property claims can be resolved, as a threshold matter, solely by examination of the meaning of the word "property."[125] The intuitive assertion of IOLTA opponents that any income produced must be allocated to each individual client in proportion to each client's share of the pooled attor-

---

plicitly agree, or the custom and practice could sanction, the attorney's placement of client funds at interest, with the attorney retaining any interest earned. In that situation, the attorney-client relationship would be no different from the depositor-bank relationship. Today, in the United Kingdom, the solicitor retains interest earned on short-term or nominal client funds. Solicitors' Accounts (Deposit Interest) Rules (1965). Rule 3 dictates that amounts in excess of 500 pounds expected to be held for two months or more should be deposited at interest for the benefit of the client. *See* COUNCIL OF LAW SOCIETY, A GUIDE TO THE PROFESSIONAL CONDUCT OF SOLICITORS (London 1974).

124. 449 U.S. at 165.

125. It may oversimplify the analysis to treat the issues of property and taking separately. Nevertheless, failure to do so ignores an essential threshold determination. Professor Stoebuck notes:

> The constitutional concepts of "taking" and "property" are intertwined. To discuss one sometimes requires the making of assumptions about the nature of the other. In fact one of the persistent problems that complicates most analysis of certain difficult eminent domain cases is the failure of judges and legal writers to separate the two concepts. Rigorous separation is necessary for analysis. . . .

Stoebuck, *Police Power, Takings and Due Process,* 37 WASH. & LEE L. REV. 1057, 1083 (1980). The threshold is also important for another reason. Before a claim of taking can be examined, there must be a specific item of property at issue. Hodel v. Virginia Surface Min. & Reclam. Ass'n, 452 U.S. 264 (1981).

ney trust account is certainly not weak. Undeniably, the beneficiary of a trust is entitled to the net income produced by the trust res.[126] It is often said, although not usually for purposes of deciding a concrete controversy, that the essence of property is the right to the income generated therefrom.[127] This assertion, however, is overbroad, and belied by *Webb's*, if it is meant to include more than the net income produced by the res. IOLTA's imputation of the real but unitemized costs of trust administration, and the shift of those costs to the provision of legal services to the poor, produces a hybrid, thoroughly scrambling the distinction between gross and net income. Whether the property/no property conflict can be resolved by a methodology that defines the word "property" is the question for this section, which searches for a reasoned and principled way to resolve the property/no property conflict by examining what we mean when we use the word "property."

The typical taking case involves real property. The threshold question, therefore, of whether the proposed governmental action impacts on property of the claimant is generally not at issue.[128] Nonetheless, the issue of whether a claimant possesses a protectible property interest is very much alive where other than real property interests are at stake.[129] Indeed, the common law has a long tradition of determining whether newly asserted rights constitute property.[130] The word "property" appears four times in the Constitution.[131] Yet nowhere in the Constitution is the word defined. In hornbook terms, property is said to denote the group of rights inhering in the individual's relation to a physical thing.[132] Of course, to speak only of a

126. 3 A. SCOTT, *supra* note 15, §§ 242, 244.

127. "What makes the right to mine coal valuable is that it can be exercised with profit." Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 414 (1922). The right to profit, however, has never been deemed the critical element of property. Andrus v. Allard, 444 U.S. 51 (1979).

128. The critical issues to be assessed can be approached in different ways. It is possible to consider the question of "property" and "taking" as only one question. One view is that the definition of property is essentially self-evident and that a detailed analysis of the issue simply serves to obscure the fact that property is, in fact, taken. Epstein, *Not Deference, But Doctrine: The Eminent Domain Clause*, 1982 SUP. CT. REV. 351, 363.

129. *Compare* Flemming v. Nestor, 363 U.S. 603 (1960) (a person covered by the Social Security Act does not have a protectable property right to receive old age benefit payments) *with* Goldberg v. Kelly, 397 U.S. 254 (1970) (those entitled to welfare benefits have protectable property interests and the benefits cannot be terminated without sufficient due process requirements). *See* Reich, *The New Property*, 73 YALE L.J. 733 (1964).

130. Philbrick, *Changing Conceptions of Property in Law*, 86 U. PA. L. REV. 691 (1938). *But see* Reichelderfer v. Quinn, 287 U.S. 315 (1932), where the Court noted that "[b]eyond the traditional boundaries of the common law only some imperative justification in policy will lead the courts to recognize in old values new property rights." *Id.* at 319.

131. U.S. CONST. art. IV, § 3, amend. V (twice), and amend. XIV, § 1.

132. *See* United States v. General Motors Corp., 323 U.S. 373, 378 (1945); Buchanan v. Warley, 245 U.S. 60, 74-75 (1917). In more detail, property has been defined as a "complex

physical thing is far too narrow. The law recognizes many non-tangible items as property.[133] Moreover, property concepts are not static. As civilization changes, civilization's conception of property also changes.

The search for meaning begins with philosophy. American property law is the legacy of a long common law tradition. Foreshadowing Locke, the 1641 Massachusetts Body of Liberties guaranteed to each individual the right to own cattle, goods and estates. Nevertheless, colonial New Englanders insisted the use of private property not be contrary to the needs and interests of the general welfare.[134] While professing to adhere to Lockean principles, they saw no inconsistency in regulating wages, prices and interest rates.[135] American property law is said to owe its basic principles to Locke's theory of natural law, premised on the right of every individual to acquire ownership of private property, ownership that flowed from the individual's use and labor in working the land.[136] Locke's philosophy comfortably fit the

---

system of recognized rights and duties with reference to the control of valuable objects . . . linked with basic economic processes . . . validated by traditional beliefs, attitudes and values and sanctioned in custom and law." Hollowell, *The Nature and Function of Property as a Social Institution*, J. LEG. & POL. SOC. 115 (1943), *quoted in* 1 POWELL, ON REAL PROPERTY ¶ 7, at 10 (P. Rohan ed. 1977).

133. United States v. Security Indus. Bank, 459 U.S. 70 (1982) (lien); United States Trust Co. v. New Jersey, 431 U.S. 1, 19 n.16 (1977) (contract rights).

134. W. SCOTT, IN PURSUIT OF HAPPINESS: AMERICAN CONCEPTIONS OF PROPERTY FROM THE SEVENTEENTH TO THE TWENTIETH CENTURY 11 (1977).

135. *Id.*

136. J. LOCKE, THE SECOND TREATISE OF GOVERNMENT (T. Peardon ed. 1952). Locke's position can be summed up as follows:

> Locke argued that God originally gave the world in common to humankind. In its natural state, however, the world was essentially worthless. Property rights existed in each person's own body and its labor. That which was removed from the commons by an individual's labor became that individual's property. Only when one mixed the "Labor of his Body and the Work of his Hands" with the essentially worthless commons was there created private property that had value.

Leeson & Sullivan, *Property, Philosophy and Regulation: The Case Against a Natural Law Theory of Property Rights*, 17 WILLAMETTE L.J. 527, 560 (1981) (footnote omitted). According to the authors,

> Locke's natural rights theory of property ownership in the presocial state of nature was grounded on two suppositions. First, Locke assumed that by nature private property ownership was related directly to use and to labor. Second, he assumed that by nature opportunities always would exist for those who desired to acquire property to do so through physical work on the land. Everyone could pursue private interests in property — so long as they adhered to the moral obligation to mix their labor with that property — without running into conflicts with others who similarly were pursuing their private interest. If human beings would adhere to the laws of nature, private property ownership would be distributed relatively equally and few if any conflicts would arise. Government would be unnecessary and people could remain in their simple natural state.

Id. at 561. *See also* Corwin, *The "Higher Law" Background of American Constitutional Law*, unique American circumstance of easily and inexpensively available land and exerted a profound influence on early American conceptions of property.[137]

Locke's concept of private property, perhaps suitable for an agrarian seventeenth century society,[138] furnishes little help in understanding the ever-changing complex relationships that exist in the modern world.[139] Nevertheless, the American Revolution spoke the language of Locke.[140] Land was the politically significant form of property. Locke's natural rights theory was interpreted primarily to mean each individual had both the right to acquire and use land and the right to become a freehold farmer.[141] The Constitutional Convention intended to protect property rights, meaning ownership of land and other tangible items. Protection of those rights confronted the courts almost immediately after adoption of the Constitution. They held the preservation of property a primary object of the social compact.[142] "At first statutes were invalidated avowedly for mere violations of natural rights, absent any constitutional prohibition covering

---

42 HARV. L. REV. pt. I, 149, & pt. II, 365 (1928) (the Constitution is composed of higher law and arises from the sovereignty of the people); Fellman, *The European Background of Early American Ideas Concerning Property,* 14 TEMP. L.Q. 497 (1940) (property is sacred and springs from the personality of man and by virtue of higher law man is entitled to things he has acquired); Grant, *The "Higher Law" Background of the Law of Eminent Domain,* 6 WIS. L. REV. 67 (1931) (the right to property is derived from a higher law which civil law can recognize but not destroy); Grant, *The Natural Law Background of Due Process,* 31 COLUM. L. REV. 56 (1931) (natural, inherent and inalienable rights exist regardless of recognition by the Constitution); Hutcheson, *The Natural Law and the Right to Property,* 26 NOTRE DAME LAW. 640 (1951) (a natural law right exists to acquire property and to not be deprived of property without civil law due process). Natural law concepts still furnish a foundation for property law and may still override the notion that only positive law can create property rights. PruneYard Shopping Center v. Robins, 447 U.S. 74, 91-95 (1980) (Marshall, J., concurring); Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980). Still, property rights can be terminated without violation of the fifth amendment. *See* Texaco, Inc. v. Short, 454 U.S. 516 (1982). Annot., 87 A.L.R.3d 1011 (1978).

137. W. SCOTT, *supra* note 134, at 11.

138. Leeson & Sullivan, *supra* note 136, at 562.

139. Locke's political theory led to the concept that a higher or natural law limited the state's power to interfere with liberty and property. That philosophy finds early expression in Calder v. Bull, 3 U.S. (3 Dall.) 386 (1798). Some have argued that it comes to full fruition in Lochner v. New York, 198 U.S. 45 (1905). Locke, however, was not advancing the position that private property rights were superior to government's need to regulate for the benefit of all. Nor was he advocating the unlimited accumulation of private wealth. According to Locke, God had given man only "as much as any one can make use of to any advantage of life before it spoils, so much he may by his labor fix a property in; whatever is beyond this is more than his share, and belongs to others." J. LOCKE, *supra* note 136, ¶ 31. Locke, therefore, cannot be read to condemn governmental restrictions of the use of private property, although he certainly meant to limit the power of the legislature. W. SCOTT, *supra* note 134, at 30-35.

140. P. LARKIN, PROPERTY IN THE EIGHTEENTH CENTURY 145 (1969).

141. W. SCOTT, *supra* note 134, at 45-54.

142. Vanhorne's Lessee v. Dorrance, 2 U.S. (2 Dall.) 304 (D. Pa. 1795). *See* P. LARKIN, *supra* note 140, at 150.

the case; and the contrary view made its way with great difficulty in both state and federal courts."[143]

Eventually, however, Bentham's position, that property is not created by natural law but instead is entirely the creation of mankind, prevailed. Thus "[p]roperty and law are born and must die together. Before laws were made there was no property: take away the laws, all property ceases."[144] The continuing protection of traditional common law property rights may still be attributable to our inheritance from Locke. As the *Roth* doctrine makes clear, however, other claims of property depend on identifying positive rules of law, an approach fully consistent with Bentham's philosophy.

How to identify and apply the relevant positive rules of law is what concerns us here. When can it be said a claimant has a property right? When can one assert ownership? Care must be taken to distinguish the after-the-fact descriptive definition of property from the analytical tools necessary to determine if the claim under considera-

---

143. Philbrick, *supra* note 130, at 716-17. J. SCURLOCK, RETROACTIVE LEGISLATION AFFECTING INTERESTS IN LAND 10 (1953) states:

> [W]hen all is said and done, there have really been exceedingly few cases in which a statute was actually declared invalid on natural law grounds, notwithstanding the many discussions in the earlier cases concerning natural rights, the social compact, and the inherent incapacity of an American government to take away life, liberty, or property except when necessary for the general good.

The most famous case is Gardner v. Trustees of the Village of Newburg, 2 Johns. Ch. 162, 7 Am. Dec. 526 (N.Y. Ch. 1816). The latest is Parham v. The Justices & Decatur County, 9 Ga. 341 (1851). Ultimately, the Supreme Court was to reject the claim of natural rights as a limitation on state action. *See* Munn v. People of Illinois, 94 U.S. (4 Otto.) 113 (1877); Slaughter House Cases, 83 U.S. (16 Wall.) 36 (1873). Soon thereafter, however, the Supreme Court substituted substantive due process in its place. W. SCOTT, *supra* note 134, at 145-46. The "switch in time saves nine" ended that era of property rights. Nevertheless, adherence to Lockean principles is evident, for example, in recent criticisms of IOLTA programs. Commentators Baker and Wood reflect a Lockean viewpoint, arguing that, as a matter of some unnamed property right, interest must follow principal as a matter of course. They cite the statement of Mr. Justice Johnson: "In equity, interest goes with the principal, as the fruit with the tree." Baker & Wood, *supra* note 3, at 357 n.161, *citing* Himely v. Rose, 9 U.S. (5 Cranch.) 313, 319 (1809). That assertion, however, was offered to define the elements of a damage claim, not as a definition of property. Moreover, recovery of interest was denied. For a present day, extreme Lockean view, see Pilon, *Property Rights, Takings, and a Free Society,* 6 HARV. J. OF L. & PUB. POL'Y 165 (1983).

144. J. BENTHAM, "Theory of Legislation, Principles of the Civil Code, Part I," ch. 5, *reprinted in* THE WORKS OF JEREMY BENTHAM 308-09 (J. Bowring ed. 1962). *See also* Felix Cohen's proposition:

> That is property to which the following label can be attached:
> To the world:
> Keep off X unless you have my permission, which I may grant or withhold.
> Signed: Private Citizen
> Endorsed: The State

Cohen, *Dialogue on Private Property,* 9 RUTGERS L. REV. 357, 374 (1954).

tion qualifies as property. Examples of after-the-fact definitions of property abound. For example, property has been defined as "a valuable right or interest in something rather than the thing itself . . . the right to possess, use and dispose of that something in such a manner as is not inconsistent with law."[145] Put somewhat differently, the term property "embraces everything which has exchangeable value or goes to make up a man's wealth — every interest or estate which the law regards of sufficient value for judicial recognition."[146] The circularity of these definitions is apparent. They are conclusions, not meaningful methods to test claims of right.

Even the more elaborate attempts at objective definitions of property do not provide definitive methods to test claims of right. Professor Timothy Terrell's two recent articles are examples of that failure.[147] Terrell posits that the effort to define the term "property" "can be divided into two distinct, although complementary and somewhat overlapping, subcategories. The first is the attempt to *describe* the various discrete rights and limitations that are implied by the label. The second is the effort to *justify* philosophically and morally the rights and limitations that have been identified."[148] The technique for examining the descriptive element, according to Terrell, involves four steps:

> First, a detailed identification must be made of the full range of specific rights, limitations on rights, interactions among rights, and application of rights to various sorts of "things," all of which together constitute the substance of the term "property" as it is used in legal contexts. . . . The second step deduces order from this chaos of data by isolating and identifying the instance of private ownership in which each of these variables is at a kind of maximum, producing the most archetypical example of this concept — the "central case" or

145. State v. Ensley, 240 Ind. 472, 487, 164 N.E.2d 342, 349 (1960), *citing* Department of Fin. Inst. v. Holt, 231 Ind. 293, 303, 108 N.E.2d 629, 634 (1952).

146. Diffendall v. Diffendall, 239 Md. 32, 36, 209 A.2d 914, 915 (Ct. App. 1965), *citing* Samet v. Farmers' & Merchants' Nat'l Bank, 247 F. 669 (4th Cir. 1917).

147. Terrell, *Causes of Action as Property: Logan v. Zimmerman Brush Co. and the "Government-as-Monopolist" Theory of the Due Process Clause,* 31 EMORY L.J. 491 (1982) [hereinafter cited as Terrell, *Causes of Action*]. See his earlier work, Terrell, *"Property," "Due Process," and the Distinction Between Definition and Theory in Legal Analysis,* 70 GEO. L.J. 861 (1982) [hereinafter cited as Terrell, *Property, Due Process*], which contains the more extensive discussion of the definitional aspect of property. Professor Terrell counts at least 140 articles dealing with the concept of property and due process subsequent to the decision in *Roth.* He counts a further 160 articles concerned with property and the takings clause. *Id.* at 864. Although both Terrell articles propose a theory of property in the context of *Roth* due process, the definitional method, if valid, should be equally applicable to the property definition problem of the takings clause of the fifth amendment.

148. Terrell, *Causes of Action, supra* note 147, at 493 (emphasis in original).

> "focal meaning." This becomes the case to which all other instances or claims of "property" status are then compared to determine whether use of this label is proper. . . . The propriety of the use of the label is then determined by the third step, which establishes around the central case some boundary or perimeter that encloses the set of instances whose analogy to the central case is strong enough to result in use of the label. . . . The fourth step is the recognition that the proper handling and labeling of any new case of claimed "property" interest rests fundamentally on its analogy to the central case, *not* on its similarity to any other cases in the property set.[149]

Terrell suggests that Professor A.M. Honoré's essay, *Ownership,*[150] identifies the elements that accurately describe the central case. Honoré identified eleven "standard incidents of ownership" which, he argued, defined the "greatest possible interest in a thing which a mature system of law recognizes."[151]

> 1. The right of possession, which includes the right to exclude others;
> 2. The right to personal use and enjoyment;
> 3. The right to manage, meaning to decide how and by whom the item owned may be used;
> 4. The right to the income, meaning entitlement to any income produced, either as a result of personal use or by allowing use by others;

---

149. *Id.* at 493-96 (footnotes omitted) (emphasis in original). Terrell's starting point is H.L.A. Hart's "central" or "typical" case. Terrell, *Property, Due Process, supra* note 147, at 863-88, *citing* H. HART, THE CONCEPT OF LAW (1961). Hart meant the "most essential, irreducible" or "core elements" that characterize our understanding of a concept. Terrell, *Property, Due Process, supra* note 147, at 866. The use of the central or typical case for comparison purposes with the item under consideration depends on how accurately it identifies all the elements that fully describe a concept. Many, if not most, assertions of property will not encompass all the elements of the central case. Therefore, it is necessary to establish an outer perimeter. The absence of too many elements places the property assertion under examination outside the definition. *Id.* at 867-68. The major difficulty, a difficulty not addressed by the definitional process, occurs in attempting to set the outer perimeter.

