



# Prying attorneys from their deceptive clients

*The crime-fraud exception to attorney-client privilege can be a powerful tool to pry out defendant's secrets and separate the defendant from its former attorneys*



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The recent financial meltdown has highlighted the problem of fraud and deceptive practices in the inducement of financial investments, and the tremendous risks such practices pose to individual investors and to society at large. Misrepresentations that lead to the inducement of investments can cause millions of dollars to be wasted in unworkable schemes, with lawsuits following to recover the funds.

Often when false or misleading representations have been made to induce an investor to invest in a start-up or small company, an attorney has either knowingly or unknowingly assisted with the acts that make up the fraud. While most attorneys are not willing to do anything fraudulent, they often become unwitting assistants in fraud by drafting letters, memoranda, or investment documents, or providing in confidence the legal framework for an individual to know

how to make misrepresentations and not get caught. Regardless of the culpability of the client's fraudulent acts, an attorney often feels duty bound to assist the client when the client becomes a defendant in a case involving fraud or misrepresentation.

A discovery strategy that I have used in these types of cases is the application of the so-called "crime-fraud exception" to attorney-client privilege (Evid. Code, § 956). I find that this is a useful tool to obtain key evidence in a case, as well as to divide the opposition. It often requires extensive motion practice, but can bear significant fruit. If the attorney's advice, communications, or actions "enable or aid anyone to commit or plan to commit a crime or a fraud," then internal communications and documents may be discoverable. (Evid. Code, § 956.) Where plaintiff establishes that an attorney assisted with the fraud, attorney-client communications related to the fraud are not protected by the attorney-client privilege. (*BP Alaska Exploration, Inc. v.*

*Superior Court* (1988) 199 Cal.App.3d 1240 at pp. 1262-1263, 1269-1270.)

Elimination of attorney-client privilege as to documents related to the fraud can provide insight and key evidence, and can be used to devastating effect when questioning witnesses. The resulting situation can be used to divide the defendant from its former attorneys, such that their interests oppose each other.

## **Elements of the crime-fraud exception**

The "crime-fraud exception" to attorney-client privilege (Evid. Code, § 956) states: "There is no [attorney-client] privilege under this article if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or a fraud." (See, *General Dynamics Corp. v. Superior Court* (1994) 7 Cal.4th 1164 at p. 1191 [the attorney-client "privilege takes flight if the relation is abused"].) Although a defendant in litigation will argue that this is a narrow exception, the language on its face is quite



broad and should be so interpreted. In a case of fraud, the section 956 exception applies where the requesting party can show a “false representation of a material fact, knowledge of its falsity, intent to deceive and the right to rely.” (*BP Alaska Exploration, supra*, 199 Cal.App.3d at p. 1263.)

In the *BP Alaska* case, the plaintiff, a gas exploration company, provided confidential information to defendant oil company regarding certain underground gas reserves. Defendant at first declined to go into business with plaintiff, but later used the confidential information to go into business with a third company to exploit these reserves. Attorneys for the defendant oil company then wrote a fraudulent letter to the plaintiff’s company, falsely stating that plaintiff’s information had not been utilized. In litigation, the plaintiff claimed that, since defendant’s attorneys drafted a fraudulent letter, Evidence Code section 956 applied to communications between the defendant and its attorneys. The trial court agreed, and the Court of Appeal upheld the loss of attorney-client privilege as to the fraud-related communications. (*Id.* at p. 1247.)

*BP Alaska* discussed at length the evidentiary requirements to establish the crime-fraud exception. Pursuant to *BP Alaska*, the litigant must set forth facts evidencing the following elements:

- *False representation of a material fact:* The person must have made false statements regarding a material fact, or omitted a fact that the person was obligated to reveal.
  - *Knowledge of its falsity:* The person must have known that the statement was false.
  - *Intent to deceive:* The person must have intended to induce the injured party to rely on the false statement.
  - *Right to rely:* The injured party must have had a right to rely on the person’s representations, because of a fiduciary or business relationship or for some other reason.
- (*Id.* at p. 1263)

Importantly, it is not the attorney’s fraudulent conduct that is at issue;

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section 956 is specifically aimed at the client’s use of the attorney’s services to commit a fraud. “In that connection, it is the intent of the client upon which attention must be focused and not that of the lawyers.” (*State Farm Fire & Casualty Co. v. Superior Court* (1997) 54 Cal.App.4th 625 at p. 645, citing, *Glade v. Superior Court* (1978) 76 Cal.App.3d 738 at p. 746.) This is an important distinction that must be highlighted for a court addressing this issue and is often overlooked.

