

Missouri Law Review

Volume 76
Issue 2 *Spring 2011*

Article 5

Spring 2011

Rethinking IOLTA

Dru Stevenson

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Rethinking IOLTA

Dru Stevenson*

ABSTRACT

IOLTA (Interest on Lawyers' Trust Accounts) is a popular mechanism for funding legal services for the poor, and such programs now operate in every state. IOLTA programs suffer from badly depleted resources due to the current financial environment, causing painful cutbacks at the nonprofit legal aid entities that depend on IOLTA for their operating expenses. This shortfall casts doubt on the wisdom of widespread dependence on IOLTA.

The previous academic literature about IOLTA focused on input-side issues: the original owners' property rights in the interest taken to fund the programs, the compliance of lawyers with the program's requirements, and the role of banks as intermediaries. Instead, this Article focuses on the output side, analyzing some unconsidered consequences of IOLTA programs.

This Article analyzes five previously ignored policy concerns about IOLTA: crowding out effects, monopoly and monopsony effects, agency problems, and moral hazard problems. Finally, the Article offers some modest policy reforms in response to these issues.

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* Professor of Law, South Texas College of Law. The author would like to thank the faculty at Florida State University School of Law and South Texas College of Law for the opportunity to present this paper in faculty luncheons at each institution, and to receive helpful comments from other professors. Particular thanks are due to Professors Geoff Corn and Elizabeth Burleson for reviewing drafts of the manuscript. Research assistants Andrew Nelson, Skyler Varnadore, Lindsey Karm, and Jenny Kessler provided invaluable help with research and proofreading. Attorney Mary Beth Stevenson, the author's spouse, was extremely supportive in discussing the topic endlessly and reviewing serial versions of the manuscript.

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I. INTRODUCTION

In the United States, legal services for the poor primarily come from nonprofit legal aid agencies devoted to providing free or affordable basic services. Most of their funding comes from two sources: the federal Legal Services Corporation (LSC),¹ a quasi-governmental entity whose annual budget is congressionally apportioned, and state-based IOLTA (Interest on Lawyers' Trust Accounts) programs.² Although LSC funds are significantly larger than the aggregate of all IOLTA funds in a given year,³ they stringently limit the activities of recipient agencies.⁴ LSC-funded agencies may not engage in lobbying; class-action lawsuits; criminal defense-related work; advocacy for abortion rights; or representation of prisoners, illegal immigrants, or assisted suicide defendants.⁵ These restrictions are comprehensive enough to

1. The Legal Services Corporation (LSC) is a quasi-governmental entity, a 501(c)(3) corporation created by Congress in 1974 that receives its annual funding by Congressional appropriation. Legal Services Corporation, What is LSC?, www.lsc.gov/about/lsc.php (last visited Jan. 30, 2011). The LSC's fiscal year 2010 appropriation was \$420 million. Legal Services Corporation, LSC's Budget, www.lsc.gov/about/budget.php (last visited Jan. 30, 2011).

2. For an overview of the programs and history, see Interest on Lawyers Trust Account, www.IOLTA.org (last visited Feb. 8, 2011). See also James P. George, *Access to Justice, Costs, and Legal Aid*, 54 AM. J. COMP. L. 293, 313 (2006); Elena Romerdahl, *The Shame of the Legal Profession: Why Eighty Percent of Those in Need of Civil Legal Assistance Do Not Receive It and What We Should Do About It*, 22 GEO. J. LEGAL ETHICS 1115, 1123 (2009).

3. For example, in 2008, the IOLTA grants nationwide totaled \$263.4 million, whereas the LSC appropriation for fiscal year 2008 was over \$350.4 million. American Bar Association, IOLTA Overview, <http://www.abanet.org/legalservices/iolta/ioltback.html> (last visited Jan. 30, 2011) [hereinafter IOLTA Overview]; Legal Services Corporation, FY 08 Appropriation, <http://www.lsc.gov/about/FY08app.php> (last visited Jan. 30, 2011). The disparity grew significantly in 2009 due to the effects of the financial crisis (especially the housing market crash) on IOLTA funds. IOLTA Overview, *supra*.

4. See Omnibus Consolidated Rescissions and Appropriations Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321 (codified at 45 C.F.R. §§ 1612-1637 (2010)); Rebekah Diller & Emily Savner, *Restoring Legal Aid for the Poor: A Call to End Draconian and Wasteful Restrictions*, 36 FORDHAM URB. L.J. 687, 693 (2009); Alan W. Houseman, *Restrictions by Funders and the Ethical Practice of Law*, 67 FORDHAM L. REV. 2187, 2188-89 (1999). For more background, see Legal Servs. Corp. v. Velazquez, 531 U.S. 533 (2001) (holding unconstitutional a restriction on LSC attorneys challenging existing welfare laws).

5. See 45 C.F.R. §§ 1612-1637. The text of the Legal Services Corporation Act is available on the organization's website, www.lsc.gov/pdfs/pr_act.pdf (last visited

prompt many legal aid entities to forego LSC funds entirely and rely mostly on IOLTA money⁶ supplemented by private donations, charitable fundraisers, and small allocations from the state government.⁷

The mechanics of IOLTA are relatively simple. All lawyers must deposit their clients' funds, such as those transferred between parties in a real estate transaction, in special "trust accounts" at a bank, separate from the lawyer's own money or incoming fees before the money is moved to the other party after closing, for example.⁸ The banks holding these escrow accounts calculate a modest interest rate on the aggregate deposits of all of the attorneys and then contribute the yield to a state-sponsored nonprofit foundation. Usually an individual client's sum is too small and remains in the bank too briefly to generate any discernible interest. Cumulatively, however, all of these temporary deposits by lawyers total millions of dollars statewide at any given moment. The state-sponsored nonprofit foundation then distributes the funds to legal aid agencies and related needs in that state. Banks pay a low enough rate that they net some revenue by participating in the program.⁹ "Without taxing the public, and at no cost to lawyers or their clients, interest

Jan. 30, 2011), and the federal regulations that set the parameters of the rules are available for download at LSC Regulations, CFR 45 Part 1600 et. seq., <http://www.lsc.gov/laws/regulations.php> (last visited Jan. 30, 2011).

6. See Diller & Savner, *supra* note 4, at 689 ("In many states, justice planners have had to set up two, duplicative legal aid systems in order to ensure that state and other funds are not constrained by the non-LSC funds restriction. The result is that scarce funds must be spent on duplicate administrative costs – two rents, two copy machines, and two computer networks.") (footnote omitted); see also *Legal Aid Servs. of Or. v. Legal Servs. Corp.*, 561 F. Supp. 2d 1187 (D. Or. 2008), *aff'd*, 608 F.3d 1084 (9th Cir. 2010); Lorna K. Blake, *The IOLTA Fund and LSC Restrictions*, 17 YALE L. & POL'Y REV. 455 (1998); Kenneth W. Mentor & Richard D. Schwartz, *A Tale of Two Offices: Adaptation Strategies of Selected LSC Agencies*, 21 JUST. SYS. J. 143 (2000).

7. See, e.g., Jennifer L. Colyer et al., *The Representational and Counseling Needs of the Immigrant Poor*, 78 FORDHAM L. REV. 461, 496 (2009). The lawyers who work for these agencies also contribute significantly, albeit less directly, by accepting substantially lower wages than those earned by their counterparts in private firms or government posts.

8. See IOLTA.org, What is IOLTA?, <http://www.iolta.org/grants/> (last visited Feb. 14, 2011) [hereinafter What is IOLTA?].

9. See Betsy Borden Johnson, "With Liberty And Justice For All": IOLTA in Texas - The Texas Equal Access To Justice System, 37 BAYLOR L. REV. 725, 727 (1985) (describing the incentives for banks to accept IOLTA accounts). But see Kenneth Paul Kreider, *Florida's IOLTA Program Does Not "Take" Client Property for Public Use: Cone v. State Bar of Florida*, 57 U. CIN. L. REV. 369, 390 (1988) (explaining that some banks in the early 1980s expressed concern about the increased accounting burden of having IOLTA, but this may have been a ruse for the fact that the banks were simply keeping all the interest on these accounts for themselves before IOLTA began).

from lawyer trust accounts is pooled to provide civil legal aid to the poor and support improvements to the justice system.”¹⁰

The IOLTA funding scheme is conceptually elegant and appears to be as close to “free money” as one could imagine. It stands in contrast to most taxation programs, which impose a marginal cost or disutility on the taxpayer that is greater than the marginal value of that taxpayer’s contribution to the public fisc. Much public resentment about taxation stems from the intuition that keeping one’s money for oneself would result in greater good or utility than would come from dutifully paying the taxes if not for enforcement penalties. The problem is a classic tragedy of the commons: if everyone acted on this logic, everyone would feel the consequences of an unfunded government. IOLTA reverses this logic, taking sums so small that the value to the original owner, in practical terms, is zero. No tangible loss is present, and there is a sense that participation in IOLTA will benefit the state program more than it will benefit individuals. Taken together, the tiny sums, accrued a few cents at a time, form a statewide pool of millions of dollars each year. To the extent that IOLTA is a tax at all, it is a nanotax.

The American Bar Association maintains that the IOLTA programs have been a remarkable success.¹¹ All fifty states have implemented IOLTA programs,¹² together generating \$150-250 million every year¹³ for legal aid

10. See What is IOLTA?, *supra* note 8. Professor Mortensen, in his highly technical critique of the Australian IOLTA program, notes that the real losers in this arrangement are the private shareholders of the banks, as the banks would otherwise have internalized the funds as profits. Reid Mortensen, *Interest on Lawyers’ Trust Accounts*, 27 SYDNEY L. REV. 289, 303-05 (2005).

11. As the ABA notes, “IOLTA is among the most significant sources of funding for programs that provide civil legal services to the poor, with close to 90 percent of grants awarded by IOLTA programs (\$230.4 million in 2008) supporting legal aid offices and pro bono programs.” IOLTA Overview, *supra* note 3. Currently the greatest threat to the continued success of IOLTA programs is continuously low interest rates, which lead to lower amounts of funds collected from IOLTA accounts. See generally Kenneth W. Babcock, *A Growing Threat to the Social Safety Net in Orange County*, 51 ORANGE COUNTY LAW., June 2009, at 10, 11 (2009) (describing the Public Law Center’s need for increased funding); James B. Sales, *Access to Justice*, 72 TEX. B.J. 48, 48 (2009) (explaining how the economic downturn affected the access to justice in Texas).

12. See American Bar Association, Status of IOLTA Programs, <http://www.abanet.org/legalservices/iolta/ioltus.html> (last visited Jan. 30, 2011) [hereinafter Status of IOLTA Programs]. In 1981, Florida adopted the first IOLTA program in the United States. *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 221 (2002) (describing how Florida “authoriz[ed] the use of NOW accounts for the deposit of client funds, and provid[ed] that all of the interest on such accounts be used for charitable purposes. Every State in the Nation and the District of Columbia have followed Florida’s lead and adopted an IOLTA program, either through their legislatures or their highest courts.”); *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 161 (1998).

agencies across the nation.¹⁴ In forty-three jurisdictions, participation is mandatory for all lawyers.¹⁵ While nine remaining jurisdictions have either opt-out rules or opt-in rules, the consistent trend is toward adopting mandatory programs.¹⁶ States may switch from opt-out to mandatory rules, but never from mandatory to opt-out rules.¹⁷

Despite its prevalence and popularity, IOLTA faces a severe depletion of resources after the 2008 housing and banking crisis. A second problem looms on the horizon, as several post-*Kelo* eminent domain reforms¹⁸ appear to have made the IOLTA programs in their states illegal, albeit inadvertently. Ten states adopted measures banning all takings where the state transfers the

13. "The aggregate value of those contributions in 2001 apparently exceeded \$200 million." *Brown*, 538 U.S. at 223. The 2008 contributions total reached \$260 million. IOLTA Overview, *supra* note 3. The National Association of IOLTA Programs and the American Bar Association Commission on IOLTA estimate that between 1991-2003 more than \$1.5 billion has been produced by IOLTA nationwide. See What Is IOLTA?, *supra* note 8.

14. The state of Texas provides that "[i]nterest earned by the funds deposited in an IOLTA account is to be paid to the Texas Equal Access to Justice Foundation (TEAJF), a nonprofit corporation established by the Supreme Court of Texas." *Philips*, 524 U.S. at 162. The funds are then allocated as TEAJF sees fit to nonprofit groups that provide legal services to low-income individuals. *Id.* Each state distributes the funds created by IOLTA in different ways. See *Briefs*, TENN. B.J., Aug. 2009, at 5, 5; Aims C. Coney, Jr. & Barbara S. Rosenberg, *A Lawyer's Responsibility in Handling Funds and Property: Recent Changes to Disciplinary Rules and Procedures*, 80 PA. B. ASS'N Q. 61, 65-66 (2009); *Focus on the Vermont Bar Foundation: Grants Awarded by the Vermont Bar Foundation for FY 2007*, 33 VER. B.J. & L. DIG. 44 (2007); Jayne B. Tyrell & Lisa C. Wood, *Residual Class Action Funds: Supreme Judicial Court Identifies IOLTA as Appropriate Beneficiary*, B.B.J., Fall 2009, at 17, 17.

15. Status of IOLTA Programs, *supra* note 12; see also American Bar Association, Interest on Lawyers' Trust Accounts, <http://www.abanet.org/legalservices/iolta/home.html> (last visited Jan. 30, 2011).

16. Status of IOLTA Programs, *supra* note 12; see, e.g., John A. Tarantino, *Friends in Low Places*, R.I. B.J., Oct., 2008, at 5, 6 ("[T]he Bar Foundation and Bar Association plan to file a joint petition asking the Rhode Island Supreme Court to amend Rule of Professional Conduct 1.15 to make the establishment of Interest on Lawyers Trust Accounts (IOLTA) mandatory for all lawyers who hold client funds."); R.I. R. PROF'L CONDUCT R. 1.15 (amended Dec. 11, 2008).