150. Honoré, *Ownership, reprinted in* OXFORD ESSAYS IN JURISPRUDENCE 107 (A. Guest, ed. 1961). Honoré rejects the natural law theory of property and argues that property is a creature of positive law by emphasizing that ownership is subject to "characteristic prohibitions and limitations." *Id.* at 113.

151. *Id.* at 108 (emphasis in original deleted). Other lists of essential elements have been suggested. Usually, they reduce the number of elements denoting full ownership, postulating that many of the elements identified by Honoré are subsets of other elements. *See* Snare, *The Concept of Property,* 9 AM. PHIL. Q. 200, 202-04 (1972). L. BECKER, PROPERTY RIGHTS, PHILOSOPHIC FOUNDATIONS 18-23 (1977), suggests that the "right to the capital," standing alone, is enough to define ownership. According to Becker, "[o]ne who has all the rights in the list save that of capital may own the thing in a derivative sense, but the one who has the right to the capital is 'fundamentally' the owner." *Id.* at 20.

> 5. The right to the capital, meaning the power to alienate and the liberty to consume, waste or destroy;
> 6. The right to security, meaning the item continues to be the property of the owner indefinitely, subject only to the state's power of eminent domain, bankruptcy of the owner, or execution process for debt;
> 7. The incident of transmissibility, meaning that the item passes indefinitely to the heirs of the owner and each successive heir;
> 8. The incident of absence of term, meaning that ownership rights do not end on a fixed date or upon the occurrence of a stated contingency;
> 9. Prohibition of harmful use, meaning, in a restricted sense, the police power regulation of use;
> 10. Liability to execution, meaning that the property can be lost for debt, either by way of execution or bankruptcy; and
> 11. Residuary character, meaning that when interests less than ownership (for example, leaseholds) terminate, the owner recovers that outstanding interest.[152]

Honoré does not suggest any single incident, or any combination of incidents short of all of them, establishes ownership per se. Moreover, "each of the elements is susceptible of varying definitions — not, perhaps, enough to alter the general idea, but enough to alter emphasis and practical consequences" and each element is of "varying scope," particularly among different legal systems.[153] Nevertheless, as Honoré suggests, delineation of the standard incidents is essential if the strength of the analogies in peripheral cases is to be assessed.

Employment of Terrell's method, using Honoré's eleven standard incidents as a working hypothesis, suggests the need for a comparison between the factual circumstances relevant to the conclusion that the beneficiary of a trust is entitled to the income produced by that trust and the factual circumstances surrounding the creation, use, and termination of attorney trust accounts. If the circumstances appeared sufficiently alike, we could conclude that the right to the earnings from an attorney trust, like the right to the earnings from the customary trust, were sufficiently identical so that both should be deemed the property of the beneficiary.[154] In making that careful

152. Honoré, *supra* note 150, at 113-28.

153. L. BECKER, *supra* note 151, at 19-20.

154. The limits of the scope of comparison are not identified by Terrell. If the practice in England, *see supra* note 123, or other English common law countries is relevant, the property claim, qua property, fails. Honoré argues "that the standard incidents of ownership do not vary from system to system in [an] erratic, unpredictable way . . . but . . . have a tendency to

comparison, however, we should note that, for customary trusts, the beneficiary's property interest only extends to the income net of expenses. The property claim of the IOLTA critic is more extensive. The claim to all the income, or put differently, to ignore the real but imputed costs, would place in doubt the identical nature of the comparison. That lack of comparability would make it difficult to draw more than an intuitive conclusion concerning whether the property claims at issue were identical.

The second step of the analysis would start with agreement that the net income of the customary trust is within the outer boundary circumscribing the central case. The net income is the property of the beneficiary. Little guidance would be available, however, to assist in deciding whether the differences, although slight, between the net income of the customary trust and the hybrid income derived from nominal or short-term funds of the attorney trust affected the determination of whether the IOLTA-produced income from the attorney trust also fell within the outer boundary. Trusts, in general, lack most of the standard elements denoting ownership. Income earned on nominal or short-term funds in lawyers' trust accounts is even further removed. We might argue that as "a matter of factual description, [gross interest earned on attorney trust accounts does not] . . . have enough in common with things we clearly own, like our books, furniture, etc., to deserve" the generic label property.[155] We are unable to reach that conclusion with any assurance of certainty, however, because we lack a meaningful way to set the outer perimeter. Nor do we receive any help from Terrell on this critical issue.

Understanding how far the perimeter extends may be aided by Honoré's suggestion that different types of things can be owned in different ways. He classifies things that can be owned into five groups:

1. Material objects and interests in material objects;
2. Claims, and interests in claims;
3. Fixed collections of material objects, claims or both;
4. Variable collections of material objects, claims or both; and
5. Funds.[156]

---

remain constant from place to place." Honoré, *supra* note 150, at 109. In fact, other countries with a common law heritage find property concepts no bar to IOLTA. *See* Boone, *supra* note 1, at 542-50. *See also In re* Interest on Trust Accts., 356 So. 2d 799 (Fla. 1978); 402 So. 2d 389 (Fla. 1981). Query what that means for comparison purposes in the IOLTA context.

155. Terrell, *Causes of Action, supra* note 147, at 505-06.

156. Honoré, *supra* note 150, at 132.

The five classes of property reflect a declining application of the standard incidents. All eleven standard incidents apply to the typical ownership case of material objects. Yet only three, transmissibility, income, and capital rights, apply to the last category: funds. Acceptance of Honoré's classes of property broadens our understanding of those items that can be classed as property. Honoré, however, was not attempting to set an outer limit. His descriptive method is just that, a description. It is not an analytical tool to assess assertions of property.

Only a normative theory of property permits the outer perimeter to be drawn.[157] A normative theory requires the development and examination of a philosophical justification for deeming any particular claim to be property. For without a theory, neutral decision-making fails.[158] Little purpose would be served in attempting to apply the myriad of normative theories of property to the IOLTA property issue.[159] For they are simply theories, not actual methods of judicial

---

157. Honoré notes that describing what ownership is does not provide the answer to how far ownership extends. "No obvious linguistic convention governs the answer . . . and, if the rules of the legal system demand an answer, it must be sought in positive law, in the comparative strength of competing analogies with the paradigm case and in the light shed on the problem by the social context." *Id.* at 111. Because any effort at definition will of necessity be vague in spots, "[t]here will remain a need for some further conception of the purpose a system of property rights is to serve and the moral constraints an acceptable system must satisfy, these serving as guides when the current conception of property rights must be clarified or extended." T. SCANLON, COMMENTS ON ACKERMAN'S PRIVATE PROPERTY AND THE CONSTITUTION, *in* PROPERTY, NOMOS XXII 341, 345-46 (J. Pennock & J. Chapman, eds. 1980).

158. The *Roth* distinction between entitlements and expectancies, if considered a normative theory, is said to offer "little guidance to those who need to solve problems relating to the meaning of property." J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW 548 (2d ed. 1983). Terrell agrees, noting that *Roth* fails "to provide any guidance as to the sorts of rules and understandings, and the corresponding degree of expectation and reliance, that it would find adequate to trigger due process protections." Terrell, *Property, Due Process, supra* note 147, at 886. The surprising outcome in Logan v. Zimmerman Brush Co., 455 U.S. 422 (1982), confirms the open-ended and ambiguous nature of *Roth. See* Smolla, *The Reemergence of the Right-Privilege Distinction in Constitutional Law: The Price of Protesting Too Much,* 35 STAN. L. REV. 69 (1982). Of course, Terrell proposes his own theory, labeled "Government as Monopolist," which, he argues, is consistent with the Court's reliance and expectation doctrine. His theory is that when an individual must look to the government for a benefit, the individual possesses a property interest sufficient to trigger due process protection. Where the government is a competitor with the private market, however, no property rights exist. Terrell, *Property, Due Process, supra* note 147, at 904-08.

159. The four most frequently cited theories of property, according to Terrell, are:

> (1) John Locke's "labor" theory, according to which property is a sort of just dessert for personal efforts; (2) George Hegel's "personality" theory, which relates property to a more ambiguous exercise of our wills where external things are incorporated into our sense of ourselves; (3) the "utilitarian" theories of, among others, David Hume, Jeremy Bentham, and the modern economic theorists, which use the term property to describe the set of rules that are essential for efficient use of resources; and (4) Robert Nozick's "entitlement" theory according to which the legitimacy of present claims to one's posses-

decision-making. Two theories, however, which do claim to mirror current judicial decision-making, are worth examining for that very reason. The first Professor Bruce Ackerman's "Ordinary Observer," may help us to set the perimeter.[160]

Ackerman posits two fundamentally different ways of examining legal issues, which he calls Ordinary Observing and Scientific Policymaking. The former, said to correspond to current judicial decision-making, relies on everyday language and expectations. The latter assumes the existence of a property right in any previously existing use. This approach suggests that only a philosophical view of the purposes to be served by private property and the fifth amendment will provide an adequate methodology for solving taking claims.[161] The Ordinary Observer would have little difficulty solving the IOLTA issue. It is important to recognize, however, that Ackerman believes Ordinary Observing, while corresponding to current judicial methods, is an inadequate analytical tool.

According to Ackerman, when the Ordinary Observer is confronted with the question of whether a particular claim constitutes property, he relies on "everyday, non-legal ways of speaking" to discover the meaning of the term.[162] Private property, to the Ordinary Observer, is represented by a physical thing, not a lawyer's bundle of rights.[163] Terrell's hunt for a definition of property might easily be called sophisticated ordinary observing.

> sions depends almost entirely on the historical pedigree of that claim.

Terrell, *Property, Due Process, supra* note 147, at 874-75 (footnotes omitted). None of these theories support a client's claim to the gross income without deduction for expenses. The labor theory of Locke justifies ownership of the underlying thing, the principal. Yet it can hardly be said to justify a claim to interest earnings of monies deposited with an attorney. There is obviously no "labor" associated with such earnings. The "personality" theory is a similarly slim reed. Utilitarian or economic theories do not suggest the most efficient use is to award the interest to the client. Indeed, they undoubtedly suggest the converse. *See infra* text accompanying notes 306-20. The "entitlement" or "historical pedigree" theory has little or nothing to do with earnings. Terrell's own "government as monopolist" theory would indicate that, because clients are not usually forced to deposit funds with their attorneys, they have no claim well founded in property law. Terrell, *Property, Due Process, supra* note 147, at 901-11.

160. B. ACKERMAN, PRIVATE PROPERTY AND THE CONSTITUTION (1977).

161. Ackerman calls The Scientific Policymaker's concept a Comprehensive View. It is discussed in *infra* text accompanying notes 255-63.

162. B. ACKERMAN, *supra* note 160, at 10. In a complex society, expectations will diverge causing Ordinary Observing to break down.

163. B. ACKERMAN, FOUR QUESTIONS FOR LEGAL THEORY, in PROPERTY, NOMOS XXII, at 351, 364 n.28 (J. Pennock & J. Chapman, eds. 1980) [hereinafter cited as B. ACKERMAN, FOUR QUESTIONS]. The Ordinary Observer rejects the bundle of rights approach. Instead:

> A particular thing is *Layman's* thing when: (a) Layman may, without negative social sanction, use the thing in lots more ways than others can; and (b) others need a specially compelling reason if they hope to escape the negative social sanctions that are normally visited upon those who use another's things without receiving his permission.

Ordinary Observing is a doubtful method of explaining current judicial decision-making because it turns on Ackerman's artificial distinction between "social property" and "legal property." Social property is property protected simply because existing social practices afford protection. Legal property, on the other hand, exists whenever a person, based on social customs, does not "believe himself justified in claiming something as his without appealing to the opinion of a legal specialist."[164] Ackerman asserts that the courts protect social property as a matter of course. The holders of legal property, however, do not fare nearly as well.[165]

The Ordinary Observer's concept of property involves present physical possession. In its broadest form, it might be characterized as the difference between tangible and intangible property. While the Ordinary Observer expects to have his money used as directed, once money is deposited by the client with the attorney, it can no longer be identified as a "thing." It is no longer social property. The Ordinary Observer would recognize that the funds were no longer subject to the physical possession and control of the client. Nor would the client have an expectation of earning interest. According to the Ordinary Observer, therefore, there would be no property interest to be taken.

Ackerman's claim that Ordinary Observing corresponds to the

B. ACKERMAN, *supra* note 160, at 99-100 (emphasis in original). The Scientific Policymaker recognizes that property constitutes any "legally authorized use." Change the prevailing pattern of use, for whatever reason, and the Scientific Policymaker understands that the merits must be assessed under the rubric of just compensation. B. ACKERMAN, FOUR QUESTIONS, *supra*, at 366-67.

164. B. ACKERMAN, *supra* note 160, at 117.

165. *Id.* at 121. The reviewers have been unkind to the Ordinary Observer's conception of property, arguing that it is a far too narrow view of what the nonlawyer deems property. It is also a far too narrow view of what the courts will protect. *See* Alexander, *The Concept of Property in Private and Constitutional Law: The Ideology of the Scientific Turn in Legal Analysis*, 82 COLUM. L. REV. 1545 (1982). Soper, *On the Relevance of Philosophy to Law: Reflections on Ackerman's Private Property and the Constitution*, 79 COLUM. L. REV. 44 (1979), argues that legal doctrine's heavy reliance on ordinary modes of perception is justifiable on normative grounds. Soper argues that the link between property and existing, dominant institutions is in large part analytical, and that in difficult cases, where social institutions are in flux, Ordinary Observing and Scientific Policymaking do not necessarily point in different directions. *Id.* at 64. Epstein, *Book Review, The Next Generation of Legal Scholarship?*, 30 STAN. L. REV. 635, 656 (1978), argues that Ordinary Observing need not be "ignorant observing" and that the distinction between "legal" and "social" property is far too artificial. *See also* Humbach, *Book Review*, 39 U. PITT. L. REV. 793 (1978) (unclear, leaving too many questions unresolved); Ozar, *Book Review, Ackerman on Property and the Law*, 10 LOY. U. CHI. L.J. 247 (1979) (valuable for its insights and analytical tools but some ambiguous distinctions between scientific and ordinary). T. SCANLON, *supra* note 157, at 341, 343 (J. Pennock & J. Chapman eds. 1980) notes that the Ordinary Observer may well possess a normative view of property as well as a concept of the purpose the norm serves — "[O]rdinary property is neither static nor untheoretical." *Id.* at 343.

layperson's idea of property presents a far too narrow view of the ordinary person's conception of property. It also presents a far too narrow view of what courts actually do when deciding property claims. In effect, it ignores Honoré's categories of property. Although it provides a simple answer to the IOLTA inquiry, it fails to provide an adequate norm for setting the outer boundary. Moreover, the outer boundary it does set is of far too small a radius. Nevertheless, as a common sense approach to IOLTA, it does seem fully consistent with the analytical methods of those courts which have approved IOLTA programs. Those courts have focused directly on the realities of the situation, rather than concentrating on abstract, technical concepts of property. For the fact is that under no circumstances does the client who deposits nominal or short-term funds into an attorney's trust account have the ability to earn, or the expectation of earning, interest income.

A normative theory with a far wider conception of property, a theory said to be premised on *Roth*'s expectation and reliance doctrine, is Professor Gregory Alexander's concept of subordinated interests.[166] His thesis, built largely around a rejection of Ackerman's Ordinary Observer methodology, argues that traditional means of assessing the existence of a property interest remain adequate today. Alexander's concept of property, like Ackerman's, is intuitive, calling for an examination of what the ordinary layperson would recognize as property. His layperson's intuition, however, is far broader than Ackerman's, in large measure corresponding to traditional common law concepts. *Roth,* in his view, is consistent with those traditional common law concepts.[167]

Alexander finds it easy to use *Roth* to determine the existence of property. He postulates that the distinctions between entitlements and expectancies, or hopes and desires, are easy to perceive and should arouse little controversy.[168] An expectancy is less tangible than an entitlement, "yet more crystallized than a unilateral hope or

166. Alexander, *supra* note 165.

167. Alexander argues that Ackerman's overly narrow conception of the layman's view of property is meant to lay the groundwork for ignoring the issue of property as a threshold requirement, thereby providing more protection to the individual than warranted. *Id.* at 1552. Those swept into the avoiding category include Professors Reich, Michelman, Sax, Berger, Dunham and others. Alexander's claim may be too far reaching. His argument is that a "very considerable expansion" of protection occurs if the property, *vel non,* issue is avoided. Yet, the scholars he cites have usually been critized for developing theories that substantially reduce protection. Nonetheless, it does seem apparent, as Alexander suggests, that the result in Flemming v. Nestor, 363 U.S. 603 (1960), would be different using Ackerman's or Michelman's utilitarian calculus. Alexander, *supra* note 165, at 1555.

168. Alexander, *supra* note 165, at 1563.

desire."[169] Expectancies can be distinguished from entitlements by considering the consequences if a third party interferes. Claims are to be labeled "expectancies, unprotectible according to ordinary expectations, either because they depend on future recognition by another, . . . because they are subject to another's unlimited power to extinguish the present or future enjoyment of the asset in question and therefore are unprotectible against that person's encroachments,"[170] or because, at the time of their creation, they were "vulnerable to a legally recognized power of termination held by another person."[171]

Alexander calls these relationships the "principle of subordinated interests."[172] He argues the principle "is not simply an expression of various functional aims that courts have attempted to promote but have not articulated. Instead, this approach represents a distinct conception of property that courts have used to distinguish property from nonproperty interests."[173] According to Alexander, *Flemming v. Nestor*[174] is fully consistent with the traditional common law distinctions between property and nonproperty. It was the "government's express reservation of the right to alter, amend or terminate" the social security program that prevented finding Nestor possessed a property interest.[175] Subsequent entitlement cases are cited[176] in support of the argument "that where the government, as the source of the interest . . . retains unrestricted discretion over the future of the interest, then the interest is not a protectible entitlement."[177]

Alexander's concept of property produces a far more inclusive outer boundary. With respect to IOLTA, however, it produces the same result as Ordinary Observing. When the client loses physical control of his funds, first to the lawyer and then to the financial institution, two third parties have the power to terminate his ability to earn interest. Moreover, because the right to earn interest is a creature of statute, it can also be terminated by governmental action. The power of the government to permit or deny interest earnings as

169. *Id.* at 1564.

