NOTE

The Taking Issue In California's Legal Services Trust Account Program

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Introduction**

In 1981, California became the first American state to adopt an "interest on lawyers' trust account"[1] program by legislation.[2] It requires California attorneys to invest designated principal sums owned by their

** Sources cited in this Note are available at the *Hastings Constitutional Law Quarterly* Office.

1. "Interest on Lawyers' Trust Account" ("IOLTA") programs permit or require attorneys to invest their clients' trust funds so that the income generated will benefit public interest legal services projects. *See* Gonser, Almond & Ziegler, *Financing Public Services Activities With Interest-Bearing Attorney Trust Accounts*, 15 IDAHO L. REV. 219, 220 n.3 (1979). A recent law review article traces the phrase to the Florida Supreme Court opinion that implemented the first American program: *In re* Interest on Trust Accounts, 402 So. 2d 389, 389 (Fla. 1981). *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, 329 n.15 (1983).

2. CAL. BUS. & PROF. CODE §§ 6210-6228 (West Supp. 1985). As of January 15, 1985, 35 states had approved IOLTA programs by either supreme court order or legislation. 2 IOLTA UPDATE, Winter 1985, at 1, 8-12. Thirty states implemented the programs by supreme court order; the following list indicates the chronology of these court actions: *In re* Interest on Trust Accounts, 402 So. 2d 389 (Fla. July 16, 1981); Idaho Sup. Ct. Order (May 27, 1982); Colo. Sup. Ct. Order (Nov. 1, 1982); *In re* New Hampshire Bar Ass'n, 453 A.2d 1258 (N.H. Nov. 24, 1982); *In re* Minnesota State Bar Ass'n, 332 N.W.2d 151 (Minn. Dec. 27, 1982); Or. Sup. Ct. Order (Feb. 1, 1983); Nev. Sup. Ct. Order (Mar. 4, 1983); Va. Sup. Ct. Order (Mar. 30, 1983); Ill. Sup. Ct. Order (Apr. 29, 1983); Okla. Sup. Ct. Order (May 23, 1983); N.C. Sup. Ct. Order (June 23, 1983); Hawaii Sup. Ct. Order (Sept. 22, 1983); Del. Sup. Ct. Order (Sept. 29, 1983); Vt. Sup. Ct. Order (Oct. 18, 1983); *In re* Interest on Lawyers' Trust Accounts, 672 P.2d 406 (Utah Oct. 25, 1983); Ga. Sup. Ct. Order (Nov. 4, 1983); S.D. Sup. Ct. Order (Jan. 5, 1984); Ariz. Sup. Ct. Order (Jan. 11, 1984); Kan. Sup. Ct. Order (Apr. 5, 1984); Tex. Sup. Ct. Order (May 9, 1984); Neb. Sup. Ct. Order (May 15, 1984); Miss. Sup. Ct. Order (May 30, 1984); Wash. Sup. Ct. Opinion (June 19, 1984); N.M. Sup. Ct. Order (July 18, 1984); *In re* Interest on Lawyers' Trust Accounts, 283 Ark. 252, 675 S.W.2d 355 (Sept. 17, 1984), *modifying* 279 Ark. 84, 648 S.W.2d 480 (1983); Mo. Sup. Ct. Order (Oct. 23, 1984); Tenn. Sup. Ct. Order (Oct. 30, 1984); R.I. Sup. Ct. Order (Nov. 21, 1984); Iowa Sup. Ct. Opinion (Dec. 28, 1984); and La. Sup. Ct. Order (Jan. 14, 1985). 2 IOLTA UPDATE, Summer 1984, at 10-13; 2 IOLTA UPDATE, Winter 1985, at 8-12.

Four states in addition to California implemented IOLTA programs by legislation: MD. ANN. CODE art. 10 § 44(a)(2) (July 1, 1982); N.Y. JUD. LAW § 497 (Consol. 1983); 1984 CONN. ACTS 537 (Reg. Sess.) (June 15, 1984); and OHIO REV. CODE ANN. § 4705.09 (Page 1985).

In general, the branch of state government that regulates the legal profession implements trust account programs. *Minnesota Developments: Minnesota's New Interest On Lawyer Trust Accounts Program*, 67 MINN. L. REV. 1286, 1291 (1983).

clients in interest-bearing accounts.[3] Financial institutions then forward the resulting income to the State Bar of California for disbursal to legal aid programs and support centers that service indigents.[4]

In the past, attorneys and law firms rarely invested client trust funds. The traditional trust account practice was to commingle numerous clients' principal sums into single, non-interest-bearing accounts.[5] Since financial institutions across the state paid no interest on these accounts, they benefitted from attorneys' trust account practices. The practical impact of California's "Legal Services Trust Account Program" ("the Program") is to shift this substantial benefit from the banks to legal aid centers that service the impoverished. Although the media heralded the legislation as "almost too good to be true,"[6] attorneys across the state have opposed its implementation.[7] They contend that by taking the interest earnings, the Program "takes" their clients' property in violation of the Taking Clause of the Fifth Amendment of the United States Constitution.[8] In two lawsuits filed in 1983,[9] California plaintiffs attacked

3. CAL. BUS. & PROF. CODE §§ 6211-6212 (West Supp. 1985); *see generally* Murray, *Old Problem, New Solution: Funding Legal Services*, 3 CAL. LAW., June 1983, at 26, 27.

4. CAL. BUS. & PROF. CODE §§ 6211(a), 6216 (West Supp. 1985).

5. *See infra* notes 19-32 and accompanying text.

6. *Lawyers Rescue Legal Aid Plan*, San Francisco Chron., March 21, 1983, at 34, col. 1.

7. Declaration of Bruce Hamilton at 2, Petition For Extraordinary Relief In The Nature of Prohibition; Request For Temporary Stay; With Supporting Memorandum of Points and Authorities at app. C, The State Bar of California v. Superior Court of the State of California for County of San Diego, No. LA31749 (Cal. Sup. Ct. filed Apr. 18, 1983) [hereinafter cited as State Bar Petition].

8. *See, e.g.*, Notice of Motion and Motion for Summary Judgment and Permanent Injunction; Points and Authorities at 4-5, Seuthe v. State Bar of California, No. C455587 (Los Angeles Sup. Ct. filed June 6, 1983) [hereinafter cited as *Seuthe* Summary Judgment] (plaintiff attorneys challenging consitutionality of California program on Fifth Amendment grounds); *see also* 1 IOLTA UPDATE, Summer 1983, at 5. *Cf.* Rivlin, *I.O.L.T.A. Gains Momentum Nationwide*, 69 A.B.A. J. 1036, 1040 (1983) ("It is generally agreed among proponents and opponents [of trust account programs] that the issue of taking will most likely be resolved ultimately by the United States Supreme Court.").

9. Carroll v. State Bar of California, No. N22139 (San Diego Super. Ct. filed Mar. 16, 1983); Seuthe v. State Bar of California, No. C455587 (Los Angeles Super. Ct. filed June 6, 1983). *See* 1 IOLTA UPDATE, Summer 1983, at 5. Ultimately, these cases were consolidated in the San Diego Superior court. *See* Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984). They were the first legal challenges to an IOLTA program in the country. *See* 2 IOLTA UPDATE, Winter 1985, at 1. A Florida plaintiff filed a $20 million class action in the United States District Court in Tampa, Florida challenging Florida's plan on October 11, 1984. *See Due Process Violation Alleged: Florida Suit Challenges IOLTA Plan's Legality*, Nat'l L. J., Nov. 12, 1984, at 10, col. 3; *see generally* Allen, *Where's the Interest?*, 5 CAL. LAW, Feb. 1985, at 8. Five Iowa attorneys filed a petition for writ of certiorari before the United States Supreme Court on March 14, 1985. 2 IOLTA UPDATE, Spring 1985, at 12. The Court denied the petition on May 13, 1985. 3 IOLTA UPDATE, Summer 1985, at 4.

the Program's constitutionality on this basis.[10] The Fourth District Court of Appeal, however, rejected these contentions on December 19, 1984, in *Carroll v. State Bar of California*.[11]

This Note explores the historical background of the Program and describes it in detail. It then analyzes the Fifth Amendment Taking Clause issue as it has been presented in the California litigation. Finally, the Note concludes that California's Program may be unable to withstand constitutional scrutiny in future litigation.[12]

I. The California Legal Services Trust Account Program

A. Historical Background: The Florida Plan

The concept of using interest earned on clients' trust funds is novel in the United States, but has been common in other countries since the 1960's.[13] The Florida Bar conducted an extensive five-year study of the foreign programs and designed a similar plan for implementation in Florida.[14] In a landmark 1978 opinion, the Florida Supreme Court adopted

10. *See supra* note 8; *see also* Petition for Writ of Prohibition or Mandate; Complaint for Declaratory Relief at 2-5, Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984) [hereinafter cited as *Carroll* Complaint].

Plaintiffs have also attacked the Program on the following additional bases: that it constitutes a selective and discriminatory tax; that it deprives clients of due process of law; that it denies clients the equal protection of the laws; and that it is unconstitutionally vague. *See Carroll* Complaint at 2-3; *Seuthe* Summary Judgment, *supra* note 8, at 14-15. The Fifth Amendment challenge is the most substantial. *See* Baker & Wood, *supra* note 1, at 353.

11. 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984).

12. Plaintiffs in *Carroll* petitioned the California Supreme Court for a hearing on January 3, 1985. 2 IOLTA UPDATE, Winter 1985, at 1, 6. However, because they had stipulated to a remittitur under California Rule of Court 25(b), plaintiffs' appeal was not filed timely. *See* In the Supreme Court of the State of California In Bank, 4 Civ. No. 31635 (Sup. Ct. Order filed Mar. 14, 1985), Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984) [hereinafter cited as *Supreme Court Order*]. The California Supreme Court denied plaintiffs' petition on May 2, 1985. Order Denying Hearing After Judgment by the Court of Appeal, 4th District, Division 1, No. D001363, Civil 31635 In the Supreme Court of the State of California In Bank, Carroll v. The State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984); *see* 2 IOLTA UPDATE, Spring 1985, 1. Plaintiffs are expected to file a writ of certiorari before the United States Supreme Court. San Francisco Daily Recorder, May 3, 1985, at 1, col. 1. For a discussion of *Carroll*, see *infra* notes 199-222 and accompanying text.

13. The Australian state of Victoria was the first common law jurisdiction to adopt a program that used interest generated on client trust funds to benefit public service law projects; its Parliament first gave the idea serious consideration in 1963. 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, 543 (1979). Programs are in operation in at least sixteen other foreign jurisdictions, including several Canadian provinces. *In re* Interest on Trust Accounts, 356 So. 2d 799, 803 n.25 (Fla. 1978); *see generally* Comment, *supra* at 542-50. *See also* Baker & Wood, *supra* note 1, at 329.

14. *In re Interest*, 356 So. 2d at 799-800; *see* Baker & Wood, *supra* note 1, at 329.

the Bar's proposal.[15]

The Florida Bar's success spawned similar programs nationwide.[16] As of January 15, 1985, thirty-five programs had been approved and seventeen of those have since become operational.[17] Thus, Florida's plan and the basis of the Florida court's approval are critical to understanding California's Program as well as trust account programs across the country.[18]

The Florida plan is based upon the historical attorney practice of commingling numerous clients' trust funds into a single non-interest-bearing checking account.[19] In *In re Interest on Trust Accounts*,[20] the Florida court described several factors that contributed to this non-investment practice. The primary reason was that demand deposit investment accounts were illegal.[21] Since attorneys' strict ethical obligations to maintain client trust funds include keeping them readily available for delivery,[22] the funds could not be invested without breaching this professional duty.[23] The initial Florida plan used trust savings accounts to comport with the banking restrictions.[24] The funds would then be shifted into checking accounts for prompt delivery to clients on demand.[25]

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15. *In re Interest*, 356 So. 2d at 799, 800, 807.

16. *See In re* Interest on Lawyers' Trust Accounts, 283 Ark. 252, 253, 675 S.W.2d 355, 356 (1984), *modifying* 279 Ark. 84, 648 S.W. 2d 480 (1983); *In re* Interest on Lawyers' Trust Accounts, 672 P.2d 406, 406-08 (Utah 1983); *In re* Minnesota State Bar Ass'n, 332 N.W.2d 151, 156-57 (Minn. 1982); *In re* New Hampshire Bar Ass'n, 122 N.H. 971, 972, 975-76, 453 A.2d 1258, 1259, 1261 (1982). *See generally* Rivlin, *supra* note 8.

17. 2 IOLTA UPDATE, Winter 1985, at 1, 8. The programs became operational on the dates listed: Fla. (Sept. 1, 1981); N.H. (Jan. 1, 1983); Cal. (Mar. 1, 1983); Md. (Mar. 25, 1983); Colo. (Apr. 1, 1983); Del. (May 26, 1983); Minn. (July 1, 1983); Ill. (Sept. 1, 1983); Va. (Sept. 1, 1983); Or. (Nov. 1, 1983); Idaho (Jan. 1, 1984); N.C. (Apr. 1, 1984); Okla. (May 26, 1984); Utah (July 1, 1984); Vt. (Sept. 1, 1984); Ariz. (Oct. 30, 1984); and Kan. (Nov. 1, 1984). *Id.* at 8-11.

18. A national clearinghouse has been established to process information on IOLTA programs and also to provide states with data, materials, training, and technical assistance on IOLTA program design and operation. 1 IOLTA UPDATE, Summer 1983, at 1. Funds for the clearinghouse are provided by the Legal Services Corporation ("LSC"). *Id.* Trust account programs are viewed as a solution to recent funding cutbacks to the LSC. *See* Murray, *supra* note 3, at 26-27.

19. *See In re Interest*, 356 So. 2d at 801-02; *see also* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 348 (1982), *reprinted in* 68 A.B.A. J. 1502, 1502 (1982) [hereinafter cited as ABA Op. 348].

20. 356 So. 2d 799 (Fla. 1978).

21. *Id.* at 801-02, 802 n.19. At the time of this 1978 opinion, federal law prohibited the earning of interest on checking accounts. 12 U.S.C. § 371(a) (1945) (amended 1980).

22. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 9-102 (1981); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.15 (1983); CAL. RULES OF PROFESSIONAL CONDUCT 8-101 (1977). *See generally* Comment, *supra* note 13, at 541-42.

23. *In re Interest*, 356 So. 2d at 800-02.

24. *Id.* at 802-03, 803 n.24.

25. *See id.*

Another factor contributing to the non-investment practice was that attorneys lacked "any *personal financial incentive* to make clients' funds productive."[26] Although the court did not explain this statement, it indicated that attorneys may lack investment incentive because of administrative expense.[27] Since attorneys' obligations as trustees do not generally include the duty to make clients' funds productive,[28] attorneys could effectively fulfill their legal responsibilities through the less expensive commingled non-interest-bearing account system.

The final factor was the "complex and expensive" accounting problem that would result from investing the funds and apportioning the interest earned.[29] Opening a separate account for each individual client would be "highly impractical."[30] But the less costly commingled account system made it "exceedingly difficult, *if not impossible, to apportion the interest . . . among the respective clients.*"[31] Although the Florida court acknowledged that accounting problems had "long been resolved" by computer technology,[32] this impracticability notion was critical to its initial approval of the program.[33]

For these reasons, attorneys have commingled numerous clients' funds in single non-interest-bearing accounts. As a result, financial institutions have enjoyed a substantial monetary benefit.[34] The Florida plan and the similar programs modeled after it nationwide seek to shift the benefit from the banks to public interest legal programs. The crucial point for constitutional purposes is that theoretically, the plan removes obstacles to investment but does not eliminate practical difficulties that prevent the investment of clients' funds to benefit clients.[35]

The Florida plan changed substantially[36] after it was first approved

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26. *Id.* at 801 (emphasis added).

27. Attorneys would encounter "expensive accounting problems." *Id.*

28. *See In re* Interest on Trust Accounts, 402 So. 2d 389, 394 (Fla. 1981). *See also infra* notes 218-22 and accompanying text.

29. *In re Interest*, 356 So. 2d at 801.

30. *Id.* at 801 n.18.

31. *Id.* (emphasis added).

32. *Id.* at 803; *cf.* Hammond, *Interest on Solicitors' Trust Accounts: A New Force in the Public Interest?*, 1984 N.Z.L.J. 26. (argument that it is impracticable to calculate separate interest on clients' funds after they have been commingled "of course does not, today, make much economic sense, neither does it recognise the capabilities of modern computerised subaccounting facilities").

33. *In re Interest*, 356 So. 2d at 806 ("The general characterization of the Bar's proposal as a mechanism by which money properly belonging to clients will be improperly diverted . . . ignores . . . [that] for practical reasons [the money] cannot be made available to them.").

34. *Id.* at 802.

35. *See infra* notes 242-49 and accompanying text.

36. *Compare In re Interest*, 356 So. 2d at 807-11 *with In re Interest*, 402 So. 2d at 396-98.

in 1978.[37] These changes and the forces that precipitated them are significant to the constitutional dilemma that faced California's Program.

The first major change eliminated disclosure and client consent. The initial Florida plan included a form notice that described the program and advised clients to withdraw if they did not wish their funds used in the plan.[38] Although commentators questioned its sufficiency,[39] the form notice did provide this most basic procedural due process requirement.[40] Additionally, clients could control whether their principal funds were used. By approving the investment, clients waived their constitutional right to the income;[41] implicit in the court's notice requirement is the concept that clients have a property interest in the earnings generated on their principal sums.

