

“Going Out” and Going In-House: Chinese Multinationals’ Internal Legal Capacity in the United States

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The “in-house counsel movement” of the past few decades, with its far-reaching implications for the legal profession, the legal service market, and corporate governance, has attracted a great deal of academic attention. Few scholars, however, have examined the global expansion of emerging market companies and their in-house legal capacity. To narrow the gap, this article investigates the in-house legal capacity of Chinese firms in the United States. In doing so, it focuses on two important yet underexplored questions: (1) whether and how institutions in China influence the capacity building; and (2) whether the Chinese investors’ ownership structure makes a difference in that regard. By analyzing a unique set of survey data and 122 interviews with lawyers, in-house counsel, and business executives, this article uncovers evidence of both multi-institutional influence and state-ownership effects. The findings contribute to theoretical and policy debates about the legal profession, the legal service market, and the ramifications of expanding Chinese multinational companies.

INTRODUCTION

The past half-century has witnessed an unprecedented proliferation of corporate legal departments in the United States (Schwarcz 2007; Simmons and Dinnage 2011; Lipson 2012; Wilkins 2012), driven by a variety of factors ranging from rising service cost to a shifting regulatory environment (Simmons and Dinnage 2011, 99–100; Glidden 2013, 134). This “in-house lawyer movement” has broad implications for the legal service market, the legal profession, and corporate governance (Chayes and Chayes 1985; Gilson 1990; Lipson 2012; Wilkins 2012). Seasoned in-house lawyers, for instance, alleviate the information asymmetry between companies and their outside law firms and therefore tilt the balance of power in favor of the former (Chayes and Chayes 1985, 290; Gilson 1990, 902). Moreover, with professional training and discipline, in-house counsel are expected to uphold the ethical principles of their employers

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and “curb corporate opportunism” (Simmons and Dinnage 2011, 79), or, quite the opposite, to accommodate corporate misconduct if they yield to corrupt organizational forces (Rosen 2002, 1169–72; Kim 2005, 997). While the topic has been explored from diverse perspectives (Chayes and Chayes 1985; Roach 1990; Schwarcz 2007; Simmons and Dinnage 2011; Barnes, Cully, and Schwarcz 2012; Lipson 2012), only recently did researchers add an international angle to it by studying the worldwide diffusion of the in-house counsel movement (Kitagawa and Nottage 2007; Liu 2012; Wilkins 2012; Garth 2016; Wilkins and Khanna 2017; de Oliveira and Ramos 2018). This article takes a step further in that direction and investigates an increasingly important albeit underexplored topic—the in-house legal capacity of Chinese multinational companies operating in developed countries.

In the past decade, emerging market companies, especially those headquartered in China, have eroded the dominance of Western firms over the global flow of foreign direct investment (FDI) (Buckley et al. 2008; Luo, Xue, and Han 2010; Cui and Jiang 2012; Peng 2012), raising numerous practical, policy, and theoretical questions. For researchers of the legal profession, questions of particular interest include whether and how emerging market investors cultivate internal legal capacity to handle the complex and unfamiliar institutional environment of developed host countries, whether the in-house legal capacity exhibits any home-state characteristics, and whether state-owned companies figuring prominently in emerging market FDI—especially FDI from China—differ from privately owned firms in this regard. These questions, which should also interest practitioners and policy makers hoping to understand how the multinationals structure their investments in developed host countries, handle legal and compliance risks, and interact with local legal professionals, have not received adequate academic treatment.

This article attempts to narrow the gaps by analyzing the internal legal capacity of Chinese multinationals in the United States. The rest of the article proceeds as follows. The second section reviews the literature on the in-house counsel movement and accentuates its neglect of non-Western multinational companies, leaving a hole in our understanding of the legal service market and the legal profession in the globalization era. The neglected topic also bears on research about the adaptation of multinationals to host country legal and regulatory environment. The third section refines the conventional analytical frame by underscoring the diversity of corporate ownership structures and the multiplicity of institutional influences on Chinese multinationals in the United States. To provide readers with a necessary background, the first subsection of the third section traces the path of economic reforms taken by the Chinese Party-State, depicts the country’s state-business relations and institutional context, and recounts a hybrid in-house legal movement. Next, combining qualitative and quantitative data, the third section’s second subsection surveys the internal legal capacity of Chinese companies in the United States and then assesses the effects of state ownership on the employment of legal managers. The fourth section discusses the article’s contributions and makes several suggestions for future research. Last, the fifth section concludes the article.

LITERATURE ON THE IN-HOUSE COUNSEL MOVEMENT AND AN ANALYTICAL FRAMEWORK FOR THE LEGAL CAPACITY OF EMERGING MARKET MULTINATIONALS

The scholarship on the proliferation of in-house lawyers in the United States and their ascent in the corporate hierarchy has identified several key contributory factors (Schwarcz 2007; Simmons and Dinnage 2011; Lipson 2012; Wilkins 2012). Among them, cost is deemed the most consequential. Concerns with rising legal service price have allegedly incentivized companies to internalize its production (Lipson 2012, 240; Glidden 2013, 134). Undergirding this cost-saving argument is the perennial question of corporate “making versus buying” (Schwarcz 2007, 523). According to Coase, all economic transactions should occur via spot contracts in a perfect market, and firm-organized production arises out of market imperfections (Coase 1937, 42). This encompassing transaction cost theory, however, has been criticized for lacking predictive power—it is almost tautological to say that companies will hire in-house counsel and produce legal services internally whenever doing so costs less than purchasing the same services in the marketplace. In response to the critique, some scholars have sought to refine the theory. Williamson and others, for instance, contend that asset specificity and incomplete contracts engender opportunism that vertical integration may mitigate (Klein, Crawford, and Alchian 1978; Williamson 1979). Focusing on information cost as a type of transaction cost, Alchian and Demsetz consider the organization of the firm as a result of varied shirking opportunities and monitoring needs (Alchian and Demsetz 1972). It is sometimes cheaper to transfer knowledge and information in the form of directions to employees (to make) than instructions to suppliers (to buy) (Demsetz 1988).¹

Besides the firm-centered transaction cost theories, some scholars attribute the US in-house movement to the changing institutional environment. According to this institutional account, the transformation of certain US regulations prompted managers to adjust corporate compliance behavior and expand in-house legal capacity (Daly 1997, 1061). For instance, changes in the Federal Sentencing Guidelines motivated companies to elevate the role of chief compliance officers and to ensure direct lines of reporting, usually to the board of directors, as those implicated in a criminal offense may avoid harsh legal penalties by showing an effective compliance program (Simmons and Dinnage 2011, 101).

Still another theoretical angle of inquiry focuses on the agency of in-house lawyers. Corporate in-house lawyers formed their own organizations and collectively made the case that inside counsel, with superior business knowledge and a long-term horizon, can

1. The “make-or-buy” question does not necessarily lead to a binary answer—intermediate categories of economic relations exist. For instance, firms can “rent” outside lawyers for an extended period of time through a secondment arrangement (Schwarcz 2007, 523). Seen from this encompassing contractual perspective, the “in-house legal counsel movement” is no more than a diversification of the once-uniform contractual model for the production of legal services. Questions only remain as to the drivers of such diversification in the past few decades. By and large, the existing literature does not approach the in-house counsel movement from this theoretical perspective, which frequently evinces concern at the direction of the overall corporate trend in the United States toward in-house counsel. In this vein, for example, Smith argues that the current internalization of legal services is the extreme point in a cycle that fluctuates over time (Smith 2001).

better advise their corporate employers than outside lawyers (Rosen 1988; Nelson and Nielsen 2000; DeMott 2005; Schwarcz 2007).² The rising status of in-house counsel attracted first-rate lawyers to join their ranks, which further substantiated the claim of superior service (Glidden 2013, 135). Meanwhile, the scope of their work expanded. Apart from giving legal advice, in-house counsel typically oversee the hiring of outside lawyers and often participate in managing government relations and making key business decisions (Lipson 2012; Wilkins 2012), thereby rendering their services indispensable to corporate employers.

These three strands of scholarship, centering respectively on transaction cost, regulatory institutions, and agency, have greatly advanced our understanding of the in-house movement in the United States. However, for analyzing the internal legal capacity of multinationals, especially those originating from China, the available theoretical tools require some retuning, as they share the same basic assumption that emphasizes profit-maximizing firms operating in a mature service market relatively free from arbitrary governmental intervention. Arguably, such an assumption only partially holds for Chinese multinational companies (MNCs) and those from most other developing countries. As will be elaborated in the following section, such MNCs typically survive and thrive in a domestic setting where institutions are still undergoing significant and frequent changes, and formal rules often succumb to informal ones. Also, governments in China and some other developing countries tend to play a highly interventionist role in corporate management and business transactions, as exemplified by direct state ownership in many of the largest Chinese MNCs (Cuervo-Cazurra et al. 2014). While state-owned enterprises (SOEs) may pursue commercial interests, profit maximization rarely counts as their primary goal (Bai et al. 2000). Furthermore, the vast majority of developing countries still feature a weak rule of law, loosely organized legal professions, and underdeveloped legal service markets.