170. *Id.* at 1566.

171. *Id.* at 1571.

172. *Id.* at 1576.

173. *Id.* at 1582-83.

174. 363 U.S. 603 (1960). *Flemming* upheld a provision of the Social Security Act, 42 U.S.C. § 402(n) (1976), that terminated benefits to deported aliens, finding that the aliens lacked an "accrued property right" to continued benefits.

175. Alexander, *supra* note 165, at 1584.

176. Alexander cites: Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1 (1978); Bishop v. Wood, 426 U.S. 341 (1976); Board of Regents of State Colleges v. Roth, 408 U.S. 564 (1972); Perry v. Sindermann, 408 U.S. 593 (1972) as properly decided entitlement cases.

177. Alexander, *supra* note 165, at 1586-87. How to decide on which side of the "at-will for-cause" distinction a particular claim falls is not addressed by Alexander and need not concern us here.

it sees fit, as part of the regulation of the national economy, is a clear indication that the client's claim can only be classified as an expectancy.

Focusing solely on a descriptive effort to define the term "property" or the term "ownership" does not provide a satisfactory resolution to the IOLTA conflict. The process is inconclusive. Missing is a "why" element; a basis for determining how far property claims extend. Both Ordinary Observing and the principle of subordinated interests set an outer boundary that does not seem to include the income earned by IOLTA. While both theories seem overly facile, they do lead to the same conclusion for IOLTA. Combining the descriptive process with a normative theory of property does produce a more conclusive, and therefore, more satisfying result. The use, however, of a normative theory, in the absence of a generally accepted theory in American jurisprudence, cannot definitively answer the objections of IOLTA critics.[178] Yet from a policy standpoint, the review of these theories does serve to highlight the lack of support for the IOLTA critics' claims. Under any standard, a client's claim to the gross income earned by nominal or short-term deposits is not a property right of sufficient magnitude to be afforded constitutional protection.

B. The Roth *Approach to Defining Property: Expectation and Reliance as the Sine Qua Non of Property*

The fifth amendment protects private property from governmental appropriation without just compensation. State law creates private property and defines its parameters. States which have adopted IOLTA programs have declared, either explicitly or implicitly, that their laws do not confer a property right upon clients to the earnings of nominal or short-term funds deposited in attorney trust accounts. No federal statutory law supports the contrary position. The hornbook proposition that the owner of a fund also owns the earnings produced by the fund does, however, support the IOLTA challengers'

---

178. American jurisprudence has yet to adopt, at least overtly, a normative theory of property. The expectation and reliance theory of *Roth*, considered at *infra* text accompanying notes 179-88, does not purport to be a normative theory. It has been suggested that at least some members of the Supreme Court evidence a normative theory in their opinions. *See* Note, *Justice Rehnquist's Theory of Property*, 93 YALE L.J. 541 (1984), wherein the author argues that Justice Rehnquist has adopted economic efficiency as the norm for property adjudications. The author also discerns a two-tiered approach, noting that Justice Rehnquist appears far more willing to afford protection to traditional property interests when claims of taking are made than when that protection first requires a finding of statutory entitlement. Rehnquist's approach is similar, if not identical, to Professor, now Judge, Posner's claim that the property norm inherent in the common law is, and should be, one of "wealth maximization," a term fraught with connotation. *See* R. POSNER, ECONOMIC ANALYSIS OF THE LAW (2d ed. 1977); Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103 (1979).

position. Furthermore, after *Webb's,* a state's determination that no property interest exists is subject to challenge on grounds it terminates a pre-existing property interest.

The Constitution protects the hornbook proposition only if the fund owner possesses a legitimate claim of entitlement. The test for protection stems from the decision in *Board of Regents of State Colleges v. Roth,* where the Court held that, "[t]o have a property interest in a benefit, a person clearly must have more than abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it."[179]

The range of property interests protectible under the *Roth* test is broad, but not unlimited. An entitlement exists if the fund owner can identify substantive law that supports his assertion of a property interest.[180] Entitlements "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law — rules or relationships that secure certain benefits and that support claims of entitlement to those benefits."[181] In addition to positive rules of law, "mutually explicit understandings" may also serve to create entitlements."[182]

The distinction between "entitlement" and "expectation" is not self-evident.[183] Additionally, the Supreme Court has not yet developed a rationale for distinguishing between the two.[184] *Roth* and its progeny fail to meaningfully address the critical question of when positive laws or mutually explicit understandings are sufficient to create reliance interests that can be declared entitlements. Instead, after *Roth,* the Court has focused on the nebulous distinction between entitlement and expectancy, and thereby embarked on an ad hoc, indi-

179. 408 U.S. 564, 577 (1972).

180. Entitlement theory may mark the return of the right-privilege distinction in other colors. Smolla, *supra* note 158. If so, and this article does not adopt that premise, the IOLTA question may be even easier to answer.

181. *Id.*

182. Perry v. Sindermann, 408 U.S. 593, 601 (1972). The Court attempted to give meaning to "mutually explicit understandings" by analogy to implied contracts and to "custom and practice" of an industry. Jago v. Van Curen, 454 U.S. 14 (1981). Although not explicitly rejected, the decision in Leis v. Flynt, 439 U.S. 438 (1979), may cast doubt on the continuing validity of mutually explicit understandings as a means of establishing entitlement.

183. J. Nowak, R. Rotunda & J. Young, *supra* note 158, at 548. One student author has summarized the cases to hold that "a statute will create an entitlement . . . if [it] sets out conditions under which the benefit *must* be granted or if the statute sets out the *only* conditions under which the benefit may be denied." Note, *Statutory Entitlement and the Concept of Property,* 86 Yale L.J. 695, 696 (1977) (emphasis in original). The explanation is not satisfactory.

184. The idea that a citizen's dealing with his government should always implicate the two due rpocess clauses was rejected by the *Roth* Court. *But see* Mr. Justice Marshall's dissent, 408 U.S. at 587.

vidualized consideration of whatever substantive law the parties identify to support their claim of entitlement. A claim classed as an "entitlement" is entitled to fifth amendment protection. Conversely, a claim classed as an expectancy is not entitled to protection.

If the law identified is federal, the Supreme Court is the final arbiter of whether the law creates an entitlement.[185] If the law identified is state or local, however, the Supreme Court defers to state court decisions to determine if a property interest exists.[186] In circumstances where the state law is unclear, the Supreme Court has made its own determinations.[187]

The IOLTA critic's search for positive rules of law stops after discovering the rule that holds earnings follow principal. The critic's search is, therefore, incomplete. The critic must also search out all the rules that expand or limit the initial finding, similar to the way Terrell would search out the identifying characteristics that define and describe property rights.[188] The distinction between net and gross income is one such limitation. The restrictions on bank account earnings constitute another limitation. Any claim by owners of nominal or short-term deposits to the interest earned on such accounts does not qualify as property under the *Roth* constitutional definition. Certainly, there are no "rules or mutually explicit understandings" that the client will receive the interest. The time-honored practice has been directly to the contrary. Moreover, an individual client who directs his attorney, or his attorney's financial institution, to invest such funds in an interest-bearing account should not expect to receive the gross income produced without deduction for expenses.

Arguably, IOLTA implicates the positive rules of law identified in one of two ways. First, in accordance with the positive rules of law as they existed before the advent of IOLTA, a client totally lacked any real claim to the earnings generated by his nominal or short-term deposits. Although the assertion of no property interest is, from a legal standpoint, difficult to analyze, no persuasive reason for rejecting the assertion is apparent. Before IOLTA, nominal or short-term deposits

185. Goldberg v. Kelly, 397 U.S. 254 (1970).

186. Goss v. Lopez, 419 U.S. 565 (1975), applied Iowa law to find a right to public school education. Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1 (1978), found an entitlement to continued electric service from a publicly owned utility as a result of Tennessee statutory law. *But see* Logan v. Zimmerman Brush Co., 455 U.S. 422 (1982), where the Court rejected the state court's finding that the claimant lacked a property interest. *Webb's* is, to the same effect, specifically rejecting the state court's finding of lack of a property interest. 449 U.S. at 165.

187. Bishop v. Wood, 426 U.S. 341 (1976), applied North Carolina law to find that a city employee lacked a property interest in his job. In a single concurrence to both *Roth* and *Perry v. Sindermann*, Chief Justice Burger suggested that the Court abstain where the state law was unclear. 408 U.S. at 603. The suggestion has yet to be adopted.

188. *See supra* text accompanying notes 147-59.

simply did not produce income, except for the benefit of financial institutions. The only change made by IOLTA is that banks and other financial institutions, which previously enjoyed the free use of such funds, are now forced to pay interest. From the client's perspective, nothing has changed. Second, and more powerfully, it might be argued IOLTA modifies previously existing positive rules of law by permitting costs to be imputed for purposes of determining net income.

Government may extinguish property rights,[189] sometimes with,[190] and sometimes without,[191] being required to pay just compensation. The usual entitlement case involves a state-created or federally-created benefit. When the government proposes to terminate that benefit, the question becomes one of due process,[192] there being no dispute that, given appropriate procedures, the government may terminate the particular statutory entitlement at issue.[193] If the government's action takes property, however, as opposed to simply terminating a benefit, only just compensation, not due process, will suffice.[194] The inquiry is very different, however, if the government denies action terminates a property right. If the claimant can support his property assertion by identifying common law principles that indicate the existence of that right, the government's action will be open to serious question. In a non-technical sense, the inquiry becomes one of vested rights.[195]

---

189. The consequences that flow from the pre-existing status of a property right is not always clear. For example, in Andrus v. Allard, 444 U.S. 51 (1979), whether the claimant's acquisition occurred after enactment of a law banning resale was said to be relevant to a takings analysis of the claimant's investment backed expectations, but not a bar to the claim on the grounds there was no property interest in the right of resale. United States v. Rodgers, 461 U.S. 677, 696 n.24 (1983), sustained the right of the Internal Revenue Service to sell homestead property, not subject to forced sale under state law, for debts not attributable to the owner. The Court held: "If there were any Takings Clause objection, . . . such an objection could not be invoked on behalf of property interests that came into being after enactment of the provision." *Id.*

190. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982).

191. Texaco, Inc. v. Short, 454 U.S. 516 (1982).

192. Goss v. Lopez, 419 U.S. 565 (1975).

193. Where the statute creating the entitlement also provides the procedure for termination, the Court has, nevertheless, generally rejected procedures that failed to meet due process standards. *See* Logan v. Zimmerman Brush Co., 455 U.S. 422 (1982); Vitek v. Jones, 445 U.S. 480 (1980); Arnett v. Kennedy, 416 U.S. 134 (1974). *But see* Bishop v. Wood, 426 U.S. 341 (1976).

194. West v. Williamsport Area Comm. College, 492 F. Supp. 90 (M.D. Pa. 1980); Stringer v. United States, 471 F.2d 381 (5th Cir.), *cert. denied,* 412 U.S. 943 (1973).

195. The Constitution contains no specific prohibition against retroactive civil legislation. The Obligation of Contracts Clause, however, U.S. CONST. art. I, § 10, cl. 1, and the due process and taking clauses of the fifth amendment have all been used to void retroactive legislation. Note, *Unconstitutionality of Retroactive Lien Avoidance Under Bankruptcy Code Section 522(f)*, 94 HARV. L. REV. 1616, 1625 (1981).

Not all entitlements are of equal strength. The power of the legislature to abolish or modify property interests is far more limited when the interest is the creation of common law than when it is the creation of statutory law. For "there are certain fundamental rights, an 'irreducible minimum,' that fall within the area" of constitutional protection even if not recognized by state law.[196] "In other words, the principles we have come to think of as constitutional existed and exist also independently of written constitutions."[197] On the other hand, claims of entitlement dependent upon statutes stand upon a far weaker footing. Two nineteenth century cases clearly established this point.

In *Randall v. Krieger*,[198] the court validated changes in the state's dower law, holding:

> During the life of the husband, the right [to dower] is a mere expectancy or possibility. In that condition of things, the law-making power may deal with it as may be deemed proper. It is not a natural right. It is wholly given by law, and the power that gave may increase, diminish or otherwise alter it or wholly take it away.[199]

A similar result was reached in *Neilson v. Kilgore*.[200] At the time of judgment, in 1876, a judgment creditor could seek satisfaction out of

---

196. Kratovil & Harrison, *Eminent Domain — Policy and Concept*, 42 CALIF. L. REV. 596, 602 (1954), *quoting* NOYES, THE INSTITUTION OF PROPERTY 432 (1936). Justice Marshall, *concurring in* PruneYard Shopping Center v. Robins, 447 U.S. 74 (1980), remarked:

> I do not understand the Court to suggest that rights of property are to be defined solely by state law, or that there is no federal constitutional barrier to the abrogation of common-law rights by Congress or a state government. The constitutional terms "life, liberty, and property" do not derive their meaning solely from the provisions of positive law. They have a normative dimension as well, establishing a sphere of private autonomy which government is bound to respect. Quite serious constitutional questions might be raised if a legislature attempted to abolish certain categories of common-law rights in some general way.

Id. at 93-94. Justice Marshall expressed the same view in *Loretto*, noting that, "the government does not have unlimited power to redefine property rights." 458 U.S. at 433. While some have argued that a majority of the Supreme Court has yet to accept a federal constitutional right of property, the decision in *Webb's* can only be understood as the adoption, by a unanimous court, of this view.

197. Stoebuck, *A General Theory of Eminent Domain*, 47 WASH. L. REV. 553, 555 (1972). Professor Stoebuck cites the famous New York case of Gardner v. Trustees of Village of Newburgh, 2 Johns. Ch. 162, 7 Am. Dec. 526 (N.Y. 1816) which required compensation, on natural law principles, in the absence of a state constitutional mandate that compensation be paid. *See also* Grant, *The "Higher Law" Background of the Law of Eminent Domain*, 6 WIS. L. REV. 67 (1931).

198. 90 U.S. (23 Wall.) 137, 148 (1875).

199. *Id.* at 148.

200. 145 U.S. 487 (1892).

the property owned by the wife of the judgment debtor. That practice was terminated by an 1879 statute. When execution was attempted in 1886, the court rejected the claim the 1879 statute destroyed a vested property right, stating:

> The particular profits of the wife's estate here in dispute had not, when [the 1879] act was passed, come to the hands of the husband. They were not, at that time, in existence, nor, in any legal sense, vested in him. Nor were they ever vested in him. He had a mere expectancy with reference to them when the [1879] act was passed. Moreover, his right, prior to that enactment, to take the profits of his wife's estate, did not come from contract between him and his wife or between him and the state, but from a rule of law established by the legislature. . . . It is entirely competent for the legislature to change that rule.[201]

The distinction between statutorily created interests and traditionally created interests applies also to banking regulation. In *Veix v. Sixth Ward Building & Loan Association*,[202] the Supreme Court determined that a 1932 restriction on withdrawals could constitutionally be applied to deposits made in 1928 and 1929. Mr. Justice Reed reached back to New Jersey's long history of regulation of withdrawals, stressed the importance of financial institutions to the state's economy, and held the depositor, "when he purchased into an enterprise already regulated in the particular to which he now objects, . . . purchased subject to further legislation upon the same subject."[203]

More recently, in *United States v. Rodgers*,[204] the Court held a federal tax lien against one spouse could be enforced by the forced sale of homestead property occupied by the other spouse, even though Texas law barred such sales and even though the court recognized that homestead was a form of property. The court reasoned that "[i]f there were any Takings Clause objection . . ., such an objection could not be invoked on behalf of property interests that came into being after enactment . . . [of the tax lien provisions in 1886 because] the homestead estates at issue came into being long after 1868."[205]

201. *Id.* at 490-91.

202. 310 U.S. 32 (1940).

203. *Id.* at 38. This view of legislative power dates to the earliest years of constitutional adjudication. *See* Calder v. Bull, 3 U.S. (3 Dall.) 386 (1798).

204. 461 U.S. 677 (1983).

205. *Id.* at 696 n.24. United States v. Security Indus. Bank, 459 U.S. 70 (1982), was cited as authority. Where the issue is when legislation may constitutionally take effect, the bankruptcy power and the tax power, although both prerogatives of the sovereign, do not impact on

The *Rodgers'* decision is subject to two interpretations. The court might have meant the federal tax lien law predated the state homestead laws. Such was not the case, though. The concept of marital property is a heritage of Spanish colonial days and was protected when Texas entered the Union in 1845.[206] Therefore, only the second possible interpretation, that the claimant's specific homestead interest came into being after 1868, remains. Thus, it is not the date of the creation of the general property interest that is relevant. Instead, the relevant date is the date on which the specific, identifiable property interest of the individual was first acquired. The implications of *Rodgers* are far-reaching. Can it be that legislation can limit the scope of any property right acquired after the enactment of the legislation?[207] Where the interest is backed by historical property connotations the answer is no, for that is the very thing the fifth amendment was meant to protect. Where the property interest is, however, solely a creature of statute, the answer is yes.

Earlier cases distinguished between retroactive legislation affecting remedies and retroactive legislation affecting substantive rights. Today, if the consequences of extinguishing a right are identical to the consequences of eliminating a remedy, the distinction is best viewed in the context of whether the claimant's reasonable, investment-backed expectations are unduly impaired.[208] When a client deposits money with an attorney, a contract is created. Another con-

---

fifth amendment rights any differently than any other valid exercise of federal power. The reserved power concept applies to all governmental activities. The Charles River Bridge v. The Warren Bridge, 36 U.S. (11 Pet.) 420 (1837).

206. 1 POWELL ON REAL PROPERTY § 82 (P. Rohan ed. 1977).

207. *See* Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983). The author notes:

> I am inclined to suggest that no takings clause issue can ever be presented by a truly prospective statute. One might object that such a thesis would mean that the government could entirely avoid the just compensation requirement by simply announcing in advance, for example, that all interests in real property were thereafter held subject to the government's right to take land without compensation for schools, roads, fire stations, and the like. On the other hand, most takings clause cases involve real estate, and given the old saw of real estate brokers that "they're not making it anymore," it is hard to imagine how legislation restricting the use of land could ever be truly prospective. As soon as the government announced that a certain use of land would henceforth be prohibited or that certain land might be taken without compensation at some time in the future, the value of the affected land would be diminished, to the detriment of its current owner. There can be no new land; there can, however, be new security arrangements.

