
The Fraud Trial



Association of Certified Fraud Examiners

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II. THE LAW AGAINST FRAUD

Fraud is distinguished from larceny or theft. The elements of criminal and civil fraud hinge on willful acts of misrepresentation. Selected criminal and civil laws are defined.

Background and Definitions of Fraud

Early references to fraud in English common law—the legal system on which the American system is based—define it as cheating or deceit. A common-law cheat was one who, by false pretenses, false tokens, or intentionally false representations, induced someone else to part with his property or personal rights. Common-law cheating or fraud was considered both a crime (a misdemeanor, as opposed to larceny, which was a felony) and grounds for civil action. Fraud, then, has a historical foothold in English civil law as well as in criminal law. This dual status is retained in modern American courts. For many frauds, criminal and civil actions are both pursued in relation to the same act: Prosecutors may file a criminal complaint and the damaged party can file a civil action for recovery of damages or property. Similarly, tax evasion can be treated as a criminal and civil fraud.

In many states, fraud is now known as larceny by trick or false pretenses. *Larceny* refers to what is more widely called *theft*, and it is defined as wrongfully depriving someone of their possessions with the intent to steal. If the taking is by stealth or force, the act is larceny. If the taking is by guile or deception, false representation, or concealment of crucial information, the act is *fraud*, *false pretenses*, or *larceny by trick*. The deception may be designed to cause others to act or may be part of concealing one's own actions.

Although larceny by trick and false pretenses both involve theft by deception, there is one small difference between the two: In false pretenses, the defendant obtains title, whereas the defendant only obtains possession in larceny by trick. An example would be a “buyer” obtaining title to a vehicle by misrepresenting to the owner that he deposited money into his account (false pretenses), versus someone posing as an owner of a vehicle to trick the valet driver into transferring possession (larceny by trick). In the second instance, no title of possession transfers.

Embezzlement is a particular kind of fraud that is distinguished from larceny, and it is committed not by the act of deception, but by a breaching of one's fiduciary responsibility. The difference centers on the legal custody of the article stolen. A larcenist takes something from its rightful owner without ever having had legal custody of it himself; the embezzler, on the other hand, has been given legal custody of the article for a period of time or specific purpose and has instead assumed full and sole custody. Embezzlement exceeds the originally authorized custody agreement.

In practice, fraud embraces all the multifarious means that human ingenuity can devise for one person to gain an advantage over another by false suggestion or suppression of the truth. No final, invariable rule can be laid down in defining fraud—according to *Black's Law Dictionary*, the act of *fraud* includes surprise, trick, cunning, and a range of unfair ways by which people are cheated. The only boundaries are those that limit human knavery.

Modern tools and methods have extended the limits of fraud into new territory. The authors of *Inside Job*, an exposé of a savings-and-loan scandal, mused on the difficulty of tracking “the ways and methods of professional white-collar criminals, their intricate paper trails and Byzantine multimillion-dollar frauds. Untangling the deals is in itself an art, and explaining them to a jury of 12 honest men and women borders on the miraculous.”³

Elements of Criminal and Civil Fraud

Fraud as a human activity can be hard to get a handle on, but the legal elements of a fraud are more readily defined. Generally stated, these include:

- Misrepresentation of a material fact
- Made with knowledge of its falsity
- Made with intent to induce the victim to rely on the misrepresentation
- The victim relies upon the misrepresentation
- The victim suffers damages as a result

The key distinction between fraud and other types of theft hinges on the first element: the perpetrator acts by *misrepresentation*, as opposed to larceny, in which the perpetrator uses force or stealth to secure another's property.

Civil Fraud Actions

In *Southern Development Co. v. Silva*, 125 U.S. 247, 8 S.Ct. 881, 31 L.Ed. (1887), the U.S. Supreme Court defined the legal elements of a civil fraud as follows:

- The defendant has made a representation in regard to a material fact

Note: Statements that express an opinion or judgment, honestly entertained, are excluded. It is not fraud when an investment adviser causes big losses with a bad recommendation, as long as everything in the deal is aboveboard. Statements made during commercial exchanges have special protection. Only deliberate misrepresentations are actionable as fraud.

