NO. 01-1325

IN THE SUPREME COURT OF THE UNITED STATES

WASHINGTON LEGAL FOUNDATION, ALLEN D. BROWN, DENNIS H. DAUGS, GREG HAYES, AND L. DIAN MAXWELL,

Petitioners,

v.

LEGAL FOUNDATION OF WASHINGTON; KATRIN E. FRANK, IN HER OFFICIAL CAPACITY AS PRESIDENT OF THE LEGAL FOUNDATION OF WASHINGTON; AND GERRY L. ALEXANDER, BOBBE J. BRIDGE, THOMAS CHAMBERS, FAITH IRELAND, CHARLES W. JOHNSON, BARBARA A. MADSEN, SUSAN OWENS, AND CHARLES Z. SMITH, IN THEIR OFFICIAL CAPACITIES AS JUSTICES OF THE SUPREME COURT OF WASHINGTON,

Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF THE JUSTICES OF THE WASHINGTON SUPREME COURT

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QUESTIONS PRESENTED

The Supreme Court of Washington regulates the practice of law, including handling of client funds by the legal professionals that it licenses. The regulation challenged in this case, Washington's IOLTA (Interest On Lawyer Trust Accounts) rule helps ensure that client funds (1) earn net interest for the client whenever they are capable of doing so; (2) are not used for the benefit of the licensed legal professional when they are incapable of earning net interest for the client; and (3) in the latter circumstance, are placed in an interest-bearing account authorized by federal law. Interest on these IOLTA accounts funds public legal services, including legal services for the indigent. Admission to Practice Rule 12(h), 12.1.

1. Does Washington's rule effect a taking of interest on IOLTA accounts under the Fifth Amendment?

2. If Washington's IOLTA rule effects a taking, are Petitioners entitled to anything by way of "just compensation" when they could not realize net interest on their funds in the absence of the challenged rule?

3. When Washington provides an adequate state remedy to secure just compensation, may its IOLTA rule be enjoined?

STATEMENT OF THE CASE

The Washington Supreme Court regulates the practice of law, including the handling of client trust funds, to ensure ethical conduct by attorneys and other licensed legal professionals. The regulation challenged in this case, Washington's Interest On Lawyer Trust Accounts (IOLTA) rule, discourages licensed legal professionals from self-dealing with respect to client trust funds. Prior to adoption of the challenged IOLTA rule, licensed legal professionals placed client trust funds in non-interest-bearing accounts. In effect, these non-interest-bearing client deposits amounted to interest-free loans to the banks in which they were placed and generated additional profit making opportunity for those institutions. Before the challenged IOLTA rule, banks receiving deposits of non-interest-bearing client funds indirectly compensated licensed legal professionals in return for placement of such deposits. This was done through payment of financial incentives for the benefit of the licensed legal professionals or their employing firms. Legal professionals thus exploited client trust funds for self-gain while the client earned nothing. The availability of financial rewards in return for non-interest-bearing client deposits risked tainting the legal professional's judgment with considerations of self-interest, rather than client-interest, in placing client funds.

The challenged IOLTA rule ameliorates this risk of self-interest on the part of licensed legal professionals by banning non-interest-bearing accounts for client trust funds. It thus requires such client trust funds to be deposited in an interest-bearing account for the benefit of the client whenever the funds can earn net interest for the client; and in an interest-bearing account for the benefit of an independent nonprofit organization, the Legal Foundation of Washington, when the funds are incapable of earning net interest for the client. In this way, the rule helps remove financial incentives that attended non-interest-bearing client accounts and that created conflicts of interest for licensed legal professionals. The challenged IOLTA rule requires interest earned on IOLTA accounts to be paid to the Legal Foundation of Washington, an independent nonprofit organization created under the authority of the Washington Supreme Court to fund civil justice programs and organizations, including organizations providing legal services to the indigent. Unlike the banks that received non-interest-bearing client deposits prior to the adoption of IOLTA, the Legal Foundation of Washington (LFW) is not in a position to influence licensed legal professionals in placing client funds because the licensed legal professional is required to deposit client trust funds that are incapable of generating net interest for the client in an interest-bearing IOLTA account. And, in turn, LFW directs interest earned on IOLTA accounts to organizations that provide public legal services. Thus, under IOLTA, it is not possible for the licensed legal professional to benefit directly or indirectly from the client's trust funds.

A. History Of IOLTA Relating To Lawyers

Washington's IOLTA program was established by rule of the Washington Supreme Court in 1984 as part of Washington's ethical rules governing the practice of law. *IOLTA Adoption Order*, 102 Wash. 2d 1101, 1102 (1984), JA at 149. As originally adopted, Washington's IOLTA rule applied only to attorneys. Washington Rule Of Professional Conduct (RPC) 1.14, App. at 99a-102a.

Prior to adoption of the IOLTA rule, Washington's rules of professional responsibility did not govern an attorney's conduct with respect to investing client trust funds held in connection with providing legal services. As the Washington Supreme Court observed in the *IOLTA Adoption Order* in 1984, then existing rules of professional responsibility "d[id] not address the question of whether attorneys must invest such funds for the benefit of clients". *IOLTA Adoption Order*, 102 Wash. 2d at 1102, JA at 149. In general, the rules provided that "attorneys must hold client trust funds in accounts separate from their own funds, and are obligated to maintain complete records and pay the funds over to the clients or others as soon as they are entitled to receive them". *Id*. See also American Bar Association Formal Opinion 348 (1982), concluding that in most instances where a lawyer is entrusted with client funds, the lawyer is merely under a duty to safeguard the funds and is not liable for interest for failing to invest them. At the same time, the *IOLTA Adoption Order* recognized that common law principles relating to trustee ethics informed the ethical conduct of attorneys. JA at 149. In the *IOLTA Adoption Order*, the Washington Supreme Court observed that a trustee may not "misus[e] trust funds for his or her own pecuniary advantage" and "only the interests of the client (as opposed to the interests of the trustee or a third party) can be considered". JA at 163.

In the *IOLTA Adoption Order*, the Washington Supreme Court explained that prior to IOLTA, lawyers "usually" invested client trust funds in interest-bearing accounts and paid the interest to clients when it was economically feasible to do so. By the same token, the Washington Supreme Court recognized that when Washington lawyers received client trust funds that could not generate net interest for the client, because the costs of establishing and administering an interest-bearing account would exceed any interest that could be earned, "most attorneys" simply deposited the funds into a single non-interest-bearing trust checking account. *IOLTA Adoption Order*, 102 Wash. 2d 1102, JA at 149-50. Such deposits effectively provided interest-free loans to the banks in which they were placed. *See IOLTA Adoption Order*, 102 Wash. 2d at 1102, JA at 150 ("The banks . . . have received the interest-free use of client money."). The court below described the holding banks as receiving "a great windfall from these accounts". *Washington Legal Found. v. Legal Found. of Washington*, 271 F.3d 835, 842 (9th Cir. 2001) (en banc), App. at 4a.

In *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998), this Court recognized that two circumstances combined to result in this treatment of client funds. The first was the need for "ready access" to client funds. *Id.* at 160. Second, prior to 1980, federal law prohibited federally insured banks from paying interest on checking accounts. *Id.* Thus, a pooled non-interest-bearing checking account was the banking vehicle available and typically used by lawyers to hold client funds that could not generate net interest for the client. This left to banks the substantial additional value that such non-interest-bearing accounts generated. In 1980, Congress authorized interest-bearing demand accounts, Negotiable Order Of Withdrawal (NOW) accounts, in limited circumstances. The entire beneficial interest in a NOW account must be in one or more individuals, or a nonprofit organization operated primarily for religious, philanthropic, charitable, educational, political or similar purposes. 12 U.S.C. § 1832.

This federal authorization and limitation is integral to Washington's IOLTA rule. Admission to Practice Rule (APR) 12.1 requires client funds that cannot earn net interest for the client (funds previously deposited in a non-interest-bearing account) to be deposited in a NOW account. Consistent with federal regulations authorizing such accounts, interest on these accounts is paid to the Legal Foundation of Washington, a nonprofit organization created under the auspices of the Washington Supreme Court, for the purpose of funding providers of legal services to indigent people. JA at 166.

With the adoption of IOLTA, for the first time, Washington's rules of professional conduct required lawyers receiving client trust funds to place the funds in an interest-bearing account for the benefit of the client, in every circumstance where they could generate net interest for the client. With the adoption of IOLTA, for the first time, Washington's rules of professional conduct required lawyers who received client trust funds that could not under any circumstances generate net interest for the client to pool the client's funds with other like client funds in an interest-bearing NOW account, commonly known as an IOLTA account. Consistent with federal banking restrictions, the interest on IOLTA accounts benefits a nonprofit organization that provides legal services funding.

