MNC Lawsuit Outcomes in Authoritarian Courts: Evidence from New Litigation Data*

Frederick R. Chen† Jian Xu‡

November 14, 2019

Abstract

Existing research on foreign investment risks in emerging economies has focused on foreign investors resorting to rights protection regimes beyond host countries, such as investor-state dispute settlement (ISDS) mechanisms. However, multinational corporations (MNCs) do not sue in supranational legal institutions as often as scholars might expect. We argue that the existing literature has overlooked a platform of investment dispute settlement where foreign firms are much more frequently involved, that is, host countries' domestic courts. In this article, we investigate how foreign firms' entry modes and political connections with the host country's government affect litigation outcomes. We argue that MNCs with strong political connections and resources may not need to pursue litigation in order to protect their property rights. Nonetheless, conditional on filing lawsuits, MNCs with stronger political background are more likely to win lawsuits than firms without such political ties. By constructing a novel dataset on multinationals' litigation activities, we provide the first systematic study of the patterns of lawsuit outcomes involving foreign firms in China.

*The authors contributed equally and are listed in alphabetical order. Previous versions of this article were presented at the 2019 MPSA and 2019 APSA annual meetings. We are grateful to Jennifer Gandhi, Ned Littlefield, Jon Pevehouse, Eric Reinhardt, Miguel Rueda, Weiyi Shi, Jeff Staton, Jessica Weeks, and William Winecoff for their insightful comments and helpful suggestions. We thank Jingwei Gao, Yani Gao, Yingdi Lei, Wenting Li, Zipei Li, Shihao Liang, Xinran Ma, Julia Wang, Qing Wang, Yumeng Xu, Qiuqi Zhang, Erpu Zhu, and especially Tsz-yan Yeung and Gang Zhang for excellent research assistance.

†Ph.D. Candidate in the Department of Political Science at the University of Wisconsin–Madison. Email: frederick.chen@wisc.edu.

‡Ph.D. Candidate in the Department of Political Science at Emory University. Email: jian.xu2@emory.edu.

1 Introduction

Foreign firms face significant political risks when investing in countries with weak legal institutions to protect investor rights. The conventional wisdom often assumes that foreign investors cannot rely on domestic courts to pursue their claims and seek compensations, especially in countries that lack the rule of law. Therefore, the existing literature has focused on foreign investors resorting to alternative rights protection regimes such as investor-state dispute settlement (ISDS) mechanisms (Büthe and Milner 2008; Puig and Shaffer 2018; Wellhausen 2015). Supranational legal institutions are assumed to be more favorable venues for dispute resolution than domestic judiciaries, especially when the latter lack independence.

However, as opposed to scholars' expectations, emerging economies with weak institutions do not often appear as defendants of investment disputes resolved through ISDS mechanisms at the international level. China, for instance, was sued only three times in the period from 1955 to 2011 under clauses provided by bilateral investment treaties (BITs), though China has been the largest recipient of foreign direct investment among all developing countries in past decades. Thus, existing studies on dispute resolution vehicles have mostly overlooked the more common platform of investment dispute settlement, that is, host countries' domestic courts.

A widely held assumption, which nevertheless has not been sufficiently examined empirically, is that domestic courts tend to be biased against foreign firms in their lawsuits with domestic actors. This kind of nationality bias is believed to be more pronounced in countries with a lack of judicial independence. Ginsburg (2005, p.23) points out that "foreign investors are extremely loath to rely on local courts to resolve business disputes." The common reasoning is that domestic courts usually do not have the capacity to free themselves from the confines of their own domestic regimes "so as to give proper attention and respect to international law" and that alien firms are "cut off from any direct participation in the host state's political process" (Brower and Steven 2001, p.196). Therefore, national

courts are not perceived to be sufficiently neutral in resolving disputes between foreign investors and the host state, especially in many developing and transitioning countries where the rule of law is missing and judicial corruption is a daily business (Brower and Schill 2008).

The fact that third-party investor-protection mechanisms such as ISDS are still in demand indicates that multinational corporations (MNCs) indeed face potential judicial discrimination in (at least some) host country courts (Dugan et al. 2011; Wellhausen 2016; Slaughter 2003). Some evidence suggests that domestic firms are more likely to win in Chinese courts if they have some degree of state ownership (Firth, Rui, and Wu 2011), utilize managerial ties with government officials (Li, Poppo, and Zhou 2008), or employ other relationship-based strategies through local Chinese lawyers, although many practices would be considered corruption (Heye 2003). However, the flip side of judicial dependency implies that dependent courts may instead rule in favor of foreign firms when the latter possess certain capabilities, such as strong political connections, market power, or the ability to offer bribes, which help them wield influence over the judge and obtain adjudicatory advantages. There are instances where foreign firms with significant political, economic, and legal leverages win lawsuits against host country government even though the courts are corrupt and unreliable (Khatam 2017).

While the conventional scholarship focuses on how independent judiciaries provide stronger institutional constraints against illegal takings (Jensen 2003, 2008a), it places little value on "bad" courts. Given a firm's capability to make informal arrangements with host authorities, courts that lack independence and can be easily captured by external interests may also be valuable to investors. MNCs with strong political connections and resources, such as those in joint venture (JV) partnerships with state-owned enterprises (SOEs), may not need to pursue litigation in order to protect their property rights. Nonetheless, conditional on filing lawsuits, MNCs with stronger political background should be, on average, more likely to win lawsuits than firms without such political ties. On the other hand,

firms that are less politically endowed and less sophisticated in leveraging informal relationships should be more likely to pursue formal channels of dispute resolution, but less likely to win.

To provide a systematic account of how foreign firms use domestic courts to resolve investment disputes with local actors and their lawsuit performance under an authoritarian judiciary, we construct a novel dataset on the litigation activities of multinational corporations in Chinese courts. We examine the determinants, in addition to the merits of the cases themselves, of foreign firms' lawsuit outcomes under an authoritarian legal system. We develop our theory from the existing literature on government-business relationships. This literature has focused on the political connections of domestic corporations (Lu, Pan, and Zhang 2015) but overlooked the implications of such political connections for MNCs, in particular when it comes to lawsuits between foreign and domestic entities in authoritarian courts. Scholars have not paid sufficient attention to the informal means by which MNCs overcome "the liability of foreignness." We emphasize that MNCs resort to a variety of relationship-based strategies to minimize institutional disadvantage and to reduce local actors' discriminatory practices (see, e.g., Johns and Wellhausen 2018). Corporate Political Activity (CPA) and strategic choice of entry mode are tools commonly used by foreign firms to influence the host government's decision-making (Hillman, Keim, and Schuler 2004). Thus, we expect that foreign firms' non-market capabilities may also influence local judiciaries.