Hence, research about Chinese MNCs calls for an analytical approach that assigns more weight to the multiplicity of institutional influences and the diversity of corporate ownership. First, MNCs are subject to the institutional influences of both the host state and the home state. While the internal legal capacity of multinationals has caught only limited scholarly attention (Miyazawa 1986; Daly 1997), a vast literature exists on a related topic—the reactions of foreign persons to host country institutions (Mezias 2002; Yamazaki and Kayes 2007; Salomon and Wu 2012; Meyer et al. 2014). Researchers generally agree that the behaviors of individuals and firms residing in a foreign country are susceptible to the dual influence of their home- and host-state institutions (Miyazawa 1986; Beechler and John 1994; Ferner 1997; Fisman and Miguel 2007; Estrin et al. 2016), which have been further categorized into informal institutions, formal institutions, and organizational governance (Estrin et al. 2016, 296). Culturally grounded informal institutions, highly resistant to rapid changes (North 1990; Williamson 2000, 597), may exert normative and cognitive influence on corporate legal capacity by shaping how people perceive the law and its role in management and business transactions (Holburn and Zelner 2010, 1292–93). As multinationals usually assign expatriates to run their foreign affiliates, the informal institutions of the home states

2. Some scholars counterargue that in-house lawyers tend to be captured by management interests and are less able to play the gatekeeping role (Rosen 2002, 1169–72; Kim 2005, 997).

should continue to mold their decisions in the host countries (Meyer and Thein 2014, 158). Moreover, formal institutions of the home state have extraterritorial impacts. Many rules of MNCs’ home states, that is, the places of their principal business, restrain the foreign affiliates either directly (e.g., those concerning government approval of foreign direct investments) or indirectly (e.g., rules prohibiting money laundering, tax evasion, or foreign corrupt practices) (Cuervo-Cazurra 2008, 635). Furthermore, corporate governance may channel home-state influence to MNCs’ foreign affiliates. The headquarters typically design internal rules to align employee conduct with company goals.³ Such rules, inevitably echoing the MNCs’ home-state contexts, should alter the behavior of all their employees including those in developed host countries. In short, the legal capacity building of MNCs in developed host countries should be a function not only of the host country’s market and regulatory environments, but also of relevant home-state institutions.

Second, the in-house lawyer literature, focusing on profit-maximizing firms, has overlooked the complexity of state-owned MNCs. SOEs play a pivotal role in the expansion of emerging economies, especially China (Girma and Gong 2008; Cui and Jiang 2012; Li, Cui, and Lu 2014; Buckley et al. 2018). Though business entities worldwide may be converging in their forms and organizational structures (Hansmann and Kraakman 2000, 454–55), significant variations remain across firms of different ownership types. For instance, after two decades of systematic reform, most SOEs in China have morphed into hybrid entities taking on the form of private companies and embracing profit seeking as a managerial object. At the same time, however, SOEs are tasked with implementing government policies, safeguarding national security, and enhancing social welfare (Huang, Li, and Lotspeich 2010). This multitasking feature complicates both the SOEs’ organizational governance and their governmental control. On the one hand, SOEs react to market forces rewarding efficient firms, as the government assesses senior executives’ performance based partially on how well they preserve the market value of state assets (Hu and Leung 2012, 259–60). Thus, state-owned multinationals should develop their internal legal capacity just as their local peers in developed host countries. On the other hand, SOEs yield to pressure from non-market institutions that motivate the managers to implement various government policies (Wang 2014, 653–60). The nonmarket institutions may extend their influence abroad and shape the behavior of the foreign affiliates, including their internal legal capacity building.

To summarize, in researching the internal legal capacity of Chinese MNCs, researchers need to modify the existing theories on the in-house movement by assigning more analytical weight to the varying ownership structure of the MNCs and the dual influence of home-state and host-state contexts. The following section, which empirically examines the employment of legal managers by Chinese firms in the United States, will concentrate on these two underexplored aspects.

3. As is the case for most typologies, the three categories of institutional effects are by no means mutually exclusive.

CHINESE MULTINATIONALS IN THE UNITED STATES AND THEIR INTERNAL LEGAL CAPACITY BUILDING

Four decades of meteoric growth catapulted China to its position as the largest emerging economy. With an enormous foreign currency reserve, the Chinese government conceived and implemented a “Going Out” policy aimed at spurring outbound foreign investment. While a large fraction of the subsequent capital outflow targets resource-rich developing countries, Chinese outbound investors increasingly venture into mature and competitive markets (Globerman and Shapiro 2009; Pietrobelli, Rabellotti, and Sanfilippo 2011; Klossek, Linke, and Nippa 2012; Li 2018). Against this backdrop, Chinese direct investment in the United States grew by 32 percent annually from 2010 to 2015, and in 2016 alone the investment doubled to \$46 billion.⁴ Given the enormous institutional gaps between the two countries, Chinese MNCs face daunting challenges in adapting to the intricate legal and regulatory environment of the host country (Zhang 2014; Li 2018). Worse yet, the escalating US-China confrontation, having recently triggered a reversal of China’s FDI trajectory, further heightened the Chinese investors’ legal and compliance risks in the United States. Do they develop internal legal capacity to cope with such risks, and if so, how? Does their employment of in-house counsel reflect any attribute of the home-state institutions? And does the investor’s ownership structure make a difference? These questions, despite their policy and theoretical significance, have thus far escaped systematic research. This section will explore them in two steps. The first subsection, Hybrid In-House Movement in China, briefly recounts China’s nascent in-house counsel movement driven by both top-down state pressure and bottom-up market forces. As noted above in the second section of the article, multinationals are subject to the institutional influence of both host states and home states, so the context for the in-house movement in China should cast a shadow over the internal legal capacity of Chinese investors in the United States. Next, the second subsection of this section, Chinese MNCs in the United States and Their In-House Counsel, draws on quantitative and qualitative evidence to evaluate the institutional effects.

Hybrid In-House Movement in China

Through a series of institutional engineering, the Chinese Party-State constructed a “Socialist market economy” that intermeshes business transactions with comprehensive state intervention. As a part of the reform, the government privatized most small- and medium-sized SOEs and allowed nonstate investors to hold the equity of many large SOEs (Guo 2003, 557). Moreover, to “modernize” SOEs, the central government established the State-Owned Assets Supervision and Administration Commission (SASAC), which serves as both the dominant shareholder and the regulator of the largest state-owned corporate groups in China.⁵

4. *New Neighbors: 2017 Update Chinese Investment in the United States by Congressional District, A Report by the National Committee on US-China Relations and Rhodium Group* (April 2017), http://rhg.com/wp-content/uploads/2017/04/RHG_New-Neighbors_2017-Update_ES.pdf.

5. Some large SOEs, e.g., large state-owned Chinese banks, are not supervised by SASAC (Li 2014).

While preserving a robust state sector, the economic reform also fortified the role of the market in allocating resources and buttressed fundamental market-enabling institutions such as laws safeguarding private property and courts capable of adjudicating complex commercial disputes. Also, to facilitate the economic liberalization, the government set up securities exchanges and the regulating institutions (Hua, Miesing, and Li 2006, 403). Companies seeking to raise capital on the securities market must obtain government approval by meeting numerous organizational and performance standards (Li and Zhou 2015, 77). In the past two decades, hundreds of Chinese companies have undergone drastic reorganizations and asset reallocations and thereby succeeded in trading their securities on domestic and foreign exchanges.

To the surprise of many observers, Chinese state capitalism has thrived (Bremmer 2009; Lin and Milhaupt 2013; Milhaupt and Zheng 2015; Wu 2016). In 2019 China had more Fortune 500 companies than the United States, marking a “historic shift” in global business power, and state-owned enterprises (SOEs) contributed more than 80 percent of Chinese companies on the list (Zheng 2019). In other words, government agencies at the central and regional level continue to assert control over many of China’s largest conglomerates that have become globally competitive (Ralston et al. 2006). Yet, contrary to conventional wisdom, the prominent state sector coexists with a rather dynamic private market. By the end of 2017, 93 million privately owned Chinese businesses employed approximately 340 million people, contributing more than 60 percent of China’s GDP growth and fixed-asset investment.⁶ The country’s domestic stock exchanges now list 3,485 Chinese companies,⁷ while by one estimate SOEs account for roughly 80 percent of the market capitalization (Peng et al. 2016, 298).