Washington's rule authorizes the deposit of client trust funds in an IOLTA account only when it is not possible for the funds to earn net interest for the client. *IOLTA Adoption* Order, 102 Wash. 2d at 1101, JA at 149 ("[W]e make clear that those funds available for the IOLTA program are only those funds that cannot, under any circumstances, earn net interest (after deducting transaction and administrative costs and bank fees) for the client.") In this respect, the rule is "self-adjusting", requiring legal professionals to invest more client trust funds for clients as more cost-effective accounting services become available and make it possible to earn net interest on "increasingly smaller amounts held for increasingly shorter periods of time". *Id*. at 1114, JA at 165. The rule directs attorneys to consider all available means of achieving net interest, by exploring banking mechanisms such as a "pooled interest-bearing trust account with subaccounting that will provide for computation of interest earned by each client's funds and the payment thereof to the client". RPC 1.14(c)(2)(ii), App. at 101a. Furthermore, the Court set forth specific criteria for determining whether a client's funds could earn net interest, rather than leaving that determination to the attorney's unfettered and unguided discretion. RPC 1.14(c)(3)(i)-(iii), App. at 101a.

Put differently, there is nothing in IOLTA itself that denies any client the opportunity to earn net interest if it is possible to do so. To be sure, costs unrelated to IOLTA and beyond the control of the Washington Supreme Court might make it relatively more costly for an individual client to earn interest – such as federal income tax regulations, the costs of a lawyer's time, the fees charged by banks, and the costs involved with tracking an individual client's interest. But these costs are not incurred as a result of IOLTA.[1]

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[1] These costs help explain why the LFW can realize net interest whereas individual clients cannot. *See* Br. of the Chief Justice and Justices of the Supreme Court of Texas as *Amici Curiae* in Support of Respondents. First, a client's net interest is taxable. 26 C.F.R. § 1.61-7. A client would also be taxed if he or she were to control which charitable institution receives the net interest from a NOW account. *See Phillips*, 524 U.S. at 162, 170-71. Second, the LFW quite plainly does not have to pay a lawyer for the time spent establishing and administering an account. Third, it is less costly to administer an interest-bearing account where all the interest is paid to a single recipient than it is to administer such an account where various recipients receive individual portions of all the accrued interest – especially where many individuals contribute varying amounts in principal for different lengths of time. Because IOLTA is self-adjusting, however, if these costs lower to the point where some clients would be able to earn net interest, then IOLTA *requires* an attorney to pursue that course on his or her client's behalf. *See IOLTA Adoption Order*, 102 Wash. 2d at 1114, JA at 165 (if it becomes "possible to earn net interest for clients on increasingly smaller amounts held for increasingly shorter periods of time, more trust money will have to be invested for the clients' benefit under the new rule").

None of this is to say that the State *creates* the property at issue, for this Court has already held to the contrary. *Phillips*, 524 U.S. at 170. Rather, it is to say that costs borne by individual clients who would seek to earn net interest do not have to be borne by the LFW. In other words, the LFW is subject to fewer costs, and it may therefore realize net interest where individual clients could not. Neither the higher costs for individual clients nor the lower costs for the LFW are products of IOLTA itself.

B. History Of IOLTA Relating To Limited Practice Officers

In 1981, the Washington Supreme Court held that the selection and completion of legal documents necessary to effectuate property transactions constitutes the practice of law. *Bennion, Van Camp, Hagen & Ruhl v. Kassler Escrow, Inc.*, 635 P.2d 730 (Wash. 1981). At that time, it had become common for such services to be provided by escrow and title companies without the benefit of a lawyer. Shortly thereafter, the Washington Supreme Court adopted rules to license and regulate legal professionals to perform these functions. APR 12. These licensed legal professionals are referred to as "limited practice officers" (LPOs), or sometimes as "certified closing officers".

In 1995, the Washington Supreme Court considered a proposal to apply the state's IOLTA rule to transactions handled by LPOs, in addition to lawyers. The Washington Supreme Court received public comment on the proposal to extend the IOLTA rule to LPOs and solicited argument. In a brief arguing for application of the IOLTA rule to LPOs, the Washington State Bar Association noted that LPOs and lawyers are similarly situated with respect to the rule and pointed out that escrow and title companies employing LPOs were receiving substantial indirect benefits from banks in return for placing non-interest-bearing client deposits. JA at 142-46. The Bar Association's brief expressed concern that such benefits fostered the potential for LPOs serving their own self-interest, rather than client-interest, in handling client funds and in handling their legal transactions. JA at 142-46. It is worth quoting that brief at some length to illustrate the ethical considerations at stake:

> "Certified closing officers are in the same position as lawyers. . . .
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> "Escrow companies, title companies, and bank/lending institutions breach their fiduciary duties as trustees whenever they receive benefits from their trust accounts. This Court should not permit certified closing officers, who are licensed by the Court, to facilitate this breach of fiduciary duty . . . . A trustee is prohibited from accepting any benefit from the funds of the beneficiary . . . . The reason for this rule is simple and sound – if the trustee is permitted to receive a benefit, *even indirectly*, he or she will be tempted to use the services of the institution paying the benefit, even if that might not be in the best interest of the beneficiary. The Department of Licensing has recognized this principle in its regulations, providing that escrow companies 'shall hold the funds in trust for the purposes of the transaction or agreement and shall not utilize such funds for the benefit of the agent or any person not entitled to such benefit.' WAC 308-128E-011[2]
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> "Despite these clear principles of trust law, it is acknowledged that escrow companies and title companies derive an indirect benefit

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[2] The section of the Washington Administrative Code cited in the Brief of the Washington State Bar Association (§ 308-128E-011) was subsequently replaced (with non substantive changes) by Washington Administrative Code § 208-680E-011.

> from their client funds held in trust. *This Court stated in its letter calling for briefs, 'Both the escrow companies and the title companies admit they receive from their banks significant economic benefits from their trust account deposits.'*. . .
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> "Certified closing officers licensed by this Court should not be permitted to facilitate a breach of trust by their employers, who clearly are deriving a benefit from their customers' funds. However inadequate the ethics of the marketplace, this Court should not countenance its own licensees' participation in this breach . . . ." Brief of Washington State Bar Association in Support of Proposed Admission to Practice Rule 12(*h*) at 28-32 (Feb. 2, 1994) (emphasis added), *reprinted in* JA at 142-45.

Two months later, the Washington State Bar Association followed up this point in a letter to the Washington Supreme Court. In that letter, the Bar Association reminded the Court that it had argued in its brief "the impropriety of escrow and title companies deriving indirect benefits from their client funds held in trust, and the particular impropriety of the participation in these activities by closing officers certified by this Court". JA at 146.

The ethical difficulties presented by allowing licensed legal professionals to deposit client funds in non-interest-bearing accounts thus were well-known to the Washington Supreme Court. Non-interest-bearing accounts created additional profits for banks, and those additional profits were used to provide incentives for licensed legal professionals to direct non-interest-bearing client deposits to the offering banks. Legal professionals thus exploited the client's funds for the legal professional's gain.

These concerns were, of course, well-founded. Petitioners acknowledge that firms employing LPOs received benefits from their banks in return for non-interest-bearing client deposits, in the form of "earnings credits", prior to APR 12.1. Pet. at 5. These credits were a function of the size of the non-interest-bearing deposits, the period the deposits were held, and a contracted percentage rate. They benefited escrow and title companies who used them to pay for accounting and other services provided to them by third parties. This practice existed despite a state regulation that prohibited escrow agents from using such funds for their own benefit. Wash. Admin. Code § 208-680E-011 (an "escrow agent shall be responsible for all funds received from any principal or any party to an escrow transaction . . . and shall not utilize such funds for the benefit of the agent or any person not entitled to such benefit").

Washington's relatively recent consideration of IOLTA in the context of LPOs thus provides clear insight into marketplace opportunities for legal professionals in directing the deposit of client funds when banks are not required to pay interest on such funds. Washington's experience also makes apparent the opportunity for legal professionals to serve self-interest, rather than their client's interest, in placing client funds, in the absence of the IOLTA rule.

Indeed, Petitioners readily acknowledge, as they must, that prior to Washington's adoption of APR 12.1, escrow and title companies "placed customer trust funds into "non-interest-bearing checking accounts" (Pet. Br. at 5) and that "although banks have not paid interest on escrow accounts, in lieu thereof they have provided what are referred to in the industry as "earnings credits'" to escrow and title companies. Pet. Br. at 6. Petitioners explain that "[t]hese credits generally can be applied against fees that otherwise would be payable [by the title and escrow companies] to the bank for a wide variety of services rendered by the bank". Pet. Br. at 6.

