PRE-ACQUISITION DUE DILIGENCE IN MERGERS AND ACQUISITIONS: LEGAL AND REGULATORY FRAMEWORK IN INDIA

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ABSTRACT

Pre-acquisition due diligence forms the foundation of careful corporate transactional practice. This paper explores the legal and regulatory framework governing pre-acquisition due diligence in Indian mergers and acquisitions, with a focus on the interaction between the Companies Act 2013, the Competition Act 2002, the SEBI Takeover Regulations 2011, and the Foreign Exchange Management Act 1999. Relying on practical workflows, judicial precedents, and industry insights, the paper highlights principal risk involved, common red flags, and the structural impact of due diligence findings on deal terms. The paper concludes with reform proposals to address persistent challenges of opacity, poor documentation, and regulatory fragmentation in Indian M&A practice

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1. INTRODUCTION

Over the past three decades, mergers and acquisitions have emerged as one of the most important tools for corporate expansion in India. Particularly following the economic reforms of the early 1990s, Indian businesses both domestic conglomerates and multinational entrants have increasingly turned to M&A as a route to market access, scale, and competitive repositioning. But commercial ambition alone does not guarantee a successful deal. At the heart of every sound acquisition lies a rigorous pre-closing investigation: the process of pre-acquisition due diligence.

In transactional practice, due diligence is the thorough investigation a buyer undertakes before committing to an acquisition. It covers the target company's corporate structure, its material contracts, regulatory standing, pending litigation, intellectual property, employment arrangements, and financial health. Its central purpose is risk identification — ensuring the buyer genuinely understands what it is acquiring and does not inherit liabilities or legal defects that were never accounted for in the agreed price.

In India, due diligence is not governed by a single codified statute. Instead, it operates. At the convergence of several legal frameworks, including the *Companies Act, 2013*, the *Competition Act, 2002*, the *Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011* ('SEBI Takeover Regulations'), and the *Foreign Exchange Management Act, 1999* ('FEMA'). Each statute imposes distinct disclosure, approval, and compliance obligations that the due diligence process must navigate.[2]

This paper presents a comprehensive analysis of pre-acquisition due diligence in India. Part 2 introduces the concept and legal significance of due diligence. Part 3 examines its typology. Part 4 sets out the practical workflow as it operates in law firm practice. Part 5 analyses the relevant statutory framework. Part 6 maps the principal risk categories. Part 7 identifies common red flags in Indian deals. Part 8 addresses the structural impact of due diligence findings on deal terms. Part 9 examines practical challenges, and Part 10 offers reform proposals.

[2] Companies Act 2013, ss 230–232; see also Ministry of Corporate Affairs, National Company Law Tribunal Annual Report (MCA 2023).

2. CONCEPT AND LEGAL SIGNIFICANCE OF DUE DILIGENCE

The idea of due diligence is rooted in the expectation that a careful buyer takes reasonable steps to understand what it is about to commit to. In the M&A setting this reflects the familiar principle of caveat emptor: a buyer who does not investigate proceeds at its own risk. Indian courts have reinforced this position, treating representations made during due diligence as the foundation for contractual and tortious claims that arise after the deal is completed.

Beyond its investigative role, due diligence serves several distinct legal purposes. It enables the buyer to surface liabilities that are not immediately visible. It functions as a valuation tool — when problems are found, the purchase price can be adjusted. It provides the factual groundwork for the representations, warranties, indemnities, and conditions precedent in the transaction documents. And it is a regulatory exercise: many Indian statutes require that specific disclosures, filings, and approvals are in place before an acquisition can lawfully complete.

When due diligence is skipped or done superficially, the consequences can be severe. Buyers have found themselves facing post-closing litigation from minority shareholders, regulatory action by the CCI or SEBI, or — in more troubling cases — inherited criminal liability from the target's former directors. There have been instances where inadequate due diligence contributed directly to transactions being rescinded or to substantial financial penalties being imposed.