The rise of state capitalism foreshadows the hybrid in-house counsel movement in China. Akin to the other components of the massive socioeconomic transformation, the in-house movement comprises both a top-down state-driven process and a bottom-up market-driven process. The former refers to measures taken by government agencies to enhance corporate in-house legal capacity, the latter the economic and regulatory factors motivating firms to develop internal legal capacity. The following two subsections recount these top-down and bottom-up processes respectively.

State-Driven In-House Movement

Despite the systematic market reform, the Chinese Party-State continues to rely heavily on SOEs to implement its policies, raise revenues, and maintain social control (Naughton and Tsai 2015, 9–10). The government realizes its domination over SOEs by, among other things, retaining the power to make major personnel and management decisions for the companies (Leutert 2018, 1–2). Top SOE executives are evaluated periodically by their corresponding supervisory government bodies (Lin and Milhaupt 2013, 738–43). Due to the state control, profit maximization is rarely the

6. “China’s Private Sector Contributes Greatly to Economic Growth: Federation Leader,” *Xinhua News Agency*, March 6, 2018. http://www.xinhuanet.com/english/2018-03/06/c_137020127.htm.

7. Data from World Bank. World Federation of Exchanges Database. Listed Domestic Companies, Total. <https://data.worldbank.org.cn/indicator/cm.mkt.ldom.no>.

primary, or even a prioritized, goal for SOE managers (Bai, Lu, and Tao 2006; Estrin et al. 2016). This multitasking feature of Chinese SOEs complicates their management of risks, including legal risks.

The state control also spawns an acute multi-agency problem (Mi and Wang 2001; Bruton et al. 2015; Peng et al. 2016). While the separation of management and ownership characterizes all modern corporations, the misalignment of interests tends to be more severe in Chinese SOEs, as their managers answer to multiple layers of supervising bodies. The chain of agency relationships extends to the top CCP leadership, and the interest mismatch manifests at all levels. The complex agency problem begets suboptimal responses to corporate legal risks. On the one hand, SOE managers whose interests are imperfectly aligned with those of the shareholders discount losses from the companies' illegal acts and therefore may underinvest in diagnostic and preventive measures such as employing competent in-house counsel. On the other hand, SOE managers may overinvest in mitigating legal risks as cost savings generate no immediate personal benefits, whereas salient breaches of law may reach the public domain and jeopardize their careers. Despite the predictive ambivalence, Chinese SOEs historically underinvested in internal legal capacity (Liu 2012, 565; Wilkins 2012, 286), as their political power shields the directors and managers from legal risks (He and Su 2013; Jia, Mao, and Yuan 2019).

However, once the central government clearly signaled its preference for SOEs to expand in-house legal departments, the managers responded promptly. The top-down campaign was jump-started by a “palace war” between SASAC’s institutional predecessors and the Ministry of Justice to implement two vastly different models of in-house legal departments (Liu 2012, 558). Eventually, SASAC proved a more effective and resourceful executor. Exemplifying a typical policy implementation in an authoritarian state, SASAC designed three-year plans to boost the internal legal capacity of all SOEs under its supervision. In 2004, SASAC promulgated Measures for the Administration of In-House Legal Counsels of State-Owned Enterprises, giving detailed instructions on developing internal legal capacity.⁸ SOEs were urged to employ full-time legal advisors to safeguard state assets. SASAC also attempted to elevate the status of legal counsel within the corporate hierarchy—the 2004 Measures clearly stipulated that chief legal officers be members of the senior executive team.⁹ Additionally, the agency designed metrics to assess progress, and in doing so it repeatedly looked to Western firms for benchmarks (Zhou 2015). The stated goals of the campaign, for instance, include attaining the average ratio of in-house legal staff to total employees at MNCs from advanced economies and ensuring that one-third of the central SOEs would “become world leaders in this regard.”¹⁰

8. Order of the State-Owned Assets Supervision and Administration Committee of the State Council (No. 6), effective June 1, 2004. <http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c4258898/content.html>.

9. *The Measures for the Administration of In-house Legal Counsels of State-Owned Enterprises*, section 16.

10. Guanyu Tuidong Luoshi Zhongyang Qiye Fazhi Gongzuo Wunian Guihua Youguan Shixiang de Tongzhi [Notice re Matters Concerning the Implementation of the Five-Year Legal Reform of the Central SOEs], SASAC Directive # 193 (2014). <http://www.sasac.gov.cn/n2588020/n2588072/n2590860/n2590862/c3718525/content.html>.

The top-down in-house movement gained more momentum after the 18th CCP Congress in late 2013 initiated a concerted push to “build a rule-of-law China” (Dong 2014, 64). To implement this party policy, SASAC announced a five-year plan (following the consecutive three-year plans) to further expand the internal legal capacity of SOEs.¹¹ As a result of these efforts, in-house positions at Chinese SOEs tripled from seven thousand in 2005 to twenty-one thousand in 2016 (Zhou 2015),¹² and all of the 102 central corporate groups under direct SASAC supervision have established the requisite system of chief legal officers.¹³

The remarkable progress on paper and in numbers, however, is veneer for the many remaining problems with the corporate legal departments of Chinese SOEs. As the top-down approach relies on observable and measurable factors, the unmeasurable aspects of legal risk have been neglected. For instance, the competency of the legal staff, crucial to providing high-quality services (Tao 2016, 45), has not improved nearly as much as the size of the in-house legal departments would indicate (Dong 2014; You 2015). Although SASAC permitted open recruitments of chief legal officers, some SOEs either had senior executives retain top in-house legal posts concurrently or assigned unqualified managers to those positions (Zhai 2017). Therefore, it is not unusual for nonlawyers to be chief legal officers of Chinese SOEs (Zhai 2017). Moreover, structural relegation of legal officer roles to low status and poor compensation also contribute to the non-professional staffing of the legal departments (Ma 2013; Zhai 2017).¹⁴ According to one estimate, merely 20 percent of the in-house legal staff at Chinese SOEs have passed the national bar examination (Ma 2015a). Nor has the SASAC campaign substantially boosted the authority of in-house counsel. Although SASAC stipulates that chief legal advisors should be allowed to participate in all major corporate decisions, senior executives often attribute little or no consideration to such involvement, resulting in the tangential role of the legal departments (Chen 2015b; Ma 2015b; Zhang 2016). As noted by a Chinese lawyer who was once the general counsel of a central level SOE, the position is merely for “staging.”¹⁵

Market-Driven In-House Movement

Extensive as it is, the authority of SASAC and its regional counterparts is limited to SOEs and their affiliates. In other words, the top-down in-house movement is constrained mainly to the public sector. By contrast, market forces propel the nascent

11. Xin Hong, Luoshi Quanmian Yifa Zhiguo Zhanlue Litui Fazhi Yangqi Jianshe [Implementing the Rule of Law Strategy and Promoting Legal Development at Central SOEs], *Legal Daily*, Sept. 22, 2017. http://www.legaldaily.com.cn/index/content/2017-09/22/content_7326185.htm?node=20908. The plan sets lofty goals. See Duties and Responsibilities Are Specified by the SASAC in Rules re Duties for Primary Managers of Central SOEs in Implementing the Legal Development Plan, SASAC Party Committee Directive #8 (2017). <http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c7444087/content.html>.

12. SASAC Report on Legal Affairs #10 [Guozhiwei Xitong Fazhi Gongzuo Jianbao Dishiqi] (March 29, 2017). <http://www.sasac.gov.cn/n2588020/n2588072/n2590860/n2590862/c7857000/content.html>.

13. *Ibid.*

14. The staffing of legal departments by nonlawyers is not unusual outside the United States (Daly 1997, 1099).

15. Law firm partner, interview by Ji Li, July 3, 2019.

expansion of legal departments at private Chinese companies. The bottom-up in-house movement had a humble beginning. Much of China's economic growth in the 1980s and 1990s was made possible by entrepreneurs constantly ignoring or disobeying preexisting rules designed to perfect a Soviet-style planned economy (Li, Feng, and Jiang 2006). Widespread grassroots noncompliance created opportunities for reform-minded political elites to nurture a budding market economy (Ang 2016). This reformist mentality, however, ossified into a corporate culture of disrespect for formal rules and rampant noncompliance (Jian 2017; Li 2018). A weak judiciary, plus robust informal institutions, further marginalized the role of Chinese law in private business transactions (Zhang and Li 2017).

