

Opinion No. 626, April 2013

QUESTIONS PRESENTED

Under the Texas Disciplinary Rules of Professional Conduct, may a lawyer, who had formerly represented a corporation in circumstances where the lawyer came to possess confidential proprietary information relating to the former client's competitive position in its market, make a significant investment in a new business that will compete with the former client's business?

Statement of Facts

A lawyer represented Corporation A in several matters including the sale of Corporation A to an unrelated corporation. During the course of the representation, the lawyer had access to a range of non-public information concerning Corporation A's business, including proprietary information belonging to Corporation A that gives Corporation A a competitive advantage in its field. The lawyer's representation of Corporation A ended with the sale of the corporation. After the sale, Corporation A has continued to conduct the same business it conducted before the sale. Several months after the sale of Corporation A, the lawyer makes a significant investment in a new corporation, Corporation B, which he knows is intended to compete with Corporation A. The lawyer is not involved in the organization or formulation of the initial business plan of Corporation B and he does not provide legal services or otherwise participate in the management or operation of Corporation B's business. Corporation A has not consented to the lawyer's use of its confidential information to the disadvantage of Corporation A.

Discussion

Although Corporation A has been sold by its prior owners and has not been represented by the lawyer since the sale, the lawyer remains obligated to protect from disclosure proprietary information he acquired during the representation of Corporation A. The lawyer is also prohibited from using

the proprietary information to the disadvantage of Corporation A. These obligations of the lawyer to Corporation A, as the lawyer's former client, are not eliminated or diminished by the fact that Corporation A has new owners following its sale. With respect to information that is obtained by a lawyer in the course of the lawyer's representation of a client and that has not become generally known, after the termination of the representation the lawyer has continuing obligations to the former client not to reveal the information and not to use the information to the disadvantage of the former client.

Rule 1.05 of the Texas Disciplinary Rules of Professional Conduct provides in relevant part:

“(a) ‘Confidential information’ includes both ‘privileged information’ and ‘unprivileged client information.’ ‘Privileged information’ refers to the information of a client protected by the lawyer-client privilege of Rule 503 of the Texas Rules of Evidence or of Rule 503 of the Texas Rules of Criminal Evidence or by the principles of attorney-client privilege governed by Rule 501 of the Federal Rules of Evidence for United States Courts and Magistrates. ‘Unprivileged client information’ means all information relating to a client or furnished by the client, other than privileged information, acquired by the lawyer during the course of or by reason of the representation of the client.

(b) Except as permitted by paragraphs (c) and (d), or as required by paragraphs (e) and (f), a lawyer shall not knowingly:

(1) Reveal confidential information of a client or a former client to:

(i) a person that the client has instructed is not to receive the information; or

(ii) anyone else, other than the client, the client's representatives, or the members, associates, or employees of the lawyer's law firm.

....

(3) Use confidential information of a former client to the disadvantage of the former client after the representation is concluded unless the former client consents after consultation or the confidential information has become generally known.”

In the circumstances here considered, none of the exceptions to the lawyer's obligations specified in paragraphs (c), (d), (e) and (f) of Rule 1.05 are applicable. Rule 1.05(b)(3) would permit the use of confidential information to the detriment of a former client if the former client gave consent after consultation or if the confidential information has become generally known. In addition, it is permissible for a lawyer to act to the disadvantage of a former client so long as he can do so without breaching his continuing obligations to the former client, including those involving confidential information. See e.g. Professional Ethics Committee Opinion 544 (April 2002).

Knowing that Corporation B will be competing with Corporation A, the lawyer makes a significant investment in Corporation B. The lawyer has confidential information of Corporation A including proprietary information that gives Corporation A a competitive advantage in its market. The lawyer's decision to invest in Corporation B is made at a time when the lawyer's information concerning Corporation A continues to be relevant to Corporation A's current business operations and such confidential information is part of the lawyer's knowledge that he uses in making the decision to invest in Corporation B. The funds invested by the lawyer will be used by Corporation B to its own advantage and, since Corporation B competes with Corporation A, this use of the lawyer's funds will be to the disadvantage of Corporation A. In addition, a significant investment by the lawyer in Corporation B could reveal to interested persons information concerning the lawyer's assessment of Corporation A that is based on confidential information obtained by the lawyer in his representation of Corporation A. Thus the lawyer, in using confidential proprietary information belonging to Corporation A in the decision to make a significant investment in a competitor of Corporation A, will be using such confidential information

to the disadvantage of Corporation A in violation of Rule 1.05(b)(3) and may also be revealing to interested persons confidential information concerning Corporation A in violation of Rule 1.05(b)(1).