³ Pizzo, Stephen et al. *Inside Job. The Looting of America's Savings and Loans*. Harper-Perennial, 1991: p. 318.

- The representation was false
- The defendant knew the representation was false
- The representation was intended to provoke an action by the plaintiff
- The plaintiff suffered damage as a result
- In acting, the plaintiff reasonably assumed the representation was true

Demonstrating *materiality* means showing that statements by the defendant were not only false, but furthered along the act of fraud. Consider an embezzlement case in which a man named Hunter Pascal plundered the investment fund of a private school. It may not be material, for example, that Hunter Pascal told auditors he had three kids when he didn't have any. But hiding and destroying the financial records of his school played a role in extending the life of the embezzlement, and so this fact is material to the trial. Civil plaintiffs also have to show they actually suffered *damages* (i.e., harm) as a result of a fraudulent act, while criminal prosecutions have no such burden. You cannot take even the cattiest con man to civil court just for running a scam; you actually have to lose something.

Under the Federal Rules of Civil Procedure, *fraud claims have to meet tougher requirements than many other civil actions*. Rule 9(b) says the plaintiff's grievance must be stated with "particularity." In other words, a fraud plaintiff has to make the plea in detail, specifying what misrepresentations were made, to whom, how they were false, why the plaintiff relied on them, and so on, through the judgment for damages. Conversely, a plaintiff in a traditional negligence case can file a claim by simply making the accusation (the defendant's inattentive driving caused an accident) without including any details or supporting evidence.

The 9(b) requirement sets up a catch-22 for fraud plaintiffs. For example, suppose that the officers of Lapis Bank are convinced that a member of the bank's loan committee, Mr. Bartleby, has been arranging loans as part a kickback fraud, but they do not have the documentation necessary to levy the charge. They need access to the discovery system to get their hands on specific documents in Bartleby's control. Judges often grant leeway in civil procedure, allowing a complaint to be brought pending the results of discovery. There may have to be some hearing after the original filing and some agreement to amend the complaint after discovery has produced the information necessary to state the claim with the required particularity. The 9(b) requirement shows why the initial investigation by a fraud examiner is important if the case proceeds to trial. If the fraud examiner has done his job properly, the attorney should have all the information he needs to file a proper complaint.

Civil actions can be filed by plaintiffs in state or federal courts. The difference between criminal and civil fraud is basically a matter of who files the suit—an injured party or the government. However, there are other technical differences in actually pleading the case.

Most fraud suits, usually styled as misrepresentation claims, will be filed in state courts. Federal courts hear cases involving parties from different states with more than \$75,000 in controversy (known as *diversity* cases), and actions that arise under federal laws (known as *federal-question* cases), such as the Civil Racketeer Influenced and Corrupt Organizations Act (RICO) provisions. A federal trial is preferable for larger cases because procedural rules allow for witnesses and documents located in different states to be named in the complaint. Otherwise, building a case can become a nightmare of navigating jurisdictional bureaucracies.

Criminal Fraud Charges

Normally, a major distinction between civil actions and criminal charges is the question of criminal intent. Prosecutors must show that a criminal defendant knowingly and willfully intended to commit the act in question. In a pure fraud case, however, this distinction does not hold. This is because one of the elements of civil fraud requires that the defendant knew that the statement was false and intended the victim to rely upon it. The same is true for other asset misappropriation cases. For instance, in the embezzlement case in which Hunter Pascal is accused of embezzling the investment funds of a private school, it must be clear that Pascal meant to siphon off the money from the school's investment fund, and that it was not just a case of misapplication or mismanagement. This intent might be demonstrated by showing the different ways the defendant circumvented financial controls to get a hold of the funds.

Intent can make arguing a defendant's guilt more difficult, but prosecutors do have some leeway. In a criminal trial, they do not have to show that the fraud was successful and caused damages to another party, only that it was designed and initiated for the purpose of bilking someone. The government is not required to show that anyone ever actually fell for the fraudulent representation, just that a misrepresentation was made with fraudulent intent. In a civil fraud, by contrast, the plaintiff has to show that, because a misrepresentation was believed and acted upon, actual damages, personal or financial, were suffered by the plaintiff.

