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Research Article
Due Diligence

Applicability of AI in Due Diligence Process of Mergers and Acquisitions: An Exploratory Study

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This paper examines who should be held legally liable in India when an AI-supported due diligence tool fails to detect a critical risk during a regulated merger or acquisition. Indian advisory firms increasingly use generative AI for contract review, red-flag reporting, and financial analysis during due diligence, yet the legal framework governing its use has not kept pace with this rapid adoption. It asks whether Indian law clearly assigns responsibility for such failures, or whether accountability is lost between different areas of law.

The study addresses four categories of applicable legal rules: the duty of care of directors under Section 166(3) and the non-excludable liability of registered valuers under Section 247 of the Companies Act, 2013; warranty and indemnity provisions in Indian share purchase agreements under the Indian Contract Act, 1872; common law principles on professional negligence; and disclosure and valuation requirements under the SEBI Takeover Code, including the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2025. It then compares the Indian position with the graded-liability approach in India's AI Governance Guidelines, 2025, and the European Union's Product Liability Directive, 2024/2853.

The paper finds that Indian law is not silent on the issue, but the framework is fragmented: each rule addresses only a small facet of the problem, and none specifies the extent of human oversight required for AI tool outputs to meet the prevailing standard of care. Even the EU's Product Liability Directive, often cited as a model reform, fails to resolve this, since it excludes pure economic loss suffered by corporate claimants — precisely the loss this paper addresses. The paper recommends a contract-based AI liability allocation clause for due diligence engagement letters, a targeted SEBI circular applying existing Regulation 16C to due diligence certification, and clearer standards of practice from India's professional regulatory bodies.

Keywords: Due Diligence, Artificial Intelligence, Mergers and Acquisitions, Legal Framework

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1.Introduction

In the past, the process of mergers and acquisitions relied on teams of professionals who manually read and reviewed contracts, financial statements, and regulatory documents before finalizing any transaction. However, as the use of artificial intelligence grows, this process is also changing very rapidly. Generative AI is no longer considered merely an experimental technology in business transactions, rather, it is now used at different stages of the deal process. Due diligence is one of these stages, and it is an area where the use of artificial intelligence is growing very rapidly (Grata, 2026).

Law firms and advisory firms have also started using artificial intelligence to review contracts, enabling them to identify important clauses within large volumes of documents. Nowadays, AI is also used to prepare due diligence checklists, generate red-flag reports and summarize large documents (Mayer Brown, 2025). Advisory firms have launched AI-based 'due diligence' services to assess a target company's financial position, tax compliance, and operational performance as a key part of the overall due diligence process (KPMG Switzerland, 2025). Furthermore, accounting professionals have emphasized that generative AI is transforming the approach to financial due diligence; it helps identify unusual patterns in financial statements and enables automated variance analysis (Open Ledger, 2025).

The benefits of using AI in M&A transactions have also gained widespread recognition. According to a 2025 McKinsey survey of dealmakers, organizations using generative AI reported an average cost reduction of approximately 20 percent. The survey also found that after adopting AI tools, about 40 percent of people took 30 to 50 percent less time to close a deal. However, the survey also revealed that only 30 percent of people were using generative AI at a medium or high level. This shows that even as AI technology is becoming more advanced, its adoption in the M&A industry is still evolving (McKinsey & Company, 2026).

1.1 The Problem: A Widening Gap Between Adoption and Accountability

An AI-generated report may appear impressive and reliable, but it could contain incorrect information, omit critical details (such as material risks), or draw flawed conclusions. Therefore, relying solely on an AI report can expose you to legal and financial risks. Disputes arising after the completion of M&A deals are often not caused by sudden business problems; rather, they stem from shortcomings in deal planning or due diligence. If AI-assisted due diligence fails to identify a significant risk or issue, it can lead to disputes or financial losses later on. For example, a buyer might discover after the transaction is completed that the seller's financial performance had been overstated, because the AI tool failed to properly analyze the underlying financial data (Bloomberg Law, 2026). These studies also warn that over-reliance on AI can give rise to new legal risks, as AI systems can generate incorrect or misleading information—a phenomenon commonly referred to as "hallucination." If such erroneous information is utilized during due diligence without proper human verification, disputes concerning fraud, misrepresentation, or breach of warranty could arise after the transaction is concluded (Bloomberg Law, 2026).

Researchers and professionals working in AI have also acknowledged that these technologies have certain significant limitations when used for 'due diligence'. EY has noted that 'Large Language Models' (LLMs) can sometimes provide incorrect or fabricated information. While such errors may not cause serious problems in low-risk situations, they become critical in M&A (Mergers and Acquisitions) deals. This is because the findings from due diligence are used to determine a business's valuation and negotiate the terms of the deal. For this reason, results generated by AI should always be carefully reviewed and verified by human professionals before being relied upon (EY Switzerland, 2025).

At the same time, regulators and courts have not yet developed a clear legal approach to address failures associated with AI. Legal experts believe that liability in such situations depends on several factors—such as the level of human supervision, whether the resulting harm could have been accurately foreseen, and how risks are allocated among the parties through contracts. They also point out that the legal status may vary depending on whether an AI system is classified as a 'product' or a 'service.' Existing legal principles regarding product liability, professional negligence, and contract law were not designed to handle situations where AI systems play a critical role in decision-making processes (Internet Lawyer Blog, 2025).

Many studies indicate that AI governance is often treated as a secondary (less important) issue rather than an integral part of the design and deployment of AI systems. Consequently, a gap often persists between the technical performance of AI systems and the legal regulations governing accountability for their actions (Never Compromise to Vulnerabilities, 2025).

These concerns are not merely hypothetical; they have already materialized. Courts have imposed fines on lawyers who submitted AI-generated legal documents containing fabricated case citations. Citing these instances, legal experts have warned M&A professionals against accepting AI-generated due diligence reports or findings without thorough verification. If an AI tool cannot clearly identify the specific documents or clauses underpinning its conclusions, those results cannot be relied upon for critical commercial decisions, especially given that errors in due diligence can lead to serious legal and financial consequences (Harvey.ai, 2026).

Legal experts also point out that liability for AI-related issues could fall on various parties—such as the AI developer, the organization using the AI system, or the end-user. This depends on the extent of control each party exercised and whether the harm could have been foreseen. However, there is currently no clear legal rule that automatically determines liability in every situation (Rework, 2026). Some experts suggest expanding the scope of product liability regulations to hold the entities controlling and operating AI systems accountable for defects that emerge after the system has been deployed. This perspective has already been recognized in the European Union through the 'New Product Liability Directive' (2024/2853); the directive includes software and AI systems within the definition of a 'product' for the purpose of 'strict liability'. This allows for the determination of liability even when a party retains control over the AI system's learning and operational processes after its deployment (Taylor Wessing, 2025). However, this legal perspective has not yet been tested in the context of M&A due diligence, as the AI system here does not produce a physical product but rather generates analytical insights that influence critical commercial and legal decisions.