As one might expect, this potential for serving self-interest in placing non-interest-bearing client deposits is not limited to LPOs or to the state of Washington. Virginia Legal Ethics Opinion No. 1440 (1991) (available at Westlaw, VA LE Op. No. 1440) responds to an inquiry concerning the propriety of a law firm accepting proffered banking concessions in exchange for maintaining non-interest-bearing client accounts in the offering bank. The Virginia Opinion concludes that, absent full disclosure and client consent, "it is improper for a lawyer or a law firm to earn interest or receive any dividends for the lawyer's or firm's benefit on client's funds held in an attorney trust or escrow account . . . . An offer by a bank of tangible or substantial consideration or reward for the opening or maintaining of deposits in attorney trust or escrow accounts is the equivalent, in practice and in effect, of the payment of interest on the deposits." The Association of the Bar of the City of New York, Committee on Professional and Judicial Ethics, Formal Opinion No. 1986-5 (July 14, 1986) (available at 1986 WL 293094) considered whether an attorney acting in the capacity of an escrow agent could retain interest on the client's escrow account. The New York Opinion concluded that "[l]awyers may not retain . . . any of the interest earned in interest-bearing escrow accounts unless they have obtained the prior knowing consent of their clients and the other parties to the escrow, and even with such consent, there are still serious risks of ethical impropriety. . . . [A]greements purporting to grant consent to such arrangements present a clear danger of overreaching . . . . This is so because the lawyer would have a financial interest in delaying the event that terminates the escrow which might conflict with his duty to his client and other parties relating to the funds." Likewise, the North Carolina State Bar, Linking Trust and Business Accounts, Ethical Opinion RPC 150 (Jan. 15, 1993) (available at 1992 WL 753132) concluded that it "could create ethical problems" if a client's funds are placed in a non-interest-bearing account that earns the client "credits" if the attorney uses the client's credits to offset charges on the attorney's own business account.

The Washington Supreme Court adopted the challenged IOLTA rule for transactions handled by LPOs. In all relevant respects, the rule is identical to the rule that applies to lawyers. Thus, APR 12.1(c)(3) protects clients by requiring LPOs to deposit client trust funds in an interest-bearing account for the benefit of the client whenever it is possible to earn net interest for the client. As is the case with lawyers, APR 12.1(c)(1) also requires LPOs to pool client funds that cannot earn net interest for the client in an interest-bearing NOW account, with interest paid to the Legal Foundation of Washington. Thus, the challenged IOLTA rule ensures that when a client's funds are not able to generate net interest for the client, the funds will not be placed in a non-interest-bearing account and used to benefit the legal professional, creating the potential for conflicts of interest. Rather, the rule requires the funds to be pooled with like-client funds in an IOLTA account, with interest on the account used to provide public legal services.

C. Proceedings Below

Petitioners filed a complaint in the United States District Court for the Western District of Washington, challenging APR 12(h) and 12.1. The plaintiffs were two clients of LPOs whose escrow funds were placed in an IOLTA account (Brown and Hayes), an LPO (Daugs), a former LPO (Maxwell), and the Washington Legal Foundation, a public interest law organization. Petitioners alleged that APR 12(h) and 12.1 take property without just compensation and violate the First Amendment.

On cross motions for summary judgment, the district court held that owners of funds deposited in an IOLTA account had no cognizable claim to IOLTA interest, because their funds could not have generated such interest in the first instance. Finding such an interest "a prerequisite to establishing either a First or Fifth Amendment claim", the district court granted summary judgment to Respondents. App. at 92a, 96a. Petitioners appealed.

While hearing on Petitioners' appeal was pending in the Ninth Circuit, this Court decided *Phillips v. Washington Legal Foundation*, 524 U.S. 156 (1998). There, in the context of a Fifth Amendment challenge to a Texas' IOLTA rule, the Court held that interest earned on IOLTA accounts is the property of the clients whose principal is deposited in the accounts. The Court expressly declined to consider whether the Texas IOLTA rule constituted a taking or, if it did, what compensation, if any, would be owed clients. *Phillips*, 524 U.S. at 172.

Subsequently, a three-judge panel of the Ninth Circuit reversed the district court and held that Washington's IOLTA rule falls within the narrow class of government action that constitutes a per se taking. The panel remanded Petitioners' Fifth Amendment claim to the district court for a determination of "just compensation", if any. The panel did not reach Petitioners' First Amendment claim. App. at 84a. Respondents petitioned for rehearing and rehearing en banc. Respondents' petition was granted, and the decision of the three-judge panel was vacated.

On rehearing en banc, the Ninth Circuit first addressed Petitioners' standing. It held that two Petitioners, Brown and Hayes, LPO clients, had standing because their funds were actually placed in IOLTA accounts. *Washington Legal Found. v. Legal Found. of Washington*, 271 F.3d 835, 847-48 (9th Cir. 2001) (en banc), App. at 4a, 13a-15a. Two other plaintiffs, Daugs and Maxwell, an LPO and a former LPO, lacked standing because neither owned the principal deposited in an IOLTA account. Finally, the Washington Legal Foundation did not have representational standing. *Washington Legal Found.*, 271 F.3d at 848-50, 15a-19a. The petition for certiorari did not challenge these holdings. Thus, the only proper Petitioners before this Court are Brown and Hayes, and the Justices' references to "Petitioners" should be understood to refer only to Brown and Hayes.

Addressing the merits, the en banc court agreed that Petitioners "Brown and Hayes have a property right to whatever interest their individual deposits generate". *Id.* at 852, 22a. But the court held that APR 12.1 is not within the narrow class of government actions that constitute per se takings, determining it "entirely appropriate to apply *Penn Central*'s *ad hoc* takings analysis to the IOLTA program". *Id.* at 854-57, 27a-32a.

Applying that analysis, the court below noted that "because no interest would be earned on client funds deposited by escrow and title companies absent the IOLTA program, requiring those companies to place client trust funds in IOLTA accounts has no economic impact on the owners of the principal". *Id.* at 857, 33a. The court below also rejected Petitioners' contention that they suffer an economic impact if banks no longer give earnings credits to escrow agents. As a factual matter, the contention failed because Brown and Hayes did not establish that they were charged higher escrow fees. As a legal matter, the contention also failed because earning credits are payments to the escrow companies, not to clients such as Brown and Hayes, and such indirect economic impact is not recognized in a takings analysis. *Id.* at 858-60, 34a-35a.

The court below went on to hold that "the IOLTA program could not have interfered with [Petitioners'] investment-backed expectations", because Washington's rules require funds to be put in IOLTA accounts only if they are incapable of generating a net gain in interest. *Washington Legal Found.*, 271 F.3d at 860, 38-39a. As for the character of the government action, the court held that IOLTA "is best viewed in the context of the industry it regulates", and it noted that "the ability to practice a profession—and the conduct expected of those who do—is . . . heavily regulated", and "[l]awyers have always been held to the highest legal and ethical standards". *Id.* at 861, 39a. "Viewed in this context, the IOLTA regulations are not out of character for either the commercial industry or the professions they affect." *Id.* at 861, 39a-40a.

Finally, the court below held that even if Petitioners' property was taken, "the compensation due Brown and Hayes for any taking of their property would be nil". *Id.* at 861, 41a. Just compensation requires the government to put the owner in as good a position as if the property had not been taken, and incidental losses are not compensable. Accordingly, the court below held that Petitioners are entitled to no compensation because by regulatory definition their funds were only subject to IOLTA if they could not earn a net gain in interest. *Id.* at 862, 42a. And, furthermore, Petitioners' "right to keep their principal from earning interest . . . has no economic value". *Id.* Having found no taking of Petitioners' property and no just compensation due in any event, the court below then remanded the case to the district court for further consideration of Petitioners' First Amendment claim. *Id.* at 864, 45a.

SUMMARY OF ARGUMENT

I. With rare and narrow exception, this Court conducts an ad hoc factual inquiry to determine if a challenged regulation "goes too far" in imposing burdens that should be more broadly borne and thus effects a "taking" within the meaning of the Fifth Amendment. Petitioners request extraordinary treatment of Washington's IOLTA rule in asserting that it should be subject to per se takings analysis. Contrary to Petitioners' suggestion, when the property allegedly taken is money, this Court has employed the usual ad hoc inquiry. Taxes, tariffs, user fees, and monetary assessments are all instances in which the government literally "takes money" from private parties, and yet none are considered "takings" under the Fifth Amendment, and all are scrutinized under an ad hoc analysis (or do not implicate the Takings Clause at all).

II. Under the ad hoc analysis appropriate to consideration of Washington's rule, IOLTA does not "take" Petitioners' property. First, it serves important regulatory purposes in helping to ensure ethical treatment of client trust funds by licensed legal professionals. It is neither remarkable nor extreme in its operation. Second, it has no economic impact on Petitioners. By definition, their funds are put into an IOLTA account only if the client could not otherwise earn net interest under any circumstances. Third, IOLTA does not interfere with Petitioners' reasonable investment-backed expectations. Petitioners had no expectation to earn anything from the funds that are subject to IOLTA.