Id. at 987 n.59. Reserving to the state the right to take land without compensation was practiced in Pennsylvania as late as 1800. Stoebuck, *supra* note 197, at 558-59.

208. United States Trust Co. v. New Jersey, 431 U.S. 1, 19 n.17 (1977); Texaco, Inc. v. Short, 454 U.S. 516 (1982).

tract is created when the funds are deposited in a financial institution. Both contracts are subject to extensive governmental regulation. IOLTA is one such governmental regulation. It does not impair the legitimate expectations of the client in the narrow circumstances where income is produced only because of IOLTA. The interest earned on nominal or short-term deposits bears no resemblance to property rights backed by historical connotations, the very thing the fifth amendment was meant to protect. Arguably, no client who deposits funds with an attorney after enactment of an IOLTA program has cause to complain. Whether viewed from the perspective of trust or banking law, as to that client, the IOLTA program is prospective only.

Retroactive legislation is constitutionally valid if it does not destroy or unduly impair pre-existing property interests. The newly created income claim of IOLTA proponents fails only if mutually explicit understandings or traditional common law rules have created reliance interests among individuals who deposit trust funds with their attorneys for placement in demand, or demand equivalent, accounts. The IOLTA critic will be unable to support his claim by reference to common law.[209] The history of banking demonstrates an individual's ability to earn interest on his bank deposits has always been a matter of statutory grace.[210] It is not a natural right. Rather, it is the creation of conventional law. Subsequent statutes may prospectively withdraw privileges which previous statutes conferred.[211] Moreover, the trust law principle that a beneficiary is entitled to the net income earned by the res does not furnish support for the IOLTA critic's claim.

The client's claim to IOLTA-generated earnings is even weaker than the creditor's claim in *Neilson* or the spouse's claim in *Randell*. In those cases, prior to the law change, the plaintiffs possessed at least a chance of acquiring property for themselves. The plaintiffs only had a chance, an expectancy, because either the facts or the law might change before their chance of acquisition ripened into actual possession. Before IOLTA, the client had no chance, no expectancy, not even an "abstract need or desire." In all probability, the client

209. Technically, the trust relationship cannot be attributed to the common law. 1 A. SCOTT, *supra* note 15, § 1. Nevertheless, for purposes of constitutional protection, it can be considered a traditional or common law property right. *Id.*

210. *See supra* notes 65-99 and accompanying text.

211. Chae Chan Ping v. United States, 130 U.S. 581 (1889). *See* Flemming v. Nestor, 363 U.S. 603 (1960). "Federal regulation of future action based upon rights previously acquired by the person regulated is not prohibited by the Constitution. So long as the Constitution authorizes the subsequently enacted legislation, the fact that the provisions limit or interfere with previously acquired rights does not condemn it." Flemming v. Rhodes, 331 U.S. 100, 107 (1947).

was simply indifferent to the remote chance that his nominal or short-term funds might earn interest. After IOLTA, the client's position is entirely unchanged. Therefore, to characterize the client's attitude as an expectancy is to give it far greater weight than it deserves.

The tenuous possibility of a client deriving income from his nominal or short-term deposit can hardly be characterized as an essential constituent of the "ancient" institution of property," inherited from the common law, recognized by history as a claim "upon which people rely in their daily lives" and, therefore, protected by the fifth amendment.[212] Instead, it is a matter of statutory grace, subject to modification or extinction at the will of the lawmaking authority.[213] The right to income from bank deposits can muster even less historical support. It too is not a natural right. It is solely the creation of conventional law.[214] As a matter of constitutional imperative, ownership of a fund does not always carry with it the right to any proceeds that fund may earn. As stated previously, when the client loses control of his funds, first to the lawyer, and then to the financial institution, two third parties have the power to terminate his ability to earn interest.

The government has long exercised its power by regulating the banking industry. Before NOW accounts, the effect of governmental regulation was to reallocate the income producing potential of demand accounts from depositors to financial institutions. The effect of IOLTA is to further reallocate the income producing potential from financial institutions to the provision of legal aid to the poor. The power of the government to permit or deny interest earnings mandates the conclusion that no client is deprived of an entitlement. Absent entitlement, IOLTA takes no property belonging to a client. Neither property law nor fairness compels the conclusion that the owner of trust funds, funds that in their own right cannot produce income, has lost any property because of IOLTA.

In summary, a client's claim to the interest earned by his nominal or short-term deposit depends on his identifying a legitimate claim of entitlement. The hornbook proposition that earnings follow principal is balanced by the rule of trust law that the beneficiary is only entitled to the income net of expenses. IOLTA is best seen as a melding of those two principles. It is a meld that does not violate the property rights of clients.

212. *Roth*, 408 U.S. at 577.

213. Chae Chan Ping v. United States, 130 U.S. 581 (1889).

214. *See supra* text accompanying notes 64-99.

VI. THE TAKING ISSUE ANALYZED

The familiar prescription of the fifth amendment bars the taking of private property for public use without just compensation.[215] For purposes of this section, it will be assumed arguendo that clients have a property interest in the income producing potential of their nominal or short-term trust funds. This section examines whether IOLTA "takes" this clients' property interest.

Over twenty years ago, Professor Allison Dunham, after reviewing eighty-nine cases decided in the previous thirty years,[216] aptly described fifth amendment taking jurisprudence as a "crazy quilt pattern" which defies logical analysis.[217] In the eighteen years after that description was so aptly applied, the number of taking cases reaching the Supreme Court appreciably slowed.[218] Few cases between 1962 and 1978 are of help in evaluating the IOLTA taking issue.[219] Then, in 1978, the pattern suddenly changed. The Supreme Court was confronted with a variety of fact patterns that directly challenged governmental actions as being a taking without just compensation.[220]

---

215. U.S. CONST. amend. V.

216. Dunham, *Griggs v. Allegheny County in Perspective: Thirty Years of Supreme Court Expropriation Law*, 1962 SUP. CT. REV. 63, 64.

217. *Id.*

218. Broadly considered, there were at least 36 decisions in which the taking clause of the fifth amendment was implicated. Most of the decisions, however, do not directly involve the issue of whether "property" was "taken." Cases not applicable to the IOLTA question include: Dames & Moore v. Regan, 453 U.S. 654 (1981); United States v. Sioux Nation of Indians, 448 U.S. 371 (1980); United States v. Clarke, 445 U.S. 253 (1980); United States v. 564.54 Acres of Land, 441 U.S. 506 (1979); United States v. Bodcaw Co., 440 U.S. 202 (1979); Moore v. City of East Cleveland, Ohio, 431 U.S. 494 (1977); New Orleans v. Duke, 427 U.S. 297 (1976); Alamo Land & Cattle Co. v. Arizona, 424 U.S. 295 (1976); Blanchette v. Connecticut Gen. Ins. Corp., 419 U.S. 102 (1974); City of Pittsburgh v. Alco Parking Corp., 417 U.S. 369 (1974); Village of Belle Terre v. Boraas, 416 U.S. 1 (1974); Dean v. Gadsden Times Pub. Corp., 412 U.S. 543 (1973); United States v. Jim, 409 U.S. 80 (1972); New Haven Inclusion Cases, 399 U.S. 392 (1970); Rowan v. United States Post Office Dept., 397 U.S. 728 (1970); National Bd. of Y.M.C.A. v. United States, 395 U.S. 85 (1969); United States v. Rands, 389 U.S. 121 (1967); Jankovich v. Indiana Toll Road Comm'n, 379 U.S. 487 (1965); Katzenbach v. McClung, 379 U.S. 294 (1964); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964).

219. Three cases in that time period provide marginal guidance. *See* United States v. Fuller, 409 U.S. 488 (1973); Almota Farmers Elev. & Warehouse Co. v. United States, 409 U.S. 470 (1973); United States v. Reynolds, 397 U.S. 14 (1970). The shopping center access cases, Hudgens v. NLRB, 424 U.S. 507 (1976); Lloyd Corp. v. Tanner, 407 U.S. 551 (1972); Amalgamated Food Employees Union Local 590 v. Logan Valley Plaza, Inc., 391 U.S. 308 (1968), come to their conclusion in 1980. PruneYard Shopping Center v. Robins, 447 U.S. 74 (1980).

220. *See* United States v. Security Indus. Bank, 459 U.S. 70 (1983); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982); Texaco, Inc. v. Short, 454 U.S. 516 (1982); Hodel v. Indiana, 452 U.S. 314 (1981); Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. 264 (1981); Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980); Agins v. City of Tiburon, 447 U.S. 255 (1980); PruneYard Shopping Center v. Robins, 447 U.S. 74 (1980); Kaiser Aetna v. United States, 444 U.S. 164 (1979); Andrus v. Allard, 444 U.S. 51 (1979); Penn Cent. Transp. Co. v. New York City, 438 U.S. 104 (1978).

These latest cases figure prominently in the IOLTA analysis.

Current Supreme Court doctrine is most fully set forth in *Penn Central Transportation Co. v. City of New York.*[221] In *Penn Central,* the Court explained and confirmed its use of a multifactor balancing test. The relevant factors that must be evaluated to test taking claims are defined as the character of the governmental action and the impact of that action on the distinct investment-backed expectations of the claimant. The *Penn Central* balancing test does not produce determinate results, particularly in newly developing areas of governmental regulation. In order to understand why the multifactor test developed, a brief outline of the evolution of the taking doctrine will be helpful. Before considering application of the test to the unique circumstances presented by IOLTA, a review of alternative doctrinal suggestions for solving the taking equation is undertaken to shed light on both the difficulty of solving fifth amendment problems in general and the IOLTA controversy in particular. Finally, IOLTA is scrutinized on the basis of the current judicial doctrine embodied in the multifactor balancing test.

A. The Evolution of a Taking Test

Early English attempts to resist the power of the King are the genesis of modern fifth amendment jurisprudence. The Magna Carta protected property.[222] It did not, however, bar economic regulation of land, a practice which was widespread in England by the close of the seventeenth century.[223] The American colonists inherited both the victory of private property rights over the King's power of seizure and the understanding that regulation, even regulation that could go so far as to prohibit all productive use of land, was a legitimate exercise of governmental power.[224] Land use regulation was extensive in both urban and rural areas during the colonial period and the power of eminent domain was frequently exercised. Land seizures were usually compensated when developed parcels were taken, but not otherwise.[225]

The framers of the Constitution were deeply influenced by English conceptions of property rights which were said to consist of a person's "free use, enjoyment and disposal of all his acquisitions,

---

221. 438 U.S. 104 (1978).

222. F. BOSSELMAN, D. CALLIES & J. BANTA, THE TAKING ISSUE 51 (1973) [hereinafter cited as F. BOSSELMAN]. Chapter 39 of the Magna Carta provided that "[n]o freeman shall be arrested, or detained in person, or deprived of his freehold . . . unless by the lawful judgment of his peers or by the law of the land." *Id.* at 56.

223. *Id.* at 60-75.

224. *Id.* at 80-81.

225. *Id.* at 82-88. *See* Stoebuck, *supra* note 197, at 570.

without any control or diminution, save only by the law of the land."[226] The "law of the land" was a claim of parliamentary supremacy over the King, not a claim of natural rights or a provision for just compensation. At the same time, a claim emerged to a natural law power of eminent domain in the sovereign.[227] Takings, therefore, required no compensation, other than at the mercy of the parliament.[228]

Why was the fifth amendment adopted? Legal scholars trace the antecedents of the compensation clause to philosophers of the seventeenth and eighteenth centuries,[229] including Grotius,[230] Pufendorf,[231] Bynkershoek,[232] and Vattel.[233] Compensation for land takings was an accepted English practice during colonial days. Locke conceded the power of government to tax and to acquire private property so long as no man was charged with more than a fair share.[234] Compensation, therefore, was required to even the score when property was taken.[235] By the time of the American Revolution, Blackstone had elevated property to the "third absolute right, inherent in every English-

226. F. BOSSELMAN, *supra* note 222, at 91-92.

227. Stoebuck, *supra* note 197, at 559; Kohl v. United States, 91 U.S. (1 Otto.) 367 (1876) recognized that the power of eminent domain was an inherent and essential power of government and that the federal government could exercise the power of eminent domain in the absence of a specific constitutional authorization. *See also* City of Cincinnati v. Louisville & N. R.R., 223 U.S. 390 (1912) (the right to appropriate private property for public use is a vital sovereign power).

228. Prior to the Revolution, compensation was a common practice in England, although only as a function of specific parliamentary enactments. Stoebuck, *supra* note 197, at 575-79. Compensation was similarly well-established in the Colonies. *Id.* at 579-83. Compensation in both England and the Colonies was a matter of legislative grace, however, not judicial order. The earliest state constitution to require compensation was that of Massachusetts, ratified in 1780. Prior to 1789, several state constitutions provided that property was not be taken without the "consent of the law of the land." Others were totally silent. F. BOSSELMAN, *supra* note 222, at 94-97. Nevertheless, in the absence of a just compensation provision, state courts required compensation as a matter of natural law. Grant, *supra* note 197, at 71-81.

229. Lenhoff, *Development of the Concept of Eminent Domain,* 42 COLUM. L. REV. 596, 596-601 (1942). The scholars are agreed upon the individuals, although not necessarily the import of their works. *Compare* Sax, *Takings and the Police Power,* 74 YALE L.J. 36, 54 (1964) (the interests these writers sought to protect are difficult to ascertain) *with* Stoebuck, *supra* note 197, at 559, 583-84 (there is general agreement among the writers that compensation is required under the precept of just share and that an individual should not bear a greater share of the government's costs than any other citizen).

230. H. GROTIUS, DE JURE BELLI ET PACIS (1625) (F. Kelsey trans. 1925).

231. S. PUFENDORF, DE JURE NATURAE ET GENTIUM (1672) (C. & W. Oldfather trans. 1925).

232. C. VAN BYNKERSHOEK, QUAESTIONUM JURIS PUBLICI LIBRI DUO (1737) (T. Frank trans. 1930).

233. E. DE VATTEL, THE LAW OF NATIONS; OR, PRINCIPLES OF THE LAW OF NATURE: APPLIED TO CONDUCT AND AFFAIRS OF NATIONS AND SOVEREIGNS (1758) (C. Fenwick trans. 1916).

234. Stoebuck, *supra* note 197, at 585.

235. *Id.* at 587.

man."[236] Early state constitutions usually provided for the power of eminent domain, sometimes with and sometimes without a just compensation clause. It was always assumed, however, that compensation would be paid for any taking.[237]

Takings were not an important concern of the framers of the Constitution. This is evidenced by the lack of an express grant in the federal Constitution of eminent domain power. Nevertheless, as Blackstone explained, because the government could only take property upon payment of compensation, because of the controversy caused by property seizures during the Revolutionary War, and perhaps because the framers were men of property, the fifth amendment was drafted.[238] Its substantive provisions remained unchanged from its original draft to final enactment. No record of the debates, at either the federal or state level, has survived. Nor is there a contemporary historical record.[239] The fifth amendment did not break new ground because compensation was the expected norm. Instead it confirmed what were considered established rights of Englishmen. Certainly, the framers meant to prevent unfair confiscation of private property. At the same time, they also recognized that an essential reason for government is economic regulation. Reconciling these positions perplexes legal scholars to this day.[240]

Taking jurisprudence begins late in federal constitutional history.[241] Takings were originally conceived of as limited to physical acts, the "no taking without a touching" theory.[242] The power of eminent domain and the police power were considered separate and distinct functions of government. Absent a physical invasion, the police power could be exercised to abate a nuisance no matter how severe

236. F. BOSSELMAN, *supra* note 222, at 88-92.

237. *Id.* at 94-97.

238. *Id.* at 99-104.

239. *Id.* at 99-100; Stoebuck, *supra* note 197, at 593.

240. Professor Sax rejects the traditional argument that the core purpose of the compensation rule was to mandate the maintenance of existing economic values against government diminution. Instead, he argues the central theme of the taking clause was fairness, aimed only at physical takeovers of property, not losses resulting from economic regulation. Sax, *supra* note 229, at 53-57. Stoebuck rejects Sax's reading as far too narrow, notes that Locke's then prevailing theory of government called for the preservation of property, and argues that "compensation is designed to even the score when a given person has been required to give up property rights beyond his just share of the cost of government." Stoebuck, *supra* note 197, at 586-87. As will be seen later, Sax's theory of the taking clause will permit an extremely broad range of governmental action, while that permitted by Stoebuck without compensation will be far less. *See infra* notes 270 & 338 and accompanying text.

241. The history of state law decisions, prior to the adoption of the fourteenth amendment, and later incorporation of the fifth amendment, is traced at length in F. BOSSELMAN, *supra* note 222, at 51-139. The first significant Supreme Court decision was not rendered until 1871. *See* Pumpelly v. Green Bay Co., 80 U.S. (13 Wall.) 166 (1871).

242. Stoebuck, *supra* note 197, at 601.

the consequences to the property owner,[243] thereby permitting almost all regulatory actions.[244] *Mugler v. Kansas*[245] upheld a state law barring the manufacture and sale of intoxicating liquors resulting in Mugler's brewery becoming nearly worthless. The exercise of the police power to abate a nuisance, without compensation, was left unchecked so long as the government did not actually take possession of the property.[246] The test's lack of fairness quickly became apparent as society became more complex and the government imposed more and more regulations restricting property use.

According to Mr. Justice Holmes, the power of the eminent domain and the police power were at separate ends of a continuum. Holmes was an early proponent of a balancing test, stating that "the question narrows itself to the magnitude of the burden imposed, — to whether the tax is so great as to exceed the limits of the police power."[247] That view found its fullest expression in the case of *Pennsylvania Coal Co. v. Mahon.*[248] In *Pennsylvania Coal,* Mr. Justice Holmes recognized that the exercise of police power could validly impair previously existing property rights. When the impairment "reaches a certain magnitude," however, only compensation, and not the police power, will sustain the action.[249] Mr. Justice Holmes explained that the difference between a taking and the exercise of the police power was one of degree, not of kind. With the decision in *Pennsylvania Coal,* the takings test had evolved from frequently artificial, fixed rules to a case-by-case fairness test. This fairness test was an attempt to balance the police power against the right of private property, primarily premised on the economic loss inflicted. *Pennsylvania Coal*'s rejection of the *Mugler* distinction between taking and police power constituted an extremely significant departure from traditional takings jurisprudence and began the case-by-case approach to line drawing. Somewhere along the continuum regulation turns into taking.[250] The problem is to discover just where.

