
Prepared by the ABA Commission on IOLTA

In a June 15, 1998, 5-4 opinion authored by Chief Justice Rehnquist, the U.S. Supreme Court ruled that Texas law observes the "interest follows principal" doctrine, and, as a result, interest earned on client funds held in an IOLTA account is client property. This decision affirmed the 1996 Fifth Circuit decision in Washington Legal Foundation, et al. v. Texas Equal Access to Justice Foundation, et al., 94 F.3d 996 (CA5 1996), which held that, under Texas law, clients have a property interest in the revenues created by pooled IOLTA accounts.¹

Justices O'Connor, Scalia, Kennedy and Thomas joined the majority opinion, which expressed no view as to whether Texas had "taken" client property, or whether any "just compensation" is due the respondents. It remanded those issues to the Fifth Circuit Court of Appeals, which in turn remanded the case to the United States District Court for the Western District of Texas, Austin Division.²

The petitioners argued that no property interest is implicated in this case because the only client funds that may properly be placed in an IOLTA account are those that cannot earn net interest for the client. The Court disagreed. It ruled that a physical item does not lose its status as "property" simply because it lacks a positive economic or market value. Property, the Chief Justice wrote, also consists of "the group of rights that the so-called owner exercises in his or her dominion of the physical thing, such as the right to possess, use and dispose of it." Although the interest income at issue in this case may have no economically realized value to its owner, the Court ruled that possession, control, and disposition nonetheless are valuable rights intrinsic to property.

Justice Breyer wrote a dissent that Justices Stevens, Souter and Ginsburg joined. He agreed with the petitioners that no property interest is implicated in this case.

Justice Souter authored a dissent joined by Justices Stevens, Ginsburg and Breyer. It asserts that the Court either should have decided all three Takings Clause issues together (i.e., is there property, has the state taken the property, and is just compensation due as a result of the taking?) or returned the case to the Fifth Circuit

Court of Appeals to do the same. Justice Souter wrote that this approach would reduce the risk of placing undue emphasis on the existence of a generalized property right that may turn out to be an entirely theoretical matter, especially when, in his estimation, the respondents will have a difficult time prevailing on the other two issues.

To find a "taking," the Court must consider: 1) the nature of the government’s action; 2) the economic impact of that action; and 3) the degree of any interference with the property owner’s reasonable, investment-backed expectations. See Penn Central Transportation Co. v. New York City, 438 US 104 (1978).

As Justice Souter observed, in this case: 1) there is no physical occupation or seizure of tangible property; 2) there is no apparent economic impact, since the client would have no net interest to go in his or her pocket (IOLTA or no IOLTA); 3) the facts present neither anything resembling an investment nor any apparent basis for the client to reasonably expect to obtain net interest.

Even if the Court were to find that a taking had occurred, Justice Souter asserted, it is hard to imagine how the respondents could successfully argue that they are due "just compensation."