It should be noted that the lawyer's decision to invest in Corporation B might not violate Rule 1.05 if the lawyer's investment were not significant for Corporation B. The lawyer's investment would not be significant if it was a sufficiently small portion of the total amount invested in Corporation B and there were other investors ready to make an investment in the same amount if the lawyer did not. In that case, the lawyer's investment would make no difference in the business operations of Corporation B and no disadvantage to Corporation A would result from the lawyer's investment. Moreover, if the lawyer's former representation of Corporation A had been limited in scope so that he had not gained any confidential information that would be relevant to Corporation B's business, then the lawyer would not be using confidential information concerning Corporation A when the lawyer invested in Corporation B. Whether an investment is significant to a corporation's business or whether a lawyer in a prior representation acquired confidential information that continues to be relevant to a competing business at the time of a lawyer's

investment in the competing business are questions that can only be answered based on consideration of the facts of a specific situation.

Conclusion

Under the Texas Disciplinary Rules of Professional Conduct, a lawyer who had formerly represented a corporation in circumstances where the lawyer came to possess confidential proprietary information of the client corporation relating to the former client's competitive position in its market is not permitted to make a significant investment in a new business that the lawyer knows will compete with the former client's business at a time when the confidential information concerning the former client remains relevant to the former client's current business. The prohibition will no longer apply when confidential information possessed by the lawyer with respect to the former client ceases to be relevant to the current business operations of businesses competing with the former client.

The Supreme Court of Texas appoints the nine members of the Professional Ethics Committee from members of the bar and the judiciary. The court also appoints the committee's chair. According to Section 81.092(c) of the Texas Government Code, "Committee opinions are not binding on the supreme court."

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Opinion No. 627, April 2013

QUESTIONS PRESENTED

Under the Texas Disciplinary Rules of Professional Conduct, what are the responsibilities of a law firm for preserving or disposing of files of a former client after the lawyer who represented the former client leaves the firm?

Statement of Facts

Lawyer A is a Texas lawyer who was a member of Law Firm X for several years. During his time at Law Firm X, Lawyer A represented many clients, including some who later ceased to be clients of Lawyer A and Law Firm X. When Lawyer A left Law Firm X to become a member of Law Firm Y, Lawyer A's existing clients instructed Law Firm X to transfer their open files to Law Firm Y and these files were transferred. The closed files of Lawyer A's clients and former clients remained with Law Firm X in storage along with Law Firm X's other closed files.

Under Law Firm X's record retention policy, files are scheduled for destruction five years after being closed. Law Firm X notified Lawyer A of its plan to destroy such files of Lawyer A's clients and former clients. Lawyer A informed Law Firm X that he did not want those files and that he wanted no responsibility for maintaining or destroying those files.

Law Firm X then contacted Lawyer A's former clients to inquire whether they wanted their closed files returned to them. In most cases, those former clients responded that they did not want their closed files and that they would not be responsible for storing or disposing of them. Some of Lawyer A's former clients, however, requested that Law Firm X review the closed files to determine whether the files contained any "important papers" that should be retained. Conducting such a review would be expensive for Law Firm X, especially because Law Firm X, unlike Lawyer A, is not familiar with the contents of the files, making it difficult for Law Firm X to evaluate

whether any of the contents are potentially "important."

Discussion

At the outset it must be recognized that there are no specific provisions of the Texas Disciplinary Rules of Professional Conduct that provide detailed guidance for the question considered in this opinion. The Texas Disciplinary Rules contain specific governing rules on many subjects important in the proper conduct of the practice of law in Texas—for example, protecting client confidences, conflicts of interest, solicitation of legal business, and lawyer advertising. But, with few exceptions, the Texas Disciplinary Rules themselves do not specifically set out requirements or prohibitions with respect to the stored files relating to a lawyer's past representation of clients. The only exception relates to the continuing requirements set forth in Rule 1.05(b)(1) and (3) to protect confidential information relating to a former client against disclosure and adverse use against the former client.

