Before we begin

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SILICON VALLEY FIRST CUP OF COFFEE SEMINAR SERIES

UPCOMING SEMINARS:

2022 Artificial Intelligence (AI) Boot Camp

November 9   Patents and Copyrights and AI: Key Issues

November 10   The Ethics of Artificial Intelligence:
                For Businesses and for the Legal Profession

November 29   Large Language Models, Open Source, and Ethical/Responsible AI:
                An IP Perspective

November 30   AI and Antitrust

December 1   Pretrial Practice for AI IP Litigation

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SILICON VALLEY FIRST CUP OF COFFEE SEMINAR SERIES

UPCOMING SEMINARS:

2022 Artificial Intelligence (AI) Boot Camp

|	
December 6	M&A and Investment into AI Companies
December 8	Patent and Trade Secret Protection for Inventions that Use AI
December 13	Patenting of AI Inventions in Europe
December 14	Hot Topics in AI Under Consideration by the Executive Branch
January 11	Digital Health
January 12	CFIUS Focus on Transactions Involving AI and AI Companies
January 17	Artificial Intelligence in the Securities and Commodities Industry: A Primer

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ARTIFICIAL INTELLIGENCE (AI)
BOOT CAMP

Contracting AI: Digital Transformation

November 8, 2022

Mike Pierides and Oliver Bell
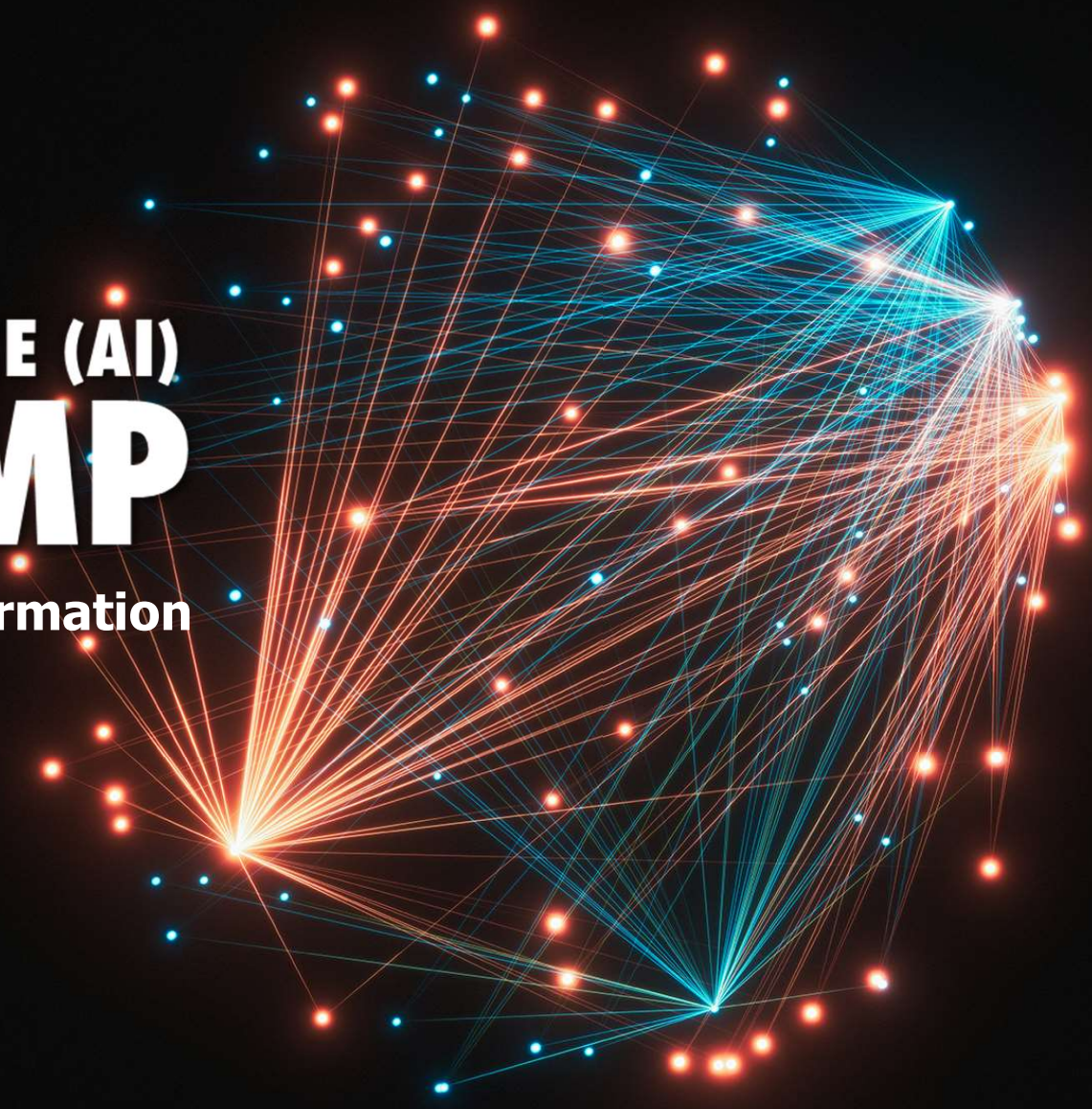
Host

Andrew J. Gray IV

Presenters

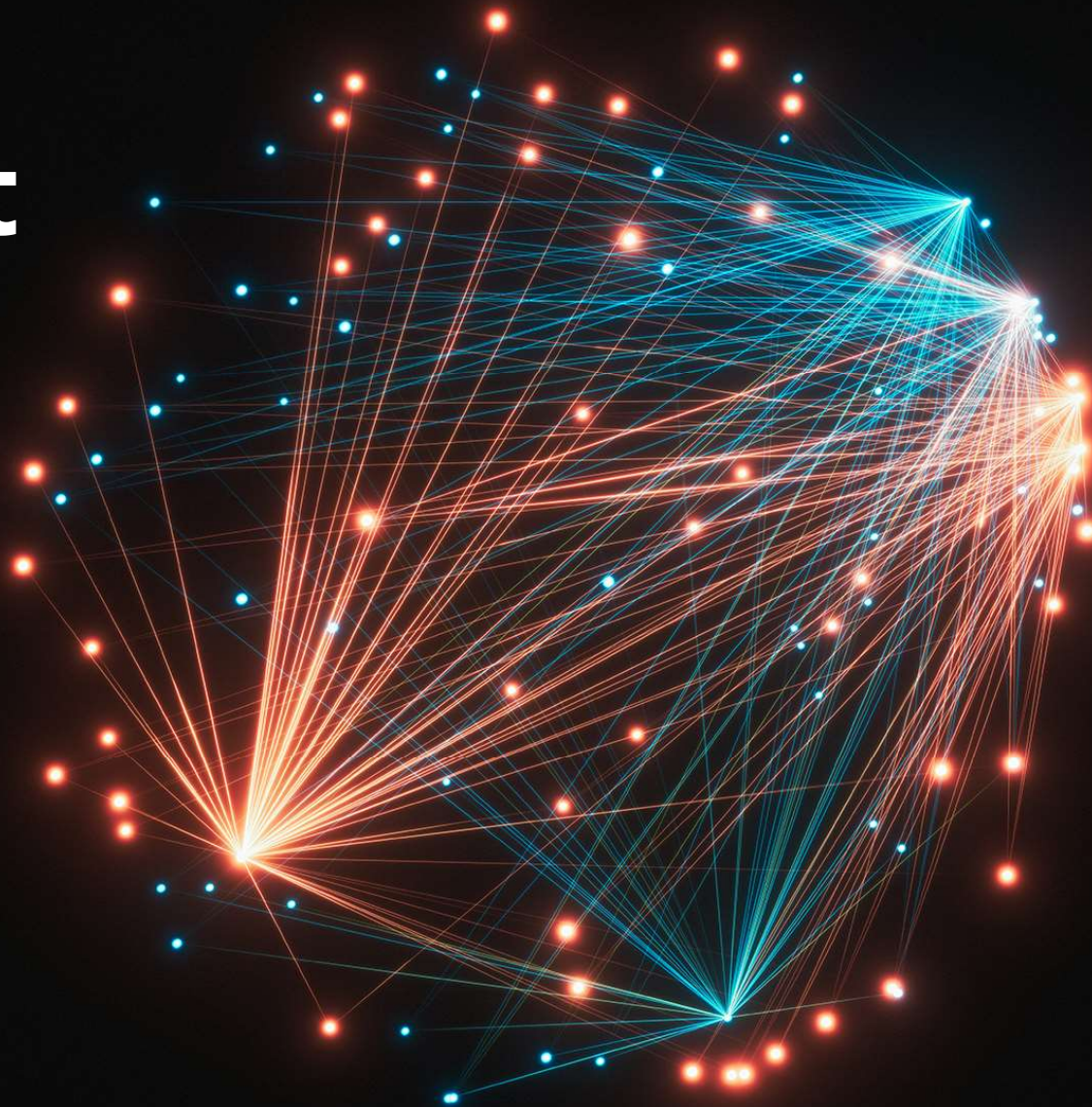**Mike Pierides**

Oliver Bell

Morgan Lewis

Agenda

1 **AI and Market Trends**

2 **Risks of using AI**

3 **Considerations when Contracting for AI**

4 **Contractual Protections**

Morgan Lewis

AI and Market Trends

Morgan Lewis

AI Defined

"Use of automated, computer-based means by which large amounts of data are processed and analyzed to reach **reasoned conclusions.**"

ABA Op-ed

Artificial general **intelligence** is the intelligence of a machine that could successfully perform any intellectual task that a human being can.

Wikipedia