1.2 Why this Matters for India Specifically

The legal framework governing Artificial Intelligence (AI) in India is still evolving. Instead of enacting a separate law for AI, the government is currently attempting to regulate its use by expanding and enforcing existing legal frameworks. On November 5, 2025, the Ministry of Electronics and Information Technology (MeitY) released the 'India AI Governance Guidelines,' which propose a 'graded liability' approach under the 'Accountability' pillar. According to this perspective, responsibility for harm caused by AI should be shared among AI developers, implementers, and users. This allocation should be based on each party's role, the level of risk, and the degree of caution exercised. However, these guidelines are merely policy recommendations and are not yet legally binding. The guidelines also acknowledge that the existing legal framework is not fully equipped to address the complex legal issues arising from AI. Instead of recommending the creation of entirely new liability laws for AI, they suggest reviewing and amending the existing legal framework to address these challenges (Lexology, 2025; BW Legal World, 2025).

Indian regulators in the fields of securities regulation and financial transactions have also begun to focus on the use of AI. However, they have not yet formulated specific rules regarding the particular issue raised in this study. Studies on India's AI regulatory framework indicate that there is no dedicated legislation to govern AI in India as of 2026. Instead, various sectoral regulators—such as SEBI and RBI—regulate the use of AI within their respective domains based on existing laws (White & Case LLP, 2026). There is currently no separate and comprehensive law for AI in India. Instead, the government uses some general guidelines and the DPDP Act, 2023. Also, regulators like RBI (banking) and SEBI (stock market) monitor the use of AI and the risks associated with it in their respective sectors. That is, AI is regulated by different institutions in their respective fields (Regulations.ai, 2025).

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In such situations, a crucial legal question arises as to who should be held liable for the losses incurred —under the Companies Act 2013, the SEBI Takeover Code, and general legal principles regarding professional negligence and contractual indemnity.

This creates a significant legal gap between Indian M&A (Merger and Acquisition) laws and AI governance. It has significant practical implications for all parties involved in M&A transactions. If a critical risk goes undetected during AI-assisted due diligence, the target company may face disputes. Meanwhile, the acquiring company could make investment decisions based on incomplete or erroneous reports generated by AI. Claims of professional negligence can be brought against lawyers, financial advisors, valuers, and other professionals involved in the due diligence process, even though the legal standards applicable to tasks performed with the aid of AI are not yet fully clear. Furthermore, SEBI has not yet clarified how AI-assisted due diligence will be viewed under existing legal regulations—such as those concerning disclosures, independent valuation, and professional responsibility. Therefore, given the steadily increasing use of AI in M&A transactions in India, an in-depth legal study of this subject is essential.

2. Aim and Scope of the Study

This research paper examines the issues of liability and accountability arising from the failure of AI-assisted due diligence tools to identify critical risks during regulated M&A (merger and acquisition) transactions in India. The primary objective of this study is to determine who should be held legally responsible when an AI-based due diligence tool fails to detect a significant risk, resulting in legal or financial loss for a party involved in the transaction. The objective is also to determine whether the existing Indian legal framework provides a clear and predictable answer to this issue, or if it creates uncertainty because liability could be distributed across different areas of law—such as contract law, tort law, and securities regulation.

This study is relevant for various groups involved in M&A (Merger and Acquisition) transactions. It is useful for M&A professionals who draft 'due diligence engagement letters' and negotiate contracts with AI service providers. It is also valuable for in-house legal teams and compliance officers who assess the legal risks associated with adopting AI tools within their organizations.

Furthermore, this study can assist policymakers at SEBI and MeitY who are currently formulating India's strategy for AI governance and graded liability. Finally, the study also contributes to the growing academic discourse on how traditional principles of legal liability should be applied when decisions are made using AI systems involving multiple stakeholders.

3. The Current Indian Legal Framework Relating to Due Diligence Failures

This section examines the legal framework in India applicable when AI is used for the 'due diligence' process in a regulated M&A transaction and fails to identify a material risk. Currently, Indian law lacks a specific legal framework to address AI-assisted due diligence; therefore, this section analyzes the issue by examining existing legal principles that could apply in such situations.

This discussion focuses on four key aspects of the law. The first aspect examines the legal liabilities of directors and officers under the Companies Act, 2013. The second aspect relates to the contractual allocation of risk through warranty and indemnity clauses typically included in Share Purchase Agreements (SPAs). The third aspect concerns the law regarding professional negligence, particularly in the context of its applicability to lawyers, chartered accountants, registered valuers, and other professionals involved in the due diligence process. The fourth point concerns the disclosure and valuation obligations imposed on acquirers under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST Regulations).

All these legal frameworks were built on the premise that 'due diligence' would be performed by human professionals who would personally examine documents, verify information, and make decisions based on their independent judgement. However, the increasing use of AI-assisted due diligence has transformed this traditional approach. Therefore, this section discusses how existing legal rules apply when significant decisions are made—either wholly or partially—based on AI-generated results. It also identifies areas where current laws may not provide a clear answer.

3.1 Duties of Directors and Officers under the Companies Act, 2013

Prior to the Companies Act, 2013, Indian company law contained no specific statutory provisions directly addressing the functions of directors. Instead, the duties of directors were based on common law principles regarding 'fiduciary duties' and the 'law of agency' (Lex Counsel, 2023). This situation changed with the enactment of the Companies Act, 2013; for the first time, this Act clearly codified the duties and responsibilities of directors within a single legal provision.

Section 166 of the Companies Act, 2013 outlines the duties and functions that every director must perform. Under Section 166(2), a director must act in good faith—without fraud or malice—to advance the company's objectives in a manner that benefits all its members. Additionally, directors are expected to consider the interests of employees, shareholders, the community, and the environment (ca2013.com, n.d.-a). Furthermore, under Section 166(3), every director is required to discharge their duties with due and reasonable care, skill, and diligence, and to exercise independent judgement when making decisions (ca2013.com, n.d.-a).

Legal liability may also arise for failure to fulfill the responsibilities prescribed under Section 166. Under Section 166(7), a director who contravenes the provisions of this section is liable to a fine ranging from one lakh rupees to five lakh rupees (ca2013.com, n.d.-a).

Two aspects of Section 166(3) are significant in the context of AI-assisted due diligence. First, the provision does not explicitly define "due and reasonable care." Indian legal experts argue that in the absence of a statutory definition, the "reasonable person" standard—derived from the law of torts—serves as the most appropriate benchmark for determining whether a director has fulfilled their obligations. This is because the duty of care under Section 166 is owed to the company as a whole, rather than to any single stakeholder (IndiaCorpLaw, 2023).

Secondly, according to the legal interpretation of Section 166, a director cannot discharge this responsibility merely by relying on expert opinions or the views of management; they must personally understand and evaluate the matter to arrive at a decision.