Most criminal prosecutions will take place on the local or state levels, using laws declared within the jurisdiction. To apply the criminal fraud statutes in the U.S. Code to a case, there must be some basis for federal jurisdiction. Crimes committed during interstate commerce or through the use of the mail are typical examples. Federal law is often used to prosecute high-dollar or unusually serious crimes, primarily because of the superior resources of federal law enforcement agencies and their nationwide jurisdiction.

Some of the more commonly invoked federal criminal statutes are cited on the following page.

Selected Federal Fraud Laws

- **Mail fraud** (18 U.S.C. § 1341): Prohibits any “scheme or artifice to defraud” that uses or involves any authorized depository for mail.
- **Wire fraud** (18 U.S.C. § 1343): Prohibits using wire, radio, or television communication during an interstate commerce fraud.
- **Racketeer Influenced and Corrupt Organizations, or RICO** (18 U.S.C. §§ 1961 *et seq.*): Prohibits the investment of ill-gotten gains in another enterprise, using coercive or deceptive acts to acquire an interest in an enterprise, and the conducting of business through such acts.
- **Federal securities laws** (The 1933 and 1934 Acts): Prohibit false statements and malfeasances of duty in securities transactions.
- **Securities fraud** (19 U.S.C. § 1348): Makes frauds involving registered securities a federal crime.
- **Conspiracy** (18 U.S.C. § 371): A combination or agreement to accomplish an unlawful purpose, or to use illegal means in accomplishing a lawful purpose. The purpose need not be accomplished in full. Conspirators can be individuals or corporate entities.
- **False statements** (18 U.S.C. § 1001): Prohibits false or fraudulent statements made to the government.
- **False claims** (18 U.S.C. § 1031): Prohibits schemes to defraud the federal government involving the supplying of products or services.
- **Identity theft** (18 U.S.C. § 1028): Makes identity theft a federal crime including stiff penalties (up to 30 years in prison and fines of up to \$250,000).
- **Economic espionage** (18 U.S.C. §§ 1831-1839): Criminalizes the theft of trade secrets and other proprietary information.
- **Tax evasion, false returns, and failure to file** (26 U.S.C. §§ 7201, 7203, 7206(1), *et seq.*): Violations of the tax code.
- **Bankruptcy fraud** (18 U.S.C. § 151, *et seq.*): Covers misconduct in bankruptcy proceedings, including intentional bankrupting or “bust out” schemes.
- **Federal corruption statutes** (18 U.S.C. § 201, *et seq.*): Chapter 11 of this portion of the code contains 19 separate provisions, describing a variety of conflicts of interest and corrupt conduct involving public officials that includes bribery, illegal gratuities and misuse of office.
- **Embezzlement and misapplication of bank funds** (18 U.S.C. § 656, *et seq.*): Covers the illegal confiscation and misuse of funds in federally regulated institutions.
- **Bank fraud** (18 U.S.C. § 1344, *et seq.*): Prohibits any “scheme or artifice” used to defraud a federally chartered or insured bank.
- **Fraud and related activity in connection with computers** (18 U.S.C. § 1030). In addition to criminalizing the commission of fraud via the computer, this statute also prohibits obtaining restricted data regarding national security, obtaining confidential financial information, unauthorized use of a federal government computer, and damaging or destroying computer information. See also the Electronic Transfer Funds Act (15 U.S.C. § 1693n).

Common Civil and Criminal Actions

The following discussion examines some of the more common civil and criminal actions for fraud. Most are civil actions (or civil tort actions); however, there may be a corresponding criminal statute as well. Do not assume that the attorney you are working with is familiar with every type of action. Although the attorney must make the decision as to what cause of action he believes is appropriate, most attorneys are open to suggestions. Attorneys who are not familiar with fraud cases will often overlook some causes of action such as breach of fiduciary duty or conflict of interest.

Misrepresentation of Material Facts (Fraudulent Misrepresentation)

This is the offense most often thought of when the term *fraud* is used. Misrepresentation cases can be prosecuted criminally or civilly under a variety of statutes, such as false statements, false claims, mail fraud, or wire fraud, or they might be the basis for common law claims. The gist of the offense is the deliberate making of false statements to induce the intended victim to part with money or property.

