

# *Study on Legal Risk of Multinational Mergers and Acquisitions*

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**Abstract:** Entering the 21st century, the process of global economic integration has been accelerating and developing rapidly. Along with the continuous advancement of the Belt and Road strategy, it has gradually become an important part of the national strategy and an important way for Chinese companies to "go out". In recent years, cross-border M&A s by Chinese companies have developed rapidly, involving a continuous expansion in scope and scale. It has made great contributions to the country's economic growth, the upgrading of its industrial structure, and the optimal allocation of resources. However, there are still asymmetries in policies, culture, law, finance, and information risks. If they are not properly guarded against, it will inevitably seriously affect the successful implementation of the foreign investment strategy of Chinese companies, and even affect the national strategy. Therefore, there is a need to address the risk of M&A is evaluated and analyzed in depth, and corresponding preventive measures are drawn up.

## **1. Introduction**

Transnational M&A s are the general term for cross-border mergers and acquisitions. They refer to the purchase by one country's enterprises (M&A s) of all assets of another country's enterprises (M&A s) or shares sufficient to exercise their operational activities through certain channels and means of payment in order to achieve certain goals. Thus, actual or complete control over the operation and management of an enterprise in another country is exercised. In the face of competitive pressures, the wave of liberalization and the opening up of new areas of investment, an increasing number of transnational corporations have made cross-border M&A s a core area of their participation in global competition in order to protect, consolidate and enhance their international competitiveness. In order to draw up the corresponding risk prevention measures, it is an important and realistic issue that Chinese companies must consider in the successful implementation of cross-border M&A behavior.

With the development of China's opening to the outside world, more and more exchanges with other countries have taken place. In particular, after China joined the World Trade Organization, the number of bilateral and multilateral treaties concluded with other countries has continued to increase. These treaties form an important judicial basis for Chinese foreign direct investment law, and of course have also become the legal source of Chinese companies' cross-border mergers and acquisitions. The Chinese Government should promote and protect OFDI by actively participating

in various bilateral and multilateral initiatives. But at present, there is no special law on regulating and supporting Chinese companies' cross-border M&A. S. Enterprises face great risks when they enter overseas internationalization.

## **2. Formulating Legal Norms on Transnational Mergers and Acquisitions**

### **2.1 Legal norms on cross-border M&A S and overseas investment management**

When Lenovo bought IBM's PC business, CNOOC's unioco and Huawei's 3Com company, the committee on foreign investment looked into laws that would have the power to prohibit foreign acquisitions of U.S. companies that undermine U.S. national security without trial. The best way to solve this unfair situation is to draw lessons from foreign experience, formulate legal norms for overseas investment management as soon as possible, and provide a legal basis for encouraging and protecting cross-border M&A S. Regulate the transnational merger and acquisition behavior of enterprises and the management behavior of government departments. The state should also study and formulate laws and regulations on the promotion and protection of overseas investment, as well as laws and regulations on freedom and opening up overseas, promoting trade processing, and attracting international talents, establish and improve international economic and trade agreements, and gradually form a legal guarantee system in line with international standards.

### **2.2 Risk guarantee mechanism for foreign investment.**

#### **2.2.1 Establishing an overseas investment insurance system.**

The OFDI insurance system has a special function in reducing the risk of OFDI and effectively protecting the security and interests of cross-border investment in capital-exporting countries. Many countries around the world have established such systems to promote and protect their own OFDI and cross-border M&A S. For example, it has enacted a series of laws and regulations such as the Trade Insurance Law, the Special Accounting Law of Trade Insurance, and the Export Credit Insurance Law, which cover all aspects of foreign trade and foreign investment. Through a set of laws, regulations and policies on overseas investment insurance, relevant countries and regions have not only defined the basic strategies for overseas investment according to the needs of their own economic development, but also made overseas investment rule-based and based on laws. And effectively protect the interests of multinational enterprises.