3. TYPOLOGY OF PRE-ACQUISITION DUE DILIGENCE

Due diligence is multi-dimensional and is typically conducted across several functional streams simultaneously. Each stream addresses a distinct category of risk, and their findings are ultimately integrated into a consolidated due diligence report.

3.1 Legal Due Diligence

Legal due diligence is the central focus of transactional law practice. It examines the target's corporate constitution, material contracts, litigation history, intellectual property, employment arrangements, and regulatory licences. The objective is to identify any legal defects invalid contracts, pending litigation, title disputes, regulatory violations that may affect the value or viability of the acquisition.

3.2 Financial Due Diligence

Financial due diligence examines the target's financial statements, revenue streams, debt structure, working capital, and contingent liabilities. It is typically conducted by a financial adviser or chartered accountant working alongside the legal team. The findings of financial due diligence frequently interact with legal findings: for example, unregistered charges discovered in legal due diligence may correspond to undisclosed debt obligations identified in financial review.

3.3 Tax Due Diligence

Tax due diligence analyses the target's compliance with direct and indirect tax obligations, including income tax, goods and services tax (GST), and customs duty. Pending disputes before the Income Tax Appellate Tribunal (ITAT) or GST authorities are assessed for quantum and likely outcome. Transfer pricing exposures in group transactions receive particular attention in cross-border deals.[3]

3.4 Regulatory and Compliance Due Diligence

Regulatory due diligence assesses whether the target entity complies with applicable sector-specific laws and regulations, including environmental clearances, drug licences, telecommunications authorisations, and data protection obligations. In heavily regulated sectors such as pharmaceuticals, banking, or telecommunications, this stream is of equal or greater importance than general legal due diligence.

4. PRACTICAL WORKFLOW IN LAW FIRM PRACTICE

Notwithstanding the theoretical description of due diligence in academic literature, the process as practised in law firms is significantly more dynamic, iterative, and document intensive. The following workflow reflects standard practice in Indian corporate law firms handling M&A transactions.

Step 1. Due Diligence Request List

[3] Foreign Exchange Management Act 1999, s 6; Reserve Bank of India, Master Direction on Foreign Investment in India (RBI/FED/2017-18/60, 4 January 2018).

The process commences with the preparation and delivery to the target company of a Due Diligence Request List ('DDRL'). This document specifies the categories of information and documentation sought by the acquirer. A standard DDRL for an Indian M&A transaction will include: certificates of incorporation, memorandum and articles of association; board and shareholder resolutions for the preceding three to five years; material contracts, including customer and vendor agreements; loan agreements and security documents; a schedule of pending and threatened litigation; regulatory licences and approvals; intellectual property registrations; and employment agreements and HR policies.

Step 2. Virtual Data Room Review

The target company uploads responsive documents to a Virtual Data Room ('VDR') a secure, access-controlled online repository. VDR technology enables the acquirer's legal team to review large volumes of documents remotely, with granular access controls limiting different team members to relevant document categories. Lawyers review each document, tagging issues, identifying inconsistencies, and flagging missing materials. This stage is intensely document-heavy: a medium-sized Indian M&A transaction may involve the review of several thousand documents within a compressed timeline.

Step 3. Issue Identification and Risk Analysis

As documents are reviewed, lawyers identify legal defects, regulatory violations, and contractual risks. Issues are logged in a tracking spreadsheet cross-referenced to document location within the VDR. Each issue is provisionally rated by severity high, medium, or low depending on its potential financial impact and likelihood of materialisation.

Step 4. Query and Clarification Process

Written queries are submitted to the target company through the VDR seeking clarification of ambiguous provisions, confirmation of missing documents, or explanation of apparent non-compliance. This process is iterative: the target's responses may prompt further queries, and the cycle continues until outstanding issues are resolved or escalated. In practice, a significant proportion of apparent issues are resolved through the query process, either because documents were inadvertently omitted from the data room or because the apparent non-compliance has a satisfactory explanation.