In a civil case, it also might be necessary to prove that the victim relied upon the false statements and actually suffered a loss. These elements of proof might not be necessary in a criminal prosecution. Also, in some statutes, materiality is assumed and need not be proven.

In most instances, only false representations of presently existing facts may be prosecuted. Thus, opinions (speculative statements about future events), even if made with the intent to mislead, may not be the basis for a fraud case. A used car salesman, for example, who assures the naive customer that the 20-year-old car that was towed to the lot will give him “years of driving pleasure” probably cannot be prosecuted for fraud. The salesman could be prosecuted, however, if he tells the customer that the car has been driven only 15,000 miles when he knows that it has gone 150,000 miles.

Normally, only material false statements may serve as the basis for a fraud case. *Materiality* usually refers to statements sufficiently important or relevant to the defendant to influence the defendant’s decision. For example, a claim that a company enjoyed a 50-percent growth in profits would probably be material to a prospective investor, whereas a statement that the company was considering moving its headquarters from Los Angeles to Burbank might not be. The materiality of allegedly false statements often is a central issue in securities fraud cases.

In all fraud cases, the prosecution or plaintiff must prove that a false statement was intentional and part of a deliberate scheme to defraud. A person intentionally makes a false statement if it is his desire to cause the social harm, or if he acts with knowledge that the social harm will almost certainly result from his actions. In some instances, particularly those involving civil actions for fraud and securities cases, the intent requirement is met if the prosecution or plaintiff is able to show that the false statements were made recklessly—that is, with complete disregard for truth or falsity.

Moreover, there is no such thing as an accidental or negligent fraud. For example, mistakenly entering incorrect numbers on a financial statement is not fraud; however, knowingly entering incorrect numbers with the intent that someone will take action in reliance on them is fraud if the other elements are present.

Negligent Misrepresentation

Although a misrepresentation fraud case may not be based on negligent or accidental misrepresentations, in some instances a civil action may be filed for negligent misrepresentation. This tort action is appropriate if a defendant suffered a loss because of the carelessness or negligence of another party upon which the defendant was entitled to rely. Examples would be negligent false statements to a prospective purchaser regarding the value of a closely held company's stock or the accuracy of its financial statements.

Concealment of Material Facts

An action for fraud may be based on the concealment of material facts, but only if the defendant had a duty to disclose in the circumstances. The essential elements of fraud based on failure to disclose material facts are:

- That the defendant had knowledge
- Of a material fact
- That the defendant had a duty to disclose
- And failed to do so
- With the intent to mislead or deceive the other party

The duty to disclose usually depends on the relationship between the parties. Those people who occupy a special relationship of trust, such as the officers or directors of a corporation, an attorney, accountant, trustee, stockbroker, or other agent, may be found to have a duty to completely disclose material facts to the parties who rely upon them. Statutes might expand the duty to disclose to areas in which traditionally there was no such duty, such as to the sellers of personal or real property, or the purchasers or sellers of securities.

Proof that the concealed fact was material probably is the most important element in a concealment case; there can be no liability if the withheld information would not have affected the other party. In addition to fraudulent concealment, a defendant might also be liable for negligent failure to discover and disclose material facts. An accountant, for example, might be liable for failure to discover or report material facts in a financial statement or audit. Of course, as with negligent misrepresentation, the penalties are less severe for negligence than fraudulent misrepresentation, and there is no criminal liability.

Bribery

Bribery is a form of corruption that may be defined as the offering, giving, receiving, or soliciting of anything of value to influence an act or a decision. Bribery includes official bribery, which refers to the corruption of a public official, and commercial bribery, which refers to the corruption of a private individual to gain a commercial or business advantage.

Types of Bribery Schemes

Bribery includes official bribery and commercial bribery.