#### **2.2.2 Strengthening the mechanism for safeguarding the risk of cross-border mergers and acquisitions.**

China's cross-border M&A insurance business started late and the investment insurance business lags behind. Before 1998, China did not have a guarantee or insurance business for overseas investment. It mainly solved the risk of foreign investment by signing bilateral investment protection agreements between countries. In 1998, the People's Insurance Company of China established an overseas investment insurance business, but the scope and impact of this business is very limited and can not meet the needs of rapid development of overseas investment. In 2001, the policy-oriented China Export Credit Insurance Company was established. However, after the establishment of the company, the main business of the company was focused on export trade insurance and rarely involved mergers and acquisitions projects. So far, there are no private institutions engaged in this business. To establish an overseas investment insurance system in China, we can make full use of the broad scope of China People's Insurance Corporation's business and the large number of branches, expand the scope and scale of its overseas investment insurance, and

encourage it to carry out cross-border M&A insurance business. Provide more effective insurance services for overseas investment companies. Second, actively expand the scope of CITIC's business, including expanding the scope of insurance coverage for overseas investments and increasing insurance coverage. Third, we need to strengthen cooperation with international organizations and foreign insurance institutions so that enterprises have more choices.

### **2.2.3 Establishing a system of legal advisory services on cross-border mergers and acquisitions.**

On the one hand, we will improve the utilization of existing information systems, provide enterprises with timely information on laws and regulations, and guide enterprises in choosing investment industries and countries and regions. On the other hand, it is also necessary to continuously improve the legal information base service system for government guidance and services to meet the needs of Chinese companies 'increasingly active cross-border M&A S.

## **3. Good Access to Legal Services**

### **3.1 Use external professional institutions.**

Legal risk exists in the whole process of cross-border M&A, and legal services can effectively prevent legal risks that may be encountered in various stages of cross-border M&A. Before mergers and acquisitions, through experienced law firms to understand the local laws and regulations involved in mergers and acquisitions and the more complex legal relationships between them, provide a basis for merger decision-making. In mergers and acquisitions, legal services can provide relevant legal advice on mergers and acquisitions to avoid conflicts with local laws. After the completion of the merger and acquisition, legal services can help companies complete the integration after the merger and avoid disputes such as labor and environmental protection.

The effective means for Chinese enterprises to prevent the legal risk of cross-border M&A is to seek professional support and implement synchronous control. Starting with the intention of cross-border M&A S, Chinese companies need to seek the support of specialized institutions familiar with local laws and regulations to obtain timely and synchronized legal services. It is a general practice in international mergers and acquisitions to entrust intermediary agencies to investigate the objects of mergers and acquisitions and to provide opinions from a professional point of view. Transnational mergers and acquisitions by Chinese companies are no exception. This includes entrusting consulting organizations to carry out merger planning, entrusting accounting firms to conduct financial audits, and entrusting law firms to issue legal opinions. The views of these professional bodies are not only an effective means of preventing risks, but also, in some cases, a necessary procedure for host Governments to approve mergers and acquisitions. For example, in most countries, before mergers and acquisitions of listed companies, mergers and acquisitions parties must submit audit reports of accounting firms and legal opinions of law firms.

### **3.2. Strengthen the internal legal processing mechanism of enterprises.**

1) The internationally accepted internal legal affairs management mechanism of an enterprise is that an enterprise establishes a functional department engaged in internal legal affairs, and is equipped with its own full-time legal personnel to handle enterprise legal affairs in a unified manner. Such as participating in major business decisions, handling non-litigation affairs, and preventing business risks. The full-time legal personnel must have the qualifications of legal advisers of the enterprise, be appointed by the enterprise and be registered by the registration authority, and are the

staff officers and assistants of the leaders of the enterprise in the legal field. There are two advantages to doing this: First, the legal personnel belong to the internal management personnel of the company and are familiar with the business management status of the company. Their own interests and reputation are closely related to the interests and reputation of the company. The second is that the legal personnel can participate in the whole process of business management of the enterprise, reduce the legal risk of the enterprise to a minimum, so as to realize the legal risk as much as possible by pre-prevention, supplemented by subsequent remedies.

