

DOJ's 'China Initiative' Uses Scheme-to-Defraud Charges for Nondisclosure of Ties to China

Skadden

04 / 02 / 20

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

Although U.S.-China bilateral tensions eased to a degree earlier this year with the signing of an interim trade agreement, fundamental differences remained. These differences — such as the role that China's industrial policy and State-Owned Enterprises (SOEs) play or should play in the Chinese economy — transcend mere policy disagreements and touch on basic issues of sovereignty and governance. As the United States and China contend with the unprecedented fallout from the COVID-19 pandemic, which itself has given rise to unsettling tit-for-tat accusations, these unresolved bilateral tensions will most likely persist and even worsen in the coming months. A few prominent voices in the U.S. Congress, such as Sen. Marco Rubio of Florida, have even called for the enactment of [new legislation](#) to counter China's economic policies and trade practices.

While it remains to be seen what, if any, new legislation will result, the U.S. government already has at its disposal a wide array of enforcement tools to further its objectives. Although [high-profile prosecutions](#) under U.S. economic sanctions laws and the Foreign Corrupt Practices Act (FCPA) have caught the attention of many companies, the U.S. authorities have increasingly turned to three other tools that may be less familiar — the federal wire fraud, mail fraud and false statement statutes.

We describe below the use of these criminal statutes in recent prosecutions against so-called “nontraditional” actors under the U.S. Department of Justice's (DOJ) China Initiative. A common theory of prosecution has begun to emerge: “scheme to defraud” charges based on the defendants' alleged nondisclosure of material ties to China or Chinese institutions. We conclude with some general observations on how companies and individuals can seek to protect themselves from running afoul of U.S. law as a result of these and similar violations.

DOJ's China Initiative: Wire Fraud, Mail Fraud and False Statement Statutes

We have previously analyzed the DOJ's [China Initiative](#), launched in November 2018, which dedicates additional governmental resources to investigating and prosecuting Chinese companies and individuals for alleged violations of U.S. law. The areas that the DOJ specifically highlighted included “trade secret theft cases” involving “non-traditional collectors (e.g., researchers in labs, universities, and the defense industrial base) that are being coopted into transferring technology contrary to U.S. interests.” This focus is unsurprising, as universities and research institutions are where much of the advanced research in the United States is being conducted and where predominance in the emerging technological competition between the United States and China may well be determined.

The DOJ's enforcement priority is reflected in the cases it has chosen to pursue thus far. In January 2020, the chair of Harvard University's chemistry department was charged and arrested for fraudulently hiding his affiliation with China's Thousand Talents Program — an initiative funded by the Chinese government that recruits prominent foreign scientists to conduct research in China. Similarly, in March 2020, a West Virginia University professor pled guilty to fraud charges arising from his failure to disclose his ties to the Thousand Talents Program and a Chinese university. DOJ's focus is not limited to individuals. In December 2019, the DOJ reached a USD 5.5 million settlement with Van Andel Research Institute to resolve allegations that the institute failed to disclose its receipt of Chinese government grants that funded the work of two of its researchers.

Despite the differing fact patterns, in all the cases described above, the DOJ charged violations of the federal wire fraud, mail fraud or false statement statutes. Although

DOJ's 'China Initiative' Uses Scheme-to-Defraud Charges for Nondisclosure of Ties to China

these statutes have somewhat different legal elements, they share the same basic structure and function: They all involve an alleged “scheme or intent to defraud” through “a material deception.” As the U.S. Supreme Court has held, these statutes are remarkably broad in scope and encompass “everything designed to defraud by representations as to the past or present, or suggestions and promises as to the future.” One appellate court described these statutes as Congress’ attempt to put the law’s “imprimatur on ... accepted moral standards [to] condemn[] conduct which fails to match the ‘reflection of moral uprightness, of fundamental honesty, fair play, and right dealing in the general and business life of members of society.’”

The professors and researchers who were charged with violating these statutes under DOJ’s China Initiative are alleged to have lied to their employers or in their federal grant applications about their ties to the Chinese government. In multiple cases, the defendants were affiliated with the Thousand Talents Program. According to the DOJ, participants in this initiative do not simply conduct original research. Instead, they are “incentivized to transfer to China the research they conduct in the United States,” thereby giving China “proprietary information” to which it is not entitled.