"A core objective of AI research...has been to automate or replicate intelligent behavior."

The Obama White House

Weak artificial intelligence, also known as **Narrow** AI, is non-sentient artificial intelligence that is focused on one specific task.

Popular Science

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Related (and more useful) Terms

Deep Learning/Neural Networks:

A subset of machine learning where artificial neural networks, algorithms inspired by the human brain, learn from large amounts of data. Similarly to how we learn from experience, the deep learning algorithm would perform a task repeatedly, each time tweaking it a little to improve the outcome.

Forbes

Natural Language Processing:

Systems that enable computers to understand and process human languages, to get computers closer to a human-level understanding of language.

Wikipedia

Machine Learning:

The use of algorithms and statistical models to perform specific tasks without explicit instructions. Instead, these systems rely on patterns and inference, and adapt with supervised learning and feedback.

McKinsey

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And for Science (Fiction) Buffs

The Singularity:

The tipping point when machines become smarter than humans. Or, when biological and machine intelligence merge and human/machine intelligence can live free of biological constraint.

Ray Kurzweil et al

The Turing Test:

A machine's ability to exhibit behavior indistinguishable from that of a human. Alleged to have occurred for the first time in 2014 by a computer mimicking a 14-year-old-boy named Eugene.

Time Magazine

AI Apocalypse:

Unabated use of AI, without built-in constraint, poses existential threat to humanity.

Stephen Hawking

Welcome, Robot Overlords.

MIT Technology Review

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Market Drivers

Shift to Cloud

Digital Transformation
- Re-platforming
- User Experience
- Business Intelligence (Data, data, data)
- Automation / AI