But the plan clashed with Internal Revenue Service ("IRS") policies regarding the "assignment of income."[42] The Florida Bar determined that the plan's success depended on the ability to tax the Bar rather than the clients for income generated by the plan.[43] Three years of negotiations with the IRS were unavailing;[44] the IRS determined that although the plan was *not* an income-shifting scheme, it would serve as precedent which could be used for that purpose.[45] The IRS only agreed to tax the

37. Although Florida's IOLTA plan was first approved in 1978, *In re Interest*, 402 So. 2d at 389, Florida's plan was not adopted until July 16, 1981, *id.*, and it did not become operational until September 1, 1981. 2 IOLTA UPDATE, Winter 1985, at 8.

38. *In re Interest*, 356 So. 2d at 810-11.

39. Comment, *supra* note 13, at 556-59 (cautioning that the form notice did not provide enough information either to fulfill basic due process requirements or to allow clients to waive their constitutional property rights to the interest income).

40. *See, e.g.*, Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314-315 (1950) ("Many controversies have raged about the cryptic and abstract words of the Due Process Clause but there can be no doubt that at a minimum they require that deprivation of . . . property . . . be preceded by notice and opportunity for hearing . . . ."); Goldwin v. Public Utilities Comm'n, 23 Cal. 3d 638, 662, 592 P.2d 289, 304-05, 153 Cal. Rptr. 802, 817-18 (1979) (citing Beaudreau v. Superior Court, 14 Cal. 3d 448, 458, 535 P.2d 713, 719, 121 Cal. Rptr. 585, 591 (1975) ("[T]he basic proposition [is] that in every case involving a deprivation of property within the purview of the due process clause, the Constitution requires some form of notice and hearing.")).

41. *But cf.* Comment, *supra* note 13, at 556-59.

42. *In re* Interest on Trust Accounts, 396 So. 2d 719, 719 (Fla. 1981).

The "assignment of income" doctrine was first articulated in Lucas v. Earl, 281 U.S. 111 (1930). It prevents taxpayers from shifting their income to others in order to lower their marginal tax brackets and thus pay lower taxes. *See In re Interest*, 402 So. 2d at 390-91.

43. *In re Interest*, 402 So. 2d at 391. Although the Florida court did not explain the Bar's reasoning, *id.*, it is linked to administrative expense for attorneys. Brief for Amici Curiae in Support of the State Bar of California and Intervenors at 6-8, Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984). Attorneys would spend time obtaining their clients' tax information and preparing Internal Revenue Service forms. *Id.* at 6-7. According to Program proponents, this added administrative expense would make IOLTA plans impracticable. *See infra* notes 237-49 and accompanying text.

44. *See In re Interest*, 402 So. 2d at 390-91.

45. *Id.* at 390-91.

Bar rather than the individual clients whose funds composed the accounts if "clients could in no way and to no degree control the creation or destiny of earnings generated on their attorney-held funds."[46]

The Florida Supreme Court responded to the IRS position by eliminating the notice and withdrawal provisions of the original 1978 plan.[47] The court concluded that no notice was required because the clients did not have a property interest in the earnings generated on their principal sums.[48] The Florida court's conclusion was essential to its finding of constitutionality, since the basic due process requirements of notice and an opportunity to be heard must be fulfilled when a recognizable property interest is affected.[49] Its reasoning, however, is less than persuasive,[50] especially given its earlier requirement that clients consent to the use of their principal sums.

Another major change that occurred between 1978 and the Florida court's final implementing opinion in 1981 was the court's emphasis on client funds that are "nominal in amount or to be held for a short period of time."[51] Although its 1978 opinion briefly mentioned this standard,[52] the court did not require that only these funds be invested under the plan. But its 1981 opinion specifically restricted the plan to nominal or short term trust funds.[53] The change is linked to two factors. First, the IRS restrictions eliminated client notice and control.[54] The Florida Bar asked the court to reaffirm the nominal or short term standard to comport with these IRS restrictions.[55] The result is new reasoning that clients have no property rights since interest earned on nominal or short term principal sums is too small to constitute a benefit.[56]

Second, the United States Supreme Court decided *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[57] in the interim period. In *Webb's*, a Florida county took interest earned on a privately owned interpleader fund.[58] The Florida Supreme Court upheld the practice by construing a Florida statute to vest ownership of the interest in the county.[59] But the United

46. *Id.* at 391.

47. *Id.*

48. *See id.* at 395-96.

49. *See supra* note 40.

50. *See infra* notes 250-56 and accompanying text.

51. *In re Interest*, 402 So. 2d at 397.

52. *See In re Interest*, 356 So. 2d at 802 n.20, 804.

53. *In re Interest*, 402 So. 2d at 397. The court, however, does not view this as a change. It states that its 1978 plan "contemplated precisely" the same standards. *Id.* at 390.

54. *Id.* at 390-91.

55. *Id.* at 391.

56. *See id.* at 395-96.

57. 449 U.S. 155 (1980). For more detailed discussions of *Webb's*, see *infra* notes 173-96, 304-18 and accompanying text.

58. *Webb's*, 449 U.S. at 155-56.

59. *See id.* at 158-59.

States Supreme Court overruled Florida and held that this practice violated the Fifth and Fourteenth Amendments.[60] In its 1981 trust account decision, the Florida court distinguished *Webb's*. It reasoned that since interest earned on nominal or short term principal funds was not "property" belonging to clients, the Supreme Court's decision did not conflict with the plan.[61] Therefore, Florida's 1981 implementing opinion restricts the plan's operation to client principal sums which are either nominal in amount or which are to be held by the attorney for a short duration.[62]

The final major change that occurred following the court's 1978 opinion was that interest-bearing demand deposit accounts became available nationwide.[63] This change prompted the Florida Bar to ask the Florida Supreme Court to require attorneys' participation in the plan.[64] Apparently, the original plan was voluntary because it burdened attorneys with shifting client trust funds from savings to checking accounts.[65] But the Bar's request to make the plan mandatory brought a response from Florida attorneys described as a "brouhaha"[66] ranging from "respectful disagreement to hyperbolic outrage."[67]

In partial deference to the vehement response it received to the proposal, the court rejected the mandatory plan.[68] But the most important reason it rejected the mandatory plan is linked to *Webb's*. The court stated: "*Webb's* . . . obviously cannot be ignored in framing any program involving a *state-directed* use of income generated on private

60. *Id.* at 164-65.

61. *In re Interest*, 402 So. 2d at 395.

62. *Id.* at 397.

63. *In re Interest*, 396 So. 2d at 719; *see generally*, Schley, *Restriction on Ownership of NOW Accounts*, 99 BANKING L.J. 196, 200-06 (1982).

Negotiable Order of Withdrawal ("NOW") accounts may only be used "with respect to deposits or accounts which 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." 12 U.S.C. § 1832(a)(2) (Supp. IV 1980). Corporations, partnerships and other profit-making organizations cannot invest in NOW accounts. 12 U.S.C. § 1832(a)(2); 12 C.F.R. § 217.157 (1985). The Board of Governors of the Federal Reserve System issued an opinion to the Florida Bar that the "entire beneficial interest" to earnings under the program belonged to the Florida Bar Foundation. Letter from Michael Bradfield to Donald M. Middlebrooks (October 15, 1981), *reprinted in* Middlebrooks, *The Interest on Trust Accounts Program—Mechanics of its Operation*, 56 FLA. B.J. 115, 117 (1982); *see, e.g.*, *Minnesota Developments*, *supra* note 2, at 1289 n.15. For a critical discussion of the Board of Governors' opinion, see Baker & Wood, *supra* note 1, at 335 n.39.

64. *See In re Interest*, 396 So. 2d at 720.

65. *See In re Interest*, 356 So. 2d at 804; *see also supra* notes 24-25 and accompanying text.

66. *In re Interest*, 402 So. 2d at 391.

67. *Id.*

68. "We cannot ignore the response of our bar. Indeed, we requested comments . . . ." *Id.* at 392.

funds."[69] Therefore, the Florida court may have retained the voluntary attorney program to attenuate any claim of state action by Florida in potential due process challenges to the plan.[70] The court's statement demonstrates implicit concern about the the program's constitutionality.

The Florida plan became operational on September 1, 1981.[71] Attorney participation is completely voluntary, apparently to avert constitutional challenges based upon *Webb's*.[72] It has no provision for notifying clients that their funds are being invested and does not allow clients to control whether or not their funds are used.[73] It applies only to principal sums of either nominal amount or which are to be held for short time periods, because interest earned on these funds is too small to constitute clients' "property."[74] The court stated: "If we have failed in any constitutional . . . sense to resolve the obstacles to implementation, and we do not believe that we have, it appears to us that we have done our best and should end our labors here."[75] Unfortunately, the plan and others like it became operational without a comprehensive resolution of the constitutional issues in an adversarial proceeding.[76] Since California's Program is based on the final Florida plan, the problems that first

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69. *Id.* at 393 (emphasis added).

See Oral Argument by Arthur J. England, Jr. Chief Justice, 1978-1980, Supreme Court of Florida, *reprinted in* England, *Interest on Lawyers' Trust Accounts*, 55 N.Y. ST. B.J. 18 (Apr. 1983). England wrote both Florida IOLTA opinions, *In re* Interest on Trust Accounts, 356 So. 2d 799 (Fla. 1978); *In re* Interest on Trust Accounts, 402 So. 2d 389 (Fla. 1981), and participated in the Florida Supreme Court opinion overruled in *Webb's*. Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951 (Fla. 1979), *rev'd*, 449 U.S. 155 (1980). In a hypothetical oral argument supporting IOLTA programs, he argues that "[t]he second distinguishing feature from *Webb's* is the absence of any state's compulsion, that is a 'taking' . . . ." England, *supra*, at 24. He indicates that voluntary attorney programs do not compel the assignment of clients' earnings to a state-directed purpose. *Id.*

70. A recent law review article criticized this notion. *See* Baker & Wood, *supra* note 1, at 337-39. Although the state may not be responsible for the private actions of attorneys in a voluntary program, it has enacted a rule which it then encourages and facilitates. *Id.* at 338. Any one of these rules may be sufficient state action to allow a constitutional challenge under the Fifth and Fourteenth Amendments. *Id.*

The state action issue was not raised in the California litigation, and was not discussed in Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984). The State Bar of California is a public corporation created pursuant to Article VI, Section 9, of California's Constitution. In addition, the Program itself is an act of the legislature. *See infra* note 77 and accompanying text. For a discussion of the state action in the procedural due process context, see Comment, *A Critique of Interest on Lawyers' Trust Accounts Programs*, 44 LA. L. REV. 999, 1026-29 (1984).

71. *In re Interest*, 402 So. 2d at 396-97; *see also supra* note 37.

72. *See supra* notes 69-70 and accompanying text.

73. *See supra* notes 38-50 and accompanying text.

74. *See supra* notes 51-62 and accompanying text.

75. *In re Interest*, 402 So. 2d at 393.

76. *See* Baker & Wood, *supra* note 1, at 336 ("[Constitutional] issues largely have been overlooked in other jurisdictions and we are concerned that Texas should not follow similar shortcuts."). *See infra* note 139.

arose in Florida were finally adjudicated in an adversarial context in the California courts.

B. The Statute

California's Program was the first plan created by legislation.[77] The Governor signed it into law on September 25, 1981,[78] just weeks after Florida's plan became operational.[79] The statute prevented the program from operating until the Board of Governors of the State Bar of California adopted regulations.[80] It was not until after the Board completed this process in January of 1983,[81] that attorneys across the state were notified of the new Program.[82]

All attorneys in California who hold client trust funds are compelled to participate. Section 6211(a) of the California Business and Professions Code states specifically that these attorneys "*shall* establish and maintain an interest bearing demand trust account."[83] This mandatory feature of the Program distinguishes it from most of the plans in the country,[84] and may have played a role in the constitutional challenges to its validity.[85] Plaintiffs filed the first California lawsuit only two weeks after attorneys

77. Four other states have established trust account programs legislatively. *See supra* note 2.

78. State Bar Petition, *supra* note 7, at 8.

79. *See supra* text accompanying note 76.

80. CAL. BUS. & PROF. CODE § 6226 (West Supp. 1985).

81. State Bar Petition, *supra*, note 7, at 16.

82. During the last week of February 1983, the State Bar of California mailed a packet of materials to approximately 79,000 bar members. *Id.* at 20. It included a letter from State Bar President Anthony Murray describing the Program, and a booklet containing the statute, the approved regulations and a set of instructions. The final item in the packets was an attorney compliance statement which all attorneys were required to return to the Bar with proof that they had opened interest-bearing trust fund accounts. *Id. See* THE STATE BAR OF CALIFORNIA, LEGAL SERVICES TRUST FUND PROGRAM: GUIDELINES, STATUTE AND REGULATING RULES 3 (1983) [hereinafter cited as THE STATE BAR OF CALIFORNIA GUIDELINES]. By the end of March 1983, over 16,000 attorneys had responded, with nearly 4,200 opening the accounts. State Bar Petition, *supra* note 7, at 20.

83. CAL. BUS. & PROF. CODE § 6211 (West Supp. 1985) (emphasis added).

84. Only California, Minnesota, Arizona, Washington, Iowa and Ohio have approved mandatory trust account programs. 2 IOLTA UPDATE, Winter 1985, at 8-12. The remaining 29 states approved programs that are voluntary on the part of attorneys. *Id.* Several states have adopted "opt-out" programs that require participation unless an attorney voluntarily declines. *See* 1 IOLTA UPDATE, Winter 1984, at 1. Delaware, Utah, and Rhode Island use this participation method. 2 IOLTA UPDATE, Winter 1985, at 8-12.

85. *Cf. In re* Interest on Trust Accounts, 402 So. 2d 389, 392 (Fla. 1981) ("Quite obviously, the Foundation's proposal has struck a nerve in the legal profession, and the focus of the pain is the mandatory nature of the proposal. The original idea of creating a [voluntary] program . . . brought some negative views, but no comparable outcry . . . .").

were notified of the Program,[86] and the second suit was filed by attorneys seeking plaintiff class action status for other similarly situated attorneys.[87]

Attorneys must open the interest bearing accounts in financial institutions "authorized by the Supreme Court."[88] As of July 1983, over 800 banks and savings and loans in California offered the authorized account.[89] In practical effect, this provision forced attorneys who kept their clients' funds in unauthorized banks to change banks in the three month period between March 1, 1983 and May 31, 1983.[90]

The statute compels attorneys to invest their clients' funds in two different situations. Under Section 6211(a), attorneys *must* invest clients' funds that are "nominal in amount or are on deposit for a short period of time" to earn interest for the State Bar of California.[91] Under Section 6211(b), attorneys *may* invest clients' funds to benefit clients, but only if the funds are "not deposited in accordance with subdivision (a)."[92] Regulations explain that nominal or short-term funds are those that the attorney determines are "not practical to segregate . . . to earn income for the benefit of the client in the light of the income the funds could earn or the costs involved in earning or accounting for any such income."[93] Thus, attorneys must make this initial practical determination about each client's funds. If an attorney believes in good faith[94] that a client's funds cannot practically be invested to benefit the owner, then that attor-

86. Petition for Writ of Prohibition or Mandate; Complaint for Declaratory Relief, Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984); *see supra* note 82.

87. *See* Complaint for Declaratory Relief, Preliminary and Permanent Injunctions at 1-2, Seuthe v. State Bar of California, No. C455587 (Los Angeles Super. Ct. filed June 6, 1983).

88. CAL. BUS. & PROF. CODE § 6212(a) (West Supp. 1985).

89. 1 IOLTA UPDATE, Summer 1983, at 5.

90. *See* THE STATE BAR OF CALIFORNIA GUIDELINES, *supra* note 82 at 3. The *Carroll* lawsuit, filed on March 16, 1983, included a declaration stating that plaintiff's attorney "would be forced to open a new account in a different bank." Declaration of Elizabeth Carroll at 2, Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984).

91. CAL. BUS. & PROF. CODE § 6211(a) (West Supp. 1985).

The trial court in *Carroll* concluded that clients could choose whether their nominal or short-term funds were invested to benefit the clients or perhaps other charities. Judgment at 3, Carroll v. State Bar, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740; *see State Bar Leaders Assert Trust Fund 'Intact' After Ruling; Legal Aid Money*, Los Angeles Daily Recorder, Nov. 21, 1983, at 1, col. 2. The court of appeal rejected this construction of § 6211(a). *Carroll*, 162 Cal. App. 3d at 1102, 209 Cal. Rptr. at 744.

92. CAL. BUS. & PROF. CODE § 6211(b) (West Supp. 1985); *see Carroll*, 162 Cal. App. 3d at 1101, 209 Cal. Rptr. at 744 ("We hold subdivision (b) plainly applies only to monies *not* nominal in amount or deposited for short term, i.e., to funds which may be segregated to earn net income for benefit of a client." (emphasis in original)).