It is, therefore, no surprise that in-house legal staff are generally confined to a low status in the corporate hierarchy (Jian 2017, 277), and the majority are not qualified to practice law (Ma 2015b). As observed by a seasoned in-house lawyer, general counsel in China often spend more than half of their time on nonlegal work (Jian 2017). Nonetheless, a market-driven in-house movement has begun to gain speed. Formal law has become relatively more important in commercially developed regions and in transactions between parties of political and economic parity (He 2012; Li 2017b). Hence, some private companies have learned to take rules more seriously (Yan and Ding 2014; Li 2018). For instance, China-based MNCs such as Alibaba employ hundreds of in-house lawyers, and its general counsel occupies a top executive position (Wilkins 2012, 288; Jian 2017, 262). Like their US counterparts, some Chinese in-house lawyers recently began to extend their sphere of influence beyond managing corporate legal risks by participating in policy and lawmaking (Yan and Ding 2014, 89).

In summary, two sets of institutional forces have propelled a nascent in-house counsel movement in China. The top-down pressure from the state led to the rapid expansion of legal departments in Chinese SOEs, and the bottom-up market forces incentivized some large private firms to foster internal legal capacity. As previously discussed, the institutional influence may reach abroad and shape the internal legal capacity building of Chinese multinationals in the United States. First, home-state institutions exert normative and cognitive influence on the managers of Chinese MNCs' foreign affiliates (Holburn and Zelner 2010; Meyer and Thein 2014). The relatively low status of in-house counsel in China and the peripheral role of law in business transactions may affect how the managers running the US operations weigh the importance of internal legal capacity. Second, the set of institutions governing SOEs should have regulative effect on their US investments. The control of the Chinese government over state-owned MNCs does not end at the national border, as the headquarters in China typically retain the power to make major personnel decisions concerning top-level and sometimes even mid-level managers of the US affiliates (Li 2018, 76). In addition, SASAC and its peers have promulgated increasingly complex rules to curb the discretion of SOE managers. Due to the extraterritorial, hierarchical control, the set of institutions governing Chinese SOEs can modify the corporate behavior of their US affiliates, including their internal legal capacity building.

Chinese MNCs in the United States and Their In-House Counsel

To briefly recapitulate, the worldwide expansion of Chinese MNCs raises vital questions that the existing scholarship on in-house lawyers, having concentrated on privately owned companies in mature domestic markets, has neglected. A step forward necessitates widening the inquisitive lens to incorporate the multi-institutional influences over MNCs and their varied ownership structures. From this refined perspective, and combining quantitative and qualitative methods, the rest of the subsection analyzes the employment of full-time in-house legal managers by Chinese MNCs in the United States.

The quantitative analysis relies primarily on a set of comprehensive survey data collected in 2019 through a collaboration with the China General Chamber of Commerce USA (CGCC), by far the largest business association of Chinese companies in the United States.¹⁶ The survey questionnaires were sent to about 600 CGCC members, fielding 247 respondents—a response rate of approximately 41 percent. A comparison between the CGCC members and all Chinese firms registered with the Ministry of Commerce to have made direct US investment indicates an overrepresentation of large companies and SOEs in the CGCC sample,¹⁷ which serves well the purposes of this study.¹⁸

The qualitative evidence comprises information derived from 122 interviews with business executives, in-house counsel, lawyers, and consultants employed by Chinese companies in the United States.¹⁹ The interviews were collected through multisource snowball sampling. Personal acquaintances, that is, friends and former colleagues working for Chinese MNCs in the United States, constitute one core group of the interview

16. Besides Chinese-invested companies, the membership also includes many fee-paying US companies that do not have the right to vote. The US firms are excluded from the survey sampling.

17. The comparison was conducted by a member of a separate research team working on the CGCC survey and used the Ministry of Commerce data for 2014. Some more discussion about possible issues of bias is in order. First, one may suspect survival bias; in other words, one does not observe Chinese companies that have withdrawn from the US market after the realization of certain legal risks for inadequate legal capacity. Chinese companies began to invest substantially in the US market only in the past six years, so nearly all were fast expanding before the onset of the trade war and the growing hostility toward Chinese FDI. A thorough search of public sources has not identified any sizable Chinese corporate members of CGCC that have completely withdrawn from the US market by 2019. Second, a few words on possible nonresponse bias. The CGCC annual survey has been conducted annually, with different sets of questions. Tests run on the 2014 data show no significant evidence of nonresponse bias to the survey questionnaires. Regarding the question-specific nonresponses, tests using the 2019 data show no significant differences between the responding firms and the nonresponding firms in terms of their major firm characteristics such as size and ownership structure. Third, common method bias is another potential methodological issue for survey research. In this article, however, it is of less concern because the variables used herein are simple and specific objective attributes, e.g., the existence and status of in-house legal managers, not any complex subjective outputs of the survey subjects that are prone to generating systematic error variance; also, the questions producing the data for the variables were placed far apart in the survey, with no indication of any implicit theories connecting them (Podsakoff et al. 2003, 883–85).

18. This study focuses on the companies with the potential to hire full-time in-house lawyers, not small Chinese-invested businesses such as takeout restaurants, laundromats, and travel agents, which will account for the majority of Chinese-invested companies in the United States if the selection for the sample is not qualified.

19. The semistructured interviews were conducted over many years for a long-term project exploring Chinese MNCs' adaptation to various US institutions. Some of the interviews only touch on the topic of in-house counsel. That said, they provide important background information for this article.

subjects. They shared valuable insights and introduced me to more interviewees. Another cohort comprises CGCC members, some of whom also tapped into their personal and business networks for possible research subjects. Additionally, some interviews were conducted at various panels, workshops, and conferences on law and foreign investment.²⁰ The multisource snowball method generated a sample of professionals with diverse backgrounds (see Table 3 in Appendix for more details).

The empirical findings are presented in two parts. The first subsection below offers an overview of the internal legal capacity of Chinese MNCs in the United States, which I contend clearly evinces the influence of the home-state institutions. The next subsection statistically tests the intercompany variations of the in-house capacity, with the spotlight on the effects of Chinese investors' ownership structure.

Varying Internal Legal Capacity of Chinese MNCs

The term “internal legal capacity” is broad. This study centers on the key aspect of it—the employment of full-time staff managing corporate legal matters. In assessing this variable, the survey presents the respondents with three choices: (1) having a full-time in-house legal manager licensed to practice US law, (2) having a full-time in-house legal manager *not* licensed to practice US law, or (3) having no full-time in-house legal manager. Had the Chinese MNCs reacted exclusively to the US institutional environment, the data should show that all in-house counsel are legal professionals (Nelson and Nielsen 2000; Wilkins and Khanna 2017, 121). But if, as this article posits, the home-state institutions continue to shape the acts of Chinese MNCs in the United States, one should observe nonlegal professionals employed as full-time legal managers, which remains a common practice in China.²¹

As shown in Figure 1, the majority (56.9 percent) of the Chinese companies surveyed do not retain full-time in-house legal managers. Cost analysis appears to be a major factor. Many Chinese companies, having recently ventured into the competitive US market, have devoted their attention and resources to cultivating a niche clientele, for example, businesses with extensive exposure to China (Li 2018, 38). Without a steady stream of repetitive legal matters, such companies consider the employment of full-time counsel to be wasteful. One respondent, an executive of a large Chinese SOE, dismissed the idea of hiring a full-time internal lawyer as too expensive, regardless of the company's capacity to afford such hiring, and unnecessary, since the firm's current US operations do not give rise to many legal problems.²² Even incremental rise of legal service demand does not necessarily result in the hiring of full-time in-house counsel, as less costly means such as a retainer arrangement are easily available. By paying a fixed retainer fee, typically a fraction of the salary for professional in-house counsel, Chinese investors ensure timely legal service, and such arrangements are usually made with

20. An example of such events is the annual Practising Law Institute program on Doing Business in and with Emerging Markets. See more details at <https://www.pli.edu/programs/doing-business-in-and-with-emerging-markets>.

21. Nonlawyers are sometimes responsible for corporate legal affairs in other countries, such as India and Japan (Miyazawa 1986; Wilkins and Khanna 2017).

22. Executive of the US operations of a Chinese state-owned company, interview by Ji Li, January 17, 2018.

TABLE 1.
Summary Statistics

Variable	Mean	Std. Dev.	Min	Max	Number of Observations
State Ownership (50%)	0.304	0.461	0	1	230
State Ownership (10%)	0.38	0.487	0	1	230
Years in the US	10.27	8.325	1	38	218
Number of Employees	485.645	3240.041	1	40950	231
Listed Company	0.398	0.491	0	1	226
Listed Company (US)	0.066	0.249	0	1	226
Entry Mode	0.214	0.411	0	1	220
Annual Revenue	2.535	1.587	1	5	202
Recent M&A	0.2697	0.445	0	1	178
Sectoral Regulation	50656.02	52294.36	511.455	214953.4	230

Source: 2019 CGCC Annual Membership Survey.