We focus on China because the country has been one of the largest recipients of foreign direct investment (FDI) inflows in the world. This study tries to engage with the burgeoning scholarly interest in the judicial politics of China and how the Chinese government regulates foreign investments through legal channels. Research on this front will help us understand why there is so much variation in levels of private investment in developing countries with highly corrupt judiciaries and weak property rights regimes (Stasavage 2002). Moreover, it has important implications for understanding the rule of law, devel-

opment of business environment, and policy-making in China. To our best knowledge, this study is the first attempt to systematically investigate the litigation outcomes of foreign firms in China. Moreover, we provide an original dataset on lawsuits adjudicated by Chinese courts between foreign corporate litigants and Chinese litigants. Future research on this topic can benefit from this dataset.

The remainder of this article proceeds as follows. In the second section, we point out that the existing literature on supranational investment dispute settlement mechanisms is insufficient to fully explain the relationship between political risks and foreign direct investments. We argue that we need more empirical evidence of how local courts adjudicate legal disputes between MNCs and domestic (public or private) entities. The third section discusses how domestic connections may affect foreign enterprises' judicial outcomes. The fourth section lays out the details of the research design, including discussions about how we construct the new dataset. The fifth section then conducts statistical analyses of the dataset and also tests our theoretical implications using additional data from the World Bank Enterprise Survey. The final section concludes.

2 Political Risks, Legal Institutions, and FDI

The existing literature on the relationship between regime type and foreign direct investment is mixed (Li, Owen, and Mitchell 2018). The traditional argument in favor of democratic advantage often points to checks and balances, a large number of veto players over public policy, executive constraints, and legislative and judicial oversight as reasons for fewer expropriations in democracies (Jensen 2003; Li and Resnick 2003; Stasavage 2002; Clague et al. 1996; Li 2009, 2006; Biglaiser and Staats 2012). In particular, it is believed that strong legal institutions reduce risks of expropriation, contract repudiation, and government corruption, all of which improve the investment environment for foreign businesses and therefore encourage foreign investment (North and Weingast 1989; Keefer and Knack

1997; Li, Owen, and Mitchell 2018).

However, the empirical patterns of the relationship between instituional quality and firms' perceived levels of political risks is not so conclusive (Wright and Zhu 2018; Zhu and Deng 2018). For example, Kenyon and Naoi (2010) show that there is a nonlinear relationship between regime type and firms' perception of economic policy uncertainty as a constraint on investment. They find that firms in hybrid regimes report higher levels of concern over policy uncertainty than those in either more authoritarian regimes or liberal established democracies.

Moreover, the existing research on political risks concentrates on supranational legal channels such as investor-state dispute settlement (ISDS) mechanisms as stipulated in investment treaties and trade agreements (Allee and Peinhardt 2011; Büthe and Milner 2008). This focus is inadequate to understand MNCs' risk mitigation strategies and risk preferences, for three reasons.

First, ISDS litigation and arbitration mainly involve the **government** as the defendant who is alleged to be violating foreign firms' agreed-upon rights (Wellhausen 2015). Yet, foreign firms' daily operations engage with a much wider set of actors, including suppliers, customers, business partners, employees, NGOs, front-line regulators and law enforcers, and thus have to find ways to compel these local actors to fulfil their contractual obligations. MNCs are frequently victims of discriminatory and predatory practices by both public and private entities that need to be addressed locally (Eden and Miller 2004; Zaheer 1995). Therefore, MNCs have to resort to domestic legal remedies to seek compensations, to uphold contract integrity, and to protect their basic rights from infringement by diverse host actors.

Second, international arbitration is generally a last resort for firms since it can have repercussions by shaming the host government (Jensen 2008b). For example, Kerner (2009) points out that, in *Lauder v. The Czech Republic*, Ronald Lauder filed cases in international tribunals to sue the Czech government for failing to uphold his contracts only

after Lauder had exhausted all other remedies, including appealing the case to an industry regulatory council and to the Czech courts.

Third, the enforcement of ISDS awards has many limitations (Baldwin, Kantor, and Nolan 2006; Jensen 2008b), such as national courts' attempts to delay or avoid compliance with ICSID rulings. Many host countries are hostile towards ISDS clauses as they consider such legal delegation to be tantamount to infringement of sovereignty (Allee and Peinhardt 2010; Bronckers 2015). At the end of the day, international arbitration and adjudication awards have to rely on domestic courts for enforcement. The discretion and capacity of local legal institutions to honor private and public contracts are vital to understanding a country's political risk landscape.

For all these reasons, the frequency of MNCs' usage of third-party resolution mechanisms is disproportionately low considering the sheer volume of daily business activities and the underlying propensity for disputes to emerge in high-risk markets. Using a variety of data sources, Wellhausen (2016) counts 676 public international investment arbitrations filed from 1990 to 2014 in ICSID and non-ICSID venues. According to her statistics, the maximum number of total arbitrations worldwide in a single year is only 65 (in 2013). From 1955 to 2011, emerging economies with weak institutions do not appear that often as defendants of public arbitrations: Mexico appeared 16 times, Russia 8 times, South Africa twice, and China and Nigeria each appeared only once. According to the ICSID data up till November 13, 2019, China has been sued only 3 times, Mexico has been the respondent 25 times, South Africa appeared once, and the total number of cases filed by all countries is merely 759.[1] Statistics from the United Nations Conference on Trade and Development (UNCTAD) show that there is a total of 983 known treaty-based investor-state arbitrations.[2]

Therefore, it is important to turn our attention to firm-level outcomes in **local** dispute

[1] See the official website of ICSID.

[2] As of November 13, 2019, Russia has been the respondent for 24 times, Mexico with 32 times, China with 3 times, and South Africa and Nigeria were each sued only once. See the statistics at `http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry`.

resolutions, especially when domestic courts lack independence. We argue that "bad institutions" such as dependent judiciaries do not necessarily deter foreign investments. When judges' decision-making in the host country can be easily influenced by undue outside pressure, foreign firms may benefit from bringing lawsuits before domestic judges whose rulings can be easily shaped in favor of foreign litigants.