93. Regulating Rule 1.4, *reprinted in* THE STATE BAR OF CALIFORNIA GUIDELINES, *supra* note 82, at 14.

94. *See* Regulating Rule 1.5, *reprinted in* THE STATE BAR OF CALIFORNIA GUIDELINES, *supra* note 82, at 14.

ney must invest the funds in a Section 6211(a) account to benefit the Program. If, however, the attorney believes investment could benefit the client, then that attorney must invest the funds in either a Section 6211(b) account or "as the client directs in writing."[95] In practical effect, these sections abrogate attorneys' option to maintain clients' funds in non-interest-bearing accounts. The Program is therefore a dramatic shift from the historical attorney practice of non-investment.[96]

Financial institutions remit interest generated on the Section 6211(a) nominal or short-term accounts to the State Bar of California directly;[97] attorneys play no part in calculating or accounting for the interest. The institution computes the earnings for each account and subtracts "reasonable"[98] service charges. It must forward the interest to the State Bar at least quarterly,[99] and include a detailed accounting statement.[100] The attorney or law firm also receives a copy of the statement.[101] Although the financial institutions must not pay less interest on trust fund accounts than they pay on comparable accounts,[102] they maintain discretion in setting "reasonable" service fees. Therefore, the amount of interest generated per account depends not only on the total value of the clients' commingled sums, but also on the expenses charged by the particular financial institution.

The rest of the statute details how interest earnings are disbursed under the Program. Section 6210 expresses the purposes of the article as "to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them."[103] After subtracting the Bar's administrative expenses, eighty-five percent of the remaining balance funds non-profit "qualified legal service projects" that service the poor,[104] and fifteen percent funds "qualified support centers" that train and assist legal services projects employees.[105] Census figures on indigency are used as part of a formula to distribute the funds pro-rata on a county by county basis.[106] The State Bar of California distributed funds for the first time on March 4, 1985.[107]

95. Regulating Rule 1.4, *supra* note 93, at 14.
96. *See supra* notes 19-35 and accompanying text.
97. CAL. BUS. & PROF. CODE § 6212(c)(1) (West Supp. 1985).
98. *Id.*
99. *Id.*
100. *Id.* at § 6212(c)(2).
101. *Id.* at § 6212(c)(3).
102. *Id.* at § 6212(b).
103. *Id.* at § 6210.
104. *Id.* at §§ 6216(b), 6213(a).
105. *Id.* at §§ 6216(c), 6213(b).
106. *Id.* at § 6216(b).
107. *Trust Account Funds Released*, CAL. LAW., April 1985, at 65. Interview with Leroy Cordova, Director, California Legal Services Trust Fund Program (Mar. 25, 1985).

C. Current Status of the Program

Plaintiffs challenged the California Program in two lawsuits filed March 16, 1983 and June 6, 1983.[108] The State Bar of California immediately petitioned the California Supreme Court for extraordinary relief.[109] It asked the supreme court to stay the trial court proceedings and prayed that the court determine the merits of the constitutional challenges.[110] But the California Supreme Court refused relief.[111]

In an order filed December 20, 1983,[112] the trial court in *Carroll v. State Bar of California*,[113] anomalously sustained the Program: it construed the Program as constitutional and yet granted plaintiffs' motions for summary judgment as if the Program were unconstitutional.[114] It decided that clients have "the right to choose" whether their sums are invested to benefit the Bar under a Section 6211(a) account or are invested with the interest payable to them under a Section 6211(b) account.[115] This procedure would satisfy the basic procedural due process requirement of notice, and the clients' control could reasonably constitute a waiver of clients' Fifth Amendment rights when the funds were invested to benefit the Bar.[116] However, the appellate court promptly rejected the trial court's analysis. Not only did "clear and unambiguous"[117] statutory language eliminate client control, but IRS policy compelled its elimination.[118] In addition, legislative history demonstrated that legislators intended to eliminate clients' optional participation, unless the funds could be invested for the clients' benefit.[119] The court of appeal admonished that the court "should not rewrite legislation to avoid constitutional questions if doing so subverts legislative intent."[120]

The *Carroll* court also analyzed the history of trust account programs,[121] as well as several constitutional issues.[122] It concluded that the

108. *See supra* note 9.

109. *See* State Bar Petition, *supra* note 7.

110. *Id.* at 7-8.

111. Order of the California Supreme Court, The State Bar of California v. Superior Court of the State of California for the County of San Diego, No. LA31749 (Cal. Sup. Ct. filed Apr. 18, 1983).

112. Judgment, *supra* note 91, at 1.

113. 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984).

114. Judgment, *supra* note 91, at 3-4.

115. *Id.* at 3; *see supra* notes 91-92 and accompanying text.

116. *See supra* notes 39-41 and accompanying text.

117. *Carroll*, 162 Cal. App. 3d at 1101, 209 Cal. Rptr. at 744.

118. *Id.* at 1102, 209 Cal. Rptr. at 745. *See supra* notes 42-50 and accompanying text.

119. *Carroll*, 162 Cal. App. 3d at 1102, 209 Cal. Rptr. at 745.

120. *Id.* (citing Marina Village v. California Coastal Zone Conservation Comm'n, 61 Cal. App. 3d 388, 393, 132 Cal. Rptr. 120, 123 (1976)).

121. *Id.* at 1099-1100, 209 Cal. Rptr. at 743-44.

122. The court considered whether the Program was unconstitutionally vague; whether it violated the Taking Clause of the Fifth Amendment; whether it denied plaintiffs equal protec-

Program was entirely constitutional and reversed the superior court judgment.[123]

Although plaintiffs petitioned the California Supreme Court for a hearing, the court denied the petition on May 2, 1985.[124] The State Bar of California distributed $7.2 million of the $12.2 million it had collected since the Program's implementation in March 1983,[125] on March 4, 1985.[126]

II. The Taking Clause Issue

A. Introduction

The Fifth Amendment of the United States Constitution provides that private property shall not "be taken for public use, without just compensation."[127] These familiar and yet imponderable words apply to the states through the Fourteenth Amendment,[128] and pose a formidable threat to California's Legal Services Trust Account Program.[129] In published opinions, the highest courts of five states,[130] and an appellate court

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tion of the laws; and whether it violated plaintiffs' Sixth Amendment right to counsel. *Id.* at 1104-09, 209 Cal. Rptr. at 746-49.

123. *Id.* at 1109, 209 Cal. Rptr. at 749.

124. *See* 2 IOLTA UPDATE, Spring 1983, at 1; *see also supra* note 12.

125. *Trust Account Funds Released, supra* note 107, at 65.

126. Interview, *supra* note 107.

127. U.S. CONST. amend. V. For a discussion of the philosophical source of the Taking Clause, see Comment, *Property Versus Civil Rights: An Alternative to the Double Standard*, 11 N. KY. L. REV. 51 (1984). The author traces the clause to John Locke's theories on government. *Id.* at 100.

Every state constitution has a comparable provision. 3 J. SACKMAN, NICHOLS' THE LAW OF EMINENT DOMAIN § 8.1(2) (rev. 3d ed. 1981). California's taking provision states: "Private property may be taken or damaged for public use only when just compensation, . . . has first been paid to, or into court for, the owner . . . ." CAL. CONST. art I, § 19. The scope of compensable injury to property is more expansive under the California Constitution due to the additional "damage" language. 5 B. WITKIN, SUMMARY OF CALIFORNIA LAW 3448-49 (8th ed. 1974). Under the independent state grounds doctrine, California may provide more, but not less, protection for property owners than that provided by the federal Constitution. *See generally*, Stoebuck, *San Diego Gas: Problems, Pitfalls and a Better Way*, 25 WASH. J. URB. & CONTEMP. L. 3, 4 (1983).

128. Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 160 (1980); Penn Central Transp. Co. v. New York, 438 U.S. 104, 122 (1978); *see* Chicago, Burlington and Quincy RR Co. v. Chicago, 166 U.S. 226, 239 (1897).

129. *See* Rivlin, *supra* note 8.

130. *In re* Minnesota State Bar Ass'n, 332 N.W.2d 151, 158 (Minn. 1982); *In re* New Hampshire Bar Ass'n, 122 N.H. 971, 975-76, 453 A.2d 1258, 1261 (1982); *In re* Interest on Trust Accounts, 402 So. 2d 389, 395-96 (Fla. 1981). *Cf. In re* Interest on Lawyers' Trust Accounts, 283 Ark. 252, 254, 675 S.W.2d 355, 357 (1984) (approving program by modifying prior decision that questioned program's feasibility on "taking" and due process grounds), *modifying* 279 Ark. 84, 648 S.W.2d 480, 480-81 (1983); *In re* Interest on Lawyers' Trust Accounts, 672 P.2d 406, 408 (Utah 1983) (citing reasoning of Florida, New Hampshire and Minnesota, that there is "no federal or state constitutional impediment" to the program).

in California,[131] have concluded that the Fifth Amendment does not apply to interest on lawyers' trust account programs. Yet, "[i]t is generally agreed among proponents and opponents [of the programs] that the issue of taking will most likely be resolved ultimately by the United States Supreme Court.[132]

Proponents of California's Program have asserted constitutionality based upon three major concepts. The first is that clients have no recognizable property interest in the earnings generated through the Program.[133] If clients have no property, they have no procedural due process rights to notice and no interest that can be taken in violation of the Fifth Amendment. The second concept is that the recent United States Supreme Court decision of *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[134] is inapposite.[135] Finally, proponents assert that even if clients have some cognizable property right in the interest income, the Program is a constitutional exercise of California's inherent police powers.[136] The following discussion will demonstrate the tenuous nature of these propositions.

Takings law generally conjures up images of land use zoning and eminent domain proceedings. The classic takings case occurs when the government formally condemns a landowner's fee simple title.[137] It is important to note that the same constitutional standards apply to personal property interests.[138] Because there are so few cases on point,[139] it

131. Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984).

132. Rivlin, *supra* note 8, at 1040.

133. *See Carroll*, 162 Cal. App. 3d at 1106, 209 Cal. Rptr. at 747-48.

134. 449 U.S. 155 (1980). *See supra* text accompanying notes 57-62.

135. *Carroll*, 162 Cal. App. 3d at 1106, 209 Cal. Rptr. at 748 ("*Webb's* does not address issues pertinent to this case.").

136. *See id.* at 1107, 209 Cal. Rptr. at 748 (describing program as a regulation that promotes the common good).

137. *See, e.g.*, San Diego Gas & Electric Co. v. San Diego, 450 U.S. 621, 651 (1980) (Brennan, J., dissenting).

138. *See* 1 J. SACKMAN, NICHOLS' THE LAW OF EMINENT DOMAIN § 2.1[2] (rev. 3d. ed. 1981).

Recent Supreme Court cases applying the Fifth Amendment to deprivations of personal property include Ruckelshaus v. Monsanto Co., 104 S. Ct. 2862 (1984) (forced disclosure of trade secrets under federal statute held to constitute taking when confidentiality previously assured); *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (interest income earned on interpleader fund taken by Florida county held to constitute taking); and Andrus v. Allard, 444 U.S. 51 (1979) (right to sell Indian artifacts composed of protected bird parts barred by Eagle Protection Act held not to constitute taking). All apply standards developed in Fifth Amendment cases involving real property.

139. *See supra* note 130. Until *Carroll*, no published opinion addressed the constitutional issues raised by trust account programs in an adversarial proceeding. *See, e.g., In re Minnesota*, 332 N.W.2d at 151 (opinion in response to Minnesota State Bar Ass'n petition seeking amendments to state's Code of Professional Responsibility); *In re New Hampshire*, 122 N.H. at 975, 453 A.2d at 1259 (opinion in response to New Hampshire Bar Ass'n petition seeking amendment to supreme court rules); *In re* Interest on Trust Accounts, 356 So. 2d 799, 799

is necessary to examine the California Legal Services Trust Account Program and the recent *Carroll* decision through criteria developed largely in the area of real property law.

B. The Property Issue

1. What is property?

In an early description of property, Blackstone listed the "free use, enjoyment and disposal" of physical acquisitions as three rights that cannot be controlled or diminished in the absence of lawful authority.[140] Similarly, the United States Supreme Court has declared that "property" includes the rights to "acquire, use and dispose of" things in addition to the physical objects themselves.[141] The Court has repeatedly reaffirmed this "group" or "bundle" of rights approach to property in the context of Taking Clause challenges.[142]

During the 1970's, the Court devised a parallel and considerably more expansive concept of property in procedural due process cases.[143] In the 1972 decision of *Board of Regents v. Roth*,[144] the Court declared that "[p]roperty interests . . . are not created by the Constitution.

(Fla. 1978) (opinion in response to petition of Board of Governors of the Florida Bar requesting amendments to rules governing the practice of law). The only other adversarial proceeding in the United States was filed in the federal district court in Tampa, Florida on October 11, 1984. Glaeser v. State Bar of Florida, No. 84-1345 (M.D. Fla. Oct. 11, 1984). *See generally supra* note 9. Other than *Carroll*, the published opinions have not analyzed the Fifth Amendment issue in detail. *See Carroll*, 162 Cal. App. 3d at 1105-07, 209 Cal. Rptr. at 747-48.

140. 1 W. BLACKSTONE, COMMENTARIES *134-35, *quoted in* BOSSELMAN, CALLIES & BANTA, THE TAKING ISSUE 51, 56 (1973).

141. The Court often cites its description of Fifth Amendment property as set forth in United States v. General Motors Corp., 323 U.S. 373, 377-78 (1945) (emphasis added):

> It is conceivable that [the term "property" in the Taking Clause] was used in its vulgar and untechnical sense of the physical thing with respect to which the citizen exercises rights recognized by law. On the other hand, it may have been employed in a more accurate sense to denote *the group of rights* inhering in the citizen's relation to the physical thing, as the right to *possess, use and dispose of it*. In point of fact, the construction given the phrase has been the latter.

See, e.g., Ruckelshaus v. Monsanto Co., 104 S. Ct. 2862, 2873-74 (1984); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 435 (1982); Pruneyard Shopping Center v. Robins, 447 U.S. 74, 82 n.6 (1980); Penn Central Transp. Co. v. New York City, 438 U.S. 104, 142 (1978) (Rehnquist, J. dissenting). *See also* Agins v. City of Tiburon, 24 Cal. 3d 266, 273, 598 P.2d 25, 28, 157 Cal. Rptr. 372, 375-76 (1979), *aff'd* 447 U.S. 255 (1980). *See generally* Michelman, *Property, Utility, And Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1185 n.41 (discussing RESTATEMENT OF PROPERTY ch.I, Introductory Note (1936)); Oakes, *"Property Rights" in Constitutional Analysis Today*, 56 WASH. L. REV. 583, 584-90 (1981).

142. *See, e.g.*, *Monsanto*, 104 S. Ct. at 2878; United States v. Security Industrial Bank, 459 U.S. 70, 75-76 (1982) (dicta); *Loretto*, 458 U.S. at 435; *Pruneyard*, 447 U.S. at 82; Kaiser Aetna v. United States, 444 U.S. 164, 176, 179-80 (1979); Andrus v. Allard, 444 U.S. 51, 65-66 (1979).

143. *See generally* Oakes, *supra* note 141, at 596-98; Comment, *supra* note 127, at 74-85.

144. 408 U.S. 564 (1972).

Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law. . . ."[145] The Court demanded that persons claiming procedural due process protection have more "than an abstract need or desire" or "unilateral expectation of property."[146] They must have a "legitimate claim of entitlement to it."[147] The Court devised a two-tier test which requires identification of a substantive interest on the first tier,[148] and determination of whether that interest constitutes a "legitimate claim of entitlement" under the federal constitution on the second tier.[149] Under this standard, entirely incorporeal interests have been recognized as "property" subject to procedural due process protection.[150] However, these Fourteenth Amendment procedural protections are only available to safeguard interests a "person *has already acquired*."[151]

Commentators have criticized this distinction between the constitutional definition of property in taking cases and procedural due process cases.[152] For example, Professor Tribe found that there was "no good reason" that the broader procedural due process concept of property was not used in the takings context.[153]

Recently, the United States Supreme Court has applied the *Roth*

145. *Id.* at 577. *See also* Arnett v. Kennedy, 416 U.S. 134, 151-52 (1974).

146. *Roth*, 408 U.S. 564, 577 (1972).

147. *Id.*

148. Bishop v. Wood, 426 U.S. 341 (1976); Perry v. Sindermann, 408 U.S. 593, 601-02 (1972); *Roth*, 408 U.S. at 577.

149. *E.g.*, Memphis Light, Gas & Water Div. v. Craft, 436 U.S. 1, 9 (1978). For general discussions of the two-tiered procedural due process test of property interests, see generally Van Alstyne, *Cracks in "The New Property": Adjudicative Due Process in the Administrative State*, 62 CORNELL L. REV. 445, 457-70 (1977) and Monaghan, *Of "Liberty" and "Property,"* 62 CORNELL L. REV. 405, 434-39 (1977). Monaghan stresses this second tier stating that no "principled analysis" could depend entirely on reference to state law. *Id.* at 440-41, 442.

150. *See, e.g.*, Goss v. Lopez, 419 U.S. 565 (1975) (ten-day suspension from school deprived students of property interest in education); *see* Oakes, *supra* note 141, at 597; Baker & Wood, *supra* note 1, at 359-60.

151. *Roth*, 408 U.S. at 576 (emphasis added); *see, e.g.*, Oakes, *supra* note 141, at 598.

152. L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 9-3 at 459 n.11 (1977) *discussed in* Baker & Wood, *supra* note 1, at 355-56. *See also* Oakes, *supra* note 141, at 598.