17. The ABA lists eighteen states that have made the change from opt-out status to mandatory status and fifteen that have made the change from opt-in to mandatory status. See Status of IOLTA Programs, *supra* note 12.

18. The Supreme Court's decision in *Kelo v. City of New London*, 545 U.S. 469 (2005), touched off a nationwide legislative response at the state level. *Kelo* upheld a municipal eminent domain action that transferred real property from private homeowners to commercial developers. *Id.* at 489-90. In the aftermath, nearly every state passed either a statute or constitutional amendment to limit *Kelo*-style eminent domain actions.

property to another private entity¹⁹ – one of the main functions of IOLTA.²⁰ Litigation under these new enactments has not yet begun, but it seems inevit-

19. Arizona, Idaho, Kansas, Louisiana, Nevada, New Hampshire, North Dakota, Texas, Washington, and Wyoming now have either statutes or state constitutional amendments that ban private-to-private takings. See ARIZ. CONST. art. II, § 17 (“Private property shall not be taken for private use, except for private ways of necessity, and for drains, flumes, or ditches, on or across the lands of others for mining, agricultural, domestic, or sanitary purposes.”); LA. CONST. art. I, § 4 (“[P]roperty shall not be taken or damaged by the state or its political subdivisions: (a) for predominant use by any private person or entity; or (b) for transfer of ownership to any private person or entity.”); N.H. CONST. pt. 1, art. 12-a; N.D. Measure 2 (amending N.D. CONST. art. I, § 16) (“[P]ublic use or a public purpose does not include public benefits of economic development, including an increase in tax base, tax revenues, employment, or general economic health. Private property shall not be taken for the use of, or ownership by, any private individual or entity, unless that property is necessary for conducting a common carrier or utility business.”); TEX. CONST. art. I, § 17; WASH. CONST. art. I, § 16 (“Private property shall not be taken for private use, except for private ways of necessity, and for drains, flumes, or ditches on or across the lands of others for agricultural, domestic, or sanitary purposes.”); WYO. CONST. art. I, § 32 (“Private property shall not be taken for private use unless by consent of the owner, except for private ways of necessity, and for reservoirs, drains, flumes or ditches on or across the lands of others for agricultural, mining, milling, domestic or sanitary purposes, nor in any case without due compensation.”); IDAHO CODE § 7-701A(2)(a) (2006) (“Eminent domain shall not be used to acquire private property . . . [f]or any alleged public use which is merely a pretext for the transfer of the condemned property or any interest in that property to a private party”); IDAHO CODE § 7-701 (providing a definition of “public use” that does not include helping the poor or providing legal services); Act of May 18, 2006, ch. 192, 2006 Kan. Sess. Laws 1345, §§ 1-2 (codified at KAN. STAT. §§ 26-501a, 26-501b (Supp. 2008)); NEV. REV. STAT. § 37.010(2) (2007) (“Notwithstanding any other provision of law and except as otherwise provided in this subsection, the public uses for which private property may be taken by the exercise of eminent domain do not include the direct or indirect transfer of any interest in the property to another private person or entity.”); N.D. CENT. CODE § 32-15-01(2) (2007).

20. Most of these post-*Kelo* enactments have limited effect or are merely procedural, as other commentators have noted. See, e.g., Ilya Somin, *The Limits of Backlash: Assessing the Political Response to Kelo*, 93 MINN. L. REV. 2100, 2103-05 (2009). Even so, some states’ reforms may bear directly on their state’s IOLTA program by prohibiting any “takings” where the government takes property and gives it to a private or non-governmental entity, regardless of the public purpose served or the compensation paid to the owner. See *id.* IOLTA was certainly not the target of any of these resolutions or amendments; instead, states were responding to the public uproar over the *Kelo* decision. Barbara A. Bardes et al., *AMERICAN GOVERNMENT AND POLITICS TODAY: THE ESSENTIALS* 15 (2009) (“The Court’s decision [in *Kelo*] caused an immediate uproar across the nation.”). The IOLTA programs in these states have continued operating, of course, since these enactments. No significant new legal challenges to IOLTA have emerged since the *Brown* decision. The post-*Kelo* reform measures, however, could furnish the legal ammunition for a completely new wave of attacks targeting IOLTA, if opponents of the programs were inclined to try, or when the opponents realize that the arsenal for attacks is expanding. The Su-

able given the tenacity of previous legal challenges to IOLTA by conservative advocacy groups.²¹

These two new challenges to IOLTA present an opportunity to pause and evaluate the IOLTA system. There are some theoretical weaknesses of IOLTA that until now have received no consideration in academic or public policy literature. Rethinking IOLTA would enable states to make the necessary adjustments to mitigate some of the inherent problems and to balance the programs with other sources of funding and volunteers for legal services to the poor, such as “civil *Gideon*” programs²² and pro bono efforts. The purpose of this Article is not to discuss the current funding crisis or legal challenges facing IOLTA,²³ nor the property-rights issues that were the focus of the last round of IOLTA litigation in the 1990s.²⁴ Instead, this Article addresses the previously ignored problems inherent in the programs even when they are operating well.

The first of these concerns is the “crowding out”²⁵ effect that IOLTA programs seem to have on pro bono efforts and other potential funding

preme Court’s 2003 IOLTA decision in *Brown* explicitly stated that IOLTA programs constitute a “taking.” See *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 235 (2003). The Supreme Court’s earlier decision about IOLTA, *Phillips v. Washington Legal Foundation*, was similarly explicit in holding that IOLTA funds were “‘private property’ of the owner of the principal,” that is, each lawyer’s clients. 524 U.S. 156, 164, 172 (1998).

21. See *Brown*, 538 U.S. at 227-28; John D. Jurcyk, *Be Not Afraid*, 78 J. KAN. B. ASS’N. 10, 10 (2009) (“There has been a great deal of confusion over the legality of IOLTA programs. This confusion has ended. The U.S. Supreme Court upheld the constitutionality of IOLTA programs.”); see also *Marshall v. Commonwealth ex rel. Hatchett*, 20 S.W.3d 478, 482-83 (Ky. Ct. App. 2000) (describing the *Phillips* case as a challenge to the Texas IOLTA program by a Texas attorney and “a conservative legal foundation”).

22. “Civil *Gideon*” refers to the civil counterpart to the criminal defense lawyers provided by right under the Supreme Court’s decision in *Gideon v. Wainwright*, 372 U.S. 335, 344 (1963). Several states are experimenting with pilot programs to provide court-appointed lawyers for indigent litigants in certain types of cases, especially juvenile delinquency actions by the states. See, e.g., Norman Lefstein, *In Search of Gideon’s Promise: Lessons from England and the Need for Federal Help*, 55 HASTINGS L.J. 835, 836 (2004).

23. See Dru Stevenson, *A Million Little Takings 2* (2010) (unpublished manuscript, on file with author).

24. This Article summarizes the previous round of litigation, *infra* Part II, as part of the historical background of IOLTA.

25. “Crowding out” is an economic term describing situations in which government funding of public goods can cause a decline in private contributions and volunteer activity. See, e.g., Burton A. Abrams & Mark D. Schmitz, *The Crowding-Out Effect of Governmental Transfers on Private Charitable Contributions*, in *THE ECONOMICS OF NONPROFIT INSTITUTIONS: STUDIES IN STRUCTURE AND POLICY* 303, 303-12 (Susan Rose-Ackerman ed., 1986); see also Gary E. Bolton & Elena Katok, *An Experimental Test of the Crowding Out Hypothesis: The Nature of Beneficent*

sources for legal services, such as LSC funds and private donations.²⁶ The second problem inherent in IOLTA is that a few agencies in each state receive IOLTA funds, leading to the monopolization of legal services²⁷ and a tendency toward “viewpoint monopoly”²⁸ among the legal aid agencies in each state. Third, IOLTA produces a monopsony, or single-buyer, problem.²⁹

Behavior, 37 J. ECON. BEHAV. & ORG. 315, 315-31 (1998) (“We find extensive but incomplete crowding out”); Jane K. Dokko, *Does the NEA Crowd Out Private Charitable Contributions to the Arts?* (Fed. Reserve Bd., Working Paper No. 2008-10, 2008), available at <http://ssrn.com/abstract=1327111>. For a more skeptical view of the crowding out hypothesis, or at least a more nuanced version, see Thomas A. Garrett & Russell M. Rhine, *Does Government Spending Influence Charitable Contributions or Vice Versa?* 14 (Fed. Reserve Bank of St. Louis, Working Paper 2007-012B, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1021285 [hereinafter Garrett & Rhine, *Does Government Spending Influence Charitable Contributions or Vice Versa?*] (“Thus, charitable giving to education appears to influence federal education spending but not state and local government spending, and federal education spending does not influence education giving but state and local education spending does influence education giving.”); Thomas A. Garrett & Russell M. Rhine, *Does Government Spending Really Crowd Out Charitable Contributions? New Time Series Evidence* 18-19 (Fed. Reserve Bank of St. Louis, Working Paper 2007-012A, 2007) available at <http://ssrn.com/abstract=970535> [hereinafter Garrett & Rhine, *New Time Series Evidence*] (“We found that increases in federal spending reduce total charitable giving by roughly 20 percent. This finding is not robust, however, across different empirical specifications and categories of charitable giving.”); Susan Rose-Ackerman, *Do Government Grants to Charity Reduce Private Donations?*, in *THE ECONOMICS OF NONPROFIT INSTITUTIONS*, *supra*, at 313 (modeling at least three scenarios where government grants would increase private donations but acknowledging crowding out in other circumstances).

26. See AMIHAI GLAZER & LAWRENCE S. ROTHENBERG, *WHY GOVERNMENT SUCCEEDS AND WHY IT FAILS* 102-06 (2001).

27. See Edward Rubin, *The Possibilities and Limitations of Privatization*, 123 HARV. L. REV. 890, 918-25 (2010) (book review) (discussing the book’s discussion of the monopoly problem inherent in the outsourcing of public benefits to private entities, as IOLTA does with legal aid agencies); Dru Stevenson, *Privatization of Welfare Services: Delegation by Commercial Contract*, 45 ARIZ. L. REV. 83, 91-92 (2003).

28. See *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 253 (Kennedy, J., dissenting).

29. See Rubin, *supra* note 27, at 920. Monopsony describes situations where there is only one purchaser or funder for particular services, such as legal services for the poor. *Id.* Economics literature demonstrates that monopsony tends to lower the wages of those working, and it lowers the availability of the purchased service or good to below-optimal levels. See R. Baldwin et al., *Regulating Legal Services: Time for the Big Bang?*, 67 MOD. L. REV. 787, 792 (2004) (discussing the monopsony problem with legal services in Great Britain); see also Robert L. Bish & Patrick D. O’Donoghue, *Public Goods, Increasing Cost, and Monopsony: Reply*, 81 J. POL. ECON. 231 (1973) [hereinafter Bish & O’Donoghue, *Public Goods*]; Robert L. Bish & Patrick D. O’Donoghue, *A Neglected Issue in Public-Goods Theory: The Monopsony Problem*, 78 J. POL. ECON. 1367 (1970) [hereinafter Bish & O’Donoghue, *The Mo-*

IOLTA has a fourth inherent problem: the special type of agency costs associated with government outsourcing or privatization.³⁰

One might expect moral hazard problems to be an additional concern with civil *Gideon*, as they are present in other government-funded social services; that is, people with free lawyers might litigate too much (i.e., when it is unnecessary) or unduly prolong litigation. With legal aid, however, the opposite effect occurs, at least with civil *Gideon* programs,³¹ for which we have a body of empirical studies.³² Unlike other welfare programs, government-funded legal services reduce the symptoms of moral hazard in local legal arenas, rather than contributing to them.

The following sections discuss each of these issues in order. Part II provides background about the history of IOLTA and the policy rationales supporting it, as well as a quick overview of the litigation over the programs that culminated in the Supreme Court's decision to endorse IOLTA. The substantive discussion begins in Part III, with a detailed explanation of the "crowding" issue, as well as some proposals for reform. The problem of monopoly or oligopoly in legal services, and the extent to which IOLTA fosters the problem, is the subject of Part IV.

Part V focuses on the monopsony problem and recommends mitigating its effects by permitting more pro bono efforts and promoting more civil *Gideon* programs to balance the existing legal aid infrastructure. Part VI discusses agency costs inherent in IOLTA programs and possible solutions to those costs. The last substantive section, Part VII, briefly discusses moral hazard concerns and the empirical evidence showing the absence of moral

nopsony Problem]; Michael Cooke & Daniel Lang, *The Effects of Monopsony in Higher Education*, 57 HIGHER EDUC. 623 (2009); Josse Delfgaauw & Robert Dur, *From Public Monopsony to Competitive Market: More Efficiency but Higher Prices*, 61 OXFORD ECON. PAPERS 586 (2009); Marvin B. Johnson, *The Effect of Monopsony Power on Teachers' Salaries*, 10 ST. & LOC. GOV'T REV. 56 (1978); Hirofumi Shibata, *Public Goods, Increasing Cost, and Monopsony: Comment*, 81 J. POL. ECON. 223 (1973).

30. See Stevenson, *supra* note 27, at 102-04.

31. See, e.g., TEX. FAM. CODE ANN. §§ 107.013, .015 (2008); Laura K. Abel, *Keeping Families Together, Saving Money, and Other Motivations Behind New Civil Right to Counsel Laws*, 42 LOY. L.A. L. REV. 1087, 1088 (2009); Lana Shadwick & Sandra Hachem, *Expert Witnesses in Child Abuse and Neglect Cases Involving Termination of Parental Rights*, 69 TEX. B.J. 756, 758 (2006); Press Release, Kimberly Schmitt, Tex. Access to Justice Comm'n, *Texas Access to Justice Foundation Awards New Grants for Pilot Projects Impacting the Texas Legal Delivery System* (Dec. 15, 2009), available at <http://www.texasatj.org/node/347>.