3 Domestic Connections and Foreign Firms

In the event of local litigation, foreign firms with strong political resources and privileged access to the judiciary will choose to exert pressure over judges to extract favorable resolutions. In this section, we elaborate on the importance of political connections and resources for foreign firms investing in markets without independent judiciaries.

Political Risks and Corporate Political Activities

The international business literature has long viewed political environments as "risks" to factor into planning. However, Boddewyn and Brewer (1994) argue that governments represent opportunities for MNCs as well. Bonardi (2004) also points out that MNCs integrate their political efforts with their market strategies to maintain monopoly rents. In spite of the progress in recent years, the effectiveness of strategies used by MNCs to affect opportunities in the host country remains a largely understudied area of research.

Mellahi et al. (2016) categorize nonmarket strategy mechanisms into buffering and bridging activities, where buffering strategies include building personal and organizational ties to sociopolitical institutions and actors, lobbying, campaign contributions, and public relations campaigns. Other scholars have also shown that firms seek to co-opt political agencies and actors by a variety of tactics, aimed at gaining influence over regulations and receiving preferential treatments from government officials (Hillman, Withers, and Collins 2009; Hillman, Keim, and Schuler 2004; Peng 2012; Sun, Mellahi, and

Wright 2012). Especially in emerging economies where resource dependencies on the government are stronger, firms are expected to develop political connections to shield themselves from the perils of political extortions (Peng and Luo 2000).

Henisz and Zelner (2005) point out that an organization's own internal capabilities is an important determinant of political risk. They argue that the interaction of investors and governments throughout the investment cycle involves a variety of interest group activities. In addition to effective checks and balances in the policy-making process, the use of appropriate organizational linkages and distinctive knowledge lowers the probability that political actors will overturn, alter, or reinterpret an emergent institution. This is because strong direct or indirect ties to relevant political actors permit organizations to craft "side deals" with these actors for special contract terms or individualized exceptions to adverse changes in emergent institutions. More specifically, Lyles and Steensma (1996) argue that investors' management of their relationship with the government is an important organizational capability and key "factor of success" in Asian infrastructure projects. Lu, Pan, and Zhang (2015) show that in Chinese corporate lawsuits, political connections could help domestic firms win corporate lawsuits against other domestic firms.

This stream of literature demonstrates the importance of developing and utilizing political resources for multinational enterprises to navigate political risks in emerging economies and authoritarian regimes. Nonetheless, foreign firms can potentially turn political risks into profitable opportunities if they possess sufficient political capacities.

Political Risks and Corporate Structure

MNCs opt for a variety of managerial tools and corporate vehicles to circumvent and mitigate political risks. One strategy foreign firms adopt to overcome institutional obstacles and manage policy uncertainty is to choose a market entry mode that builds political connections either directly with host government authorities or indirectly with government-affiliated actors such as SOEs.

Interdisciplinary research at the intersection of international business and political science has examined the concept of "institutional distance." This stream of literature looks at how MNCs choose specific ownership structures or investment vehicles to overcome long institutional distances, which usually imply greater political hazards. Specifically, scholars have focused on negotiations between MNCs and host governments at the time of initial entry into a country, that is, the choice of entry modes (e.g., Dunning 1992; Dunning and Lundan 2008; Uhlenbruck et al. 2006; Doh et al. 2003; Grosse 1996).

In a classic work, Henisz (2000) examines the effects of corruption on FDI market entry and ownership mode for U.S.-based multinational firms. He argues that MNCs' choice of market entry mode between using minority versus majority equity control relative to domestic firms is dependent on two types of independent risks and their interaction: contractual hazards and political hazards.[3] Partnering with host country firms that possess a comparative advantage in connecting with host country governments can safeguard against the political hazards but not the contractual hazards. A multinational firm is more likely to choose a minority-owned joint venture as a market entry mode as the level of political hazards increases.

Many scholars have studied JV's advantages as an investment structure for foreign corporations (Beamish 1993; Lu 1998; Luo 1997). For example, Smarzynska et al. (2000) argue that in Eastern European and the former Soviet economies, the probability of an MNE investing abroad through a joint venture rather than a wholly owned subsidiary increases with the level of corruption. Uhlenbruck et al. (2006) also find that foreign firms adapt to the pressures of corruption via short-term contracting and entry into joint ventures. They show that MNEs use nonequity-entry modes or partnering as an adaptive strategy to participate in markets despite the presence of corruption. Analyzing a sample of Japanese investors' ownership decisions in the U.S., Chen and Hennart (2002) find that

[3]Political hazards are defined as the feasibility of policy change by the host-country to directly seize assets or adversely change taxes, regulations or other agreements. Contractual hazards are defined as the expropriation hazards from MNCs' potential joint-venture partners in the host country.

Japanese investors facing high market barriers in the target industry are more likely to choose joint ventures than wholly owned subsidiaries.

When the local institutional framework is weak, resources held by the local firm such as permits and licenses for operation are especially valuable for foreign investors facing idiosyncratic regulatory restrictions (Meyer et al. 2009). The local partner's operating privileges help MNCs gain legitimate rights to conduct business in restrictive regulatory environments (Yiu and Makino 2002). Puck, Holtbrügge, and Mohr (2009) find that when the perceived external uncertainty (such as political and legal risks, or the complexity of government regulations for foreign firms) is high, MNCs are less likely to convert from JV to WOE (Wholly-owned Enterprise) even if they have the choice. Luo (2001) also finds that the level of governmental intervention and environmental uncertainty as perceived by MNC managers are positively associated with the probability of choosing the joint venture mode. Morschett, Schramm-Klein, and Swoboda (2010) similarly show that country risk is positively associated with cooperative entry modes, such as JV, rather than wholly owned subsidiaries.

In summary, scholars have generally found that JV partners' resources can help MNCs mitigate operational and political risks inherent in the local institutional context. The source of competitive advantages of JV derives from the fact that local linkages and personal connections are very important in FDI activities (Chen et al. 2004; Davies et al. 1995). A major motivation for establishing JV is to utilize the political influence and support of domestic firms (Henisz 2002). However, existing studies often use the mode of firm entry as the dependent variable, and use political hazards as the independent variable usually proxied by levels of corruption or institutional constraints on the executive branch. We still know relatively little about whether any of these ex ante strategies used by MNCs to hedge against non-market risks are actually effective in protecting the interests of MNCs ex post.