243. F. BOSSELMAN, *supra* note 222, at 106-14. The physical invasion approach to eminent domain, a literal application of the word "taken," led states to adopt a "taken or damaged" standard for when just compensation was due, thereby permitting payment for certain nontrespassory governmental acts. Kratovil & Harrison, *supra* note 196, at 599-600; Stoebuck, *supra* note 197, at 555.

244. *See, e.g.,* Richmond, F. & P. R.R. v. Richmond, 96 U.S. (6 Otto.) 521 (1877).

245. 123 U.S. 623 (1887).

246. Powell v. Pennsylvania, 127 U.S. 678 (1888) (sustained a statute barring the manufacture of oleomargarine).

247. Interstate Consol. St. Ry. v. Massachusetts, 207 U.S. 79, 87-88 (1907). The "tax" was a requirement that the railroad transport children at half fare.

248. 260 U.S. 393 (1922).

249. *Id.* at 413, 415.

250. Yet whether a "diminution of value" test is, or can be, meaningfully applied, is doubtful. *Compare* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922) (property can be regu-

Current Supreme Court doctrine supports the claim that IOLTA is not a taking.[251] Before embarking on the line-drawing analysis required by *Penn Central*, however, an examination of suggested solutions to the "crazy quilt pattern" is in order. This examination will highlight the complex nature of the issue and determine whether the conclusion that IOLTA is not a taking is buttressed by the work of some of the leading writers in the area of fifth amendment jurisprudence. Review of all, or even most, of the scholarly works is impossible. Nor is it the purpose of this article to urge the adoption of any of the suggested solutions. They are reviewed only to provide some assurance of reaching a reasonable result.

B. Scholarly Analysis of Takings

Prior to embarking on this journey, two things should be noted. First, all the scholars agree that in the absence of loss, there is no taking.[252] Here, that basic requirement is ignored. Second, some of the writers suggest legislative solutions.[253] Whatever the intrinsic merits of their proposals, the fact remains the fifth amendment cannot be abrogated by ordinary legislation. Absent a constitutional amendment, the Supreme Court is the definitive arbiter of the taking clause.

Commentary falls into two broad and overlapping categories, which can be categorized as rule versus policy. Those who suggest that takings cases can be decided through the application of uniform rules attempt to distill a set of distinctions by harmonizing prior cases. The rules may or may not adequately incorporate the value served by the fifth amendment. Even if they do, however, the rules are difficult to apply to new situations.

The policy approach, in the takings context, attempts to delineate the philosophical values served by the fifth amendment and assess each claim of taking in light of those values. Professor Bruce Ackerman's "Scientific Policymaker" is the epitome of this method.[254] The Scientific Policymaker, as opposed to his "Ordinary Observer," believes the legal system contains a relatively small number of princi-

---

lated as a general rule, but if the regulation goes too far it will be considered a taking) *with* Hadacheck v. Sebastian, 239 U.S. 394 (1915) (a city can enforce regulations which are in its best interest even if it requires a businessman to abandon use of his property).

251. *See infra* text beginning at note 349.

252. *See infra* text accompanying notes 254-341.

253. *Id.*

254. B. ACKERMAN, *supra* note 160, ch. 2. Ackerman's book is not necessarily a work on constitutional law. Nor is his suggested methodology meant to apply to specific concrete cases. Rather, it is meant to show the way to a sounder analysis of takings claims, a way which would require major revisions in the way courts now function. B. ACKERMAN, *supra* note 163, at 357.

ples forming a self-consistent whole, which Ackerman calls a Comprehensive View. Competing claims are judged in accordance with the society's Comprehensive View.[255] The Scientific Policymaker understands that the role of property law is to determine the way in which user rights should be parceled out to competing claimants.[256] The real issue, according to Ackerman, is not to search out property rights "through some mysterious intuitive process," but to concede their existence and determine in whose bundle they belong.[257] The Scientific Policymaker, adhering to the bundle of sticks approach, finds that almost any change in prevailing usage patterns constitutes a taking.[258] The merits of the change are assessed by determining if compensation should be awarded, not by asking whether a taking has occurred.[259] This approach shields the individual from losses attributable to shifts in governmental policy and means that the "new property" of Professor Reich is no different, for analytical purposes, from traditional property recognized by the common law.[260]

Ackerman posits that American lawyers largely espouse two different comprehensive views. One is essentially utilitarian. In the takings context, Professors Michelman and Sax are the leading exponents. The other, a reaction to utilitarianism, is labeled Kantian by Ackerman. It emphasizes the rights of individuals, not collective goals. Examples of both comprehensive views will be considered.

1. The First in Time Rule[261]

Professor Lawrence Berger proposes a first in time rule to solve the taking issue. That rule is said to derive from the paramount goals of the fifth amendment, fairness and economic efficiency. "A decision is fair if it is in basic accord with the community's sense of justice

---

255. B. Ackerman, *supra* note 160, at 11. The Comprehensive View, which Ackerman rightly says the American judicial system lacks, could be any political philosophy.

256. *Id.* at 26.

257. *Id.* at 27.

258. IOLTA, of course, may not constitute a change as far as the client is concerned. The banking industry is indirectly impacted, but that impact is caused more by a change in banking law than by the IOLTA program. Some lawyers are also indirectly affected by loss of the privileges they received from their banks because they maintained interest free accounts. They are in no position to complain, however, because they were never entitled to those benefits in the first place.

259. B. Ackerman, *supra* note 163, at 364-65.

260. *Id.* at 363. Ackerman shifts the analysis from the taking stage to the compensation stage, arguing that it is the purpose of the Comprehensive View to provide the principles of "just" compensation. Professor Epstein argues that Ackerman's utilitarian doctrine destroys "the special place of private property" and is unlikely to lead to constant results: "There not only would be an abundance of hard cases, but also a marked absence of easy ones." Epstein, *supra* note 164, at 643.

261. Berger, *A Policy Analysis of the Taking Problem*, 49 N.Y.U. L. Rev. 165 (1974).

. . . a decision is unfair if it offends our sense of injustice."[262] This intuitive notion is Berger's key element; "normal community expectations should not ordinarily be frustrated by legal decisions."[263] Or, put differently, unexpected acts causing severe loss are unjust if not compensated. Fairness is paramount. Yet economic efficiency, meaning "the reduction to a minimum of the social costs caused by conflicts," is also critical to any sound theory of eminent domain.[264]

Berger argues that the traditional taking tests fail to achieve either goal. The physical invasion test is far too limited, can produce manifestly unfair determinations, and promotes economic efficiency.[265] The noxious use test also produces manifestly unfair results because of its "over-simplified" separation of good from bad, its failure to promote economic efficiency and its failure to account for social costs.[266] The diminution of value test, at least partially, accords with the community's sense of justice and can promote economic efficiency. This test, however, fails to take into account all costs associated with governmental resource-allocation decisions.[267]

---

262. *Id.* at 167.

263. *Id.* at 168.

264. *Id.* at 169.

265. *Id.* at 171. Without exception, all the writers agree the physical invasion test is unsatisfactory. All would agree that compensation is properly due in situations involving a physical invasion and that is the current state of the law, although application is difficult and prediction nearly impossible. Moreover, although most agree the physical invasion test is a useful guidepost, none argue it should be deemed to create a *per se* rule.

266. *Id.* at 172-75.

267. Berger argues that the enterprise-arbitral distinction proposed by Professor Sax in his first article is unfair. Sax, *supra* note 229. Sax's second article is even more permissive. Sax, *Takings, Private Property and Public Rights,* 81 YALE L.J. 149 (1971) [hereinafter cited as Sax, *Takings, Private Property*]. Both articles are discussed at *infra* text accompanying notes 333-44. Berger argues the flaw in Sax's approach is "that it gives the government essentially untrammeled power to destroy previously established property values without paying compensation." Berger, *supra* note 261, at 180. Carried to its end, it may limit compensation to only cases of physical invasion — an unfair and economically inefficient result. According to Berger, Sax permits government decision making to restrict or eliminate one legitimate activity to benefit another. Berger would reach the opposite result.

Professor Michelman's position fares little better. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law,* 80 HARV. L. REV. 1165 (1967). Professor Michelman's relevant variables are efficiency gains, settlement costs and demoralization costs. Utilitarian theory holds that no measure should be undertaken where there are no efficiency gains, or where both settlement costs and demoralization costs exceed such gains. If demoralization costs exceed settlement costs, compensation should be paid, but not otherwise. Michelman concedes that a realistic method of computing demoralization costs is unknown. In addition, Berger suggests this approach ignores an important factor, that the person benefiting from the redistribution does so at no cost — an inefficient allocation of resources. Michelman also asks whether the utilitarian calculus is just. To answer that question, he looks at it from the standpoint of the rejected claimant who ought to be able to judge whether in the long term he will be better off without compensation. Berger believes the concept of fairness advocated by Michelman is unrealistic and "would be perceived as unfair by most of those who lived under it." Berger, *supra* note 261, at 182-84.

In place of the traditional tests, Berger would protect the first lawful use, what he calls "the first in time rule." His basic principle of fairness requires that "every realty owner should be protected in his reasonable expectations as of the time of his purchase . . . with regard to those variables under government control that affect its value."[268] Compensation is required unless the owner, at the time of acquisition or other detrimental act, knew or should have known of existing or proposed government plans, implementation of which would have the effect of decreasing the value of his property. All other value losses would be compensated. Conversely, all gains directly attributable to governmental actions would be recouped to prevent windfall profits.[269] If the government only implemented projects that resulted in positive gains to society, there might be no net cost to the government.

The first in time rule results in far more compensable incidents. It would require compensation to those indirectly injured by a government project, such as those who lose access to a highway or suffer from pollution caused by a new road,[270] to those whose once lawful activity is prohibited either to benefit nearby landowners[271] or in the name of the public interest[272] and to those who are forced to expend money or terminate their once lawful use.[273] In order to promote economic efficiency, compensation need "not be paid unless the damage to the property adversely affected is substantially more than the cost of administering payment, essentially this is a de minimis notion."[274]

Application of the first in time rule to IOLTA would mean no compensation. IOLTA is first in time for all new clients' trust deposits. The client who deposits funds with an attorney would be charged with the knowledge that IOLTA will strip his funds of any income-

268. *Id.* at 196.

269. *Id.* Berger suggests a variety of possible methods to recoup benefits, including taxes, special assessments and excess condemnation awards. All have serious application difficulties. Implementation would require extensive legislation and probably constitutional amendment. Limited experiments, similar to Berger's proposal, failed in England. Moreover, a rule that authorizes government to recoup the benefits conferred by its programs is contrary to "normal community expectations" and thereby offends the community's sense of justice. That may help to account for the failure of the English experiments. *Id.* at 202-07.

270. The first in time rule would result in reversal of a long line of access cases. F. BOSSELMAN, *supra* note 222, at 122.

271. Reversal of Hadacheck v. Sebastian, 239 U.S. 394 (1915), would result.

272. Reversal of Mugler v. Kansas, 123 U.S. 623 (1887), and Andrus v. Allard, 444 U.S. 51 (1979), would result.

273. Reversal of the long line of grade crossing cases would result. F. BOSSELMAN, *supra* note 222, at 121-22. *Penn Central* must also be reversed, or at least that portion of the landmarks preservation law which required the landowner to maintain the building's facade unchanged.

274. Berger, *supra* note 261, at 201.

producing potential. As long as the client is not forced to make the trust account deposit as a condition of obtaining legal assistance or invoking the judicial process, the first in time rule would preclude a claim for compensation.[275] Moreover, even if trust deposits, in some instances, cannot be considered voluntary, the de minimis and windfall profits elements of the rule would eliminate the need for compensation. The loss to the client, if any, would be far exceeded by the cost of administering a payment scheme. The impact of IOLTA is truly de minimis. Finally, the income is produced only because of a government program. Gains in value attributable to governmental actions are to be recouped. Although the benefit calculation in most situations would be exceedingly difficult, it is exceedingly simple for IOLTA. Under the first in time rule, IOLTA passes muster.

2. Freedom of Use and Enjoyment[276]

Professor John Humbach constructs a "unifying" theory by distinguishing the *right to exclude* from the *freedom to use and enjoy.* Property, according to Humbach, is primarily the "right of exclusivity," the power to keep others away.[277] An individual has a property right when, and only when, that asserted right is enforceable in court.[278] The freedom of use and enjoyment is the ability of the owner to make use of his property without legal sanction.[279] The taking question is decided by drawing a distinction between government impairment or destruction of pre-existing causes of action and government actions which restrict the owner's freedom to use and enjoy his property, but do not impair or destroy any legally enforceable

275. The freedom of choice is whether the client must make the deposit, not whether any deposit must go into an IOLTA account. If clients are forced by law to make cash deposits, as may be the case at times, the first in time rule should not apply because the clients lack volitional choice and thus lack the opportunity to discount the impact of potential governmental activities. *Id.* at 195-97.

276. Humbach, *A Unifying Theory for the Just-Compensation Cases: Takings, Regulation and Public Use,* 34 RUTGERS L. REV. 243, 252-54 (1982). It has been argued the exceptions to the "unifying theory" swallow the rule. Costonis, *Presumptive and Per Se Takings: A Decisional Model for the Taking Issue,* 58 N.Y.U. L. REV. 465, 474 (1983).

277. Humbach, *supra* note 276, at 256.

278. *Id.* at 254-55.

279. *Id.* at 257. The author has developed an elaborate, point by point comparison of "rights" and "freedoms." *Id.* at 258-60. It is more than reminiscent of Hohfeldan analysis. *See* Hohfeld, *Fundamental Legal Conceptions,* 23 YALE L.J. 16 (1913). The dichotomy between rights and freedoms, according to Humbach, can be deduced from the difference in result between United States v. Pewee Coal Co., 341 U.S. 114 (1951) (seizure of a coal mine constituted a taking requiring government compensation) and United States v. Central Eureka Min. Co., 357 U.S. 155 (1958) (government order closing gold mines during wartime does not require compensation).

right the owner previously possessed.[280]

To effect a taking, the governmental action must have the legal effect of depriving an owner of pre-existing factual predicates for one or more potential causes of action.[281] If the governmental action only prevents a use, however, such as the placing of funds at interest to generate income, it is not a taking. Humbach attempts to escape the inadequacy of that overly simple formulation by adding to it the concept of "deregulation." If a law is repealed, or amended, its effect may be to terminate a pre-existing cause of action.[282] Humbach separates compensatory from non-compensatory changes in law by distinguishing government acquisition of property for retransfer in some public program from government reallocation of rights among private persons, albeit for a public purpose. Only the first requires compensation.[283]

Use of the unifying theory to resolve the IOLTA controversy

---

280. Humbach, *supra* note 276, at 253. According to Humbach, "the holdings of Supreme Court cases point unambiguously to the conclusion that the just-compensation clause meaning of property *does not* include freedoms, at least not the freedoms of use and enjoyment." *Id.* at 261 (emphasis in original). Humbach concedes that "the rights/freedom dichotomy has not usually been the ostensible basis for any court's decision." *Id.* at 254. Whether this after-the-fact descriptive definition is useful as a predictor for novel situations is open to doubt. It also depends on one's starting point, as in Kaiser Aetna v. United States, 444 U.S. 164 (1980).

281. Thus by imposing burdens on owners, land use restrictions reduce freedoms, but do not eliminate or reduce rights. Humbach, *supra* note 276, at 269. Mugler v. Kansas, 123 U.S. 623 (1887), is cited in support of the rule. Humbach subjects police power regulations to two limitations. The first is the general substantive due process limitation on the police power itself. Humbach insists that the fourteenth amendment's due process limitation is analytically distinct from the fifth amendment issue. Humbach, *supra* note 276, at 270-75. Costonis, on the other hand, argues that the police and eminent domain powers cannot be so compartmentalized. Costonis, *supra* note 276, at 485-95. The second limitation, derived from Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922), treats restrictions on freedoms as a taking if they "go too far" on the principle that when a regulation "leaves a landowner with no practical use of his land, the result is to render his right of exclusivity, though technically unimpaired, actually nugatory." Humbach, *supra* note 276, at 270-73.

282. Humbach, *supra* note 276, at 286.

283. This position is derived from Sax's enterprise/arbitral distinction. *Id.* at 286-87. Sax, *Takings and the Police Power*, *supra* note 229, at 62. The distinction, as Sax notes, may not always be obvious:

> In a technical sense certain situations like workmen's compensation, since they may involve a payment to a government fund, seem to fit the description of an enterprise. *E.g.*, Mountain Timber Co. v. Washington, 243 U.S. 219 (1917) (workmen's compensation); Nobel State Bank v. Haskell, 219 U.S. 104 (1911) (Bank depositor's protection fund); California Auto Ass'n v. Maloney, 341 U.S. 105 (1951) (assigned risk law). But here the government acts only as a stakeholder for the redistribution of economic values to the regulatee's private competitors, usually a customer or employee in these situations. The clue that these cases are to be treated as non-compensable, non-enterprise situations is the fact that they might alternatively be administered either through a private or a government agency. Thus the involvement of the government, when it occurs, is irrelevant.

Id. at 70 n.156.

turns on whether a client has a cause of action against his attorney to compel receipt of the income his trust deposit generates. Nothing in the unifying theory helps resolve the basic question of whether the claimant has a cause of action. If it is assumed the client is entitled to any income earned under any circumstances, then the client does have a cause of action, and IOLTA does take the property of the client. If, however, the initial property question is answered by assuming that a client is only entitled to the income net of imputed expenses, then the client lacks a cause of action and IOLTA does not take any property of the client.[284] It may not even impair a freedom because banking restrictions and economic constraints, not IOLTA, prevent the production of income. In the event IOLTA is viewed as modifying trust law, and thus as deregulation, the question is whether IOLTA constitutes a reallocation of rights among private individuals or a government acquisition in its corporate capacity. It is possible to view IOLTA either way. Perhaps IOLTA is a reallocation from financial institutions and attorneys to providers and/or users of legal services. On the other hand, it may be a government acquisition of monetary resources which the government thereafter uses to purchase legal services for the poor. The unifying theory fails to provide a definitive answer.

