ARTIFICIAL INTELLIGENCE: THE TORCHBEARER FOR FUTURE DUE DILIGENCE

G. Srividhya Iyer, B.B.A; L.L.B (Hons), Sastra Deemed To Be University

ABSTRACT

Borders have diminished. Cross country transactions are very prevalent now. Globalization has paved way for complex commercial transactions and business proposition to be done on a war footing. Intelligence is a global sovereign ruler. Might is right. It upholds this in every grammatical way. The business intelligence requires the usage of both human intelligence and Artificial Intelligence (AI). Whichever is fast and would be accurate would be applied or used to accelerate development. Complex surgeries are now done by Artificial Intelligence led robots. Technology is an obedient servant to humans when properly used. AI is the emerging branch where there is a very wide, ample scope for universal application. This paper deals with the usage of AI in due diligence and other legal process.

Keywords: Artificial Intelligence, Due Diligence, Software, Kira Systems

I.   INTRODUCTION

Intelligence: It is a priceless mental faculty of a human being. To do or not to do and to proceed with an instinct of doing it with care than an ordinary human being would do. Whereas Artificial Intelligence (AI) is defined as "the ability of a digital computer or computer-controlled robot to perform tasks commonly associated with intelligent beings."[1] The difference between intelligence and AI is that intelligence is an act of doing things with an inbuilt instinct and AI is the act of doing things after taking into account or factoring numerous inputs and the probability of the success of the output as desired done through a software in a digitalized environment with no human intervention but for inputs. The analytical approach determines the degree of AI. It could be either inductive or deductive.

Therefore AI's usage in this digitalized world is an inescapable imperative. Since AI's application would be as wide as the universe, attempt has been taken to present a bird's eye view of its application in due diligence for mergers and acquisitions (manufacturing) and in legal sector.

II.   DUE DILIGENCE

Due diligence has been defined as "an investigation or audit of a potential investment consummated by a prospective buyer. The objective is to confirm the accuracy of the seller's information and appraise its value."[2] In the corporate sector due diligence is mainly carried out for two reasons. They are-

i.   Mergers and acquisitions results out of due diligence. A company which seeks to acquire another company checks as to whether the company which is going to be acquired is prospective. The main purpose of due diligence is to check the debit and credit score of the company, its prospective customers, contracts and agreements signed by the company, legal position of the company (i.e.) lawsuits against the company if any.

Tie up with a sick organization would lead to damage. Thus due diligence helps in ascertaining as to whether a company is healthy or not to have any sort of relationship with.

---

[1] https://www.britannica.com/technology/artificial-intelligence
[2] https://dealroom.net/faq/due-diligence-meaning

III.   PROCESS OF DUE DILIGENCE

The following details are collected for due diligence[3]-

1. General information - AOA, MOA, JV and partnership agreement, vision, mission, scope of business, areas of operation, meetings held, minute book etc.

2. Organization and ownership details - Staff hierarchy in an organization, shareholder details, related documents etc.

3. Administrative information -Number of offices, location etc.

4. Regulation and compliance- License from government / regulatory body, internal policy of the company etc.

5. Financial details.

6. Operational - Company's model, data about any research carried out on the company, key performing factors, manufacturer details, suppliers, intermediary in supply chain, distribution channels etc.

7. All tax related documents.

8. Legal - Lawsuits- ongoing/ concluded, government inquiry, loan agreements, bank financing agreements, guarantee agreement etc.

9. Technology - All technology contracts and agreements entered into by the company, security protocols and policy, cyber attack in the past if any, interfaces, softwares used by the company, IT processes etc.

10. Physical assets- Sale/ purchase/ lease/ mortgage related documents.

11. Intellectual property related details - Copyright/ patent/ trademark, trade secrets etc- owned/ application made for, social media handles, web pages of the company etc.

12. Human resource details- Employee demographic/ handbook details, recruiting process, performance review, pay roll, ESOP plans, retirement benefits etc.

13. Commercial- Goods and services dealt with, market indicators, prospective buyers, market success rate, warrant matters, supplier and distributor details, competitor details etc.