III. Even if IOLTA effects a taking of Petitioners' property, "just compensation" due to them is zero. The Fifth Amendment requires compensation for the value taken from the owners, not the value gained by the government. But the value of the property "taken" from Petitioners is zero, for the only property subject to IOLTA would not generate a net gain for Petitioners if they attempted to earn interest for themselves. Thus the property allegedly taken from Petitioners – IOLTA interest – has no realizable value to Petitioners, and the "just compensation" due is nothing.

IV. Even assuming that IOLTA "takes" Petitioners' property and that some "just compensation" would be due to them, Petitioners are not entitled to the remedy of an injunction. First, the federal courts should not grant Petitioners any remedy – equitable or otherwise – unless and until Petitioners seek a remedy using available and adequate state proceedings. If this Court holds that IOLTA takes Petitioners' property and that just compensation is due, Washington has an available and adequate procedure that Petitioners can use to obtain their just compensation remedy, Washington's inverse condemnation procedure.

Furthermore, even if a federal court could grant a remedy at this time, the appropriate relief would not be an injunction. Injunctive relief is not available when there is an adequate remedy at law, which there is in this case: a monetary award. Even assuming that injunctive relief is appropriate when a monetary award is exactly equal to the money taken by the government, that proposition does not help Petitioners, since the value of anything taken would be less than the value received by the government.

ARGUMENT

I. AD HOC ANALYSIS IS THE APPROPRIATE FRAMEWORK FOR EVALUATING WASHINGTON'S IOLTA RULE

Except in extraordinary circumstances, whether government regulation effects a taking under the Fifth Amendment "depend[s] on a complex of factors including the regulation's economic effect . . . the extent to which the regulation interferes with reasonable investment-backed expectations, and the character of the government action". *Palazzolo v. Rhode Island*, 533 U.S. 606, 617 (2001) (citing *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104, 124 (1978)). As recently as last Term, the Court reaffirmed the broad application of ad hoc takings analysis and the Court's long resistance "to adopt what amount to *per se* rules in either direction". *Tahoe-Sierra Pres. Coun., Inc. v. Tahoe Regional Planning Agency*, 122 S. Ct. 1465, 1478 (2002) (quoting *Palazzolo*, 533 U.S. at 636 (O'Connor, J., concurring)). As the Court explained in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992), "[i]n 70-odd years of . . . regulatory takings jurisprudence [succeeding *Pennsylvania Coal Co. v. Mahone*, 260 U.S. 393 (1922)], we have generally eschewed any set formula for determining how far is too far, preferring to engage in essentially ad hoc factual inquiries". (Internal punctuation omitted.)

A. IOLTA Does Not Fall Within Either Of The Two Narrow Categories Of Per Se Analysis

In only two limited instances this Court has employed a per se test, finding that certain kinds of deprivations are automatically deemed "takings" under the Fifth Amendment. First, "a permanent physical occupation authorized by government is a taking without regard to the public interests that it may serve". *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 426 (1982). Second, this Court has "found categorical treatment appropriate . . . . where regulation denies all economically beneficial or productive use of land". *Lucas*, 505 U.S. at 1015.

In both instances, the Court stressed the narrowness of the two circumstances. *See Loretto*, 458 U.S. at 441 ("Our holding today is very narrow."); *Lucas*, 505 U.S. at 1018 (noting "the relatively rare situations where the government has deprived a landowner of all economically beneficial uses"). *See also Tahoe-Sierra Pres. Coun.*, 122 S. Ct. at 1479 & n.19 ("physical appropriations are relatively rare [and] easily identified" while "*Lucas* carved out a narrow exception to the rules governing regulatory takings for the 'extraordinary circumstance' of a permanent deprivation of all beneficial use"). Indeed, as recently as the last two Terms, this Court has continued to reject pleas to establish more per se rules. *See id.* at 1478 ("In our view the answer to the abstract question whether a temporary moratorium effects a taking is neither 'yes, always' nor 'no, never'; the answer depends upon the particular circumstances of the case."); *Palazzolo*, 533 U.S. at 628 ("a blanket rule . . . is too blunt an instrument"); *id.* at 636 (O'Connor, J., concurring) ("The temptation to adopt what amount to *per se* rules in either direction must be resisted.").

Washington's IOLTA rule implicates neither of these narrow circumstances. Petitioners do not contend otherwise, but nevertheless assert that per se takings analysis should be applied to APR 12.1. Petitioners are wrong. Petitioners would have this Court erect yet another per se rule, contending that when, in Petitioners' parlance, the government "takes money", it should categorically be treated as a taking. Pet. Br. at 13. The suggestion is flawed. It is enormously overbroad. The circumstances in which transfers of money or monetary value attend government action are so varied that it is simply not a useful categorization.

B. This Case Provides No Basis For Creating A Third Category Of Per Se Analysis

This Court has repeatedly held that many instances in which the government "takes money" –

by requiring payment either to the government or to a third party – are subject to an ad hoc analysis and are often not "takings" at all. For example, in the literal parlance of Petitioners, taxes and tariffs clearly "take money" from a private party, yet neither is subject to a per se analysis or thought to violate the Takings Clause at all. *See Penn Central Transp. Corp. v. City of New York*, 438 U.S. 104, 124 (1978) (taxes). *See also County of Mobile v. Kimball*, 102 U.S. 691, 703 (1880) (taxes); *Legal Tender Cases*, 79 U.S. (12 Wall.) 457, 551 (1879) (tariffs).

Similarly, a user or service fee that, quite literally, "takes money" from private parties, is not a taking either. *United States v. Sperry Corp.*, 493 U.S. 52, 63 (1989) ("[A] reasonable user fee is not a taking if it is imposed for the reimbursement of the cost of government services."). In *Sperry Corp.*, the Court also rejected the argument that a payment of money should be analyzed as a physical appropriation of property.

> "It is artificial to view deductions of a percentage of a monetary award as physical appropriations of property. Unlike real or personal property, money is fungible. . . . If the deduction in this case were a physical occupation requiring just compensation, so would be any fee for services[.]" *Sperry Corp.*, 493 U.S. at 62 n.9.

As *Sperry Corp.* recognized, "[s]uch a rule would be an extravagant extension of *Loretto*." *Id*. See also *Yee v. City of Escondido*, 503 U.S. 519, 529-30 (1992), recognizing that simply because a particular regulatory scheme may make the transfer of wealth "more *visible* than in the ordinary case . . . the existence of the transfer itself does not convert regulation into physical invasion". (Citation omitted.)

Further, the government may require one private party to assume a monetary liability and pay that sum to a third party – again, literally "taking money" from one private party and giving it to another – but that does not necessarily "take" a person's property within the meaning of the Fifth Amendment. *See Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225, 228 (1986) (O'Connor, J., concurring) (holding that the Multiemployer Pension Plan Amendments Act of 1990 did not constitute a taking, although "there is no doubt that the Act completely deprives an employer of whatever amount of money it is obligated to pay to fulfill its statutory liability") ("the mere fact that legislation requires one person to use his or her assets for the benefit of another will not establish . . . a violation of the Taking Clause") (internal punctuation omitted) (citation omitted). Instead, such a requirement is examined under the usual ad hoc factual inquiry ordinarily employed in takings cases.

For instance, in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), the Court considered a takings challenge to the Coal Industry Retiree Health Benefit Act of 1992 (the Coal Act). Under the Coal Act, Congress required certain companies to make monetary payments to a Combined Fund for the purpose of providing health benefits to retired coal miners. The plurality was quite candid about the sizable "annual premiums" imposed on the liable companies – as much as $5 million in a single year. *Apfel*, 524 U.S. at 514, 517 (O'Connor, J.). "By operation of the Act," the plurality further observed, "Eastern is permanently deprived of those assets." *Id.* at 523 (quoting *Connolly*, 475 U.S. at 222). But despite this clear deprivation, the plurality concluded that the case "d[id] not present the 'classic taking' in which the government directly appropriates private property for its own use", specifically commenting that monetary "liability is not, of course, a permanent physical occupation of Eastern's property of the kind that we have viewed as a *per se* taking". *Id.* at 522, 530. Rather, the Court applied an ad hoc analysis. *Id.* at 528 ("applying the three factors that traditionally have informed our regulatory takings analysis").[3]

Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155 (1980), also used an ad hoc analysis even though the regulation at issue literally "took money". At issue in *Webb's* was whether a statute authorizing a county to keep interest earned on interpleaded funds, in addition to a separate service fee, constituted a taking of the interest. The *Webb's* Court did not simply identify the interest as the