Privacy and Security
- Enhanced Regs
- Third Party Threats

Covid

FinTech

Geo-political issues

Social issues

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Digital Transformation

Digital transformation is **the process of using digital technologies to create new — or modify existing — business processes, culture, and customer experiences to meet changing business and market requirements**.
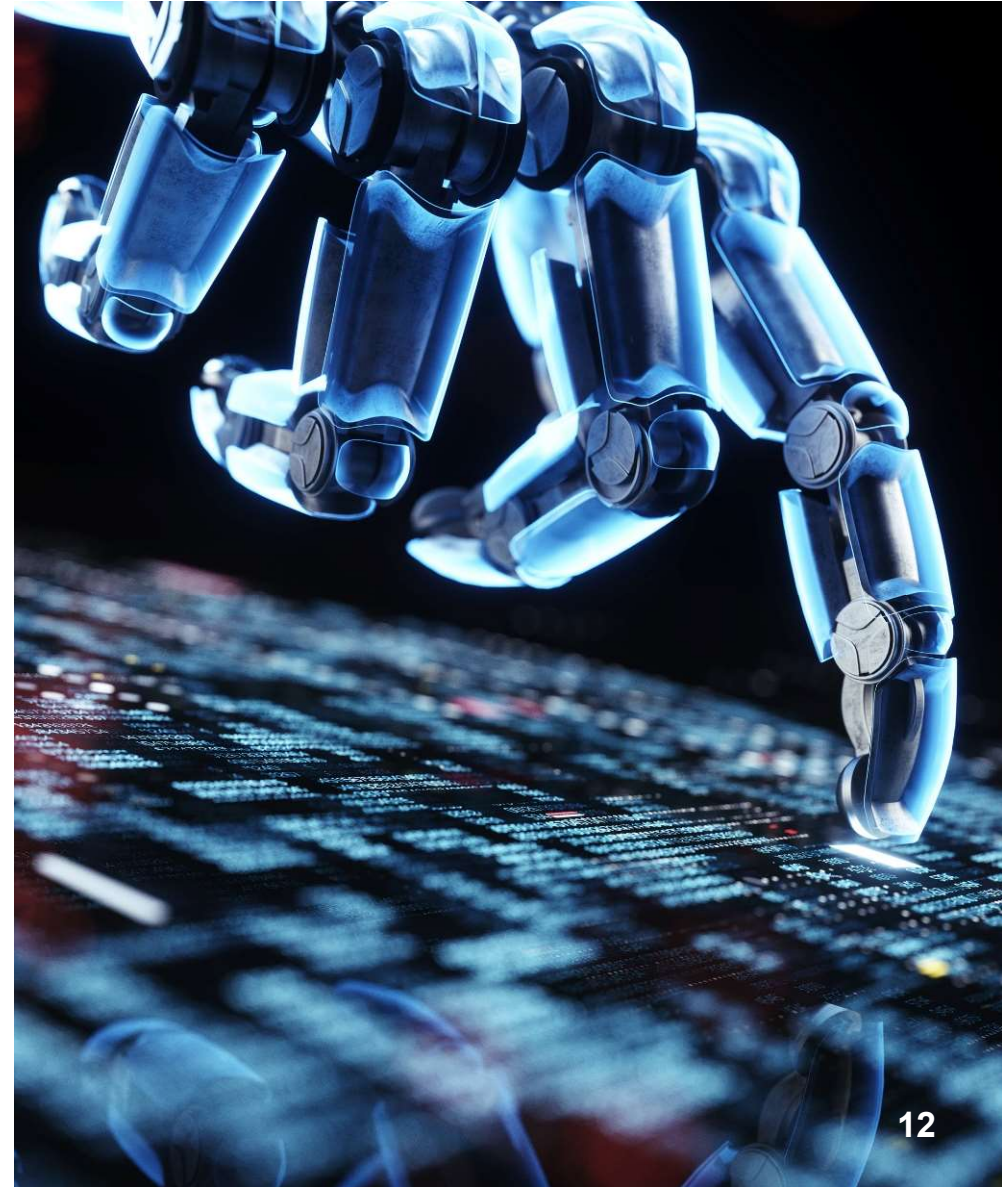
(Salesforce)

Digital transformation can refer to anything from IT modernization (for example, cloud computing), to digital optimization, to the invention of new digital business models. modernization.

(Gartner)

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Artificial Intelligence and Machine Learning

The financial services sector has also been one of the keenest early adopters of AI, where its role in the automation of repetitive processes, risk assessment, and fraud prevention is well established.

During the pandemic, almost half of us made significant changes to the way we bank due to Covid-19. **This means that as we go into 2022, we will see an increase in use cases around understanding and responding to changing customer behavior.**

Established banks face competition from more directions than ever before – with fintech startups, big retailers, and tech giants like Google, Amazon and Apple all signing up customers to services that would traditionally have been their domain.