Even when professional advice has been sought, it remains the director's responsibility to independently examine and assess that information before making any decision. Legal experts suggest that relying entirely on another's opinion without independent evaluation could amount to a breach of the 'duty of care' (Barristery, 2026). Indian courts have also adopted a similar stance in cases involving non-executive and nominee directors.

Even if such directors are not involved in the company's day-to-day operations, they retain an ongoing responsibility to oversee its affairs and cannot evade accountability by citing limited involvement (Barristery, 2026). Similar principles are evident in the observations made by the National Company Law Appellate Tribunal (NCLAT) in the MCX Stock Exchange case and in the actions taken by the Securities and Exchange Board of India (SEBI) against Zee Entertainment Enterprises. These rulings clarify that independent directors are expected to do far more than merely rely on the accuracy of financial information provided by management or professional advisors; instead, they are expected to exercise independent judgement before approving significant corporate decisions (Law Zone, 2026).

This provision does not define "due and reasonable care"; experts favor the objective standard of the "reasonable person" found in tort law (IndiaCorpLaw, 2023). A director cannot discharge their duties merely by relying on expert advice or management information without independently verifying it—blind reliance can constitute a violation of regulations, even for non-executive or nominee directors (Barristery, 2026), as evidenced by NCLAT's observations in the MCX stock exchange case and SEBI's action against Zee Entertainment Enterprises (Law Zone, 2026). These principles apply equally when a director relies primarily on AI-generated reports without independent verification: Section 166(3) makes no distinction between human advice and AI output. However, this duty is owed to the company rather than to third parties; consequently, if an acquirer suffers a loss due to a failure to oversee the AI-assisted due diligence of a target board, they have no direct legal recourse (Lex Counsel, 2023).

Section 247 imposes a parallel duty on registered valuers to conduct fair and reasonable valuations with due diligence (IBC Law, n.d.); the Companies (Registered Valuers and Valuation) Rules, 2017, preclude a valuer from disclaiming this responsibility, except where the valuation relies on facts provided by the company or available in the public domain (Corporate Law Reporter, n.d.). Thus, a valuer cannot evade liability simply because an AI tool has presented an erroneous analysis, as the duty is personal. Whether AI-generated analysis used in a valuation counts as the valuer's own judgement—for which liability cannot be excluded—or as third-party information is a question that Indian law has not yet addressed.

However, a crucial legal question remains unanswered. If a registered valuer utilizes AI-generated analysis while preparing a valuation report, it is currently unclear whether that AI-generated output would be considered part of the valuer's own professional opinion—for which liability cannot be evaded—or treated as third-party information, akin to factual data provided by the company. Indian law has not yet addressed this issue, resulting in a significant gap regarding the legal liability of registered valuers who employ AI-based tools during the valuation process.

3.2 Warranty and Indemnity Provisions in Indian Share Purchase Agreements

Under Indian law, there is no general legal obligation on the seller to disclose every shortcoming or risk to the buyer during an M&A transaction. Consequently, Indian M&A practice relies heavily on contractual representations, warranties, and indemnity clauses to allocate risk. These provisions address the risk of issues that remain undetected during the due diligence process—whether conducted manually or with the aid of AI.

In the case of *Shri Krishnan v. Kurukshetra University*, the Supreme Court of India held that mere silence cannot be construed as fraud. This principle aligns with the doctrine of *caveat emptor* (let the buyer beware), which expects the buyer to conduct due diligence before finalizing a transaction (Mondaq, 2020). Since due diligence has its limitations, parties often incorporate 'indemnity clauses' into Share Purchase Agreements (SPAs) to ensure the seller remains liable for specific risks.

Under Section 124 of the Indian Contract Act, 1872, a contract of indemnity is an agreement wherein one party promises to compensate the other for any loss caused by the conduct of the promisor or any other person (Lexology, 2019).

Claims for indemnity under Sections 73 and 74 of the Indian Contract Act can only be made if the claimant proves actual loss, and the recoverable amount is limited by principles of foreseeability, remoteness, and mitigation of loss. Indian courts have acknowledged that a person entitled to indemnity can recover it once the liability is established, even prior to making actual payment (Lexology, 2019). For this reason, indemnity clauses have become one of the most critical contractual safeguards against risks that are not identified during the due diligence process.

Indian courts have held that a buyer can enforce an indemnity clause even after conducting their own due diligence, provided a representation or warranty subsequently proves to be incorrect. In the case of *GWL Properties Limited v. James Mackintosh & Co. Private Limited*, the share purchase agreement explicitly stated that the representations and warranties were material and relied upon by the buyer, irrespective of any investigation, due diligence, or inspection conducted prior to the transaction. The Bombay High Court upheld this arrangement and enforced the indemnity clause (IRCCL, 2021). Legal commentary on this judgement indicates that Indian courts generally view indemnity clauses as independent contractual protections and do not allow the doctrine of *caveat emptor* (buyer beware) to undermine their enforceability simply because the buyer had conducted due diligence (IRCCL, 2021).

This legal framework becomes especially important when disputes arise related to AI-assisted due diligence. Indian courts have generally held that a buyer's indemnity claim cannot be rejected merely because the buyer's due diligence was incomplete or inadequate. Therefore, even if the AI-assisted investigation fails to detect any material issues, the buyer can still recover compensation from the seller under a properly drafted indemnity clause. In such a case, it is not necessary for the buyer to prove that the AI tool was used negligently. This means that ‘indemnity clauses’ between buyer and seller can distribute the risk in such a way that the reliability of the AI tool becomes less important.

However, this addresses only the legal liability between the parties to the contract. It does not answer the central question of this research: whether the buyer's professional advisors can be held legally liable if they selected, supervised, or relied upon an AI-assisted due diligence tool, and that tool failed to identify a material risk. There is no clear answer to this question within the current Indian legal framework.

In Indian M&A (Merger and Acquisition) practice, the use of 'sandbagging' and 'anti-sandbagging' clauses in Share Purchase Agreements (SPAs) has become common. A 'sandbagging' clause generally permits the buyer to claim indemnification even if they were aware of the incorrect information or misrepresentation prior to the completion of the deal. Conversely, an 'anti-sandbagging' clause precludes the buyer from making such a claim if they had actual knowledge of the inaccuracy before the deal closed (Lexology, 2022).

In this context, AI-assisted due diligence raises a novel legal question. Consider a scenario where an AI-generated due diligence report clearly highlights a critical issue, yet the reviewing lawyer or professional either overlooks that information or decides not to act upon it. In such a situation, it remains unclear whether the buyer can be deemed to possess "actual knowledge" of the issue for the purposes of an "anti-sandbagging clause." There is currently no clear guidance from Indian courts or standard transaction documents on how to resolve this issue, creating significant legal uncertainty regarding the use of AI in M&A transactions.