Another possible source of guidance in the Texas Disciplinary Rules are rules governing the handling of clients' money and other property (Rule 1.14) and the handling of a client's files when a lawyer's representation of the client in the matter terminates (Rule 1.15(d)). Rule 1.14 of the Texas Disciplinary Rules of Professional Conduct, entitled "Safekeeping Property," provides in full as follows:

"(a) A lawyer shall hold funds and other property belonging in whole or in part to clients or third persons that are in a lawyer's pos-

session in connection with a representation separate from the lawyer's own property. Such funds shall be kept in a separate account, designated as a 'trust' or 'escrow' account, maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other client property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(b) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(c) When in the course of representation a lawyer is in possession of funds or other property in which both the lawyer and other person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of their interest. All funds in a trust or escrow account shall be disbursed only to those persons entitled to receive them by virtue of the representation or by law. If a dispute arises concerning their

respective interests, the portion in dispute shall be kept separated by the lawyer until the dispute is resolved, and the undisputed portion shall be distributed appropriately.”

Rule 1.15(d) provides as follows:

“Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client’s interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payments of fee that has not been earned. The lawyer may retain papers relating to the client to the extent permitted by other law only if such retention will not prejudice the client in the subject matter of the representation.”

The committees of other states that deal with questions of professional ethics of lawyers are split as to whether the equivalent of Texas Disciplinary Rules 1.14 and 1.15(d) provide specific guidance for a lawyer’s handling of closed client files. See Louisiana State Bar Association Rules of Professional Conduct Committee Public Opinion 06-RPCC-008 (2006) (Louisiana rules, which include provisions similar to Texas Rule 1.14, do not contain any specific provisions dealing with the retention of client files); Pennsylvania Bar Association Committee on Legal Ethics and Professional Responsibility Formal Opinion 2007-100 (2007) (provisions equivalent to Texas Rule 1.14 do not directly apply to the complete client file); Illinois State Bar Association Advisory Opinion on Professional Conduct No. 95-2 (1995) (the equivalent of Texas Rule 1.14(b) applies to closed client files); and Alabama Ethics Opinion 2010-02 (2010) (applying the equivalent of Texas Rule 1.14 to closed client files). Although the committees in

other states differ as to whether the detailed provisions of the equivalent of Texas Rule 1.14 and Rule 1.15(d) should be treated as applying to closed client files, most or all committees on professional ethics in other states that have considered the issue have made reference to these rules (particularly to part or all of the equivalent of Texas Rule 1.14) for guiding principles on lawyers’ handling and disposition of closed client files.

Although this Committee relied in part upon Rule 1.14(b) and Rule 1.15(d) of the Texas Disciplinary Rules of Professional Conduct in Professional Ethics Committee Opinion 570 (May 2006), which ruled that a lawyer is normally required to turn over files including the lawyer’s notes if requested by a client, the Committee does not believe that Rule 1.14 and Rule 1.15(d) should be interpreted as providing specific, detailed guidance for lawyers with respect to the disposition of closed client files generally. Rule 1.14 does not refer to “files” but does refer to “other property” as part of the phrase “funds and other property” in contexts where clearly the meaning of the word “property” is “property similar to cash” (such as bonds and stock certificates). The conclusion that “property” in Rule 1.14 refers to valuable property like certificates for stocks or bonds and not client files is supported by the analysis used in the American Law Institute’s Restatement of the Law Governing Lawyers (2000) (the “Restatement”). Sections 44 and 45 of the Restatement, entitled “Safeguarding and Segregating Property” and “Surrendering Possession of Property” respectively, are based largely on Rule 1.15 of the American Bar Association Model Rules of Professional Conduct which is similar to Texas Rule 1.14 quoted above. These sections of the Restatement deal with lawyers’ obligations concerning money and valuable property of clients and others, but these

sections do not include client files within the scope of “property.” On the other hand, Section 46 of the Restatement, entitled “Documents Relating to a Representation,” deals with client files as a category separate from “property.”

Rule 1.15(d) of the Texas Disciplinary Rules uses the term “papers” in a way that clearly refers to client files in paper form. However, that Rule by its terms applies at the time a lawyer’s representation of a client terminates and the Rule does not apply to files that are retained and stored by a lawyer as closed files after the representation of the client in a matter ends.