Notwithstanding the very different ways in which the Thousand Talents Program is being characterized by the Chinese government and in the DOJ’s charging instruments, the differing characterizations are not, in the end, dispositive. The crux of the criminal charges is not the defendants’ affiliations with the Thousand Talents Program — which are not unlawful in themselves — but rather the defendants’ alleged lies about their participation in the program or, at the very least, their alleged failure to disclose this as a material fact to their U.S. employers or in their federal grant applications. These misstatements or omissions are key to the alleged “scheme[s] to defraud” — criminal offenses that carry significant criminal penalties upon conviction.

US Litigation Against Chinese Companies

This concept — of being held legally liable not for the underlying conduct, which may be perfectly lawful, but for failing to disclose the relevant facts — may be foreign to nonlawyers, but it is, in fact, a common feature of U.S. law. This is true, for example, of the disclosure-based federal securities laws — another area of increasing concern for Chinese business executives, as the number of cases filed in U.S. courts against U.S.-listed Chinese companies has seen year-to-year increases in the past few years. Just last year, approximately 28% of all cases filed against non-U.S. companies in federal court were against Chinese companies.

Despite their endless variety, these lawsuits share the same basic legal theory, namely that the defendant companies misstated or failed to disclose material facts about one or more aspects of their operations or finances. While these cases are civil in nature — unlike the criminal prosecutions brought by the DOJ described earlier — the legal theory underlying these civil cases, like the criminal cases, is premised not on the underlying conduct in question, as to which U.S. law may be powerless to reach (*e.g.*, noncompliance with local Chinese law), but on the defendant company’s alleged failure to disclose the relevant facts fully and accurately in its public statements and documents, such as its prospectus or registration statement.

Never ‘Just Paperwork’

These cases illustrate that formal disclosure documents — whether intended for submission to a U.S. government agency, a U.S. bank or a U.S. counterparty — are never “just paperwork.” Whether due to ignorance, carelessness or otherwise, a company doing business in the U.S. that views decisions about what information to disclose or withhold as purely a “business decision” without an awareness of the potential legal implications risks incurring significant legal liabilities, including criminal exposure, under U.S. law. Indeed, while many U.S. government forms may appear redundant and repetitive, they are, in fact, often crafted to enable the enforcement authorities, including DOJ, to bring an enforcement action, including under the criminal statutes discussed above, if the applicant fails to answer all questions truthfully.

For multinational companies that often have to operate under conditions of uncertainty, disclosure decisions are rarely straightforward. For example, how should a pre-IPO company disclose potential violations of law in a way that complies with the U.S. securities laws without, at the same time, providing a roadmap to the enforcement authorities that all but invites a full-blown government investigation? These questions do not lend themselves to easy answers but rather call for legal and business judgment based on an assessment of all the facts and circumstances. For a company that sought and followed legal advice, it could show, at the very least, that it acted honestly and in good faith — which, if established, is a complete defense to criminal liability under the wire fraud, mail fraud and false statement statutes — in the event its disclosure decisions are second-guessed by the U.S. authorities, often with the benefit of 20/20 hindsight.

DOJ's 'China Initiative' Uses Scheme-to-Defraud Charges for Nondisclosure of Ties to China

Contacts

Jack P. DiCanio

Partner / Palo Alto
650.470.4660
jack.dicanio@skadden.com

Patrick Fitzgerald

Partner / Chicago
312.407.0508
patrick.fitzgerald@skadden.com

Ryan D. Junck

Partner / London
44.20.7519.7006
ryan.junck@skadden.com

Bradley A. Klein

Partner / Washington, D.C.
202.371.7320
bradley.klein@skadden.com

Steve Kwok

Partner / Hong Kong
852.3740.4788
steve.kwok@skadden.com

David Meister

Partner / New York
212.735.2100
david.meister@skadden.com

William Ridgway

Partner / Chicago
312.407.0449
william.ridgway@skadden.com