The *BP Alaska* case is frequently cited to set forth the elements of the crime-fraud exception and the method of proof. (See, *State Farm, supra*, 54 Cal.App.4th 625 at p. 645 [Evid. Code, § 956 exception applies where insurer’s agent committed forgery in issuing the policy]; *Cunningham v. Conn. Mut. Life Ins.* (S.D. Cal. 1994) 845 F.Supp. 1403 at p. 1414 [where letter evidenced plaintiff had lied about his inability to work, the letter was not privileged because of the crime-fraud exception].)

### Issues in establishing the crime-fraud exception

Ordinarily, as the crime-fraud exception is a discovery issue, the exception will arise in the context of a motion to compel responses to discovery. Where the responding party asserts attorney-client

privilege objections, the propounding party can attack the privilege by asserting the section 956 crime-fraud exception. A successful ruling establishing the crime-fraud exception should also apply to other discovery issues subsequently arising in the litigation.

The elements required to show the crime-fraud exception are similar to the elements to show fraud. (See CACI 1900.) Defendants will often argue that in a discovery motion the plaintiff must satisfy the same burden of proof for an actual claim of fraud. However, courts are clear that the evidentiary requirements for section 956 are lower than the proof of actual fraud. The court is “not reviewing the merits of a fraud cause of action . . . but rather we are reviewing the merits of a discovery order . . .” (*BP Alaska, supra* at p. 1263.) Fewer elements are required for the crime-fraud exception, as there is no need to prove the plaintiff was harmed by the fraud. In fact, the fraud need not have been completed at all; a plan to commit fraud suffices to trigger the exception. Section 956 “applies to attorney communications sought to enable the client to plan to commit a fraud, whether the fraud is successful or not.” (*Id.* at p. 1262.)

Mere assertion of fraud is insufficient; there must be a showing the fraud has some foundation in fact. This highlights an inherent problem for litigants attempting to prove up the crime-fraud exception. The goal of the litigant is to gain increased access to discovery hidden behind the attorney-client privilege. However, there may be many facts which are not accessible because of the privilege – facts which could be important to establish the existence of fraud.

Fortunately, courts interpreting section 956 have not required litigants to comprehensively prove that a fraud occurred. Pursuant to *BP Alaska*, a prima facie case establishing the crime-fraud exception is “one which will suffice for proof of a particular fact unless contradicted and overcome by other evidence.



In other words, evidence from which reasonable inferences can be drawn to establish the fact asserted, i.e., the fraud.” (*BP Alaska, supra*, 199 Cal.App.3d at p. 1262.)

Courts have applied relatively relaxed evidentiary requirements regarding certain elements that may be difficult for the litigant to prove directly. For example, the defrauder’s intent to deceive, which may be difficult to demonstrate directly, “can be inferred from the circumstances” to show a prima facie case of fraud. (*Cunningham, supra*, 845 F.Supp. 1403 at p. 1414 [where plaintiff falsely claimed disability and obtained insurance benefits, intent to deceive can be inferred].) In the context of investor fraud, statements made as part of a sales pitch to potential investors can be assumed to be made with the intent to induce reliance. (*Anderson v. Deloitte & Touche* (1997) 56 Cal.App.4th 1468 at pp. 1477-78 [fraud case].)

Similarly, the defrauded person’s right to rely on the fraudulent representations can be inferred from the circumstances of their relationship. For example, a person has a right to rely on the truth of a business partner’s representations. “Only [i]f the conduct of the plaintiff [in relying upon a misrepresentation] in the light of his own intelligence and information was manifestly unreasonable’ will he be denied recovery. (citations)” (*Winn v. McCulloch Corp.* (1976) 60 Cal.App.3d 663 at pp. 671 [fraud case].) In the context of investor fraud, a potential investor has a right to rely on, for example, the truth of written factual statements in documents attempting to solicit investment.

### Effect of the crime-fraud exception on discovery

Once the litigant establishes the section 956 exception by showing a fraud occurred, the next issue is which attorney-client communications are subject to the exception. For the crime-fraud exception to apply to a particular communication, there must be “reasonable relationship between the fraud and the attorney-client communication.” (*BP Alaska,*

*supra*, (1988) 199 Cal.App.3d at p. 1268.)