An additional factor that makes specific provisions of the Texas Disciplinary Rules unsuited to be a source of detailed guidance for the handling of closed client files is that the files of clients and former clients are no longer solely, or in most cases even primarily, in tangible paper form. Particularly in the last twenty years or so, the law practice of most lawyers in Texas has evolved to the extent that paper notes and documents are frequently a small part of the total records of a lawyer’s work on a matter. The increasingly important part of most lawyers’ files is electronic data stored in digital form on the lawyers’ computers and servers. These relatively recent developments would make it even more difficult to use the literal terms of Rule 1.14 and Rule 1.15(d) as the primary source of guidance on handling closed client files.

The conclusion that the literal terms of Rule 1.14 and Rule 1.15(d) do not supply specific guidance for a lawyer’s handling of closed client files does not mean that these Rules are irrelevant to the Committee’s response to the question here considered. Instead the principles and values underlying these Rules—particularly the emphasis on the duty of lawyers to protect the interests of current and former clients—are critical guides for

lawyers' conduct with regard to closed client files.

A number of principles relating to a lawyer's or law firm's closed files of clients or former clients arise from provisions of the Texas Disciplinary Rules. Application of these principles will in most cases be subject to modification by agreement between lawyer and client and will also be subject to any requirements of applicable statutory and decisional law.

First, since client files almost invariably contain confidential information concerning clients, lawyers in possession of client files must comply with the obligations of Rule 1.05 of the Texas Disciplinary Rules of Professional Conduct requiring that confidential information of current and former clients not be disclosed outside the law firm except in specific, narrowly defined circumstances set forth in Rule 1.05. The obligation to protect confidential client information would preclude any disposition of closed client files that could result in unauthorized persons having access to the contents of the files.

Second, subject to limitations to protect important interests of other persons as well as the interests of clients themselves in certain circumstances, the client concerned normally has the right to obtain possession of the lawyer's files arising from the lawyer's representation of the client. See Professional Ethics Committee Opinion 570 (May 2006); *Hebisen v. State*, 615 S.W. 2d 866 (Tex. App.—Houston [1st Dist.] 1981, no writ) (applying former Disciplinary Rule 9-102(B)(4) of the Texas Code of Professional Responsibility as in effect before 1990, which is a predecessor of current Rule 1.14(b) of the Texas Disciplinary Rules of Professional Conduct).

Third, under the Texas Disciplinary Rules a lawyer has continuing obligations not to harm the interests

of former clients with respect to matters for which the lawyer provided legal services. Under Rule 1.09 and Rule 1.10, a lawyer may not act adversely to a former client on a matter for which the lawyer provided legal services. In the case of closed files held by a lawyer, this principle requires that a lawyer protect from destruction files arising from the representation of the client if the lawyer has reason to believe there is a reasonable likelihood that important interests of the former client would be harmed by destruction of information and documents contained in the file. Among the factors that a lawyer should consider in determining whether there is a reasonable likelihood that important interests of the former client would be harmed by destruction of a file are any client instructions concerning the file, the amount of time that has passed since the file was closed, the nature and content of the file as known to the lawyer based on memory or on the labeling of files, and normal business practices. A detailed review of files for items of information that might be of value to a particular client is not required before closed files are destroyed. However, the obligations to protect property of current and former clients embodied in Rule 1.14 would require that a lawyer proposing to destroy closed files have an adequate basis for assurance that items of property—such as jewelry, currency, stock and bond certificates, and original deeds—are not included in the files destroyed. There would be an adequate basis for such assurance if the law firm had procedures in place to review all files prior to placing the files in storage so that all items of property that had been contained in the files are identified and delivered to the client before the closed files are sent to storage. Where there is not another adequate basis for certainty as to the absence of

client property in closed files, there should be at least a brief visual review of the actual contents of physical files proposed to be destroyed so that items of property that can be identified in such a review may be removed and not destroyed along with the rest of the files. These obligations to protect closed files from destruction that would be likely to be harmful to former clients and to protect items of property contained in closed files will apply not only to the lawyer or law firm in possession of a particular closed file but also to other lawyers of the former client if these lawyers are requested by the former law firm or by the former client to assist in the evaluation of closed files.

Beyond the principles set forth above, the Texas Disciplinary Rules of Professional Conduct do not provide guidance as to how these principles should be implemented. For example, questions of how long files should normally be retained by a lawyer, whether notice should be given to clients before closed files are destroyed in a manner consistent with the principles discussed above, which lawyers should continue to hold closed client files when a lawyer or lawyers leave a law firm, and whether closed files originally in paper form may be converted and stored as electronic files are questions of importance but are simply not specifically answered in the Texas Disciplinary Rules. Instead these and similar questions must be answered with reference to the principles set forth above as these principles relate to particular circumstances.

