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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provide dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

# **THE ROLE OF COMPLIANCE AND DUE DILIGENCE IN CORPORATE DEALS: A LEGAL AND STRATEGIC ANALYSIS WITH INDIAN AND GLOBAL PERSPECTIVES**

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## **Abstract**

The paper evaluates the pivotal role of compliance and due diligence in corporate governance, with a specific highlight on Indian legislations in comparison to global best practices. It underlines how due diligence encompasses a wide scope to include legal, tax, environmental, labor, governance, and data protection considerations along with financial risk assessment.

The key Indian statutory frameworks such as the Companies Act, 2013, SEBI regulations, the Competition Act, 2002, FEMA, IBC, and taxation laws ensure transparency, accountability, and risk management underscoring corporate compliance. Parallely, the UNSPs, OECD due diligence guidance, the FCPA, UK Bribery Act, SOX, GDPR, and BEPS on the global level demonstrate the expanding scope of compliance obligations in cross-border transactions. The research establishes that due diligence promotes sustainable corporate governance that is no longer limited to transactional checks but it operates as a structural safeguard. It concludes that Indian law mirrors and aligns with international standards, ensuring that corporate transactions are both legally and strategically viable in a globalized economy.

**Keywords:** Compliance, Due Diligence, Corporate Governance, Mergers and Acquisitions, Risk Mitigation, SEBI, FEMA, IBC, OECD, UNGPs, Corporate Law

## **Introduction**

In the prevailing state of the corporate sector, which is driven by digitization, globalization and strict regulations, compliance and due diligence play an integral role in adopting sustainable

business practices. The importance of compliance due diligence is on a rise with the rise in cross-border transactions. Due diligence may be defined as the level of judgement, care, prudence, determination and activity that a person would reasonably be expected to practice under particular circumstances, whereas, compliance may be defined as adherence to laws, regulations, standards and ethical practices relevant to a particular industry or sector. Due diligence is the process of evaluation of a prospective business decision by obtaining and reviewing legal and commercial state of target.

A company has several fiduciary obligations towards its external stakeholders and investors, so it cannot simply splurge all its funds without any probable cause. It needs to acquire due diligence in order to be able to justify its extensive transactions. On a basic level, one can position due diligence as an indispensable process when an information-disclosing party wants to convince an information-receiving party to make an investment, become a partner, license a patent, buy a product, etc.<sup>1</sup>

Sectors that are highly regulated or deal with sensitive transactions such as banking, finance and insurance rely heavily on compliance to meet regulatory norms like anti-money laundering (AML), and know-your-customer (KYC) standards. Similarly, even mergers, acquisitions and contract negotiations require law firms and corporate advisory businesses to conduct routine legal due diligence. In various other sectors like pharmaceutical and healthcare, technology and IT companies, manufacturing, infrastructure and real-estate businesses, compliance and due diligence play a pivotal role in avoiding legal obligations and negative impact on their reputation.

This paper aims to explore the legal, strategic and procedural facets of compliance and due diligence within the context of Indian statutory frameworks while integrating global best practices. Through an analysis of applicable laws, regulatory requirements, and real-world case studies, the research outlines the necessity of thorough due diligence and compliance protocols to mitigate risks, enhance transparency, and ensure the long-term sustainability of business ventures.

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<sup>1</sup> S. De Cleyn & J. Braet, “The Due Diligence Process—Guiding Principles for Early Stage Innovative Products and Venture Capital Investments” (2007) 10(3) Journal of Private Equity 43.

## Due Diligence Taxonomy

At the core of any Mergers & Acquisition (M&A) is corporate due diligence. Before an organisation decides to join hands with or take over any target company, it becomes indispensable to thoroughly look into all aspects of the target's conduct in order to be able to weigh the merits and the demerits of the potential deal. When we talk about various aspects of the target that need to be examined, it involves applying different types of due diligence in accordance with the type of dealing the buyer is interested in. To name the most prominent and essential types of due diligence that different M&A's practice, it can be classified into the following categories:

### 1. Financial Due Diligence (FDD)

Financial due diligence is a systematic way of examining the financial reports, health, and underlying financial liabilities of the target company. It is typically conducted before a major transaction, such as merger and acquisitions to verify the accuracy of financial information provided by the target company and identify any inconsistency or red-flag that could affect the business deal.

Financial due diligence (FDD) research involves evaluating the revenue trends, customer concentration, assessing the liquidity or operational efficiency of the target, checking if the company has fulfilled tax obligations and identifies any tax exposures and clarifying the company's actual indebtedness and ability to generate free cash flow. It evaluates the reliability of financial projections and the assumptions behind them and also uncovers contingent liabilities, such as lawsuits, penalties, or off-balance sheet risks. Ultimately, its goal is to enable the internal management of the buyer company to make an informed decision especially when it involves extensive requirements of funds.

The transactions that this due diligence process is appropriate for include major loans, leveraged buy-outs, recapitalization as well as other transactions. The process can be used by the analyst to determine, for example, whether the company is currently in sufficiently good financial condition to sustain the pressures of the additional debt.<sup>2</sup>

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<sup>2</sup> P.A. Gaughan, "A Due Diligence Process for Highly Leveraged Transactions" (1993) 6(3) Journal of Forensic Economics 197.

