SUPREME COURT OF THE UNITED STATES

No. 96–1578

THOMAS R. PHILLIPS, ET AL., PETITIONERS *v.* WASHINGTON LEGAL FOUNDATION ET AL.

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

[June 15, 1998]

JUSTICE SOUTER, with whom JUSTICE STEVENS, JUSTICE GINSBURG, and JUSTICE BREYER join, dissenting.

The Court holds that "interest income generated by funds held in IOLTA accounts is the 'private property' of the owner of the principal." *Ante*, at 14. I do not join in today's ruling because the Court's limited enquiry has led it to announce an essentially abstract proposition; even on the assumption that the abstraction proposition is a correct statement of law, it may ultimately turn out to have no significance in resolving the real issue raised in this case, which is whether the Interest on Lawyers Trust Account (IOLTA) scheme violates the Takings Clause of the Fifth Amendment. Since the sounder course would be to vacate the similarly limited judgment of the Court of Appeals for the Fifth Circuit and remand for the broader enquiry outlined below, I respectfully dissent.

The Court recognizes three distinct issues implicated by a takings claim: whether the interest asserted by the plaintiff is property, whether the government has taken that property, and whether the plaintiff has been denied just compensation for the taking. *Ante*, at 14. The Court is careful to address only the first of these questions, *ibid.*, which is the only one on which the Fifth Circuit ruled. See *Washington Legal Foundation* v. *Texas Equal Access to*

Justice Foundation, 94 F. 3d 996, 1004 (1996).

The affirmative answer given by the Court and the Fifth Circuit to the question whether IOLTA interest attributable to a client's funds is the client's property states, in essence, a proposition of state law, which is one source of property interests entitled to federal constitutional protection, see *Board of Regents of State Colleges* v. *Roth,* 408 U. S. 564, 577 (1972), and *Lucas* v. *South Carolina Coastal Council,* 505 U. S. 1003, 1030 (1992). In this instance the relevant state law is said to embrace the general principle that property in interest income follows ownership of the principal on which the interest is earned, *ante*, at 7, and n. 4, and the Court treats any income generated by a client's funds like income that the client could derive directly through a method of money management or investment that costs more than it produced, *ante*, at 12–13.

In addressing only the issue of the property interest, leaving the questions of taking and compensation for a later day in the litigation of respondents' action, the Court and the Court of Appeals have, however, postponed consideration of the most salient fact relied upon by petitioners in contesting respondent's Fifth Amendment claim: that the respondent client would effectively be barred from receiving any net interest on his funds subject to the state IOLTA rule by the combination of an unchallenged federal banking statute and regulation, 12 U. S. C. §1832(a), 12 CFR §204.130 (1997); a separate, unchallenged Texas rule of attorney discipline, Texas Bar Rules, Art. 10, §9, Rule 1.14(b); and unchallenged Internal Revenue Service interpretations of the Tax Code, Rev. Rul. 81–209; 1981–2 Cum. Bull. 16, Rev. Rul. 87–2, 1987–1 Cum. Bull. 18. The argument for the view contrary to the one taken by the Court would emphasize that salient fact right now. The view that the client has no cognizable property right in the IOLTA interest is said to rest not only on a different understanding of the scope of the general principle and its

place in state law,[1] but also upon the very regulatory framework that would prevent a client from obtaining any net interest on funds now subject to IOLTA, even if IOLTA did not exist.[2] It is not, of course, that the federal and state regulatory combination includes some rule that is facially inconsistent with the general principle that interest follows principal; the components of the regulatory structure do not even directly address the question of who owns interest. Indeed, the most obvious relevance of the regulatory provisions and their effects is to the issues of whether IOLTA results in a taking of the client's property and whether any such taking requires compensation. And yet by this route the regulatory structure becomes relevant to the property issue as well, simply because the way we may ultimately resolve the taking and compensation issues bears on the way we ought to resolve the property issue. If it should turn out that within the meaning of the Fifth Amendment, the IOLTA scheme had not taken the property recognized today, or if it should turn out that the "just compensation" for any taking was zero, then there would be no practical consequence for purposes of the Fifth Amendment in recognizing a client's property right in the interest in the first place; any such recognition

---

[1] The highest court of Texas has not understood the general principle that a property right in interest always follows property in principle in a way that supports respondents in this IOLTA challenge. See *Sellers* v. *Harris County*, 483 S. W. 2d 242, 243 (Tex. 1972) (owner of principal is entitled to interest, less administrative and accounting costs). *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith,* 449 U. S. 155 (1980), is not on point precisely because it dealt with interest actually in the hands of the fiduciary, net of any administrative expense.