Costs of complying with the basic principles of the Texas Disciplinary Rules governing closed client files may be substantial. In many cases the most significant cost will be the cost of secure storage of files before the time when the files may be appropriately destroyed. It is implicit in the Texas Disciplinary Rules that, in the

absence of agreement with clients for a different treatment, ordinary costs of complying with applicable rules, whether relating to the treatment of client files or other matters, should be borne by the lawyers incurring these costs and should be treated as part of the costs of providing legal services to clients. Thus costs of storing client files should, absent an agreement to the contrary or other special factors, be borne by the lawyers concerned. However, costs of complying with client requests concerning closed client files that go beyond what is required by the principles of the Texas Disciplinary Rules of Professional Conduct should be borne by the client making the requests. Consequently, if a client requests that a lawyer continue to hold files beyond the time that the files are required to be held under the principles discussed above, a lawyer need not comply with the former client's request unless the client takes appropriate steps to pay for the requested additional period of storage. Moreover, if, after a law firm determines that files may be destroyed under the principles discussed above, a former client requests a lawyer to undertake a detailed review of the contents of closed files to identify information that the client would want to preserve, such detailed review should be treated as additional legal services subject to normal rules as to lawyer competence to provide the services requested and subject to arrangements for the client to pay for the additional legal services involved in such a review.

In view of the discussion above, it is clear that Law Firm X is permitted under the Texas Disciplinary Rules to destroy, after evaluation of the files as discussed above, closed files of a current or former client as to which lawyers in Law Firm X do not have reason to believe there is a reasonable likelihood that important inter-

ests of the client would be harmed by destruction of the files. If Lawyer A is notified or otherwise becomes aware of the proposed destruction by Law Firm X of closed files of a former client and Lawyer A has reason to know that there is a reasonable likelihood that important interests of the former client will be harmed by destruction of the information and any documents contained in the closed files scheduled for destruction, Lawyer A will have a duty to inform Law Firm X and to offer to assist in other steps necessary to protect the apparent interests of Lawyer A's former client. Law Firm X and Lawyer A should each bear their own costs of steps necessary to protect likely interests of the former client, and any additional services requested by the client should be provided if the lawyers believe themselves competent to provide the services and if the client makes arrangements to provide compensation for the additional services provided.

Conclusion

Under the Texas Disciplinary Rules of Professional Conduct, closed files of current or former clients that are held by a lawyer or law firm are held subject to certain basic principles. First, confidential information of clients or former clients must be protected from unauthorized disclosure. Second, except when important interests of other persons or the client would be compromised, a lawyer or law firm possessing closed client files should turn them over to the client if requested by the client to do so. Third, a lawyer or law firm is permitted to destroy closed files when circumstances, including the passage of time, the nature of the files, and the absence of client instructions to the contrary, justify a reasonable conclusion that destruction of the file is not likely to harm material interests of the client

concerned, provided that reasonable steps (such as a brief visual review of physical files) have been taken to avoid destruction of items of client property, such as currency, bonds and original deeds, that might be included in the files to be destroyed. Outside lawyers who are no longer practicing law with the lawyer or law firm in possession of closed client files may be called upon to assist the lawyer or law firm in possession of closed client files with respect to decisions as to the appropriateness of destroying particular closed files that were created or contributed to by the outside lawyer. Lawyers are not required to undertake a detailed review of the contents of closed files if destruction of the files is otherwise permitted, and any such detailed review should be treated as additional legal services subject to normal rules concerning lawyer competence to provide particular services and agreed compensation for legal services provided. Costs of complying with the basic principles of the Texas Disciplinary Rules of Professional Conduct applicable to closed client files should be borne by the lawyers and law firms having responsibility for the files, and costs of additional services provided at the request of a client should be borne by the client requesting such services. In addition to the principles of the Texas Disciplinary Rules of Professional Conduct, requirements with respect to the treatment of closed client files may also be created or modified by statutory or decisional law of Texas and by agreement between client and lawyer.

The Supreme Court of Texas appoints the nine members of the Professional Ethics Committee from members of the bar and the judiciary. The court also appoints the committee's chair. According to Section 81.092(c) of the Texas Government Code, "Committee opinions are not binding on the supreme court."