3.3 Professional Negligence under Indian Law

There is no specific legislation in India that exclusively governs the law of negligence. Instead, the principles of negligence have primarily evolved through 'common law'. One of the most widely accepted definitions was provided by Winfield. According to Winfield, negligence occurs when a person fails to exercise the care required by law and that negligence causes harm to another, even if there was no intention to cause such harm (Legal Service India, n.d.).

Under Indian law, three essential elements generally need to be proven for a claim of negligence. First, the defendant must owe a legal duty of care to the plaintiff. Second, there must be a breach of that duty; this breach is assessed based on the standard expected of a reasonable and competent person within the same profession. Third, the plaintiff must have suffered harm as a result of that breach (Legal Service India, n.d.).

Indian courts have adopted these principles from English common law. The judgement in *Bolam v. Friern Hospital Management Committee* has been pivotal in determining whether a professional has acted negligently. The Supreme Court of India relied on this very principle in the case of *Jacob Mathew v. State of Punjab*. The Court held that a professional is not expected to possess the highest level of skill; rather, the law requires the professional to exercise the ordinary level of skill and care expected of a competent member of that profession (Mondaq, 2024).

Although it originated in cases of standard medical negligence, its application is not limited solely to the healthcare sector. Indian legal understanding holds that these same principles apply to the conduct of other professionals as well—including chartered accountants, registered valuers, engineers, lawyers, and those providing specialized professional services to clients. In every instance, the question is whether the professional acted with the level of skill and care reasonably expected of a competent person practicing in that profession (iPleaders, 2021; Legal Fund, n.d.).

Academic research on ICAI's disciplinary decisions reveals that Indian courts have generally treated ordinary negligence and gross negligence alike when evaluating the conduct of auditors. Given that auditors are responsible for supporting corporate governance and protecting investors, lapses in office or professional procedures have sometimes been deemed acts of gross professional misconduct (IIM Ahmedabad, n.d.). In the Price Waterhouse case, the Bombay High Court also held that the Securities and Exchange Board of India (SEBI) possesses the independent authority to take action against auditors when their conduct impacts the securities market. This authority is distinct from the disciplinary proceedings conducted by the ICAI (IIM Ahmedabad, n.d.).

However, none of these legal frameworks were designed with AI-assisted professional work in mind. The prevailing standard of a "reasonably competent professional" assumes that the professional personally examines available information and applies their own knowledge, skills, and judgement. The law does not explicitly specify the extent of oversight, verification, or independent review expected when a significant portion of the analysis has been generated by an AI system (such as a large language model).

For instance, if a chartered accountant, registered valuer, or legal advisor relies on AI-generated summaries of financial statements or contracts without independent verification—and the AI provides incorrect or fabricated information leading to subsequent loss—Indian negligence law would likely ask whether a competent professional in similar circumstances would have detected the error. However, there is currently no clear legal guidance regarding the extent of independent verification required for AI-generated outputs. Nor is it specified whether the level of review for AI-generated work should differ from that applied to the work of a junior employee or trainee. This lack of clarity creates a significant legal gap, an issue increasingly being recognized in international discourse surrounding AI hallucinations and professional liability (EY Switzerland, 2025; Bloomberg Law, 2026).

3.4 Disclosure and Valuation Requirements under the SEBI Takeover Code

When a lapse occurs during AI-assisted due diligence in a regulated M&A transaction involving a listed company, another critical legal framework comes into play: the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST Regulations). To ensure transparency and protect the interests of public shareholders, these regulations impose obligations on the acquiring company (acquirer) to disclose detailed information and launch an open offer.

Under Regulation 29 of Chapter II of the SAST Regulations, if an acquirer—either individually or acting in concert—crosses the 5% threshold in the shares or voting rights of a listed company, they are required to notify both the target company and the recognized stock exchanges within two working days. Similar disclosure is also required when there is a further change of 2% or more in the acquirer's shareholding or voting rights (Bhatt and Joshi Associates, 2026).

The SAST regulations also outline the circumstances under which making an open offer becomes mandatory. Under Regulation 3, an open offer is required when an acquirer obtains 25% or more of the shares or voting rights of a listed company. In contrast, Regulation 4 focuses on the acquisition of control, mandating an open offer regardless of whether the 25% threshold has been crossed.

In both scenarios, pursuant to Regulation 7, the acquirer is required to make an open offer for at least 26% of the target company's total shares (Beacon Filing, 2026).

These regulations also include specific provisions regarding valuation. One such provision is 'Regulation 5,' which applies when control of a listed Indian company is acquired indirectly through the acquisition of its foreign holding company. If the Indian company constitutes a significant part of the overall transaction, the acquiring company is required to calculate the value of the Indian target company and disclose both the per-share valuation and the valuation methodology in the offer letter (SEBI, 2017; PwC, 2011).

In the “Sanofi-Aventis vs. SEBI” case, the Securities Appellate Tribunal (SAT) also acknowledged the importance of a fair and transparent valuation. This case involved the indirect acquisition of the Indian target company, Shantha Biotechnics, through the purchase of its foreign parent company. The Tribunal held that the price paid for the foreign holding company should correspond to the true value of the Indian target company. It stated that an acquirer cannot deliberately undervalue the Indian company to pay a lower open offer price to public shareholders (Bhatt & Joshi Associates, 2026).

This amendment is particularly significant for the present study as it establishes a direct link between valuation requirements under SAST regulations and the legal obligations of registered valuers under Section 247 of the Companies Act. As previously noted, registered valuers are legally obligated to exercise due care while performing their professional duties. Therefore, even if an AI-assisted valuation or due diligence report is utilized in determining the open offer price, the responsibility remains with the registered valuer relying on that analysis to exercise due care before issuing the valuation report.

A similar safeguard exists under the Companies Act, 2013, regarding 'related-party transactions' (transactions between interconnected parties). Under Section 188, prior Board approval is mandatory for certain types of related-party transactions. Additionally, if prescribed financial limits are exceeded, shareholder approval via an ordinary resolution is also required.

These rules apply when the transaction is not conducted in the ordinary course of business or not on an 'arm's length basis' (i.e., a fair and independent basis) (ca2013.com, n.d.-b; UJA, 2026). Furthermore, under Section 177(4), the Audit Committee is required to verify whether a related-party transaction is being conducted on an 'arm's length basis' before making a recommendation to the Board (S Choudhary & Co., 2026). In discharging this responsibility, the Audit Committee will typically rely on valuation reports and information related to 'due diligence'; this may include reports generated with the assistance of AI tools.

Despite these changes, a significant limitation remains within SEBI's takeover code. Even after the 2025 amendments, SEBI's role in reviewing the 'draft letter of offer' remains limited. The regulator verifies whether the acquiring company has disclosed the information required under the SAST regulations. However, SEBI does not vouch for the accuracy or veracity of the information provided in the 'letter of offer,' nor does it assume responsibility for its contents (SEBI, 2017).