32. See, e.g., PHILLIP GRANBERRY & RANDY ALBELDA, ASSESSING THE BENEFITS OF PROVISION OF LEGAL SERVICES THROUGH THE DISABILITY BENEFITS PROJECT (2006), available at <http://www.nlada.org/DMS/Documents/1236007115.86/Disabilitybenefitreport7-07.doc>; STEFAN C. NORRIN ET AL., AN EVALUATION OF TEAM CHILD IN FLORIDA (2002), available at <http://www.nlada.org/DMS/Documents/1195243887.58/FL%20TeamChild%20Evaluation%20Report.pdf>.

hazard effects in civil *Gideon* programs. Part VIII summarizes the Article's main points.

Since the early years of IOLTA programs, academic literature has focused on input-side issues: the property rights of the original owners of the interest, the lawyers' compliance with the program's requirements, and the role of the banks as intermediaries.³³ This Article focuses instead on the output side, analyzing some unconsidered consequences and effects of IOLTA programs. Because next year marks the thirtieth anniversary of IOLTA in the United States, the time has come to evaluate its impact and reassess its policies.

33. See, e.g., James D. Anderson, *The Future of IOLTA: Solutions to Fifth Amendment Takings Challenges Against IOLTA Programs*, 1999 U. ILL. L. REV. 717; Dawn M. Beauchesne, *Just Compensation for Zero is Zero: The Supreme Court's Decision in Brown v. Legal Foundation of Washington Kept IOLTA Programs Exactly Where They Belong*, 38 NEW ENG. L. REV. 293 (2004); Donald L. Beschle, Phillips v. Washington Legal Foundation: *The Future of IOLTA*, 79 B.U. L. REV. 1277 (1999); Lorna K. Blake, *The IOLTA Fund and LSC Restrictions*, 17 YALE L. & POL'Y REV. 455 (1998); J. David Breemer, *IOLTA in the New Millennium: Slowly Sinking Under the Weight of the Takings Clause*, 23 U. HAW. L. REV. 221 (2000); Jay Carlson, *Interest or Principles?: The Legal Challenge to IOLTA in Washington State*, 74 WASH. L. REV. 1119 (1999); Dan Chern, *Why Mandatory IOLTAs Should be Eliminated*, 4 TEX. WESLEYAN L. REV. 123 (1997); Halimah D. DeLaine, *The Importance of Nominal Interest: An Analysis of the Supreme Court's Decision Regarding IOLTA Accounts*, 13 GEO. J. LEGAL ETHICS 183 (1999); Terence E. Doherty, *The Constitutionality of IOLTA Accounts*, 19 WHITTIER L. REV. 487 (1998); Bryan C. Goldstein, Phillips v. Washington Legal Foundation: *The Future of IOLTA*, 79 B.U. L. REV. 1277 (1999); Adam J. Katz, *Making a Silk Stocking Out of a Sow's Ear: An Analysis of IOLTA in Light of Brown v. Legal Foundation of Washington*, 54 SYRACUSE L. REV. 765 (2004); Barry Kaufman, *An Overview of IOLTA*, 1 FLA. COASTAL L.J. 515 (2000); Cecily W. Kerr, *Nothing Taken, Something Gained: State Action as an Alternative Defense for IOLTA Programs in the Aftermath of Phillips v. Washington Legal Foundation*, 31 CONN. L. REV. 1543 (1999); Erin E. Heuer Lantzer, *IOLTA Lost the Battle But Has Not Lost the War*, 33 IND. L. REV. 1015 (2000); Tara E. Montgomery, *Washington Legal Foundation v. Legal Foundation of Washington: Much Ado About Nothing*, 63 LA. L. REV. 485 (2003); W. Frank Newton & James W. Paulsen, *Constitutional Challenges to IOLTA Revisited*, 101 DICK. L. REV. 549 (1997); Ronald D. Rotunda, *Found Money: IOLTA, Brown v. Legal Foundation of Washington, and the Taking of Property Without the Payment of Compensation*, 2003 CATO SUP. CT. REV. 245; Brent Salmons, *IOLTAs: Good Work or Good Riddance?*, 11 GEO. J. LEGAL ETHICS 259 (1998); Katharine L. Smith, *IOLTA in the Balance: The Battle of Legality and Morality Between Robin Hood and the Miser*, 34 ST. MARY'S L.J. 969 (2003); Hillary A. Webber, *Equal Justice Under the Law: Why IOLTA Programs Do Not Violate the First Amendment*, 53 AM. U. L. REV. 491 (2003).

II. BACKGROUND OF IOLTA

The concept of IOLTA originated in Australia and was already operating there and in Canada before minor changes in U.S. banking law made the programs possible in the United States.³⁴ Beginning in Florida in 1981,³⁵ IOLTA became a ubiquitous feature of the American legal system, present today in every state.³⁶

Despite its widely acknowledged successes, IOLTA programs present some chronic, albeit unavoidable, problems. For example, the wide fluctuations in available funds are a continuing source of consternation for dependent legal aid entities.³⁷ Budget planning is difficult when a major funding source is inherently unstable.³⁸ Additionally, variations in interest rates can deplete the funds available for legal aid agencies in a given year.³⁹ Moreover, most IOLTA deposits are from real estate transactions, so a downturn in the real estate market means fewer IOLTA deposits to generate interest. Depressed property values shrink the size of the IOLTA deposits that do come in, further depleting the funds.⁴⁰ Many IOLTA programs try to mitigate these problems by having the entity that receives and distributes the funds engage

34. IOLTA History, http://www.iolta.org/grants/item.IOLTA_History (last visited Feb. 1, 2011) [hereinafter IOLTA History].

35. See Mortensen, *supra* note 10, at 289-95 (explaining the origin of IOLTA in Australia in the 1960s and its spread to other English-speaking countries); IOLTA History, *supra* note 34.

36. Status of IOLTA Programs, *supra* note 12 and sources cited therein.

37. See Diller & Savner, *supra* note 4, at 691; Kevin H. Douglas, *IOLTAs Unmasked: Legal Aid Programs' Funding Results in Taking of Clients' Property*, 50 VAND. L. REV. 1297, 1303 (1997) ("Since the amount of IOLTA-eligible funds is highly sensitive to changes in interest rates, IOLTAs are an inherently unstable source of revenue.").

38. See, e.g., Chris Tweeten, *Legal Services Needs Your Help: Take a Case, Give Money, Call Your Legislator*, MONT. LAW., Apr. 2009, at 4, 4 (noting that when the Federal Reserve Board lowered the benchmark interest rate to zero in 2008, "[r]ates of interest on deposit accounts have fallen to historic lows" and that "[s]ince IOLTA funds come from interest on deposits, the dramatic decrease in interest rates is projected to result in a 65 percent drop in IOLTA revenues by the end of this year"); see also Romerdahl, *supra* note 2, at 1123.

39. See Diane Curtis, *Economic Downturn Puts a Crimp in Legal Services*, CAL. BAR J., Feb. 2009, at 1 ("This was the year IOLTA funds were supposed to swell and California legal aid organizations, which get much of their funding from trust account interest, were going to reap the benefits of the bulging coffers. The high hopes couldn't have been more misplaced . . .").

40. See Laurie Barron et al., *Don't Do It Alone: A Community-Based, Collaborative Approach to Pro Bono*, 23 GEO. J. LEGAL ETHICS 323, 323-24 (2010); Russell Engler, *Pursuing Access to Justice and Civil Right to Counsel in a Time of Economic Crisis*, 15 ROGER WILLIAMS U. L. REV. 472, 474 (2010); John A. Tarantino, *No, We Can't*, R.I. B.J., May/June 2009, at 5; Kathy B. Weinman, *"Send Lawyers, Guns, and Money"*, BOSTON B.J., Jan./Feb. 2009, at 2.

in regular charitable fundraising and apply for grants from other private foundations or government entities.⁴¹

IOLTA faced a wave of legal challenges in the 1990s, and the U.S. Supreme Court considered the legality of IOLTA in two related cases involving the same plaintiffs. Leading up to these Supreme Court cases, conservative public interest groups challenged the constitutionality of IOLTA programs in several rounds of litigation, four of which went to federal appellate courts.⁴² The central argument against IOLTA was that it constituted an unconstitutional government taking of private property in violation of the Fifth Amendment's Takings Clause.⁴³ States must demonstrate a public purpose and offer just compensation for exercising eminent domain.⁴⁴ In *Phillips*, the Supreme Court's first IOLTA case, the Court held, narrowly, that the interest generated by IOLTA accounts was really the "private property" of the clients whose funds were on deposit.⁴⁵ The Court remanded the case for the lower court to consider whether there had been an unconstitutional taking.⁴⁶ This remand postponed an inevitable consideration of the remaining points under the Takings Clause, namely, whether such a taking violated the Constitution.

The *Phillips* Court split 5-4 along partisan lines; the conservative justices voted against IOLTA, and the liberals voted in favor.⁴⁷ By 2003, when the Court heard another IOLTA case with similar issues, those dividing lines had changed.⁴⁸ Justice O'Connor switched sides in the controversy, meaning that the dissenters from the previous IOLTA case became the majority in *Brown*,

41. These alternative sources that contribute to the pool of funds, however, do not match the IOLTA-generated revenues in any state.

42. See *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 162 (1998); *Wash. Legal Found. v. Legal Found. of Wash.*, 271 F.3d 835, 841 (9th Cir. 2001); *Wash. Legal Found. v. Tex. Equal Access to Justice Found.*, 94 F.3d 996, 999 (5th Cir. 1996); *Wash. Legal Found. v. Mass. Bar Found.*, 993 F.2d 962, 968 (1st Cir. 1993); *Cone v. State Bar of Fla.*, 819 F.2d 1002, 1003 (11th Cir. 1987); David Luban, *Taking Out the Adversary: The Assault on Progressive Public-Interest Lawyers*, 91 CAL. L. REV. 209, 209-11 (2003).

43. See, e.g., *Phillips*, 524 U.S. at 164 & n.4. The *Phillips* Court granted certiorari in part because a split developed between the various federal courts "over whether the interest income generated by funds held in IOLTA accounts [wa]s private property for purposes of the Fifth Amendment's Takings Clause." *Id.* at 163.

44. *Id.* at 163-64.

45. *Id.* at 172.

46. *Id.* The Court failed to address whether or not the funds in question had "been 'taken' by the State" and gave no "opinion as to the amount of 'just compensation,' if any, due [to the] respondents." *Id.* The justices left these questions to the lower courts to decide and in the process left uncertainty for lawyers everywhere. *Id.*

47. The opinion was delivered by Justice Rehnquist and joined by Justices O'Connor, Scalia, Kennedy, and Thomas. *Id.* at 158. Justices Souter, Stevens, Ginsburg, and Breyer dissented. *Id.*

48. *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 240 (2003).

and vice-versa.⁴⁹ The new majority⁵⁰ held that IOLTA was indeed a taking but found that it was perfectly legitimate:⁵¹ it served an obvious public purpose,⁵² and the “just compensation” required was zero.⁵³ The Court’s determination that no compensation was due was the crux of the Court’s decision and the focus of the dissenters’ attack.⁵⁴ The standard for “just compensation” was the actual, objective value of the interest taken in isolation, not the subjective or expectation value of the property owner himself.⁵⁵ This seemed contradictory to the Court’s previous ruling in *Phillips*, which had relied heavily upon the “expectation value” of the IOLTA interest.⁵⁶ *Brown* ended nearly all IOLTA litigation in the United States for several years.⁵⁷ Since that time, there has been a steady trend of states making the program mandatory for all lawyers; a related trend is for participating banks to offer comparability in the interest rates they pay on IOLTA accounts and on their other clients’ accounts.⁵⁸ Most states now have mandatory IOLTA programs, and each year more banks agree to comparability requests from IOLTA advocates.⁵⁹

49. Compare *Phillips*, 524 U.S. at 158 (noting Justice O’Connor’s adherence to the majority opinion), with *Brown*, 538 U.S. at 218-19 (establishing Justice O’Connor’s alignment with the dissenters in *Phillips*).

50. This time Justice Stevens delivered the opinion and was joined by Justices O’Connor, Souter, Ginsburg, and Breyer. *Brown*, 538 U.S. at 218. Justices Scalia, Rehnquist, Kennedy, and Thomas dissented. *Id.* at 218-19.

51. The Court viewed this as a *per se* taking and not a regulatory taking, explaining that “[a] state law that requires client funds that could not otherwise generate net earnings for the client to be deposited in an IOLTA account is not a ‘regulatory taking.’ A law that requires that the interest on those funds be transferred to a different owner for a legitimate public use, however, could be a *per se* taking requiring the payment of ‘just compensation’ to the client.” *Id.* at 240.

52. *Id.* at 232.

53. *Id.* at 240.

54. *Id.* (holding that no compensation was due); *id.* at 243-45 (Scalia, J. dissenting) (disagreeing with the majority’s definition of “just compensation”).

55. *Id.* at 235-36 (majority opinion) (noting that previous judges across the country had concurred that “the ‘just compensation’ required by the Fifth Amendment [wa]s measured by the property owner’s loss rather than the government’s gain”).