## 2. Legal Due Diligence

Legal due diligence involves a comprehensive investigation or review of the legal, regulatory and compliance status of an individual, business, or transaction. It is generally conducted before finalising any major business deal or transaction such as mergers, acquisitions, investments and partnerships. It ensures that all the legal and regulatory compliances are adhered to in order to avoid any potential legal risks or liabilities that may impact the success of such transactions.

Legal due diligence involves the scrutiny of corporate documents, contracts, employee and labour matters, intellectual property (IP), tax obligations, litigations, and regulatory compliance enabling the company to ascertain the legal position of one another. Doing so not only helps the companies avoid any future hindrances, but also to re-value the transaction in accordance to their legal obligations and liabilities providing a true and fair deal for both the parties.

The scope of due diligence can vary significantly between common law and civil law jurisdictions. In common law countries, comprehensive due diligence is expected before closing the acquisition, while in some civil law countries, it may be viewed as intrusive or a sign of mistrust. The timing of the due diligence review can also lead to cultural clashes.<sup>3</sup> In summary, legal due diligence is a vital step in the M&A process that requires careful planning and consideration of cultural differences, team composition, and the balance between legal opinions and thorough investigation.

The importance of legal due diligence can be considered three-folded - It helps ensure that investors take an informed decision before they step into heavy transactions, it ensures avoidance of any future unforeseen legal obligations and it helps renegotiate the terms of the contract in accordance with the legal position. Properly drafted representations, warranties, and covenants are crucial in these transactions. They help establish a common understanding between the parties regarding the due diligence conducted and the expectations for future activities following the agreement.<sup>4</sup>

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<sup>3</sup> W. Chu, "Cross-Border M&A: Avoiding Surprises through Due Diligence" (1997) 6(3) Business Law Today 8.

<sup>4</sup> A.S. Gutterman, "A Legal Due Diligence Framework for Inbound Transfers of Foreign Technology Rights" (1990) 24(4) International Lawyer 976.

### **3. Tax Due Diligence**

Tax due diligence, also known as fiscal due diligence is the process that involves reviewing a company's tax affairs to identify and analyse any tax liabilities and risks, to analyse the compliance with applicable tax laws and to assess their timely returns. It involves the thorough examination of tax audits and tax returns.

Tax due diligence also helps spot opportunities for savings by evaluating how tax-efficient the structure of the company is. It ensures that the income of the target company is being duly reported and the taxes are being timely paid. This assurance provides the investors and buyers with peace of mind by avoiding any future legal obligations arising out of tax failures. Many nonprofits benefit from exemptions on property taxes, which can lead to significant savings. The exemption is not automatically granted and must be confirmed as part of the due diligence process.<sup>5</sup>

### **4. ESG Due Diligence**

The abbreviation, ESG stands for Environmental, Social and Governance. ESG due diligence involves a comprehensive study of the environmental, social and governance practices of a company before making a decision to invest, partner and acquire. This goes beyond financial due diligence and provides information regarding the target's sustainability, ethical and governance practices in order to aid informed investment decision-making. Environmental factors including review of impact of the company's operations on its biodiversity, waste management, carbon and green-house gas emissions, etc. Social factors include how well they treat the people of the company and how much they take into consideration the people around them. Lastly, governance factors deal with how the company is run by the stakeholders including shareholder' rights, board composition, anti corruption and prevention laws, etc.

### **5. Cybersecurity and Data Privacy Due Diligence**

Cybersecurity and data privacy due diligence involves assessing how well the company protects its digital assets and manages personal information and ensures compliance with data protection laws. It deals with examining the IT infrastructure, policies,

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<sup>5</sup> W.L. Boyd, "Mergers, Acquisitions, and Affiliations Involving Nonprofits: Not Typical M&A Transactions" (2014) Business Law Today 1.

incidents in the past, and outsider risks to uncover vulnerabilities, regulatory non-compliance, or hidden liabilities that could pose a risk to the company's legal standing, reputation or financial stability. This due diligence protects the investors, partners or acquirers from potential cybersecurity breaches and privacy violations.

## **6. Operational Due diligence**

Operational due diligence is the process of evaluating the core business operations involving the day-to-day activities. It goes beyond financial numbers and looks at how effectively and efficiently the company manages its functions like supply chain management, manufacturing processes, human resources, compliance and the overall organisational structure. This due diligence is practiced to examine the strengths and weaknesses in the operations of the business to estimate the performance efficiency, profitability, and long-term sustainability. The information ascertained helps buyers, partners and investors look beyond numbers and take informed decisions.

### **Behind the Deal: The Power of Compliance and Due Diligence**

Before a company enters into any corporate deal involving investment, acquisition or partnership, it is indispensable to understand the significance of practicing compliance and due diligence to avoid industrial uncertainties to a large extent. To elaborate, here are some listed importance -

#### **1. Risk Identification and Mitigation**

Through practicing the previously stated types of due diligence and compliance checks, a company that is to carry out heavy investments uncovers any financial, tax, legal or operational risks and any lackings in adherence to relevant laws like environmental laws, labour laws, tax laws etc., by the target company. It helps the company avoid any unbeneficial acquisition or partnership, restructure contracts in accordance with the information thus uncovered, and counter any future corporate or legal obligations.