4. Sufficiency of the Existing Framework: The Indian Graded-Liability Proposal Compared with the Recent European Union Developments

This section examines whether the existing legal frameworks are sufficient to provide a clear and predictable answer to the central question raised in this research. In other words, it considers whether the current Indian legal framework can effectively establish accountability when an AI-supported due diligence tool fails to identify a critical risk during an M&A transaction, or whether legal uncertainties persist.

Section 1 analyzes three practical scenarios where AI-assisted due diligence might fail and examines how the existing Indian legal framework would apply in each case. Section 2 discusses the tiered liability model proposed in the India AI Governance Guidelines, 2025, and assesses whether this approach can address the legal gaps identified in the previous section. Section 3 compares the Indian approach with recent developments in the European Union, including the revised Product Liability Directive and the decision not to proceed with a separate AI Liability Directive. Finally, Section 4 compares the Indian and European approaches and identifies areas where both legal systems leave significant questions regarding AI-assisted due diligence in mergers and acquisitions transactions unanswered.

4.1 Examination Based on Three Failure Scenarios of the Existing Indian Framework

The reality of any legal framework is better understood by applying it to actual situations rather than merely discussing it in theory. For this reason, this section examines three hypothetical scenarios based on the legal framework outlined in Part III. These scenarios help clarify where the existing Indian legal framework provides clear answers and where legal uncertainties still persist.

The first scenario involves a professional—whether internal to the company or external, such as a chartered accountant, registered valuer, or legal advisor—who relies on an AI-generated summary of financial statements or contractual documents without independently verifying its accuracy. If that AI-generated summary contains a material error that subsequently leads to financial loss, general principles of professional negligence provide a recognized legal remedy. In such a case, a duty of care arises, and the standard of care is measured against what would be expected of a reasonably competent member of that profession, as elucidated by the Supreme Court in “Jacob Mathew v. State of Punjab” (Mondak, 2024). The situation becomes even more stringent when the professional is a Registered Valuer, as Section 247 of the Companies Act, 2013, and the Companies (Registered Valuers and Valuation) Rules, 2017, impose a statutory duty to exercise due diligence—an obligation that cannot be circumvented through contractual disclaimers (IBC Law, n.d.; Corporate Law Reporter, n.d.). However, the primary challenge lies not in the existence of a potential legal claim, but in determining how the standard of care should be applied. Indian law on negligence has yet to articulate how independent verification of AI-generated work should be assessed, or whether it should be distinguished from the level of review expected for work prepared by a junior human professional. Currently, there are no Indian appellate rulings that directly address this question.

The second scenario concerns directors of a target company who approve a transaction based on AI-generated 'due diligence' reports prepared by management or external advisors, or who fail to recognize the need for proper valuation in a 'related-party transaction.' Section 166(3) of the Companies Act, 2013, clearly expects directors to exercise independent judgement; this obligation cannot be fulfilled by merely accepting the findings of reports produced by experts or AI without proper scrutiny (Barristery, 2026). Rulings in cases involving the MCX stock exchange and Zee Entertainment also demonstrate that independent directors are expected to exercise their own discretion and cannot blindly rely on management, professional advisors, or automated systems (Law Zone, 2026). However, the primary issue in this context relates to the available remedy rather than the legal liability itself. Although Section 166 establishes a clear legal obligation, its enforcement is primarily effected through financial penalties payable to the State. Furthermore, Indian law remains unclear on whether an external party—such as an acquirer who has suffered financial loss due to the directors' default—possesses a private right to bring a direct claim against those directors (Lex Counsel, 2023). Thus, while liability is clearly recognized, the legal remedy available to an affected third party remains uncertain.

The third scenario—arguably the most likely to arise in practice—involves an acquirer who completes an M&A transaction relying on AI-assisted due diligence, only to subsequently discover a significant liability that the AI system failed to identify. As discussed in Part III, Indian courts—notably in *GWL Properties Ltd. v. James Mackintosh & Co. Pvt. Ltd.* —have generally held that the quality of the buyer's own due diligence does not preclude them from claiming compensation under a valid indemnity clause (IRCCL, 2021). Consequently, the buyer's contractual remedy against the seller generally remains available, even if the due diligence failure was caused by an AI tool rather than a human professional. However, the existing legal framework does not answer a different but equally important question. It is unclear whether the buyer's own professional advisors—who selected, configured, oversaw, or relied upon the AI tool—can themselves be held liable to the buyer for failing to identify that critical risk. This question brings the analysis back to the same uncertainty discussed in the first case.

A common issue is evident across all three scenarios. The existing Indian legal framework defines where legal liability lies and establishes a general standard of care. However, none of the legal frameworks discussed in Part III were designed with AI-assisted due diligence in mind. Consequently, they do not specify the appropriate level of reliance to place on AI-generated reports, nor do they clarify the extent to which directors, professionals, or other parties involved in M&A deals are expected to independently verify AI-generated outputs. Thus, the problem is not the absence of a legal framework; rather, the existing framework becomes ambiguous precisely where AI-assisted due diligence gives rise to novel legal questions.

4.2 The Graded-Liability Model in the India AI Governance Guidelines, 2025

The Ministry of Electronics and Information Technology (MeitY) released the 'India AI Governance Guidelines' under the IndiaAI Mission on November 5, 2025. These guidelines represent the Government of India's first comprehensive framework for the governance of Artificial Intelligence (AI) (Saikrishna & Associates, 2025). As stated in the introduction, these guidelines do not create a separate AI law. Instead, they adopt a 'soft-law' approach; that is, they rely on the existing legal framework and suggest specific modifications where necessary, rather than introducing a standalone AI Act like the European Union (Bettering Results, 2025). While releasing them, IT Secretary S. Krishnan explained that India deliberately chose a path to foster innovation while keeping an eye on international developments; therefore, it was deemed preferable to rely on existing laws and regulatory frameworks rather than enacting an entirely new AI law (Saikrishna & Associates, 2025).

The guidelines are based on six key pillars: infrastructure, capacity building, policy and regulation, risk mitigation, accountability, and institutions (Insights on India, 2025). Among these, the accountability pillar is the most relevant to this research. Under this pillar, the guidelines propose a system of tiered liability, wherein responsibility is distributed according to the roles played by various participants in the AI ecosystem—such as developers, deployers, and users.

The level of liability also depends on the risk associated with the AI application and the degree of caution or due diligence exercised by each participant (Mondak, 2026; Saikrishna & Associates, 2025). The guidelines also recommend transparency reporting, grievance redressal mechanisms, and oversight through audits or peer reviews. However, rather than establishing a separate AI regulator, they suggest that enforcement should continue through existing sectoral regulators (The AI Track, 2025).