56. See *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 180-81 (1998).

57. See, e.g., *Wieland v. Lawyers’ Trust Fund of Ill.*, 836 N.E.2d 166, 168 (Ill. 2005) (“[W]e affirm the circuit court’s order on the basis that *Brown* is dispositive.”). One isolated post-*Brown* case challenging the legality of an IOLTA program, which was also unsuccessful, is *Mottl v. Missouri Lawyer Trust Account Foundation*, 133 S.W.3d 142 (Mo. App. W.D. 2004). Without reaching the takings question that was the subject of *Brown*, the Missouri Court of Appeals in *Mottl* dismissed the case because it found no state action where the IOLTA program was voluntary, as in Missouri. *Id.* at 147. For excellent discussion of this case, see Timothy D. Steffens, Note, *Are You Misappropriating Client Funds? Missouri’s IOLTA Plan After Mottl*, 71 Mo. L. REV. 247 (2006).

58. At least twenty states have adopted comparability rules for banks offering IOLTA accounts to lawyers. See, e.g., ALA. RULES OF PROF’L CONDUCT R. 1.15

III. CROWDING OUT

IOLTA programs appear to have a “crowding out”⁶⁰ effect on pro bono efforts and legal aid fundraising. Academic literature musters both theoretical models and empirical evidence to support this claim, with results varying depending on how the question is framed.⁶¹ The consensus view is a nuanced assessment: public funding causes partial crowding out of private donations, but the effect varies significantly depending on the type of the nonprofit organization (such as whether it focuses on education, arts, or poverty relief) and on whether the public funding comes from the federal, state, or local government.⁶²

(2007); ARK. RULES OF PROF'L CONDUCT R. 1.15 (2007); RULES OF THE STATE BAR OF CAL. R. 2.110-.130 (2008); CONN. RULES OF PROF'L CONDUCT R. 1.15 (2010); RULES REGULATING THE FLA. BAR R. 5-1.1 (2009); HAW. SUP. CT. R. 11 (2008); ILL. RULES OF PROF'L CONDUCT R. 1.15 (2009); LA. RULES OF PROF'L CONDUCT R. 1.15 (2008); MD. RULES R. 16-610 (2007); MASS. RULES OF PROF'L CONDUCT R. 1.15 (1997); ME. BAR RULES R. 3.6(e) (2008); MICH. RULES OF PROF'L CONDUCT R. 1.15 (2005); MINN. RULES OF PROF'L CONDUCT R. 1.15 (2010); MISS. RULES OF PROF'L CONDUCT R. 1.15 (2007); MO. RULES OF PROF'L CONDUCT R. 4-1.15 (2007); N.J. RULES OF CT. R. 1:28A (2003); N.Y. RULES OF PROF'L CONDUCT R. 1.15 (2010); OHIO RULES OF PROF'L CONDUCT R. 1.15 (2007); SUP. CT. OF TEX. ACCESS TO JUDICIAL FOUND. R. 7 (2009); UTAH RULES OF PROF'L PRACTICE R. 14-1001 (2005); *see also* Bruce Beesley, *IOLTA, Doing the Right Thing*, NEV. LAW., Nov. 2008, at 4, 4-5; Jim Davis, *We Are Stuck in 1982!*, 51 ADVOC. 38, 39 (2008) (advocating adoption of comparability rules in Idaho); Dean R. Dietrich, *Banks to Pay Comparable Interest on IOLTA Accounts*, WIS. LAW., Apr. 2009, at 25, 25; James A. Kawachika & Robert J. LeClair, *Increase Funding for Access to Justice by Bank “Rate Comparability” in IOLTA Accounts*, HAW. B.J., Mar. 2008, at 27, 27 (“An IOLTA Comparability Rule requires attorneys to place their IOLTA accounts in a financial institution that pays those accounts the highest interest rate generally available at that institution to other customers when IOLTA accounts meet the same minimum balance or other account qualifications, if any.”); Thomas J. Methvin, *Access To Justice – Now More Than Ever*, 70 ALA. LAW. 319, 320 (2009) (discussing Alabama’s recent adoption of comparability rules for IOLTA); James B. Sales, *Access To Justice*, 72 TEX. B.J. 48, 48 (2009) (discussing adoption of comparability rules in Texas); Marta-Ann Schnabel, *IOLTA Rates: No Disappointing Comparables Here*, 56 LA. B.J. 11, 11 (2008).

59. Status of IOLTA Programs, *supra* note 12.

60. *See supra* note 25; *see also* GLAZER & ROTHENBERG, *supra* note 26, at 102-06; Dennis Coates, *A Diagrammatic Demonstration of Public Crowding-Out of Private Contributions to Public Goods*, 27 J. ECON. EDUC. 49 (1996) (graphing a clear visual presentation of the crowding out phenomenon).

61. *See supra* note 25 and sources cited therein.

62. *See* GLAZER & ROTHENBERG, *supra* note 26, at 102-06; Arthur C. Brooks, *Public Subsidies and Charitable Giving: Crowding out, Crowding in, or Both?*, 19 J. POL'Y ANALYSIS & MGMT. 451 (2000) (modeling how lower levels of government subsidies may increase private donations (crowding in) but how higher levels crowd out and concluding that nonprofits cannot maximize private donations and govern-

In the legal field, crowding out specifically affects pro bono work. Recent reports from state bar associations suggest an inverse relationship between the abundance of IOLTA funds and the level of pro bono activity by individual lawyers.⁶³ Of course, the downturn in the economy not only depleted IOLTA funds, but also left many lawyers, whose client base had shrunk, with extra time to do pro bono work, which could account for part of the inverse correlation. Part of the increase in pro bono work could also be due to intensified efforts by state bar associations to recruit pro bono attorneys.⁶⁴

The academic literature about crowding out has focused on areas unrelated to legal services. For example, crowding out occurred with the National Endowment for the Arts (NEA): private donations for the arts increased when

ment subsidies at the same time); J. Stephen Ferris & Edwin G. West, *Private Versus Public Charity: Reassessing Crowding out from the Supply Side*, 116 PUB. CHOICE 399 (2003) (arguing that incompleteness in crowding out of charity by government subsidies is attributable to transaction costs inherent in government action).

63. See, e.g., Anita M. Alvarez, *Celebrating Pro Bono Week*, 23 CHI. B. ASS'N REC. 12, 12, 57 (2009) (noting an increase in pro bono hours contributed by lawyers as IOLTA-funded services decreased); Janice Baker, *Wyoming Legal Services, Inc.: A Much-Needed Wyoming Resource*, WYO. LAW., Aug. 2008, at 22, 22; Ruth V. McGregor, *Rule of Law in Challenging Times*, 34 OKLA. CITY U. L. REV. 549, 559-60 (2009) (observing the increase in pro bono activity as IOLTA programs have faltered); Susan Hayes Stephan, *Blowing The Whistle On Justice As Sport: 100 Years of Playing A Non-Zero Sum Game*, 30 HAMLINE L. REV. 587, 602 (2007) (suggesting that pro bono hours decreased during the same period when IOLTA funding was steadily increasing); Zoe Zulakis, *Justice Foundation Is Facing Unprecedented Funding Drop*, MONT. LAW., May 2009, at 9, 9 (noting that dwindling IOLTA funding contributed to the creation of statewide pro bono coordinator). But see Quintin Johnstone, *An Overview of the Legal Profession in the United States, How That Profession Recently Has Been Changing, and Its Future Prospects*, 26 QUINNIPIAC L. REV. 737, 769 (2008) (asserting, without supporting citations, that pro bono efforts have been increasing). The trend seems to apply to LSC funding as well. See Scott L. Cummings & Deborah L. Rhode, *Public Interest Litigation: Insights from Theory and Practice*, 36 FORDHAM URB. L.J. 603, 621 (2009) (noting that declining LSC funds have caused an increase in pro bono efforts).

Admittedly, some data suggests that the recent downturn in the economy not only depleted IOLTA funds, but it also left many lawyers with extra time to do pro bono work as their client base shrank. See, e.g., Engler, *supra* note 40, at 497. In addition, there may be a cultural shift in the legal profession in favor of pro bono work, which would also contribute to the increase during the period when IOLTA programs were floundering. See, e.g., Scott L. Cummings & Deborah L. Rhode, *Managing Pro Bono: Doing Well by Doing Better*, 78 FORDHAM L. REV. 2357, 2365-66 (2010). One area of valuable future research would be disentangling these different influences and quantifying the extent to which IOLTA funding for legal aid crowds out pro bono activities by other lawyers.

64. See Weinman, *supra* note 40 (pleading with practicing attorneys to take more pro bono cases to fill in the gaps left by the IOLTA shortfalls after the housing crisis); see also Elizabeth E. Mack, *Chair's Report: Pro Bono Providers Need Us Now*, ADVOCATE, Spring 2009, at 4, 4-5.

NEA funding decreased, and fell off when government funding was restored.⁶⁵ On the other hand, federal funding does not appear to crowd out private support for education, but state and local funding does. The reason is that federal funds go mostly for research grants and local funds are direct appropriations for general operating costs.⁶⁶ Augmenting the effect for local schools is the fact that the administrators have more incentive to solicit private donations when operations are in jeopardy.⁶⁷

One of the earliest empirical studies showed nearly complete crowding out in the context of direct financial assistance to the poor.⁶⁸ Individual charitable giving, once a common feature of American culture, faded in the years following the New Deal and the advent of widespread welfare programs. Similarly, in the field of medical care for the indigent, a study indicated that government support supplanted private charity, with individual donations dropping with each increase in government spending in a one-to-one correspondence.⁶⁹

Theorists have posited several reasons why such crowding may occur. First, there is often a declining marginal value in each dollar given to a particular charity, for the nonprofit, the donor, or both, because the donation means less to the donor and is worth less to the organization based on how

65. See generally Dokko, *supra* note 25. For more background, see *Nat'l Endowment for the Arts v. Finley*, 524 U.S. 569, 572-73 (1998) (upholding the constitutionality of an NEA rule, while "taking into consideration general standards of decency and respect for the diverse beliefs and values of the American public").

66. See Garrett & Rhine, *Does Government Spending Influence Charitable Contributions or Vice Versa?*, *supra* note 25, at 13-17; Garrett & Rhine, *New Time Series Evidence*, *supra* note 25, at 19.

67. See Garrett & Rhine, *Does Government Spending Influence Charitable Contributions or Vice Versa?*, *supra* note 25, at 15-16.

State and local government revenue is a much greater percentage of total (primary, secondary, and post-secondary) education revenues than is revenue from the federal government, and state and local governments spend a higher percentage of their budgets on all levels of education than does the federal government. Thus, educational institutions are much more sensitive to changes in state and local education expenditures (changes in appropriations) than they are federal education expenditures (changes in grants). They are therefore more likely to encourage charitable giving in response to state and local government changes. As more private contributions flow to the institution from increased fundraising efforts, institutions reduce their efforts to obtain federal grants and future federal funds to the institution then decrease.

Id. (footnotes omitted).

68. See GLAZER & ROTHENBERG, *supra* note 26, at 104; Russell D. Roberts, *A Positive Model of Private Charity and Public Transfers*, 92 J. POL. ECON. 136 (1984).

69. See GLAZER & ROTHENBERG, *supra* note 26, at 104; Kenneth E. Thorpe & Charles E. Phelps, *The Social Role of Not-For-Profit Organizations: Hospital Provision of Charity Care*, 29 ECON. INQUIRY 472 (1991).

much revenue the organization already creates.⁷⁰ This is particularly true after the charity establishes its operations and moves beyond its startup costs.⁷¹ First-time donors may feel more impact from an initial hundred-dollar contribution to a charity as compared to their fifth donation of the same amount.⁷² From the organization's perspective, there is also a diminishing marginal value in revenues, so that donations that come in after a substantial government grant or subsidy have less import. A donation of \$10,000 to a charity with a \$100,000 annual budget has greater impact than the same donation (\$10,000) would have for a large international organization with a \$100 million budget. A nascent nonprofit can expand its charitable services significantly with such a donation. In contrast, a donation of that amount probably will not change the actions of an established multinational organization.⁷³ A second explanation for the crowding out phenomenon is that higher taxes deplete the disposable income of some donors, which they would have given to charity,⁷⁴ since donors generally give less when they feel pinched by higher taxes.⁷⁵

70. See Abrams & Schmitz, *supra* note 25, at 305-06 (demonstrating this phenomenon and noting that private charitable donations do not grow as federal funding for charities grows).

71. See Rose-Ackerman, *supra* note 25, at 316-18.

72. See Abrams & Schmitz, *supra* note 25, at 305-06.

73. Of course, donors may still prefer the larger organization. A larger nonprofit organization can obtain much greater economies of scale. In addition, there may be a "knee of the curve" in terms of the social impact charities can have in relation to their size. A multi-jurisdictional organization not only has economies of scale but can also address more widespread problems and shift resources from areas of surplus to areas of need. From donors' perspectives, large organizations have a brand-name advantage, signaling more legitimacy, oversight, and support from a broad base of other donors. See, e.g., Garrett & Rhine, *New Time Series Evidence*, *supra* note 25, at 19 (discussing rational ignorance on the part of the donors (albeit in the context of arguing against the crowding out effect)). These authors' results may be due to the fact that citizens are rationally ignorant of the agencies they donate to; meaning they do not spend the time researching each entity's goals or finances because the cost of researching is greater than the benefit. *Id.* This kind of crowding can lead to entry barriers for new agencies, a point discussed below in connection with IOLTA and legal services. See *infra* Part III.A.

74. See Abrams & Schmitz, *supra* note 25, at 304-06.

75. See *id.* Of course, a serious economic recession has the same effect and causes many charities to downsize or shut down. For an experimental study that challenges the notion of lump-sum taxation crowding out completely, see James Andreoni, *An Experimental Test of the Public-Goods Crowding-Out Hypothesis*, 83 AMER. ECON. REV. 1317, 1322-26 (1993) (finding up to seventy percent crowding out in certain circumstances but arguing that this is an incomplete picture and may have an offset from increased crowding-in effects of the same government programs).