14. Environmental details- Infrastructure, safety protocols, insurance, hazardous waste regulation etc.

15. Cultural details- The "way of working of the company.

---

[3] https://www.netsuite.com/portal/assets/pdf/brainyard-due-diligence-checklist.pdf

16. Strategic assessment- This is to look into details as to whether the alliance would be profitable.

Thus it is a strenuous process.

IV.   ISSUES IN MANUAL DUE DILIGENCE

1. Elaborate process is involved.
2. It is strenuous in nature.
3. The fee is high owing to the amount of work he should plough in.
4. Time taken to complete the process is huge.
5. To err is human. Thus no matter how cautious we are we might commit mistakes. In certain cases the mistake so committed will cost the goodwill and reputation of the organization.

V.   CASE STUDIES: ERRORS IN DUE DILIGENCE WHICH TOOK TOLL ON THE ORGANIZATION

1. In the year 2017 Deutsche Bank was held liable for not carrying out due diligence properly. It failed to take note of money laundering.
2. Quaker Oats sought to acquire Snapple. Their due diligence was not proper since they failed to look at the intellectual property issues. Above all their estimation for the transaction itself was incorrect.
3. Hewlett-Packard acquired Autonomy for exorbitant price than the supposed cost.
4. Bharathi Airtel acquired Zain. It wasn't a success since due diligence was not carried out properly. Details as to assets were not properly scrutinized.

VI.   ARTIFICIAL INTELLIGENCE : TORCH BEARER FOR FUTURE DUE DILIGENCE

Artificial intelligence has stamped its feet in due diligence as well. Artificial intelligence can be used for "identifying, classifying, organizing, prioritizing and highlighting documents that are relevant in the context of the transaction in a more effective (time) and efficient (cost)

manner.[4]"

a.   AI doesn't have language barriers like humans.

b.   It doesn't burn out after working for some time.

c.   It detects mistakes which might not be within the reach of human eyes, and there is less scope for error as opposed to manual checking.

d.   It picks out the relevant provision in few minutes from the large pool of data available. The same work would take lot of energy, human resource and time if done manually.

e.   It is more accurate in nature than manual work. IBM stated that its AI had predicted with 95% accuracy as to the list of employees who would quit their job soon[5].IBM'S CEO further added that AI is performing better than the traditional human resource model.

f.   AI can easily point out over estimated mergers and thereby would save the company from financial crash.[6]

Softwares would be programmed for carrying out due diligence. It would be incorporated with a check list for carrying out all the procedures in the due diligence process. Legal position, documents to be reviewed, agreements and contracts to be scrutinized, major provisions in a document etc are to be inbuilt in the software application. Two similar contracts can be compared and difference between them can be traced out through artificial intelligence based due diligence. Anomalies are also pointed out by the artificial intelligence software.[7]

Thus market players who use AI for due diligence will certainly have an edge over their competitors.

VII.   ARTIFICIAL INTELLIGENCE IN DUE DILIGENCE: APPLICATION AROUND THE GLOBE

Kira Systems's AI is popularly being used by leading law firms and companies for due

---

[4] https://nysba.org/NYSBA/Sections/International/Events/2017/Corporate%20Wedding%20Bells%20Cross-Border%20Mergers%20and%20Acquisitions/Coursebook/Panel%202/Artificial%20Intelligence%20and%20Mergers%20and%20Acquisitions%20Due%20Diligence.pdf

[5] https://www.cnbc.com/2019/04/03/ibm-ai-can-predict-with-95-percent-accuracy-which-employees-will-quit.html

[6] https://www.law.com/americanlawyer/sites/americanlawyer/2017/11/30/wall-street-wakes-up-to-legal-ai-for-due-diligence/?slreturn=20180120224441.