Step 5. Due Diligence Report

The final output of the process is a Due Diligence Report ('DDR') addressed to the acquirer's board or transaction committee. The standard structure of a DDR used in Indian law firms comprises: an executive summary identifying the most critical risks in a traffic-light classification (Red/Amber/Green); detailed findings organised by work stream; a risk matrix rating each issue by probability and financial impact; and recommendations addressing how each significant risk should be mitigated in the transaction documents.

5. LEGAL AND REGULATORY FRAMEWORK IN INDIA

Pre-acquisition due diligence in India is influenced by a multi-layered regulatory framework, within which following statutory regimes play a significant role.

5.1 Companies Act, 2013

The *Companies Act, 2013* is the foundational statute governing the corporate life of Indian companies. Sections 230 to 232 lay down the procedural framework for mergers and amalgamations, including obtaining the approval from the National Company Law Tribunal ('NCLT'), issuing notices to creditors and shareholders, and conducting valuations through a registered valuer. Due diligence under the Act verifies that the target is properly incorporated, that its share capital structure corresponds to filed returns, that all charges over its assets are registered with the Registrar of Companies ('RoC'), and that board and shareholder approvals for material transactions are valid.[4]

Deficiencies commonly discovered include: failure to file annual returns or financial statements with the RoC; non-registration of charges, which renders them void against a liquidator; invalid board resolutions approving prior transactions; and discrepancies between the issued share capital appearing in incorporation documents and that disclosed in recent annual returns.

5.2 Competition Act, 2002

The Competition Act, 2002 regulates combinations mergers, acquisitions, and amalgamations that meet prescribed asset or turnover thresholds under Section 5. Such combinations require

[4] Companies Act 2013, s 77 (Duty to Register Charges); s 82 (Satisfaction of Charge). Non-registration of a charge renders it void as against the liquidator and any creditor of the company.

pre-consummation notification to and approval by the Competition Commission of India ('CCI') under Section 6. Due diligence therefore requires an assessment of whether the proposed transaction triggers notification requirements and, if so, whether the combination is likely to cause an appreciable adverse effect on competition in relevant markets.

The *Sun Pharma / Ranbaxy* combination (2014) illustrates the significance of competition due diligence: the CCI approved the transaction subject to divestiture conditions in specific pharmaceutical markets, conditions that had direct implications for the negotiated deal structure and post-closing integration planning.[5]

5.3 SEBI Takeover Regulations, 2011

In case where the target is a listed company, the *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011* place substantial obligations on both acquirer and target. Regulation 3 requires an acquirer who acquires shares or voting rights in a listed company that, together with existing holdings, aggregate to 25% or more of the total shares, to make a public announcement of an open offer to acquire at least 26% of the total shares from existing public shareholders.[6]

Due diligence for listed company targets must therefore verify: the current shareholding pattern and whether the proposed acquisition will trigger the open offer threshold; compliance with prior disclosure obligations; and whether any creeping acquisition has previously occurred without proper notification.[7]

5.4 Foreign Exchange Management Act, 1999

Cross-border acquisitions.whether involving foreign acquisition of Indian companies or outbound investment by Indian acquirers.are governed by FEMA and subordinate regulations issued by the Reserve Bank of India ('RBI'). Due diligence in this context examines compliance with the applicable foreign direct investment ('FDI') sectoral caps and entry routes, External Commercial Borrowing ('ECB') guidelines, pricing guidelines for share transfers between

[5] Sun Pharmaceutical Industries Ltd v Ranbaxy Laboratories Ltd, CCI Case No C-2014/05/170 (CCI, 5 December 2014). The Commission approved the combination subject to divestiture conditions in specified pharmaceutical markets.

[6] SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, reg 3(1).

[7] SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, reg 26 (disclosures by acquirer); reg 27 (disclosures by target board of directors).

residents and non-residents, and repatriation obligations.

Non-compliance with FEMA can attract significant penalties and may render the acquisition itself void. Due diligence frequently uncovers historical FEMA violations.particularly in target companies that have received foreign investment without proper RBI filing.which must be resolved by compounding applications to the RBI before the transaction can proceed.