Managers of acquiring firms receive negative information from the process of due diligence, and any missed signal during the process may lead to overpayment or hidden losses.<sup>6</sup>

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<sup>6</sup> P. Puranam, B.C. Powell & H. Singh, "Due Diligence Failure as a Signal Detection Problem" (2006) 4(4)

## **2. Regulatory Adherence**

Many jurisdictions often require deals to comply with various regulatory bodies and laws around antitrust or competition, securities, environmental laws, labor laws, etc. Non-compliance may either lead to derailment of the contract or reputational damage along with penalties. Practicing due diligence helps smooth transfer without any legal hurdles while ensuring the target has obeyed with all relevant legal obligations.

## **3. Financial Verification**

Due diligence helps a company verify the valuation of the financial statements of the target company. It provides a fair view of the assets, liabilities and revenues of the company and prevents overvaluation of the target thus, helping the acquirers avoid overpayment or negotiation under wrong circumstances. It helps in confirming that there are no hidden issues or "black holes" in the financial records that could affect the transaction.<sup>7</sup>

## **4. Deal Structuring**

Insights gained through the rigorous process of due diligence guide how deals should be structured, i.e., whether it should be an asset purchase or a share purchase. The representations, warranties and indemnities in a contract can also be negotiated based on these insights helping a company to either shift or share the potential risks. It helps develop strong contractual protections that act as a legal safeguard against undisclosed liabilities. For example - The HP- Autonomy acquisition shows how inadequate due diligence and weak contractual protections can lead to significant financial losses. In the case, Hewlett-Packard acquired Autonomy for approximately USD 11 billion in the year 2011, which was later written down to almost USD 8.8 billion due to discovery of accounting irregularities and misrepresentations. It reaffirms the importance of translating the findings into representations, warranties and indemnities to safeguard the contracts.<sup>8</sup>

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Strategic Organization 319.

<sup>7</sup> W.A. Wexler & J. Connor, "Beyond the Number Crunching: 'Doing' Diligence Right" (2007) 10(2) Journal of Private Equity 80.

<sup>8</sup> *Hewlett-Packard Company v. Michael Lynch and Sushovan Hussain*, Case No. 3:15-cv-05345 (N.D. Cal. 2015).

## 5. Avoiding Litigation & Reputational Damage

When a company invests in a target company that engages in corruption, fraud like tax evasions, violations of relevant laws or pending litigations, it can cause the acquiring company loss to its brand value and reputation along with legal obligations such as penalties or lawsuits. The contract or partnership would result as a major setback for the investing company. In such cases, due diligence ensures that the target has been compliant and saves the company from loss of reputation and the burden of litigation.

## 6. Operational Synergies

Beyond financial and legal obligations, due diligence also involves evaluating whether the HR practices, intellectual property, organisational structure and management incentives of the target company aligns with its own. The integration may fail even if the deal is financially or legally valid if there is a mismatch between the two, resulting in internal conflicts and ultimately, a failed deal. For eg.- “*The Risk Implications of Mergers and Acquisitions with Information Technology Firms*” (Chang & Cho, etc.) discusses how non-monetary risk like IT systems can significantly affect post-merger success.<sup>9</sup>

## Regulatory Framework Governing Compliance and Due Diligence in India

### 1. Companies Act, 2013

Companies Act, 2013<sup>10</sup> is the principal legislative framework that mandates corporate governance, ethical transparency and governance. There are various provisions that provide for compliance and due diligence under this act-

- **Duties of Directors (Section 166)** - It provides for directors to act in good faith and with reasonable care while handling corporate governance to avoid conflicts with the aim of the company. This imposes a legal duty to practice due diligence before major corporate deals which may affect the company and its resources.
- **Books of Accounts and Financial Statements (Sections 128 & 129)** - Under the given provisions, companies are required to maintain and provide a true and fair view of their financial position through their books of accounts such as balance sheet, P&L statement and cash flow statement. The financial statements

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<sup>9</sup> Y. B. Chang and W. Cho, “The Risk Implications of Mergers and Acquisitions with Information Technology Firms” (2017) 34(1) *Journal of Management Information Systems* 232.

<sup>10</sup> Companies Act, 2013 (Act 18 of 2013).

also require to be in accordance with the accounting standards and they must be audited. Due diligence involves verification of the accuracy of the financial statements and ensuring that no “black holes” exist. The Supreme Court reinforced the importance of adequate disclosure in the case of *Union of India v. Reliance Industries Ltd.* (2018).<sup>11</sup>

- **Board’s Report & Disclosure (Section 134)** - Along with the financial statements, this provision requires the board of directors to provide a board’s report containing disclosure on risk management, related party transactions and Corporate Social Responsibility (CSR) initiatives to enhance clarity and transparency in the due diligence process.
- **Audit Committee (Section 177)** - This provides for mandating the listed companies and a number of public companies to form an Audit Committee to oversee the financial reporting, compliance with relevant laws, and internal controls which ensures a systematic form of due diligence at the level of governance itself.
- **Internal Audit (Section 138)** - It requires a certain standard of companies to conduct internal audits evaluating internal control, compliance systems and risk management which ultimately forms the backbone of due diligence.
- **Corporate Social Responsibility (CSR) (Section 135)** - It forms a part of non-monetary due diligence by setting a threshold for an expenditure of at least 2% of their average net profit for certain companies of a class to comply with social and ethical obligations.
- **Fraud Prevention & Serious Fraud Investigation Office (Section 447 & 211)** - Under this provision, the Serious Fraud Investigation Office (SFIO) investigates fraud and corporate misconduct especially the ones involving financial fraud, public interest or multidisciplinary complexities.
- **Annual Return & Filing (Section 92)** - This section requires companies to file annual returns containing shareholder’s information, management and governance details, forming the basis for the documentary due diligence process.