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[3] Justice Kennedy would have gone even further. Rather than apply an ad hoc analysis, he found it "both imprecise and . . . unwise" to apply the Takings Clause at all when the monetary assessment "neither targets a specific property interest nor depends upon any particular property for the operation of its statutory mechanisms". *Apfel*, 524 U.S. at 540, 543 (Kennedy, J., concurring in the judgment and dissenting in part). That view was shared by the four dissenting Justices. *See id.* at 555-56 (Breyer, J., dissenting). While Petitioners in this case may have a "specific property interest", the concurring and dissenting opinions in *Apfel* illustrate that government regulations that "take money" come in many forms and variations, and this Court should be cognizant of those nuances and wary of adopting any per se rule that glosses over these distinctions.

property of Webb's creditors, declare a per se taking, and end its inquiry, as Petitioners would have the Court do in this case. Rather, the Court weighed the public and private interests involved and found a taking "under the narrow circumstances" of that case only after concluding that there was not "any reasonable basis to sustain the taking of the interest". *Webb's*, 449 U.S. at 163-64. The Court considered the nature and purpose of the government's action, the legitimate expectations of Webb's creditors, and the statute's economic effect on them. In this respect, the Court examined possible justifications for the county's retention of the interest (*see id.* at 162-63), noted the necessity of resorting to the statute if the depositor was to have any protection from creditor claims (*id.* at 164), and considered that "Webb's creditors . . . had more than a unilateral expectation" in the interest earned on the interpleaded funds (*id.* at 161).

Simply put, to describe the government's action as "taking money" from a private party does little to advance the legal inquiry, and to assert that every time the government "takes money" it is a per se taking disregards this Court's precedents regarding such deprivations. There are simply too many disparate circumstances where the government "takes money", in many of which the government's act either does not implicate the Takings Clause at all or is analyzed under *Penn Central Transportaion Corp.*'s ad hoc factual inquiry.

Petitioners argue that "where, in order to fund government programs of general application, the government simply takes property from a few individuals and can offer no rational explanation for singling them out", then a per se rule ought to apply. Pet. Br. at 26-27. It is of course true that if this Court asks "what would justify" the circumstances in which a government regulation takes money, and "[n]o police power justification is offered for the deprivation", the regulation can effect a taking. *Webb's*, 449 U.S. at 162-63. But that is not because a per se analysis applies, as Petitioners would have it; as shown above, the Court applies an ad hoc analysis even when government regulations literally "take money". It is because the "bare transfer of private property" to the government, with no discernible regulatory justification, is an easy case under the standard ad hoc analysis.[4] *Sperry Corp.*, 493 U.S. at 62 n.8.

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[4] It may be appropriate to look for supporting evidence of the State's legitimate regulatory purpose. For example, the Court might look to whether the seizure actually serves the regulatory purpose asserted. *See Lucas*, 505 U.S. at 1035 (Kennedy, J., concurring in the judgment) ("the means, as well as the ends, of regulation must accord with the owner's reasonable expectations"); *Pennell v. City of San Jose*, 485 U.S. 1, 20 (1988) (Scalia, J., concurring in part and dissenting in part). On that score, IOLTA furthers its ethical purpose by removing the interest from the hands of the very actors – the banks and legal professionals – who have an incentive to engage in unethical conduct if the interest were left in their possession.

Or this Court might look to whether the amount seized is "so clearly excessive as to belie [its] purported character", making the seizure look more like a "bare transfer of private property". *Sperry Corp.*, 493 U.S. at 62, 62 n.8. Again, on that score, IOLTA's regulatory purpose rings true in light of its minimal imposition and utter lack of excessiveness. *Compare Webb's*, 449 U.S. at 158 (interest accrued was over $90,000), *with infra* pp. 32-37. Finally, this Court might look to whether there is an "'average reciprocity of advantage' to everyone concerned". *See Lucas*, 505 U.S. at 1018. Yet again, on that

But even assuming that Petitioners' contention had any merit – that a "bare transfer" with "no police power justification" should be analyzed as a per se taking – that argument would have no application here. Petitioners' proposed rule appears to be crafted to exempt measures like taxes and user fees, for which the government's police power justification is usually obvious and clear. But IOLTA, too, serves an important regulatory purpose and is justified by something entirely different from a "bare" desire to transfer wealth to the government. *See infra* Part I.C. IOLTA itself, that is, falls outside the category proposed by Petitioners for per se treatment under the Takings Clause.

C. IOLTA Serves Important Regulatory Functions

Washington's IOLTA rule benefits and protects clients by regulating licensed legal professionals in handling client funds. It does this in two ways. First, whenever client funds are capable of earning net interest for the client, the rule requires the licensed legal professional to place client funds in an interest-bearing account for the client. Prior to IOLTA, this neither was required by ethical rules governing licensed legal professionals, nor uniformly done. The rule thus provides a clear economic benefit to Petitioners and, as discussed below, protects them against LPO self-dealing by

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score, the clients receive a substantial benefit from IOLTA, because ethical treatment of their funds are ensured in all cases, as a legal professional is *required* to use interest-bearing accounts for the client's benefit whenever net interest can be attained, or, when net interest cannot be obtained, the interest is taken out of the hands of those who might otherwise act unethically with the client's funds.

requiring their funds be placed in an interest-bearing account. Second, when client funds cannot earn net interest for the client, the rule requires the funds to be pooled with like client funds in an interest-bearing account with interest payable to a nonprofit corporation, created by direction of the Washington Supreme Court, to fund organizations providing civil legal services, including legal services to the indigent.

Both aspects of the challenged rule protect clients who place funds with licensed legal professionals. This is so because, as Petitioners concede, prior to IOLTA, LPOs and escrow and title firms employing them received substantial financial benefits from banks in return for non-interest-bearing client deposits. These financial benefits, “earnings credits”, increase with the size and length of the deposit. In this respect, earnings credits are a function of the fact that prior to IOLTA, banks had interest-free use of client funds. Earnings credits present clear opportunities for licensed legal professionals to serve self-interest, rather than client-interest in placing client funds and handling client transactions. They provide incentive to deposit client funds in non-interest-bearing accounts. They also provide incentive to deposit client funds to maximize the escrow or title companies’ return on client deposits, without regard to other considerations such as the depository’s strength or stability, or its responsiveness to client needs. Similarly, earnings credits provide an incentive to delay closings of property transactions, as disbursement of client funds terminates their receipt.

By requiring productive client funds to be deposited in an interest-bearing account for the client, and by requiring pooling of client funds incapable of generating net interest for the client in an interest-bearing IOLTA account, the challenged rule diminishes the potential for LPO self-interest that plainly existed before its adoption. Removing incentives for harmful conduct or the evasion of regulatory prohibitions is well within the government's police power. *Andrus v. Allard*, 444 U.S. 51, 58-59 (1979). This is particularly important in the courts' regulation of those practicing law, since confidence and trust are critical elements in an attorney-client relationship. Proper operation of the legal system requires measures to prevent erosion of confidence in legal professionals. *See Florida Bar v. Went For It, Inc.*, 515 U.S. 618, 635 (1995). The absence of potential financial interests promotes trust in the representational relationship, thereby facilitating the provision of legal services and ultimately the administration of justice. In this respect, the IOLTA rules operate to provide benefits to the legal system that outweigh any harm Petitioners can claim here, similar to the systemic benefits provided by upholding the attorney-client privilege. *See Swidler & Berlin v. United States*, 524 U.S. 399 (1998).

Unless licensed legal professionals are required to deposit client funds in interest-bearing accounts of some nature, such deposits would continue to present opportunities for self-interested dealing between banks and licensed legal professionals. Certainly, in this case, it is clear that in the absence of IOLTA, client funds would continue to be placed in non-interest-bearing accounts and would be used to provide financial incentives to LPOs and the escrow and title companies who employ them in the practice of law. Such financial incentives are at odds with the ethical obligation of licensed legal professionals to avoid self-interest in handling client property.

Banking mechanisms for earning interest on nonproductive client funds while keeping them immediately available to clients are limited by federal law. Federal banking regulations, unchallenged by Petitioners, require such accounts to "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, political, or other similar purposes and which is not operated for profit". *Phillips*, 524 U.S. at 161 (quoting 12 U.S.C. § 1832(a)(2)). That IOLTA employs this banking option to accomplish its regulatory purposes is not constitutionally significant. Indeed, Petitioners, like the petitioners in *Phillips*, do not appear to argue that placing their small and/or short-term deposits, incapable of generating net interest, in an IOLTA account, implicates the Takings Clause. And, of course, Petitioners' Fifth Amendment claim would be no different had Washington directed interest on IOLTA accounts to another nonprofit charitable foundation or to an individual. In enacting IOLTA, the Washington Supreme Court properly was "the judge of the necessity or expediency of the means adopted". *Andrus*, 444 U.S. at 59 (quoting *New York ex rel. Silz v. Hesterberg*, 211 U.S. 31, 40 (1908)).