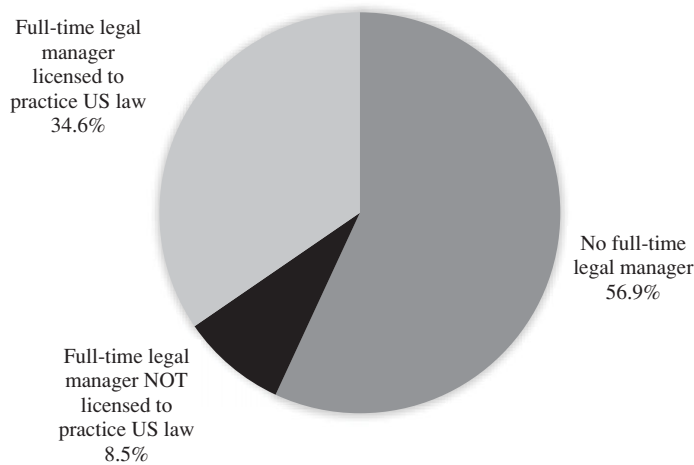


FIGURE 1.
Full-Time Legal Manager at Chinese Companies in the United States.

outside lawyers familiar with their businesses. According to the CEO of a Chinese-invested business, his company keeps a lawyer on retainer because it has only a few lawsuits a year and conducts mostly standardized transactions.²³ Apart from the cost-based calculus, lack of legal risk awareness also explains the absence of in-house counsel at some Chinese firms. An experienced lawyer describes Chinese investors as “headless flies” with “shocking ignorance of US law.”²⁴ Another lawyer echoes the observation, noting, “Chinese managers don’t respect rules, so they find the US market full of

23. Manager of the US business of a Chinese private company, interview by Ji Li, April 7, 2019.

24. Partner at the New York office of a Chinese law firm, interview by Ji Li, July 3, 2019.

landmines.”²⁵ Some investors even manage their US businesses “as if they were Chinese domestic subsidiaries.”²⁶

Meanwhile, 43.1 percent of Chinese companies have employed full-time legal managers in the United States. Again, cost-based calculation plays a key role. According to the interviews, some Chinese executives engage in the conventional “making versus buying” analysis. For the companies with substantial US investments, high demand for repeated legal services justifies the internalization of their production. At the same time, major attributes of the corporate culture, organizational structure, and management style of Chinese companies are foreign to US lawyers who, in order to provide high-quality service, would need to acquire the specific knowledge. This “asset specificity” typically induces mutual dependence, opportunism, and consequently vertical integration (Williamson 1979; Rosen 1988; Schwarcz 2007). US lawyers normally lack a strong incentive to accumulate firm-specific knowledge of Chinese corporate clients, as they generally do not constitute a significant revenue source.²⁷ An in-house counsel of a Chinese company with substantial US investments commented that most US lawyers lack requisite knowledge about Chinese businesses, yet at the same time Chinese managers, new to the US market, are oblivious about potential legal and regulatory issues. His company decided to hire an in-house lawyer after learning that lesson from several costly setbacks.²⁸ Another executive interviewee observed that, in comparison to local peers, Chinese firms tend to encounter more intricate legal issues and therefore are in acute need of tailored legal advice. Hence, the company recruited a former outside lawyer, a Chinese licensed to practice in both China and New York, as its general counsel.²⁹ Additionally, in cases where a US lawyer has acquired firm-specific knowledge, the Chinese corporate client would become highly dependent on the services. During one of the interviews, the in-house lawyer of a Chinese MNC’s New York subsidiary complained about the occasional overbilling of its outside law firm, yet she took no action. “The firm has been working with us for years. We don’t want to offend the senior partner [who overbilled], as it’s hard for us to switch.”³⁰ Such costly reliance further incentivizes Chinese MNCs to internalize the production of US legal services (Gilson 1990, 899).

Significantly, 8.5 percent of Chinese companies have employed full-time legal managers unlicensed to practice US law, evidencing the multi-institutional influence. Had Chinese investors responded solely to the US context, none would have hired a layperson to manage US legal matters. By contrast, nonlawyers often lead corporate legal departments in China. Apparently, the institutions of both the host state and the home state shape the legal capacity building of MNCs (Holburn and Zelner 2010, 1292–93). As noted earlier, home-state institutional influence may materialize

25. Lawyer at an international law firm, interview by Ji Li, November 16, 2018.

26. Comments made by a senior executive of a Chinese investment company, June 23, 2017.

27. The average legal expense by a Chinese MNC in the United States was merely \$356,283 (2019 CGCC Survey), slightly higher than the market pay for a mid-level associate at a top US law firm.

28. In-house counsel of the US subsidiary of a listed Chinese company, interview by Ji Li, May 14, 2017.

29. Senior executive of the US subsidiary of a state-owned Chinese company, interview by Ji Li, June 23, 2017.

30. In-house lawyer at the US subsidiary of a large Chinese company, interview by Ji Li, December 2, 2017.

in multiple ways. First, Chinese MNCs feel regulatory pressure from Beijing. SASAC stimulated a top-down in-house counsel expansion, and the agency’s influence extends beyond the Chinese border. In other words, state-owned Chinese companies may have nonlawyers direct the US legal department simply to satisfy the SASAC requirements. According to the chief legal officer of a Chinese SOE’s US subsidiary, he got the position largely because the headquarters in Beijing trusted him. Though he initially declined the offer, citing lack of any legal training, the management insisted.³¹ When asked why the company had to establish such a position if a “trustworthy” legal professional was unavailable in the United States, he pointed out that the position was “required by SASAC.”³² Second, normative and cognitive pressure may also play a role. Managers in China, treating law as a peripheral matter, often consider professional in-house staff dispensable. Given the mindset, Chinese MNCs in the United States may be reluctant to invest in high-quality in-house legal service. “They took US law seriously only after ‘paying a heavy tuition.’”³³ Third, internal organizational control is relevant. Chinese MNCs may expatriate nonlawyer executives to oversee legal matters in the United States as a natural extension of the parent’s governance structure. Given the strategic significance of the US market, the Chinese headquarters feel a strong need to assign a trusted person to lead the legal department, and that trusted person is more likely to be a Chinese executive not licensed to practice US law. As will be discussed, this is especially true for state-owned Chinese investors that tend to assert tight control over their US operations.

To summarize, the descriptive survey data present a snapshot of the internal legal capacity of Chinese multinationals in the United States, and the interviews offer preliminary explanations about the intercompany variations of this capacity. The following subsection will further examine the variations.

Varying Internal Legal Capacity

To test the legal capacity variation, I create a categorical dependent variable corresponding with the three scenarios in the survey question: (1) a Chinese company does not have a full-time manager of US legal matters; (2) the company has a full-time legal manager, but he or she does not have a license to practice US law; (3) the company has a full-time legal manager and he or she is a qualified US lawyer. Scenario (1) serves as the baseline, and the question to be investigated is why some Chinese MNCs in the US deviate from it by hiring either US lawyers or non-US lawyers to manage their legal matters.

As discussed earlier, scholars have explored the US in-house movement from three theoretical perspectives: transaction cost, regulatory context, and the agency of in-house lawyers. The subsection on Varying Internal Legal Capacity of Chinese MNCs above clearly illustrates that for understanding the internal legal capacity of Chinese multinationals it is crucial to broaden the analytical scope by incorporating

31. Executive of the US subsidiary of a Chinese company, interview by Ji Li, May 24, 2018.

32. *Ibid.*

33. In-house lawyer at the US subsidiary of a large Chinese company, interview by Ji Li, December 2, 2017.

the effects of home-state institutions and state ownership. Through this more inclusive theoretical lens, this subsection conducts further analysis of the legal capacity variations revealed by the survey data.

The analysis will give special attention to the effects of the investors' ownership structure, which characterizes Chinese MNCs and has spawned heated debates. As previously discussed, SASAC retains extensive control over most of the Chinese conglomerates. The agency, in order to boost SOEs' legal capacity, set measurable goals such as reaching certain percentages of full-time in-house counsel. In response, "many central SOEs adopted a top-down model by first creating a whole [in-house legal] frame and then extending it to their subsidiaries" (Lin 2015). Consequently, the size of the in-house legal staff grew rapidly, yet nonlegal professionals have filled many of the positions (Ma 2013; Zhai 2017).

As state-owned Chinese MNCs venture overseas, the top-down pressure to expand in-house legal departments diffuses to their foreign affiliates. Note that, due to the limit of SASAC authority, private Chinese companies are not susceptible to the top-down pressure. Therefore, the ownership character of Chinese investors may influence their employment of full-time legal managers in the United States. To be more concrete, some Chinese headquarters appoint lay people to lead US legal departments partially to satisfy relevant SASAC requirements.³⁴ In the words of an experienced Chinese lawyer, nothing but the governmental pressure led to such "staging" behavior.³⁵ Hence, I hypothesize that Chinese companies with state ownership would be more likely to have full-time staff in charge of legal matters who are *not* licensed to practice US law.