A. "Crowding Out" Pro Bono

Crowding out sometimes occurs because the public perceives that the government already has an area completely covered, making private donations for that particular service seem unnecessary.⁷⁶ As mentioned previously,⁷⁷ state bar association reports indicate an inverse relationship between IOLTA fund amounts and pro bono hours – the donation of regular lawyers' time and skills.⁷⁸ Lawyers may perceive that legal aid lawyers are already addressing the current needs of indigents and that lawyers themselves are already "helping" by participating in the IOLTA program. IOLTA compliance involves some transaction costs for lawyers and risks of disciplinary actions for mistakes. IOLTA presents this problem much more than do LSC funds, because lawyers are acutely aware of IOLTA. In contrast, LSC does not require their participation or attention. Year after year, pro bono efforts are disappointingly low, despite pressure from state bar associations urging universal involvement.

Almost all of the crowding out literature focuses on funding, rather than on volunteer activities, and none to date have focused on legal services.⁷⁹ A huge gap persists in legal representation for the poor,⁸⁰ and there are constant pleas from the state bar associations for more pro bono work.⁸¹ IOLTA funds

76. Arguably, this is an extreme version of the diminishing marginal value type of crowding. Others would characterize this as a free-rider problem. GLAZER & ROTHENBERG, *supra* note 26, at 104.

77. See *supra* note 63 and accompanying text.

78. See Thomas J. Stipanowich, *The Quiet Revolution Comes to Kentucky: A Case Study in Community Mediation*, 81 KY. L.J. 855, 912 (1993) (noting the competition between legal services clinics funded by IOLTA and state pro bono programs). But see Andreoni, *supra* note 75 (arguing that some government provisions of public goods may "seed" the system and promote more charity or philanthropy). Andreoni does not address, however, whether his suggestion would apply to volunteer labor to the same extent as donations of funds; his experiment focused on donated money.

79. This author has found only one study devoted to crowding out of volunteerism by government provisions of services. See Kathleen M. Day & Rose Anne Devlin, *Volunteerism and Crowding Out: Canadian Econometric Evidence*, 29 CAN. J. ECON. 37 (1996) (studying data limited to Canada). Their conclusions related to legal services are discussed in the remainder of Part III.A.

80. See Earl Johnson, Jr., *Justice For America's Poor in the Year 2020: Some Possibilities Based on Experiences Here and Abroad*, 58 DEPAUL L. REV. 393, 395-96 (2009) (showing research that almost one third of the nation's population is in need of government-funded legal counsel, and there are approximately 6500 civil legal aid lawyers to serve them).

81. See, e.g., Minn. Legal Servs. Planning Comm'n Drafting Comm., *Recommendation of the Minnesota Legal Services Planning Commission on the Configuration of LSC-Funded Programs*, 26 HAMLIN J. PUB. L. & POL'Y 265 (2005) (suggesting increasing attorney registration fees and real estate filing surcharges as additional revenue sources).

and LSC funds have never been adequate to provide representation for all who need it.⁸²

The only study on crowding out and volunteerism in the legal field suggests that government investment in legal aid may encourage law-related volunteer work, as opposed to other types of government provisions of social services.⁸³ The study suggests that government funding can set an example or inspire others to volunteer, as a way to prime the pump of community service.⁸⁴ At the same time, the study's data and modeling suggests that funding for legal aid would have no effect on the actual pro bono hours donated by lawyers but rather on the number of lawyers participating in pro bono programs.⁸⁵ The study's usefulness is limited by the fact that it evaluated a wide range of volunteer activities, not legal services in particular, and that it only evaluated the phenomenon in Canada, not in the U.S.⁸⁶ Its main conclusion is that crowding effects vary significantly depending on the nature of the public good, implying that more research is needed in this area.⁸⁷

Additionally, both pro bono lawyers and IOLTA-funded agencies present issues of what economists call "cream skimming," that is, taking the "easy" cases in order to help more clients in less time.⁸⁸ This, of course, leaves some of the neediest clients unrepresented. Cream skimming could exacerbate the crowding out effects between IOLTA funded agencies and pro bono lawyers if both strive to assist more clients and avoid complex cases. All of these crowding out concerns and implications lead to several alternative funding issues.

B. "Crowding Out" Alternative Funding

As mentioned above, the classic "crowding out" scenario pertains to funding.⁸⁹ Official funding for charities often triggers a drop-off in donations from other sources. Professor George Schatzki described an incident where Connecticut legislators explicitly declined to apportion funding for legal services because IOLTA was already in place, despite the agencies' underfunded status.⁹⁰ Financial crowding also occurs because funding affects the behavior of nonprofit directors and managers by causing nonprofit directors to bring in

82. See Diller & Savner, *supra* note 4, at 688-92.

83. See Day & Devlin, *supra* note 79, at 51-52.

84. *Id.*

85. *Id.*

86. *Id.* at 39-43.

87. *Id.*

88. See Rose-Ackerman, *supra* note 25, at 322-25.

89. *Supra* Part III.A.

90. See George Schatzki, *The Survival of Legal Services for the Poor in Connecticut*, 70 CONN. B.J. 313, 320 (1997) (citing an actual instance of state legislators refusing to fund legal services for the poor because they already received IOLTA funding).

less money for the organization. Empirical studies show that nonprofit managers engage in more fundraising when government funding declines⁹¹ and less fundraising when government grants increase.⁹² While this may be a benefit in some cases, as the nonprofit spends fewer resources on fundraising,⁹³ recipient organizations like IOLTA become vulnerable to financial crises when funding is variable, forcing agencies to curtail services and outreach when a crisis occurs.⁹⁴ Moreover, the increased time managers spend on preparing necessary reports for government funding can offset the savings in time and resources previously spent on fundraising. For example, comprehensive LSC audits have periodically distracted managers and directors.⁹⁵

After changes in federal law in the late 1990s, many legal aid programs shifted their efforts toward activities expected by the IOLTA administrators and away from activities that the LSC forbids,⁹⁶ such as class action suits.⁹⁷ When nonprofits make such shifts, private donors may feel alienated or worry that their contributions do not influence the organization. At the same time, this shifting can attract other donors who prefer the changes.⁹⁸ In special circumstances, public funding can have a “crowding in” effect, where would-

91. See Dokko, *supra* note 25, at 28-29 (discussing a twenty-five percent increase in fundraising expenditures by artistic charities after being defunded by the NEA in the late 1990s).

92. See Katherine M. O'Regan & Sharon M. Oster, *Does Government Funding Alter Nonprofit Governance? Evidence from New York City Nonprofit Contractors* (Yale Sch. of Mgmt. Working Paper Series PM-03 2001), available at http://papers.ssrn.com/paper.taf?abstract_id=279310 (discussing recent empirical studies showing that government funding in New York changes the behavior of nonprofit managers – the boards engage in substantially less fundraising and more meticulous reporting); see also Frank H. Stephen et al., *Incentives, Criminal Defence Lawyers and Plea Bargaining*, 28 INT'L REV. L. & ECON. 212, 214-16 (2008) (documenting that a change in government funding for criminal defense lawyers from hourly rates to per-case fees alters lawyer behavior and significantly reduces the time spent on each case).

93. See Dokko, *supra* note 25, at 4.

94. See O'Regan & Oster, *supra* note 92.

95. See, e.g., 42 U.S.C. § 2996g (a)-(b) (2006) (authorizing LSC to audit legal services offices and require reports); Robert L. Bach, *Building Community Among Diversity: Legal Services For Impoverished Immigrants*, 27 U. MICH. J.L. REFORM 639, 643 (1994); Matthew Diller et al., *Constitutional Issues Panel*, 25 FORDHAM URB. L.J. 345, 353 (1998); Margaret Graham Tebo, *A Privilege to Serve: Battle Over Legal Aid Funds Spills Over to Attorney-Client Confidentiality*, 6 NO. 6 A.B.A. J. E-REP. 5 (2007).

96. See, e.g., Diller & Savner, *supra* note 4, at 689 (“In many states, justice planners have had to set up two, duplicative legal aid systems in order to ensure that state and other funds are not constrained by the non-LSC funds restriction.”).

97. See Henry Rose, *Class Actions and the Poor* (Loyola Univ. Chi. Sch. of Law Pub. Law & Theory Research Paper No. 2009-16), available at <http://ssrn.com/abstract=1477031>.

98. See Rose-Ackerman, *supra* note 25, at 325.

be donors feel uncertain about the legitimacy of a particular charity and government funding operates as an endorsement or signal of the nonprofit's value.⁹⁹ Similarly, where the government provides a necessary input for the production of a public good – perhaps in the form of infrastructure, access, or development of new technologies – the government provision can complement private charity and encourage more, or greater, contributions.¹⁰⁰ Unfortunately, these crowding in situations do not seem to have emerged with IOLTA programs.

IOLTA's crowding out problems are complex because of multi-tiered government funding for legal services, as funding comes from both the federal LSC and state IOLTA. Supplementing these are some county or municipal grants.¹⁰¹ Generally, federal funding of local activities such as legal aid tends to crowd out state and local expenditures, although the crowding tends to be incomplete or partial.¹⁰² Adding to this complexity is the fluctuating nature of IOLTA revenues compared to its federal counterpart, the LSC, whose funds are an ever-increasing Congressional apportionment with many restrictions. The availability of unrestricted IOLTA grants diminishes any political pressure to ease the burdensome restrictions on LSC funding.¹⁰³ This availability also creates disincentives for the managers of IOLTA-funded agencies to develop alternative sources of funding or revenue.¹⁰⁴ Thus, IOLTA may

99. See *id.* at 319, 321; see also GLAZER & ROTHENBERG, *supra* note 26, at 105 (listing four factors that limit or offset crowding out of philanthropy).

100. An example of crowding in is protection of aid workers by police or military personnel in the wake of natural disasters or war devastation. For discussion (with no mention of this particular example), see GLAZER & ROTHENBERG, *supra* note 26, at 105-06.

101. See Helaine M. Barnett, *An Innovative Approach to Permanent State Funding of Civil Legal Services: One State's Experience - So Far*, 17 YALE L. & POL'Y REV. 469 (1998) (describing a successful program in New York where abandoned property is used as the funding source for civil legal services).

102. GLAZER & ROTHENBERG, *supra* note 26, at 104; James R. Hines, Jr. & Richard H. Thaler, *The Flypaper Effect*, 9 J. ECON. PERSP. 217 (1995) (arguing that states will spend money received from the federal government); Richard Steinberg, *Voluntary Donations and Public Expenditures in a Federalist System*, 77 AM. ECON. REV. 24, 32 (1987) (analyzing "simple crowd out" effects). For a rebuttal to Steinberg's model, arguing instead that federal expenditures can indeed create "complete" crowding out, see Robert McClelland, *Voluntary Donations and Public Expenditures in a Federalist System: Comment and Extension*, 79 AMER. ECON. REV. 1291 (1989).

103. See Omnibus Consolidated Rescissions and Appropriations Act of 1996 § 504(a)(2)-(17), 110 Stat. 1321-53 (codified at 45 C.F.R. §§ 1612-1637); Alan W. Houseman, *Restrictions by Funders and the Ethical Practice of Law*, 67 FORDHAM L. REV. 2187, 2188-89 (1999). For more background, see *Legal Servs. Corp. v. Velazquez*, 531 U.S. 533, 548-49 (2001) (holding unconstitutional a restriction on LSC attorneys challenging existing welfare laws).

104. See Dokko, *supra* note 25 (discussing a twenty-five percent increase in fundraising expenditures by artistic charities after being defunded by the NEA in the late

actually have undermined the political impetus to fix the LSC problem by providing an alternate source of funding.

In addition, pro bono services could have lateral relationships with civil *Gideon*,¹⁰⁵ by which courts appoint attorneys for certain poor clients in a similar manner to their appointment of criminal defense lawyers. For example, courts appoint civil attorneys for poor parents when the state seeks to remove their children. Because regular attorneys sign up to be court-appointed lawyers in these cases, legal aid agencies that have been doing this work will probably shift to other types of cases. Most civil *Gideon* pilot programs receive funding from court filing fees or government apportionments rather than IOLTA.¹⁰⁶ This means the crowding effect on IOLTA, or on IOLTA funded agencies, could become even more complex, with more lateral shifting of casework. It seems urgent, therefore, to find solutions to these problems.

C. Proposals to Offset the Negative Impact of "Crowding Out"

Two simple regulatory changes could increase the pool of non-coerced pro bono lawyers and offset any crowding out effect from IOLTA. First, states should change their rules to allow out-of-state attorneys to do pro bono work without obtaining a new license.¹⁰⁷ Second, the federal government should permit lawyers or firms to claim a federal income tax credit or deduction for donated legal services.¹⁰⁸ This is a modest change, but it is one that would nevertheless require an act of Congress.¹⁰⁹

1990s); O'Regan & Oster, *supra* note 92; see also Stephen et al., *supra* note 92, at 214-16.

105. Abel, *supra* note 31 (describing these programs in Alabama, Arkansas, Connecticut, Florida, Hawaii, Louisiana, Montana, New York, and Texas).

106. See *id.*

107. Ironically, the trend is for states to raise their pro hac vice fees in order to generate revenue to fund pro bono programs, not recognizing that making it more difficult for out-of-state lawyers to take individual cases in the state actually shrinks the pool of available pro bono attorneys. See, e.g., Alan W. Houseman, *The Future of Civil Legal Aid: A National Perspective*, 10 UDC L. REV. 35, 64 n.105 (2007); Methvin, *supra* note 58, at 320.