In each of these respects, the rule substantially furthers the public welfare. It safeguards important interests of clients whose deposits it regulates, and it benefits the justice system.

II. UNDER AD HOC ANALYSIS, APPROPRIATE TO WASHINGTON'S IOLTA RULE, THE RULE DOES NOT "TAKE" PETITIONERS' PROPERTY

The Takings Clause "preserves governmental power to regulate, subject only to the dictates of 'justice and fairness'". *Andrus*, 444 U.S. at 65 (citing *Penn Central*, 438 U.S. at 123). Government regulation does not implicate the Takings Clause unless it "goes too far" (*Pennsylvania Coal Co. v. Mahone*, 260 U.S. 393, 415 (1922)), and "forc[es] some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole" (*Armstrong v. United States*, 364 U.S. 40, 49 (1960)). Whether government regulation goes too far "depend[s] on a complex of factors including the regulation's economic effect . . . , the extent to which the regulation interferes with reasonable investment-backed expectations, and the character of the government action". *Palazzolo v. Rhode Island*, 533 U.S. 606, 617 (2001) (citing *Penn Central*, 438 U.S. at 124). As the Court recognized in *Palazzolo*, these are among the factors that inform the question of whether government regulation "goes too far". Under such an analysis, IOLTA clearly does not "take" Petitioners' property within the meaning of the Fifth Amendment.

A. IOLTA Interferes With No Reasonable Investment-Backed Economic Expectations Of Petitioners

IOLTA expressly permits – indeed, it requires – licensed legal professionals to deposit client funds to earn net interest for the client if that possibly can be achieved. In other words, IOLTA's very terms ensure that it has no economic impact on Petitioners. The only client funds that may be deposited in IOLTA accounts under Washington's rule are funds that cannot otherwise earn net interest for the client. As this case demonstrates, such funds would not have been put in an interest-bearing account at all, absent the challenged IOLTA rule. Thus, it cannot be said that the rule interferes with any reasonable investment-backed expectations of clients. Petitioners in this case readily admit that they had no expectation of earning a return on these funds. App. at 38a-39a. Nor does IOLTA interfere with accomplishing any purpose for which Petitioners transferred their funds to the commercial marketplace in the first instance. Under IOLTA, client funds surrendered to a legal professional and deposited in an IOLTA account remain available to the client without delay, and accomplish all of their intended purposes. APR 12.1(c), App. at 105a-06a.

Petitioners argue that it is inappropriate to determine the effect of IOLTA on their economic expectations by considering those expectations in a "hypothetical pre-IOLTA world". Pet. Br. at 32. There is nothing hypothetical about the pre-IOLTA world or Petitioners' reasonable economic expectations in it. Prior to Washington's adoption of APR 12.1, no rule of professional conduct required escrow or trust companies engaging in the practice of law to secure interest on behalf of clients, even when client deposits could generate net interest for the client. When Congress authorized the creation of NOW accounts in 1980, before IOLTA even existed or was expanded to include LPOs, these accounts were permitted only for deposits that "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, political, or other similar purposes and which is not operated for profit". 12 U.S.C. § 1832(a)(2).

Second, it is far from apparent how Petitioners would have one evaluate the effect of a regulation on a claimant's reasonable investment-backed economic expectations without considering what those expectations were independent of the challenged regulation. Certainly, for example, if one were to evaluate the impact of a land use regulation on the land owner's reasonable economic expectations, one aspect of the inquiry would be the landowner's economic expectations with respect to the property in the absence of the challenged rule. *Palazzolo*, 533 U.S. at 635-36 (O'Connor, J., concurring) ("Courts properly consider the effect of existing regulations under the rubric of investment-backed expectations in determining whether a compensable taking has occurred."). There is no basis for a different approach here. It is Petitioners who seek to have the Court consider their claim against the backdrop of a world that never has existed, where Petitioners could generate net interest on the funds that they placed with LPOs.

Petitioners further contend that evaluating their economic expectations in the absence of the challenged IOLTA rule is tantamount to claiming that IOLTA interest is "'government created value' to which petitioners can have no claim". Pet. Br. at 34. This is not so. Respondents recognize the Court's holding in *Phillips* that interest earned on IOLTA accounts is the property of clients whose funds are placed in the accounts. But the fact that a regulation affects property of a claimant or costs a claimant value hardly makes out a takings claim. Although *Phillips* specifically disavowed any view on whether Texas' IOLTA rule constituted a taking, or if it did, whether any payment would be required by way of "just compensation", *Phillips* recognized that "the interest income at issue . . . may have no economically realizable value to its owner". *Phillips*, 524 U.S. at 170. Surely, the fact that Petitioners could enjoy no economically realizable value from their property is a relevant consideration in evaluating the economic effect of the challenged IOLTA rule on Petitioners' reasonable economic expectations. The fact of the matter is that as to Petitioners' reasonable investment-backed expectations, the challenged IOLTA rule is a "wash", "since the client would have no net interest to go into his pocket, IOLTA or no IOLTA". *Phillips*, 524 U.S. at 176 (Souter, J., dissenting). It is this "wash" that Petitioners repeatedly characterize as the "burden" that IOLTA singles them out to bear.

Petitioners also assert that interference with their non-economic interests should lead the Court to conclude that they have suffered a taking by virtue of Washington's IOLTA rule. In this respect, Petitioners point to the Court's statement in *Phillips* that property consists of more than economic value. *Phillips*, at 524 U.S. 169. But this does not assist Petitioners. First, by definition, whenever government regulation entails a cost or diminishes the value of property, its owner loses the right to possess, control, and dispose of the property represented by the cost or lost value. Second, the right to possess, control and dispose of *money* that has no economically realizable value surely would seem to be a right of diminished and doubtful worth in the context of an inquiry concerned with the extent to which a rule interferes with economic expectations. *Cf. Pruneyard Shopping Ctr. v. Robins*, 447 U.S. 74, 84 (1980) (owners "failed to demonstrate that the 'right to exclude others' is so essential to the use or economic value of their property that the state-authorized limitation of it amounted to a 'taking'"). In any event, whatever significance it may have in the takings balance, the loss of such a right hardly would seem to indicate that a regulation has "gone too far" or burdened too greatly.

Finally, Petitioners engage in the artificial exercise of carving out one aspect of Washington's integrated IOLTA rule in arguing that the rule interferes with their reasonable economic expectations. Petitioners look solely to the rule's alleged "cost" to them. The Court has determined that such an approach is artificial in virtually every takings case (*see, e.g., Tahoe-Sierra Pres. Coun.*, 122 S. Ct. at 1481; *Concrete Pipe & Prods. of California, Inc. v. Constr. Laborers Pension Trust for So. California*, 508 U.S. 602, 643-44 (1993)), but it is particularly artificial here, as the property allegedly taken – IOLTA interest – would not exist but for the challenged rule. Directing otherwise nonproductive client funds to an interest-bearing account is but one facet of the integrated regulatory framework of IOLTA. It is instrumental to the rule's effectiveness and is not challenged as a taking by Petitioners. Like the Petitioners in *Phillips*, Petitioners here do not seem to seriously argue that requiring LPOs to deposit non-interest-bearing client funds in an

IOLTA account implicates the Takings Clause. *Phillips*, 524 U.S. at 164 ("Respondents do not contend that the State's regulation of the manner in which attorneys hold and manage client funds amounts to a taking of private property."). Instead, Petitioners seek as "just compensation" the very funds generated only by virtue of this process. It is highly contrived then, to look solely to the disposition of interest from IOLTA accounts in considering whether IOLTA interferes with their reasonable economic expectations.[5]

[5] Petitioners make a passing reference to their right to control their funds and exclude others from using them, even temporarily. Pet. Br. at 35. This appears to be a reference to interest earned on IOLTA accounts. However, to the extent that this is a separate takings claim based on the deposit of Petitioners' principal in an IOLTA account, and to the extent that it is even fairly encompassed in the questions presented in their petition for certiorari, the claim has no merit. Viewed either as an independent claim under an ad hoc analysis or as a component of alleged economic or investment-backed harm in the principal takings claim, the argument fails. The banking industry is so heavily regulated that Petitioners can have no reasonable expectation of unfettered use of their funds, or to control who may benefit from them, once they put them in the commercial marketplace and they are deposited into a bank account. *See, e.g.*, 12 U.S.C. § 4002 (establishing complex scheme dictating when funds deposited in cash, by check, or otherwise become available for withdrawal by the depositor). Finally, Petitioners argue that they are entitled to unfettered control over who benefits from their funds. Given the extensive regulation of banking and the fact that banks survive by providing deposits for the use of others, this claim lacks merit. But to the extent there is any substance to the contention, it is a claim that sounds in First Amendment free speech doctrine, and thus it is more properly addressed on remand in the context of that argument.

