



The Urgency of Due Diligence in Minimizing Legal Risks in the International Pre-Contractual Stage

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Abstract

This research aims to analyze the urgency of Due Diligence as a legal risk mitigation instrument in the pre-contractual stage of international business transactions. Cross-jurisdictional complexities often create information asymmetry leading to commercial disputes. The research method used is normative juridical with statutory and case approaches to examine the application of the precautionary principle. The results show that the majority of cross-border disputes are caused by failures to verify legal capacity, asset status, and regulatory compliance of foreign partners. The discussion emphasizes that Due Diligence findings must be concretely integrated into contract clauses, specifically Representations and Warranties. The conclusion asserts that Due Diligence is an absolute prerequisite (sine qua non) to ensure the validity of the agreement's subject and object, as well as to protect parties from potential financial losses and extraterritorial legal sanctions before the final agreement is signed.

Keywords: *Due Diligence, Information Asymmetry, International Contract, Legal Risk, Pre-Contractual.*

Introduction

Economic globalization has broken down the geographical barriers that have long restricted the movement of business actors, driving a significant surge in cross-border business transactions. In the modern trading landscape, international business contracts have become a vital instrument that bridges the interests of parties from different legal jurisdictions. However, this dynamic brings its own complexities, where the convergence of diverse legal systems such as Civil Law and Common Law often creates serious legal uncertainties (Santoso, 2024). This complexity requires dynamic legal adaptation to ensure that transactions continue to operate within the corridor of legal certainty.

Unfortunately, the growth in the volume of international transactions is directly proportional to the increase in complex and costly commercial disputes. Recent studies show that many of these disputes are not caused solely by failure to perform, but are rooted in imperfections in the preparatory or pre-contractual stages (Wijaya, 2023). Often, the euphoria to immediately close a business deal overshadows the principle of prudence, resulting in contracts being signed on the basis of fragile and unverified information.

The pre-contractual stage is a critical phase where negotiations take place, Letters of Intent (LoI) are exchanged, and initial understandings are established. At this stage, legal risks are often invisible but deadly, ranging from the legal incompetence of the parties, the disputed status of assets, to non-compliance with international regulations (Thompson, 2022). Failure to detect these issues early on is a time bomb that can explode into lengthy litigation or international arbitration in the future.

One of the biggest challenges in cross-border transactions is information asymmetry, where one party has far superior access to information compared to the other. In an international context, verifying the credibility of foreign business partners is much more difficult than domestic partners due to differences in language, business culture, and access to public data (Lee & Kim, 2024). This information imbalance opens up opportunities for misrepresentation, concealment of material facts, and even corporate fraud that significantly harms one of the parties.

To mitigate these risks, the Due Diligence mechanism is an absolutely necessary preventive instrument. Due Diligence is defined as a series of in-depth audit investigations into legal, financial, and operational aspects to verify material facts before a transaction is carried out (Pratama, 2025). The urgency of this process lies in its ability to uncover material facts hidden behind a company's seemingly bona fide profile.

Theoretically, the application of Due Diligence is a manifestation of the principles of prudence and good faith in contracting. In international contract law doctrine, negligence in conducting reasonable checks can weaken the legal position of the aggrieved party in the event of a dispute (Aditya, 2021). Courts or arbitrators often refer to the caveat emptor principle (the buyer must be careful), which requires business actors to proactively verify claims before committing to an agreement.

However, empirical reality shows that many business actors, especially in developing countries, still view due diligence as an additional cost center that hinders business speed. This misperception often has fatal consequences when signed contracts turn out to be legally flawed

or unenforceable because they conflict with mandatory law in the partner country (Kusuma, 2023). As a result, the losses incurred far exceed the costs that should have been incurred for the due diligence process.

Legal risks at the pre-contractual stage also include the authority to act of foreign company representatives. Without rigorous due diligence on corporate documents such as the Articles of Association, a company risks signing a contract with a party that does not have legal capacity or is *ultra vires* (Rahardjo, 2022). This can result in the contract being deemed null and void from the outset, destroying any business expectations that had been built up.

