Debits and Credits in the Battle Over IOLTA

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Almost three years after the U.S. Supreme Court's decision in *Phillips v. Washington Legal Foundation*,Ftn 1 courts and legal services programs across the nation are still trying to figure out whether Interest on Lawyers Trust Account (IOLTA) programs will survive constitutional scrutiny.Ftn 2 Two courts have recently reached opposite conclusions, leaving in question the net effect of the Supreme Court's decision.

Since Congress declared in 1980 that banks could offer interest on checking accounts,Ftn 3 most states have developed programs to fund legal services for poor people by gathering the nominal interest earned on lawyers' pooled trust accounts. The driving force behind such programs has been that small amounts of client funds or amounts that will be held for a very short period of time do not generate sufficient interest in a separate trust account to justify the cost of opening and maintaining such an account. IOLTA programs created a win-win situation: without lawyers or their clients forfeiting any money, a substantial new funding source arose to support a worthy cause.

Nevertheless, some clients and a nonprofit organization challenged an IOLTA program in Texas. In *Phillips*, the Supreme Court held that clients do have a Fifth Amendment property right to the interest earned on funds held in lawyer trust accounts. The interest may be nominal, but it is still property. The court did not reach the issues of whether IOLTA programs constitute a taking of that property or whether any potential taking had occurred without just compensation.Ftn 4

The federal District Court in Texas dealt with these issues on remand.Ftn 5 The court conducted a two-day bench trial during which it heard extensive testimony regarding various methods of accounting separately for interest earned by each client's funds, including software and commercial bank services. Ultimately, the court found that any of these methods would cost a lawyer more money in staff hours and bank charges than the Texas IOLTA program. "These costs make net interest to clients infeasible except in cases where large sums of money are held or when client funds are held for long periods of time."Ftn 6

In the Texas case, despite all the expert testimony, the IOLTA challengers failed to offer any evidence of an actual dollar loss to a particular client. In the absence of "an identifiable compensable loss," the court found there had been no taking without compensation in violation of the Fifth Amendment.Ftn 7 The Texas IOLTA program could continue to operate.

Meanwhile, the same nonprofit organization had found new clients in the state of Washington and had initiated a similar challenge to that state's IOLTA program.Ftn 8 In that case, the challengers presented evidence that for at least one of the plaintiffs, "a measurable amount of money, about $20 in interest," was diverted through the IOLTA program.Ftn 9 The court construed the plaintiff's position as saying "it is not so much that I want the $20, though I do, as that I don't want the [IOLTA program's] donees to get it, because I don't like what they do with it."Ftn 10

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The 9 U.S. Circuit Court of Appeals was not nearly as willing as the Texas District Court to concede that the cost of opening separate trust accounts for client funds, or performing the necessary sub-accounting to parse out the interest from a pooled account, would exceed the amount of interest earned by client funds. The court suggested that if, in fact, lawyers had to pay trust account interest to clients, software programs might be developed to make it easy to do so and that lawyers overestimate the cost of providing this interest to clients.Ftn 11 For whatever reasons, a client "may think it is worth having a lawyer spend $19.95 worth of time to get the client $20 in interest."Ftn 12 The 9th Circuit held that Washington's IOLTA program did "take" private property within the meaning of the Fifth Amendment.Ftn 13 The 9th Circuit made no reference to the analysis or outcome of the Texas case.

A taking, however, may still be constitutional because the Fifth Amendment only prohibits the taking of private property for public use "without just compensation." The court did not close the books on the possibility that an IOLTA fund might still be the least expensive way of generating interest on client funds. As a result, that interest might sustain an IOLTA program without depriving any of the clients of just compensation for the takings.Ftn 14 The court remanded to further develop the record on just compensation, leaving the Washington IOLTA program intact for the moment.

It is still unclear whether the final accounting for IOLTA programs will be written in black or red ink. For the time being, lawyers should continue to pay close attention to the manner in which they hold client funds, whether in an IOLTA account or separate interest bearing trust accounts.

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1 524 U.S. 156, 118 S. Ct. 1925 (1998).

2 See "Supreme Court decision provokes review of IOLTA accounts" in the July 3, 1998, edition of *Minnesota Lawyer*.

3 See 12 U.S.C. sec. 1832.

4 See the Fifth Amendment to the U.S. Constitution ("private property" shall not "be taken for public use, without just compensation.").

5 *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, 86 F.Supp.2d. 624 (W.D. Texas 2000).

6 Id. at 641-42. These factors, of course, are exactly what lawyers are supposed to consider when deciding whether it would be prudent to open up a separate trust account for a particular client's funds. See Rule 1.15(g), Minnesota Rules of Professional Conduct (MRPC).

7 *Washington Legal Foundation,* 86 F.Supp.2d at 642-43.

8 *Washington Legal Foundation v. Legal Foundation of Washington*, 236 F.3d 1097 (9th Cir. 2001).

9 Id. at 1109.

10 Id. at 1105.

11 Id. at 1105, 1112.

12 Id. at 1112.

13 Id. at 1115.

14 Id. at 1114.