153. L. TRIBE, *supra* note 152. *But cf.* Baker & Wood, *supra* note 1, at 355-56.

The United States Court of Appeals for the District of Columbia Circuit has refused to apply the procedural due process property definition in Taking Clause challenges. *E.g.*, Kizas v. Webster, 707 F.2d 524, 539 (D.C. Cir. 1983) (presupposition that a legitimate claim of entitlement rises to the level of "property" protected by the Taking Clause lacks foundation). *Cf. Security*, 459 U.S. at 75 (rejecting contention that because broad definition of property under Due Process Clause encompasses both contractual and traditional rights, Taking Clause should give no greater protection to traditional rights than contractual rights) (dicta); Geneva Towers Tenants Org. v. Federated Mortgage Investors, 504 F.2d 483, 494 n.2 (9th Cir. 1974) (Hufstedler, J. dissenting) (if procedural due process entitlements were absolute, government could not take them without paying just compensation despite procedural due process protections).

procedural due process definition of property in Taking Clause cases.[154] In these decisions, the Court has identified a state or federal law source for the property interest but has not analyzed whether the interest is a legitimate claim of entitlement under the federal Constitution.[155] Although it appears that the Court is moving towards a "unified theory of constitutional property,"[156] it has not yet fully embraced the concept.[157]

2. *Do clients have a property interest in the earnings generated through the Program?*

Property is one of the "three key words" in the Taking Clause.[158] In *Penn Central Transportation Co. v. New York City*,[159] the Court acknowledged that taking challenges are dismissed when the claimant's interest is not "property" for Fifth Amendment purposes.[160] Proponents of trust account programs across the country have claimed that clients have no cognizable property interest in the earnings.[161]

a. The Florida Formulation

In its final implementing decision of 1981,[162] the Florida Supreme Court formulated the concept that clients have no property interest in the earnings. It stated two reasons. First, "no client is compelled to part with 'property' by reason of a state directive, since *the program creates*

154. *See Monsanto*, 104 S. Ct. at 2872 ("We are mindful of [this] basic axiom . . . ."); Texaco, Inc. v. Short, 454 U.S. 516, 525 (1982); Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980) ("We, of course, also accept [this] proposition, pressed upon us by appellees . . . ."); *cf. Pruneyard*, 447 U.S. at 84; *Kaiser Aetna*, 444 U.S. at 166, 179. Justice Blackmun questioned the *Kaiser Aetna* Court's use of state property definitions in a dissent. *Kaiser Aetna*, 444 U.S. at 191-92 (Blackmun, J., dissenting).

155. *See, e.g., Monsanto*, 104 S. Ct. at 2872-74; *Texaco*, 454 U.S. at 525-30; *Webb's*, 449 U.S. at 161-62; *Pruneyard*, 447 U.S. at 84.

156. Baker & Wood, *supra* note 1, at 356.

157. *Compare Security*, 459 U.S. at 75 (various interests can be "property" under broad Due Process Clause definition and yet receive differing protection under Taking Clause) *with Webb's*, 449 U.S. at 161-64 (interests can be rejected as "property" under state law and broad Due Process Clause definition and yet receive protection under Taking Clause).

158. Penn Central Transp. Co. v. New York City, 438 U.S. 104, 142 (1978) (Rehnquist, J., dissenting).

159. 438 U.S. 104 (1978).

160. *Id.* at 124-25. The Court stated: "[W]hile the challenged government action caused economic harm, it did not interfere with interests that were sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes." It cites several cases and a 1964 law review article for this proposition. *Id.* at 125. The article states in part: "Since the question being asked is what sort of protection is to be given to property, the initial task must be to develop a workable concept of what we mean when we talk about property." Sax, *Takings and the Police Power*, 74 YALE L.J. 36, 61 (1964).

161. *See supra* notes 47-50 and accompanying text.

162. *In re* Interest On Trust Accounts, 402 So.2d 389 (Fla. 1981).

income where there had been none before."[163] The court cited the property definition passage[164] from *Board of Regents v. Roth*.[165] The unmistakable import of this passage is that since clients had no prior right to interest under state law,[166] they could have no constitutional "property" once any interest was generated.[167] This conception of property was first used in procedural due process cases.[168]

Second, clients have no property interest in income that "*would never benefit* [them] under any set of circumstances."[169] The Florida court offered no legal support for this proposition. It postulated that client concerns would not hinder the program "since only clients with nominal funds or those to be held for short durations—that is, clients who cannot themselves benefit from investing—are in effect providing the pooled income source."[170] This second argument hinges on the impracticability of investing nominal or short-term client trust funds: clients have no "property" until the interest earned on their principal exceeds administrative costs and thus can benefit them.

The Florida court's formulation was quickly adopted by other states as they began implementing trust account programs.[171] Indeed, the American Bar Association Committee on Ethics and Professional Responsibility also accepted the Florida Court's conclusion that interest earned on clients' nominal or short-term deposits does not constitute clients' property.[172]

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163. *Id.* at 395 (emphasis added).

164. "[P]roperty interests . . . are not created by the constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law . . . ." *Id.* at 395 (citing Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980)).

Although the original source of this quoted passage is Board of Regents v. Roth, 408 U.S. 564, 577 (1972), the Florida court cited its repetition in the *Webb's* case, attempting to harmonize its holding with *Webb's*. *Cf. infra* notes 186-90 and accompanying text.

165. 408 U.S. 564 (1972).

166. *See supra* text accompanying notes 145-51.

167. *But see infra* notes 186-92 and accompanying text.

168. *See supra* notes 143-57 and accompanying text.

169. *In re Interest*, 402 So. 2d at 395 (emphasis added).

170. *Id.* at 396.

171. *See In re* Interest on Lawyers' Trust Accounts, 283 Ark. 252, 254, 675 S.W.2d 355, 357 (1984) ("The funds in question are not now available to individual clients, and for practical reasons cannot be made available to them."), *modifying* 279 Ark. 84, 648 S.W.2d 480 (1983); *In re* Minnesota State Bar Ass'n, 332 N.W.2d 151, 158 (Minn. 1982) ("There simply is no 'property' now in existence that would be taken."); *In re* New Hampshire Bar Ass'n, 122 N.H. 971, 976, 453 A.2d 1258, 1261 (1982) ("[A]s a practical matter, [the income] would not have been available for return to clients nor would otherwise exist[.]. . . [T]he income generated [can]not fairly be classified as client 'property.' ").

172. Citing the Florida court, the ABA Committee on Ethics and Professional Responsibility states, "[T]he rationale for the ethical acceptability of these programs is the same as the premise for acceptability in constitutional law and tax law. . . . [T]he interest earned is not the clients' property . . . ." ABA Op. 348, *supra*, note 19, at 1506.

b. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[173]

In *Webb's*, the United States Supreme Court specifically addressed the constitutionality of a statute that took interest earned on a privately owned principal fund. The amount of interest involved was approximately $100,000.[174] Therefore, for obvious reasons, the court did not address the issue raised by Florida's second argument: whether interest must exceed expenses before it constitutes "property" for purposes of the Taking Clause. It did, however, address the Florida court's first point: that a state may create new property interests and take them without offending the Constitution.[175]

Webb's involved a Florida statute which provided that "[a]ll interest accruing from moneys deposited [in Florida court registries] shall be deemed income of the office of the clerk of the circuit court . . . ."[176] In 1976, Eckerd's of College Park, Inc., a Florida corporation, agreed to purchase the assets of Webb's Fabulous Pharmacies, Inc., another Florida corporation. When it appeared that Webb's debts exceeded its purchase price, Eckerd's filed a complaint of interpleader. Webb's and approximately two hundred of Webb's creditors were named as defendants.[177] Pursuant to the interpleader statute,[178] Eckerd's paid the entire $1,812,145.77 purchase price to the court registry.[179] The only Florida statute that permitted the fund to earn interest was the same statute that vested ownership of that interest in the court clerk.[180] Thus the defendants had no pre-existing, state created right to interest, apart from the very statute that vested ownership of the earnings in the government.

When a receiver was finally appointed, he requested the accumulated interest as well as the principal; but the court clerk refused to re-

173. 449 U.S. 155 (1980).

174. *Id.* at 158.

175. *Id.* at 163.

176. FLA. STAT. ANN. § 28.33 (West 1974). The pertinent part of the statute provided:

> Moneys deposited in the registry of the court shall be deposited in interest-bearing certificates at the discretion of the clerk, subject to . . . guidelines . . . . All interest accruing from moneys deposited shall be deemed income of the office of the clerk of the circuit court investing such moneys and shall be deposited in the same accounts as are other fees and commissions of the clerk's office.

177. *Webb's*, 449 U.S. at 156-57.

178. FLA. STAT. ANN. § 676.106(4) (West 1966). The statute derives from the Uniform Commercial Code; it provided in part:

> A transferee may within ten days after taking possession of the goods, discharge his obligations under this section by an action in the circuit court for the county where the transferor had his principal place of business in this state interpleading all creditors in the list of creditors required by § 676.6-104. In such event *the court shall require the consideration to be deposited into the registry of the court* and thereupon shall decree the goods to be free and clear of the claims of such creditors and that such creditors should file their claims with the court. (Emphasis added).

179. *Webb's*, 449 U.S. at 157.

180. Brief For The Appellees at 5, 13-14, *Webb's*, 449 U.S. 155.

lease the interest.[181] Ultimately, the Florida Supreme Court ruled that the Florida county could keep the earnings.[182] One of the court's reasons was that the statute only took the interest that the statute itself created.[183]

The United States Supreme Court granted certiorari to determine whether Florida violated the Fifth and Fourteenth Amendments by exacting the interest earned on the privately owned fund.[184] The Supreme Court held that it did.

The Court addressed the argument that Florida's statute created the right to interest and thereby could vest ownership of the interest in the county.[185] The Court acknowledged that apart from the Florida statute involved, Florida law did not require that any interest be earned.[186] The Court also acknowledged that " '[p]roperty interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by . . . state law . . . .' "[187] However, the Court rejected the notion that Webb's creditors had a mere "unilateral expectation" of property on this basis.[188] Since the principal was held solely for Webb's creditors' benefit, the creditors had a state-created property right to their portions of the principal.[189] Additionally, the Court stated unequivocally:

> [A] claimant ultimately determined to be entitled to all or a share of the [principal] fund [may claim] a proper share of the interest, the fruit of the fund's use, that is realized in the interim. . . . *[T]he State's having mandated the accrual of interest does not mean the State or its designate is entitled to assume ownership of the*

181. *Webb's*, 449 U.S. at 158.

182. *Id.* (Justice Arthur J. England, Jr. participated in Florida's per curiam decision in Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951 (Fla. 1979). England authored the two Florida trust account decisions.) *See supra* note 69.

183. *Webb's*, 449 U.S. at 158 (quoting Beckwith v. Webb's Fabulous Pharmacies, Inc., 374 So. 2d 951, 952 (Fla. 1979)).

Proponents of the California Program have distinguished *Webb's* by emphasizing its rejection of Florida's public money rationale. State Bar of California's Notice of Cross-Motion for Summary Judgment and Memorandum of Points and Authorities in Support Thereof, at 43, Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984) [hereinafter cited as State Bar Summary Judgment]. This view ignores the Florida court's further reasoning—equally applicable to the California program—which was rejected by the Supreme Court. *See infra* notes 186-93 and accompanying text.

184. *Webb's*, 449 U.S. at 160.

185. *See supra* notes 143-51 and accompanying text.

186. "Appellees submit . . . and we accept the proposition—that, apart from statute, Florida law does not require that interest be earned . . . ." *Webb's*, 449 U.S. at 161 (citations omitted).

187. *Id.* (quoting Board of Regents v. Roth, 408 U.S. 564, 577 (1972)). The Court described this further proposition as one "pressed upon us by the appellees." *Webb's*, 449 U.S. at 161.

188. *Webb's*, 449 U.S. at 161.

189. *Id.*

interest.[190]

In another part of its opinion, the Court stated definitively, "*The earnings* of a fund are incidents of ownership of the fund itself and *are property* just as the fund itself is property."[191] It stressed that the practical effect of the statute was to appropriate the value of "*the use* of the fund for the period in which it is held . . . ." [192] In these passages the Supreme Court clearly rejected Florida's rationale that the statute takes only what it creates.[193]

How did the Supreme Court of Florida base its trust account decision on a procedural due process argument rejected in *Webb's*? Clearly, the value of the earnings appropriated by the state in *Webb's* played a large part in distinguishing the cases.[194] But the critical difference is not that the state created a new property right through its powers to create and define property interests, but that as a practical matter this particular property *could not exist* but for the statute.[195]

In *Webb's*, the $1,812,145.77 principal fund was capable of generating interest in excess of expenses without regard to any statute at issue in the case. But, *by definition*, the trust account programs apply only to

190. *Id.* at 162 (emphasis added).

191. *Id.* at 164 (emphasis added).

192. *Id.* (emphasis added).

193. *See supra* notes 180-83 and accompanying text; *cf. Minnesota Developments, supra* note 2, at 1298 n.68 ("*Webb's* thus established that the Supreme Court may recognize a constitutionally protected property interest even when a state's highest court, interpreting its own statutes, does not recognize a property right.").

194. Proponents of California's Program and of other trust account plans nationwide have devoted substantial attention to distinguishing *Webb's*. In fact, the Taking Clause arguments in the Florida case address the taking issue solely in this context. *In re* Interest on Trust Accounts, 402 So. 2d 389, 395-96 (Fla. 1981). The court described two "distinguishing features." *Id.* at 395. The first is that no client is compelled to part with "property." *Id.* The second is that the program is voluntary "not only from the perspective of attorneys but, in the most practical sense, from the will of clients, for no attorney or firm will participate in the program in the face of a strenuous objection from its clients." *Id.* at 396. As to this second feature, it is difficult to understand the court's reasoning since the Florida plan does not require that clients be notified of the plan in the first place. *See supra* notes 42-50 and accompanying text.

In the California litigation, *Webb's* was distinguished in three significant respects. First, the *Webb's* Court specifically restricted its holding to the facts of the underlying controversy. *Webb's*, 449 U.S. at 164-65. Second, the principal sum was deposited in *Webb's* as a prerequisite to use of the court in accordance with a state statute. *Id.* Third, $100,000 in interest is a significant sum, while the unknown amounts of interest generated on nominal or short-term deposits are not. *See* State Bar Summary Judgment, *supra* note 183, at 44.

Although these factual differences may appear decisive, the Court's reasoning in *Webb's* is indistinguishable on the significant legal issues that arose in the litigation over California's Program. *See supra* notes 185-93; *see also infra* 251, 255-57, 304-18, 400 and accompanying text.

195. State Bar Summary Judgment, *supra* note 183, at 46-47. The State Bar of California described this difference as one between funds "inherently" able to earn "significant interest" and those "intrinsic[ally]" without "interest-bearing potential."

principal amounts incapable of generating interest in excess of expenses.[196] As a practical matter, the only way for nominal or short-term funds to generate enough interest to offset costs is if the costs are lowered by the programs.

In essence, Florida's second reason that clients have no property—impracticability—subsumes its procedural due process argument. The state is not merely redefining property interests and vesting ownership. It is actually creating property that could not practicably exist before. This impracticability argument was offered by Florida and subsequently cited without legal support,[197] until *Carroll v. State Bar of California*.[198]

c. The California Court of Appeal Formulation

In *Carroll*, the California Court of Appeal did not reason that California can create new property interests and vest ownership in the state.[199] Instead, it stressed Florida's second point: that it is impossible for clients to benefit from investment.[200] Additionally, the court addressed an important property issue overlooked by the Florida court: whether the Program takes clients' property right to use and control the uses of their principal.[201] This final issue arises from the traditional Taking Clause formulation of constitutional property: the rights to acquire, *use*, and dispose of physical things in addition to the rights to the things themselves.[202]

The court bolstered the impracticability theory with legal support. "Economics" not only prevents investment to benefit clients, but banking law creates an additional "barrier."[203] The Program requires attorneys to invest their clients' funds in negotiable order of withdrawal ("NOW") accounts.[204] NOW account regulations bar deposits "which consist solely of funds in which the entire beneficial interest is held by" profit-earning organizations.[205] Absent the Program, profit-earning corporations or partnerships cannot utilize NOW accounts.

The Program "overcomes" this banking law barrier by designating a public entity, the State Bar of California, as the beneficiary of the inter-

196. *See supra* notes 93-95 and accompanying text. *Id.*

197. *See supra* note 171 and accompanying text.

198. 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984).

199. This argument surfaced earlier in the *Carroll* litigation. *See* State Bar Petition, *supra* note 7, at 57 (California has "Broad Power To Define New Forms Of Property"); *id.* at 61-62 (California is "bound solely by the limits of its ingenuity" in defining and vesting new property interests.).

200. Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 1100, 209 Cal. Rptr. 740, 743-44 (1984).

201. *See infra* notes 214-16 and accompanying text.

202. *See supra* notes 140-42 and accompanying text.

203. *Carroll*, 162 Cal. App. 3d at 1100, 209 Cal. Rptr. at 744.

204. *See supra* notes 63, 83 and accompanying text.

205. 12 U.S.C. § 1832(a)(2) (Supp. IV. 1980); 12 C.F.R. § 217.157 (1983).

est.[206] The *Carroll* court reasoned that "the affected class of legal clients is by definition limited to those persons whose deposited funds cannot, *under present banking regulations* be deposited in an interest-bearing account so as to earn net income for the client's individual profit . . . ."[207] There are two problems with this reasoning. First, current banking regulations *do not* prevent the entire affected class of legal clients from investing since profit-earning individual clients, public entity clients, and nonprofit organizational clients are free to invest in NOW accounts.[208]

Second, NOW regulations prohibit deposits in which *any part* of the "beneficial interest" in the account is owned by profit-earning organizations.[209] Clearly, even a profit-earning corporation that places funds in trust with its attorney has a beneficial interest in its attorney's trust fund account. California's Program, like all IOLTA plans, depends upon Federal Reserve Board rulings that construe the banking statutes so that clients have no beneficial interest.[210] Commentators have compared this result[211] to the same "*ipse dixit*" technique rejected by the United States Supreme Court in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*.[212] The *Carroll* court's reliance on banking regulations is unsatisfactory[213] because its reasoning is inaccurate, and the regulations themselves have been construed to benefit the Program.