B. IOLTA Protects Clients Of Legal Professionals And Promotes The Public Welfare

IOLTA serves legitimate and important regulatory purposes. It requires licensed legal professionals to handle client funds in ways that ensure (1) the funds earn net interest for the client whenever they are capable of doing so; (2) are not used for the benefit of the licensed legal professional when they are incapable of earning net interest for the client; and (3) in the latter circumstance, are placed in an interest-bearing account that funds public legal services, including legal services for the indigent. In each of these respects, the rule substantially furthers the public welfare. It safeguards important interests of clients whose deposits it regulates, and it benefits the civil justice system. Moreover, contrary to Petitioners' claim that they are arbitrarily singled out for application of IOLTA, Petitioners encounter the rule and benefit from its protections precisely because they interact with legal professionals in a regulated aspect of the profession. The handling of client property and the avoidance of conflicts of interest are facets of the practice of law that have long been regulated. APR 12.1 is unremarkable in this respect.

C. Petitioners' Argument Based On "Lost" Earnings Credits Fails

Perhaps recognizing the futility of trying to show that Washington's IOLTA rule interferes in any significant way with their reasonable investment-backed expectations, Petitioners assert that they nonetheless "lost" an indirect economic benefit by virtue of IOLTA. Petitioners had no expectation of return in the form of "earnings credits" based in marketplace practices or in law. Based on the marketplace practices, Petitioners not only could expect to receive nothing on their deposits, but also could expect their deposits to be used for the financial benefit of their escrow providers with the secondary benefit – if any – indirect and entirely discretionary. Further, Petitioners could expect legal constraints on escrow agents' use of the funds to avoid self-dealing. Wash. Admin. Code § 208-680E-011 (emphasis added), clearly states that an "escrow agent shall be responsible for all funds received from any principal or any party to an escrow transaction . . . and shall not utilize such funds for the benefit of the agent or any person not entitled to such benefit".[6]

Moreover, the indirect economic loss alleged by Petitioners consists entirely of the possibility that some escrow and title companies may have chosen to pass on to their clients any overhead cost savings that the companies may have realized in return for depositing client funds in non-interest-bearing accounts, prior to IOLTA. Such attenuated economic circumstances are irrelevant to whether the

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[6] In their Cert. Reply at 7, Petitioners claim that "the Washington State Department of Licensing (which regulates escrow companies in the State) has long been aware of, and approves of, the 'earnings credits' system". Petitioners provide no citation for this claim, but apparently they refer to a 2-page letter from the Department of Licensing that they appended to their reply brief before the Ninth Circuit. That letter fails to even mention § 208-680E-011 or its predecessor § 308-680E-011. Nor does the letter even mention "earnings credits". And for good reason – the letter requesting the Department of Licensing's opinion also neglected to mention "earnings credits" or either section of the Washington Administrative Code. The opinion provides no definitive ruling on whether the "earnings credits" system is consistent with this regulation.

government has taken Petitioners' property. The Takings Clause does not recognize every conceivable and alleged loss as part of an owner's reasonable investment-backed expectations. "A 'reasonable investment-backed expectation' must be more than a 'unilateral expectation or an abstract need.'" *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005 (1984) (quoting *Webb's*, 449 U.S. at 161). It necessitates a legitimate claim of entitlement based on positive rules of substantive law or mutually explicit understandings. *Perry v. Sindermann*, 408 U.S. 593, 601-02 (1972); *Penn Central Transp. Co.*, 438 U.S. at 124-25.

Petitioners have acknowledged, as they must, that they have no property interest in earnings credits received by escrow and title companies. *A fortiori*, Petitioners have no property interest in the private discretionary pricing decisions of escrow or title companies related to the companies' enjoyment of earnings credits. Petitioners point to no authority supporting the notion that such discretionary pricing decisions of private third parties play any role in a takings claim. They do not. Otherwise, any consumer of goods or services from a business whose pricing decisions are affected by regulatory costs could press a takings claim. This would be a massive expansion of the Takings Clause, ungrounded in its provisions and its history. "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." *Pennsylvania Coal Co.*, 260 U.S. at 413. Thus, even if Petitioners could show that their escrow providers charged them higher fees because their providers lost earnings credits as a result of IOLTA (and neither made such a showing), it would not matter. Except insofar as earnings credits vividly demonstrate the potential for conflicts of interest in handling non-interest-bearing client funds, and the resulting need to direct those funds to interest-bearing accounts, they are irrelevant to the inquiry before the Court.

In sum, when one actually considers the valid and important regulatory purposes that IOLTA serves and its nonexistent economic effect on Petitioners or their investment-backed expectations, it is difficult to understand how it could be said that IOLTA "is so unreasonable or onerous as to compel compensation" (*Palazzolo v. Rhode Island*, 533 U.S. 606, 627 (2001)), or otherwise put, that it "goes too far" and forces Petitioners to bear a "burden" that "in all fairness and justice, should be borne by the public as a whole" (*Armstrong v. United States*, 364 U.S. 40, 49 (1960)). To the contrary, the IOLTA rules substantially protect Petitioners' interests in their relationship with licensed legal professionals, and the economic "burden" the rule allegedly imposes on them is illusory.

III. EVEN IF THE IOLTA RULE CONSTITUTES A TAKING, JUST COMPENSATION TO PETITIONERS WOULD BE ZERO

The purpose of "just compensation" under the Fifth Amendment is to place the property owner in the same economic position that the owner would have been in absent the government regulation. *United States v. 564.54 Acres of Land*, 441 U.S. 506, 510 (1979); *United States v. Reynolds*, 397 U.S. 14, 16 (1970); *United States v. General Motors Corp.*, 323 U.S. 373, 379 (1945); *Olson v. United States*, 292 U.S. 246, 255 (1934); *Dohany v. Rogers*, 281 U.S. 362, 367 n.1 (1930). Consequently, the measure of "just compensation" is the value taken from the owner, not the value gained by the State. "[T]he Constitution . . . merely requires that an owner of property taken should be paid for what is taken from him. . . . And the question is, What has the owner lost? not, What has the taker gained?" *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189, 195 (1910). *See also City of Monterey v. Del Monte Dunes at Monterey*, 526 U.S. 687, 710 (1999); *United States v. Causby*, 328 U.S. 256, 261 (1946); *United States ex rel. Tennessee Valley Auth. v. Powelson*, 319 U.S. 266, 281-82 (1943). Even if APR 12.1 effected a taking of IOLTA interest, it is undisputed that Petitioners would not have realized interest on their funds absent the rule. Indeed, it is plain that Petitioners' funds never would have been placed in an interest-bearing account at all without IOLTA, and thus, Petitioners would have earned *no* interest on their funds, gross *or* net. *Cf. Phillips*, 524 U.S. at 169 ("[I]t is not that the client funds to be placed in IOLTA accounts cannot generate *interest*, but that they cannot generate *net interest*."). Thus, the amount of compensation necessary to return Petitioners to the position they were in prior to the adoption of IOLTA is zero.

In seeking IOLTA interest as "just compensation", Petitioners do not ask to be placed in their pre-IOLTA position. Petitioners seek substantial betterment of that position – payment of value that they could not have realized. This is contrary to the Court's jurisprudence under the Fifth Amendment. Rather than address this bedrock principle relating to the proper measure of "just compensation", Petitioners endeavor to attribute to the court below and to the Respondents the position that government may confiscate property where it confiscates only what it has created (Pet. Br. at 36); and that government may take property and deny just compensation "simply because of . . . difficulty in measuring the property owners' loss with precision". Pet. Br. at 37. The court below did not premise its "just compensation" holding on any such notions, and the Justices do not advance them.

Petitioners' only acknowledgment of the fundamental principle that "just compensation" is limited to restoring the claimants' pre-taking economic position is a passing reference in footnote 14 of their brief. Pet. Br. at 36. There, Petitioners assert that even if the appropriate measure of "just compensation" is the amount necessary to put them in the economic circumstances they enjoyed prior to IOLTA, they would be entitled to the value of "earnings credits" "that would have been applied to their real estate transactions absent IOLTA", and that there is a genuine issue of material fact about the value of those credits. Pet. Br. at 36. Petitioners are wrong on both counts. Earnings credits are irrelevant to the issue of compensation, just as they are irrelevant to the takings inquiry. "Just compensation" does not include incidental losses related to a taking. *United States v. Bodcaw Co.*, 440 U.S. 202, 203 (1979); *General Motors Corp.*, 323 U.S. at 382. The value of earnings credits amounts to nothing more than an alleged incidental loss. Petitioners have no property interest in earnings credits and no property interest in the private discretionary pricing decisions of escrow and title companies related to the availability of earnings credits. Second, Petitioners failed to demonstrate that the value of earnings credits would have reduced the cost of *their* real estate transactions, or even to raise a genuine issue on that score. Tellingly, for their contention on this point, Petitioners cite only to JA at 51-52, an affidavit from the LPO who handled the closing of Petitioner Hayes' real estate transaction. The LPO simply states that sometime after APR 12.1 was adopted, Seafirst Bank stopped paying earnings credits to her employer, Fidelity National Title Company. The LPO's affidavit does not even suggest that Fidelity Title would have passed on to Petitioner Hayes the value of any such credits had the company continued to receive them, or that it did so before the IOLTA rule was adopted. Petitioner Hayes acknowledged that he did not know how Fidelity Title set its fees. JA at 122.