[7] https://nysba.org/NYSBA/Sections/International/Events/2017/Corporate%20Wedding%20Bells%20Cross-Border%20Mergers%20and%20Acquisitions/Coursebook/Panel%202/Artificial%20Intelligence%20and%20Mergers%20and%20Acquisitions%20Due%20Diligence.pdf

diligence. Some of them include Clifford Chance, King & Wood Mallesons, Freshfields, Deloitte etc. In India Cyril Amarchand and Mangaldas was the first firm to adopt this technology. Kira has the following features-

a. "Kira helps in highlighting important provisions.

b. It aids in comparing the document with the original document.

c. It keeps track of the changes made in the document.

d. It also has a track of viewed and assigned documents.

e. It has a dashboard which highlights on the overall work completed. It helps in finding risks involved in the project.

f. Importing documents is made easy.

g. Texts can be extracted even from scanned documents and summary charts for the same can be prepared."[8]

h. It is pre-programmed to scrutinize the following-

"Title, Parties, Date, Term and Renewal, Pricing, Termination for Convenience, Most Favored Nation, Exclusivity/ Non Compete, Assignment, Change of Control, Confidentiality, Indemnity, Survival, Warranty."[9]

VIII.   ISSUES REVOLVING AROUND AI DUE DILIGENCE

a.   *General issues-*

1. Software might get corrupted at times. This would hamper the work.

2. Malfunctioning of the software would lead to incorrect output.

3. Requirements of parties differ. The client might not consent to his data being processed by AI.

4. Costs involved in outsourcing software from a third party developer is to be given due consideration.[10]

5. Employment would move towards techno savvy people. Educating the older generation regarding the usage of AI will be a hectic task.

6. Name anything there is a pirated version for the same available in the market. Customers are at times fooled by the dealers who sell such pirated versions. It is highly

---

[8] https://kirasystems.com/how-kira-works/due-diligence/
[9] https://kirasystems.com/solutions/due-diligence/
[10] https://assets.kpmg/content/dam/kpmg/za/pdf/pdf2020/due-diligence-incorporating-al-the-pros-and-cons.pdf

possible that such issues might crop up in this domain as well. It is not to be forgotten that the consequences which would arise out of data corruption would be disastrous.

b. *Legal issues-*

1. There isn't any regulation to deal with issues which might arise due to AI based due diligence. Protocols to be followed in each stage of scrutiny are not laid out.

2. Question of liability- If any gross error occurs due to the malfunctioning of AI on whom does the liability lie?

    a. Should the advocate take up the responsibility since he is the one who is entrusted with the case ultimately?

    b. Whether the manufacturer of the AI software will be held liable for its malfunctioning?

    c. Whether the intermediary who sold the product can be held liable?

    d. Whether the operator employed in the law firm to handle the product can be held liable?

    e. What status does the AI hold? In Saudi Arabia a robot named Sophie was granted citizenship. Countries around the world might not grant the same to AI. Thus in case of cross- border transactions the question as to its capacity would arise. Jurisdictional issues would also come in.

    The question of liability is a crucial point to be considered.

3. Data breach cases- Questions as to whether the firm employing such AI for due diligence had sufficient safeguards against cyber attacks would arise. What constitutes "sufficient safeguard" is again a question to be deliberated upon.

4. The Artificial Intelligence wouldn't be protected by one single Intellectual Property Right. Various parts of the AI would be governed by different IP rights.[11]

5. Antitrust issues might arise.[12]

6. General Data Protection Regulation (GDPR) should particularly address the said issue. It has to be ensured that both the parties comply with GDPR (wherever applicable). AI should comply with the law of the home country as well.

---

[11] https://www.jdsupra.com/legalnews/new-due-diligence-challenges-facing-6554178/
[12] https://www.jdsupra.com/legalnews/new-due-diligence-challenges-facing-6554178/

IX.   CONCLUSION

Technology can never replace human resources. Technology has its own pitfalls. Thus usage of Artificial Intelligence wouldn't lead to unemployment as such. In India the Information Technology Act, 2000 and other corporate laws should be amended appropriately to deal with AI based due diligence. The issues mentioned above should be addressed appropriately. Privacy laws around the globe should be harmonized for paving way for cross country transactions.