108. Currently, the tax code does not permit individuals or corporations to claim deductions for donated services or time volunteered to charities. See Treas. Reg. § 1.170A-1(g) (as amended in 2008); U.S. Tax Rep. (RIA) 1705.36(5) (2011) ("Contribution of Services"); FED. TAX COORDINATOR (SECOND) ¶ K-3557 (2009); JOSEPH P. TOCE, JR. ET AL., TAX ECON. OF CHAR. GIVING ¶ 4.04(4) (2009) ("Services"); Marilyn Phenlan, Annotation, *Form of Contributions: Services*, 8 MERTENS LAW OF FED. INCOME TAX'N § 31:85 (West 2011) ("No Deduction for Services Contributed"). The Federal Tax Court has held twice that section 1.170A-1(g) of the Tax Code prohibits lawyers from claiming deductions for the value of their time or services donated as pro bono hours. See *Levine v. Comm'r*, 54 T.C.M. (CCH) 209 (1987); *Grant v. Comm'r*, 84 T.C. 809 (1985), *aff'd*, 800 F.2d 260 (4th Cir. 1986).

Regarding the first proposal, some will argue that allowing automatic cross-jurisdictional acceptance for pro bono lawyers will do nothing because lawyers who neglect pro bono work in their home state will not travel to another state to do it. Yet many lawyers live right across the state line from a major urban center (e.g., southern Connecticut and New York City or Kansas City, Missouri and Kansas City, Kansas), where there may be an efficient pro bono program where lawyers can walk in and help immediately. Lawyers who relocate to another state could do pro bono cases to build a local reputation before they move or before they obtain their license in the new state. Charitable organizations could arrange trips that bring lawyers from colder climates to sunny tourist destinations in winter, such as Florida or San Diego, and require the attorneys to spend a few hours per day representing the poor in that area.¹¹⁰

The second proposal, the tax deduction or credit, would provide an incentive for lawyers to donate their time, and the lost tax revenue would be offset by a public good.¹¹¹ Currently, the tax code does not permit individuals or corporations to claim deductions for services donated or time volunteered to charities.¹¹² The Federal Tax Court has held twice that section 1.170A-1(g) of the Tax Code prohibits lawyers from claiming deductions for the value of their time or services donated as pro bono hours.¹¹³ It would require a legislative or regulatory change, therefore, to allow lawyers to take

109. See, e.g., Adam Ross Pearlman, *Valuing Volunteers: The Case for a Community Service Tax Benefit* (Mar. 7, 2009) (Working Paper presented at the American University Graduate Leadership Council, Conference on Urban Transformation), available at <http://ssrn.com/abstract=1355322> (proposing changes to amend Treasury Regulation § 1.170A-1).

110. For more discussion of the incentives and self-interest of lawyers in doing pro bono work, see Stephen Daniels & Joanne Martin, *Legal Services For the Poor: Access, Self-Interest, and Pro Bono* (Am. Bar Found. Research Paper Series 09-02), available at <http://ssrn.com/abstract=1357680>.

111. This would most likely have a crowding in effect and draw even more attorneys into public interest law, because government inducements toward individual actions by private actors (as opposed to direct government provision or funding of goods) often generate crowding-in pressures that prompt others to imitate or follow suit. For more discussion of this concept, see GLAZER & ROTHENBERG, *supra* note 26, at 142. This conclusion also finds some support in the study done by Day & Devlin, *supra* note 79, at 51-52. In contrast, Patrick Francois has argued that more people will feel motivated to donate labor (in general, not just pro bono lawyers) if there is no performance-related compensation involved. See Patrick Francois, *Making a Difference*, 38 RAND J. ECON. 714, 728-29 (2007). A tax deduction for donated professional services would avoid the problem he discusses, because it mostly functions as an offset to the opportunity cost or lost time of the lawyer, and it gives a less direct incentive to the attorneys. A lawyer could always come out better financially by spending the time on paying clients.

112. See *supra* note 108 and sources cited therein and accompanying text.

113. See *Levine*, 54 T.C.M. (CCH) 209; *Grant*, 84 T.C. 809.

credits or deductions for legal services rendered to the poor.¹¹⁴ The ban on deductions for services donated to charity is an entrenched doctrine, but it is certainly not necessary for the effective administration of the federal income tax system. The Internal Revenue Service could easily establish a fixed amount – perhaps \$75 or \$100 per hour, far below the current market rate for billable hours – that would give lawyers the incentive to volunteer while minimizing the revenue impact for the treasury. In addition, a modest and fixed amount would streamline reporting issues. The hours would have to be performed for or through a 501(c)(3) entity, such as a legal aid clinic, which would provide the attorney with a receipt for the hours volunteered. This is no different from the current method for obtaining documentation of financial donations to charity.¹¹⁵

The historic rationale against tax deductions for volunteer services is that deductions must offset taxes already imposed on the income – where there has been no income and no tax yet applied (as in the case of volunteering), there can be no deduction.¹¹⁶ For this reason, a tax credit would be less problematic conceptually, avoid the issue of no offsetting income, and provide greater incentive for lawyers. On the other hand, a tax credit represents a greater depletion in tax revenue than a tax deduction and therefore may be less politically viable. Either alternative would accomplish the purposes set forth here – to encourage, but not coerce, more pro bono work by attorneys.

IV. MONOPOLIES AND OLIGOPOLIES

IOLTA has an inherent problem with monopoly and oligopoly effects: only a few entrenched IOLTA recipients receive the funding year after year in each state.¹¹⁷ Typically, a handful of legal aid clinics operate in each state, covering separate territories. Monopoly effects are present where there is only one provider of services in a market. Usually monopolies and a related

114. For two well-developed arguments in favor of a tax credit for pro bono work (presenting alternative proposals), see Chris Sanders, *Credit Where Credit is Due*, 74 TENN. L. REV. 241, 246-57 (2007); Jason M. Thiemann, *The Past, the Present, and the Future of Pro Bono: Pro Bono as a Tax Incentive For Lawyers, Not a Tax on the Practice of Law*, 26 HAMLINE J. PUB. L. & POL'Y 331, 370-83 (2005).

115. See Miriam Galston, *Civic Renewal and the Regulation of Nonprofits*, 13 CORNELL J.L. & PUB. POL'Y 289, 365-67 (2004) (mostly responding to the administrative cost argument for disallowing tax deductions for volunteering); see also Brian Dorini, Book Note, 9 HARV. J.L. & TECH. 231, 235 (1996) (reviewing JEREMY RIFKIN, *THE END OF WORK: THE DECLINE OF THE GLOBAL LABOR FORCE AND THE DAWN OF THE POST-MARKET ERA* (1995)) (discussing Rifkin's proposal of a tax deduction – called a “shadow wage” – for volunteer services to public charities).

116. See *Levine*, 54 T.C.M. (CCH) 209; *Grant*, 84 T.C. at 816 & n.11.

117. See *supra* note 27 and accompanying text.

issue, rents, are a problem in the for-profit sector,¹¹⁸ but nonprofit entities, like the agencies that receive IOLTA funding, are not immune.

“Rents” is the term economists use for the above-market prices monopolists can charge customers.¹¹⁹ Nonprofit actors often seek rents in the form of relaxed working conditions, reduced working hours, lack of efficiency and effectiveness, and the freedom to pursue “pet projects” at the expense of providing actual representation for the poor.¹²⁰ IOLTA creates an environment where such problems can go largely unchecked, even if such abuses do not characterize all, or even most, legal aid entities.

Oligopoly scenarios, where there is a small set of joint monopolists, typically feature market entry barriers, albeit sometimes hidden ones, for new providers of the same services.¹²¹ This appears to be a pervasive problem across the country; it is rare to see new legal aid clinics opening their doors. The absence of new market entrants who provide legal services for the poor leaves most indigent litigants without representation.¹²²

“Viewpoint monopoly” among the legal aid agencies in a given state is another unfortunate consequence of IOLTA. As IOLTA programs fund the same set of legal aid organizations from year to year, there are few innovations or new perspectives within these organizations about how best to aid the poor, the nature of the poor’s rights and entitlements, and their access to the legal system.¹²³ Homogeneity pervades managers’ views even about practical matters such as allocation of time and resources, prioritization of cases and clients, and approaches to hiring.

This type of monopoly was what Justice Kennedy raised in his dissenting opinion in *Brown*:

[T]he State . . . grants to itself a monopoly which might then be used for the forced support of certain viewpoints. Had the State, with the help of Congress, not acted in violation of its constitutional responsibilities by taking for itself property which all concede to be that of the client, . . . the free market might have created various and diverse funds for pooling small interest amounts. These funds would have allowed the true owners of the property the option to express views and policies of their own choosing. Instead, as these

118. See JOHN D. DONAHUE, *THE PRIVATIZATION DECISION: PUBLIC ENDS, PRIVATE MEANS* 92-93 (1989).

119. *Id.* at 91.

120. See *id.* at 92; Stevenson, *supra* note 27, at 92-93.

121. See Rubin, *supra* note 27, at 920 n.146; Alexander Volokh, *Privatization and the Law and Economics of Political Advocacy*, 60 STAN. L. REV. 1197, 1216 (2008).

122. See, e.g., Johnson, *supra* note 80, at 395-96.

123. For a similar point in an analogous context of government funding and outsourcing, see Kathleen M. Sullivan, *The New Religion and the Constitution*, 116 HARV. L. REV. 1397, 1415 (2003).

programs stand today, the true owner cannot even opt out of the State's monopoly.¹²⁴

Justice Kennedy was concerned only with anticompetitive effects for the marketplace of ideas or viewpoints, but there are other serious policy issues related to a single payer, the state IOLTA foundation in this situation, and a handful of suppliers of legal services in each state.

Edward Rubin recently observed that government outsourcing of welfare services, which include legal aid for the poor, often presents monopoly problems.¹²⁵ Ideal market efficiency depends on many buyers and many sellers vying for a product or service. Even though the government purchases routine services or commodities, like window washing or office supplies, at a price close to the market price, the equation changes when the government demands unusual items or services, such as free lawyers for the poor. Necessarily, a dearth of suppliers for these items will stand in a monopolist, or at least oligopolist, position.¹²⁶ IOLTA-funded agencies in a given state compete, albeit partially, for the state's IOLTA funds in a zero sum game. This competition occurs on the state level with centralized IOLTA distribution decisions. In contrast, the agencies tend not to compete with each other in providing services. Instead, they serve different locales (rural vs. urban, or City A vs. City B) or do completely different types of legal work, such as when one agency represents domestic violence victims while another represents children with disabilities. The legal aid providers in a state function either as an oligopoly, or as a set of regional monopolies.¹²⁷ As an aside, this also applies to LSC funding, albeit on a broader federal level, as the con-

124. *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 253 (2003) (Kennedy, J., dissenting) (citations omitted).

125. Rubin, *supra* note 27, at 918-25.

126. *See id.* at 918-19.

127. *See also* Rose-Ackerman, *supra* note 25, at 319 (noting that government funding for charity can lead to a "more concentrated charitable sector"). There may be some competition with pro bono lawyers in the same area, but not enough to distort the matter being discussed here. Lee and McKenzie make a similar point about competition among the recipients of social services, which seems applicable here, noting that privately-funded charities reduce the recipients' ability to "exploit" or grow dependent on the programs. Dwight R. Lee & Richard B. McKenzie, *Second Thoughts on the Public-Good Justification for Government Poverty Programs*, 19 J. LEGAL STUD. 189, 199-200 (1990). Agencies that need to solicit and renew private donations, they argue, have an inherent incentive to focus on helping recipients who will use the aid to become productive and self-sufficient. *Id.* at 200. "As charity becomes increasingly the function of government, the recipient's ability to exploit relief payments becomes greater since those who distribute the payments realize that the individual who is denied aid has fewer alternative sources of help." *Id.* The IOLTA funding programs seem to implicate the same problem, in terms of beneficiary competition concerns, as direct provisions of government social services.

ditions attached to receipt of the funds narrow the field of potential providers and increase the stakes for those remaining.¹²⁸

The extent to which IOLTA program administrators scrutinize the reports of recipient organizations annually may constitute a proxy for market selection, but it is barely an approximation. Path dependence emerges, as it does with private foundations and their pet charities. The grant recipients become entrenched and the distribution proportions are generally constant year to year. The grant writers' skill and honesty also play a role in the grantmaking decisions, even though these traits are unrelated to the provision of legal services to the poor.

Of course, legal aid oligopolists do not enjoy "rents" in the typical sense. Instead, one could surmise that the small cluster of recipients would reduce the usual market pressures to innovate, to expand their clientele, or even to maximize the returns on each IOLTA dollar spent. Legal aid lawyers or their managers may have altruistic motivations to help as many poor people as possible, or to be as effective as possible, but altruism is not a market force and may not respond to varying incentives created by IOLTA funds. Ultimately, state IOLTA may constrain administrators' choices about how or where to distribute the collected funds. This lack of choice may be an unavoidable feature of government funding for poverty lawyers,¹²⁹ but it is a policy consideration to weigh alongside other alternatives.

V. MONOPSONY

IOLTA programs also create a situation where the government is the sole purchaser of legal services for the indigent – that is, a monopsony.¹³⁰ When there is a single buyer of the goods or services dominating a market, it

128. See Johnson, *supra* note 80, at 411-12. A related observation pertains to the government provision or funding of social services in general, compared to privately-funded charities that perform the same functions. See Lee & McKenzie, *supra* note 127, at 199 (noting that private charities must perform their services well because they acquire funds from donors that may monitor their effectiveness). While this describes a zero-competition situation for the government welfare agencies, legal aid agencies competing for IOLTA grants pose an analogous, perhaps oligopolistic, problem. Instead of having to cull and retain donors from the general population (which would require impressing them with the agency's use of the contributed funds), the agencies have to impress only one grant-maker – the IOLTA administration for that state – and they have a smaller set of competitors for the grants.

129. See Rubin, *supra* note 27, at 923 (arguing in part that governments should not outsource welfare programs for the poor to private corporations, which is essentially what IOLTA does).