[2] These unchallenged state and federal rules clearly fall within the general category of relevant law defining property subject to constitutional protection, see *Board of Regents of State Colleges* v. *Roth,* 408 U. S. 564, 577 (1972) ("Property interests" are "created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law").

would be an inconsequential abstraction. Cf. *Hooker* v. *Burr,* 194 U. S. 415, 419 (1904) (If a contractual obligation is impaired, but the obligor is "not injured to the extent of a penny thereby, his abstract rights are unimportant"). The significance of the regulatory structure, and the issues of taking and compensation, should therefore be considered today.

Approaching the property issue in conjunction with the two others would, in fact, be entirely faithful to the Fifth Amendment, for as we have repeatedly said its Takings Clause does nothing to bar the government from taking property, but only from taking it without just compensation, see, *e.g., First English Evangelical Lutheran Church of Glendale* v. *County of Los Angeles,* 482 U. S. 304, 315 (1987); *Williamson County Regional Planning Comm'n* v. *Hamilton Bank of Johnson City,* 473 U. S. 172, 194 (1985). It thus makes good sense to consider what is property only in connection with what is a compensable taking, an approach to Fifth Amendment analysis that not only would avoid spending time on what might turn out to be an entirely theoretical matter, but would also reduce the risk of placing such undue emphasis on the existence of a generalized property right as to distort the taking and compensation analyses that necessarily follow before the Fifth Amendment's significance can be known.[3]

---

[3] For example, with respect to the determination whether government regulation "goes too far" in diminishing the value of a claimant's property, we have repeatedly instructed that a "parcel of property could not first be divided into what was taken and what was left for the purpose of demonstrating the taking of the former to be complete and hence compensable." *Concrete Pipe & Products of Cal., Inc.* v. *Construction Laborers Pension Trust for Southern Cal.,* 508 U. S. 602, 644 (1993); see also *Penn Central Transp. Co.* v. *New York City,* 438 U. S. 104, 130–131 (1978). With its narrow focus on a party's right to any interest generated by its principal, the Court's opinion might be read (albeit erroneously, in my view) to mean that the accrued interest is the

That is not to say, of course, that we should resolve either the taking or compensation issues here, for the Fifth Circuit did not address them. Rather, we should determine here whether either of the remaining issues might reasonably be resolved against respondents; if so, we should not abstract the property issue for resolution in their favor now, but should return the case to the Court of Appeals to consider all three issues before resolving the first. Suffice it to say that both the taking and compensation questions are serious ones for respondents.

First, as to a taking, we start with *Penn Central Transp. Co.* v. *New York City,* 438 U. S. 104 (1978), and its guidance about certain sorts of facts that are of particular importance in what is supposed to be an "ad hoc, factual" enquiry, *id.,* at 124, into whether the government has "go[ne] too far." *Pennsylvania Coal Co.* v. *Mahon,* 260 U. S. 393, 415 (1922). Attention should be paid to the nature of the government's action, its economic impact, and the degree of any interference with reasonable, investment-backed expectations. *Penn Central, supra,* at 124. Here it is enough to note the possible significance of the facts that there is no physical occupation or seizure of tangible property, cf. *Loretto* v. *Teleprompter Manhattan CATV Corp.,* 458 U. S. 419, 426 (1982) (noting that physical intrusion is "unusually serious" in the takings context); that there is no apparent economic impact (since the client would have no net interest to go in his pocket, IOLTA or no IOLTA); and that the facts present neither anything resembling an investment nor (for the reason just given) any apparent basis for reasonably expecting to obtain net interest. While a court would certainly consider any proposal that respondents might make for a departure from the *Penn Central* approach to vindicating the Fifth Amendment in

---

only property right relevant to the question whether IOLTA effects a taking.

these circumstances, application of *Penn Central* would not bode well for claimants like respondents.