We propose the following hypotheses regarding the relationship between the out-

comes of rights protection through domestic judiciaries and the relationship-based risk mitigation strategies adopted by MNCs in high-risk markets, with a particular focus on the corporate structure used by foreign investors for market entry:

Hypothesis 1: All else equal, MNCs with political connections are more likely to win lawsuits than foreign firms without political connections.

Hypothesis 2: All else equal, joint ventures formed by MNCs and host SOEs are more likely to win lawsuits than other types of foreign firms.

4 Empirical Strategy

Data

To examine the performance of MNCs' rights protection efforts via institutional channels when the host country lacks judicial independence, we construct a new dataset of MNCs' lawsuit outcomes in Chinese courts. We used web-scraping to obtain legal documents related to lawsuits involving foreign litigants in Chinese courts from the China Judgement Online database. The database was established and maintained by the Supreme Peoples Court (SPC) of China and contains court rulings of all levels of Chinese courts from 1996 to present.

In 2013, the Supreme People's Court of China started to require all levels of courts in China (i.e., basic, intermediate, high, and supreme) to publish court judgment documents in a publicly accessible database,[4] as an effort to increase judicial transparency. The SPC requires that every court must publish judgments online within seven days after judicial decisions. The database is currently only available in Chinese and several ethnic minority languages (i.e., Uighur, Korean, Kazakh, Mongolian, and Tibetan). But the Supreme People's Court has plans to offer the website in English, as disputes involving foreign litigants

[4] http://news.xinhuanet.com/english/china/2013-11/27/c_132923578.htm

Table 1: MNC lawsuit origin countries

Country	Number of lawsuits
Japan	1320
South Korea	924
U.S.	527
Singapore	236
Germany	235
France	198
U.K.	125
Australia	114

are rising rapidly.[5] The website shows that it now stores about 64.7 million court documents, including 41 million documents arising from civil lawsuits and approximately 2 million documents related to administrative lawsuits (where the defendants are government functionalities).[6]

We searched for all cases where a foreign company is one of the litigating parties, either as the plaintiff or as the defendant. Due to budgetary constraints, we have focused on the China's major FDI inflow origin countries, including the U.S., Japan, South Korea, the U.K., France, Germany, Singapore, and Australia. As an improvement over existing research on investor-state dispute settlements that focuses on disputes between foreign investors and local government authorities, we are able to examine legal disputes between MNCs and private actors in the host economy as well. The compiled dataset includes 3,719 cases involving at least one foreign company, and the distribution of MNC origin countries is in Table 1.[7]

Table 1 shows that Japanese and South Korean firms are frequent participants in Chinese judicial proceedings, even though they are not the largest FDI origin countries in China. U.S. companies have been involved in 527 coded lawsuits. To put it into per-

[5] https://thenanfang.com/chinese-court-verdicts-published-english-language-website/

[6] The website can be accessed at https://wenshu.court.gov.cn/.

[7] Considering the strong ethnic ties between Hong Kong, Macao, and Taiwanese investors with mainland Chinese citizens and the fact that firms from these three localities receive different policy treatments from central and local governments than other foreign companies, Hong Kong, Macao and Taiwan firms are categorized as Chinese firms instead of foreign MNCs.

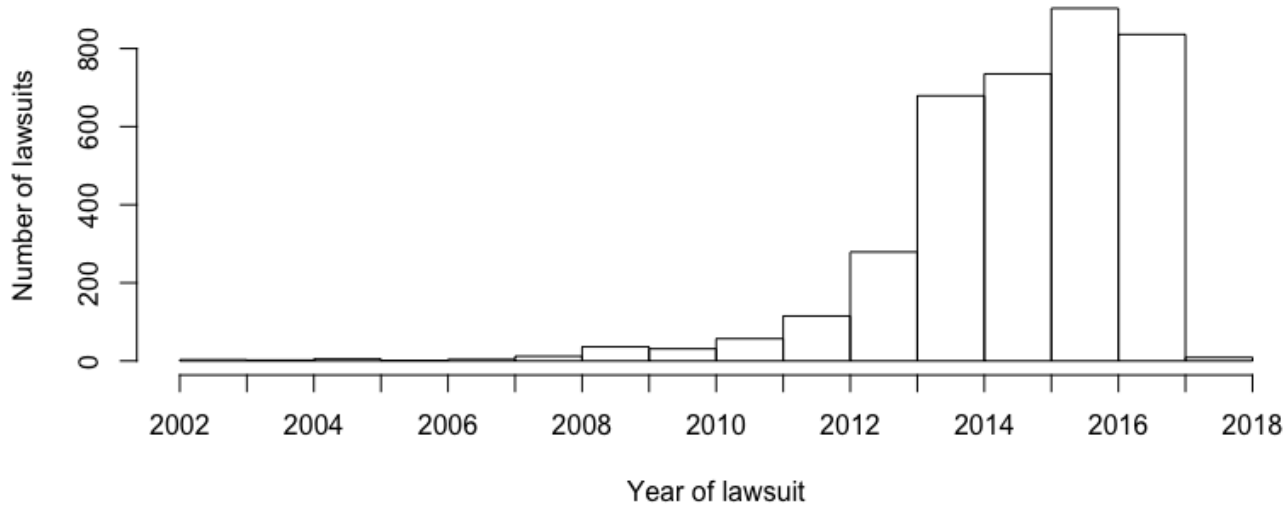

Figure 1 Yearly distribution of MNC lawsuits

spective, according to UNCTAD statistics on investor-state disputes, the U.S. has only appeared 16 times as respondent state and 174 times as the home state of claimant.[8] And none of the total 190 disputes involves Chinese government or firms. The comparative statistics indicate that the volume of foreign-related disputes adjudicated by Chinese domestic courts is quite significant compared with international venues of dispute resolution, even after taking into account the number of private arbitrations as documented by Wellhausen (2016).

The distribution of lawsuit filings is skewed in time coverage. Figure 1 shows that most of the foreign-related lawsuit filings are reported in recent years, especially after 2013. Therefore, our dataset may under-report lawsuits filed in Chinese courts before 2013, the year when the judicial transparency reform initiative started to require the publication of all legal documents. Given the temporal constraint of the judicial transparency requirement, our dataset is more representative of litigation patterns in recent years.

[8]See the country statistics at `https://investmentpolicyhub.unctad.org/ISDS/FilterByCountry`.

Variables

The main outcome of interest is the ruling outcome for plaintiff who brings a claim before the court. For this project, we use several ways to measure lawsuit outcomes. The first measure is whether the court's legal arguments and findings are supportive of or against the plaintiff's claims. Most legal documents include a section that summarizes the court's findings and conclusions. The ruling outcome is coded 1 if the court expresses clear support or mostly favorable opinions towards the plaintiff, and 0 otherwise.