AI and smart, data-driven technologies are a key tool for all of those competitors, meaning that traditional banks and insurance companies have no choice but to adopt them themselves if they hope to stay in the game.

Worldwide, IDC predicts that the financial services industry will be second only to retail when it comes to spending on AI between 2021 and 2025, accounting for nearly 14% of the $204 billion that will be spent annually by the end of that period.

**The 5 Biggest Financial Services Tech Trends In 2022** *Bernard Marr, Forbes*

The Growth of Automation

- Automation is increasingly becoming part of the mainstream for corporates, and the use of outsourcers to help corporates adopt these technologies will continue to grow rapidly, fueled by the pandemic, with **Forrester predicting for 2022**:
  - Thirty-five percent of service companies will introduce physical robot workers
  - Five percent of the Fortune 500 will adopt automation fabric to drive extreme innovation
  - There will be a new wave of AI-led vendors in the robotic process automation (RPA) and digital process automation (DPA) sectors
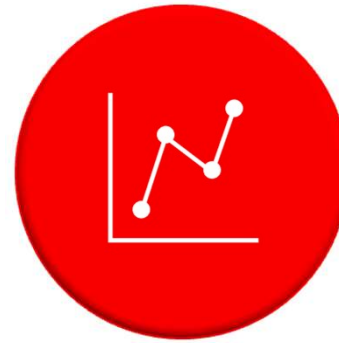
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Popular Uses