130. See *id.* at 920, 923 (discussing this monopsony problem with regard to privatization and government outsourcing); see also *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 794 n.64 (1968) ("Monopsony is the term used to describe a situation in which the relevant market for a factor of production is dominated by a single purchaser.").

often forces down the price of the purchased goods or services, suppresses the wages of the workers who provide the service, and often lowers the quantity produced.¹³¹ Even though government monopsony might intuitively seem to be a benefit to taxpayers, as the government is in a position to demand the lowest possible price for a service when it is the sole purchaser, monopsony can backfire.¹³²

A single buyer in a market (the monopsonist) unavoidably affects the price for the good or service, as paying for one more unit of the service raises the demand correspondingly and therefore raises the price. Buying or funding one additional unit of service costs the monopsonist a higher price than before. As a result, monopsonists tend to constrict the market in order to keep the price as low as possible.¹³³ IOLTA programs provide a vivid example: the available funds create an artificial cap on the amount of legal services available to the state's poor population and on the wages for legal aid lawyers,¹³⁴ making it difficult to recruit new attorneys to the field.

Monopsony created by government funding for private entities incentivizes service providers to manipulate the state officials into funding unnecessary services and continue utilizing those familiar entities rather than newcomers.¹³⁵ As a result, monopsony reinforces all of the monopoly/oligopoly problems in that it ends up narrowing the field of providers.¹³⁶ In the context of government outsourcing, Rubin observes that ultimately, "government monopsony breeds contractor monopoly," and the monopsony and monopoly effects "reinforce each other."¹³⁷ A state official responsible for outsourcing (or an IOLTA program administrator, which is the equivalent) is "subject to concerted efforts from each potential contractor interested in persuading it to adopt a program design that only that contractor can fulfill."¹³⁸ The number

131. See Baldwin et al., *supra* note 29, at 792 (discussing the monopsony problem with legal services in Great Britain); see also Cooke & Lang, *supra* note 29, at 626; Delfgaauw & Dur, *supra* note 29; Johnson, *supra* note 29, at 59, 61. For commentary on another negative ramification caused by the monopsony of the provision of public goods, namely the potential for the costs of those goods to increase, see Bish & O'Donoghue, *Public Goods*, *supra* note 29; Bish & O'Donoghue, *The Monopsony Problem*, *supra* note 29; Shibata, *supra* note 29.

132. See Rubin, *supra* note 27, at 921-22.

133. See Gregory J. Werden, *Monopsony and the Sherman Act: Consumer Welfare in a New Light*, 74 ANTITRUST L.J. 707, 710 (2007) (explaining the concept of monopsony).

134. See Richard A. Posner, *Are American CEOs Overpaid, and, if so, What if Anything Should be Done About It?*, 58 DUKE L.J. 1013, 1019 (2009) (explaining that most professionals working for public "goods," depending on state funding, have suppressed wages compared to the regular market due to the state's monopsony power).

135. See Rubin, *supra* note 27, at 921.

136. *Id.* at 921-22.

137. *Id.*

138. *Id.* at 921.

of legal aid clinics in each state is small enough that the managers can become personal acquaintances of one another and their respective IOLTA administrators; this type of monopsony can lead to cozy, entrenched relationships. The number of clinics does not grow, the number of those served does not seem to grow, and the legal aid grant writers can apply for funding for earmarked initiatives that they themselves pitched to the administrators.

For-profit monopsony is an area of growing interest in the field of anti-trust and employment law,¹³⁹ especially in light of a recent Supreme Court case on the subject,¹⁴⁰ but so far there has been little analysis of monopsony as it applies to nonprofits and government grants. For-profit monopsonies are more commonplace but are outside the scope of this Article.¹⁴¹ Monopsony is a looming issue in healthcare reform, where it usually goes under the moniker “single-payer system.”¹⁴² Regarding the provision of public services,

139. See, e.g., Bennett S. Miller, Note, *No Such Thing as a Free Lunch: Hurricane Katrina and the Davis-Bacon Act*, 16 S. CAL. REV. L. & SOC. JUST. 197, 209 (2006) (explaining the relationship between the Davis-Bacon Act and monopsony); David Neumark & William Wascher, *Minimum Wages and Low-Wage Workers: How Well Does Reality Match the Rhetoric?*, 92 MINN. L. REV. 1296, 1305 (2008) (describing “models that lead to monopsony-like implications in markets”); see also Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 CORNELL L. REV. 297 (1991); Alan Devlin, *Questioning the Per Se Standard in Cases of Concerted Monopsony*, 3 HASTINGS BUS. L.J. 223 (2007); Einer Richard Elhauge, *The Scope of Antitrust Process*, 104 HARV. L. REV. 667, 734 (1991).

140. See *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007); Natalie Rosenfelt, *The Verdict on Monopsony*, 20 LOY. CONSUMER L. REV. 402 (2008); see also Albert A. Foer, *Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust*, 39 CONN. L. REV. 1307, 1314 (2007) (arguing that “if monopsony is truly and fully a mirror image of monopoly, there are no national monopsonistic retailers in the United States”); David Schwartz, Note, *The Natural Gas Industry: Lessons for the Future of the Carbon Dioxide Capture and Storage Industry*, 19 STAN. L. & POL’Y REV. 550, 558 (2008) (discussing federal regulation of pipeline monopsonies); Werden, *supra* note 133, at 709-13.

141. For other Supreme Court decisions discussing for-profit monopsony, see *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 283 (1997); *Nat’l Collegiate Athletic Ass’n v. Bd. of Regents of Univ. of Okla.*, 468 U.S. 85, 93 n.11 (1984); *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 794 (1968); *United States v. Griffith*, 334 U.S. 100, 103-04 (1948).

142. See, e.g., John H. Cawley & Andrew B. Whitford, *Improving the Design of Competitive Bidding in Medicare Advantage*, 32 J. HEALTH POL. POL’Y & L. 317, 333 (2007); Sherry Glied, *Single Payer as a Financing Mechanism*, 34 J. HEALTH POL. POL’Y & L. 593 (2009) (discussing empirical evidence that single-payer-like healthcare systems do not consistently control physician incomes, but they “do achieve some administrative cost savings compared to more fragmented systems”); David A. Hyman, *Employment-Based Health Insurance and Universal Coverage: Four Things People Know that Aren’t So*, 9 YALE J. HEALTH POL’Y L. & ETHICS 435, 450-51 (2009) (conceding that a single-payer healthcare system functions as a monopsony but arguing that this is beneficial because it suppresses healthcare costs and wages).

however, economists have demonstrated that when the government becomes a monopsonist purchaser of public goods and costs increase, the result is too little consumption of the public goods and a commensurate decrease in social welfare.¹⁴³ In the context of legal services for the poor, this could help explain why most indigent litigants continue to lack legal representation, despite the presence of IOLTA-funded clinics in the state.

The effects of monopsony are notoriously difficult to measure,¹⁴⁴ so it is impossible to quantify the true extent to which it hinders the poor's access to legal representation.¹⁴⁵ It does seem, however, that Professor Rubin is correct in asserting that government monopsony for funding outside welfare services engenders monopoly effects among the service providers, limiting the field and thus the availability of the services.¹⁴⁶

Alternative venues for providing legal representation to the poor are less susceptible to the monopsony problem. Pro bono work by regular lawyers would seem to avoid the distorted prices that monopsony causes and thus should not constrict the availability of services. Civil *Gideon* programs, which work like our established court-appointed criminal defense system, avoid monopsony problems because the court-appointed lawyers are also available for fee-paying clients.¹⁴⁷ The government purchases their services

143. See Bish & O'Donoghue, *The Monopsony Problem*, *supra* note 29, at 1370.

144. See Charles E. Hyde & Jeffrey M. Perloff, *Can Monopsony Power Be Estimated?*, 76 AMER. J. AGRIC. ECON. 1151, 1154 (1994).

145. Similarly, cutbacks in federal provisions of public services, such as the reduction of LSC funding in the 1980s and 90s, generally leave a gap that local governments and private donors do not completely fill. See Steinberg, *supra* note 102, at 32, where he concludes:

That is, whether donations rise or fall in response to an exogenous federal cutback, it is likely that the total of donations and local government expenditure will rise, but only by some fraction of the cutback. One should not count on the local and private sectors to replace the federal government's role in social service provision.

See also McClelland, *supra* note 102, at 1292-95.

146. See Rubin, *supra* note 27, at 923; see also Susan R. Sandler, *Cross-Border Competition in the European Union: Public Procurement and the European Defence Equipment Market*, 7 WASH. U. GLOBAL STUD. L. REV. 373, 437 (2008) ("The inherent problem of monopsony, with the state the sole buyer of a good that can be produced by several different suppliers, is that it renders market pricing difficult, and long-term competition among suppliers nearly impossible. Dependency easily develops between buyer and seller, and state aid is often the result.").

147. Civil *Gideon* (court-appointed civil lawyers for indigents) avoids or at least minimizes monopsony problems because there is no single-payer system if several different courts in a geographic region have independent appointment programs and policies. In addition, *Gideon* appointments occur as they are requested by the indigent parties themselves, in lieu of proceeding pro se, so the "demand" for the services would not be a unilateral decision by a single party. But see Kneave Riggall, *Should Tax Informants Be Paid? The Law and Economics of a Government Monopsony*, 28 VA. TAX REV. 237, 246-48 (2008) (analyzing the IRS' reward program for individual

as one participant in a broad legal market, analogous to a government agency procuring standard office supplies from a vendor.¹⁴⁸ While IOLTA-funded clinics provide a forum for some attorneys to specialize as poverty lawyers, the monopsony effects may offset the net gains to social welfare from this specialization. Lawyer specialization such as this, in fact, is a factor that economists would expect to contribute to monopsony in the labor market.¹⁴⁹

VI. AGENCY COSTS, PRINCIPAL COSTS, AND PROPOSED REFORMS

IOLTA is a system for purchasing and using a public good: legal services for the poor. The private foundations that receive IOLTA funds disburse the money to various nonprofit entities around the state, making the system a private one, when it might otherwise be a government service. This is the civil equivalent of the public defender system. Privatization of the provision of certain public goods creates a disjunction between the purchasers and users of those goods, or, in the case of IOLTA, between the needs and desires of the ultimate beneficiaries (the represented indigents) and the interests of the private, non-profit entities that IOLTA funds to provide the representation.¹⁵⁰ For example, in the IOLTA context, interagency competition for funding operates separately from interagency competition in providing services,¹⁵¹ both in terms of quality and quantity.¹⁵²

taxpayer-informants, which still operates essentially as a monopsony, despite the use of many individual service providers). The IRS offsets some of the deadweight losses of the scenario by having a four-tiered reward system that functions as a type of monopsonist price discrimination. *See id.* at 248.

148. *See* Norman R. Williams, *Taking Care of Ourselves: State Citizenship, the Market, and the State*, 69 OHIO ST. L.J. 469, 505-07 (2008) (arguing that state government monopsonies are legitimate when they favor in-state businesses).

149. *See* Jan K. Brueckner et al., *Local Labor Markets, Job Matching, and Urban Location*, 43 INT'L ECON. REV. 155, 166 (2001); Martin Chalkley, *Monopsony Wage Determination and Multiple Unemployment Equilibria in a Non-Linear Search Model*, 58 REV. ECON. STUD. 181, 190 (1991); Mark M. Hager, *The Emperor's Clothes Are Not Efficient: Posner's Jurisprudence of Class*, 41 AM. U. L. REV. 7, 53 (1991); Richard A. Posner, *Some Economics of Labor Law*, 51 U. CHI. L. REV. 988, 991 (1984); Daniel Shaviro, *The Minimum Wage, the Earned Income Tax Credit, and Optimal Subsidy Policy*, 64 U. CHI. L. REV. 405, 451 (1997).

150. Stevenson, *supra* note 27, at 116-18; *see also* Rubin, *supra* note 27, at 922-24.

151. For a discussion of the concerns with similar competition for funding from the federal Legal Services Corporation, *see* Minn. Legal Servs. Planning Comm'n Drafting Comm., *supra* note 81, at 277.

Based on input from existing providers and discussions with providers in other states, the Commission was also concerned that creation of a single statewide administrative structure could result in increased competition for funding; blurring of the role of pro bono; duplication of the coordination between the LSC entity and the present Coalition programs; the loss

A. Principal Costs

Any provision of services at the behest of another involves agency costs. When the government is the principal in the relationship, however, there can be a special type of cost, which is hereinafter referred to as a “principal cost.” Contracts for services usually address agency costs by trying to align the agent’s interests or incentives with the principal’s interests or goals. The law may even impose fiduciary duties on agents to act in accordance with the principal’s best interests. What happens, however, when the principal’s interests are indeterminate or self-contradictory? This occurs when the principal is the government, trifurcated organizationally into parts intended to be in enough conflict or tension with each other to provide checks and balances. These principal costs are a feature of governance-constituency issues. Further complicating the picture of this principal’s goals is the notion of representation of the public, which includes a broad range of conflicting constituencies. From the perspective of the agent, which privately provides services at the behest of the government, the principal’s best interests are a chaotic melee of different interests that vary over time. The resulting nonalignment of interests between the service provider and the government leave the agency costs unchecked compared to normal agent-principal relationships. From the perspective of the recipient of the services, it may look like an agency problem if the services do not meet their needs or wants, but there is an underlying problem here with *principal* costs – not merely agency costs. Principal costs generate a disconnect between the constituents and the funder of the services.

B. Agency Costs Inherent in Public Funding of Charities

Most organizations, like individuals, respond to incentives. Lawyers and firms usually respond to the goals and purposes of the clients in the legal market. One example is the recent growth of alternative dispute resolution as a method of lowering clients’ costs in litigation, reflecting the preference for cost savings. For all the disadvantages and failures of the free market, it does reveal a brutally realistic picture of the preferences of consumers.¹⁵³

of staff interaction when intake and advice services are separated from extended representation; and, most significantly, a huge diversion of resources at a time when the Coalition programs are already facing a cumulative reduction in funding by the end of 2004 of more than 30%.