The second measure is whether the plaintiff is demanded to pay fewer court fees than the defendant. In China, the judge usually asks the party that she rules against to pay higher litigation-related fees and expenses to the court than the party receiving favorable ruling. Therefore, the relative allocation of court fees is a good indicator of which side has the upper hand in the lawsuit.

The third measure is the conventional measure of whether any amount of monetary compensation is awarded by the court to the plaintiff. The case outcome is coded as 1 if the plaintiff receives an monetary award greater than zero RMB, and 0 otherwise. This coding rule for case outcomes is widely used in the literature on corporate lawsuits (Wang 2016; Lu, Pan, and Zhang 2015).

The other measurements raise the threshold of defining lawsuit victory by looking at whether the plaintiff is awarded a monetary compensation that is equal to or greater than (1) one quarter of, (2) one half of, and (3) the full mount of compensation sought by the plaintiff.

While judges are oftentimes unequivocal in their opinions towards the litigants' claims, sometimes the court's stance is mixed and thus less clear. Therefore, the first measure involves more subjective reading and interpretation of the court's judgement. Meanwhile, a judge's explicit support for the plaintiff's claims does not always translate into adequate compensation for the injured party. The other measures are based on monetary values, which are more objective indicators of the court's (un)favorable ruling. Mone-

tary penalty-based measurements are used to capture the sufficiency of legal remedy as received by the victim.

Following the convention (Faccio, Masulis, and McConnell 2006; Wang 2016), a firm is coded as having political connection (PC) if its board members include any individual who has served in the Chinese Communist Party, the government, or SOEs. Considering the extensive role that the Chinese government plays in the national economy, we also code a firm as politically connected if it participated in any social and/or economic projects that were led or promoted by the government.[9]

5 Empirical Results

Preliminary Results

Table 2 shows the summary statistics for MNCs' lawsuit outcomes in China. It indicates that, across all of the six measures of lawsuit outcomes, the average win rates are actually higher for MNCs suing domestic entities,[10] including Chinese firms, individuals, and government agencies, than for domestic entities suing foreign firms.

However, while MNCs are more likely to obtain supportive rulings for MNCs' claims from the court, the favorable judgements do not translate into substantial monetary remedies. Chinese judges are more likely than not to issue favorable opinions toward MNCs as plaintiffs, but relatively rarely award substantial compensations. Only in 32% of all claims pursued by MNCs against domestic entities did they receive any amount of pecuniary compensations, and the likelihood is even lower for more substantial awards. Similarly, domestic firms seeking reparations from foreign firms are also more likely to score superficial lawsuit victories than to obtain meaningful compensations.

[9]Such projects include government procurement contracts, infrastructure constructions, economic development projects, charity and public welfare programs, etc.

[10]There are only 3 cases of foreign natural persons suing Chinese domestic entities in the entire dataset.

Table 2: Plaintiff win rate (all cases)

	Foreign v. All	Foreign v. Domestic	Foreign v. Foreign	Domestic v. Foreign
Judgement	0.544	0.529	0.653	0.472
Court fee	0.238	0.240	0.201	0.113
Compensation > 0	0.313	0.320	0.243	0.229
Compensation $> \frac{1}{4}$ claim	0.212	0.210	0.198	0.175
Compensation $> \frac{1}{2}$ claim	0.180	0.176	0.176	0.142
Compensation $\geq$ full claim	0.122	0.120	0.120	0.095
Number of cases	2343	2014	300	1388

Table 3: Plaintiff win rate (other cases)

	Administrative	IPR (suing domestic)	IPR (sued by domestic)
Judgement	0.292	0.515	0.182
Court fee	0.140	0.246	0.077
Compensation > 0	0.026	0.274	0.073
Compensation $> \frac{1}{4}$ claim	0.023	0.107	0.040
Compensation $> \frac{1}{2}$ claim	0.020	0.061	0.040
Compensation $\geq$ full claim	0.017	0.031	0.028
Number of cases	648	1102	293

Table 3 examines two types of particular cases. The first type is administrative cases where the defendants are government agencies or government-affiliated institutions. This type of litigation can be seen as the domestic equivalent of investor-state disputes adjudicated in international forums. The results show a pattern similar to that in Table 2, that is, MNCs are more likely to obtain more shallow forms of remedies than more substantial legal redress. The results also indicate that MNCs still actively use domestic courts to sue local government bodies, even though the local judiciary lacks independence and the winning rate is low. The litigation frequency is greater (648 adjudicated cases) than the usual ISDS proceedings against state actors' actions that infringe upon investor rights, which indicates a significant yet still overlooked venue of dispute resolution for foreign firms against authoritarian governments.

The second type of cases involves intellectual property rights (IPR) infringement. Inadequate IPR protection and forced technological transfer have long been the concerns of foreign firms operating in China (Awokuse and Yin 2010; Du, Lu, and Tao 2008), and IPR-related issues are frequently the point of contention in trade disputes (Maskus 1998, 2000; Saggi 2002; Mansfield and Mundial 1994; Grossman and Lai 2004). In response to greater demands for protecting IPR and incentivizing innovation, China established specialized IP courts in Beijing, Shanghai, and Guangzhou in 2014, and more IP tribunals have been set up successively in other cities.[11] These IP courts are staffed with professional legal per-

[11]See a summary of the development of IP courts at `https://www.lexology.com/library/detail.`

sonnel who deal with highly technical and complex IP disputes. The second column of Table 3 shows a similar pattern of adjudication outcomes even in the highly technical area of IP lawsuits, that is, MNCs struggle to win more substantial compensations. Therefore, even though IP courts are expected to enjoy greater independence due to judges' technical expertise and other institutional guarantees of judicial professionalism (Matthews 2017; Zhang 2019), MNCs only enjoy very superficial forms of rights protection.

The statistical evidence is also corroborated by the qualitative evidence obtained from the authors' interviews with officials from the American Chamber of Commerce (AmCham) in Shanghai.[12] AmCham officials indicate that U.S. MNCs are reluctant to resort to Chinese courts for dispute resolution because the amount of sanctions imposed on offenders is usually too small to deter future violations, and MNCs are not awarded sufficient compensations even if they win the lawsuit.