Document Reviews
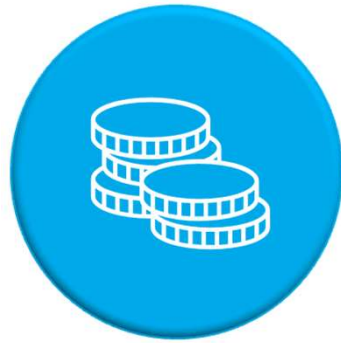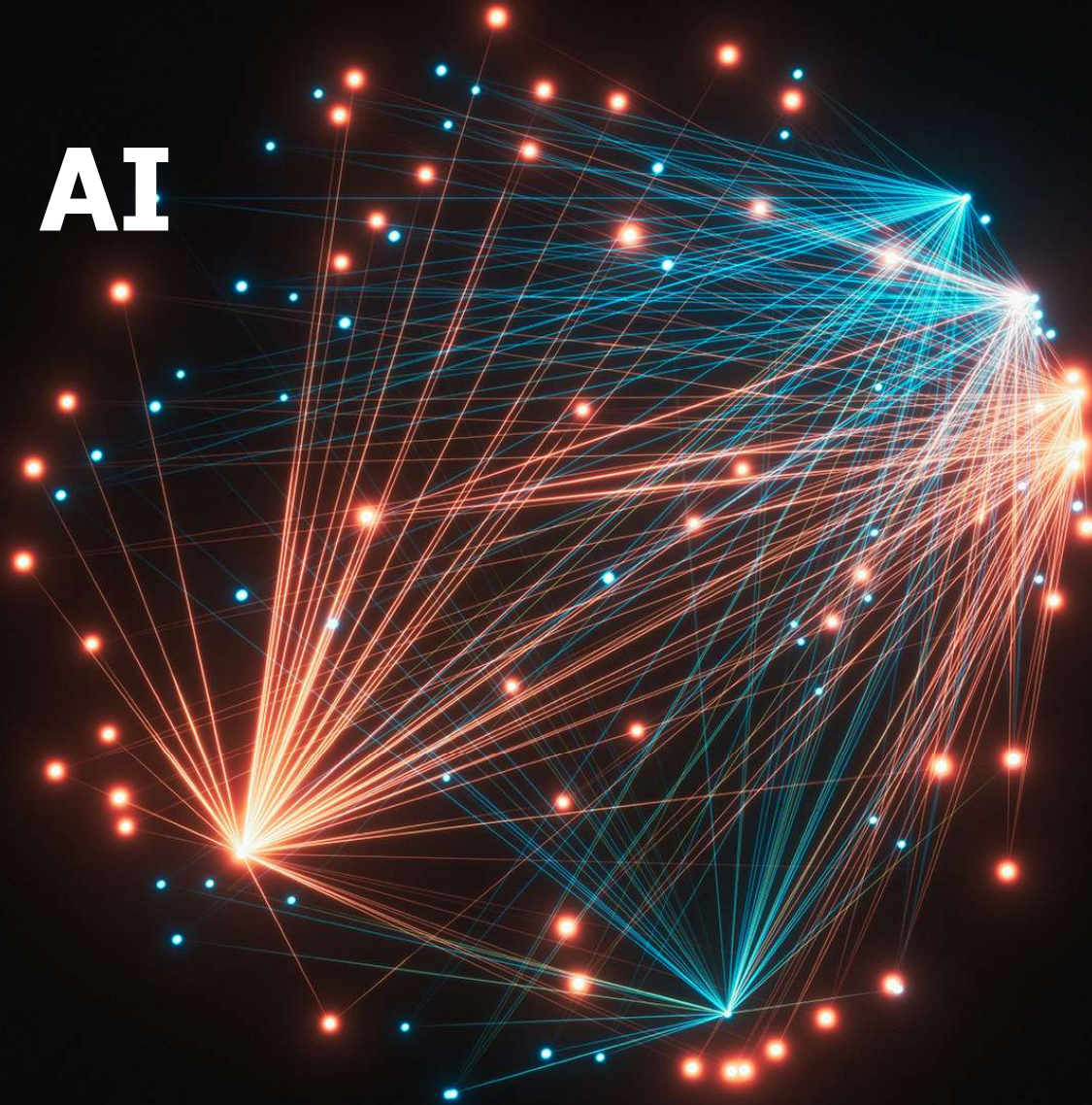