3. The Rule of Presumptive Takings[285]

Professor John Costonis postulates that the Supreme Court has relegated property rights to second class status as a result of treating regulatory measures as economic legislation. He suggests the property values inherent in the Constitution, which he calls "dominion interests," are entitled to consideration more nearly equivalent to that afforded to constitutionally protected liberty interests.[286] He also discerns a movement toward greater protection in recent cases[287] and argues that substantive due process concepts should play a much greater role in decision-making.[288] Costonis declares that taking issues, like liberty issues, should never be resolved on a per se basis. Instead, the taking clause must be deemed to state a presumption that may be, and in fact usually is, rebuttable by the government. To determine if the presumption has been rebutted, a court must balance the "welfare principle" against the "indemnity principle." The

284. Humbach makes no attempt to resolve property issues. Humbach, *supra* note 276, at 245-48.
285. Costonis, *supra* note 276.
286. *Id.* at 468-69.
287. *See, e.g.*, Lynch v. Household Fin. Corp., 405 U.S. 538 (1972).
288. Costonis, *supra* note 276, at 468.

former permits the police power to further the community's health, safety, morals or general welfare at the expense of recognized property interests, while the latter protects the individual, and not the community, from governmental acts that redistribute property interests.[289]

In addition to rejecting the per se rule of *Loretto*,[290] the author also rejects a wide variety of distinctions with a long, although not necessarily illustrious, history in fifth amendment jurisprudence. For example, Costonis rejects distinctions between property as a "thing" and property as a "relation," between "direct" and "consequential" damages, between "permanent" and "temporary" invasions, between "destruction" and "appropriation," and between "physical invasions" and "regulatory incursions."[291] Instead, Costonis proposes a four element decisional model.

The first element, the "dominant rule," holds that any governmental act that deprives an owner of a property interest is always a presumptive, and never a per se, taking.[292] Three additional elements then determine whether the government has successfully overcome the presumption. The first, termed the "due process-takings phase" requires the government to establish that its redistribution is fair in principle. The core value of fairness, whether a property owner has been singled out to bear an unfair share, is examined by a "use-dependency" test, which measures the strength of the "connection between a measure's *goals* and the burdened property's *use*."[293] The test is designed to accommodate the public purpose and indemnity concerns of the fifth amendment.

If the action is fair in an abstract sense, the second element, termed the "pure takings phase," considers whether the governmental action is fair as applied or whether it infringes more severely upon the property taken than is required to achieve its intended goals.[294] The third element imposes a graduated burden of proof upon the government, the extent of the burden depending primarily upon the

289. *Id.* at 477-78.

290. 458 U.S. 419 (1982). Costonis, who participated in the *Teleprompter* litigation, rejects the per se rule applied by the Court, but does not fully assess the outcome if the Court had used his suggested decisional model. Depending on judicial view, it is possible for a court to decide *Loretto* either way using the Costonis model. That very real possibility seriously undercuts the value of the model.

291. Costonis, *supra* note 276, at 467.

292. *Id.* at 469.

293. *Id.* at 488 (emphasis in original). Costonis agrees with Professor Sax that "fairness" is the dominant goal of the taking clause, not the preservation of existing property rights. *Id.* at 507. That reading of history is necessary to Costonis' analysis, but probably not consistent with the intent of the framers.

294. *Id.* at 495.

relative weight assigned to the specific welfare and indemnity values.[295]

Application of the theory starts with a presumption of taking if even one stick from the client's bundle has been removed, causing the burden to shift to the government to justify removal of the particular right at issue.[296] A taking will be found unless the reason for the governmental measure and the use of the property are sufficiently linked[297] so that the owner has not been unfairly singled out to bear a loss that should be distributed to the public in general.[298] If a program is found to be fair in principle, the "pure takings inquiry" asks whether a measure has "gone too far" by imposing a burden greater than necessary to implement the legislative scheme.[299] Somewhat akin to substantive due process in the *Lochner* era, this element asks whether the burden imposed on the owner is more onerous than necessary to achieve the legislative purpose.

Costonis reserves to the graduated burden of proof element the resolution of the ambiguous nature of his other criteria. He proposes a sliding scale, much like three-tiered equal protection analysis, and suggests that the "level of scrutiny . . . will depend upon the identity of the competing welfare and indemnity values at issue and the precise manner . . . of infringement."[300] The government's burden will

295. *Id.* at 499. Costonis equates the per se approach to the equal protection standard of strict scrutiny (or, in fact, something even stronger than strict scrutiny) and the *Penn Central* balancing process to a rational relationship test. Clear takings cases would utilize the strict scrutiny standard. Clear non-takings cases would use the rational basis test. Difficult cases would employ the intermediate standard of review found in Craig v. Boren, 429 U.S. 190 (1976), which requires a substantial relationship between the action taken and the end to be achieved. How one first determines the appropriate test, and how one then applies that test, is not fully answered by Costonis.

296. Costonis does accept that at times analysis must begin with whether there is a property right, but submits that in almost all cases the property stick issue is conceded. Costonis, *supra* note 276, at 484.

297. The notion of linkage seems to be a resurrection of the noxious use test, abandoned long ago. Linkage is swallowed by economic expectation. Alabama Power Co. v. Ickes, 302 U.S. 464 (1938); Duke Power Co. v. Greenwood County, 302 U.S. 485 (1938); Norman v. Baltimore & O. R.R., 294 U.S. 240 (1935). Public purpose is sufficient to sustain regulatory acts without regard to evil. Penn Central Transp. Co. v. City of New York, 438 U.S. at 104.

298. Costonis, *supra* note 276, at 487. The meaning of linkage is not well-developed. Costonis rejects the all-encompassing linkage argument that derives from Munn v. People of Illinois, 94 U.S. (4 Otto.) 113 (1877), but nevertheless seems to use the universally discredited "nuisance" test. He argues that "use-dependent invasions — those predicated on government's effort to control legislatively-declared evils associated with the burdened land's use — should not be categorized as takings *provided that government establishes a plausible connection between the evil and the use of the land.*" *Id.* at 492-93 (emphasis in original). Apparently, the lesser the evil, the greater the government's burden of proof.

299. *Id.* at 496. PruneYard Shopping Center v. Robins, 447 U.S. at 74, supports this element.

300. Costonis, *supra* note 276, at 499. That the Supreme Court has never enunciated such a rule is conceded. *Id.*

be greatest where less established police powers conflict with dominion interests. Conversely, the government's burden will be minimal where clearly established police powers conflict only with an owner's economic interests.[301]

Costonis chastises those who criticize his model for failing to predict the outcome of particular controversies or for leaving substantial room for political value judgments.[302] Yet his model does just that. The analysis needed to balance welfare versus indemnity interests, to decide if legislation has gone too far, and to choose a standard of review, seems more complex, and no more predictable, than the multifactor balancing test. Its value to the IOLTA issue is that it moves the decision-making process away from a per se rule and thereby permits consideration of more relevant factors.

Translating Costonis' general principles to specific application is not an easy task. If IOLTA removes even one stick from the bundle, it is presumptively a taking. The welfare values benefited by IOLTA, a mechanism for providing more equal access to justice, are powerful. The indemnity values are weak because the owner's dominion interest, whether deemed to rest on economic or non-economic concerns, is not meaningfully impaired.[303] Although the linkage is slight, and the only "evil" IOLTA eliminates is the financial institution's free use of client money, it is hard to conclude that IOLTA is not fair in principle. IOLTA does not violate the pure takings analysis because it is also fair as applied.[304] Moreover, IOLTA meets a test of fairness that requires the government to make "a more than minimally plausible case" for fairness. IOLTA passes muster under the presumptive taking test.

4. Utilitarianism, Efficiency and Fairness[305]

Professor Frank Michelman explores the relationship of ethical concepts and Supreme Court doctrine from a utilitarian perspective as modified by John Rawls' concept of fairness. According to

---

301. *Id.* at 500.

302. *Id.* at 524.

303. Two values can be identified. The first, growing out of Honoré's right of use is, in the IOLTA context, the right to commit economic waste by continuing the practice of keeping funds in non-interest bearing accounts. It is not a value meriting serious concern. The second value could be deemed a "right of refusal" to assist in rendering legal aid. Yet if public funds are constitutionally available for legal aid purpose — a use not open to real challenge — then IOLTA cannot be challenged because the client is not in favor of legal aid to the poor. PruneYard Shopping Center v. Robins, 447 U.S. at 74.

304. That it is fair as applied rests upon the fact of *no* economic loss to the client and the tenuous nature of an "entitlement" to interest.

305. Michelman, *supra* note 267.

Michelman, a strictly utilitarian theory of compensation would consider three criteria: efficiency gains, demoralization costs, and settlement costs.[306] No project should be undertaken absent efficiency gains. Nor should a measure be undertaken if either settlement costs or demoralization costs exceed efficiency gains. If compensation must be paid, there will be settlement costs, but not demoralization costs. Conversely, if compensation is not paid, there will be demoralization costs, but not settlement costs. Because society must bear one cost or the other, compensation is due whenever demoralization costs exceed settlement costs, and not otherwise.[307]

Utilitarian philosophy, according to Michelman, does not furnish the full answer. Any system must also serve an individual liberty notion, a concept of "fairness" that Michelman derives from Rawls.[308] Fairness assures each individual the maximum liberty consistent with the corresponding liberty enjoyed by every other individual. Departures from equality are just if everyone has the opportunity to benefit from the differential treatment and the arrangement can reasonably be supposed to work to the advantage of all, particularly those who receive the least advantageous treatment. Efficiency-motivated governmental actions require compensation if they impair liberties unequally. Departures from full compensation, however, are permitted if the long range effect of the action will advantage the least favora-

---

306. According to Michelman:

> "Efficiency gains" are defined as the excess of benefits produced by a measure over losses inflicted by it, where benefits are measured by the total number of dollars which prospective gainers would be willing to pay to secure adoption, and losses are measured by the total number of dollars which prospective losers would insist on as the price of agreeing to adoption. "Demoralization costs" are defined as the total of (1) the dollar value necessary to offset disutilities which accrue to losers and their sympathizers specifically from the realization that no compensation is offered, and (2) the present capitalized dollar value of lost future production (reflecting either impaired incentives or social unrest) caused by demoralization of uncompensated losers, their sympathizers, and other observers disturbed by the thought that they themselves may be subjected to similar treatment on some other occasion. "Settlement costs" are measured by the dollar value of the time, effort, and resources which would be required in order to reach compensation settlements adequate to avoid demoralization costs. Included are the costs of settling not only the particular compensation claims presented, but also those of all persons so affected by the measure in question or similar measures as to have claims not obviously distinguishable by the available settlement apparatus.

Michelman, *supra* note 267, at 1214 (footnotes omitted).

307. *Id.* at 1215.

308. Rawls, *Justice as Fairness,* 67 PHIL. REV. 164 (1958); *Constitutional Liberty and the Concept of Justice,* in NOMOS VI, *Justice* 98 (1963); *The Sense of Justice,* 72 PHIL. REV. 281 (1963). The contrast between utilitarian concerns and individual liberties is also evident in Ackerman's distinction between Utilitarian and Kantian adjudication. B. ACKERMAN, *supra* note 160.

bly benefited individual.[309]

The fifth amendment protects individuals against the "evil" of collective actions that immediately harm some individuals in order to benefit other individuals whose "claim to satisfaction has been ranked as intrinsically superior."[310] Such burdens are acceptable if they are distributed "evenly" enough to make everyone a net gainer. The utilitarian approach and the individualistic approach, grounded in justice or fairness, thereby implicate the same criteria and often lead to the same result.[311] The tests, in Michelman's view, are not inconsistent with existing Supreme Court taking doctrine, although they obviously call for far different results in some situations.

According to Michelman, the physical invasion test is, at most, "a convenience for identifying *clearly compensable* occasions."[312] It cannot, however, justify refusal to compensate and the test fails to the extent it requires compensation for relatively insignificant losses. Nevertheless, using utilitarian calculus, the physical invasion test, although arbitrary, does protect against high demoralization costs. At the same time, however, it fails a fairness test where the relevant comparison is between large and small losses.[313] The diminution of

309. Michelman, *supra* note 267, at 1220-21. The issue is whether a specific decision not to compensate is fair.

> By the very asking of the question we adopt the vantage point of the disappointed claimant and assume on his part a capacity (a) to appraise his treatment and calculate his advantage over a span of time (that is, he is not without patience) and (b) to view the particular decision in question as a specific manifestation of a general practice which will be applied consistently to situations involving other people.

Id. at 1221. The relevant risk of always requiring compensation is that settlement costs will force abandonment of efficient projects as compared with a less stringent compensation practice which may sustain concentrated losses directed at specific individuals without offsetting benefits. *Id.* at 1222.

310. *Id.* at 1225.

311. *Id.* at 1225-26. Michelman suggests that a philosophy grounded in efficiency and a philosophy grounded in fairness will often produce the same outcome:

> If we set about to make practical use of this approach, we shall find ourselves asking much the same questions to determine whether a compensability decision is fair as were suggested by the utilitarian approach. The relevant risks plainly are minimized by insistence on compensation when settlement costs are low, when efficiency gains are dubious, and when the harm concentrated on one individual is unusually great. They are also minimized if insistence on compensation is relaxed when there are visible reciprocities of burden and benefit, or when burdens similar to that for which compensation is denied are concomitantly imposed on many other people (indicating that settlement costs are high and that those sustaining the burden are probably incurring relatively small net losses — else, being many, they probably could have been mobilized to deflect the measure which burdens them).

Id. at 1223.

312. *Id.* at 1228 (emphasis in original).

313. *Id.* at 1229.

value test recognizes expectations, and thus demoralization costs, where enforcement of restrictions would "totally defeat a distinctly crystallized expectation."[314] A balancing test is aimed "at discovering not whether a measure is or is not efficient, but whether it is *so obviously* efficient as to quiet the potential outrage of persons 'unavoidably' scarified in its interest."[315] Similarly, the function of the "harm-prevention/benefit-extraction dichotomy" is to decide whether a potential occasion for compensation exists, not whether compensation shall be paid.[316] Utilitarian calculus

> easily allows that compensation need not be paid in respect of investments which, when they were made, either (a) interrupted someone else's enjoyment of an economic good, as should have been apparent; or (b) were of a sort which society has adequately made known should not become the object of expectations of continuing enjoyment.[317]

---

314. *Id.* at 1233.

315. *Id.* at 1235 (emphasis in original).

316. *Id.* at 1239.

317. *Id.* at 1241. A slightly different version of utilitarian calculus is offered by Professor Ackerman. His starting place is the same, the most efficient resource allocation. Ackerman posits, however, that the concept of demoralization costs more accurately includes two elements, uncertainty costs and disaffection costs. When a property redistribution occurs, compensation is a function of three factors: (1) uncertainty costs, ("U"); (2) process costs, ("P"); and, (3) disaffection costs, ("D"). Uncertainty costs are the result of risk-adverse persons taking economically inefficient measures to protect themselves from unexpected governmental actions. Process costs are the costs of compensation plus the costs of claims processing. Disaffection costs are incurred when individuals perceive that governmental actions may not be fair. B. ACKERMAN, *supra* note 160, at 44-46. Only process costs can be estimated with any degree of reliability. Moreover, the decision to compensate or not to compensate will often be a function of judicial outlook. According to Ackerman, the restrained utilitarian judge is most responsive to just compensation claims as process costs decline, as uncertainty costs increase and as the general utility of the legislation is increasingly subject to reasonable doubt. Where uncertainty costs are high, or process costs are low, a claim for compensation receives "sympathic scrutiny." *Id.* at 45-46. Whenever the sum of uncertainty costs and disaffection costs exceeds process costs, compensation should be paid. *Id.* at 47. The activist utilitarian judge, on the other hand, is less sanguine of the good intentions of government. He believes the government in its "entrepreneurial" capacity will seek resources not justified on a "sober utilitarian cost-benefit analysis" and will make decisions on a partisan or corrupt basis. *Id.* at 50-58. The activist judge committed to implementation of a utilitarian comprehensive view would seek to identify "the social group which can bear the burden . . . with the smallest loss in overall utility." He would consider: (1) cost of insurance; (2) cost of disaffection; (3) cost of settlement; (4) potential for abuse by the state; and, (5) relationship of just compensation law to the overall distribution of property rights. *Id.* at 64. Ackerman's utilitarian calculus reduces to a formula. "The critical question, in any given class of cases, is whether $P \gtrless U + D$, where P = process costs, U = uncertainty costs, and D = costs of citizen disaffection. If $P > U + D$, compensation should be denied. If $P < U + D$, it should be granted." *Id.* at 48-49 (footnotes omitted).

According to Ackerman, his approach differs from that of Professor Michelman's because:

> It is true that, in his general account of the Utilitarian's compensation calculus, Michelman does not relate his argument as clearly as he might to the restrained concep-

The utilitarian approach has been roundly criticized. Among other criticisms, it is said to prefer collective goals to the exclusion of individual rights, causing some critics to view it as a device to escape those parts of the social compact embedded in the Constitution. A constant theme is the impossibility of solving the utilitarian equation. Neither efficiency gains nor demoralization costs are subject to actual measurement.[318] Utilitarianism would open wide the doors to compensation. In particular, recipients of social security, welfare and other governmentally conferred benefits stand to benefit. Conversely, utilitarian theory would not recognize per se decision-making, thereby closing the door on presently compensable acts where little real loss is incurred.[319]

Utilitarian calculus would approve IOLTA. It tends to maximize efficient resource allocation. Unused resources are directed toward a worthy social goal. The program is clearly a promoter of net social utility. Yet there is a cost. Commercial banks would suffer demoralization costs because of the loss of interest-free money. Other financial institutions, however, would benefit because NOW accounts permit them to attract a new source of funds. One could conclude the gains and losses for the different types of financial institutions balance.[320] The client's position is unchanged. There are no surprises. Demoralization costs should be minimal. Clients who understood the mechanics of IOLTA would not think it unfair that the interest generated does not go to them because they would realize that, standing on their own, they cannot receive any income. Some clients might incur demoralization costs as a result of their dislike of civil legal assistance to the poor. Such individuals, however, should be relatively few and their concerns should be greatly outweighed by the net

> tion of judicial role. Nor does he distinguish clearly between the Appeal to General Uncertainty and the Appeal to Citizen Disaffection. On a substantive rather than methodological level, Michelman seems to emphasize far too little the importance of reasonable doubt as to the Utilitarian basis of the challenged legislation in leading a restrained judge to order compensation of those who have lost by the doubtful decision.