Less straightforward is the tie between a Chinese investor's state ownership and the employment of professional in-house counsel. As noted earlier, managerial risk aversion and agentic discount of cost saving generate conflicting predictions about SOEs' investment in legal capacity. That said, for the same reasons SOEs fill the legal director positions with nonlawyers in China, I adopt the working hypothesis that state-owned Chinese investors are less likely to employ professional legal managers in the United States.

To statistically assess the independent variable of interest—state ownership—a dummy variable is created from the survey data and assigned the value of one if a Chinese government entity owns more than 50 percent of the Chinese investor's equity interest, and zero otherwise. Majority ownership affords the home state clear legal control over the US investments. In some circumstances, however, a state owner may exert substantial influence without being the majority shareholder, for example, significant minority shareholders in companies featuring dispersed ownership (Milhaupt and Zheng 2015). Hence, I also create an alternative state-ownership measure that equals one if a Chinese government body owns more than 10 percent of a Chinese investor, and zero otherwise.

Moreover, the theories extrapolated from the existing literature suggest several other variables as possible explanations for the varied in-house legal manager attributes

34. Executive of the US subsidiary of a Chinese company, interview by Ji Li, May 24, 2018.

35. Law firm partner, interview by Ji Li, July 3, 2019.

(Table 1). As discussed earlier, scholars adopting the transaction cost view would predict that companies with substantial business internalize legal service production as they encounter frequent and repetitive legal issues (Schwarcz 2007, 516; Coates et al. 2011, 240). Moreover, companies running large US operations also have more complex legal and corporate issues that constitute a steep learning curve for outside lawyers (Schwarcz 2007). Bringing lawyers in-house may reduce the education cost usually born by the clients. In other words, asset specificity, another typical attribute of large businesses, engenders potential opportunism in corporation–outside counsel relationships that will be alleviated by internalizing legal service production. In short, economies of scale and complex firm-specific information, both of which characterize sizable US operations, are conducive to the employment of full-time legal staff. In testing this conventional argument, I use two variables to approximate the size of US operations. The first one is US business revenue reported by the responding Chinese companies. The survey subjects chose one of five levels of revenue, with the lowest level being “below one million dollars” and the highest level “above 100 million dollars.”³⁶ The second measure of business size is the number of employees in the United States reported by the surveyed Chinese companies.

I also include additional variables that account for the potential influence of relevant host country institutions. As discussed in the second section, some scholars ascribe the US in-house legal movement to changing regulatory environment (Simmons and Dinnage 2011, 99–105). Companies in heavily regulated sectors tend to have repeated and complex legal and regulatory issues and therefore are more likely to hire full-time in-house counsel to manage those risks. Moreover, in-house legal departments bear “primary, though not exclusive, responsibility for compliance efforts” undertaken by large US corporations (Chayes and Chayes 1985, 287). Hence, it is arguable that companies operating in heavily regulated sectors with onerous compliance burdens be more likely to cultivate internal legal capacity. The same logic may apply to foreign-based MNCs in the United States. For instance, prior research on Japanese MNCs contends that the decision to employ in-house US lawyers hinges on the type of business and the disputes arising therefrom (Miyazawa 1986; Kitagawa and Nottage 2007). In the same vein, sectoral regulation may associate with the internal legal capacity of Chinese companies in the United States. According to the manager of a Chinese firm operating in the financial sector, which is extensively regulated at both the federal and the state level, a third of the firm’s US staff were hired to handle compliance and legal matters.³⁷ That is much higher than the average ratio of legal to total employees at commercial banks in China (Chen 2015a, 60). To account for the possible effect of the host-state institution, I add sectoral regulation to the tests. I collect the data for this variable from the regulation intensity index compiled by McLaughlin and his colleagues. Each of the survey respondents is assigned to an industry designated by a two-digit North American Industry

36. In earlier annual membership surveys, the respondents were asked to report the exact revenue amounts; unfortunately, however, the response rate for the question remained at a very low level. To address the problem, CGCC used a scale question in each of the 2017, 2018, and 2019 surveys, which increased the response rate significantly.

37. Executive of the US branch of a Chinese company, interview by Ji Li, September 1, 2018.

Classification System (NAICS) code, which corresponds to a regulatory intensity index number.³⁸

Another variable that falls under the regulatory environment frame is Chinese MNCs' listing status. As discussed above in the subsection on Hybrid In-House Movement in China, securities markets in China and elsewhere facilitated the reform by "modernizing" and "Westernizing" Chinese companies (Chen, Firth, and Rui 2006; Steinfeld 2010). Many SOEs and private Chinese companies large enough to make US investments have listed their stocks on major exchanges in China and abroad. The listing status may be relevant for several reasons. First, the additional oversight by securities regulators magnifies US legal risks for publicly traded companies. For instance, both the Chinese and the US securities regulations mandate the disclosure of major lawsuits that will have "a material effect" on the share price of a listed company.³⁹ Such disclosure may generate more transaction and compliance costs for public companies. Second, mandatory disclosures of this type—which are intended to inform the market of the potential level of legal risk—have a negative and costly impact on the capital market that can be difficult to control for a public company, and prior research has recorded share price fluctuations following such disclosures (Griffin, Grundfest, and Perino 2004, 25). Although the Chinese capital market is still evolving, it nonetheless responds to the disclosures of major legal and regulatory risks (Yu, Guo, and Kang 2014, 137–38). In short, Chinese companies listed on the stock exchanges, falling under extra market and regulatory oversight, may take legal risks more seriously than other Chinese firms. A question in the survey inquired about the listing status of the responding firm's managing entity. From the data, a dummy is created and assigned the value of one if a Chinese business in the United States is managed by a listed company, zero otherwise. Moreover, one may reasonably argue that listing on a US stock exchange is materially different from having securities traded in other commercial centers such as Shanghai, as the former is subject to more rigorous regulation and enforcement, and US law elevates corporate legal officers' gatekeeping role in public companies (Kim 2005, 997). Accordingly, I create an alternative listing status dummy that equals one if a Chinese investor is listed in the United States, zero otherwise.

Additionally, the mode of Chinese investment in the United States may also have an effect on the intercompany variations of the internal legal capacity. Presumably, if a Chinese MNC expands into the United States by acquiring an established local company, the workforce may be subject to less institutional effect from China (Tan and Mahoney 2006, 475). I use two dummy variables gleaned from the survey data to evaluate this hypothesis. The first dummy equals one if a Chinese MNC entered the US market via a merger or an acquisition or by forming a joint

38. All the respondents report their industries. I checked all their official Web sites or, when such Web sites are not available, third-party reports to ascertain their industries. For those operating in multiple industries, I use the one most heavily regulated. As typical with this type of proxy measures, the index is not perfect. For instance, real estate is a relatively heavily regulated industry. But, because it is normally regulated at the state and local level, the industry appears to be subject to light federal regulation. For more details, see Patrick A. McLaughlin and Oliver Sherouse, *RegData US 3.1 Annual* (dataset). QuantGov, Mercatus Center at George Mason University, Arlington, VA, 2018. <https://quantgov.org/regdata-us/>.

39. Paragraph 1, section 11, Rules re Listing of Shares on the Shenzhen Stock Exchange; Paragraph 1, section 11, Rules re Listing of Shares on the Shanghai Stock Exchange.

venture, zero otherwise. Such an entry mode arguably facilitates localization and adaptation (Ahmed et al. 2002; Cui and Jiang 2009). An executive interviewee noted that her company acquired a US firm located in New York City and kept the entire workforce, including the in-house legal team. The Chinese headquarters only sent one person, the interviewee herself, to oversee the US operations.⁴⁰ As a result, the US affiliate operates just like a local company. For some of the Chinese MNCs, however, entry mode does not fully account for the extent of localization. They may begin by setting up a representative office or a small business in the United States to survey the market and identify potential acquisition targets, and large-scale mergers or acquisitions may not occur until years after their initial entry. Also, a merger or acquisition agreement typically fixes a time limit on the retention of a target company’s management team. Therefore, I create another dummy variable that equals one if a responding firm has engaged in a merger or acquisition in the past two years, zero otherwise.

Furthermore, the tests also include investment duration as a control, as the length of time a Chinese MNC has operated in the United States may be associated with both the investors’ ownership structure and their employment of internal legal counsel. According to a recent study, state-owned Chinese investors are generally more responsive to home-state policies, so their US investments might coincide with the government’s “Going Out” policy (Li 2018, 91). Moreover, recent Chinese investors and their predecessors tend to occupy different sectors. In the few years leading up to 2019, Chinese FDI in the United States spanned a wide range of businesses, whereas earlier the investments were more concentrated in trade. Miyazawa’s study of Japanese companies in the United States suggests that those specializing in trade tend toward employment of non-US lawyers as legal managers (Miyazawa 1986). Adding the variable of investment duration will help to control for potential temporal factors relating to the legal service preference.