Table 4 examines the impact of different types of corporate structure and modes of market entry on MNCs' lawsuit outcomes against domestic entities. It shows that foreign firms that have entered joint-venture partnerships with state-owned enterprises enjoy substantial adjudicative advantages. Compared with other types of MNCs, JVs with SOE are more likely to receive favorable rulings by all measurements, including both trivial and substantial victories. In over a third of the cases, the amount of compensation awarded to JVs with SOE is equal to or greater than the claim. Meanwhile, MNCs with fixed asset investments in China experience better lawsuit outcomes than MNCs who are pursuing transnational litigation without any physical presence in the host country. The average win rates suggest the importance of building local economic and political ties, especially with state actors. Interestingly, the results also indicate that JVs with private Chinese firms do not enjoy superior litigation performance compared with average MNCs. Therefore, partnering with private entities may not provide sufficient political

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[12]The fieldwork and related interviews were conducted during the summers of 2018 and 2019, under the protocol of Emory IRB (IRB00096709 and IRB00103588).

resources to overcome the institutional deficiency.

Overall, the results indicate that market entry modes are important for MNCs in terms of overcoming adjudicative biases by courts susceptible to political influences in authoritarian regimes (Straub 2008). Making fixed asset investments and establishing joint ventures with local partners in the host market help provide MNCs with protections not enjoyed by MNCs without any local business ties (Henisz 2016; Mellahi et al. 2016). Meanwhile, forging connections with government-affiliated actors is an effective way for MNCs to exert informal influence over judicial proceedings. Relationship-based corporate strategies and political activities can potentially turn a discriminatory and risky political environment plagued by corrupt judiciaries and bureaucrats into investment opportunities and nonmarket advantages.

Table 4: MNC lawsuit outcomes against domestic entities

	All MNCs	General JV	JV with SOE	With Fixed Assets	Without Fixed Assets
Judgement	0.529	0.638	0.600	0.548	0.487
Court fee	0.240	0.245	0.426	0.254	0.218
Compensation > 0	0.320	0.283	0.611	0.345	0.268
Compensation $> \frac{1}{4}$ claim	0.210	0.181	0.514	0.231	0.162
Compensation $> \frac{1}{2}$ claim	0.176	0.156	0.486	0.195	0.135
Compensation $\geq$ full claim	0.120	0.108	0.343	0.132	0.095
Number of cases	2014	401	105	1400	593

Regression Results

In this subsection, we present more credible empirical evidence using regression analysis. We use logit regressions to examine the effect of corporate political connections on each of the six dichotomous lawsuit outcome measures. The models include a variety of firm- and case-level control variables.

Table 5 provides more evidence of the importance of litigants' political connections for lawsuit outcomes. Panel (1) presents the baseline model, the result of which shows that JV partnerships between MNCs and Chinese SOEs are significantly more likely to win substantial compensations than other types of corporate structure. Considering that lawsuits against domestic entities may be subject to different political dynamics than lawsuits against foreign firms, Panel (2) controls for whether or not the defendant is a domestic entity. Results show that the effect size of SOE JV becomes even larger when adjusting for the national identity of the defendant, which suggests that the effect of SOE JV is robust to the rival litigant's national origin.

Panels (3) and (4) examine whether the effect of MNC's partnership with SOE is driven by the relative political connectedness of the plaintiff vis-á-vis the defendant. If our theory is correct in that it is the political resources of SOEs that generate the adjudicative privileges enjoyed by the JV partnership, then we should expect the effect of SOE JV to decrease after including a measurement of the defendant's political capital. This is because what matters in the lawsuit is the relative distribution of power among the litigants (Li 2017). A more politically powerful defendant indicates a less powerful plaintiff, holding constant the latter's political ties.

The empirical pattern in Panel (3) supports the theory. The defendant's political connection is significantly and negatively correlated with the lawsuit outcomes of the plaintiff. Meanwhile, since *Defendant PC* is a competing indicator of the relative power status of the SOE JV, the effect size of SOE JV becomes smaller after controlling for *Defendant PC*, especially in terms of obtaining more substantial remedies. Panel (4) similarly shows that,

Table 5: Political connections and lawsuit outcomes

(1)	*Judgement*	*Court fee*	*Comp* > 0	*Comp* $> \frac{1}{4}$	*Comp* $> \frac{1}{2}$	*Comp* $\geq$ *full*
SOE JV	0.594^{**}	-0.063	0.381^{**}	0.481^{**}	0.623^{***}	0.395^{**}
	(0.257)	(0.311)	(0.194)	(0.188)	(0.224)	(0.193)
Num. obs.	1966	1346	1299	1276	1276	1283
(2)			**Controlling for domestic defendants**			
SOE JV	0.593^{**}	-0.037	0.474^{**}	0.555^{***}	0.716^{***}	0.441^{**}
	(0.256)	(0.326)	(0.176)	(0.165)	(0.201)	(0.196)
Against Domestic	0.302^{*}	1.175^{***}	1.307^{***}	0.901^{***}	0.908^{***}	0.710^{***}
	(0.165)	(0.231)	(0.262)	(0.210)	(0.218)	(0.231)
Num. obs.	1966	1346	1299	1276	1276	1283
(3)			**+ Controlling for defendant political connection**			
SOE JV	0.667^{**}	-0.148	0.479^{*}	0.513^{**}	0.582^{**}	0.389^{**}
	(0.308)	(0.442)	(0.254)	(0.209)	(0.273)	(0.194)
Against Domestic	0.503^{***}	1.375^{***}	1.451^{***}	0.982^{***}	0.989^{***}	0.711^{**}
	(0.157)	(0.230)	(0.270)	(0.232)	(0.224)	(0.290)
Defendant PC	-0.621^{***}	-1.154^{***}	-1.536^{***}	-0.856^{**}	-0.832^{**}	-0.668^{***}
	(0.149)	(0.298)	(0.439)	(0.372)	(0.393)	(0.231)
Num. obs.	1855	1276	1235	1213	1213	1220
(4)			**+ Controlling for plaintiff political connection**			
SOE JV	0.587	-0.183	0.407	0.421^{*}	0.521^{*}	0.288
	(0.301)	(0.409)	(0.260)	(0.228)	(0.271)	(0.198)
Against Domestic	0.518^{***}	1.367^{***}	1.456^{***}	0.997^{***}	0.992^{***}	0.728^{**}
	(0.155)	(0.250)	(0.267)	(0.225)	(0.220)	(0.300)
Defendant PC	-0.632^{***}	-1.225^{***}	-1.584^{***}	-0.914^{**}	-0.886^{**}	-0.742^{***}
	(0.156)	(0.280)	(0.423)	(0.361)	(0.381)	(0.233)
Plaintiff PC	0.213	0.183	0.297	0.362^{**}	0.255	0.422^{**}
	(0.148)	(0.278)	(0.169)	(0.183)	(0.198)	(0.201)
Num. obs.	1829	1254	1228	1206	1206	1213
Firm Size (registered capital)			✓			
Fixed Effects:	province, year, court type, appealed cases, ruling procedure, plaintiff industry, defendant industry, contract lawsuits, IPR lawsuits, administrative lawsuits					