For the purposes of this research, three aspects of the tiered-liability model are particularly significant. At the same time, each of them also highlights a critical limitation.

First of all, a 'role-based approach' is well-suited for AI-assisted due diligence in M&A transactions. Distinct responsibilities can be assigned to the various parties involved—such as the AI tool developer, the advisory firm utilizing the tool during the due diligence process, and the acquiring or target company relying on the AI-generated insights—based on their respective roles.

Secondly, these guidelines link liability to the level of care exercised by each participant. This approach broadly aligns with the existing standard of a "reasonably competent professional" outlined in Part III. Therefore, rather than altering the prevailing law regarding professional negligence, this graded-liability model appears to build upon it by providing additional guidance on how responsibility can be distributed among various AI actors.

Thirdly, and most importantly, these guidelines are merely policy-related recommendations and are not legally binding. Legal experts have repeatedly stated that the 'graded-liability model' (a model involving varying levels of responsibility) cannot be directly implemented unless backed by legislation or amendments to existing laws, such as the Information Technology Act, 2000 (The AI Track, 2025; Anevagi, 2025). The guidelines themselves acknowledge this limitation, recommending that future legal reforms clearly define the roles and responsibilities of developers, deployers, and users under the Information Technology Act. This clearly indicates that the 'graded-liability model' has not yet become an enforceable legal standard (Anevagi, 2025).

However, this proposal still leaves several critical questions unanswered. It does not specify the extent of human oversight or independent review required before relying on AI-generated outputs. Furthermore, it offers no new private legal recourse for buyers or minority shareholders who might suffer losses due to flaws in AI-assisted due diligence. Consequently, the previously noted legal uncertainty persists even after the publication of the 'India AI Governance Guidelines.' While India now possesses a useful policy framework for discussing AI-related accountability, there remains no binding legal standard that courts can apply when adjudicating disputes arising from AI-assisted due diligence in M&A transactions.

4.3 The European Union: The Product Liability Directive and the Withdrawal of the AI Liability Directive

The European Union is an important example for comparison because it has taken a different approach to regulating liability related to AI. Instead of relying mainly on existing laws, the EU has attempted to create specific legal rules for AI-related liability. However, despite this approach, there are some legal questions that still remain unanswered.

In September 2022, the European Commission presented two separate legislative proposals under a single legal package. The first was a revised version of the 'Product Liability Directive,' and the second was the proposed 'AI Liability Directive.' The aim of the AI Liability Directive was to make it easier for claimants to prove fault and causation in cases involving AI-related damage (Taylor Wessing, 2025). However, only one of these proposals ultimately became law.

Directive (EU) 2024/2853, which amended the Product Liability Directive, was formally adopted on October 23, 2024. It entered into force on December 8, 2024, and requires all member states to transpose it into their national laws by December 9, 2026. This directive will apply to products placed on the market or put into service on or after that date (Basil Puglisi, 2026; LexisNexis, 2026). In contrast, the proposed AI Liability Directive did not progress through the legislative process, and the European Commission officially withdrew it on October 6, 2025. The Commission stated that it might introduce separate legislation in the future specifically to address software liability (Taylor Wessing, 2025; Basil Puglisi, 2026).

Even before the revised Directive was finalized, legal experts had identified significant challenges in applying product liability rules to AI systems. Writing in the "Computer Law & Security Review" Buiten, de Streel, and Peitz (2023) argued that applying traditional product liability becomes difficult when AI systems continue to learn or behave autonomously after deployment. In such situations, it becomes extremely hard to determine whether a problem stems from a defect in the product or from the way the system was used after deployment (Buiten et al., 2023).

Another issue discussed in legal literature is whether AI systems should be classified as "products" or "services." This distinction is significant because products generally fall under the scope of "strict liability," whereas services are typically governed by "fault-based principles" (such as professional negligence). Legal experts have noted that courts have traditionally distinguished professionals—such as accountants, financial advisors, and other service providers—from manufacturers, as these professionals offer expert advice rather than physical products. Since AI-assisted "due diligence" also involves professional analysis and advice, it is not always clear whether it should be treated as a product or a professional service for liability purposes (Lawfare, 2024).

For the purposes of this research, the revised 'Product Liability Directive' has two significant limitations.

Firstly, the Directive primarily protects natural persons. It provides compensation for death, personal injury, damage to consumer property, and the destruction or corruption of personal data used for non-professional purposes (Regulations.ai, 2026). However, the scenario examined in this research differs; here, the loss was incurred by a company that had acquired another business based on AI-assisted 'due diligence'. This loss is purely economic and arose within a commercial business-to-business transaction. Such commercial losses do not fall under the categories of harm covered by the revised Directive.

Secondly, the Directive is premised on the concept of a defective product that fails to provide the level of safety a person is reasonably entitled to expect (Lexology, 2025). This standard applies when a defective product causes physical injury, property damage, or data security issues. However, an AI-powered 'due diligence' tool typically does not cause such harm. Instead, a defect in this context relates to flawed financial, legal, or commercial analysis that subsequently impacts a critical business decision. Therefore, the safety-centric approach adopted in the Directive does not readily apply to the type of analytical error observed in this study.

For these reasons, even though the revised 'Product Liability Directive' now includes AI systems within the definition of a 'product,' it is unlikely to provide a comprehensive legal solution for lapses in AI-assisted due diligence during M&A (Mergers and Acquisitions) deals. Furthermore, the withdrawal of the 'AI Liability Directive' means that the European Union currently lacks a distinct legal framework to address fault-based liability regarding AI-driven professional services. Although the European Commission has indicated that legislation concerning software liability could be introduced in the future, no such framework currently exists (Basile Puglisi, 2026). Consequently, legal uncertainty persists within the European Union regarding AI-assisted due diligence.

4.4 Comparative Assessment

India and the European Union employ different approaches, yet the ultimate outcome is similar. India has adopted a flexible, principles-based approach centered on the concept of 'graded liability.' Under this framework, liability is determined by the role of the AI actor, the level of risk involved, and the precautions taken prior to utilizing the AI system (Saikrishna & Associates, 2025; The AI Track, 2025). This approach appears well-suited for AI-assisted due diligence in M&A (merger and acquisition) transactions. However, it currently remains merely a policy recommendation; it is not legally binding and does not establish a clear right to legal recourse for buyers, sellers, or any other party that might suffer losses due to deficiencies in AI-assisted due diligence.

On the other hand, the European Union has adopted a legally binding framework through the revised 'Product Liability Directive.' However, the scope of this directive is primarily limited to cases involving product safety, personal injury, damage to consumer property, and similar losses. It does not effectively address the type of commercial loss that occurs when an AI-assisted 'due diligence' tool fails to identify a critical risk during an M&A transaction.