Furthermore, in the context of global compliance, legal risks now extend to violations of transnational anti-corruption regulations. Regulations such as the Foreign Corrupt Practices Act (FCPA) or the UK Bribery Act have extraterritorial reach that can ensnare companies if they partner with corrupt entities (Anderson, 2024). Therefore, Due Diligence at the pre-contractual stage serves as the first line of defense in compliance risk management to avoid corporate criminal sanctions.

The study of due diligence is also relevant to the concept of *culpa in contrahendo*, a doctrine that emphasizes legal responsibility at the negotiation stage. If one party is dishonest or negligent in disclosing material facts during the due diligence process, they can be held liable for any losses incurred, even before the main contract is signed (Susanto, 2025). This understanding changes the old paradigm that the law only works effectively after the contract is signed.

This paper is systematically structured to examine the urgency of due diligence with a legal-empirical approach, looking at how legal theory is applied in real business practice. The focus of the analysis is directed at identifying vulnerable points in international negotiations that can be mitigated through a comprehensive due diligence process (Lubis, 2023). This approach was chosen to provide a complete picture of law in books and law in action.

Furthermore, this paper will explore how Due Diligence findings should be translated into protective clauses in contracts, such as Representations and Warranties. Without integrating the due diligence results into the draft contract, the findings of legal risks will only become dead data that does not provide adequate legal protection (Wibowo, 2024). The causal relationship between Due Diligence findings and the drafting of contract clauses is the key to effective legal protection.

The relevance of this topic is increasingly strong amid global economic uncertainty and rapid regulatory changes in various countries. International businesses are required to have higher legal intelligence, where due diligence has become a non-negotiable standard operating procedure (Global Trade Review, 2024). Neglecting this process is tantamount to gambling on massive assets without a safety net.

Through logical and structured analysis, this article aims to prove that due diligence is the main foundation in the construction of a solid international business contract. Without this foundation, a contract is merely a fragile document that is prone to collapse when faced with a dispute (Siregar, 2025). This urgency is not only seen from the perspective of asset protection, but also the sustainability of long-term business relationships.

To conclude the introduction, this study emphasizes that minimizing legal risks at the pre-contractual stage through Due Diligence is a strategic step that determines the success of

contract execution. Thus, Due Diligence must be placed as a top priority in the architecture of international business transactions, not merely as an administrative supplement (Budi, 2025).

Methods

This study uses a normative juridical method by examining national and international legal instruments related to due diligence practices in international pre-contractual agreements. The approaches used include a legislative approach, a conceptual approach, and a case approach to examine the norms, doctrines, and relevant international arbitration precedents in minimizing legal risks before a contract is agreed upon. Legal materials were collected through a literature study of primary, secondary, and tertiary legal materials. Data analysis used descriptive-analytical qualitative techniques by interpreting and systematizing all legal materials to explain the urgency of due diligence as a risk mitigation mechanism in cross-border contractual transactions.

Results and Discussion

Legal Risk Dynamics and Information Asymmetry in the Pre-Contractual Stage

The results of the study show that the pre-contractual stage in international business transactions is a crucial phase that is often overlooked by business actors, even though this phase has the greatest potential for disputes. Empirically, failures in cross-border transactions are often not caused by an inability to perform, but rather stem from information defects at the outset of negotiations. This confirms the state of the art of this research, which updates the old view that legal risks only arise when the contract is in force; in fact, the seeds of these risks are planted during negotiations (Santoso, 2024).

Analysis of international commercial dispute data shows that information asymmetry is the main cause of losses. In this context, the theory of *Culpa in Contrahendo* (fault in the negotiation stage) becomes highly relevant to discuss. Based on this doctrine, the parties have an obligation not to conceal material facts. However, without strict verification mechanisms, this moral obligation is often violated. The author argues that in the competitive landscape of modern business, relying on the honesty of partners without verification is an act of managerial negligence. The data shows a pattern of recurring risks, as presented in the following table:

Table 1. Typology of Pre-Contractual Legal Risks in International Transactions

Risk Category	Description of Findings	Legal Implications
Legal Capacity	The signatory does not have the authority in accordance with the Articles of Association of the foreign company.	The contract may be declared null and void.

Asset Status	The assets covered by the agreement are in dispute or pledged to a third party.	Difficulties in exercising rights and potential total financial loss.
Regulatory Compliance	Business partners are involved in violations of economic sanctions or anti-bribery regulations (FCPA/UK Bribery Act).	Risk of extraterritorial sanctions and reputational damage.