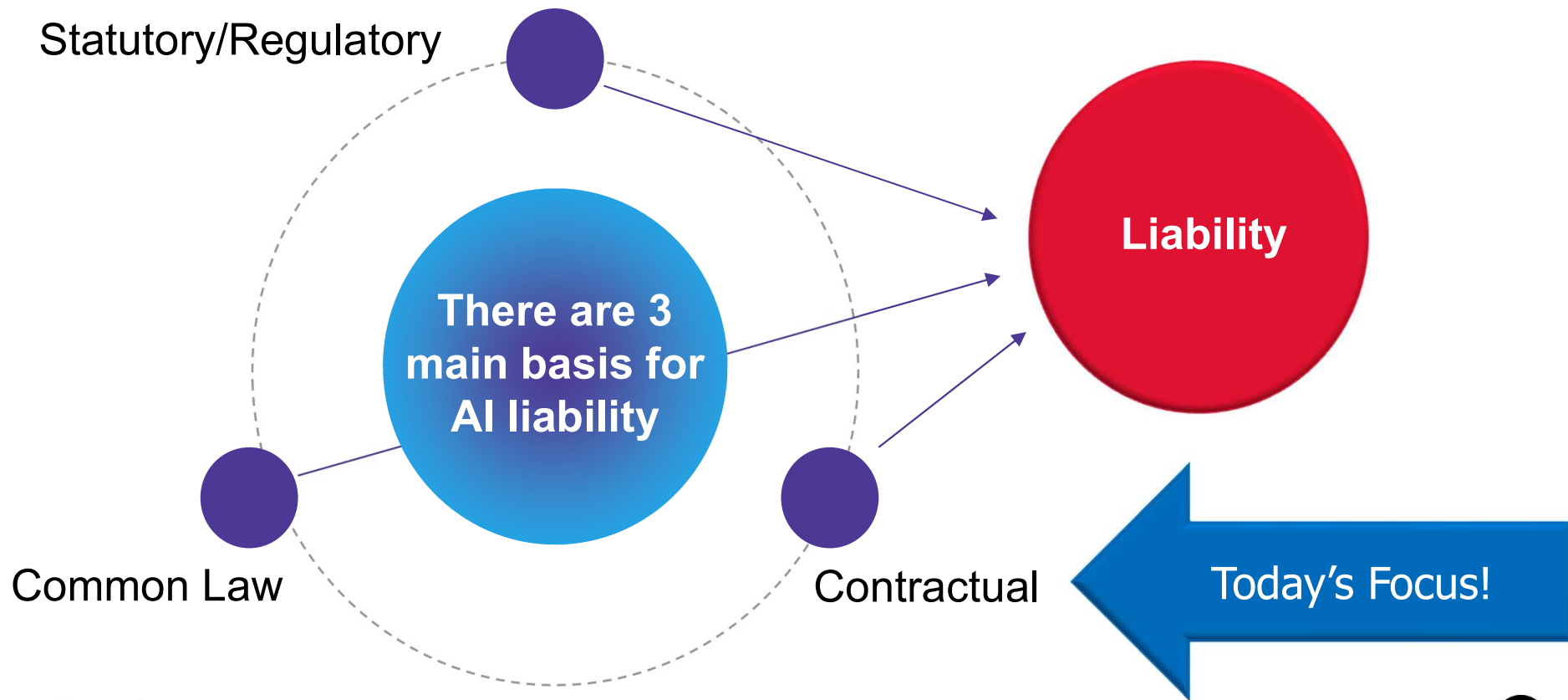
Finance and Accounting