Because the dependent variable consists of three nominal categories, I run a series of multinomial logistic regression tests to assess the hypothetical associations articulated above. Table 2 below list the results from various model specifications, with the scenario of “no full-time legal manager” as the baseline. Because the effect of Chinese MNCs’ ownership structure is the key independent variable of interest, the tests all revolve around it. Four of the models use the 50 percent state-ownership dummy, and the other four employ the alternative dummy of 10 percent state ownership.⁴¹

State ownership

The test results confirm the hypothetical link between state ownership of Chinese investors and the employment of non-US lawyers as legal managers in the United States. To be more concrete, when other factors such as the size of US operations, investment duration, and listing status are held constant, state-owned Chinese multinationals are more likely than private Chinese investors to have full-time non-US lawyers to manage their US legal matters. The finding, highly significant and robust across all the model specifications, further confirms the influence of the rules of relevant

40. Executive of the US subsidiary of a Chinese company, interview by Ji Li, June 23, 2017.

41. In addition to the test results presented in Table 2, interested readers may find the cross-tabulation of the state-ownership variables and the legal manager attributes in Table 4 in the Appendix.

TABLE 2.
Regression Results

		1	2	3	4	5	6	7	8
Having full-time in-house legal manager who is licensed to practice US law	State Ownership (50%)	.427 (.434)	.399 (.435)	.432 (.438)	.549 (.446)				
	State Ownership (10%)					.501 (.405)	.467 (.407)	.509 (.412)	.579 (.413)
	Years of US Investment	-.026 (.025)	-.024 (.025)	-.024 (.025)	-.028 (.025)	-.026 (.025)	-.024 (.025)	-.024 (.025)	-.028 (.025)
	US Revenue	.357*** (.128)	.341*** (.129)	.368*** (.135)	.408*** (.135)	.349*** (.128)	.335** (.129)	.361*** (.134)	.396*** (.135)
	Mergers & Acquisitions	.638 (.415)	.615 (.416)	.678 (.429)	.638 (.432)	.659 (.417)	.636 (.418)	.700 (.432)	.661 (.435)
	Entry Mode	-.026 (.453)	-.013 (.453)	.068 (.465)	.014 (.467)	.015 (.458)	.025 (.458)	.110 (.470)	.059 (.472)
	Sectoral Regulation	-1.35e-06 (3.72e-06)	-1.41e-06 (3.74e-06)	-1.33e-06 (3.77e-06)	-1.84e-06 (3.80e-06)	-1.80e-06 (3.75e-06)	-1.83e-06 (3.77e-06)	-1.79e-06 (3.80e-06)	-2.32e-06 (3.83e-06)
	Listing Status		.264 (.375)	.299 (.38)			.250 (.377)	.283 (.382)	
	Listing Status (US)					-1.110 (.857)			
	Number of US Employees			-.00003 (.00009)	-.00004 (.00009)				-.00003 (.00009)
Constant	-1.442*** (.453)	-1.532*** (.475)	-1.684*** (.493)	-1.515*** (.469)	-1.485*** (.459)	-1.569*** (.481)	-1.725*** (.499)	-1.558*** (.476)	
Having full-time in-house legal manager who is NOT licensed to practice US law	State Ownership (50%)	1.852*** (.624)	1.82*** (.626)	1.836*** (.628)	1.891*** (.634)				
	State Ownership (10%)					1.408** (.625)	1.372** (.631)	1.396** (.634)	1.428** (.631)
	Years of US Investment	-.011 (.033)	-.008 (.034)	-.008 (.034)	-.011 (.033)	-.0027 (.033)	-.0005 (.033)	.0006 (.034)	-.0023 (.033)
	US Revenue	.252 (.197)	.242 (.197)	.233 (.204)	.251 (.204)	.231 (.193)	.221 (.194)	.210 (.202)	.226 (.200)
	Mergers & Acquisitions	.556 (.655)	.532 (.656)	.509 (.677)	.541 (.679)	.549 (.645)	.527 (.646)	.500 (.668)	.540 (.670)
	Entry Mode	.500 (.693)	.508 (.694)	.47 (.72)	.467 (.723)	.503 (.683)	.506 (.684)	.475 (.705)	.492 (.709)
	Sectoral Regulation	-3.44e-06 (6.38e-06)	-3.50e-06 (6.39e-06)	-3.32e-06 (6.36e-06)	-3.21e-06 (6.40e-06)	-3.91e-06 (6.18e-06)	-3.91e-06 (6.19e-06)	-3.84e-06 (6.16e-06)	-3.60e-06 (6.21e-06)
	Listing Status		.246 (.581)	.262 (.583)			.221 (.575)	.243 (.576)	
	Listing Status (US)					-.130 (.919)			.128 (.901)
	Number of US Employees			.00003 (.0001)	.00003 (.0001)			.00003 (.0001)	.00003 (.0001)
Constant	-3.123*** (.763)	-3.218*** (.817)	-3.225*** (.825)	-3.136*** (.786)	-3.024*** (.757)	-3.101*** (.797)	-3.110*** (.806)	-3.063*** (.785)	
No full-time in-house legal manager		(base outcome)							
	N	157	157	156	156	157	157	156	156
	Pseudo R ²	0.08	0.08	0.09	0.09	0.07	0.07	0.07	0.08

Notes: *p < 0.1, **p < 0.05, ***p < 0.001.

home-state institutions such as SASAC on state-owned Chinese investors in the United States, channeled through hierarchical corporate control and regulative extra-territoriality. Recently SASAC, in reaction to several high-profile outbound investment failures involving Chinese SOEs, began to emphasize the mitigation of overseas legal and compliance risks.⁴² Consequently, among all the metrics used to assess SOE managers, those relating to corporate legal capacity have been foregrounded. The top-down pressure has translated into more superficial compliance by state-owned Chinese MNCs in the United States.

Meanwhile, state-owned Chinese MNCs are not significantly different from their privately owned counterparts in hiring professional legal managers when the other variables are controlled for. One may interpret the lack of significance as evidence that SOEs respond to market forces, so when business needs justify the internalization of legal service production, Chinese MNCs, regardless of their ownership type, will hire professionals to get the work done. However, given the sample size, anything more than a preliminary inference awaits future research.

Size of US operations

In line with the existing literature, the US revenue of the Chinese MNCs is significantly associated with the employment of US legal professionals as in-house legal managers. To be concrete, with all the other variables such as investment duration and ownership structure held constant, Chinese MNCs with larger US businesses are more likely to employ US lawyers to manage their US legal matters. And the finding is robust across all the model specifications. As is well documented in prior research, companies with substantial operations inevitably encounter a steady flow of repetitive legal matters that are cost-effectively dealt with by in-house lawyers. Also, Chinese MNCs with large operations tend to confront complex and firm-specific legal issues unfamiliar to US lawyers. Meanwhile, US law firms, few of which rely heavily on Chinese clients as a main source of revenue,⁴³ find little incentive to accumulate such client-specific knowledge necessary for high-quality diagnostic and preventive services crucial to managing long-term legal risks (Gilson 1990, 893). Bringing US lawyers in-house will help to mitigate this problem.

Unsurprisingly, size of US operations is not significantly associated with the hiring of non-US lawyers as full-time legal managers. Once the influence of the SASAC rules and other home-state institutions is insulated, the MNC managers' cost-based calculus cannot reasonably lead to the employment of lay people to manage complicated US legal matters.⁴⁴ Again, the interpretation, consistent with the existing literature, can be further buttressed by findings of nonsignificance from testing larger samples.

42. Zhongyang Qiye Jingwai Touzi Jiandu Guanli Banfa [Rules re Management of Overseas Investments by Central SOEs] (Jan 7, 2017), replacing Zhongyang Qiye Jingwai Touzi Jiandu Guanli Zaxing Banfa [Provisional Rules re Management of Overseas Investments by Central SOEs] (2012), at <http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c4258448/content.html>.

43. See note 27.

44. I run tests using an alternative dummy that equals one if a Chinese MNC has a full-time legal manager in the United States (regardless of the professional qualification), zero otherwise. The size of US operation remains significant, suggesting that Chinese MNCs with larger US operations are more likely to establish the full-time legal manager position in the United States.