2) In the course of cross-border M&A S, Chinese enterprises have strengthened the legal risk prevention of cross-border M&A S, and established and improved the general legal advisory system of enterprises, which is a very effective countermeasure. As the chief designer and coordinator of legal risk prevention of merger and acquisition, the general legal adviser may, together with the relevant departments of the enterprise, determine and assess the specific scope and matters of legal risk of the company; Draft and implement legal risk management documents. Chinese enterprises should improve the status and ability of their internal legal departments accordingly, systematically manage the relevant legal resources of the enterprises, and introduce or train legal personnel familiar with the legal system of the place where the target enterprises are located. In this respect, Chinese companies could learn from the experience of large foreign multinationals that attach great importance to legal resources, such as Chevron, which employs one lawyer in every 13 employees.

3) We will gradually improve the legal level of decision-making and management of cross-border mergers and acquisitions. Enterprises qualified for cross-border M&A investment activities must have the knowledge background of international law and international business management. At present, most Chinese legal professionals lack international business management knowledge, and corporate management managers generally lack systematic legal training. Law is a highly specialized discipline. It is not enough to understand some legal knowledge and read several legal provisions. Only after systematic basic theory learning can it be possible to cultivate legal thinking ability and it is possible to provide professional services to enterprises. The best approach is to train managers involved in cross-border M&A s in the legal aspects of the system.

#### **4. Actively Participate in the Establishment and Improvement of International Investment Legal Norms**

The international investment system is fundamentally multilayered, multifaceted and fragmented, unlike the international trading system and the International Monetary system. At present, more than 5,500 IIAs worldwide form the basis of international investment rules, the purpose of which is to provide a stable, regular and transparent environment for international investment. Despite the absence of a universal system of global investment legal rules, IIAs have continued to develop rapidly, with an estimated average of more than three investment agreements signed per week worldwide. By the end of 2006, the total number of BITs worldwide had reached 2,573. In addressing the interlinkages in the international investment rule-making process, the approach is moving towards integration. On April 30, 1988, China acceded to the "Multilateral Investment Agency Guarantee Convention", the "Seoul Convention." On July 1, 1992, China acceded to the Washington Convention on the Settlement of Investment Disputes between States and Peoples of Other States. Investors can refer investment disputes with the host country to the ICSID arbitration process to address political risks through the Multilateral Investment Guarantee Agency(MIGA). However, So far, the research and utilization of these two mechanisms by Chinese multinational M&A investors have been insufficient. Some investment agreements do not protect the overseas investment of Chinese companies at the time of signing, but only stipulate the obligation to protect foreign investment in China; Some investment protection agreements may result in the application

of the laws of third countries under the laws of the host country because of the absence of provisions on conflict-of-laws norms, and third country laws may not adequately protect Chinese enterprises' investments abroad. As a result, some investment protection agreements signed by China in the past need to be renegotiated and revised. Replacing old agreements with newer, more comprehensive agreements through revision is also a trend in the development of international investment agreements. For example, 109 BITs were revised globally in 2006.

Protectionism in the area of investment has increased in recent years, mainly in the form of increased protection of the energy industry and important sectors of the economy in a number of countries (both developed and developing), stronger regulation of foreign investment and barriers to foreign market access. The rapid growth of Chinese OFDI and the rapid development of Chinese companies' cross-border M&A s have attracted worldwide attention and triggered the "China Threat Theory." Transnational M&A s by Chinese companies should maximize the benefits from the package of investment promotion measures provided by host countries and minimize the effects of protectionism. In that regard, the international investment provisions and standards contained in investment agreements would also help to give the Chinese Government a good role. To move from being a passive participant in globalization to being a promoter of globalization and liberalization, China needs to change its previous thinking model of keeping a low profile or even being passive in the process of setting international economic standards. To further protect and promote its rapidly growing economic interests in investment worldwide. It is in the strategic interest of Chinese companies to actively participate in the formulation of future international investment rules and standards.

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