



From the November 20, 2001 NLADA Update

9th Circuit En Banc Panel Finds Washington State's IOLTA Program Constitutional

In a decision of great importance to the equal justice community, on November 14 an en banc panel of the U.S. Court of Appeals for the 9th Circuit overturned an earlier decision by a three-judge panel of that court in affirming the constitutionality of the Washington IOLTA program under the 5th Amendment to the U.S. Constitution.

Judge Kim McLane Wardlaw wrote the opinion on behalf of a 7 – 4 majority of the court. Judge Wardlaw's opinion reaffirmed the earlier district court decision upholding, on other grounds, the validity of the Washington IOLTA program under the 5th Amendment. That decision was overturned by a three-judge panel in *Washington Legal Foundation v. Legal Foundation of Washington*, 236 F.3d 1097 (9th Cir. 2001), holding that the IOLTA program was a per se taking of client property. The en banc panel's decision finds no 5th Amendment violation and remands the case to the district court for consideration of the appellant's 1st Amendment claims.

ANALYSIS OF THE DECISION

Factual Background. This case, brought by the Washington Legal Foundation, on behalf of itself and four individual plaintiffs, challenged the constitutionality of a certain aspect of the Washington IOLTA program under the 1st and 5th amendments to the U.S. Constitution. In 1995, the state of Washington extended the applicability of the IOLTA program to Limited Practice Officers (LPO), state licensed nonlawyers who prepare legal documents for title or escrow companies incident to real estate transactions. Money deposited in short-term accounts in connection with these transactions by LPOs must be deposited in interest bearing IOLTA accounts. The four individual plaintiffs challenging the program in this case were two individuals who regularly purchase and sell real estate and two employees of title and escrow services organizations.

Majority Legal Analysis. The court analyzed the case with respect to a number of legal issues critical to the underpinnings of the IOLTA program nationwide. These included:

1) Standing. The court first considered the standing of the various plaintiffs in the case to challenge the IOLTA program. The opinion found that the two individual plaintiffs whose money was actually subject to being deposited in an IOLTA account had standing to challenge the program, given that they owned the principal and interest generated by the property under the U.S. Supreme Court's decision in *Phillips v.*

Washington Legal Foundation, 524 U.S. 156 (1998). The other two plaintiffs who worked for the escrow companies were found not to have standing, in that they did not own the principal and, therefore, the interest that is the subject of the lawsuit. The Washington Legal Foundation was likewise found to lack representational standing. In so finding, the court drew an important distinction between itself and the 5th Circuit in its recent decision in the Texas IOLTA case, *Washington Legal Foundation v. Texas Equal Access to Justice Foundation*, (5th Circuit, No. 00- 50139) – Reported in November 1, 2001 Edition of the *NLADA Update*.

In finding that the Washington Legal Foundation lacked standing, the 9th Circuit found that prospective injunctive relief is not appropriate in a 5th Amendment takings case, before the question of whether just compensation is due has been addressed. The potential for such injunctive relief formed the basis for the Washington Legal Foundation's standing claim.

2) Ripeness. The Legal Foundation of Washington (the Washington IOLTA program) had argued that the case was not ripe for decision, in that the appellants should first have sought just compensation from the state of Washington if any taking had occurred. The court ruled against this claim, citing the lack of an appropriate state mechanism to pursue compensation and the fact that the program is ultimately administered by the Supreme Court of the State of Washington, a defendant in the case.

3) The 5th Amendment Analysis.

For the first time in the recent series of IOLTA cases, the 9th Circuit provided a comprehensive analysis of all three prongs of the 5th Amendment test: 1) was there a property interest, 2) that was taken and 3) without just compensation. Noting the “trifurcation” of this analysis into its component parts in the Washington District Court decision, *Phillips* and the subsequent Texas cases, the court fully analyzed the Washington program under all three tests. In doing so, the 9th Circuit held:

Is there a property interest in the two appellants with standing?

Yes. While the Legal Foundation of Washington argued that the *Phillips* decision could be distinguished on differences between Texas and Washington property law, the court held that the *Phillips* doctrine of interest following principal applied to this case and created a property right in the interest in the appellants with standing.

Has there been a taking of property?