OFFICIAL BRIBERY

Official bribery refers to corruption of a public official. Illegal payments to public officials can give rise to stiff criminal penalties. The elements of official bribery vary by jurisdiction, but generally are:

- Giving or receiving
- A thing of value
- With the intent to corruptly influence
- An official act

COMMERCIAL BRIBERY

Conversely, *commercial bribery* refers to the corruption of a private individual to gain a commercial or business advantage and may either be prosecuted as a criminal act or form the basis of a civil action. About half of the states have criminal statutes that prohibit commercial bribery. If a state does not have a commercial bribery statute, commercial bribery schemes can usually be prosecuted under criminal fraud statutes on the theory that the payment of a commercial bribe defrauds the business owner of the right to an employee's unbiased and loyal services.

There is no federal statute prohibiting commercial bribery but, such offenses may be prosecuted at the federal level as mail or wire fraud, as a RICO violation, or as a violation of some other law. The elements of commercial bribery vary by jurisdiction, but typically include:

- Giving or receiving
- A thing of value
- With intent to corruptly influence
- A business decision
- Without the knowledge or consent of the principal

The “without the knowledge or consent of the principal” element is included on the theory that a private business owner is not defrauded if the owner knows of or allows employees to accept gifts, favors, or other payments from vendors or other business contacts.

Businesses injured by commercial bribery schemes may sue for treble damages and attorney's fees under the Civil RICO statute (18 U.S.C. § 1964) and the Clayton Antitrust Act (15 U.S.C. § 13(c)), and for compensatory and punitive damages for common law fraud, conflict of interest, and breach of fiduciary duty. Civil actions may be brought even if commercial bribery is not a crime in a jurisdiction.

Methods of Making Corrupt Payments

In bribery schemes, the thing of value is not limited to cash or money. Any tangible benefit given or received with the intent to corruptly influence the recipient may be an illegal payment. Courts have held that such things as lavish gifts and entertainment, payment of travel and lodging expenses, payment of credit card bills, "loans," promises of future employment, and interests in businesses can be bribes if they were given or received with the intent to influence or be influenced. Some state statutes might distinguish between felonies or misdemeanors according to the amount of illegal payment.

Corrupt Influence

To establish a bribery claim, it must be proven that the defendant acted with proof of *corrupt influence*. Such proof often involves demonstration that the person receiving the bribe favored the bribe-payer in some improper or unusual way, such as by providing preferential treatment, bending or breaking the rules, taking extraordinary steps to assist the bribe-payer, or allowing the bribe-payer to defraud the agency or company. It is not necessary, however, that the prosecution or plaintiff demonstrate that the bribe-taker acted improperly; a bribe might be paid to induce an official to perform an act that otherwise would be legal, or an act that the official might have performed without a bribe. Bribery schemes involving these circumstances, however, are difficult to prove and lack appeal for prosecution.

Illegal Gratuity

Illegal gratuities are similar to bribery schemes. In fact, under the federal legislation governing the offenses of bribery and illegal gratuity (18 U.S.C. § 201), an illegal gratuity is a lesser-included offense of official bribery. The elements of an illegal gratuity are:

- Giving or receiving
- A thing of value
- For or because of
- An official act

The big difference between a bribe and an illegal gratuity is that an illegal gratuity does not require proof that the gratuity was given for the purpose of influencing an official act. In other words, an illegal gratuity only requires that the gratuity be given for or because of an official act.

In the typical illegal gratuities scenario, a decision is made and the decision happens to benefit a certain person or company. The party who benefited from the decision then gives a gift to the person who made the decision. The gift is merely offered as a “thank you” for something that has been done.

The federal statute governing the illegal gratuity offense prohibits a public official from accepting any payment of money or other thing of value other than his lawful compensation. In practice, the statute often is applied when relatively small payments, such as gifts or entertainment, are used to attempt to influence a public official.

Extortion

An extortion case is often the flip side of a bribery case. *Extortion* is defined as the obtaining of property from another when the other party’s “consent” has been induced by wrongful use of actual or threatened force or fear. Fear might include the apprehension of possible economic damage or loss. A demand for a bribe or kickback, coupled with a threat of adverse action if the payment is not paid, might also constitute extortion.

In most states and the federal system, extortion is not a defense to bribery. That is, a person who makes a bribe payment upon demand of the recipient still is culpable for bribery. In New York, however, extortion may be a defense in certain circumstances.