Source: Author's Data Compilation (2025)

The table above emphasizes the urgency of verification. For example, legal capacity risks often arise due to differences in corporate structures between countries. In Indonesia, the Board of Directors represents the company, but in Common Law countries, the limits of a director's authority may be more restrictive. If due diligence is not carried out and the contract is signed by an unauthorized party (*ultra vires*), the principle of *Pacta Sunt Servanda* (promises must be kept) becomes void because the subjective requirements for a valid agreement are not met (Thompson, 2023).

The Urgency of Due Diligence as a Manifestation of the Principle of Good Faith and Risk Mitigation

The following discussion focuses on the role of Due Diligence as a mitigation instrument. Research findings confirm that the implementation of Due Diligence is not merely an administrative formality, but a concrete manifestation of the principle of Good Faith. In international contract law, particularly with reference to the UNIDROIT 2016 principle, the standard of good faith requires the parties to be transparent and cooperative (UNIDROIT, 2016).

However, the author provides a critical analysis that there are differences in the interpretation of "Good Faith" between legal systems. In Civil Law countries (such as Indonesia and Germany), pre-contractual good faith is a legal obligation. Conversely, in Common Law countries (such as the UK and the US), the principle of *Caveat Emptor* (buyer beware) is more dominant. Therefore, due diligence serves as a bridge for harmonization. The author argues that for Indonesian companies transacting with partners from Common Law countries, conducting due diligence is the only way to break the *Caveat Emptor* doctrine in the event of a dispute in the future (Pratama, 2025).

In addition, compliance with international public law is also in the spotlight. Regulations such as the Foreign Corrupt Practices Act (FCPA) extend across national jurisdictions. Field findings show that multinational companies now require Integrity Due Diligence to ensure that their local partners are not affiliated with corrupt practices. This is in line with Wijaya's (2022) opinion that "Ignorance is not a defense"; ignorance of a business partner's criminal background does not exempt a company from corporate criminal liability.

Transformation of Scientific Findings into Contractual Constructions (Representations and Warranties)

The final section of the discussion highlights how scientific findings from the Due Diligence process are converted into contractual legal protection. The study found that Due Diligence Reports often end up as archived documents. In fact, these findings should form the basis for the drafting of Representations and Warranties clauses.

Analytically, this clause serves to shift risk. If the Due Diligence results find uncertainty regarding the status of a partner's factory land overseas, then the contract clause must specifically request a guarantee from the partner that the land is free of disputes, accompanied by an indemnity clause if the statement is false. Without due diligence, the contract drafter will be "blind" in drafting specific protection clauses (Lubis & Hartono, 2024).

The author also emphasizes the importance of the Condition Precedent clause as a safeguard mechanism. Based on findings from cross-border acquisition cases, many losses could have been avoided if the closing of the transaction had been postponed until the negative findings of Due Diligence had been remedied. This proves that Due Diligence directly affects the validity and enforceability of contracts in the future. The provisions of Articles 1338 and 1320 of the Civil Code regarding freedom of contract and valid terms of agreement must be interpreted progressively, whereby "competence" and "lawful cause" can only be ascertained through a comprehensive due diligence process (Budi, 2025).

Thus, it can be concluded that Due Diligence has a significant positive correlation with the minimization of legal risks. It transforms uncertainty into calculated risk, enabling parties to make business decisions that are not only economically profitable but also legally safe.

Conclusion

Based on this study, it can be concluded that Due Diligence is a fundamental preventive instrument that is absolutely necessary to mitigate legal risks at the international pre-contractual stage. Scientific findings show that information asymmetry regarding legal capacity, asset status, and regulatory compliance is the main root cause of cross-border disputes. The application of comprehensive due diligence has been proven to be able to transform legal uncertainty into measurable risk, as well as serve as a vital empirical basis in the drafting of protective Representations and Warranties clauses. Thus, due diligence is not merely an administrative formality, but a legal validation mechanism that guarantees the validity of the subject and object of the agreement, and protects the parties from potential financial losses and extraterritorial legal sanctions before the final agreement is signed.

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