Merger and acquisition

This variable is weakly associated with the employment of US lawyers as in-house legal managers, and the significance is found in several of the eight model specifications.⁴⁵ As previously discussed, the mode of investment may influence the extent to which Chinese MNCs localize their US operations. Chinese investors that recently engaged in a merger or acquisition tend to be more adaptive to the host country's institutional contexts as they typically retain the management team of the target companies, including the in-house lawyers. Take Lenovo as another example. After the Chinese MNC acquired IBM's PC business, it set up a US headquarters and expatriated only a few senior executives. The US operations have been run like a local business ever since the acquisition (Li 2018, 26). The variable has no significant connection with the hiring of nonprofessional managers. Though inconclusive, this intuitive finding indirectly evinces the effects of the home-state institutions such as the SASAC rules and the underlying extraterritorial state control.

As Table 2 shows, none of the other variables such as listing status and entry mode is significant. However, given the size of the sample in this study, more definitive conclusions of their irrelevance to Chinese MNCs' internal legal capacity await future empirical research.

CONTRIBUTIONS AND SUGGESTIONS FOR FUTURE RESEARCH

This article makes several theoretical and policy contributions. First, it adds to the scholarship on the in-house counsel movement. To date, much of the research has been premised on profit-maximizing firms operating under market forces and an increasingly complex regulatory environment, either domestic or foreign (Schwarcz 2007; Simmons and Dinnage 2011; Barnes, Cully, and Schwarcz 2012; Lipson 2012; Wilkins 2012; Wilkins and Papa 2013; Wilkins and Khanna 2017; de Oliveira and Ramos 2018). By examining the experience of Chinese MNCs in the United States, this article takes the crucial first step in a long-term endeavor to explore the legal capacity of MNCs, especially those from developing countries that are assuming a growing role in the global economic order. The study delineates the mechanisms through which the Chinese government has compelled SOEs to develop internal legal capacity. And the top-down pressure, according to the empirical findings, extends beyond the national border and impacts how SOEs' foreign affiliates cope with local legal risks. In particular, state-owned Chinese MNCs are prone to employing non-US lawyers to manage US legal matters. At the same time, the article finds evidence confirming the extant literature. All else being equal, larger Chinese businesses in the United States are more likely to hire professional in-house legal managers.

Second, the article contributes to the vast literature on international business, which has traditionally focused on MNCs from developed countries. While nascent scholarship explores emerging market MNCs (Rui and Yip 2008; Luo and Rui 2009; Barnard 2010; Knoerich 2010; Luo, Xue, and Han 2010; Sauvant, McAllister, and Maschek 2010; Wang et al. 2012; Wang et al. 2014; Xia et al. 2014), only a very

45. They are weakly significant at close to 10 percent level.

few studies have touched on their capacity to adapt to the sophisticated legal and regulatory systems of developed host countries (Zhang 2014; Li 2018). To narrow the gap, this article investigates a critical component of that adaptive capacity—corporate legal managers—and seeks to draw out the factors shaping its development. The article helps to explain how developing country MNCs attempt to overcome the liability of foreignness, particularly in the legal and regulatory ground, and will assist in understanding their internalization of service production in other areas such as accounting and human resource management (Smith and Zheng 2016; Ouyang et al. 2019). The findings also underscore the tension between the institutional influence of the home state and the pressure the Chinese MNCs endure in the host state. The tension, if not managed properly, has dire practical consequences. Take SANY (a large China-based multinational manufacturing heavy machinery) as an illustrative example. Without professional in-house counsel participating in key management decisions, the company failed to consider the national security implications of a substantial US investment that ultimately led to forced divestiture (Li 2017a, 8). Likewise, the New York branch of Agricultural Bank of China disregarded grave US legal and compliance risks that resulted in a severe penalty of \$215 million (Matthews 2016).

Third, the empirical findings shed light on research about the evolving legal service market. The minority of Chinese firms that employ non-US lawyers as legal managers are unable to rectify the information asymmetry when dealing with outside lawyers. Anecdotal evidence indicates that some Chinese law firms have expanded abroad to fill the gap by serving as “outside general counsel” for Chinese MNCs.⁴⁶ They establish satellite offices in commercial hubs such as New York City and Los Angeles, recruit US lawyers with extensive Chinese backgrounds, and connect their clients with local legal service providers.⁴⁷ Future research on this phenomenon will add to the emerging literature on the globalization of law firms, especially those headquartered in developing countries (Liu 2008; Wilkins and Papa 2013; Li 2019).

Fourth, this article highlights the impacts of globalization on the in-house counsel movement in China (Wilkins and Khanna 2018). In-house legal departments were initially established in late 1970s and early 1980s by Chinese SOEs trading internationally (Zhou 2015). Growing exposure to foreign legal risks led to heavy losses, forcing them to react by enhancing internal legal capacity (Guo 2017; Shaffer and Gao 2018, 163). Moreover, SASAC has been using MNCs based in developed countries as benchmarks for advancing in-house legal departments in Chinese SOEs (You 2015; Zhou 2015). For instance, China Coal Group, one of the largest central SOEs, selected three large MNCs in the coal industry—two US-based, and one headquartered in Switzerland—for an extensive comparative study and found “major gaps” such as “disparities in compliance culture and legal management concept” (Zhou 2014, 140). The study then urged Chinese SOEs to “learn from large European and US companies,” and implored the government to make rules that would strengthen the authority of in-house counsel (Zhou 2014, 144). Furthermore, foreign companies investing in China tend to establish

46. Law firm partner, interview by Ji Li, January 8, 2020. Before the 1980s, some large US corporations also relied on “a single or a few outside law firms to act as general counsel” (Chayes and Chayes 1985, 277).

47. Law firm partner, interview by Ji Li, January 8, 2020.

professional in-house legal departments, offering a role model for domestic Chinese companies to imitate. Future research should explore more systematically this dynamic aspect of the transnational legal ordering (Halliday and Shaffer 2015; Shaffer 2016).

Fifth, the employment by Chinese MNCs of nonlawyers as legal managers in the United States clearly implicates their attorney-client privilege. The application of the privilege rules is complex, and much of it turns on factual analysis. Nonetheless, the key legal conditions are well established, and the most important one for claiming attorney-client privilege by a corporate client over communications with in-house counsel is that “the person to whom the communication is made [must be] a member of the bar of a court.”⁴⁸ Those Chinese MNCs hiring nonlawyer legal managers in the US risk inadvertent forfeiture of the privilege, unnecessary litigation costs, and reputational damage from the disclosure of otherwise privileged materials.

Apparently, the study leaves open some key questions to be investigated in future research. First, what demographic factors help us to define these legal managers? Are they expatriated from China or recruited locally? Second, what are the typical roles of these lawyers? Do they, like their counterparts at US companies, participate in major management decisions? Third, to what extent do Chinese managers defer to in-house counsel? Are they as marginalized as their colleagues in China, or can they veto transactions burdened with substantial legal risk in the United States? Fourth, how do Chinese MNCs in the United States compare with MNCs from other countries and local companies regarding in-house legal capacity? Anecdotal evidence suggests that some Chinese MNCs, due to their “liability of foreignness,” may overcompensate and invest more than their local peers in managing US legal risks.⁴⁹ In regard to these questions, extensive, rigorous empirical research is needed before we can orient a path toward any decisive conclusion.

CONCLUSION

The past few decades have witnessed an expansion of in-house legal departments both in the United States and abroad. The existing literature on the subject, however, has focused on profit-maximizing firms operating in a mature and competitive service market. The global expansion of MNCs from China poses novel and important questions calling for a modified analytical framework that accommodates ownership diversity and institutional multiplicity. Taking a step in that direction, this article empirically examines the internal legal capacity of Chinese MNCs in the United States. It finds that some Chinese MNCs employ non-US lawyers as legal managers. Further analysis reveals that state-owned Chinese MNCs are prone to having nonprofessionals hold the position, and in contrast, Chinese MNCs with large US operations or recent mergers or acquisitions tend to employ US lawyers as legal managers. The findings have several theoretical and policy implications and chart the course for future research about the in-house counsel of MNCs from China and other emerging economies.

48. *Wultz v. Bank of China*, 11 Civ.1266 (SAS), 2013 U.S. Dist. Lexis 154343 (S.D.N.Y. Oct. 24, 2013).

49. Executive of the US subsidiary of a Chinese company, interview by Ji Li, June 23, 2017.

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APPENDIX

TABLE 3.
Background of Interviewees

Managers	In-House Counsel	Lawyers	Consultants	Others
56	15	38	9	4

TABLE 4.
State Ownership and Legal Manager Attributes

		No Full-Time Legal Manager	Full-Time Legal Manager Who Is Not a US Lawyer	Full-Time Legal Manager Who Is a US Lawyer	Total
State Ownership	0	80	6	45	131
Variable (>50%)	1	25	11	20	56
Total		105	17	65	187
State Ownership	0	71	6	39	116
Variable (>10%)	1	34	11	26	71
Total		105	17	65	187