In sum, Petitioners' request for compensation in this case asks the Court to turn a blind eye to economic reality. The Fifth Amendment does not require what Petitioners demand – that government "pay for a loss of theoretical creation, suffered by no one in fact". *Boston Chamber of Commerce*, 217 U.S. at 194.

IV. INJUNCTIVE RELIEF IS NOT APPROPRIATE

Petitioners argue that when an owner's property is taken within the meaning of the Fifth Amendment, and the property taken "is money", then the "most appropriate" remedy is equitable relief. Pet. Br. at 39. This argument is without merit. It is without merit because Petitioners are entitled to no relief at all and because they are entitled to no relief in a federal court – equitable or otherwise – unless and until they first seek appropriate relief in state proceedings. If this Court holds that IOLTA "takes" Petitioners' property and that some "just compensation" is due, then Petitioners must seek their remedy in the first instance before a state court. Petitioners' argument is also without merit because equitable relief is unavailable whenever there is an adequate remedy at law. Here, Petitioners have not shown that a monetary remedy is inadequate.

A. Federal Courts Should Not Grant Relief In A Takings Case Unless And Until The Owner Seeks Available Relief In State Proceedings

It is well established that "because the Fifth Amendment proscribes takings *without just compensation*, no constitutional violation occurs until just compensation has been denied". *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 194 n.13 (1985). "If the government has provided an adequate process for obtaining compensation, and if resort to that process yields just compensation, then the property owner has no claim against the Government for a taking." *Id*. at 194-95 (internal punctuation omitted). *See also First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 315 (1987) (Fifth Amendment "is designed not to limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking"); *Hudson v. Palmer*, 468 U.S. 517, 539 (1984) (O'Connor, J., concurring); *Ruckelshaus*, 467 U.S. at 1016 ("Equitable relief is not available to enjoin an alleged taking of private property for a public use, duly authorized by law, when a suit for compensation can be brought against the sovereign subsequent to the taking.") (footnote omitted). Accordingly, "if a State provides an adequate procedure for seeking just compensation, the property owner cannot claim a violation of the Just Compensation Clause until it has used the procedure and been denied just compensation". *Williamson County*, 473 U.S. at 195. "The nature of the constitutional right", this Court held, "requires that a property owner utilize procedures for obtaining compensation before bringing a § 1983 action". *Id.* at 194 n.13. *See also* JA at 12 (Petitioners' claims arise under § 1983).

Washington provides "an adequate procedure for seeking just compensation", namely, an action for inverse condemnation. *See, e.g., Phillips v. King County*, 968 P.2d 871, 876 (1998). The Just Compensation Clause requires use of this procedure before obtaining a remedy in federal court. Petitioners correctly observe that if "the inverse condemnation procedure is unavailable or inadequate", there is no need for an owner to avail him- or herself of that procedure. *Williamson County*, 473 U.S. at 197; Pet. Br. at 44. But this observation does not assist Petitioners. Washington's procedure is neither unavailable nor inadequate. Petitioners simply discount the procedure because the Justices of the Washington Supreme Court, who Petitioners sued, are defending IOLTA against Petitioners' allegations that it effects a taking and violates the First Amendment.

The Ninth Circuit did not address the adequacy of state law takings remedies as Petitioners assert. It addressed only the ripeness of Petitioners' takings claim in this case. App. at 19a-21a. The Ninth Circuit simply concluded that Petitioners were not required to seek compensation in state court in order for their claim to be considered ripe in light of the Justices' defense of APR 12.1. App. at 21a. The Justices do not take issue with the ripeness determination of the court below, although the Washington Supreme Court, acting in its judicial capacity, has reviewed rules promulgated by the court in its legislative capacity. *See, e.g.*, *Nielsen v. Washington State Bar Ass'n*, 585 P.2d 1191 (Wash. 1978) (holding invalid a provision of Admission to Practice Rules requiring a resident alien bar applicant to have declared intent to become a citizen). Nonetheless, Petitioners could have reasonably anticipated that had they presented their just compensation claim to the Washington Supreme Court, the Court would have likely rejected that argument, and so resort to such a procedure might have been futile. But the Justices' defense of APR 12.1 against Petitioners' takings claim has no bearing on the adequacy of an inverse condemnation action if this Court determines that just compensation may be available to Petitioners. The United States Constitution, as interpreted by this Court, is the supreme Law of the Land, and "the Judges in every State shall be bound thereby". U.S. Const., art. VI, § 2. If this Court were to hold that IOLTA "takes" Petitioners' property and that some "just compensation" may be due, the Justices of the Washington Supreme Court unquestionably would follow that judgment and enforce it, in an inverse condemnation proceeding or otherwise.

Petitioners' argument that they nevertheless are entitled to injunctive or other relief from a federal court must therefore rest on the assumption that "*after a decision* [by this Court] that IOLTA effects a taking and requires compensation", the Justices would refuse to obey that decision. Pet. Br. at 47 (emphasis added). Petitioners' argument improperly asks this Court to attribute to Washington's highest judicial body an utter lack of respect for the rule of law. *See Dombrowski v. Pfister*, 380 U.S. 479, 484 (1965) ("It is generally to be assumed that state courts . . . will observe constitutional limitations as expounded by this Court."). The federal courts accordingly should not provide Petitioners with a remedy before the state has had an opportunity to do so.

B. Even If A Federal Court May Grant A Remedy, Injunctive Relief Is Not Appropriate

"It is a fundamental principle of long standing that a request for an injunction will not be granted as long as an adequate remedy at law is available." *Nat'l Farmers Union Ins. Co. v. Crow Tribe of Indians*, 471 U.S. 845, 856 n.22 (1985). Further, "one of the most important considerations governing the exercise of equitable power is a proper respect for the integrity and function of local government institutions. Especially is this true where . . . those institutions are ready, willing, and . . . able to remedy the deprivation of constitutional rights themselves." *Missouri v. Jenkins*, 495 U.S. 33, 51 (1990). Assuming that some just compensation is due to Petitioners, they have an adequate remedy at law, namely, a monetary award of any value taken from them.

Petitioners argue, however, that when the property taken is money, the appropriate remedy is an injunction. Pet. Br. at 18, 38. They point to the plurality opinion in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), which observed that where the government "takes" a monetary payment, monetary relief against the government would require the state to compensate owners for the very dollars "taken", and that, in turn, "would entail an utterly pointless set of activities", namely, a dollar-for-dollar exchange. *Apfel*, 524 U.S. at 521. The implicit assumption of *Apfel* is that when the Coal Act requires payment of a company's money, the just compensation due is exactly equal to the amount of the monetary payment required under the Act. But the same is not true of IOLTA. Assuming the interest on Petitioners' IOLTA funds is "taken", the value of that interest to Petitioners is something less than the value received by the Legal Foundation of Washington. That is because individual clients who seek to earn interest from those funds would be subject to greater costs than those borne by the Foundation. *See supra* p. 7; note 1. And, as noted earlier, the Fifth Amendment requires compensation only for the value taken from the owner, not the value received by the government. Consequently, the implicit assumption of *Apfel* – that the amount of compensation due is exactly equal to the amount collected by the government – is not present in this case. Petitioners themselves seem to recognize this point. *See* Pet. Br. at 42 ("if the IOLTA program is held to violate the Takings Clause, Washington State could be required . . . to refund *some* or all of the very money it had just collected") (emphasis added). Because any just compensation due would be something less than the interest collected by the Foundation, injunctive relief is not appropriate.

Petitioners' only remaining argument for injunctive relief is that claimants would have to use Washington's inverse condemnation remedy, and it may not be particularly convenient or economical. Pet. Br. at 42. This argument simply ignores the well-settled rule that the Fifth Amendment does not prohibit the taking of private property for a public purpose when a suit for compensation subsequent to the taking is available. *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987); *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 697 n.18 (1949). Petitioners' position would radically alter takings jurisprudence. Cost and inconvenience inhere in eminent domain and inverse condemnation actions, just as cost and inconvenience inhere in virtually every legal remedy. Petitioners' position effectively would negate the ability of government to take private property for public purposes at all, rendering meaningless the conditional authority granted to it by the Fifth Amendment.

CONCLUSION

For these reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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