Note: Robust standard errors are clustered on province.
$^{***}p < 0.01$, $^{**}p < 0.05$, $^{*}p < 0.1$

after controlling for the plaintiff's political connections, the effect size of SOE JV further decreases, and is no longer significant for all six lawsuit outcome measures. Therefore, the adjudicative advantages of JV SOE mostly derives from its access to and possession of political resources.

Overall, the results indicate that more politically-endowed litigants are able to capture the dependant courts in China and extract significant institutional rents in terms of adjudicative privileges. For MNCs in China, forming JVs with SOE partners deliver the most substantial benefits when using the authoritarian judiciary to advance and protect their interests.

Comparative Results

In this section, we put the results from China into comparative perspectives and further demonstrate the proposed theoretical mechanism, using the World Bank Enterprise Survey (WBES). The WBES provides cross-national survey data in emerging markets and developing countries.[13] The surveys were administrated to business owners and top executives from a representative sample of firms in emerging economies across all geographic regions, covering small, medium, and large companies. The respondents were asked questions about characteristics of the business environment including topics on bribery and perceptions of the courts.

To measure firms' perception of the court system, the WBES asked firms the extent to which they agree or disagree with the statement "The court system is fair, impartial and uncorrupted." The responses included "**Strongly disagree**" (1), "**Tend to disagree**" (2), "**Tend to agree**" (3), and "**Strongly agree**" (4). Therefore, higher scores indicate more positive perceptions of the respondent firm towards the legal system.

Table 6 compares the average responses from surveyed firms in China with those in other developing economies, across different types of corporate ownership. The first row

[13]More details about the data are available at `http://www.enterprisesurveys.org`.

indicates that respondents in China, including all foreign and domestic firms, have higher evaluations of the court system than those in other countries. Firms in China also have a higher median response (”Tend to agree”) than firms in other developing countries (”Tend to disagree”). The second row focuses on surveyed firms with non-zero foreign ownership. Similarly, in China respondents with foreign investments also have a more positive view of the judicial system than foreign-invested enterprises in other countries, in terms of both mean and median responses. The third row shows the results for firms where “foreign individuals, companies or organizations” own more than 50% of the firms. This type of enterprises can be seen as foreign companies in the real sense of the definition. Interestingly, the results show that for this category of “real” foreign firms, they also express more positive views of the court system than their counterparts in other emerging economies. Moreover, unlike in other countries, firms with greater foreignness (as measured by the percentage of foreign ownership) in China seem to have more positive perceptions of the court system than domestic firms, which is consistent with the micro-level patterns of firm litigation outcomes.

Therefore, the summary statistics indicate that traditional notions of the “liability of foreignness” and ”institutional distance” need to be reexamined in light of foreign firms’ abilities to adapt to the host country’s institutional environment, and in particular to the local judicial system.

Table 6: Firms' perceptions of the court system

	China (average)	China (median)	Other countries (average)	Other countries (median)	t-score (Welch t-test)
All surveyed firms	2.635	3	2.260	2	27.812
With foreign investments	2.681	3	2.263	2	6.743
With foreign majority ownership	2.820	3	2.244	2	7.536
Number of obs	2,700		141,311		

In Table 7, we further use the WBES data to explore different potential sources of adjudicative advantages for firms with majority ownership held by foreign entities. *Foreign owned* is a binary indicator of whether "foreign individuals, companies or organizations" own more than 50% of the firm's stakes. *State ownership* is a standardized measure of the percentage of stakes owned by the government. *Sales* is a standardized measure of the firm's annual total sales. *Informal payment* is the firm's reported percentage of total annual sales paid as "gifts or informal payments to public officials to 'get things done'." *Use foreign technology* indicates whether the firm uses technology licensed from a foreign-owned company.

We can find that for firms across different countries, a majority foreign ownership is associated with more positive perceptions of the court system. This is a surprising and interesting finding. In the upper panel of Table 7, Model (2) shows that state-ownership is associated with worse evaluations of the legal system for firms in China; controlling for state-ownership decreases the coefficient size of *Foreign-owned*. This may reflect two possibilities. First, state-affiliated actors are more familiar with the inner workings of China's corrupt judicial proceedings, and therefore have less favorable opinions about the court system. Second, stronger affiliation with the state emboldens the respondent firm to express genuine attitudes towards the court system. Either way, the result suggests that state-ownership is a significant factor in shaping the firm's perception of the legal environment.

Model (4) shows that informal payments are negatively and significantly associated with court perceptions. This is an expected result and may further suggest that the negative sign for *State ownership* can be attributed to corrupt exchanges between state-affiliated actors and court officials. Interestingly, two conventional indicators of the significance of a firm's contribution to local economy, i.e. sales volume and the use of foreign technology, do not seem to matter for firms' perceptions of Chinese judiciary.

The lower panel of Table 7 suggests a different mechanism for the adjudicative advan-

Table 7: Corporate capabilities and judicial advantages

	DV: Perception of the Court System				
	In China				
	(1)	(2)	(3)	(4)	(5)
Foreign-owned	0.257**	0.234**	0.258**	0.318***	0.354***
	(0.102)	(0.102)	(0.102)	(0.118)	(0.114)
State Ownership		−0.108***			
		(0.019)			
Sales			0.006		
			(0.018)		
Informal Payment (% of sales)				−0.117***	
				(0.022)	
Use Foreign Technology					−0.006
					(0.059)
City FEs			✓		
Industry FEs			✓		
Observations	2,649	2,648	2,649	1,853	1,661
Adjusted R^2	0.138	0.148	0.138	0.194	0.152
	In other countries				
Foreign-owned	0.029***	0.030***	0.029***	0.040***	0.023*
	(0.010)	(0.010)	(0.010)	(0.013)	(0.013)
State Ownership		0.018***			
		(0.003)			
Sales			0.0001		
			(0.011)		
Informal Payment (% of sales)				−0.037***	
				(0.003)	
Use Foreign Technology					0.027***
					(0.009)
Country FEs			✓		
Industry FEs			✓		
Observations	116,080	116,054	116,043	79,293	80,032
Adjusted R^2	0.183	0.184	0.183	0.199	0.190
Note:					*p<0.1; **p<0.05; ***p<0.01

tages enjoyed by foreign firms in other countries. State ownership still matters for firms' assessment of the court system, but it does not explain foreign advantages as well as in the case of China. Instead, firms' use of foreign technology seems to matter the most for their experiences with the judicial system. Both the effect size and the significant level for *Foreign-owned* decreases after controlling for *Use foreign technology*.