The *Carroll* court also analyzed whether clients have a property interest in controlling the use of their principal funds. It reasoned that clients relinquish control of their principal property when they place it in trust with their attorneys.[214] The only "meaningful" right of control clients retain is to recover their prinicipal because the principal property "is not economically capable of generating net income . . . ."[215]

The court also noted that once clients' funds generate interest, clients have no compensable right to control who benefits from the earnings: "The abstract right to control where interest earned on a person's money may be funneled is not an economic loss subject to monetary

206. *See Carroll*, 162 Cal. App. 3d at 1100, 209 Cal. Rptr. at 744.

207. *Id.* at 1105, 209 Cal. Rptr. at 747 (emphasis added).

208. 12 U.S.C. § 1832(a)(2); 12 C.F.R. § 217.157.

209. 12 U.S.C. § 1832(a)(2).

210. Baker & Wood, *supra* note 1, at 334-35, 335 n.39.

211. *Id.* at 335 n.39.

212. 449 U.S. 155, 164 (1980) ("[A] State, by *ipse dixit*, may not transform private property into public property without compensation . . . . This is the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent. That Clause stands as a shield against the arbitrary use of governmental power.").

213. Indeed, banking regulations did not bar one of the plaintiffs, Elizabeth Carroll, from investing in NOW accounts since she is an individual. *See* 12 U.S.C. § 1832(a)(2).

214. *Carroll*, 162 Cal. App. 3d at 1107, 209 Cal. Rptr. at 748.

215. *Id.*

compensation."[216]

The practical effect of *Carroll* is that client property will not be accorded constitutional protection until its value rises to a certain economic level. This result contradicts basic trust principles under California law and does not comport with some recent United States Supreme Court precedent.

Under California law, interest is defined as "the compensation allowed by law or fixed by the parties for the use, or forbearance, or detention of money."[217] When California attorneys hold their clients' funds, the law of trusts and provisions of the California Rules of Professional Conduct govern the attorney-client relationship.[218] In the past, these standards imposed no duty upon attorneys to invest client trust funds to benefit clients. For example, Rule 8-101 requires safekeeping, accounting and prompt delivery of client funds, but does not require investment.[219] Basic trust law principles generally impose a duty to invest,[220] but not when the primary purpose of the trust is safeguarding rather than productivity.[221] As in Florida, California attorneys have deposited their clients' funds in commingled, non-interest bearing trust accounts and "clients have accepted this practice."[222]

California law may not have required attorneys to invest client trust funds as trustees, but if they did, any interest generated belonged to the clients.[223] For example, in a 1970 ethics opinion,[224] the San Francisco Bar Association ruled that attorneys could properly open trust savings[225]

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216. *Id.* at 1106, 209 Cal. Rptr. at 747. The court's reasoning is difficult to understand since invalidation of the Program rather than compensation is the proper remedy under California law. *See infra* notes 444-47 and accompanying text.

217. CAL. CIVIL CODE § 1915 (West 1985).

218. *See* CAL. RULES OF PROFESSIONAL CONDUCT Rules 1-100, 8-101 (1984); G. WARVELLE, ESSAYS IN LEGAL ETHICS § 288 (2d ed. 1920).

219. CAL. RULES OF PROFESSIONAL CONDUCT Rule 8-101 (1984).

220. *E.g.*, CAL. CIV. CODE §§ 2261-2262 (West 1985); 2 A. SCOTT, THE LAW OF TRUSTS § 181 (3d ed. 1967); G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 611 (rev. 2d ed. 1980).

221. SCOTT, *supra* note 220; BOGERT, *supra* note 220. *See* Allin v. Williams, 97 Cal. 403, 409, 32 P. 441, 443 (1893); Higgins v. City of Santa Monica, 62 Cal. 2d 24, 29-30, 396 P.2d 41, 44, 41 Cal. Rptr. 9, 12 (1964).

222. ABA Op. 348, *supra*, note 19, at 1502.

223. *See* Board of Law Library Trustees v. Lowery, 67 Cal. App. 2d 480, 154 P.2d 719 (1945) *cited with approval in* Webb's Fabulous Pharmacies Inc. v. Beckwith, 449 U.S. 155, 162-63 (1980); Pomona City School Dist. v. Payne, 9 Cal. App. 2d 510, 516, 50 P.2d 822, 825 (1935). *See also* SCOTT, *supra* note 220, at 1464 (Trustee who has no duty to invest trust property is accountable for any income actually earned.); *cf.* Greenbaum v. State Bar of California, 15 Cal. 3d 893, 903, 544 P.2d 921, 927, 126 Cal. Rptr. 785, 791 (1976).

224. Bar Ass'n of San Francisco Legal Ethics Comm., Op. No. 1970-3 (1970). *Cf.* ABA Comm. on Ethics and Professional Responsibility, Informal Op. 545 (1962); R. WISE, LEGAL ETHICS 239 (1966).

225. *See supra* note 63. In 1970, interest bearing demand checking accounts were not generally available.

accounts, but only if any interest generated went to the clients and not to the attorneys. In *Greenbaum v. State Bar of California*,[226] the California Supreme Court imposed sanctions on an attorney who deprived his client of interest by misappropriating his client's principal.[227] This result comports with American Bar Association rulings that attorneys cannot charge their clients for the costs of administering trust funds.[228] It follows that although clients may have had no state-created right to earn interest in the first place, they did have existing rules and understandings[229] which entitled them to interest if any was in fact earned. The *Carroll* court's conclusion that clients relinquish control of their principal to their attorneys does not comport with this precedent.

In recent Taking Clause challenges, the United States Supreme Court has analyzed the nature of the property interest taken rather than its economic value. In *Loretto v. Teleprompter Manhattan CATV Corporation*,[230] defendants argued that cable television equipment installed on plaintiff's building was so small that it impaired no constitutional interest.[231] The Court determined that the size of the interest invaded was a matter of degree rather than of principle,[232] and accorded Taking Clause protection.[233] Most recently, the Supreme Court addressed whether the resale value of household goods was too "low" to merit protection under the Taking Clause.[234] While the Court could not reject the contention "out of hand," it indicated that this analysis contradicted state law property characterizations.[235]

It therefore appears that clients' traditional property right in using and controlling the uses of their principal cannot be denied because of its small economic value.[236] It becomes necessary for the "property" issue to rest largely on the unique nature of trust account programs and the novel assertion that interest only constitutes "property" when it exceeds its owner's expenses.

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226. 15 Cal. 3d 893, 544 P.2d 921, 126 Cal. Rptr. 785 (1976).

227. *Id.* at 903, 544 P.2d at 927, 126 Cal. Rptr. at 791.

228. ABA Comm. on Ethics and Professional Responsibility, Informal Op. 545 (1962); ABA Comm. on Ethics and Professional Responsibility, Informal Op. 991 (1967).

229. *See supra* notes 145-51 and accompanying text.

230. 258 U.S. 419 (1982).

231. *Id.* at 438 n.16. The New York Court of Appeals concluded that the economic impact on the plaintiff was de minimus. *Id.* at 445 (Blackmun, J., dissenting). It also determined that plaintiff could have no reasonable investment-backed expectation in the space since she was unaware of the cable equipment when she purchased the property. *Id.*

232. *See id.* at 436-37 & n.13, 438 n.16 ("[W]hether the installation is a taking does not depend on whether the volume of space it occupies is bigger than a bread box.").

233. *Id.* at 441.

234. United States v. Security Industrial Bank, 459 U.S. 70, 76, 78 (1982) (dicta).

235. *Id.*

236. One recent commentator surveys procedural due process deprivations and determines that "the property right itself must be significant; the loss in dollars and cents to an individual should not be dispositive." Comment, *supra* note 70, at 1025.

d. Impracticability: The Trust Account Theory of Property

(i) Plan details

In the California litigation, as in the original Florida decision that formulated the concept,[237] the impracticability argument rests on practical rather than legal support.[238] Justice Frankfurter once embraced similar common sense reasoning when he said: "[T]here comes a point where this Court should not be ignorant as judges of what we know as men."[239] Impracticability is the import of proponents' statements such as "Existing Case Law Recognizes . . . Economic Realities."[240] In *Carroll*, the California Court of Appeal described "economics" as a barrier to client investment.[241] Proponents' "property" arguments, therefore, depend in large part on impracticability as it is demonstrated in the details of the plan.

Prior to the Program, attorneys or law firms maintained single, non-interest-bearing commercial checking accounts in which they commingled all their clients' nominal or short-term funds.[242] Financial institutions used this money without paying interest and gained a substantial benefit. By requiring the institutions to pay interest on these accounts, the Program ends this practice. The financial institutions forward the net balance to the State Bar of California at least quarterly,[243] with detailed statements for each account.[244] In theory, the administrative costs and fees at this point are small enough that even nominal or short-term principal amounts are capable of generating interest in excess of these charges.[245]

If the interest were made available to the clients rather than the State Bar of California, then attorneys and law firms would incur additional fees and expenses. Attorneys receive statements from their financial institutions showing the net interest earned after subtracting the service fees. They would have to determine which clients' funds were deposited in the account during the period of the statement, the amounts

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237. *See supra* notes 169-70 and accompanying text.

238. *See id.*

239. Watts v. Indiana, 338 U.S. 49, 52 (1949).

240. State Bar Summary Judgment, *supra* note 183, at 41.

241. Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 1100, 209 Cal. Rptr. 740, 744 (1984).

242. *See generally supra* notes 19-33 and accompanying text.

243. CAL. BUS. & PROF. CODE § 6212(c) (West Supp. 1982).

244. *Id.*

245. This theory has not always proved to be true in the actual operation of the Program. In the period between May 1983 and early January 1984, approximately one-third of the trust fund accounts had not generated enough interest to offset bank service charges. Interview with Bruce Hamilton, Director, California Legal Services Trust Fund Program (Jan. 9, 1984). The Bar paid these charges with funds generated on other accounts. *Id.*

The negative balances may result from high service charges set by some banks. *Id. See supra* notes 98-102 and accompanying text.

deposited, and the portion of the net interest earned on the account attributable to each client. Computer sub-account techniques could be used for this purpose.[246] Attorneys would have to credit each client's account.[247] Perhaps checks would be written to each client for his or her portion of the interest; mailing the checks would require postage. Telephone charges might be incurred to contact the client. The entire process would necessarily require attorney, accountant or secretarial time, as well as expenses for the paper, computer and other administrative costs.

In the theory of the Program, these additional costs of sub-accounting each client's pro rata share "dissipate the benefit."[248] The basis of the Program is that nominal or short-term funds are capable of generating enough interest to offset expenses when the interest is remitted to a single source[249] (the State Bar of California), but not when it is remitted to multiple individual clients. Thus, if a client's principal will not generate enough earnings to offset all of these various expenses, the client has no property interest. According to the Program's proponents, this situation justifies transfering the earnings to legal aid programs—at least as long as the expenses are low enough to ensure a positive balance.

(ii) The theory applied

There are serious problems with this impracticability theory. It assumes that clients will receive no benefit from investing their nominal or short-term trust funds because it will cost them more in expenses than they will gain in interest. For example, if a client's net portion of the interest were $50.00, but the administrative fees and costs were $55.00, then that client would have lost $5.00. But this argument assumes that all of the costs will be charged to the client in a pro rata share. American

246. *See supra* note 32 and accompanying text; *see also* 2 IOLTA UPDATE, Spring 1985, at 5.

247. Professor Orlando Delogu of the University of Maine School of Law testified before the Supreme Judicial Court of Maine that program expenses would be reduced if attorneys adopted this method of allocating interest to individual clients. *See* Points and Authorities Re: Summary Judgment at 7-8, Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984) [hereinafter cited as Carroll Summary Judgment]. The Supreme Judicial Court of Maine rejected the proposed trust account program in early 1983. 1 IOLTA UPDATE, Summer 1983, at 2.

248. State Bar Summary Judgment, *supra* note 183, at 39.

249. The State Bar of California advised attorneys that $50.00 was a reasonable estimate of the amount of interest a given principal fund would have to generate before its earnings would offset expenses. THE STATE BAR OF CALIFORNIA GUIDELINES, *supra* note 82, at 3. The Bar conducted no independent study to determine the accuracy of this figure; it borrowed the $50.00 benchmark from the Maryland program, which designates $50.00 as a recommended investment standard. Interview, *supra* note 245. *See* MD. ANN. CODE art. 10, § 44(a)(2) (Supp. 1983). *See Minnesota Developments, supra* note 2, at 1291-93, 1309-10 (recommending specific guidelines for attorney investment to avert "taking" challenges).

In order to earn $50.00 in interest at the current 5 1/4% rate, a $500.00 principal sum would have to be held in an account for 654 days. *Id.* at 1292 n.36.

Bar Association Ethics Committee rulings prohibit attorneys from charging their clients for these costs.[250] If either the bank or the law firm absorbs the costs, or distributes the costs among all its clients, then the individual client will experience a benefit despite the loss to the system as a whole. For example, if a client's funds earn $50.00 in interest, but the law firm does not charge that client for its extra expenses in computing and forwarding the interest, then the client will gain. This would result even if the administrative expenses totaled $100.00. However unwise this system would be from the standpoint of efficiency, it cannot be said that clients cannot benefit from the investment of their nominal or short-term funds.

In fact, under current American Bar Association rulings, the likely result of this system would be that law firms would raise all of their clients' bills by some set amount rather than attempt to distribute the expenses pro rata per client. This result is also likely because the process of apportioning the expenses would be cumbersome and costly. In this instance the expenses have not been decreased, but have been diluted in the pool of all of the firm's clients.

In short, even within the confines of this impracticability argument, the notion that clients could never benefit by investing their nominal or short-term funds is highly debatable. While it may be senseless to impose a system on attorneys that would cost them more than it would benefit their clients, this does not mean that clients have no "property" for purposes of the Taking Clause.

The effect of this impracticability argument denies property status to any interest that only potentially benefits its owner. In other words, "property" is redefined as an interest that must necessarily benefit its owner. This notion is without legal support and contrary to *Webb's*. In *Webb's*, the Supreme Court warned that states may not redefine property in order to appropriate it without paying compensation.[251] As a factual matter, the interest generated for each client may be minimal.[252] But this

250. *See supra* note 228 and accompanying text.

251. Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 164 (1980). *Accord* Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 439 (1982) ("[T]he government does not have unlimited power to redefine property rights").

252. *See supra* note 249. Commentators have described "the best argument" available to proponents of trust account programs as the common law doctrine of *de minimis non curat lex*. Baker & Wood, *supra* note 1, at 358, 360-61. The thrust of the argument is that the interest sums involved are too small to deserve constitutional protection. *Id.*

This notion is contrary to cases that have held the doctine inapplicable to positive and wrongful property invasions. *See* Allen v. Stowell, 145 Cal. 666, 668-69, 79 P. 371, 372 (1905); *see also* Ives v. Edison, 124 Mich. 402, 409-410, 83 N.W. 120, 122-23 (1900) (Courts have a duty to protect persons in their property rights even though the actual property holding may be small.). The doctrine also has been excluded from use in cases of statutory interpretation. *See* Montgomery Light & Traction Co. v. Avant, 202 Ala. 404, 405, 80 So. 497, 498 (1918); Ballin v. Los Angeles County Fair, 43 Cal. App. 2d Supp. 884, 887, 111 P.2d 753, 755 (1941)

fact does not justify denying clients' ownership interest and taking the sums to benefit others without clients' consent.[253]

(iii) Traditional theory conflicts

The traditional definition of property as the right to possess, *use* and dispose of[254] physical things highlights another problem with proponents' argument. The principal sums held by attorneys are clients' property. In *Webb's*, the Court described the statute that took the interest as "appropriating for the [state] *the value of the use* of the [principal] fund for the period in which it is held."[255] The right to use property and control its uses is itself a property right which is recognized as one of the sticks in the bundle of rights.[256] Thus, the State of California has affected a property interest through the Program without regard to complicated notions of economic benefit to the owner. The fact that clients may not *necessarily* benefit from the use of investment does not justify investing the funds to benefit others without clients' consent.

e. Conclusion: Clients Have Property

It follows that clients have a property interest in the earnings generated through the Program. *Webb's* instructs that an owner of a principal sum is entitled to its earnings as the "fruit of the fund's use."[257] The state may not appropriate the interest—either by mandating its accrual,[258] or by redefining it as non-property until it exceeds a certain value.[259] Practical problems in crediting individual clients with their portions of the interest or with assessing them for their share of the expenses do not eliminate clients' property rights in controlling the *use* of their principal sums.

(quoting Feeney v. Eastern Racing Ass'n, 303 Mass. 602, 603, 22 N.E.2d 259, 259-260 (1939)). It also has been excluded when the underlying issue involves a private individual against the sovereign. United States v. Lamb, 294 F. Supp. 419, 420 (E.D. Tenn. 1968).