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<sup>11</sup> *Union of India v. Reliance Industries Ltd.*, (2018) 17 SCC 581.

## 2. Securities and Exchange Board of India Act (SEBI), 1992

The Securities and Exchange Board of India (SEBI) <sup>12</sup> necessitates the companies to fulfill certain requirements that play a crucial role in the process of compliance and due diligence.

- **Listing Obligations and Disclosure Requirements (LODR), 2015** - This mandates quarterly financial disclosure statements, corporate governance compliance and disclosure of material information including mergers, acquisitions, defaults, etc. thus forming the backbone of continuous compliance by the listed companies. Non-compliance may result in fine, suspension or even delisting.
- **SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Code)** - Under this provision, an acquirer crossing 25% of shareholding must make an open offer to its minority shareholders and disclosure of all shareholdings to ensure transparency. Acquirers or investors can thus know the trigger points for open offers, existing shareholder agreements, and status of compliance.
- **SEBI (Prohibition of Insider Trading) Regulations, 2015** - This provision regulates confidential trading of unpublished price sensitive information (UPSI) ensuring transparency during mergers, acquisitions or restructuring while preventing insider trading, ensuring compliance and market integrity. It mandates the information's recording in a Structured Digital Database (SDD). In the case of *SEBI v. Deep Industries Ltd. (2017)*<sup>13</sup>, the Securities Appellate Tribunal (SAT) held due diligence as a "legitimate purpose" for sharing UPSI given that it is backed by confidentiality agreements and need-to-know basis access.
- **SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR)** - This provision regulates the raising of capital by a company through IPO's, rights issues, preferential issues and QIP's, while protecting the investor's interest by mandating full disclosure in offer documents, which is further verified by merchant bakers through due diligence certificates. SEBI

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<sup>12</sup> Securities and Exchange Board of India Act, 1992 (Act 15 of 1992).

<sup>13</sup> *SEBI v. Deep Industries Ltd.*, Appeal No. 64 of 2016, decided on 9 March 2017 (SAT–Mumbai).

may impose strict liability in case of non compliance with disclosure and due diligence requirements irrespective of the intent.<sup>14</sup>

- **SEBI's Role in Enforcement** - Under the SEBI Act, 1992, SEBI acts as a quasi-judicial body that can conduct investigations, issue orders and impose penalties. By acting so, it ensures compliance with disclosure and due diligence processes. The issues passed by the SEBI can even be appealed before the Securities Appellate Tribunal (SAT) and the Supreme Court of India.<sup>15</sup>

### 3. Competition Act, 2002

The Competition Act, 2002<sup>16</sup> integrates compliance and due diligence in corporate deals, particularly in mergers, acquisitions and combinations.

- **Anti-Competitive Agreements (Section 3)** - This provision prevents agreements that cause or can potentially cause an appreciable adverse effect on competition (AAEC) making it indispensable to evaluate the target company's joint ventures, contracts and distribution agreements before any acquisition or investment.
- **Regulation and Combinations (Section 5 & 6)** - These define and mandate the combinations crossing an asset and turnover threshold to gain approval of the Competition Commission of India (CCI) before its implementation to avoid causing any AAEC.
- **Competition Commission of India (Section 18, 19 & 20)** - The Competition Commission of India, under the stated sections, gets the power to direct and inquire into practices and combinations that cause adverse effects on competition and protect consumer interests. Before any corporate deal, a company must ensure adherence to the competition policies by the target company.
- **Penalties (Sections 42, 43A, 44 & 45)** - Under these sections of the Competition Act, judicial bodies may impose penalties for violation of CCI's orders, "gun-jumping", and for furnishing false information. It ensures accuracy

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<sup>14</sup> *SEBI v. Shri Ram Mutual Fund*, (2006) 5 SCC 361.

<sup>15</sup> *Ibid.*

<sup>16</sup> Competition Act, 2002 (Act 12 of 2003).

in regulatory filings. The companies can be scrutinized for inadequate disclosures and inaccurate due diligence before filings.<sup>17</sup>

#### 4. Foreign Exchange & Management Act (FEMA), 1999

The Foreign Exchange and Management Act (FEMA), 1999<sup>18</sup> has been established to regulate foreign exchange transactions in India, ensuring compliance with legal standards in transactions involving foreign entities. Unlike its predecessor, the Foreign Exchange Regulation Act (FERA), its aim is to facilitate external trade and payments while ensuring orderly development of the foreign exchange market in India rather than criminalization.