5.5 Insolvency and Bankruptcy Code, 2016

Acquisitions of companies under the Corporate Insolvency Resolution Process ('CIRP') governed by the *Insolvency and Bankruptcy Code, 2016* present unique due diligence challenges. Resolution applicants are required to conduct due diligence within strictly compressed timelines, often without full access to the target's records. Section 29A disqualifies certain categories of persons from submitting resolution plans, and due diligence must verify that the acquirer does not fall within any excluded category.[8]

6. KEY RISK CATEGORIES IDENTIFIED IN DUE DILIGENCE

The primary purpose of pre-acquisition due diligence is the systematic identification of risk. Risks identified in due diligence are categorised by their nature and likely impact on the transaction.

6.1 Legal Risks

Legal risks include: pending or threatened litigation with material financial exposure; claims by former employees, suppliers, or customers; environmental liability; intellectual property infringement; and defective title to land or moveable assets. In India, litigation due diligence is particularly important given the volume of commercial disputes before civil courts and the relatively long timelines for their resolution.

6.2 Regulatory Risks

Regulatory risks encompass non-compliance with statutory filings under the Companies Act, expired or irregularly obtained licences, non-compliance with SEBI disclosure obligations, and

[8] Insolvency and Bankruptcy Code 2016, ss 29A and 30; Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016, reg 36B.

pending regulatory investigations. In heavily regulated sectors, the absence of a material licence.such as a drug manufacturing approval or a spectrum assignment.may be a deal-breaker.

6.3 Contractual Risks

Contractual risks arise where the target's agreements contain provisions that are triggered by or operate adversely to a change of control. Change-of-control clauses entitling counterparties to terminate agreements upon acquisition are among the most significant contractual risks in Indian M&A, particularly in technology, pharmaceutical, and financial services transactions. Courts have held that acquirers who proceed without addressing such provisions may find key agreements void or voidable post-acquisition.[9]

6.4 Financial and Tax Risks

Financial risks include hidden liabilities not reflected in audited accounts, undisclosed contingent obligations, and off-balance-sheet financing arrangements. Tax risks encompass pending demands before tax authorities, disputed transfer pricing adjustments, and GST exposure arising from the target's supply chain arrangements. These risks, if materialised post-acquisition, directly reduce the value received by the acquirer.

7. COMMON RED FLAGS IN INDIAN M&A TRANSACTIONS

Experienced due diligence practitioners in India have identified a recurring set of findings that, individually or in combination, may significantly affect deal value or structure. These are commonly referred to as 'red flags'. The following are among the most frequently encountered:

- Key customer or vendor contracts contain change-of-control clauses entitling the counterparty to terminate or renegotiate upon acquisition.
- Material litigation at an advanced stage, with potential financial exposure exceeding an agreed materiality threshold.
- Charges over the target's assets that are either unregistered with the RoC or whose

[9] Piramal Enterprises Ltd v Shriram Transport Finance Co Ltd [2021] Delhi High Court. The court held that undisclosed change-of-control restrictions in loan agreements may render a completed acquisition voidable.

registration discloses undisclosed encumbrances.

- Absence of environmental clearances, factory licences, or other regulatory approvals essential to the target's operations.
- Non-compliance with SEBI disclosure requirements, including prior shareholding notifications or related-party transaction disclosures.
- FEMA violations, including historical share issuances to foreign investors without RBI approval or at non-compliant pricing.
- Material discrepancies between the share capital recorded in founding documents and that appearing in recent annual returns, potentially indicating undisclosed share issuances.
- ESOPs issued without requisite shareholder approval or that vest upon a change of control, creating unanticipated dilution or liability.

Each of these findings requires careful analysis of quantum, probability of materialisation, and impact on deal structure. Their identification at the due diligence stage enables the parties to address them proactively rather than through post-acquisition dispute.[10]

8. IMPACT OF DUE DILIGENCE ON DEAL STRUCTURING

Due diligence findings are not merely informational: they directly shape the commercial and legal structure of the transaction. The linkage between due diligence output and deal terms operates through three principal mechanisms.