Id. at 49 (footnotes omitted).

318. *See* Posner, *supra* note 178, at 111-19; Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 510-11 (1980).

319. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982), would certainly have been decided differently.

320. While the deposit of client trust funds in NOW accounts produces positive utility gains as between clients, attorneys, and providers and consumers of legal services to the poor, one cannot be sure, if it were possible to factor in banks, their employees and stockholders, that IOLTA is a creator of positive utility — no matter how likely that seems. The calculus is lacking. Nor do we know the limits of whose gains and losses we must consider. *See* Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 491 (1980). If one applies Posner's theory of wealth maximization, however, IOLTA should be permitted.

utility of the program. Settlement costs would be high if compensation was required. Indeed, the cost of compensation plus the cost of administration would exceed the net benefit to society. Utilitarian calculus should, therefore, lead to the conclusion that compensation is not required.

5. Individualism[321]

Professor Richard Epstein argues there "is a clear collision between the traditional notions of property as a source of individual autonomy and the power of the state to regulate its use and disposition."[322] Epstein believes the multifactor balancing test is not a test at all. Instead, he believes it permits the court to reach whatever result it wants in a particular case. At the same time, Epstein feels the test "blocks the development of a rigorous theory with which to harmonize the cases, thereby making each new decision an embarrassment to those that have preceded it."[323]

The critical question to Epstein is whether the governmental action can be justified: "[C]learly an account of the police power requires some limited class of ends that it is proper to achieve without compensation. Whatever their weaknesses, the traditional antinuisance justifications of the police power at least had this desirable characteristic."[324] The police power, therefore, "should be construed to recognize in the state no lesser — but no greater — rights than private individuals have in their relationships with each other."[325] Epstein's view of the scope of the police power is far too limited.[326] Nevertheless, standing alone, that simple formulation may validate

---

321. Epstein, *Not Deference, But Doctrine: The Eminent Domain Clause*, 1982 SUP. CT. REV. 351.

322. *Id.* at 352.

323. *Id.* Epstein proposes a four-part test to replace the multifactor balancing test: Has property been taken? If so, was it taken for public use? Has the taking been accompanied by just compensation? If not, was the taking justified by the police power? *Id.* at 353. Only the last question is relevant here.

324. *Id.* at 370.

325. *Id.* at 354. If carried to its logical conclusion, limiting the police power to those acts which private parties could compel, essentially actions to abate nuisances, easements by necessity, and the like, would eliminate almost all land use restrictions. On this theory, *Penn Central* constitutes an invalid exercise of the police power. When Epstein discusses *Texaco* and *Loretto*, however, he shifts gears. The former is disapproved because less drastic means for simplifying land titles could be devised. The latter is dismissed without explaining why promotion of "rapid development of . . . a means of communication which has important educational and community aspects" does not justify the exercise of the police power. *Id.* at 372.

326. Epstein believes the public use limitation of the fifth amendment has been stretched, if not entirely ignored, and that governmental powers should be far more limited. *Id.* at 365-69. *See also* Epstein, *Taxation, Regulation and Confiscation*, 20 OSGOODE HALL L.J. 433 (1982). Put simply, his is not the prevailing view. Hawaii Hous. Auth. v. Midkiff, 104 S. Ct. 2321 (1984).

IOLTA since two private actors, the attorney and the financial institution, have the ability, absent government prohibition, to utilize the income from client funds for their own purposes.

A far different view of individualism is presented by Professor Ackerman's Kantian Comprehensive View. Critics of utilitarian theory argue that individuals, because they are individuals, are entitled to certain rights which cannot be overruled simply by an appeal to general utility. In other words, the principle of exploitation prevents viewing citizens as merely a means to maximize social utility.[327] The Kantian judge's calculus is a function of three factors: (1) process costs ("P"); (2) project benefit ("B"); and, (3) other project costs, including the costs of compensation ("C").[328] A Kantian judge, even if satisfied that a governmentally imposed redistribution serves a sound public purpose and that society has gained more than a particular individual has lost, would still require compensation if the process costs were less than the net project benefits. Compensation would only be denied if the process costs were so high as to make it impossible to compensate the individual without making all worse off. The utilitarian, on the other hand, would deny compensation if the process costs were more than the sum of uncertainty and disaffection costs.

The philosophical difference is between collective action and individual impact. Where $P < B\text{-}C$, the Kantian will always insist upon compensation. Where $P > B\text{-}C$, the Kantian will never insist upon compensation. In both instances, the utilitarian may reach the opposite result.[329] A judge applying the Kantian Comprehensive View, unlike Epstein's notion of severely limited police power, would have no trouble sustaining the IOLTA program. There is a clear benefit to society. More importantly, no person is made worse off and no person is exploited. Compensation, if required, would exceed the net benefit to society and destroy the IOLTA program. Applying the formula, $P > B\text{-}C$, a taking does not exist and compensation is not required.

327. B. Ackerman, *supra* note 160, at 71-72. Ackerman uses Kantian as a general term and not a specific description of the philosophy of Immanuel Kant.

328. *Id.* at 74.

329. *Id.* at 76. Hybrid theories are possible. A judge could well combine both utilitarian and Kantian theories. He would be concerned with maximizing overall utility, but would still be concerned that one citizen not be treated as a means for the gratification of another. The Kantian test would be first applied to see whether it was possible that nobody was made worse off at time two. "If, however, such a solution was made impossible by virtue of relatively high process costs, the judge would put on his Utilitarian spectacles and consider whether the costs of disaffection and uncertainty were greater than the process costs." *Id.* at 75.

6. Spillover[330]

Professor Joseph Sax initially suggested that governmental activities could be divided into two categories. Where government acts in an "enterprise" capacity as a competitor for the use of resources, its activities are deemed to be takings. Where government acts as a "mediator" to settle conflicts between private claimants, however, its activities are not deemed to be takings.[331] IOLTA would be deemed a taking if it was determined that IOLTA constituted the acquisition of resources, rather than reallocation of resources from banks to the provision of legal assistance.

Professor William Stoebuck's concept of transfers to the government is similar.[332] The core of his approach "is the principle that an exercise of eminent domain always involves a transfer of property."[333] The word "taking" is given a broad, plain-English meaning. Yet "[o]ne cannot find the transfer of anything unless he can visualize and identify the proprietary interests involved."[334] The eminent domain power is implicated when the government's actions diminish an owner's property rights by transfering them from the owner to the government.[335] The usual land use restrictions, which benefit the general public, would not fit the transfer to the government element and, therefore, would not constitute a taking. In order to avoid the criti-

---

330. Sax, *Takings, Private Property, supra* note 267.

331. Sax, *supra* note 229. According to Sax:

> The rule proposed here is that when economic loss is incurred as a result of government enhancement of its resource position in its enterprise capacity, then compensation is constitutionally required; it is that result which is to be characterized as a taking. Yet losses, however severe, incurred as a consequence of government acting merely in its arbitral capacity are to be viewed as a non-compensable exercise of the police power.

Id. at 63. Arguably, IOLTA enhances the government's resource position by permitting the accumulation of funds to provide public services. Sax, however, recognizes that there must be a loss before resource enhancement equals a taking. *Id.* at 76.

332. Stoebuck, *supra* note 125. His earlier work contains a particularly valuable part on the historical development of the law of eminent domain. Stoebuck, *supra* note 197.

333. Stoebuck, *supra* note 125, at 1084.

334. *Id.* at 1089.

335. *Id.* at 1091. Stoebuck concedes his test restates Mugler v. Kansas, 123 U.S. 623 (1887), with one qualification. If the police power restriction "is specially directed toward benefiting a governmental entity in the use of land in which that entity holds incidents of ownership," it may constitute a taking. *Id.* at 1095. Stoebuck also concedes his test is essentially equivalent to Sax's initial distinction between enterprise capacity and arbitral capacity. It is not significantly different from his earlier view that a taking occurs when the "government has acquired unto itself a property right — an interest that is literally or effectively transferred and increases government's store of proprietary interests." The police or regulatory power passes no such interest to the government, although it may "decrease some private owners' property interests and may, in equal measure, increase other private owners' interests." Stoebuck, *supra* note 197, at 570.

cism that his distinction permits unlimited regulation (nothing is "too far"), Stoebuck suggests the use of substantive due process as a check on the system.

Professor Sax subsequently rejected his arbitral enterprise distinction. His revised approach, which he calls spillover, permits far greater governmental regulation. He contrasts the traditional view of property rights, which focused solely on activities occurring within the physical boundaries of the user's property, with an emerging view founded on a recognition of the "interconnectedness" between various uses of seemingly unrelated pieces of property.[336] Sax suggests that by changing the focus "[m]uch of what was formerly deemed a taking is better seen as an exercise of the police power in vindication of what should be called 'public rights'."[337]

Sax's primary concern is with protection of the environment. He argues the "dominant doctrinal model of takings law" is diminution of value. Using that model, a court asks whether the owner's ability to profit has been overly reduced.[338] Sax insists the "dominant doctrinal model of takings law" is far too narrow. It frequently fails to recognize the impact one use has on another. Recognition of such spillovers would permit government to decide, without paying compensation, which use is to be permitted, no matter how severe the economic loss to the restrained owner.[339] Conversely, where property lacks a spillover effect, restriction without compensation is not permissible "simply because a neighboring demand would provide a greater net benefit to the society."[340] Adoption of a spillover doctrine would justify almost all restrictions on land use. It would not permit mandated use, however, and would probably bar physical takeovers. Sax denies that his formulation permits restrictions whenever society

336. Sax, *Takings, Private Property, supra* note 267, at 149.

337. *Id.* at 151. Sax reads constitutional history to say that the core purpose of the fifth amendment is fairness, not protection of private property. That reading is questionable. *See* Stoebuck, *supra* note 197, at 586-87. Contrast the view of Pilon, who argues that "public rights" are the antithesis of a free society and private property rights, that eminent domain is not a legitimate power of government, and that most police power regulations, such as zoning restrictions, amount to a taking for which compensation is due. Pilon, *supra* note 143.

338. Sax, *Takings, Private Property, supra* note 267, at 151. He also recognizes three other models, the invasion theory, the noxious use test and the cause of harm test. *Id.* at 151 n.6.

339. *Id.* at 161. Spillovers include: (1) activities on my land that produce physical effects on your land; (2) pollution of the common elements, such as water, air, and view; and, (3) imposition of affirmative burdens on the community by the use of my land, such as construction of a new residential area, thus creating a need for additional police protection, schools and other public services. *Id.* at 161-62.

340. Sax, *Takings, Private Property, supra* note 267, at 162. The fairness of Sax's proposal can be questioned. Perhaps the spillover theory's greatest deficiency is its lack of method for determining which use to favor where there is a spillover. Berger, *supra* note 261, at 178-79.

would be advantaged. Yet, the line between spillover restrictions and redistributions to benefit society generally is not clear. It is doubtful whether his theory for distinguishing takings from police power regulation furnishes much guidance outside of the realm of land use regulations.

IOLTA affects the competing uses of financial institutions, attorneys and those in need of legal services. The placement of those funds in a trust account has no spillover effect, as spillover is defined by Sax. Of course, the "ownership of property [does not] necessarily imply a government guarantee to profit from it when and as the owner in his sole discretion wishes."[341] The application of spillover theory to IOLTA is problematical. If all governmental regulations which adversely impact on property values, but which are not premised on spillover effects, are considered to be a taking, Sax would hold IOLTA to be a taking. Because the theory seems confined to regulation of land, however, it neither justifies nor condemns IOLTA. It simply does not provide an effective means of answering the unique issue IOLTA raises.

None of the suggested solutions to the taking issue unambiguously require the conclusion that IOLTA is a taking. Indeed, several lead to the conclusion IOLTA is not a taking. Paramount to all the suggested doctrines are the justice and fairness concerns central to fifth amendment jurisprudence. They buttress the conclusion that, because clients suffer no loss, IOLTA cannot be deemed a taking.

C. The Supreme Court's Multifactor Balancing Test

After the decision in *Pennsylvania Coal*,[342] the Supreme Court soon began to hold that "no rigid rules"[343] or "set formula"[344] are available to determine when regulation ends and taking begins. The result was a multifactor balancing test, a pragmatic case-by-case resolution, which attempts to resolve the policy conflict between public need and private loss. The test compensates for the earlier mechanical approaches which were based on: (1) the physical invasion test, whereby government was only required to compensate if it occupied, used, destroyed or took legal or factual possession of the claimant's property; (2) the noxious use or harm-benefit test, whereby no matter how severe a regulation's economic impact, it was not deemed a taking if it eliminated a noxious use or resolved competing resource use problems, and thus served the public interest; and (3) the diminution

341. Sax, *Takings, Private Property*, *supra* note 267, at 169.
342. Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922).
343. United States v. Caltex, 344 U.S. 149, 156 (1952).
344. Goldblatt v. Town of Hempstead, 369 U.S. 590, 594 (1962).

of value or "too far" test. The fullest exploration of the multifactor balancing approach appears in *Penn Central Transportation Co. v. City of New York.*[345] *Penn Central* is an admission by the court of its inability to develop, or even attempt to develop, a judicial doctrine for determining when "justice and fairness" compel the shifting of economic injuries from specific individuals to the public. The no rigid rules or set formula is not really a test. Instead, it is a case-by-case, ad hoc factual inquiry that has become the norm for resolving the policy conflict between public need and private loss.

The core factors are identified as: (1) the character of the governmental action; and, (2) "the economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations."[346] Perhaps *Penn Central*'s greatest deficiency is the failure to even attempt to reconcile *Mugler* and *Pennsylvania Coal.*[347]

1. Character of the Governmental Action

Prior to 1933, the owner of a demand account possessed the ability to earn interest from funds in his checking account. That "right" disappeared with the adoption of the National Banking Act of 1933. IOLTA does use private property as the catalyst to generate funds to meet societal needs. Yet the funds that are generated are a loss to the financial institution, which has no claim to them, and not a loss to the individual client. If that use, without more, is enough to trigger a per se fifth amendment bar, IOLTA programs are at an end. Such an argument, however, is far too simplistic. IOLTA utilizes resources previously neither used, nor capable of use, to generate funds to meet a critical public need. Requiring a private owner to devote, without compensation, a portion of his resources to public use is not uncommon. Requiring it where absolutely no loss results to the owner

345. 438 U.S. 104 (1978).

346. *Id.* at 124. The threshold property issues remain. A taking will not be found where economic harm "did not interfere with interests that were sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes." *Id.* at 124-25. If there is no property interest, there can be no taking. Hodel v. Virginia Surface Min. & Reclam. Ass'n, 452 U.S. 264 (1981). The distinct investment-backed expectations criterion does not come into play until it has first been determined that a property interest has, in fact, been taken.

347. There is no taking where, in the exercise of the police power, a particular use is prohibited to the economic detriment of the owner, Euclid v. Ambler Realty Co., 272 U.S. 365 (1926), unless the regulation goes too far and destroys all viable economic use. Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922). At least five Justices of the Court still adhere to the "too far" rationale. See the concurring and dissenting opinions of Justices Brennan, Stewart, Marshall, Powell and Rehnquist in San Diego Gas & Elec. v. City of San Diego, 450 U.S. 621 (1981).

should be *a fortiori* permissible.

There is one exception to the multifactor balancing test. The actual physical acquisition or permanent physical occupation of an individual's property is the paradigmatic taking.[348] That kind of activity is the one thing the fifth amendment meant to prohibit. It is the only per se taking rule recognized by the Supreme Court.

IOLTA does not result in the acquisition or permanent physical occupation of a client's property. The client's property, his trust deposit, is totally unaffected by IOLTA. It remains subject to the client's control in exactly the same manner it was subject to the client's control prior to IOLTA.[349] The primary case IOLTA opponents cite, *Webb's Fabulous Pharmacies, Inc. v. Beckwith,* did not apply the per se rule. Instead, the Court asked, "[w]hat would justify the County's retention of that interest?"[350] Finding that the county's retention of the interest was not reasonably related to the costs of using the courts, the Supreme Court found a taking. The Court, however, expressed "no view as to the constitutionality of a statute that prescribes a county's retention of interest earned, where the interest would be the only return to the county for services it renders."[351] The critical factor for IOLTA is that separating interest from principal does not, per se, constitute a taking. With that threshold question determined, application of the multifactor balancing test easily establishes that IOLTA is not a taking.

All governmental actions that impact on private property interests are tested by employing the multifactor balancing test, with the sole exception of actual permanent physical invasions.[352] It is the

348. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982).

349. The position of IOLTA proponents was nicely summed up in the Brief of the California State Bar, at 88, filed in Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984), *appeal denied,* No. 4 Civ. 31635 (Cal. May 2, 1985), to wit:

> If an individual trust account *inherently* can earn interest, that interest is the principal owner's property right. If the government appropriates that private right for itself, as in *Webb's,* that may be a taking. If, however, the account is so nominal or short-term that as a practical reality it cannot earn interest, there is no property right beyond that in the principal. No interest is expected. The government may reasonably regulate the *use* to be made of this principal, so long as it does not deprive the owner of all beneficial use. If as a byproduct of such use regulation, revenues are generated that would not otherwise have existed, the state may define ownership of that byproduct without offending constitutionally protected private expectation.

(emphasis added). The *Carroll* court, by essentially resting its decision on the lack of taking, did not reach the property argument.

350. 449 U.S. 155, 162 (1980).

351. *Id.* at 165.