Key Compliance Mechanisms -

- **Authorization and Approvals:** FEMA mandates that all foreign exchange trades must be carried out after obtaining general or special permission from the Reserve Bank of India (RBI). For instance, Foreign Direct Investment (FDI) in Indian companies requires approval from the RBI first-hand or it must fall within the route specified by the government in India.
- **Reporting and Documentation:** Companies dealing in cross-border transactions are required to report their foreign exchange transactions to the RBI through Authorized Dealers. For doing so, they are required to maintain proper documentation such as agreements, receipts and invoices for legal inspection, audits and due diligence during cross border-transactions to ensure compliance under the FEMA framework and avoid legal and financial penalties.
- **Due Diligence in Corporate Deals:** A company must practice due diligence inevitably when it comes to dealing with foreign entities like mergers, acquisitions, joint ventures or private equity investment to ensure necessary reporting and verification of relevant documents. The key aspect is to evaluate whether the repatriation of profits, dividends and remittances are done within the prescribed time frame to avoid penalties, delayed agreements or cancellation of contract.

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<sup>17</sup> *Competition Commission of India v. Jet Airways (India) Ltd. and Etihad Airways PJSC*, Combination Regn. No. C-2013/05/122, decided on 12 Nov. 2013.

<sup>18</sup> Foreign Exchange Management Act, 1999 (Act 42 of 1999).

- **Penalties for Non-Compliance:** In case of non-compliance, FEMA provides for civil penalties in order to promote accountability while encouraging voluntary adherence to the regulations. Under Section 13 of the act, it can impose a penalty up to three times the amount in default if it is quantifiable; if not, the penalty is Rs. 2,00,000. It also has the power to seize the assets in connection with the default. The enforcement authority behind the act is the Directorate of Enforcement (ED) and adjudicating officers, with orders appealable before the higher tribunals. Most importantly, FEMA also provides for compounding of the matter without extension in the litigation process.

## 5. Insolvency and Bankruptcy Code (IBC), 2016

The Insolvency and Bankruptcy Code (IBC), 2016<sup>19</sup> plays a pivotal role in the legislation and regulation of insolvency and bankruptcy in the context of mergers, acquisitions and partnerships involving distressed assets.

- **Time-Bound Insolvency Resolution (Sections 7–12)** - The Act provides for a time limit so that the Corporate Insolvency Resolution Process (CIRP) is concluded within 180-330 days. It provides satisfaction in the minds of the investors by ensuring predictability in dealings and avoiding uncertainties that could otherwise deter them.<sup>20</sup>
- **Transparency through Information Utilities (Section 210)** - This provision provides for an authorised repository to store financial data and debt records in Information Utilities (IU's), enabling potential investors and acquirers to practice adequate due diligence through the verification of claims, liabilities and defaults.<sup>21</sup>
- **Resolution Professional Oversight (Sections 17–23)** - In case a company falls into insolvency, the shift of control from the promoters to the Resolution Professionals (RP's) ensures impartiality and reliable claims verification for buyers during the process of due diligence.<sup>22</sup>

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<sup>19</sup> Insolvency and Bankruptcy Code, 2016 (Act 31 of 2016).

<sup>20</sup> A. Bose, "The Insolvency and Bankruptcy Code: A Framework for Corporate Resolution in India" (2019) 54(20) Economic and Political Weekly 45.

<sup>21</sup> S. Sarkar, "Information Utilities and Due Diligence under IBC" (2020) 12(2) Indian Journal of Corporate Law 67.

<sup>22</sup> A. Datta, "Resolution Professionals and Corporate Compliance under IBC" (2021) 16(1) NALSAR Law Review 123.

- **Waterfall Mechanism for Claims (Section 53)** - It provides for a clear hierarchy for distribution of assets in the settlement process, enabling investors to assess risks and recovery prospects before entering into a corporate transaction with the target company.<sup>23</sup>

## 6. Taxation Laws

Prominently, the Income Tax Act, 1961<sup>24</sup> and the Central Goods and Services Tax Act, 2017<sup>25</sup> ensure compliance and due diligence in corporate deals involving mergers, acquisitions and partnerships.

Under **Sections 170-174** of the Income Tax Act, 1961, the buyers act as a successor to the transferors in terms of tax obligations. Therefore, it is necessary for the acquirers to perform thorough due diligence while inheriting the tax liabilities of the target company to avoid any non-compliance towards the taxation law. The Supreme Court held that while legitimate tax planning is permissible, intended planning to evade tax liabilities is not.<sup>26</sup>

**Sections 92-92F** regulate transfer pricing rule mandating arm's length pricing, i.e., transactions between two associated companies must be as if they were unrelated and independent of each other. Violation of this provision may attract heavy penalties making it a notable provision while carrying out due diligence.<sup>27</sup> The act also requires **withholding tax (TDS)** on payments such as dividends and royalties ensuring acquiring companies follow tax compliance and reporting requirements before finalising deals.

The CGST Act, 2017 states the transfer of indirect tax regime in the form of input tax credits and past tax dues from the transferors to the buyer thus, making due diligence pivotal to avoid any undisclosed GST liabilities on the target company's end.<sup>28</sup>

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<sup>23</sup> R. Sharma, "Waterfall Mechanism in Insolvency Law: Ensuring Priority and Predictability" (2019) 12(3) NUJS Law Review 201.

<sup>24</sup> Income Tax Act, 1961 (Act 43 of 1961).

<sup>25</sup> Central Goods and Services Tax Act, 2017 (Act 12 of 2017).