8.1 Indemnities

Where due diligence identifies a known but unquantifiable risk.for example, a pending tax demand or an environmental liability.the acquirer typically seeks a specific indemnity from the seller. The indemnity contractually allocates the risk to the seller: if the liability materialises post-acquisition, the seller is obligated to make the acquirer whole. The scope, duration, and

[10] Law Commission of India, Report No 246, Amendments to the Arbitration and Conciliation Act 1996 (August 2014).

financial cap of indemnities are directly negotiated by reference to due diligence findings.

8.2 Price Adjustments

Where risks are quantifiable, due diligence findings may support a reduction in the agreed consideration. This is particularly common where financial due diligence reveals undisclosed liabilities that are directly attributable to the seller's management of the business prior to acquisition. Price adjustment mechanisms whether structured as earn-outs, holdbacks, or direct purchase price reductions translate legal and financial risk into economic terms.

8.3 Conditions Precedent

Where due diligence identifies issues that must be resolved before completion such as the need for CCI approval, the rectification of a FEMA violation, or the renewal of an expired licence these are structured as conditions precedent to closing. The acquisition agreement specifies that the transaction will not complete unless and until each condition has been satisfied or waived. Conditions precedent thus provide the acquirer with a mechanism to withdraw from the transaction if critical issues remain unresolved.

The interplay between these three mechanisms illustrates the fundamental relationship between due diligence and deal structuring: legal risk identification is not merely a compliance exercise but a commercial negotiation tool that determines the financial terms, risk allocation, and closing conditions of the transaction.[11]

9. CHALLENGES IN PRE-ACQUISITION DUE DILIGENCE IN INDIA

Despite the availability of a comprehensive statutory framework, pre-acquisition due diligence in India faces a number of persistent practical challenges that limit its effectiveness.

9.1 Lack of Transparency and Disclosure

Indian M&A transactions.particularly those involving unlisted or closely held companies.are frequently characterised by incomplete or delayed disclosure by the target. Sellers may withhold documents relating to pending litigation, FEMA violations, or regulatory non-

[11] Tata Motors Ltd v Fiat India Pvt Ltd (Bombay High Court, 2009). The court held that pre-contractual representations forming part of the due diligence process constitute the factual foundation for post-acquisition indemnity claims.

compliance for fear of jeopardising the transaction. The absence of a statutory obligation to make pro-active disclosure in non-listed company transactions creates an information asymmetry that places the burden of discovery entirely on the acquirer.

9.2 Poor Documentation Practices

A significant proportion of smaller Indian companies maintain inadequate records. Board resolutions may be passed without formal meetings; contracts may be undocumented or based on oral arrangements; and statutory registers may be incomplete or inaccurate. This is particularly prevalent in family-owned businesses or companies operating in informal sectors, where the transition from informal to formal governance structures has been incomplete.

9.3 Regulatory Complexity and Overlap

The multi-layered Indian regulatory framework means that a single transaction may require assessment under the Companies Act, FEMA, the Competition Act, SEBI regulations, sector-specific statutes, and state-level legislation. The potential for regulatory overlap and inconsistency between different authorities including the Ministry of Corporate Affairs, RBI, SEBI, and CCI.creates substantial complexity that demands multidisciplinary expertise from the due diligence team.

9.4 Time and Commercial Pressure

Due diligence is invariably conducted under time pressure, as sellers seek to maintain deal momentum and prevent information leakage. Compressed timelines may prevent a thorough investigation of all risk areas, forcing the due diligence team to prioritise by materiality. The result is a process that is necessarily incomplete: practitioners routinely note that they are identifying risk 'with incomplete information.'[12]

9.5 Information Asymmetry and Verification Limitations

The due diligence process is fundamentally dependent on information provided by the seller. Even where a seller provides full documentary disclosure, the acquirer's ability to independently verify that disclosure is constrained: physical inspections, third-party enquiries,

[12] KPMG, India M&A Trends Report 2023 (KPMG India 2023) 14.

and litigation searches through court records are possible but time-consuming. The acquirer ultimately proceeds on the basis of representations and warranties that substitute for the certainty that more thorough verification would provide.