Under California law, the doctrine has no application when a permanent right is being adjudicated and when the judgment will carry costs. Southern Cal. Collection Co. v. Napkie, 106 Cal. App. 2d 565, 572, 235 P.2d 434, 438 (1951); *Ballin*, 43 Cal. App. 2d Supp. at 887, 222 P.2d at 755. *See* Kenyon v. Western Union Tel. Co., 100 Cal. 454, 458-59, 35 P. 75, 76 (1893). *Cf.* Tucker v. Workmen's Compensation Appeals Bd., 44 Cal. App. 3d 330, 332, 118 Cal. Rptr. 567, 568 (1975).

253. *See In re* Interest on Lawyers' Trust Accounts, 279 Ark. 84, 87, 648 S.W.2d 480, 481 (1983), *modified*, 283 Ark. 252, 254, 675 S.W.2d 355, 357 (1984).

254. *See supra* notes 140-42 and accompanying text.

255. Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 164 (1980) (emphasis added).

256. *See supra* notes 140-42 and accompanying text.

257. *Webb's*, 449 U.S. at 162. *See also* Himely v. Rose, 9 U.S. (5 Cranch) 313, 319 (1809) (Johnson, J.) ("In equity, interest goes with the principal, as the fruit with the tree.").

258. *See supra* notes 175-93 and accompanying text.

259. *See supra* notes 237-51 and accompanying text.

C. The Taking Issue

1. Can a police power regulation effect a taking?

Program proponents describe the statute as a valid police power regulation.[260] The legislation appears to regulate attorney conduct, since it prescribes how attorneys may invest their clients' funds.[261] Because the United States Supreme Court often upholds regulations such as zoning laws despite their adverse economic impact,[262] proponents equate the Program with this type of legislation.

States retain the police power as an inherent attribute of sovereignty;[263] it is "one of the most essential . . . [and] least limitable" powers of government.[264] The one major restriction courts impose on the police power is that states must only exercise it to promote the health, safety, morals, or general welfare of the community.[265] As long as a regulation has a permissible purpose and bears a reasonable relationship to that purpose, then it is a valid regulation under the Fourteenth Amendment's Due Process Clause.[266]

The police power is distinct from the governmental power of eminent domain. Through an exercise of its eminent domain powers, a state may take private property as long as it is taken for public use and "just compensation" is paid to the owner.[267] Despite conflicting United States Supreme Court precedents,[268] a state's exercise of the police power may hamper a private property interest so that it amounts to a taking under eminent domain.[269] This type of regulation is invalid because it does not

260. State Bar Summary Judgment, *supra* note 183, at 62.

261. CAL. BUS. & PROF. CODE §§ 6211-6212 (West Supp. 1984).

262. *See* Penn Central Transp. Co. v. New York City, 438 U.S. 104, 124-25 (1978).

263. *See, e.g.*, Costonis, *Presumptive And Per Se Takings: A Decisional Model for the Taking Issue*, 58 N.Y.U. L. REV. 465, 478 (1983).

264. Hadacheck v. Sebastian, 239 U.S. 394, 410 (1915).

265. *See generally*, E. FREUND, THE POLICE POWER: PUBLIC POLICY AND CONSTITUTIONAL RIGHTS §§ 4-21 (1976).

266. *See, e.g.*, Nebbia v. New York, 291 U.S. 502, 525 (1934) ("[D]ue process . . . demands only that the law shall not be unreasonable, arbitrary or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained."). *See generally* L. TRIBE, *supra* note 152, § 8.3 at 436-38.

267. *See generally* SACKMAN, *supra* note 138, § 1.11 at 1-9.

268. Taking Clause jurisprudence includes the notion that a police power regulation can never constitute a taking and the idea that a regulation becomes a taking when it goes too far. *Compare* Mugler v. Kansas, 123 U.S. 623 (1887) *with* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922) (a regulation becomes a taking when it goes too far). Professor William B. Stoebuck has identified these conflicting Supreme Court precedents as the possible source of confusion in taking law generally. Stoebuck, *Police Power, Takings, And Due Process*, 37 WASH. & LEE L. REV. 1057, 1059-63 (1980). *Cf.* Costonis, *supra* note 263, at 478-82.

269. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 432 (1982) (regulation in form of permanent physical occupation authorized by government "is a taking without regard to the public interests it may serve"); San Diego Gas & Elec. Co. v. San Diego, 450 U.S. 621, 649 n.14 (1980) (Brennan, J., dissenting) (describing cases holding that police power regu-

pay compensation.[270]

2. *What is the applicable test?*

When plaintiffs challenge a police power regulation as effecting a taking under eminent domain, there is no clear standard for distinguishing the two powers.[271] Justice Brennan acknowledged this confusion when he described "the attempt to differentiate 'regulation' from 'taking' as 'the most haunting jurisprudential problem in the field of contemporary land-use law' . . . ."[272] Commentators have identified at least nine

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lations cannot constitute takings under the Fifth Amendment "as tampering with the express language of [Pennsylvania Coal Co. v. Mahon]"); Agins v. City of Tiburon, 447 U.S. 255, 260 (1980) (zoning law "effects a taking if [it] does not substantially advance legitimate state interests . . . or denies an owner economically viable use of his land"); Penn Central Transp. Co. v. New York, 438 U.S. 104, 127 (1977) ("[A] use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose . . . or perhaps if it has an unduly harsh impact upon the owner's use of the property.").

For an extensive discussion of this issue by the Court, see the dissenting opinion of Mr. Justice Brennan in *San Diego Gas*, 450 U.S. at 646-53. Brennan wrote for a plurality on this issue. *See infra* notes 444-46 and accompanying text.

270. Aside from actual physical appropriation, "regulative" legislation also comes within the purview of the law of eminent domain if it unreasonably or arbitrarily deprives a person of the complete use and enjoyment of his or her property. SACKMAN, *supra* note 138, § 1.42 1 at 1-148 to 1-155, *quoted with approval in* Agins v. City of Tiburon, 24 Cal. 3d 266, 272, 598 P.2d 25, 28, 157 Cal. Rptr. 372, 375 (1979), *aff'd*, 447 U.S. 255 (1980).

The Court has not yet determined whether courts can compel local governments to compensate property owners rather than simply void the legislation when an attempted police power regulation effects a taking. *San Diego Gas*, 450 U.S. at 623. In *San Diego Gas*, a plurality determined that the Court had no jurisdiction over the controversy and thus refused to discuss the underlying merits. Justice Rehnquist concurred on the jurisdiction issue but agreed with "much" of the dissent's discussion of the merits. *Id.* at 633 (Rehnquist, J., concurring). The dissent embraced the idea that regulatory takings are compensable. *Id.* at 653 (Brennan, J., dissenting).

For a discussion of the possible ramifications of Brennan's dissent, see Freilich, *Solving the "Taking" Equation: Making the Whole Equal the Sum of Its Parts*, 15 URB. LAW. 447 (1983).

271. In the past the Supreme Court has acknowledged its inability to provide clear guidelines. *See, e.g.*, Ruckelshaus v. Monsanto Co., 104 S. Ct. 2862, 2874 (1984) (Court has "admitted [this inability] on numerous occasions"); *Loretto*, 458 U.S. at 440 (Blackmun, J., dissenting) ("If the Court's decisions construing the Takings Clause state anything clearly, it is [this]"); Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979); Andrus v. Allard, 444 U.S. 51, 65 (1979) ("[distinguishing the two powers] calls as much for the exercise of judgment as for the application of logic"); *Penn Central*, 438 U.S. at 124 ("ad hoc, factual inquiries"); Goldblatt v. Town of Hempstead, 369 U.S. 590, 594 (1962) ("[t]here is no set formula"); United States v. Central Eureka Mining Co., 357 U.S. 155, 168 (1958) ("question [turns] upon the particular circumstances of each case"); United States v. Caltex, Inc., 344 U.S. 149, 156 (1952) ("[n]o rigid rules can be laid down to distinguish [the two powers]"); Pennsylvania Coal v. Mahon, 260 U.S. 393, 416 (1922) ("a question of degree . . . [it] cannot be disposed of by general propositions").

272. *San Diego Gas*, 450 U.S. at 649 n.15 (Brennan, J., dissenting) (quoting C. HARR, LAND USE PLANNING 766 (3d ed. 1976)).

"tests"[273] that seek to solve the " 'Taking' Equation"[274] and with each new article a new and "better" test is proposed.[275] By characterizing California's Legal Services Trust Account Program as police power regulation, proponents have thrust its constitutionality into a legal quandary.

In a recent Fifth Amendment case, the United States Supreme Court attempted to clarify the applicable standard.[276] In *Loretto v. Teleprompter Manhattan CATV Corp.*,[277] the Court warned that although the inquiry is " 'essentially ad hoc' . . . [it] *is not standardless.*"[278] The Court established that when governmental action permanently and physically occupies private property, a taking occurs regardless of any public interests the regulation serves.[279] The Court also established that absent a permanent physical occupation, regulations "*will be analyzed* under the multi-factor inquiry generally applicable to non-possessory governmental activity."[280] The multi-factor inquiry was first articulated in *Penn Central Transportation Co. v. New York City*.[281]

a. The *Penn Central* Approach

Penn Central is the Court's most comprehensive discussion of takings law in recent history.[282] It described and categorized taking jurisprudence and identified the important factors in a taking analysis.[283] First, the economic impact on the claimant and the extent to which the regulation interferes with investment backed expectations[284] are relevant.[285] Although most government conduct affects economic values, not all private losses resulting from government conduct are compensable.[286] The Court analyzes the facts to determine whether "justice and

273. Baker & Wood, *supra* note 1, at 363.

274. *See* Freilich, *supra* note 270, at 447.

275. *See, e.g.*, Costonis, *supra* note 263, at 483-501 (recommending a four-part decisional model); Humbach, *A Unifying Theory For The Just-Compensation Cases: Takings, Regulation and Public Use*, 34 RUTGERS L. REV. 243, 289-90 (1982) (suggests distinguishing between non-compensable freedoms and compensable legally enforceable rights); Stoebuck, *supra* note 268, at 1091-94 (recommending that a taking only be found when private property is transferred to a government entity with the power of eminent domain).

276. *Loretto*, 458 U.S. at 426, 440.

277. *Id.* at 426.

278. *Id.* at 426 (emphasis added).

279. *Id.* at 440.

280. *Id.* (emphasis added).

281. 438 U.S. 104 (1978).

282. *See* Comment, *supra* note 127, at 107. The author states that *Penn Central* "rewrote the past century of just compensation law."

283. *Penn Central*, 438 U.S. at 123-28.

284. *See infra* notes 370-82 and accompanying text.

285. *Penn Central*, 438 U.S. at 124.

286. *Id.* (" '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' ") (quoting Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 413 (1922)).

fairness" require redistribution of the economic harm from a few persons to the taxpayers.[287]

The Court also considers the character of the governmental action.[288] Takings are found more readily when government physically invades property than when government adjusts economic benefits and burdens to promote the common good.[289] These basic factors are the "multi-factor inquiry."[290] The Court has consistently used these factors in taking analyses since *Penn Central*.[291]

However, the *Penn Central* Court also recognized a different approach. The Court stated that "a use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose . . . ."[292] Traditionally, this language signaled a Due Process Clause analysis of the police power rather than a Taking Clause analysis.[293] Although commentators have severely criticized this merging of due process and takings principles,[294] the Court consistently blends them.[295] This is particularly important because the *Webb's* Court applied both due process principles *and* part of the multi-factor inquiry to decide that a taking had occurred.[296]

Penn Central indicated that a taking can occur at two different levels. First, an impermissible exercise of the police power can constitute a taking. Second, even a statute that "substantially furthers important public policies"[297] can amount to a taking if it "frustrate[s] distinct in-

287. *Id.* at 123-24 (quoting Armstrong v. United States, 364 U.S. 40, 49 (1960)).

288. *Id.* at 124.

289. *Id.* (citing United States v. Causby, 328 U.S. 256 (1946)).

290. *Loretto*, 458 U.S. at 440. These factors have also been described as constituting a "balancing process." *Id.* at 435 n.12.

291. *See generally infra* notes 300-85 and accompanying text.

292. *Penn Central*, 438 U.S. at 127.

293. *See supra* notes 263-66 and accompanying text.

294. *See, e.g.*, Stoebuck, *supra* note 268, at 1081. Professor Humbach reasons that the Just Compensation Clause only addresses whether otherwise valid regulations result in takings. Humbach, *supra* note 275, at 275. The Court's statements that a taking occurs when a regulation is not reasonably necessary to effect a public purpose suggest "[t]hat the government can exceed its powers for a price . . . ." *Id.* at 275 n.156.

Judge Oakes traces this confusion to the minimal protection accorded property rights under the Due Process Clause. Oakes, *supra* note 141, at 591-96. He welcomes the substantive review of legislation affecting property interests and encourages "a new recognition of substantive due process" rather than continued use of "just compensation" to fulfill this role. *Id.* at 625-26.

For further discussion of the interplay between substantive due process and the Taking Clause, see Costonis, *supra* note 263, at 485-95. Professor Costonis recommends a separate "Due Process-Takings Inquiry" as part of his four-part decisional model. *Id. See infra* notes 394-99 and accompanying text.

295. *See generally infra* notes 310-15, 331-34, 341, 354, 356 and accompanying text.

296. *See infra* notes 304-18 and accompanying text.

297. *Penn Central*, 438 U.S. at 127 (construing Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922)).

vestment-backed expectations"[298] or acquires private resources "to permit or facilitate uniquely public functions."[299]

b. Application of *Penn Central*

In *Penn Central*, and the cases that followed, the Court emphasized one or more of the factors depending on the underlying circumstances. In some cases, such as *Penn Central*, the court analyzed each factor in the multi-factor inquiry.[300] In other cases, such as *Webb's*[301] and the recent *Loretto*[302] and *Ruckelshaus v. Monsanto, Co.*[303] cases, the Court highlighted only one factor. Although it is difficult to glean broad principles from these cases, several basic ideas stand out.

First, the Court is especially wary of government conduct that physically invades or appropriates private property. In *Webb's* a Florida statute allowed the clerk of the circuit court to invest privately-owned interpleader funds to benefit a Florida county.[304] The Court did not examine the statute's economic impact on the creditor plaintiffs nor its interference with their distinct investment-backed expectations. It chose instead to focus on the character of the government action.[305] Since the statute "forced [a] contribution to general governmental revenues,"[306] it did not "merely" adjust economic benefits and burdens to promote the common good.[307] The *Webb's* Court cited *Penn Central* and *United States v. Causby*[308] and described the statute as an "appropriation of the beneficial *use*" of property rather than a mere destruction of it.[309]

The Supreme Court also analyzed whether the statute was a permissible police power regulation.[310] The Court acknowledged that courts uphold government action that promotes the general welfare, even when the action restricts a beneficial property use.[311] But the Court could find no police power justification for the appropriation.[312] Since the Florida county had already charged a separate fee for the use of its court registry, the Supreme Court found no nexus between the use of the principal fund

298. *Id.*
299. *See id.* at 128 (construing United States v. Causby, 328 U.S. 256 (1946)).
300. *Id.* at 128-37.
301. *Webb's*, 449 U.S. at 163-64.
302. *Loretto*, 458 U.S. at 426-27.
303. 104 S. Ct. 2862, 2875 (1984).
304. *Webb's*, 449 U.S. at 155-59. *See supra* notes 173-98.
305. *Id.* at 163-64.
306. *Id.* at 163.
307. *Id.*
308. 328 U.S. 256 (1945).
309. *Webb's*, 449 U.S. at 163-64 (emphasis added).
310. *See id.* at 162-63.
311. *Id.* at 163.
312. *Id.* at 162 ("What would justify the county's retention of that interest?").

and the state's further taking of the interest.[313] Florida offered no justification,[314] and the Court found that the statute had no "reasonable basis" nor was it "reasonably related to the costs of using the courts."[315]

Thus, in *Webb's*, the appropriative character of the governmental action and the absence of a legitimate police power justification constituted a compensable taking. If the Court had analyzed the economic impact and reasonable investment-backed expectations factors, the result would be unclear. Apart from the statute, Webb's creditors had no preexisting right to earn interest.[316] Many counties retain interest earned on interpleader funds for their services and the Court expressed "no view" on these practices.[317] It seems unlikely that creditors could have reasonable investment-backed expectations in an interpleader fund. Yet, the Court did not analyze this factor and concluded that a taking had occurred.[318]

In other cases, the Court emphasized the government conduct factor despite legitimate police power justifications for the invasion or the appropriation. In *Kaiser Aetna v. United States*,[319] petitioners leased a shallow lagoon that was segregated from navigable water by a barrier beach.[320] With the permission of the Army Corps of Engineers, they converted the pond into a private marina accessible to the Pacific Ocean.[321] The United States wished to impose a navigational servitude on the marina and open it to the public, but Kaiser Aetna refused.[322] According to the Supreme Court, there was "no question" that Congress could regulate petitioners' marina under its expansive Commerce Clause authority.[323] But this regulation caused actual physical invasion of petitioners' property.[324] As in *Penn Central* and *Webb's*, the Court cited *Causby* as an example of a compensable physical invasion by govern-

313. *Id.*

314. *Id.* at 163 ("No police power justification is offered for the deprivation.").

315. *Id.*

316. *Id.* at 161.

317. *See id.* at 164-65.

318. *Id.* at 164-65 ("This is the very kind of thing that the Taking Clause . . . was meant . . . to prevent.").

319. 444 U.S. 164 (1979).

320. *Id.* at 166-67. Until 1984, large trusts owned most Hawaiian land and leased parcels to individuals and organizations. *See* Hawaii Housing Authority v. Midkiff, 104 S. Ct. 2321 (1984). Kaiser Aetna leased its property from the Bishop Estate, one of these trusts. *Kaiser Aetna*, 444 U.S. at 166-67.