Market Intelligence

Data Analysis

Underwriting

Risks of Using AI

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Potential Liabilities

Statutory/Regulatory

There are 3 main basis for AI liability

Liability

Common Law
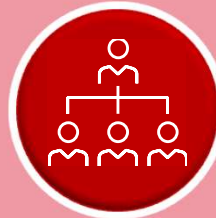
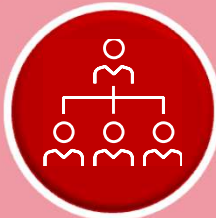Contractual

Today's Focus!

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Contractual Liability

Liability relating to AI could arise under a number of contractual relationships

Organization and AI Provider

Organization and Corporate Customer

Organization and Consumer

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Contractual Liability – Organization and AI Provider

Organization Breaches Contract

Warranty that input data provided by organization does not contain errors or bias that could cause issues

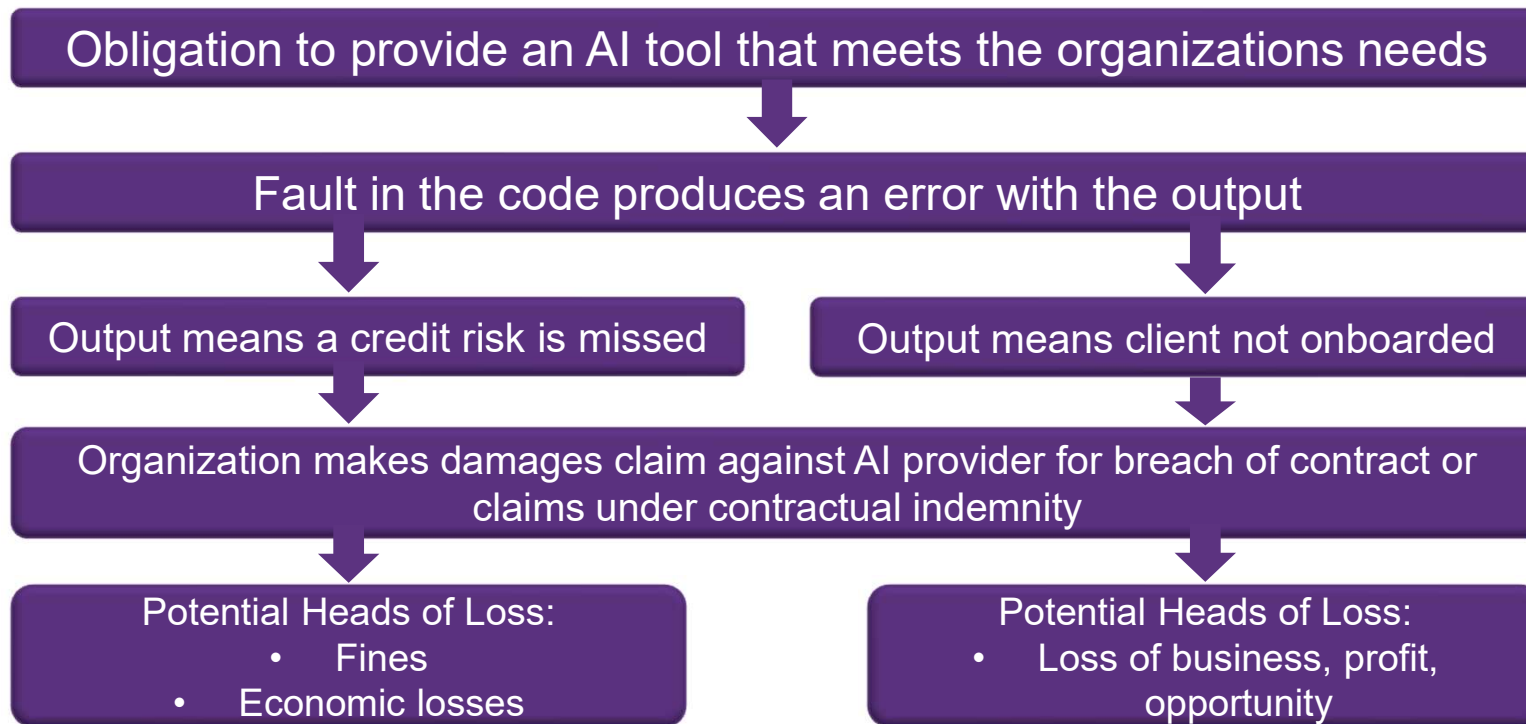The input data does contain errors and there is an issues with the output