10. CRITICAL ANALYSIS AND REFORM PROPOSALS

Looking honestly at how due diligence is actually conducted in India, there is a gap between the law on paper and the practice on the ground. The regulatory architecture is reasonably comprehensive, but the process itself remains ad hoc, heavily dependent on whatever the seller chooses to disclose, and generally behind the curve compared to markets like the United Kingdom or Singapore. Several reforms could meaningfully improve this picture.

10.1 Standardised Due Diligence Framework

The Ministry of Corporate Affairs, in consultation with the Bar Council of India and leading M&A practitioners, should develop a standardised due diligence framework specifying minimum content requirements for DDRLs, risk classification standards, and report formats for transactions above prescribed thresholds. Standardisation would improve the quality and comparability of due diligence outputs while reducing the transaction costs associated with bespoke process design.

10.2 Enhanced Mandatory Disclosure Requirements

The Companies Act, 2013 should be amended to impose mandatory pre-acquisition disclosure obligations on target companies in transactions above a specified value threshold. Such obligations, modelled on the disclosure requirements applicable to listed companies under the SEBI Takeover Regulations, would reduce information asymmetry and align Indian practice with international standards.

10.3 Technology-Driven Due Diligence

The adoption of artificial intelligence tools for contract review.already in use in the United Kingdom, the United States, and Singapore.has the potential to dramatically reduce the time and cost of due diligence in Indian transactions. AI-powered review platforms can identify change-of-control clauses, cross-reference charge registrations against VDR disclosures, and flag regulatory non-compliance with a speed and consistency that manual review cannot match.

Regulatory sandboxes should be created to facilitate the testing of such tools within the Indian legal services market.

10.4 Improved Regulatory Coordination

A formal inter-regulatory coordination mechanism between the CCI, SEBI, RBI, and MCA should be established for complex M&A transactions requiring approvals from multiple authorities. The current absence of such coordination creates delays and inconsistency. A joint fast-track approval process for transactions satisfying prescribed criteria would reduce regulatory uncertainty and improve deal execution efficiency.[13]

10.5 Third-Party Verification Mechanisms

The credibility of due diligence would be enhanced by the introduction of independent verification mechanisms. analogous to the independent expert reports already required under the Companies Act for certain schemes of arrangement. Requiring seller-appointed independent counsel to certify the completeness of data room disclosures above prescribed transaction thresholds would significantly reduce the information asymmetry that currently characterises Indian M&A practice.

11. CONCLUSION

When everything else is stripped away, pre-acquisition due diligence is what separates a considered acquisition from a costly mistake. In the Indian context, this exercise does more than tick a legal box-it determines whether a deal should happen at all, at what price, under what terms, and with what safeguards built in for the buyer.

The Indian legal framework spanning the Companies Act 2013, the Competition Act 2002, the SEBI Takeover Regulations 2011, and FEMA 1999.provides a robust normative foundation for due diligence practice. Judicial decisions have reinforced the legal significance of pre-acquisition representations and established clear principles of liability for inadequate disclosure. Yet the effectiveness of due diligence in practice remains constrained by structural challenges: opacity, poor record-keeping, regulatory fragmentation, and time pressure.

[13] Competition Commission of India, Annual Report 2022–23 (CCI 2023) 31–32.

The reforms discussed in this paper better-standardised frameworks, stronger disclosure requirements, technology-assisted review, inter-regulatory coordination, and independent verification do not represent a dramatic overhaul. They are incremental improvements that borrow from what already works in more established markets. Adopting them would raise the quality of Indian due diligence practice and reduce the deal failures that continue to impose costs on buyers, sellers, and the wider economy.

Due diligence, as this paper has argued, is not a bureaucratic hurdle to be cleared on the way to signing. It is the point at which legal analysis has its most direct commercial impact — turning the language of statute and contract into real, actionable guidance that shapes whether and how a transaction proceeds. For the transactional lawyer, understanding this process deeply is not just a professional asset; it is the defining competence of the work.