Conflict of Interest

Conflicts of interest occur when an employee has an undisclosed personal or economic interest in a transaction. These schemes involve self-dealing by an employee and can occur in various ways. A conflict may arise where an employee accepts inappropriate gifts, favors, or kickbacks from vendors, or when an employee engages in unapproved employment discussions with current or prospective contractors or suppliers.

Statutes in every state and the federal system (as well as common law decisions in all jurisdictions) prohibit people from engaging in conduct that involves a conflict of interest. A conflict of interest may be prosecuted civilly or criminally. The criminal statutes vary widely and include prohibitions on public officers from accepting employment with government contractors or lobbying government agencies during specified times.

Elements of a typical civil claim for conflict of interest include:

- An agent taking an interest in a transaction
- That is actually or potentially adverse to the principal
- Without full and timely disclosure to and approval by the principal

An *agent* includes any person who, under the law, owes a duty of loyalty to another, including officers, directors, and employees of a corporation; public officials; trustees; brokers; independent contractors; attorneys; and accountants. People who do not occupy positions of trust with another party, such as arms-length commercial parties, do not owe a duty of loyalty to each other and therefore are not subject to conflict of interest restrictions.

The defendant in a civil conflict of interest case must repay any losses that the conflict caused and must “disgorge” any profits he earned as a result of the conflict even if there was no actual loss to the principal. The disloyal party also might be required to forfeit all compensation received during the period of disloyalty. The victim of a conflict of interest may also void any contracts entered into on its behalf that were the result of or influenced by the conflict.

Forgery

Forgery includes two distinct offenses at common law: forgery and uttering a forged instrument. Both crimes are specific intent offenses (i.e., they both require proof of specific intent to defraud).

Forgery is defined as:

- The fraudulent making or altering
- Of a false writing or instrument that has apparent legal significance
- With the intent to defraud

Uttering a forged instrument expands the forgery offense by including the offering or passing of a forged document as genuine. The elements of uttering a forged instrument are:

- Offering as genuine
- A forged instrument
- With the intent to defraud

A forgery occurs when the document is not what it purports to be. It is not forgery just because the writing contains a false representation. The writing as a whole must have apparent legal significance. Forgery occurs not just when an entire writing or instrument is created, but also when there is any material alteration that affects the legal significance of the document or whenever a signature on a writing is fraudulently procured from a person who does not know what he is signing. Furthermore, the offense is committed even if no one actually is defrauded.

Although forgery is a crime, not a civil wrong, it can occur in connection with a fraud or a conversion of property or property interests, for which the victim can seek civil remedies.

Theft of Money and Property

Theft is a term often used to describe a wide variety of fraudulent conduct. Many state statutes, for example, describe misrepresentation fraud as theft by deception or larceny by trick. As used here, the term theft is limited to embezzlement, larceny, and misappropriation of trade secrets and proprietary information.

Embezzlement

Embezzlement is the wrongful appropriation of money or property by a person to whom it has been lawfully entrusted (or to whom lawful possession was given). Embezzlement implicitly involves a breach of trust, although it is not necessary to show a fiduciary relationship between the parties. The elements of embezzlement vary somewhat by jurisdiction, but generally are:

- The defendant took or converted
- Without the knowledge or consent of the owner
- Money or property of another
- That was properly entrusted to the defendant (defendant had lawful possession of the property)

Larceny

Larceny is defined as the wrongful taking of money or property of another with the intent to convert or to deprive the owner of its possession and use. In larceny, unlike in embezzlement, the defendant never has lawful possession of the property. The elements of larceny typically include:

- Taking or carrying away
- Money or property of another
- Without the consent of the owner
- With the intent to permanently deprive the owner of its use or possession

Misappropriation of Trade Secrets

Misappropriation is the intentional, illegal use of the property, funds, or ideas of another person for an unauthorized purpose. In the fraud context, misappropriation claims generally involve trade secrets or other proprietary information.

Trade secret includes not only secret formulas and processes, but also more mundane proprietary information, such as customer and price lists, sales figures, business plans, or any other confidential information that has a value to the business and would be potentially harmful if disclosed.