<sup>26</sup> McDowell & Co. Ltd. v. CTO, (1985) 154 ITR 148 (SC).

<sup>27</sup> Y. Kuppusamy, "Issues Involving Transfer Pricing in India" (2024) 6(2) International Journal of Legal Science and Innovation 89.

<sup>28</sup> R. Chitalia, "Tax Due Diligence — Indirect Taxes" (2010) Bombay Chartered Accountant Journal 112.

Additionally, under **Section 281** of the Income Tax Act, 1961, asset transfers are prevented if there exists any tax proceedings dues, making approval of the taxation authorities mandatory in order to protect revenue interests. It reaffirms the importance of verifying pending tax assessments to avoid inheritance of any undisclosed liability by a company.<sup>29</sup>

## 7. Labour and Employment Laws

Labour and employment laws in India are established to protect the interests of the workers while maintaining orderly industrial management. They form a critical pillar of corporate deals such as mergers, acquisitions and restructuring.

Key legislations include **Industrial Disputes Act, 1947**<sup>30</sup> which regulates lay-offs, retrenchments, and closures, making sure companies evaluate pending disputes and union agreements before finalising a corporate deal.<sup>31</sup> The **Employees' Provident Funds & Miscellaneous Provisions Act, 1952 (EPF Act)**<sup>32</sup> mandate verification of contributions to pension schemes, provident funds, and insurance schemes. Non-compliance towards audit of statutory contributions may amount to heavy penalties under the act.

The **Payment of Gratuity Act, 1972**<sup>33</sup> acts as a safeguard for the gratuity obligations towards the employees. Moreover, **the Factories Act, 1948**<sup>34</sup> and a number of **Shops and Establishments Acts** govern workplace safety, working hours and employee welfare.<sup>35</sup>

Due diligence becomes important with respect to the employment laws, labor agreements, union agreements and any pending litigation to ensure a smooth post-deal integration and avoid any undisclosed liabilities, with the aim to develop a sustainable corporate deal.<sup>36</sup>

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<sup>29</sup> CIT v. B.M. Kharwar, (1969) 72 ITR 603 (SC).

<sup>30</sup> Industrial Disputes Act, 1947 (Act 14 of 1947).

<sup>31</sup> *Workmen of Hindustan Lever Ltd. v. Hindustan Lever Ltd.*, (1995) 5 SCC 1.

<sup>32</sup> Employees' Provident Funds and Miscellaneous Provisions Act, 1952, No. 19 of 1952, INDIA CODE.

<sup>33</sup> Payment of Gratuity Act, 1972 (Act 39 of 1972).

<sup>34</sup> Factories Act, 1948 (Act 63 of 1948).

<sup>35</sup> Reddy, S., "Employee Welfare and Statutory Compliance in India" (2019) 12 Journal of Industrial Relations 78.

<sup>36</sup> *Management of Bharat Coking Coal Ltd. v. Workmen*, (1983) 1 SCC 120.

Violations may lead to penalties, back payments and even criminal liability for the company and hence, it directly affects the deal valuation, risk assessment, and integration strategies, making compliance towards it a non-negotiable instrument in corporate governance.<sup>37</sup>

## 8. Environmental Laws

Environmental laws make environmental due diligence an indispensable part of corporate deals like mergers, acquisitions and partnerships through imposition of a stringent compliance framework. The **Environment (Protection) Act, 1986**<sup>38</sup> acts as a broad regulatory framework, empowering the Central Government to impose restrictions on industrial operations to safeguard the environment. Therefore, it is necessary for companies to diligently assess the environmental legislations and liabilities before any acquisition or investment.

Certain statutes such as the **Water (Prevention and Control of Pollution) Act, 1974**<sup>39</sup> and the **Air (Prevention and Control of Pollution) Act, 1981**<sup>40</sup> mandate industries to gain approval of the Pollution Control Boards before carrying out operations, with non-compliance leading to imposition of penalties or cancellation orders. Furthermore, compliance must be adhered to for projects related to land acquisition or forest diversion under the **Forest (Conservation) Act, 1980**<sup>41</sup> and the **Wildlife (Protection) Act, 1972**<sup>42</sup> to protect biodiversity and ensure ecological preservation. The stated provisions mandate due diligence as a practice to ensure that the target companies have obtained the requisite consents.

The Supreme Court has evolved the concept of absolute liability to prevent companies from escaping liability, even during restructuring when they cause environmental damage.<sup>43</sup> The **National Green Tribunal (NGT)** established under the 2010 Act provides for specialised forums for environmental conflicts, thus, strengthening

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<sup>37</sup> Kaur, A., & Singh, R., "Labour Due Diligence in Corporate Transactions" (2021) 8 NALSAR Law Review 101.

<sup>38</sup> Environment (Protection) Act, 1986.

<sup>39</sup> Water Act, 1974.

<sup>40</sup> Air Act, 1981.

<sup>41</sup> Forest (Conservation) Act, 1980.

<sup>42</sup> Wildlife (Protection) Act, 1972.