No. In the heart of its analysis, the court overturned the three-judge panel finding that the Washington IOLTA program amounted to a per se taking of property. That finding formed the basis of the recent 5th Circuit decision as well. Judge Wardlaw's decision turned on her finding that the “ad hoc” analysis central to the decision in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978) was controlling in this case rather than the “per se” test set out in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) that was applied by the three-judge panel and the 5th Circuit. The ad hoc analysis requires a court to perform an essentially factual inquiry into the individual property acquired to determine whether the acquisition

amounts to a taking. The per se analysis, on the other hand, assumes that for certain types of property interests, governmental acquisition amounts to a categorical taking under any circumstance. The critical distinction reached in this opinion is based, among other factors relating to the state's regulatory functions, upon the fact that prior per se cases involved real property, rather than money as in the case of the IOLTA program. The court recognized that states have traditionally exercised a great deal of control over commercial dealings and found a number of distinguishing characteristics between the commercial regulation of moneyed transactions and a permanent, physical invasion of real property. Judge Wardlaw noted that the highly regulated nature of the banking industry creates the expectation that commercial transactions, including bank deposits, will be government regulated. In drawing the critical distinction with the *Loretto* per se analysis, the court said: "While allowing an apartment owner to allow the 'direct physical attachment of plates, boxes, wires, bolts, and screws to the building' is directly contrary to the history and tradition of property law, regulating what a bank depositor may earn on a particular bank de-posit is concordant with the history and tradition of banking practice" (en banc decision, No. CV-97-00146- JCC, pp. 15671-15672). In reaching this conclusion, the court specifically noted the 5th Circuit's opinion and rejected that analysis. In applying the ad hoc analysis to the Washington IOLTA program, the court found no taking in that:

- 1) Since no interest would be generated by the owners' principal if not for the IOLTA program, there was no direct economic impact on them. In making this finding the court pro-vided a detailed analysis as to why the loss of "earnings credits" previously given by banks to escrow companies for placing deposit accounts in their institution did not create a property interest in the potentially reduced escrow costs levied on the owners of the deposits;
- 2) No reasonable investment-backed expectation was lost by the depositors, since without the existence of the IOLTA account no interest would be generated by the deposit; and
- 3) The government did not act unfairly in dictating that all interest must go to IOLTA in that a public need (legal services) was being addressed and that, in the context of the banking industry, regulation of particular types of deposits is often the subject of banking regulation. The appellants had argued that, once interest is created, they have a right to determine what – if anything – is done with that interest.

Is just compensation due? No. Even though the court found no taking in this case, it went on to state a second reason why no 5th Amendment violation existed in the case of the Washington IOLTA program. The court held that, even if there had been a taking, "the compensation due (appellants) for any taking of their property would be nil" (Opinion p. 15680). This finding was based upon a long line of 5th Amendment cases holding that just compensation requires simply placing the property owner in the same position pecuniarily as if the property had not been taken. The question is not affected by what the state might gain from its use of the property. In recognizing that, at most, appellants would have had the right to keep their principal from earning interest,

the court placed no economic value on that loss. Judges Schroeder, Fisher, Pregerson, Tashima, Berzon and Rawlinson joined Judge Wardlaw in the majority.

Dissent. Judge Alex Kozinski, joined by three other judges, wrote a dissent, supporting the per se takings analysis used by the three-judge panel and the 5th Circuit. In doing so he distinguished the *Penn Central* ad hoc analysis on the grounds that the real distinction between the two tests was between “regulatory takings” where the government does not take the property outright, but rather regulates its use for a regulatory purpose, and the actual taking of property for a public purpose. Judge Kozinski saw no difference between real and personal property (including money) in a takings context, analogizing the taking of money to the government taking a Renoir from someone’s wall to exhibit in a museum.

The bulk of the dissent, however, consisted of Judge Kozinski attaching Judge Kleinfeld’s opinion on behalf of the three-judge panel in the case. Judges Kleinfeld, Trott and Silverman joined him in dissent.

Remand. The 9th Circuit, for the reasons stated above, affirmed the district court’s grant of summary judgment for the Washington IOLTA program on its 5th Amendment claims and remanded for consideration of the appellants’ free speech claims under the 1st Amendment.

This decision is a tremendous victory for the entire equal justice community, although a long run of continuing appeals is likely to keep the issue alive until final resolution by the U.S. Supreme Court. In the meantime, IOLTA programs across the country continue to be fully operational. NLADA would like to offer its congratulations and thanks for the tremendous advocacy of the many pro bono lawyers involved in the appeal, in particular David Burman of Perkins Coie in Seattle, who argued the case, and his colleagues Nick Gellert and Kathleen O’Sullivan. Tom Brown of Heller Ehrman White & McAuliffe in San Francisco, Steve Rummage of Davis Wright Tremaine in Seattle, and the Florida Justice Institute also provided outstanding representation as counsel for the various amici curiae, including NLADA, in the case.

The decision can be read at http://www.nlada.org/Civil/Civil_IOLTA

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