Theft or misappropriation of trade secrets may be prosecuted under a variety of federal and state statutes and the common law. The definition of what constitutes a trade secret depends on the organization, industry, and jurisdiction, but the following three characteristics are common to most definitions:

- The information is not generally known to the relevant portion of the public.
- It confers some sort of economic benefit on its holder (where this benefit must derive specifically from its not being generally known, not just from the value of the information itself).
- It is the subject of reasonable efforts to maintain its secrecy.

The elements of a typical theft of trade secret claim are:

- A party possessed information of value to the business.
- The information was treated confidentially.
- The defendant took or used the information by breach of an agreement, confidential relationship, or other improper means.

An organization can only maintain legal protection over its trade secrets if it takes reasonable steps to keep that information secret. Thus, it is critical that the information was treated confidentially, although absolute secrecy is not required; it is sufficient if the information was substantially undisclosed. Limited disclosure to people with a need to know or pursuant to confidentiality agreements will not void the secret. Methods of demonstrating that information was intended to be kept confidential include a written policy describing the information as proprietary or secret, strict limitations on distribution of the information, and physically securing the information to prevent unauthorized access and use.

The owners of the information also should enforce restrictive agreements and act promptly to remedy any inadvertent disclosures. Failure to do so might be construed as a waiver of confidentiality and make it impossible to prevent future use or disclosures.

The most typical defense in trade secret cases is that the defendant developed the information independently. If the aggrieved party demonstrates that the information came to the defendant as the result of or during a confidential relationship, the burden of proof shifts to the defendant to demonstrate independent discovery. The defendant also might defend a misappropriation claim by showing that the information was not in fact a secret, that the third party's use was authorized, or that the trade secret or proprietary information had been abandoned by the owner.

Breach of Contract

If the fraudster has any kind of a contractual relationship with the victim, there may also be a *breach of contract* claim. Any non-performance of a contractual obligation or an announcement that a party cannot or will not perform constitutes a breach. In other words, a breach of contract occurs when one party fails to perform, or announces that it does not intend to perform, without just cause.

A breach of contract claim can arise under an oral or written contract. Many states have recognized certain implied or unwritten duties as a part of almost every contract. For instance, some courts have

held that it is an implicit part of a contract that each party will use its best efforts to fulfill its duties under the contract. A similar duty that has been recognized by some states is the duty to deal with each other in good faith. If a party to a contract, which includes an employment contract, steals from the other party or acts in bad faith, there may be a civil claim for breach of contract.

Gross Negligence

Gross negligence can be generally defined as the intentional failure to perform a duty in reckless disregard of the consequences to the victim. Although the exact definition varies by state, the basic element of this civil cause of action is that the defendant committed an intentional act, knowing that it was at least substantially likely to cause harm to the victim. In regard to an employee, the employee has a duty to act in the best interests of the employer. If the employee consciously steals from the employer, the employee has breached that duty and caused his employer harm; further, the employee knew that the harm would occur when he committed the act. Additionally, punitive or exemplary damages generally are available if the defendant is found liable for gross negligence.

Breach of Fiduciary Duty

People in a position of trust or *fiduciary relationship*, such as officers, directors, high-level employees of a corporation or business, or agents and brokers, owe certain duties imposed by law to their principals or employers.

Two General Duties

The primary fiduciary duties are loyalty and care.

DUTY OF LOYALTY

The duty of loyalty requires that the employee/agent act solely in the best interest of the employer/principal, free of any self-dealing, conflicts of interest, or other abuse of the principal for personal advantage. Thus, corporate directors, officers, and employees are barred from using corporate property or assets for their personal pursuits, or taking corporate opportunities for themselves. More traditional fraudulent conduct, such as embezzlements, thefts, acceptance of kickbacks, and conflicts of interest, also violate the duty of loyalty and may be prosecuted as such in addition to or instead of the underlying offense.

DUTY OF CARE

The *duty of care* requires that a corporate officer, director, or high-level employee, as well as other people in a fiduciary relationship, conduct business affairs prudently with the skill and attention normally exercised by people in similar positions. Fiduciaries who act carelessly or recklessly are responsible for any resulting loss to the corporate shareholders or other principals. Damages may be recovered in a civil action for negligence, mismanagement, or waste of corporate assets.