<sup>43</sup> M.C. Mehta v. Union of India (1987) 1 SCC 395.

compliance. Failure of adequate environmental due diligence before entering into a corporate transaction can result in heavy financial and reputational risks.<sup>44</sup>

## **Comparative Study of Compliance and Due Diligence Regimes**

In the prevailing mutually dependent global economy, global due diligence and compliance form the heart of corporate governance. With increasing statutory scrutiny and investors' expectations, due diligence not only involves the financial risk assessments but it steps beyond including other social and ethical conducts such as tax litigations, corruption frauds, labor laws, and environmental concern, etc. This section of the research paper analyses the global frameworks that shape due diligence and compliance, along with a comparative analysis in relation to the Indian context.

- **International Soft-Law Standards**

The international soft-law standards established under the two complementary instruments, namely, the **UN Guiding Principles on Business and Human Rights (UNGPs)**<sup>45</sup> and the **OECD Due Diligence Guidance for Responsible Business Conduct (2018)**<sup>46</sup>, have established the foundation for global due diligence.

The UNGPs provide for a tripartite framework - the duty of the state to protect, the corporate responsibility for respecting human rights, and the need for access to remedy. It states that the companies must inculcate human rights practices into their corporate governance involving identification of risk, integrating the insights into the corporate governance systems, and consistent evaluation and adequate reporting. Furthermore, the OECD guides due diligence by providing risk-based steps that can be applied to various sectoral standards such as responsible supply chain management and garment industry practices. Even though the given frameworks are non-binding, they still set a benchmark for various domestic legislations such as the **French Duty of Vigilance**

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<sup>44</sup> S. Ghosh, "Corporate Environmental Responsibility and Due Diligence in India" (2019) 14(2) NUJS L Rev 221.

<sup>45</sup> United Nations, "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework" (2011) UN Doc HR/PUB/11/04.

<sup>46</sup> Organisation for Economic Co-operation and Development, *OECD Due Diligence Guidance for Responsible Business Conduct* (OECD Publishing 2018).

**Law (2017)**<sup>47</sup> and the **German Supply Chain Due Diligence Act (2021)**<sup>48</sup>. Thus, while being non-mandatory, they set a shift towards sustainability industrial practices.

- **Anti-Corruption Frameworks**

To provide for corruption risks, the anti bribery legislations have expanded the scope of corporate due diligence. The **U.S. Foreign Corrupt Practices Act, 1977**<sup>49</sup> prohibits bribery of foreign officials and mandates accurate record-keeping. Establishments like the Department of Justice (DoJ) and the Securities and Exchange Commission (SEC) underlines the importance of pre-acquisition due diligence and post-deal integration. It highlights the need for rigorous background checks to avoid any successor liabilities. Additionally, the **UK Bribery Act, 2010**<sup>50</sup> provides for criminalisation of bribery in both the public and private sectors, also providing for “failure to prevent bribery” as a corporate offense. The defense that a company can use is followance of “adequate procedures” which involves due diligence and policies reassessment. Thus, this act provides a broader scope, compelling the practice of due diligence globally.

- **Financial Governance and Reporting**

In response to accounting scandals like the Enron<sup>51</sup>, the **Sarbanes-Oxley Act, 2002**<sup>52</sup> was established in the United States to revolutionize corporate accountability. It provides for mandatory CEO/CFO certification for financial statements under Section 302 and internal control reporting under Section 404, thus reinforcing managerial accountability.<sup>53</sup> SOX has profound implications on cross-border mergers and acquisitions, making due diligence in terms of internal reporting mechanisms inevitable. It establishes that due diligence is not merely transactional, but structural, protecting long-term integrity.

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<sup>47</sup> Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre (France).

<sup>48</sup> Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten [Supply Chain Due Diligence Act], BGBl I S. 2959, 2021 (Germany).

<sup>49</sup> Foreign Corrupt Practices Act of 1977, Pub L No 95–213, 91 Stat 1494 (US).

<sup>50</sup> Bribery Act 2010, c.23 (UK).

<sup>51</sup> *In re Enron Corporation Securities, Derivative & ERISA Litigation*, 235 F. Supp. 2d 549 (S.D. Tex. 2002).

<sup>52</sup> Sarbanes-Oxley Act, 2002, Pub. L. No. 107–204, 116 Stat. 745 (U.S.).

<sup>53</sup> J. Coffee, “Gatekeepers: The Professions and Corporate Governance” (2007) Oxford University Press.

- **Data Protection and Privacy**

The **General Data Protection Regulation (GDPR), 2018**<sup>54</sup> of the European Union imposes stringent requirements on data processors, mandating lawful processing, data-keeping, data protection breach assessment and prompt breach notification within 72 hours. GDPR compliance is central in corporate deals, with non-compliance resulting in severe financial obligations, including fines amounting to 4% of the global annual turnover. Therefore, it becomes a necessity for the buyer company to assess the legal bases for data processing, valid cross-border transfer mechanisms, and effective security protocols.<sup>55</sup>

- **Tax Transparency**

Taxation frameworks emerge as another critical point for compliance due diligence globally. The **OECD's Base Erosion and Profit Shifting (BEPS) framework**<sup>56</sup> mandates Country-by-Country reporting, non-negotiable disclosure of global arrangements and transfer pricing alignment. Similarly, the **Foreign Account Tax Compliance Act (FATCA), 2010**<sup>57</sup> imposes disclosure obligations on foreign financial institutions of U.S.-linked accounts. These frameworks necessitates the buyers to diligently scrutinize the reporting compliance, tax filings, and intercompany pricing arrangements.