321. *Kaiser Aetna*, 444 U.S. at 167-68.

322. *Id.* at 168.

323. *Id.* at 174.

324. *Id.* at 180 ("This is not a case in which the Government is exercising its regulatory power in a manner that will cause an insubstantial devaluation of petitioners' private property; rather, the imposition of the navigational servitude in this context will result in an actual physical invasion of the privately owned marina.").

ment.[325] The Court ruled that this physical invasion destroyed petitioners' "right to exclude"[326] others from its property. Thus, the Court ordered the government to pay just compensation.[327]

Similarly, *Loretto v. Teleprompter Manhattan CATV Corp.*[328] illustrates the Court's concern with the government action factor. In *Loretto*, the plaintiff owned an apartment building in New York City.[329] She challenged a New York statute that required landlords to permit a cable television company to install cable equipment on their buildings.[330] The New York Court of Appeals determined that the statute served a legitimate public purpose and thus was "within the State's police power."[331] The United States Supreme Court agreed.[332] But the Court stressed that physical intrusions by government are "unusually serious" and concluded that "the character of the government action" factor is determinitive when government action permanently and physically occupies private property.[333] In these cases, public interests served by statutes are irrelevant and a taking occurs.[334] The Supreme Court did not consider the other *Penn Central* factors. *Loretto* demonstrated that the Court is especially sensitive to police power regulations outside the traditional zoning context.[335] It also exemplifies the Court's current emphasis on the character of the governmental action factor.

Another basic idea emerges from reviewing the Court's recent Taking Clause decisions. In traditional regulatory cases,[336] the Court stresses the economic impact factor and imposes a high burden on property owners. The Court requires almost "complete destruction" of the owners' ability to profit from their property.[337]

Several cases illustrate this principle. In *Penn Central*, plaintiffs owned one of New York City's most famous buildings, the Grand Central Terminal.[338] A commission designated the building as a landmark

325. *Id.* at 180.
326. *Id.* at 179.
327. *Id.* at 180.
328. 458 U.S. 419 (1982).
329. *Id.* at 421.
330. *Id.* at 423-24. Plaintiff challenged N.Y. EXEC. LAW § 828(1) (McKinney Supp. 1982).
331. *Id.* at 425.
332. *Id.*
333. *Id.* at 426.
334. *Id.*
335. *Id.* at 439-40 & n.17. (Logical extension of proponent's arguments "would . . . allow the government to requisition a certain number of apartments as permanent government offices").
336. As used in this Note, traditional regulatory cases involve laws that seek to promote the health, safety or general welfare of the community by prohibiting or restricting property uses. *See Penn Central*, 438 U.S. at 125. Zoning laws are the "classic example." *Id.*
337. *Id.* at 127-28.
338. *Id.* at 115.

under New York's Landmarks Preservation Law.[339] When plaintiffs applied to the commission for permission to build an office tower above the terminal, they were rebuffed.[340] Plaintiffs challenged the New York statute as a taking. The Court began its analysis with police power principles; there was no dispute that the legislation was permissible.[341]

It then applied the factors from the multi-factor inquiry. It quickly dismissed plaintiffs' argument based on the character of the government action, since the law did not exploit the property for city purposes nor arise from the city's entrepreneurial activities.[342] The Court focused instead on the economic impact factor. It reasoned that existing uses of the property were unaffected and that plaintiffs obtained a "reasonable return" from these uses.[343] Additionally, the law did not abrogate all use of plaintiffs' air space.[344] Finally, plaintiffs received some compensation in the form of "transferable development-rights."[345] The Court concluded that no taking had occurred because "[t]he restrictions imposed . . . not only permit[ted a] reasonable beneficial use . . . but also afford[ed] . . . opportunities further to enhance" plaintiffs' properties.[346] In dissent, Justice Rehnquist stressed that the law imposed a cost of several million dollars per year on Penn Central.[347] He criticized the majority's rule that a taking requires destruction of "all reasonable return" on private property.[348]

Andrus v. Allard[349] is another example of this principle. Appellees traded in American Indian artifacts composed of bird feathers.[350] They challenged the Eagle Protection Act[351] and the Migratory Bird Treaty Act[352] which completely abolished their right to sell these products.[353] As in *Penn Central*, the Court began its analysis by examining whether the statutes were permissible under the police power.[354] It then applied the multi-factor inquiry.

339. *Id.* at 115-16; NEW YORK, N.Y., N.Y.C. ADMIN CODE ch. 8-A, § 205-1.0 (1976).
340. *Penn Central*, 438 U.S. at 115-17.
341. *Id.* at 129 ("[A]ppellants do not contest that New York City's objective . . . is an entirely permissible governmental goal. They also do not dispute that the restrictions imposed on its parcel are appropriate means of securing the purposes of the . . . law.").
342. *Id.* at 135.
343. *Id.* at 136.
344. *Id.* at 136-37.
345. *Id.* at 137.
346. *Id.* at 138.
347. *Id.* at 149 (Rehnquist, J., dissenting).
348. *Id.* at 149 n.13 ("Difficult conceptual and legal problems are posed by [the] rule.").
349. 444 U.S. 51 (1979).
350. *Id.* at 54-55.
351. 16 U.S.C. § 668(a) (1978).
352. 16 U.S.C. § 703 (1978).
353. *Andrus*, 444 U.S. at 56.
354. *Id.* at 58 ("The prohibition . . . is fully consonant with the purposes of the Eagle Protection Act. It was reasonable.").

The Court stressed that the government did not appropriate the artifacts nor restrain plaintiffs' ability to possess them.[355] It then addressed the economic impact of the regulation. Although the regulations prevented plaintiffs' "most profitable use,"[356] it was not clear that the statutes destroyed all "economic benefit."[357] The Court recognized that courts are "not especially competent" to predict future profits,[358] but nevertheless speculated that these appellees could "exhibit the artifacts for an admissions charge."[359]

The Court did not analyze the reasonable investment-backed expectations factor. Prior to the regulations, appellees' trade was lawful.[360] Additionally, plaintiffs composed their artifacts before Congress enacted the statutes.[361] It therefore appears that plaintiffs had reasonable investment-backed expectations in selling their wares, especially the products composed while the trade was lawful. Yet the Court did not address this factor and instead focused on the regulatory nature of the law and the fact that it allowed some possible profit for plaintiffs. The Court rejected plaintiffs' taking claim.[362]

One further case illustrates the Court's high standard for the economic impact factor in traditional regulatory cases. In *Agins v. City of Tiburon*,[363] plaintiffs purchased five acres of land in Tiburon, California. Tiburon then adopted zoning ordinances that prohibited high density development of the parcel.[364] Plaintiffs challenged the zoning ordinance as "facially unconstitutional" under the Fifth Amendment Taking Clause.[365]

As in previous cases, the Court first determined that the statute "substantially advance[d] legitimate governmental goals" under the police power.[366] It also considered the character of the government's conduct and concluded that the law validly adjusted economic benefits and burdens throughout the community.[367] The Court then addressed the economic impact of the regulation on the plaintiffs. Although the ordinances limited development, plaintiffs could still build "as many as" five

355. *Id.* at 65.

356. *Id.* at 66.

357. *See id.* at 66 ("[I]t is not clear that appellees will be unable to derive economic benefit from the artifacts.").

358. *Id.*

359. *Id.*

360. *Id.* at 53-54.

361. *Id.* at 54.

362. *Id.* at 66-68.

363. 447 U.S. 255, 257 (1979).

364. *Id.* at 257.

365. *Id.* at 258.

366. *Id.* at 261.

367. *Id.* at 262; *see supra* notes 288-89 and accompanying text.

single family homes on their five acre tract.[368] The Court decided that no taking occurred since plaintiffs could still exercise their development rights to this limited extent.[369]

One additional basic idea emerges from the Court's most recent taking analysis. In *Ruckelshaus v. Monsanto Co.*,[370] the Court stressed the reasonable investment-backed expectation factor of the *Penn Central* inquiry. In some previous decisions, the Court did not analyze this factor[371] or gave it only passing reference.[372] But in *Monsanto* the Court found this factor "so overwhelming" that it did not examine the economic impact or the governmental action factors.[373]

Plaintiff developed and produced pesticides.[374] A federal statute[375] required Monsanto to submit health, safety and environmental data to the Environmental Protection Agency ("EPA") before its products could be registered and marketed.[376] Monsanto contended that this information was valuable trade secret property and contested statutory provisions that required public disclosure of the information.[377] The United States Supreme Court accepted Monsanto's argument as to some of the information, but rejected it as to others.[378]

The Court ruled that Monsanto could have no reasonable investment-backed expectations in the data it submitted *after* the EPA enacted the public disclosure provisions.[379] The requirements were "rationally related to a legitimate government interest"[380] and Monsanto had full notice in advance.[381] Since Monsanto chose to submit the data in exchange for its own economic advantage, the law could "hardly be called

368. *Agins*, 447 U.S. at 262.

369. *Id.* at 262-63.

370. 104 S. Ct. 2862, 2875 (1984).

371. *See supra* notes 305, 316-18, 360-62 and accompanying text.

372. In *Penn Central*, the Court stated that Penn Central's "primary expectation" concerning the parcel was its "present use" as a low rise terminal with commercial rental space, 438 U.S. at 136, despite the fact that Penn Central had already entered a lease worth $3,000,000 per year that it could not perform without building the office tower above the terminal. *Id.* at 116. In *Agins*, the Court stated that appellants were "free to pursue their reasonable investment expectations" although the zoning ordinance limited appellants' ability to improve its parcel to five single family dwellings. 447 U.S. at 262.

373. *Monsanto*, 104 S. Ct. at 2875.

374. *Id.* at 2870.

375. The Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. §§ 136-136y (1975).

376. *Monsanto*, 104 S. Ct. at 2867.

377. *Id.* at 2871.

378. *Id.* at 2875.

379. *Id.* The Court accepted Monsanto's arguments as to trade secret property it submitted prior to the public disclosure requirements. *Id.* at 2877-79.

380. *Id.* at 2876.

381. *Id.* at 2875.

a taking."[382]

Monsanto is significant for two reasons. First, it exemplifies the Court's selective approach to the *Penn Central* factors. Second, it fleshes-out the reasonable investment-backed expectations factor. The Court clearly tied this consideration to the property owners' advance notice of government restrictions on their property rights.

In summary, it is clear that the United States Supreme Court applies the *Penn Central* factors selectively, and often in conjunction with police power/due process principles. When the government appropriates or invades private property, the Court stresses the character of the governmental action factor.[383] In more traditional regulatory cases, like zoning challenges, the Court stresses the economic impact factor.[384] Finally, in at least one recent case, the Court linked the reasonable investment-backed expectation factor to notice and determined that it overwhelmed the other *Penn Central* factors.[385]

c. Application of *Penn Central* to California's Program

Under *Penn Central* and its descendants, the United States Supreme Court has analyzed Taking Clause challenges in an *ad hoc* fashion.[386] The decisions reveal that due process considerations are often analyzed under the takings rubric. In addition—despite the Court's effort to set a multi-factor standard—the Court analyzes these factors selectively, depending on the underlying controversy. While it is difficult to predict the Court's approach, examination of the Court's recent decisions indicate that the California Program may constitute a taking.

(i) Due process inquiry

In *Penn Central* the Court recognized that takings occur when statutes are not reasonably related to permissible police power objectives.[387] In *Webb's*, the Court applied this basic analysis and found that the interpleader statute had no "reasonable basis" and was not "reasonably related to the costs of using the courts."[388] The *Carroll* court should have examined whether California's Program was permissible under the police power, since it is an important aspect of taking analysis.[389]

It appears that the purpose of the Program, found in an express

382. *Id.* at 2876.

383. *See supra* notes 304-09, 319-35 and accompanying text.

384. *See supra* notes 336-69 and accompanying text.

385. *See supra* notes 370-82 and accompanying text.

386. *Supra* note 271.

387. *See supra* text accompanying notes 292-99.

388. Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 163 (1980). *See supra* notes 310-15 and accompanying text.

389. In *Carroll*, the California Court of Appeal described the statute as a "regulation [that] promotes the common good, even by adjusting the benefits and burdens of economic life," but

provision of the enabling legislation,[390] is a permissible police power objective. While funding legal aid programs to benefit the indigent may raise ethical questions for the legal profession,[391] no one can seriously contend that California may not provide legal services as part of its inherent police power to promote the general welfare.[392]

The more difficult inquiry is whether the Program bears a reasonable relationship to these laudable goals.[393] The Program generates funds; funds are needed to pay attorneys fees and court costs for those persons unable to pay; therefore, the Program bears a reasonable relationship to the legitimate objectives of the statute. But this "syllogism" is not valid. Any government program that creates income would bear a reasonable relationship to virtually any permissible government goal.

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did not explain its reasoning. Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 1107, 209 Cal. Rptr. 740, 748 (1984).

390. CAL. BUS. & PROF. CODE § 6210 (West Supp. 1985) ("It is the purpose of this article to expand the availability and improve the quality of existing free legal services in civil matters to indigent persons, and to initiate new programs that will provide services to them.").

391. Traditional ethical standards prohibit attorneys from benefitting in any way from the investment of their clients' funds. *See* ABA Comm. on Professional Ethics, Informal Op. 991 (1967); ABA Comm. on Professional Ethics, Informal Op. 545 (1962); MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 9-102 (1980); CAL. RULES OF PROFESSIONAL CONDUCT Rule 8-101 (1984). Most funds generated under the Program ultimately will be received by attorneys in the form of legal fees. *See* CAL. BUS. & PROF. CODE §§ 6216(b), 6218-6220 (West Supp. 1985). Thus, California's Program and others like it appear to divert clients' property to benefit attorneys. *Cf. In re* Interest on Trust Accounts, 356 So. 2d 799, 805 (1978) (Critics contend that "the proposal . . . cast[s] a shadow of impropriety on the profession . . . . "); *In re* Interest on Lawyers' Trust Accounts, 283 Ark. 252, 675 S.W.2d 355 (1984) (prohibiting participating attorneys from acquiring earnings generated under the program and requiring notice to clients that these attorneys will receive no interest).

The American Bar Association issued a formal ethics opinion that distinguishes program participation from its previous ethics opinions on client trust funds. ABA Op. 348, *supra* note 19, at 1502. It proffers three major differences: 1) there is no conflict of interest between lawyers' own financial interests and those of their clients; 2) there is public scrutiny and accountability in the state-authorized programs; and 3) there is no commingling between lawyers' and clients' funds under the programs. *Id.* at 1506.

While these differences are clearly valid, they do not address the most basic ethical contradictions created by the programs. There may be no conflict of interest between individual attorneys and their clients, but the program clearly benefits the profession as a whole by paying attorneys' fees with interest earned on clients' funds without clients' consent. There may be public accountability and scrutiny, but the programs are administered by bar associations and other attorney organizations—an apparent conflict of interest.

The programs allow the profession to fulfill its obligations to the poor without lowering the increasingly high costs of legal services. These more comprehensive ethical considerations have not been given adequate consideration by proponents of the programs. *Cf. In re* Emergency Delivery of Legal Services to the Poor, 432 So. 2d 39 (Fla. 1983) (rejecting proposed rule requiring mandatory *pro bono* work by attorneys, while exhorting all bar members to participate in Florida's interest on trust account program).

392. *See* Baker & Wood, *supra* note 1, at 353.

393. *Id.*

For example, if the purpose of the legislation was to provide hospital care for indigent leukemia victims, it certainly would be a legitimate police power objective. The Program, in that it generates income, would be a rational means to carry out the purpose of the legislation since money is critical to providing health care. Indeed, it is hard to imagine a government program that could not be implemented with funds generated under the Program.

Professor John J. Costonis criticizes the reasonable relationship test in the taking context.[394] He believes it is fundamentally unfair to single out individual property owners to bear the cost of public programs unless there is a connection between the burdened property's use and the goal of the legislation.[395] This "use dependent" test determines whether the legislative decision is fair *in principle*. Applied to California's Program, the test asks: is it fair to impose the burden of funding legal services for the indigent on clients who forward nominal or short-term trust funds to their attorneys?[396] The test examines the relationship between the evil the Program seeks to eradicate and the current use of the property.[397] California would have to show that expanding the availability and improving the quality of existing free legal services to indigent persons[398] is linked so closely to the use of nominal or short-term client trust funds that clients have not been unfairly singled out to pay for the program without compensation.[399] Clearly, when framed in this manner, the Program seems unreasonable.

As in *Webb's*, proponents of the Program have offered no police power justification that shows a nexus between the use of the funds and the purpose of the state's appropriation of the interest.[400] There is no evidence that clients who advance nominal or short-term funds to their attorneys have any reasonable relationship to the fact that poor Californians cannot afford legal counsel. Arguments, however, could be contrived. For example, proponents could assert that legal services are beyond the means of the poor precisely because clients with money pay

394. Costonis, *supra* note 263, at 488.

395. *Id.* at 469.

396. *See id.* at 490.

397. *Id.* at 493.

398. *See* CAL. BUS. & PROF. CODE § 6210 (West Supp. 1982).

399. Costonis, *supra* note 263, at 487.

400. *See supra* notes 312-15 and accompanying text.