Id.; see also Lua Kamál Yuille, Note, *No One’s Perfect (Not Even Close): Reevaluating Access to Justice in the United States and Western Europe*, 42 COLUM. J. TRANSNAT’L L. 863, 873-74 (2004).

152. For a discussion on similar problems with privatized provision of entitlement benefits, see Stevenson, *supra* note 27, at 102-04.

153. Rubin, *supra* note 27, at 923.

Even for nonprofits, there usually exists a connection between rewards (funding) and productivity or quality of services. Nonprofit hospitals compete for local patients and local donors; churches compete for members (who, in turn, will hopefully tithe); private schools compete for students (who later provide tuition dollars and alumni giving). In contrast, legal aid clinics do not compete for clients.¹⁵⁴

Professor Rubin notes, “[T]he efficiency of the market resides in its preference-revealing character.”¹⁵⁵ When a state government acts to buy or fund private legal service clinics, it acts either on behalf of the indigent parties or on behalf of the public at large who want the poor to have these resources.¹⁵⁶ In either case, the preference-revealing function inherent in normal markets is absent, because principal-agent costs distort the system.¹⁵⁷ For example, indigent clients of legal aid clinics have no choice about where to obtain legal representation. Other nonprofit entities, like religious institutions, hospitals, or schools, reveal consumer preferences because certain types of institutions flourish while others languish.

The legal services sector, however, reveals nothing about the preferences of the poor for the type of representation they receive: the relative efficiency or thoroughness of their lawyers, the types of legal problems the agencies handle, or the location of the legal aid offices. The legal aid managers and IOLTA administrators make these decisions beforehand and sometimes misunderstand what the recipients of the services actually want or need.¹⁵⁸ Due to limited resources, agencies must prioritize among different types of legal problems, such as family law, administrative hearings for welfare benefits, landlord-tenant law, and eldercare. They must choose between different types of clients: the working poor or the unemployed, complex time-intensive issues or straightforward problem-solving, and racial minorities or lowest-income clients. The poor have almost no choice about where to get legal help, and the current system of IOLTA-funded clinics lacks the prefe-

154. As mentioned previously, most states have a few IOLTA-funded legal aid organizations that cover different territories of the state or that cover non-overlapping areas of law (e.g. domestic violence vs. disability benefits). See *supra* notes 27 and 117 and accompanying text.

155. See Rubin, *supra* note 27, at 923.

156. For a related discussion of agency costs with legal aid providers (in the context of a proposal to allow poverty lawyers to charge contingency fees), see Note, *Settling For Less: Applying Law and Economics To Poor People*, 107 HARV. L. REV. 442, 455 (1993).

157. Two commentators have posed the question of whether IOLTA is as efficient a system of funding legal services as is a straightforward tax on participants in the legal system. See Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 HARV. L. REV. 997, 1020 n.93 (1999).

158. See, e.g., *Grants Awarded by the Vermont Bar Foundation for FY 2007*, 33 VT. B.J. 44, 44 (2008) (“The award of competitive grants is at the discretion of the Foundation; if the Foundation designates funds for the Competitive Grants Program, non-profits compete for a finite amount of money.”).

rence-revealing features of the free market. IOLTA, therefore, perpetuates an unhappy disjunction between the users of legal services and the buyer. This disjunction may be an unavoidable consequence of government funding for certain charitable entities, but it prevents healthy, competitive pressure to enhance the quality of the services, at least from the recipients' standpoint.¹⁵⁹

Pro bono efforts do not provide a very useful offset to this problem. Pro bono lawyers themselves choose what type of representation to provide, and they typically choose familiar areas of law or cases they can handle from beginning to end within the time they budgeted for volunteering. Pro bono efforts are also susceptible to the disjunctive problem if they occur in a program that channels volunteer lawyers into certain types of work. Fostering more pro bono work across the board, however, would mitigate this problem and provide more effective matching between volunteer lawyers and the needs of the unrepresented poor.

Civil *Gideon* programs seem less susceptible to this disjunction problem. IOLTA clumsily aligns the interests of the poor, the legal aid agencies, and the IOLTA fund administrators.¹⁶⁰ In contrast, civil *Gideon* potentially avoids this ineffectual interests-alignment by hiring lawyers on a case-by-case basis. This case-by-case approach offers a preference-revealing feature that is absent from IOLTA-funded legal aid and pro bono. Appointments on a case-by-case basis naturally allow for clients to self-select according to their individual needs.¹⁶¹ Cases where few indigents need or want representation will therefore have fewer court appointees, and high-demand areas will have more. Of course, where court-appointed civil representation is available for only one or two areas, as is presently the case where it is available at all, there will be no market forces shifting the resources to the areas the poor value most.

C. Proposed Reforms

To mitigate the effects of monopoly and monopsony, IOLTA and LSC administrators should lower barriers for new entrants by earmarking a certain percentage of the funds each year for grant recipients who open new offices or agencies that need help with startup costs.¹⁶² Alternatively, if there is not necessarily a need to open new offices each year, whenever the fund surpasses a certain level, the "surplus" should automatically go toward setup or startup costs for the creation of new entities the next year, while the regular funding could still go to the existing entities that depend on it.

159. See Rubin, *supra* note 27, at 924.

160. See *id.*

161. For a similar proposal with outsourced welfare eligibility determinations, see Stevenson, *supra* note 27, at 123-24.

162. See, e.g., James Andreoni, *Toward a Theory of Charitable Fund-Raising*, 106 J. POL. ECON. 1186 (1998) (modeling the tremendous value or necessity of government-provided "seed money" for private charities in their capital campaigns).

A legitimate increase in pro bono work would help dilute the monopoly, monopsony, and disjunction problems. As mentioned previously, a modest tweak to American tax laws would allow both firms and private attorneys to claim a tax credit or deduction for the donation of their professional services. Even with a universal, minimal lodestar rate like \$75 an hour, attorneys would have an incentive to volunteer their time. Allowing attorneys to practice pro bono anywhere in the country would also increase the potential pool of lawyers volunteering at legal aid clinics; states could easily issue special licenses or juris numbers for out-of-state pro bono lawyers.

A more radical idea, which is probably unrealistic to set forth as a “modest proposal,” would be to allow certain disbarred attorneys to perform pro bono legal work. At least in cases where the disbarment was unrelated to actions that would cause concern about potential harm to the pro bono clients themselves, this could prove beneficial. This would increase the pool of pro bono lawyers, while helping to rehabilitate lawyers who violated rules that do not relate to their ability to help the poor with simple legal matters. A similar benefit comes from the common practice of allowing law students in law school clinics to help the poor with legal matters under the supervision of licensed attorneys.

Overhead costs for legal aid providers are part of the market entry barrier, but there are ways to lower these expenses. Discounted or donated office space would lower setup costs and entry barriers, especially in urban centers. The federal tax code currently forbids deductions for donated facility space, such as free rent.¹⁶³ Changing this rule, even as a specific exception for donated space to legal services, would encourage commercial landowners to allow legal aid organizations to use a portion of their space without paying market-level rent. Some municipalities allow landlords an exemption from property taxes on space leased to nonprofit organizations on a pro rata basis. If more municipalities did this, it could help lower overhead costs for charities. Lower costs may be even more feasible if the exemption were conditioned on the nonprofit having free or deeply discounted rent, but there do not appear to be any municipalities that presently have such a rule.

VII. IS THERE A MORAL HAZARD PROBLEM?

A potential litigant who does not have to bear any legal costs even if she loses could litigate more than otherwise possible, and could do so beyond the optimal level from a social welfare standpoint. Thus, it might seem that subsidies for legal services would effectively clog judicial dockets. Those who must pay for their lawyers are more likely to avoid occasions to need one.¹⁶⁴

163. See I.R.C. § 170(f)(3)(A) (2006); Treas. Reg. § 1.170A-7(a) (2010).

164. There is also an adverse selection problem with legal aid – separate from the moral hazard problem, and more difficult to solve. Those who turn to legal aid could self-select for being particularly needy of legal services; that is, they have a serious,

A moral hazard problem emerges if the poor do not have the same incentives as others to avoid legal problems in the first place, because they may choose to over-litigate.

The empirical data, however, indicates the opposite is true. At least in the civil *Gideon* context, where advocates have tracked systemic trends and results for the pilot programs in various states, such programs reduce judicial caseload.¹⁶⁵ Apparently, having representation fosters resolutions before litigation is necessary. In other words, providing legal representation to indigent clients serves as a check on the moral hazard problem rather than augmenting it.

Pro bono attorneys lower the risk of over-litigation. The appointed lawyer presumably wants to help as many clients as possible – or at least more than just the client at hand. In addition, most attorneys want to avoid the embarrassment of censure by a court or administrative agency for frivolous filings or arguments. On the other hand, pro se litigants proceed without representation with little guidance and little to lose. They are prone to erroneous or missed filings; missed deadlines at the administrative level that lead to otherwise avoidable denials and appeals; frivolous filings, arguments, and appeals; and impediments in negotiating and resolving problems out of court. The moral hazard problems are already latent in a system that allows pro se

complicated problem to solve. Those with less serious legal problems would presumably be more likely to proceed on their own without bothering to find a legal aid lawyer. Moreover, many legal aid directors prioritize serious cases rather than take clients in the order that they come.

For example, the agency may give priority to eviction cases where there are children living in the home who could become homeless, where the tenant is at risk of losing a Section 8 housing voucher, or where the applicant has a disability. An applicant for legal aid who has all of these conditions would become a high priority case. The problem is that the agency will take a client who has a complicated set of problems, and the client is likely to take a disproportionate amount of time. The agency must turn away many other needy applicants, who must go without any representation because of the complexity of priority clients' cases.

Of course, it is hard to quantify the costs and benefits in this equation, but it is certainly possible that the value of helping the client with worse problems does not exceed the cost of leaving others with no help at all. It is at least possible for an agency to miss the optimal balance in this regard. In addition, a client with a host of serious problems – as opposed to a client with one discrete issue that would take a lawyer little time to solve – could be self-selected to be a “difficult client.” This type of adverse selection could further limit the agency's ability to help the optimal number of poor clients, whatever that number is. For a similar discussion related to the prevention of homelessness, see MALCOLM GLADWELL, *WHAT THE DOG SAW AND OTHER ADVENTURES* 177-97 (2009).

165. Laura K. Abel & Susan Vignola, *Economic and Other Benefits Associated with the Provision of Civil Legal Aid* 11-12 (NYU Univ., Working Paper version 11-10-09, 2009), available at <http://ssrn.com/abstract=1503009>.

litigants, but legal aid lawyers seem to serve as a check on this problem. This seems to be a net benefit for society, and especially for courts and lawyers.

To the extent that IOLTA fosters judicial economy, it lowers the state's financial burden: the civil *Gideon* lawyers and legal service providers bring millions of dollars into each state, mostly from the federal government in the form of Medicare payments, food stamps, Social Security Disability payments, and similar benefits. The flow of federal funds into a state may represent a zero sum game between state and federal coffers or between states. This potentially means no net social benefit, except that the legal aid lawyers are facilitating the disbursement of funds that representatives in Congress have already apportioned for this purpose. Thus, IOLTA lowers the transaction costs of welfare programs, which is a net gain.

VIII. CONCLUSION

The popularity of IOLTA programs is evident from the fact that they have gained nationwide acceptance. After nearly thirty years of helping fund legal services for the poor, Americans should support analysis of and policy planning regarding the programs. This will help mature our approach to the provision of legal representation for the poor. The purpose of this Article was to confront some lingering theoretical problems that were overlooked until now.

IOLTA is susceptible to the crowding out syndrome that economists have identified and documented with other government provisions of funds and services, and more attention should be devoted to the possibility that IOLTA is crowding out pro bono endeavors by non-legal aid attorneys and alternative funding sources for legal aid. The legal community should also consider whether IOLTA creates a disincentive for lawmakers to ease the restrictions placed on LSC funding in the 1990s. Taking measures to bolster pro bono volunteering and civil *Gideon* pilot programs would help offset the crowding effect so IOLTA could provide a greater net benefit to the community.

Both oligopoly and monopsony problems are present with IOLTA programs, as the programs result in an entrenched group of legal service providers that vie for funding under a single-payer system. These oligopoly and monopsony problems paralyze the expansion of legal services for the poor because they constrict the availability of clinics, suppress the wages of legal aid lawyers, and subsidize inefficiencies that remain unchecked. Certain countermeasures would ameliorate or dilute these effects, lowering entry barriers for new legal aid entities and fostering more viewpoint diversity in the legal services community.

Agency costs are also present in legal representation, and the provision of legal representation for the poor is no exception. IOLTA creates a special type of multi-level agency cost for which state program administrators make funding allocation decisions and pay for certain types of representation, while the legal aid managers make another set of decisions about prioritizing par-

ticular cases or needs. Meanwhile, the consumers – the indigent parties themselves – have little or no choice in the matter. This disjunction of interests and incentives inherent in IOLTA programs is the opposite of the preference-revealing feature of the free market; indeed, the preferences of IOLTA's ultimate beneficiaries remain unknown. A similar problem besets pro bono programs, but civil *Gideon* programs are superior to legal aid and pro bono programs in this regard. The disjunction is not in itself a reason to abandon IOLTA or IOLTA-funded programs, but it should be a consideration in shaping legal services policy in the future.

IOLTA serves an important purpose. The time has come, however, to rethink IOLTA so that it can achieve its purposes more effectively. With some adjustments and additional cooperation with pro bono efforts and civil *Gideon* programs, the American legal system can provide greater access and fairness for indigent parties.