- **Sectoral Regulations: AML, Environmental, and Human Rights**

Several other sectoral regulations such as anti-money laundering, environment and human rights have also shaped compliance practices. The **Financial Action Task Force (FATF) Recommendations**<sup>58</sup> mandate anti-money laundering (AML) controls, including client due diligence, beneficial financial transparency, and enhanced due diligence for high-prospect customers. These are pivotal checks in financial sector deals.

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<sup>54</sup> General Data Protection Regulation, Regulation (EU) 2016/679.

<sup>55</sup> C. Voigt and A. von dem Bussche, *The EU General Data Protection Regulation (GDPR): A Practical Guide* (2017) Springer.

<sup>56</sup> Organisation for Economic Co-operation and Development, *OECD Due Diligence Guidance for Responsible Business Conduct* (OECD Publishing 2018), supra note 46.

<sup>57</sup> *Foreign Account Tax Compliance Act, 2010*, Pub. L. No. 111-147, 124 Stat. 71 (U.S.).

<sup>58</sup> *Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (Paris: FATF, updated 2023).

Adding to it, **OECD's**<sup>59</sup> **environmental framework** and domestic environmental legislations mandate corporations to evaluate environmental approvals, waste management systems, and historical liabilities before entering into transactions with the target. Certain judicial decisions in India reinforce the importance of compliance in corporate acquisition and restructuring such as the case of **M.C. Mehta v. Union of India (1987)**<sup>60</sup>, establishing the concept of absolute liability. Various national supply chain policies codify the integration of human rights thus emphasizing that due diligence must extend to social impacts, particularly in labor-intensive industries.

- **Comparative Analysis with Indian Frameworks**

Indian compliance legislation incorporates several frameworks that reflect global laws shaping due diligence and compliance. The **Foreign Exchange Management Act (FEMA), 1999**<sup>61</sup> mandates accurate and adequate reporting of cross-border transactions, transfer pricing alignment, and compliance with the RBI guidelines. This ensures transparency and unlawful corporate deals.<sup>62</sup>

As interpreted in **McDowell & Co. Ltd. v. CTO (1985)**<sup>63</sup>, the Indian taxation laws similarly provide for robust tax due diligence. The **Insolvency and Bankruptcy Code (IBC), 2016**<sup>64</sup> requires reliable disclosure of information through information utilities and assigns resolution professionals to reassess corporate compliance, thereby, ensuring transparency.

Labour laws such as the **EPF Act, 1952** and the **Payment of Gratuity Act, 1972** necessitate adherence to employee benefit liabilities, aligning with global frameworks that incorporate human rights like the **UN Guiding Principles on Business and Human Rights (UNGPs)**<sup>65</sup>.

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<sup>59</sup> Organisation for Economic Co-operation and Development, *OECD Due Diligence Guidance for Responsible Business Conduct* (OECD Publishing 2018), supra note 46 & 56.

<sup>60</sup> *M.C. Mehta v. Union of India*, AIR 1987 SC 1086.

<sup>61</sup> Foreign Exchange Management Act, 1999 (Act 42 of 1999), supra note 18.

<sup>62</sup> *SEBI v. Shri Ram Mutual Fund*, (2006) 5 SCC 361, supra note 14.

<sup>63</sup> *McDowell & Co. Ltd. v. CTO*, (1985) 154 ITR 148 (SC), supra note 26.

<sup>64</sup> Insolvency and Bankruptcy Code, 2016 (Act 31 of 2016), supra note 19.

<sup>65</sup> United Nations, "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework" (2011) UN Doc HR/PUB/11/04, supra note 45.

Lastly, **environmental regulations** such as the **Environment (Protection) Act, 1986**<sup>66</sup> impose compliance obligations that must be reviewed before corporate dealings such as acquisitions and restructuring. Thus, Indian frameworks mirror global standards by incorporating compliance and due diligence into diverse aspects of corporate governance.

## Conclusion

Through the insights gained from the research paper, it can be concluded that compliance and due diligence form an integral part of modern corporate governance, acting as a bridge between legal obligations and ethical business conduct. The research reveals that both Indian and global regulations aim towards a common objective, i.e., corporate transactions must be transparent, sustainable, and accountable. Indian legislations such as FEMA, IBC, SEBI frameworks, and environmental and labor compliance obligations incorporated compliance legislation directly into corporate governance, thereby protecting the interests of the investors, creditors, employees, and the public interest at large. Judicial decisions as in the cases of *McDowell & Co. Ltd. v. CTO* and *M.C. Mehta v. Union of India* reaffirms the judicial power in expanding the scope of due diligence and compliance.

Global instruments like the UNGPs, OECD guidance, the FCPA, UK Bribery Act, SOX, GDPR, and BEPS demonstrate that compliance crosses jurisdictional boundaries, requiring comprehensive due diligence that addresses financial, operational, social, and environmental threats. Overall, the frameworks symbolise that due diligence is a strategic necessity for a company's survival and growth.

Ultimately, compliance and due diligence act as not only a defensive mechanism but as a proactive tool that fosters trust, stability, and long-term value creation in corporate deals. The alignment between Indian and global frameworks affirms a universal fact: responsible governance is the bedrock of sustainable corporate transactions.

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