Furthermore, the 'AI Liability Directive'—originally proposed to address issues such as fault, causation, and AI-related liability across various scenarios—was withdrawn before becoming law, and no alternative legal instrument has been introduced to replace it so far (Taylor Wessing, 2025; Basil Puglisi, 2026).

Therefore, even though India and the European Union have adopted different approaches, there is currently no liability framework in any legal system specifically designed for AI-assisted due diligence in regulated M&A transactions.

Of the two approaches, the 'graded-liability model' (a tiered approach to assigning responsibility) suggested in the 'India AI Governance Guidelines' appears to be a more suitable starting point for future legal reforms in India. Unlike the European approach, it is not predicated on the concept of product safety. Instead, it can be integrated with the existing Indian legal framework—encompassing laws regarding professional negligence, director liabilities under the Companies Act, 2013, and disclosure and valuation obligations under the SEBI Takeover Code (as outlined in Part III). This implies that the existing legal framework need not be overhauled; rather, it can be strengthened by introducing clear rules that determine how liability is apportioned when AI systems are utilized during the 'due diligence' process.

However, making the 'graded-liability model' (a model based on levels of responsibility) effective will require further legal or regulatory measures. As acknowledged in the 'India AI Governance Guidelines' themselves, there is a need to clearly determine the extent of "reasonable" reliance that can be placed on professional work generated by AI, as well as the level of independent human verification expected before relying on such work. Currently, neither Indian case law nor the European Union's 'Product Liability Directive' provides clear legal standards to address these questions. This research highlights this gap as a key issue.

5.Discussion, Recommendations, and A Future Framework

This section consolidates the insights from Parts II through IV into concrete recommendations. These recommendations are addressed to three distinct groups: the parties determining risk allocation in contracts and their advisors; the regulators governing the content of binding standards (primarily SEBI, MeitY, and professional self-regulatory bodies); and the professional bodies themselves, which govern the operational standards to be followed by their members.

5.1 The Central Finding

An analysis of Parts III and IV reveals that Indian law does not lack a legal basis for addressing lapses in AI-assisted due diligence; rather, the deficiency lies in the absence of a defined 'standard of care' for such processes. Directors bear the responsibility for independent decision-making under Section 166, registered valuers face inescapable due diligence obligations under Section 247, professionals are generally required to act with the competence expected of a qualified member of their profession, and acquiring and selling companies allocate residual risks regarding latent defects through indemnity clauses—which Indian courts typically enforce regardless of the level of diligence exercised by the buyer. However, none of these frameworks specify to directors, valuers, advisors, or courts the extent of independent verification required for AI-generated information.

The 'India AI Governance Guidelines, 2025' provide a conceptual framework—such as assigning responsibility based on roles, risks, and precautions—to address this issue; however, these are merely advisory policy guidelines and are not mandatory (Saikrishna & Associates, 2025). In contrast, the European Union's revised 'Product Liability Directive' is mandatory but does not apply to pure economic or business-to-business losses resulting from a lack of 'due diligence,' as the regulation is primarily limited to death, personal injury, and damage to consumer property (Regulations.ai, 2026). As for India, SEBI has taken a small yet concrete step in this direction: under Regulation 16C of the SEBI (Intermediaries) Regulations, 2008 (effective from February 10, 2025), any entity falling under SEBI's purview will be held fully accountable for the accuracy of outputs generated by any AI or ML tools it employs, whether developed in-house or procured from a vendor (TaxGuru, 2025). Since merchant bankers are SEBI-registered intermediaries, this rule already applies—at least in principle—to the 'due diligence certification' process discussed in 'Part III'.

The issue is that it was originally drafted for trading and portfolio management activities and has not yet been explicitly linked to 'due diligence certification' in any circular or guidance note.

5.2 Recommendations

(A) Contractual Risk Allocation

First, the 'due diligence' engagement letter between the acquiring company (or target company) and their professional advisors should include a clause explicitly detailing the use of AI. This should specify which AI tools were employed, the types of documents or analyses for which they were used, and the steps taken to verify the accuracy of the tool's output before relying on it. This is not a novel concept; existing Share Purchase Agreement (SPA) practices already mandate similar levels of detailed disclosure regarding information completeness. Adopting this approach for the due diligence process would create a documentary record enabling a retrospective assessment of whether a qualified professional exercised proper oversight. Industry discourse on generative AI due diligence tools has identified the absence of such audit trails as a significant practical challenge (Ur AI, 2026); the proposed measure offers a straightforward and cost-effective solution to address this gap.

Secondly, when drafting an SPA (Share Purchase Agreement), the 'due diligence' conducted with the aid of AI should be explicitly factored into the 'sandbagging' and 'anti-sandbagging' provisions commonly used in Indian M&A practice. If an AI-assisted due diligence report reveals an issue that was not conveyed to—or was overlooked by—the human due diligence team, current Indian drafting practices do not clarify whether the buyer should be deemed to have "knowledge" of that fact for the purposes of an anti-sandbagging clause (Lexology, 2022). "Buyer's knowledge" in the SPA should be defined based on information actually conveyed to and reviewed by a human member of the deal team, rather than the entire output of the AI tool; this ensures that an issue flagged by the AI but not escalated does not inadvertently invalidate a legitimate 'indemnity claim'.

Thirdly, acquiring companies and their advisors should ensure, as a condition for commencing work, that the advisor's 'professional indemnity' or 'errors-and-omissions' insurance policy explicitly extends to work produced with the aid of AI.

This recommendation takes into account the rapid and distinct shifts observed in the global professional liability insurance market during 2025 and 2026. During this period, major insurers such as Hamilton Insurance Group and Berkley Insurance Company implemented policies excluding coverage for claims arising from the use of generative AI, whereas a smaller number of insurers began offering specialized coverage for AI-related activities (Insurance Insider, 2026; AI Vortex, 2026). Since a 'due diligence' engagement letter is a contract governed by the general principles of the Indian Contract Act, 1872, it is legally sound for acquiring companies to mandate—and obtain written confirmation of—insurance coverage for AI-assisted work; absent such confirmation, an acquiring company relying on an AI-generated due diligence report might find that its only effective recourse lies against the advisor's own balance sheet rather than the insurer (Honigman, 2026).

(B) Regulatory Guidance

Fourth, SEBI’s consultation paper on the responsible use of AI/ML in the Indian securities market, issued on June 20, 2025, establishes the necessary regulatory principles for this study, even though it was not specifically drafted with M&A due diligence in mind: the paper proposes that a regulated entity using a third-party AI/ML tool remains as accountable for the tool's output as if it had developed the tool in-house; this aligns with the "sole responsibility" standard already established in Regulation 16C (Chambers and Partners, 2026; Finsclaw, 2025). This study suggests that SEBI issue a specific circular explicitly extending this principle of "non-delegable responsibility" to registered valuers and merchant bankers operating under the SAST and Merchant Banker regulations; this would ensure that a valuer or merchant banker cannot cite erroneous AI tool output as grounds to diminish the scope of due diligence obligations already mandated under Section 247 of the Companies Act and the 2017 Valuation Rules (IBC Laws, n.d.; Corporate Law Reporter, n.d.). Since Regulation 16C is already in place, this proposal does not require new primary legislation—merely a clarifying circular applying an existing principle to a specific, hitherto unaddressed category of regulated activity. This would allow for the relatively easy implementation of this reform.