352. *Compare* Kaiser Aetna v. United States, 444 U.S. 164 (1979) *with* PruneYard Shopping Center v. Robins, 447 U.S. 74 (1980). Both involve temporary, or intermittent, physical invasions. Both involve the public's use of private property. Because the invasions were not

character of the government's action that is the critical determinant of whether a taking has occurred. "[G]overnment regulation — by definition — involves the adjustment of rights for the public good. Often this adjustment curtails some potential for the use or economic exploitation of private property. To require compensation in all such circumstances would effectively compel the government to regulate by *purchase*."[353] "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law."[354] Therefore, compensation is not provided for a technical invasion of property rights which does not harm the owner.[355] If there is no physical invasion or interference with the owner's present physical possession or control, the adjustment of "the benefits and burdens of economic life to promote the public good" is not the type of activity that amounts to a taking.[356]

A physical invasion takes the owner's full bundle of rights, the very thing the fifth amendment was meant to bar, absent the payment of compensation. The removal of one stick from the bundle is a very different thing, however, as the court made clear in *Andrus v. Allard*,[357] in which it sustained an absolute ban on the sale of protected migratory birds. Mr. Justice Brennan stated:

> But the denial of one traditional property right [the right of sale] does not always amount to a taking. At least where an owner possesses a full "bundle" of property rights, the destruction of one "strand" of the bundle is not a taking because the aggregate must be viewed in its entirety.[358]

---

permanent, however, the multifactor balancing test applied, not the per se rule of *Loretto*. At least one state supreme court has held that *Webb's*, 449 U.S. 155 (1980), does not set forth a per se rule. In First Nat'l Bank & Trust Co. v. Rosewell, 93 Ill. 2d 388, 444 N.E.2d 126 (1982), *cert. denied*, 104 S. Ct. 50 (1983), the Illinois Supreme Court rejected a taxpayer's contention that failure to remit the interest earned on taxes paid under protest and later refunded constituted a taking, in direct violation of *Webb's*. Holding that *Webb's* did not establish a per se rule, and noting that Illinois did not assess a service charge, the Court held that the retention of the interest earned (on a principal amount exceeding $1 million) was not constitutionally prohibited. *But see* Comment, *supra* note 3, at 1017-18.

353. Andrus v. Allard, 444 U.S. at 65 (emphasis in original).

354. Pennsylvania Coal Co. v. Mahon, 260 U.S. at 393.

355. A good example of this rule is United States v. Sponenbarger, 308 U.S. 256 (1939). There a flood control plan for the lower Mississippi Valley contemplated escape routes, over "fuse plug levees," for extraordinarily severe floods. The claimant's land, historically subject to flooding, was in the escape path of one fuse plug levee. Employing a balancing test, the court held the fifth amendment did not require compensation because "the same floods and the same damages would occur had the Government undertaken no work of any kind." *Id.* at 265.

356. 438 U.S. at 124.

357. 444 U.S. 51 (1979).

358. *Id.* at 65-66.

The removal of one strand is evident in many cases. Frequently, the removal of that one strand is designed specifically to grant the government or the public some specific use of the owner's property. In *Interstate Consolidated Street Railway v. Massachusetts*,[359] a trolley car company was required to carry school children at half fare. The company alleged that the price restriction resulted in the children being carried at a loss. Mr. Justice Holmes sustained the requirement, emphasizing the importance of education and stating "the present requirement is not different in fundamental principle, although the tax is paid in kind and falls only on the class capable of paying that kind of tax, — a class of quasi-public corporations specifically subject to legislative controls."[360]

Both *PruneYard Shopping Center v. Robins*[361] and *Penn Central* deprive the property owner of one or more strands and compel him to use his property in a specific way. The railroad in *Penn Central* is compelled to maintain an existing use "in good repair"[362] in order to preserve "structures and areas with special historic, architectural, or cultural significance" for the benefit of the general public.[363] Likewise, to serve the public and not the owner, the shopping center in *PruneYard* is compelled to permit strangers to enter and use its premises for their own political purposes. These purposes are far removed from the nuisance[364] or mutuality of land use restrictions,[365] justifications which sustained earlier governmental activities.

Interstate Consolidated, Penn Central, and *PruneYard* all uphold police power regulations that force a private property owner to permit public use of his property, even though no claim can realistically be made that permitting the public use is designed to redress an evil attributable to the property owner.[366] In each case, the property owner suffers a real loss.[367] Yet laws that force property owners to

---

359. 207 U.S. 79 (1907).

360. *Id.* at 87. *Penn Central* and *Interstate Consolidated* are unlike the grade crossings cases where, it is at least arguable, the railroads' own actions contributed to or caused the need for safety installations. *See, e.g.,* Missouri P. Ry. v. Omaha, 235 U.S. 121 (1914).

361. 447 U.S. 74 (1980).

362. 438 U.S. at 111.

363. *Id.* at 129.

364. Mugler v. Kansas, 123 U.S. 623 (1887).

365. Euclid v. Ambler Realty Co., 272 U.S. 365 (1926).

366. Some earlier cases went to great lengths to demonstrate that at least some responsibility rested upon the property owner. *See, e.g.,* New Orleans Gaslight Co. v. Drainage Com. of N.O., 197 U.S. 453 (1905); Chicago, B. & Q. R.R. v. Illinois ex rel. Grimwood, 200 U.S. 561 (1906); Missouri P. R.R. v. Omaha, 235 U.S. 121 (1914).

367. In Chicago, B. & Q. R.R. v. City of Chicago, 166 U.S. 226 (1897), Chicago condemned a right of way over the railroad's tracks. The railroad's ability to operate was not impaired. Its ability to use the right of way for any other purpose, however, was totally destroyed. The railroad's contention that its measure of loss included the value of the land was rejected, the Court

permit their resources to be used in the public interest, or even force them to make out-of-pocket expenditures, do not constitute a taking so long as they serve an important police power purpose.[368] Most importantly, such laws do not constitute a per se taking. Instead, they are judged by the multifactor balancing test.[369]

Is IOLTA a greater intrusion on property rights than section 11(b) of the Banking Act of 1933? With the latter, Congress permitted banks to benefit from the use of demand deposit accounts and barred depositors from using their funds to earn interest.[370] Unlike the client whose funds are deposited in an IOLTA account, the pre-1933 demand depositor suffered a real loss. The 1933 Act destroyed an established entitlement.[371] Can it be said that reallocating the benefit attributable to the deposit from the bank to the provision of legal aid so changes the situation as to invoke the taking lcause? The reallocation IOLTA makes is no different from the routinely accepted adjustment of the benefits and burdens of economic life. Moreover, the usual rules governing client trust funds accomplish the same thing as section 11(b) by restricting client funds to demand accounts and effectively barring interest accumulation. Does IOLTA so alter the relationship that just compensation must be paid? Unless a per se rule is applied, the answer must be no.

Governmental action that prevents a use, such as the placing of funds at interest to generate income, is not a taking. Banking law changes may terminate existing income expectations. The loss of expected income, however, does not constitute a taking. Reallocation of economic benefits among private persons, albeit for a public purpose, does not require compensation. For example, if the state were to require the pooling of nominal or short-term deposits for any number of reasons, such as to preclude lawyer misuse of trust accounts or to facilitate supervision and regulation of the banking industry, no one would doubt the constitutionality of the exercise of police power for those purposes. Certainly, the clients would have no objection. They would not be concerned with the internal treatment of their accounts, so long as the security and availability of their funds were not ad-

---

holding that because the only realistic use was as a railroad, there was really no loss requiring additional compensation.

368. *See* Noble State Bank v. Haskell, 219 U.S. 104 (1911) (requiring contributions to a depositors' guaranty fund, a precursor of the F.D.I.C.); Day-Brite Lighting v. State of Missouri, 342 U.S. 421 (1952) (requiring employers to compensate workers absent to vote); Dean v. Gadsden Times Pub. Corp., 412 U.S. 543 (1973) (requiring employers to compensate workers absent for jury duty).

369. Kaiser Aetna v. United States, 444 U.S. 164 (1978).

370. *See supra* note 88.

371. *See* Steingut v. Guaranty Trust Co. of New York, 161 F.2d 571 (2d Cir.), *cert. denied*, 332 U.S. 753, 807 (1947).

versely affected. As a practical matter, that is precisely what happened before IOLTA. The IOLTA programs are functionally equivalent to the combination of banking law restrictions and attorney trust account mandates that prevented interest from being earned on nominal or short-term deposits. In terms of clients' fifth amendment rights, there is no reason to view the state's action differently, dependent upon whether the banks or legal services providers benefit from the interest. The character of the IOLTA program is not remotely similar to the character of governmental programs that require just compensation.

2. Investment-Backed Expectations

The justice and fairness concerns of the fifth amendment prevent shifting losses to a few individuals in order to benefit the public at large. A de minimis argument, favored by some commentators, fails after *Loretto* if the government action is deemed a per se taking.[372] If the government's action is not a per se taking, however, there must be a real loss.[373] The client whose nominal or short-term funds are placed in an IOLTA account suffers no loss of investment-backed expectations. The client did not expect any income. The client is not treated unfairly. In essence, the client has lost nothing. The fifth amendment does not protect inchoate, unilateral expectations.[374]

If there is no loss as a result of government action, there is nothing to shift. Mr. Justice Rehnquist posits that "it is the character of the invasion, not the amount of damage resulting from it, so long as the damage is substantial, that determines the question whether it is a taking."[375] Superficially, his opinion for the majority in *United States v. Security Industrial Bank*[376] casts some doubt on the "substantial" damage criterion. In order to avoid an alleged taking, resulting from the destruction of state-created secured creditor status, he construed amendments to the bankruptcy act as prospective and refused to employ the multifactor balancing test to consider whether

372. Special Project, *supra* note 1, at 848; Baker & Wood, *supra* note 3, at 358-61.

373. B. ACKERMAN, *supra* note 160, at 203, notes:

> In the cases that will concern us, the claimants have suffered a real money loss as a result of the legislative redistribution of property rights. While this requirement of a real loss may seem obvious, claims for compensation are sometimes raised that may be denied for failure to fulfill this threshold condition.

374. Note that this concept is used to determine, *vel non*, both whether a property interest exists and whether a property interest is worthy of protection. The former use is primarily legal, although custom and usage may be relevant. The second is essentially factual.

375. Penn Central Transp. Co. v. City of New York, 438 U.S. at 149-50 (Rehnquist, J., dissenting).

376. 459 U.S. 70 (1982).

the creditors' interests were of little realistic economic value.[377] The critical fact in *Security Industrial Bank,* unlike the IOLTA situation, was the total destruction of the creditor's property interest.[378] Conversely, where only one stick of the bundle is destroyed, the analysis properly rests on whether reasonable investment-backed expectations have been unduly harmed.[379] That was clearly established by a unanimous court in *Andrus v. Allard.*[380] In *Andrus,* Mr. Justice Brennan noted that "loss of future profits — unaccompanied by any physical property restriction — provides a slender reed upon which to rest a takings claim."[381] That view is fully consistent with earlier opinions of the Court. "The Constitution is concerned with practical, substantial rights, not with those that are unclear and gain hold by subtle and involved reasoning."[382] If a claimant is "not injured to the extent of a penny . . . his abstract rights are unimportant."[383]

One might ask what compensation would be due if IOLTA were deemed a taking? If the answer were none, it would be hard to conclude that any investment-backed expectations of the client had been frustrated. By definition, if there has been a "taking" of "property" in the constitutional sense, it must be possible to determine the "just compensation" due the property owner. It is, after all, the failure to provide just compensation that invokes the taking clause of the fifth amendment. If no compensation is due, it must follow that no "property" has been "taken." In the IOLTA context, no compensation would be due.

The normal standard of compensation is fair market value, what a willing buyer would pay in cash to a willing seller at the time of the taking.[384] "[J]ust compensation means the full monetary equivalent

---

377. The concurring opinion would have engaged in the multifactor balancing test, except for what it deemed prior binding precedent. *Id.* at 83, *citing* Holt v. Henley, 232 U.S. 637 (1914).

378. *Security Indus. Bank* can be viewed as a partial taking case. In that view, the secured creditor has only lost that strand of his bundle which makes him a secured creditor, but has not lost that strand which makes him a creditor. *But see* Armstrong v. United States, 364 U.S. 40 (1961). If the multifactor balancing test is then invoked, the public purpose served by the Bankruptcy Act in eliminating potential creditor overreaching and abuse, coupled with the minor economic loss suffered by the creditor, should result in the denial of a claim of taking. That it was not denied demonstrates the weakness of the analytical tools furnished by the test. Rogers, *supra* note 207, at 1014-21.

379. 447 U.S. 74 (1980).

380. 444 U.S. 51, 65 (1979).

381. *Id.* at 66.

382. Federal Hous. Admin. v. Darlington, Inc., 358 U.S. 84, 91 (1958).

383. Hooker v. Burr, 194 U.S. 415, 419 (1904). *Accord* Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984), *appeal denied,* No. 4 Civ. 31635 (Cal. May 2, 1985).

384. United States v. 564.54 Acres of Land, 441 U.S. 506, 511 (1979); United States v. Fuller, 409 U.S. 488, 490 (1973).

of the property taken. The owner is to be put in the same position monetarily as he would have occupied if his property had not been taken."[385] The guiding principal is that the owner "must be made whole but is not entitled to more."[386] He is entitled to what the property is actually worth under the circumstances existing at the time of the taking.[387] The fair market value of the earning's potential of a client's nominal or short-term deposit is nil.

The fact that IOLTA accounts produce income as a result of the aggregation of many nominal or short-term deposits does not change the result. The value, if any, that accrues to the earnings potential of the client's nominal or short-term deposit is caused solely by the operation of the IOLTA program. Compensation is awarded for what the owner lost, not what the taker gained.[388] Increments in value attributable to the government's own actions are not to be considered in just compensation awards. Compensation is neither increased nor decreased because of an alteration in market value attributable to the government's own activities.[389] For example, if a government project benefits a landowner when measured as a whole, the government is entitled to offset any loss incurred against the benefit conferred. No compensation is due because to compensate the owner "would be to grant him a special bounty."[390]

Application of the rule that compensation is awarded for what the claimant lost and not what the taker gained means that claimants have been unsuccessful when recovery would produce windfall profits,[391] where the value of the property has been enhanced by the totality of the government's project,[392] where the value has been enhanced by government created scarcity[393] and where enhanced value

385. United States v. Reynolds, 397 U.S. 14, 16-17 (1970) (footnotes omitted). *See, e.g.*, Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 473-74 (1973).

386. Olson v. United States, 292 U.S. 246, 255 (1934).

387. Boston Chamber of Commerce v. Boston, 217 U.S. 189 (1910).

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

389. United States v. Reynolds, 397 U.S. 14, 16-17 (1970).

390. United States v. Sponenbarger, 308 U.S. 256, 266-67 (1939). Where only part of a parcel is taken and the value of the remaining portion is enhanced, just compensation will net the benefit against the loss. United States v. River Rouge Improvement Co., 269 U.S. 411 (1926). The net benefit approach was applied in Washington Metropolitan Area v. One Parcel of Land, 691 F.2d 702 (4th Cir. 1982), where the property owner's loss was offset by the benefit he received from special high density zoning that accompanied the taking of part of his land for the Washington rapid transit system. *See also* Bartz v. United States, 633 F.2d 571 (Ct. Cl. 1980) (applying the *Sponenbarger* test by which any losses of a landowner are offset against actual benefits conferred), *cert. denied*, 450 U.S. 967 (1981).

391. United States Trust Co. of New York v. New Jersey, 431 U.S. 1 (1977).

392. "Since the owner is to receive no more than indemnity for his loss, his award cannot be enhanced by any gain to the taker." United States v. Miller, 317 U.S. 369, 375 (1943) (footnotes omitted).

393. United States v. Cors, 337 U.S. 325 (1949).

occurs because of the government's actions in its capacity as the sovereign.[394] Moreover, the owner is not entitled to value resulting from a right the government can grant or withhold as it sees fit. This rule applies whether the government acts, intends to act, or does nothing.[395] In summation, the Supreme Court has said that "the general principle [is] that the Government as condemnor may not be required to compensate a condemnee for elements of value that the Government has created, or that it might have destroyed under the exercise of governmental authority other than the power of eminent domain."[396]

There is a major flaw in the IOLTA opponents' fifth amendment claim because none of the clients would have a basis for compensation. The total absence of loss means that IOLTA has not taken anything of value from any client. Therefore, to compensate the client would constitute a windfall. What expectation of the client has the IOLTA program destroyed? None. Any income generated is purely a function of the IOLTA program. The only "thing" the client has lost is his ability to decide that economic waste is preferable to supporting civil legal assistance and other valuable public services. That "loss" is not the type of loss the fifth amendment protects.

VII. Conclusion

If IOLTA removes even one stick from the client's bundle, it implicates the fifth amendment. The welfare values benefited by IOLTA, a mechanism for providing more equal access to justice, are powerful. The indemnity values, because the client's rights are not meaningfully impaired, are weak. IOLTA is not unfair in principle. No client is required to shoulder more than his fair share. No client is forced to bear any burden. No client is stripped of any earning potential. Instead, IOLTA recognizes economic realities that are part and parcel of banking and trust relationships and puts that recognition to work in the public interest. That IOLTA operates at no cost whatsoever to the client means there is no taking.

The IOLTA puzzle is not easy to solve. The legal issues are complex because IOLTA is unique. Resolution of both the property claim and the taking claim is not free from doubt. It requires balancing IOLTA's use of nonproductive nominal or short-term deposits and the rule that beneficiaries are only entitled to net income, with the generality that earnings follow principal. Clients are unable to earn

394. United States v. Twin City Power Co., 350 U.S. 222 (1956).

395. United States v. Rands, 389 U.S. 121, 125 (1967).

396. Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 492 (1973).

income on their nominal or short-term deposits because of banking restrictions and economic realities, not because of IOLTA. Trust beneficiaries are entitled to the income produced by the trust, net of expenses. IOLTA uses the client's nonproductive property as a means to earn income for public purposes.

The "newly created property" assertion of IOLTA proponents is not a persuasive rationale for upholding IOLTA. It is the same argument that the Supreme Court rejected in *Webb's*. The issue is not whether the property is old or new. The issue is who possesses an "entitlement" to it. If the government did no more than bar the earning of interest on checking accounts, as it did in 1933, it would be clear that no depositor was deprived of something that could be called an entitlement. Checking account deposits after 1933 did produce income. That income, however, was retained by financial institutions. IOLTA reallocates income from financial institutions to the provision of legal aid. The client's position remains unchanged. Simply shifting the income to a different use should not serve to create an entitlement.

Nevertheless, in light of the intuitive feeling that clients have lost something, a factually inaccurate claim, the justification for IOLTA is better rested on the total lack of loss clients suffer. To characterize IOLTA as depriving a client of a legal right to interest ignores the realities of the situation. The client never had, and never will have, the ability to earn interest on a nominal or short-term deposit. That lack of ability is not caused by IOLTA. It is caused by the inherent inability of such deposits individually to earn net income under any set of circumstances. The alleged property infringement worked by IOLTA pales in comparison to cases in which the Supreme Court has found no taking. The justice and fairness concerns of the fifth amendment are not invaded. If IOLTA is unconstitutional, only the banks will benefit.