Second, as to the just compensation requirement, the client's inability to earn net interest outside IOLTA, due to the unchallenged federal and state regulations, raises serious questions about entitlement to any compensation (which, if required, would convert any "taking" into a wash transaction from the client's standpoint). "Just compensation" generally means "the full monetary equivalent of the property taken." *United States* v. *Reynolds,* 397 U. S. 14, 16 (1970). In determining the amount of just compensation for a taking, a court seeks to place a claimant " 'in as good a position pecuniarily as if his property had not been taken.' " *United States* v. *564.54 Acres of Monroe and Pike County Land,* 441 U. S. 506, 510 (1979) (quoting *Olson* v. *United States,* 292 U. S. 246, 255 (1934)), calculating any loss objectively and independently of the claimant's subjective valuation, see, *e.g., Kimball Laundry Co.* v. *United States,* 338 U. S. 1, 5 (1949).

Thus, in deciding what award would be needed to place the client respondent in as good a position as he would have enjoyed without a taking, a court presumably would look to the claimant's putative property interest as it was or would have been enjoyed in the absence of IOLTA, cf. *Boston Chamber of Commerce* v. *Boston,* 217 U. S. 189, 195 (1910), and consequently would measure any required compensation by the claimant's loss, not by the government's (or the public's) gain, *ibid.* This rule would not obviously produce much benefit to respondents. While it has been suggested in their favor that a cognizable taking may occur even when value has been enhanced, on the supposed authority of *Loretto, supra,* at 437, n. 15, that case dealt only with physical occupation, it rested on no finding that value had actually been enhanced, and it held nothing about the legal consequences of an actual finding that enhancement had occurred. The Court today makes a

further suggestion of a way in which respondents might deflect the objection that they have lost nothing, when it observes that the notion of property is not limited by the concept of value, *ante*, at 12. But the Court makes the point by equating the government's seizure of funds from the pocket of a failing business owner with IOLTA's disposition of funds the client never had or could have received. Neither the equation, nor its relevance to the Fifth Amendment's guarantee of just compensation, is immune to question.

But, however these issues of taking and compensation may someday be adjudicated, two things are clear now: the issues are serious and they might be resolved against respondents. If that should happen, today's holding would stand as an abstract proposition without significance for the application of the Fifth Amendment.

If abstraction were guaranteed to be harmless, of course, an abstract ruling now and again would not matter much, beyond the time spent reaching it. But our law has been wary of abstract legal propositions not only because the common-law tradition is a practical one, but because abstractions pose their own peculiar risks. As THE CHIEF JUSTICE noted in a different but related context, there is a danger in "cutting loose the notion of 'just compensation' from the notion of 'private property.' " *Almota Farmers Elevator & Warehouse Co.* v. *United States,* 409 U. S. 470, 486 (1973) (REHNQUIST, J., dissenting); see also *id.,* at 482–483 ("While the inquiry as to what property interest is taken by the condemnor and the inquiry as to how that property interest shall be valued are not identical ones, they cannot be divorced without seriously undermining a number of rules dealing with the law of eminent domain").

One may wonder here not only whether the theoretical property analysis may skew the resolution of the taking and compensation issues that will follow, but also how far today's holding may unsettle accepted governmental prac-

tice elsewhere. By recognizing an abstract property right to interest "actually 'earned' " by a party's principal, *ante*, at 10–11, does the Court not raise the possibility of takings challenges whenever the government holds and makes use of the principal of private parties, as it frequently does? When, for example, the National Government, or a State, has engaged in excessive tax withholding, it does not refund the interest earned between the time of withholding and the issuance of a refund. For any number of reasons unrelated to the recognition or nonrecognition of a generalized property right in interest, but tied to the questions of takings and compensation, it seems unlikely that such withholding practices would violate the Fifth Amendment. Nevertheless, the Court's abstract ruling may encourage claims of just this sort.

To avoid the dangers of abstraction, I would therefore vacate the judgment of the Court of Appeals and remand for plenary Fifth Amendment consideration. If, however, the property interest question is to be considered in the abstract, I would recast it and answer it as JUSTICE BREYER has done in his own dissenting opinion, which I join.