Fifth and most importantly, MeitY and SEBI should collaboratively formulate sector-specific guidance to implement the concept of 'graded liability' within the 'India AI Governance Guidelines,' rather than leaving this concept to evolve solely through future litigation. The guidelines themselves suggest that any legal enforcement under the 'Information Technology Act, 2000' must clearly delineate the liabilities of developers, deployers, and users (Anevagi, 2025). This study proposes adopting a 'materiality-based test' for such clarifications: liability should arise when there is a lapse in AI-assisted 'due diligence,' and an erroneous or 'hallucinated' output proves material to a transaction's outcome without having been independently verified prior to disclosure; conversely, liability should not arise when an AI error occurs in the context of an outcome that is otherwise correct and independently substantiated. This test is directly grounded in the 'graded liability' concept already proposed in the guidelines, translating 'risk' and the 'level of due diligence performed' into a practical standard that courts, SEBI’s SAT bench, or the NCLT can apply consistently.

(C) Professional Standards

Sixth, the Institute of Chartered Accountants of India (ICAI), the Institute of Company Secretaries of India (ICSI), and Registered Valuer Organizations recognized under the Companies (Registered Valuers and Valuation) Rules, 2017, should issue specific practice standards outlining minimum requirements for independent verification and sampling in AI-driven financial due diligence and valuation tasks. These standards should mirror the disciplinary frameworks already in place for auditor conduct by the ICAI (IIM Ahmedabad, n.d.). This would not be a novel initiative: the ICAI’s revised Code of Ethics, effective April 1, 2026, already incorporates guidance on "contemporary challenges, including AI" (ICAI, 2025), and the International Valuation Standards Council has released a discussion paper on AI in valuation, applicable from January 31, 2025. This paper emphasizes that regardless of the technology employed, professional judgement and a spirit of skepticism remain essential (IVSC, 2025). The suggestion here is simply that Indian professional bodies should not limit this general awareness to the level of ethical principles but should translate it into a specific standard focused on due diligence.

A useful precedent is the American Bar Association’s 'Formal Opinion 512,' issued in July 2024, which affirms that existing obligations regarding a lawyer's competence and integrity apply equally to AI-assisted work (GC AI, 2026); the Bar Council of India has yet to issue such an opinion, and this study suggests it should do so—ensuring the guidance applies explicitly to due diligence conducted as part of transactions, rather than being confined solely to litigation practice.

5.3 Limitations of the Study

This study analyzes legal principles and does not include data on actual instances of AI-assisted due diligence failures in Indian M&A (merger and acquisition) deals, as such data is not publicly available: due diligence information is confidential, and related disputes are typically resolved through negotiation, arbitration, or confidential settlements rather than published judgements. As of the writing of this study, no judicial or regulatory ruling has emerged in India specifically addressing failures in AI-assisted due diligence within M&A transactions. This fact is a significant finding in itself and should be explicitly acknowledged rather than overlooked: it implies that the analysis in this paper is grounded in legal principles and future possibilities rather than Indian court precedents, and its recommendations should be viewed as proactive precautionary measures rather than a response to an established pattern of failures in legal disputes. The study is limited to Indian law and two comparative frameworks—the 'India AI Governance Guidelines' and the 'European Union's product liability system'—identified as most relevant in the paper's introduction; it does not provide an exhaustive survey of approaches taken by other countries or regions regarding AI liability in professional services.

5.4 Areas for Future Research

Based on the gaps identified in this study, three areas emerge for future research. First, an empirical study could be conducted involving Indian M&A professionals, investment banks, and law firms through structured interviews or surveys. This study would help determine whether the recommendations regarding AI usage disclosure and engagement letters—outlined in Section 2(a)—are already emerging as informal market practices.

Such a trend could occur even in the absence of mandatory regulatory rules, much like how warranty and indemnity insurance became a standard part of Indian M&A practice before being mandated by any regulator. Second, once SEBI transforms its consultation paper on the responsible use of AI/ML in the Indian securities market into mandatory guidelines, a follow-up study could examine whether these guidelines apply to due diligence certifications under Merchant Banker and SAST regulations (either explicitly or by clear implication), or if the gap identified in Section 1 persists even after the guidelines are finalized. Third, a comparative study could investigate how other common law jurisdictions—specifically Singapore and the United Kingdom, which, like India, have not yet adopted EU-style horizontal AI legislation—address professional liability regarding AI-assisted financial and legal due diligence. This would reveal whether the graded-liability model proposed in this paper is a solution unique to India or if it could be widely adopted in jurisdictions that prioritize regulation through existing sector-specific laws rather than enacting separate AI legislation.

6. Conclusion

This paper aims to determine who should be held legally liable when an AI-assisted 'due diligence' tool fails to detect a significant risk in a regulated M&A (merger and acquisition) deal in India, and whether the existing legal framework provides a clear and predictable answer to this question. Based on the analysis in Parts III and IV, the answer is affirmative, albeit with certain conditions. Indian law is not silent on this matter: directors, registered valuers, professional advisors, and transacting parties are subject to obligations and contractual rules that can, in principle, establish liability for due diligence failures, regardless of whether the failure stemmed from an AI tool. What Indian law currently lacks are sector-specific, defined rules regarding the extent of independent verification of AI-generated professional work required to constitute 'reasonable care.' This question remained unresolved even after comparing the non-binding 'graded-liability model' of the 'India AI Governance Guidelines' (discussed in Part IV) with the European Union's binding—yet structurally unenforceable—'product liability system.' SEBI's Regulation 16C also addresses this only partially; while it generally places full responsibility for AI outputs on regulated intermediaries, it has not yet been specifically linked to 'due diligence certification.' This paper argues that no new legislation is required to address this gap. A contractual clause regarding AI usage, SEBI's specific circular extending the existing Regulation 16C framework to registered valuers and merchant bankers, and 'due diligence' standards formulated by the ICAI, ICSI, and registered valuer organizations—collectively, these can operationalize the existing standards of 'reasonable care' and 'due diligence' outlined in Part III, a gap that currently exists. Together, they will largely bridge this gap—well before the next deal where an error by an AI tool could become a problem for the buyer.

List of Symbols and Abbreviations

No non-standard symbols are used in this paper. All abbreviations are expanded at first use in the text (for example, AI – Artificial Intelligence; M&A – Mergers and Acquisitions; SEBI – Securities and Exchange Board of India; SAST – Substantial Acquisition of Shares and Takeovers).

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