California courts have interpreted the section 956 exception fairly broadly to encompass any communications “reasonably related to the fraud.” In *BP Alaska*, after finding the crime-fraud exception applied, the Court of Appeal held that reports from counsel, a memo by the client’s executive, and the testimony of the executive related to the misrepresentations made by the company, were all excepted from privilege because of their relationship to the fraud. (*BP Alaska, supra* at pp. 1248, 1269.)

You should expect a fight from the opposing side regarding the scope of the section 956 exception. There may be a substantial set of attorney-client privileged documents, with varying degrees of relationship to the fraud. The defendant will try to narrow the exception by claiming, for example, that the section 956 exception applies only to communications in which the client directly asked the attorney to assist in a fraud-related task. Plaintiff should argue for a more reasonable and flexible interpretation that encompasses all “reasonably related” communications. For example, where the attorneys have prepared an investment prospectus, contract, promissory note, letter, or other material that contains false representations, all attorney-client communications related to the creation of the errant documents should be considered “reasonably related to the fraud” and therefore unprotected by privilege.

You should consider moving for an *in camera* review of the defendant’s documents to determine which of the documents relate to the fraud. In *Cunningham*, the Court ordered an *in camera* review of attorney-client communications in the privilege log to determine whether the documents were related to the fraud. (*Cunningham, supra*, 845 F. Supp. at p. 1415.) In *BP Alaska*, the Court of Appeal affirmed an *in camera* review to determine whether communications “bear a reasonable relation to the alleged fraud.” (*BP Alaska, supra*, at p. 1269-70.) However,

given the prohibition on in-camera reviews for privilege issues (Evid. Code, §915), some courts may deny an in-camera review. (See, *State Farm, supra*, 54 Cal.App.4th at p. 645 [holding Evid. Code, § 915 “does not contemplate disclosure of privileged material in ruling on the crime-fraud exception.”]) Generally, case law favors an in-camera review to determine whether an exception to privilege applies. (*Moeller v. Superior Court* (1997) 16 Cal.4th 1124 at p. 1135 [Supreme Court holds that a court may conduct an *in camera* hearing notwithstanding section 915].) If such a denial occurs, case law would support a writ in order to have the material properly reviewed by an unbiased arbiter of the matter.

While the crime-fraud exception exposes relevant attorney-client communications to discovery, it does not eliminate attorney work product protection. (*BP Alaska, supra* at 1251.) Unless another exception or waiver can be shown, attorneys involved in a fraudulent transaction will be able to keep their work product confidential.

Once you have obtained documents containing attorney-client communications, these can be used in interrogating defendants and their former attorneys at deposition. Since attorney-client privilege has been eliminated as to communications related to fraud, the deponents will be forced to discuss the documents and the communications.

### Effect on settlement and trial dynamics

The finding of the crime-fraud exception is a preliminary finding by the court, limited to discovery. Plaintiff cannot assert the court’s finding of fraud at trial, as the finding does not constitute a final determination of the fraud issue.

With that caveat, establishing the crime-fraud exception has a powerful effect on the litigation. The defendant knows that an important shield of confidentiality has been removed, and their discussions with their attorneys are now exposed to scrutiny. Documents which would have been withheld or redacted



must now be made available. Defendant must respond to interrogatory and deposition questions probing into issues that often address the litigants' motives for making decisions that led to the misrepresentations and fraud. Defendant will realize that if plaintiff successfully convinces a jury that they made false statements, defendant's credibility will be severely damaged.

Further, once the shield of confidentiality is removed, the interests of the defendant and its former attorneys are no longer aligned. The former attorneys are no longer bound by confidentiality and fiduciary duty regarding the formerly privileged communications regarding the fraud. In fact, the former attorneys will often have an incentive to distance themselves from their former clients and may even blame any misrepresentations on their clients to avoid any appearance of impropriety, as the attorneys themselves may bear some liability for any fraud. "California has long adopted the view that an attorney may not, with impunity, . . . conspire with a client to defraud or injure a third person . . ." (*Roberts v. Ball, Hunt, Hart, Brown & Baerwitz* (1976) 57

Cal.App.3d 104 at p. 109; *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194 at p. 202 ["a duty is owed by an attorney not to defraud another"].)

### Conclusion

In investor fraud cases where an attorney may be peripherally or directly involved, look to the crime-fraud exception as a means to change the landscape of the litigation. You do not have to prove the actual fraud for discovery purposes; you must only establish that the exception may apply. Once the exception is established, the court should permit limited discovery into attorney-client communications that would normally be off limits.

This can be a powerful tool to pry out defendant's secrets and separate the defendant from its former attorneys.



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