6 Conclusion

In the conventional literature on institutions and economic development, the value of judicial independence and the rule of law lies in the power of courts to constrain government behavior (La Porta et al. 2004; North and Weingast 1989; Stasavage 2002). The value of an independent judiciary manifests itself in two ways. First, the court checks executive malfeasance and overreach by ruling against government behavior that infringes upon the legal rights of private citizens, such as expropriating investors' assets without compensation. Second, the court checks government policies and practices that unduly advantage certain groups or individuals over others, which helps create a level playing field. For example, the court ensures that market rules are fair and impartial to all market participants and no actor enjoys unlawfully obtained privileges (Scully 1988; Mahoney 2001; Haggard et al. 2008; Rodrik et al. 2004; Henisz 2000; Dam 2007; Feld and Voigt 2003; Levie and Autio 2011; Rose-Ackerman and Palifka 2016; Rose-Ackerman 1998).

The common belief is that, when the court is weak, the government is bounded by fewer constraints against opportunistic behavior, therefore investors face greater risks of predatory and discriminatory government actions and are thus less likely to invest (Li et al. 2018; Jensen 2008a). However, the existing literature has not examined the value of weak legal systems for investors in such an environment. While weak courts are not able to check the government's illegal takings, they also impose fewer restrictions on other self-enriching and rent-seeking activities by government officials, such as delivering par-

ticular services to firms in exchange for bribery contributions. Under certain conditions, foreign firms may prefer investing in countries that have weak judicial constraints over executive discretion and power. Investors may be better off dealing with a predatory government that is nevertheless capable of delivering things of value in return to bribe-payers than dealing with a government with tied hands who is committed to following market integrity rules.

For some foreign investors, dysfunctional judicial institutions and procedures may be perceived as potentially rewarding opportunities instead of prohibitive risks. Those firms with capabilities to make private, informal arrangements with host authorities in protecting property rights and securing investment returns may find such markets more attractive than markets safeguarded by rules of impartiality and fair competition. In Linzer and Staton (2015)'s definition of *de facto* judicial independence, a court is considered to be independent if it is both autonomous and powerful. However, powerful investors may see value in a dependent judiciary that either does the bidding of influential actors or whose rulings are often ignored by wrong-doers, because it allows sustainable streams of rents for both the government and investors.

In this sense, weak courts subject to undue influence exerted by litigants provide rent-seeking opportunities for litigating foreign firms that are capable of taking advantage of weak courts to advance their economic interests against other private entities. Research has shown that *domestic* litigants' political connections and local ties provide litigation advantages in dependent domestic courts (Ang and Jia 2014; Wang 2016; Gong 2004). If MNCs expect to receive preferential legal treatments from captured local courts, they may prefer seeking local remedies over resorting to alternative, international adjudicative venues, such as ISDS mechanisms and third-party arbitration, which are perceived as more neutral and have received more scholarly attention (Puig and Shaffer 2018).

In this study, we construct a new dataset on litigation outcomes of multinational corporations in Chinese courts. The results indicate that foreign firms frequently resort to

Chinese domestic courts to resolve disputes and protect their interests in a variety of issues. MNCs are more likely to receive superficial forms of lawsuit victory, such as the court's favorable opinion, fewer court fees, and small amounts of compensations, than to collect substantial monetary compensations. However, when foreign firms form JV partnerships with SOEs, they tend to enjoy significant adjudicative privileges compared with all other types of foreign firms. The empirical analysis further demonstrates that the source of judicial advantages comes from JV SOE's political ties. In terms of overcoming institutional deficiencies and the liability of foreignnes, it is important for MNCs to be locally embedded in the host market. Nonetheless, the more crucial factor is with whom the MNCs are connected.

As a next step, we intend to design better empirical strategies to address the selection issue. An interesting pattern is that foreign firms are more likely to win lawsuits against domestic firms than the other way around. It is still plausible that MNCs only attempt to litigate in Chinese courts when they believe they have a significant chance of winning against Chinese firms. We still need to account for all potential confounders that cause MNCs to select into domestic adjudication. Moreover, in some industries, foreign firms and investors are required to form joint ventures with Chinese partners in order to obtain market access, and many of the partners are state-affiliated firms. When such SOE JVs score substantial lawsuit victories, it is still not clear whether the foreign firms' commercial rights and interests have been sufficiently protected.

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Appendix

A Additional Information about the Dataset

Table A1: MNC lawsuit distribution by province

Province	Count
Anhui	14
Beijing	1,155
Chongqing	11
Fujian	60
Gansu	7
Guangdong	530
Guangxi	7
Guizhou	1
Hainan	8
Hebei	34
Heilongjiang	14
Henan	54
Hubei	143
Hunan	9
Inner Mongolia	19
Jiangsu	124
Jiangxi	17
Jilin	31
Liaoning	73
Shaanxi	54
Shandong	283
Shanghai	455
Shanxi	31
Sichuan	43
Tianjin	120
Xinjiang	2
Yunnan	6
Zhejiang	406

Table A2: MNC lawsuit distribution by court type

Court type	Count
Basic	736
Intermediate	1,062
High	810
Supreme	189
Maritime	540
Intellectual property rights	369
Railway	3

Table A3: MNC lawsuit distribution by ruling procedure

Ruling procedure	Count
First instance	2,266
Second instance	1,018
Retrial, retrial review, and trial supervision	205
Others	217

Table A4: MNC lawsuit distribution by issue

Issue	Count
Intellectual property rights	1,449
Contract	1,205
Administration	781
Infringement	762
Others	544
Civil disputes	283
Labor	181
Special procedures	127
Compensation	117
Property	24
Socialist economic order	5
Bribery	1
Malfeasance	1