One Commentator asserts that IOLTA programs are "closely connected to proper state concerns." *See* Comment, *Interest on Lawyers' Trust Accounts: A Proposal for Wisconsin*, 66 MARQ. L. REV. 835, 850 (1983). He views goals of the legal profession such as keeping courts accessible and providing representation for the poor as proper police power justifications for the programs. *See id.* However, this view ignores the fact that clients' funds rather than attorneys' funds are used to generate income for the programs. *Cf. supra* note 391. Additionally, this analysis shows no connection between client trust funds and the fact that indigents cannot afford legal services.

high prices. This argument creates a connection between clients who can afford to forward trust funds to their attorneys and the high cost of legal services. However, this reasoning breaks down when one considers that the Program only applies to clients who forward nominal or short-term funds.[401] Whatever marketplace analogy could be devised, there is no way to explain how only clients with nominal or short-term funds drive up the price of legal counsel to the exclusion of the poor. It is not surprising that proponents of the Program have not attempted to link the purposes of the Program and the use of clients' trust funds.

Whether the Supreme Court would undertake this more critical analysis of the Program is uncertain. In *Loretto*, the Court rejected use dependent arguments proffered by proponents of the regulation at issue.[402] However, in doing so, it expressed the use-dependent principle that owners should not be singled out to bear losses unrelated to their use of their property.[403] Furthermore, in *Webb's* the Court sought a police power justification in the nexus between the cost of using the court registry and the deposited interpleader fund.[404] Given the extraordinary nature of California's Program, the Court may be willing to examine whether the Program is truly a reasonable means to effect its commendable purposes.

(ii) Multi-factor inquiry

The United States Supreme Court applies the three basic factors in the multi-factor inquiry selectively.[405] It chooses factors based upon the circumstances of the case. The California Program's constitutionality depends upon which factors are utilized.

When government conduct invades or appropriates private property, the Court stresses the character of the government action factor.[406] This emphasis is critical because the character of California's conduct under its Program is strikingly similar to that of Florida in *Webb's*. In

401. This distinction was the basis for opponents' equal protection arguments in Carroll v. State Bar of California, 162 Cal. App. 3d 1094, 1107, 209 Cal. Rptr. 740, 748 (1984). The *Carroll* court determined that the statute impaired "no fundamental interest," *id.* at 1108, 209 Cal. Rptr. at 749, and rejected plaintiffs' equal protection arguments. *Id.* at 1107-08, 209 Cal. Rptr. at 748-49.

402. *Loretto*, 458 U.S. 419, 438-39 & n.17.

403. The Court described the use dependency argument as proving "too much" since private property owners could be forced to devote space to third party vending machine operators or to the government for governmental offices. *Id.* Professor Costonis describes the Court's "parade of horribles" as establishing "the test's indispensability as a principled means of averting these results." Costonis, *supra* note 263, at 512. "Implicit in the Court's selection of hypotheticals is the sense . . . that, if it indiscriminately approved such claims, government could single out property owners for losses that they should not be required to bear." *Id.*

404. *See supra* note 313 and accompanying text.

405. *See supra* notes 300-85 and accompanying text.

406. *See supra* notes 305-09, 316-35 and accompanying text.

both instances, the state appropriates the beneficial use of a privately owned principal fund for itself. This conduct is not merely destruction of property or regulatory adjustment of economic benefits and burdens.[407] The Program does not merely destroy clients' ability to control investment but takes this ability for state use.

If the *Webb's* rationale is strictly applied to California's Program, the economic impact and reasonable investment-backed expectations factors will not be analyzed.[408] Since the Program is limited to small sums or those held for short durations,[409] analysis of these factors could point towards upholding the Program.

The character of California's action is also similar to that of the government in *Kaiser Aetna*. The Program destroys clients' ability to exclude others from enjoying their property.[410] The *Kaiser* Court indicated that physical invasion went beyond mere regulation.[411] Although the economic harm in *Kaiser* was substantial, the Court highlighted the character of the government's conduct and the significant nature of the owner's property interest, rather than the value of the property.[412] Like the government in *Kaiser*, the California Program appropriates private property and forces property owners to allow the public to use it.

The Program is also similar to the cable television law challenged in *Loretto*. Both statutes represent unusual police power regulations directed at important public interests.[413] The *Loretto* Court accepted the statute's goals, but recoiled against its methods.[414] While it might not be appropriate to create a per se rule to govern California's Program, as the Supreme Court did to address New York's statute, the appropriative character of California's conduct may be emphasized nonetheless. Since the Supreme Court is especially sensitive to unusual police power regulations and stresses the character of the government action factor whenever private property is taken for government use,[415] it is probable that this line of cases is applicable and that California's Program represents a compensable taking.

It is less likely that the Program would be considered a traditional police power regulation.[416] In most of these cases, the Supreme Court has stressed that the regulations adjusted economic benefits and burdens and

407. *See supra* notes 306-09 and accompanying text.

408. *See supra* notes 304-18 and accompanying text.

409. *Supra* note 91 and accompanying text.

410. *Cf. supra* text accompanying note 326.

411. *See supra* notes 324-27 and accompanying text.

412. *See supra* note 324.

413. *Compare* text accompanying notes 331-32 *with* notes 103, 390-92 and accompanying text.

414. *See supra* notes 332-34 and accompanying text.

415. *Supra* note 335 and accompanying text.

416. *See generally supra* notes 336-69 and accompanying text.

did not appropriate private property. For example, in *Penn Central* the Court found no exploitation of property for city purposes,[417] and in *Andrus* the Court emphasized that the government did not take possession of the Indian artifacts.[418]

If the Supreme Court applied this line of cases to the Program, the Program could be upheld. In these decisions, the Court stressed the economic impact factor of the multi-factor inquiry and required almost complete destruction of economic benefit. Since California's Program is limited to funds ostensibly unable to benefit their owners,[419] the Court could find no taking.

However, commentators have identified a critical difference between the *Penn Central*-type cases and trust account programs on this factor.[420] The only way clients can profit from their principal funds is to invest them.[421] In *Penn Central*, the Court stressed that plaintiffs obtained a "reasonable return" from their existing use of the Grand Central Terminal.[422] Clients gain no economic benefit from the existing use of their trust fund principal. In *Agins*, the regulation prohibited the most lucrative use of plaintiffs' parcel, but did not prevent all ability to profit from it.[423] California's Program, on the other hand, proscribes the *only* way clients can profit from their trust funds.

Concededly, the regulation in *Andrus* completely abolished the appellees' ability to sell their wares,[424] just as California's Program completely abolishes not only clients' right to earn interest on nominal or short-term funds, but also their ability to control whether their funds are invested and to direct how the earnings are used.[425] The Court in *Andrus* strained to find a way for appellees to still benefit, and speculated that they could display the artifacts for an admissions fee.[426] Although it might be possible to discern a way for clients to profit from their trust funds held pursuant to the California Program, it is unlikely. Since interest represents substantially all the value in possessing money, when the interest is taken the value of the money in terms of economic benefit has been destroyed.[427] While clients may gain other benefits from their trust funds,[428] it appears that the Court's standard for the economic impact

417. *Supra* note 342 and accompanying text.
418. *Supra* note 355 and accompanying text.
419. *See supra* notes 242-51 and accompanying text.
420. *See* Baker & Wood, *supra* note 1, at 363-64.
421. *Id.*
422. *Penn Central*, 438 U.S. at 136; *supra* note 343 and accompanying text.
423. *Agins*, 447 U.S. at 262-63; *see supra* notes 368-69 and accompanying text.
424. *Andrus*, 444 U.S. at 56; *supra* note 353 and accompanying text.
425. *See generally supra* notes 368-69 and accompanying text.
426. *Andrus*, 444 U.S. at 65-66; *see supra* notes 355-59 and accompanying text.
427. Baker & Wood, *supra* note 1, at 364.
428. The primary benefit clients gain from their trust funds is the safekeeping of their principal. *See supra* notes 219-21 and accompanying text.

factor—complete denial of profit earning ability—has been met by California's Program. Thus, the economic impact factor of the *Penn Central* inquiry could point to a taking on these facts.

Finally, the Court's most recent Taking Clause decision highlights the reasonable investment-backed expectation factor as it relates to California's Program.[429] In *Monsanto*, plaintiff could have no reasonable investment-backed expectations since it turned over secret trade information with full knowledge that the government would disclose it to the public.[430] Notice was critical to the Court's decision that no taking had occurred. While it is probable that clients had no investment-backed expectations in their trust funds in the past, it is reasonable for them to expect that once their funds are invested, they will receive the benefit. Under the *Monsanto* rationale, if clients deposited trust funds with their attorneys with full knowledge that their funds would be invested, and that earnings on nominal or short-term funds would inure to the State Bar's benefit, then clients could have no reasonable investment-backed expectations in the interest. Under California's Program, clients have no advance notice that their funds will be invested to benefit others.[431] Arguably, clients' reasonable investment-backed expectations are thwarted by California's Program under the *Monsanto* rationale.

d. Conclusion: Clients' Property Is Taken

Proponents of California's Program have characterized it as a valid police power regulation that does not constitute a compensable taking.[432] While the Supreme Court has been unable to devise a "set formula" for when a regulation constitutes a taking, it has analyzed police power principles and has used a multi-factor inquiry to make the determination.[433] Other than the fact that it promotes a legitimate police power purpose, analysis indicates that the California Program may take clients' property without just compensation in violation of the Fifth Amendment. The regulation of client trust funds is not reasonably related to the inadequacy of legal services for indigent persons in California.[434] The Program completely abrogates the only means by which clients may gain an economic benefit from their trust funds;[435] and the character of the governmental action appropriates private property to fund public interest legal assistance without notice to clients and without paying compensa-

429. Ruckelshaus v. Monsanto, 104 S. Ct. 2862 (1984); *see supra* notes 370-82 and accompanying text.

430. *Monsanto*, 104 S. Ct. at 2875-76; *see supra* notes 379-81 and accompanying text.

431. *See generally supra* notes 77-107 and accompanying text.

432. *Supra* note 260 and accompanying text.

433. *See supra* notes 271-94 and accompanying text.

434. *See supra* notes 393-404 and accompanying text.

435. *See supra* text accompanying notes 420-27.

tion.[436] The laudable purpose of California's Program should not sustain it against a Taking Clause challenge.

D. The Remedy— What remedy is available for the taking of clients' property under the Program?

The Fifth Amendment does not prohibit the government from taking private property for public use; it merely prohibits this action absent payment of "just compensation."[437] In traditional eminent domain or inverse condemnation[438] cases, courts award just compensation whenever a taking is found.[439] The payment standard is generally either the value of the owner's loss, or that of the government's gain.[440] But neither standard is applicable to takings that occur due to over-regulation.

Although Justice Holmes first formulated the concept that a police power regulation could become a taking in 1922,[441] the Supreme Court and the states' highest courts have never awarded compensation in these cases.[442] Instead, courts invalidate the legislation rather than award compensation.[443]

In 1980, the Court decided a case that may herald a change in this dichotomy between regulatory takings and traditional takings. In *San Diego Gas & Electric Co. v. San Diego*,[444] a plurality determined that regulatory takings must be compensated for the period that the regulation was in force.[445] This determination, however, is not yet the official

436. *See supra* notes 406-15, 429-31 and accompanying text.

437. U.S. CONST. amend. V.

438. The phrase 'inverse condemnation' generally describes a cause of action against a government defendant in which a landowner may recover just compensation for a 'taking' of his property under the Fifth Amendment, even though formal condemnation proceedings in exercise of the sovereign's power of eminent domain have not been instituted by the government entity.

San Diego Gas & Elec. Co. v. San Diego, 450 U.S. 621, 638 n.2 (1980) (Brennan, J., dissenting) (citations omitted).

439. *See, e.g., id.* at 654 (Brennan, J., dissenting) ("[T]he just compensation requirement in the Fifth Amendment is not precatory."); United States v. Clarke, 445 U.S. 253, 257 (1980) (The Fifth Amendment is "self-executing" with respect to compensation.); Jacobs v. United States, 290 U.S. 13, 16 (1933) (A duty to pay is "imposed by the [Fifth] Amendment.").

440. *See generally*, Baker & Wood, *supra* note 1, at 365-66.

441. Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) ("The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.").

442. *See* Freilich, *supra* note 270, at 448.

443. *Id.*

444. 450 U.S. 621 (1980).

445. *Id.* at 653 (Brennan, J., dissenting). *See supra* note 270.

view of the Court on this issue.[446]

As the law stands currently, clients' remedy will be invalidation of the Program rather than just compensation. Under *Agins v. City of Tiburon*,[447] compensation is an improper remedy in California. Thus, the Program would not survive a successful appeal of *Carroll v. State Bar of California*[448] on the Taking Clause issue.

Conclusion

California's Legal Services Trust Account Program is based on a concept first introduced in this country by the Florida Bar Association.[449] Under the Program, California attorneys must[450] abandon their traditional trust account practice, which was to commingle numerous clients' funds in single, non-interest-bearing checking accounts.[451] The Program requires attorneys to invest all nominal funds or those that the attorney will hold for short periods, for the benefit of the State of California Bar Association.[452] The Bar, in turn, distributes the funds to legal aid centers that service the impoverished.[453] While the concept is laudable and the means have generated over $12,000,000 since the Program became operational in March of 1983,[454] the Program may violate the Taking Clause of the Fifth Amendment of the United States Constitution.

The argument that clients have no property rights in the interest is unlikely to withstand constitutional scrutiny. The United States Supreme Court decision of *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[455] established that states may not take interest earned on a private principal fund—either by mandating that interest be earned[456] or by

446. Professor Freilich identifies several cases nationwide that have cited the Brennan dissent rather than await a majority opinion on this issue. *See* Freilich, *supra* note 270, at 450 n.12.

Recently, plaintiffs in a California inverse condemnation action claimed compensation for a regulatory taking citing *San Diego Gas*. Aptos Seascape Corp. v. County of Santa Cruz, 138 Cal. App. 3d 484, 492, 188 Cal. Rptr. 191, 195 (1982). The Court of Appeals rejected the argument, stating: "While the United States Supreme Court may eventually conclude that California cannot limit the remedy available for a taking to non-monetary relief, it has not yet done so . . . ." *Id.* at 494, 188 Cal. Rptr. at 196. The California rule under Agins v. City of Tiburon, 24 Cal. 3d 266, 278, 598 P.2d 25, 32, 157 Cal. Rptr. 372, 379 (1979) is that compensation for a regulatory taking is unavailable.

447. 24 Cal. 3d 266, 598 P.2d 25, 157 Cal. Rptr. 372 (1979), *aff'd* 447 U.S. 255 (1979).

448. 162 Cal. App. 3d 1094, 209 Cal. Rptr. 740 (1984).

449. *See supra* notes 13-15 and accompanying text.

450. *See supra* notes 83-85 and accompanying text.

451. *See generally supra* notes 19-35 and accompanying text.

452. *See supra* notes 91-96 and accompanying text.

453. *See supra* notes 103-07 and accompanying text.

454. *See supra* notes 125-26 and accompanying text.

455. 449 U.S. 155 (1980).

456. *See supra* notes 175-93 and accompanying text.

redefining the property.[457] Additionally, traditional property formulations have recognized that the legal right to use property is itself a property right.[458]

The California Program's proponents have argued that it constitutes a valid police power regulation that legitimately impairs economic values. Although the law in this area is uncertain,[459] the Court's recent Taking Clause decisions indicate the applicable considerations.

In *Loretto v. Teleprompter Manhattan CATV Corp.*,[460] the Court stated that regulations "will be analyzed"[461] under a multi-factor inquiry first articulated in *Penn Central Transportation Co. v. New York*.[462] California's Program may be unable to withstand this analysis since it completely abrogates clients' ability to gain an economic benefit from their principal.[463] In addition, the Program transfers the economic benefit from private owners to the state without just compensation.[464] When clients have no notice that interest generated on their principal will benefit others, it is reasonable for them to expect to receive that interest.[465] Finally, the Program's regulation of clients' funds may not be reasonably related to its purpose of expanding and improving free legal services to the poor.[466]

The trust account concept is innovative[467] and effective.[468] Its constitutional difficulties under the Taking Clause could be eliminated by restoring notice and client control over the investment.[469] While these features may create destructive precedent for the IRS,[470] further validation of the present California Program under the United States Constitution will create destructive precedent of Constitutional proportions. The praiseworthy purpose and effect of California's Legal Services Trust Account Program do not and cannot override the Fifth Amendment of the United States Constitution.

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457. *See supra* notes 237-51 and accompanying text.

458. *See supra* notes 141-42 and accompanying text.

459. *See supra* note 271.

460. 458 U.S. 419 (1982).

461. *Id.* at 440.

462. 438 U.S. 104 (1977).

463. *See supra* notes 420-28 and accompanying text.

464. *See supra* notes 406-15 and accompanying text.

465. *See supra* notes 429-31 and accompanying text.

466. *See supra* notes 387-404 and accompanying text.

467. *See supra* text accompanying note 13.

468. *See supra* notes 125-26 and accompanying text.

469. *See supra* notes 38-50, 114-18 and accompanying text.

470. *See supra* notes 38-50, 114-18 and accompanying text; *see also In re* Interest on Lawyers' Trust Accounts, 672 P.2d 406, 408 (Utah 1983) (Stewart, J., writing separately) (IRS administrative complications insufficient justification for approving program that does not require client consent).

Over sixty years ago, Justice Holmes warned that even the most laudable public interest goals do not substitute for constitutional procedures.[471] California's Legal Services Trust Account Program, may exemplify a public interest program that is "too good to be true" for constitutional requirements.[472]

471. "We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutinal way of paying for the change." Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 416 (1922).

472. *See supra* text accompanying note 6.