Decision made using the output discriminates against one or more persons

Third party claim brought against AI provider or AI provider suffers reputational damage

AI provider makes damages claim against organization for breach of contract or claims under contractual indemnity!!

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Contractual Liability – Organization and AI Provider

AI Provider Breaches Contract

Obligation to provide an AI tool that meets the organizations needs

Fault in the code produces an error with the output

| Output means a credit risk is missed | Output means client not onboarded |

Organization makes damages claim against AI provider for breach of contract or claims under contractual indemnity

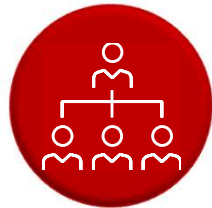| Potential Heads of Loss:
• Fines
• Economic losses | Potential Heads of Loss:
• Loss of business, profit, opportunity |

Contributory negligence from organization?

Potential third party claims too?

Contractual Liability – Organization and Corporate

Organization uses an AI tool as part of the provision of contracted services to a corporate client (e.g. the provision of suitable temporary staff)
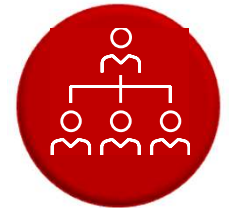
The output of the AI tool has an error and results in unsuitable staff being provided

Corporate client suffers loss due to the unsuitable staff (e.g. costs of finding replacement staff and/or economic loss caused by the staff)

Corporate client makes damages claim against organization for breach of contract or claims under contractual indemnity!!

Liability backed-off against AI provider?

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Contractual Liability – Organization and Consumer
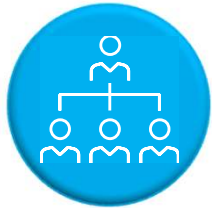
Organization provides insurance coverage to individual consumers

The organization uses an AI algorithm to decide on pay-outs under the policy

The AI algorithm produces an erroneous output and certain consumers receive pay-outs whilst others don't for exactly the same event

Consumer makes damages claim against organization for breach of the insurance contract!!

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Contractual Liability – Exclusions and Limitations

**Standard liability exclusions and limitations may be helpful**

- Loss of profits
- Loss of business
- Loss of opportunity
- Indirect and consequential Loss
- Loss of goodwill
- Liability caps

Should AI specific exclusions and limitations be considered?

- No liability for decisions made based on outputs
- No liability for incorrect input data
- No liability for faults caused by organization's instructions/specification

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23

Contractual Liability – Root Cause
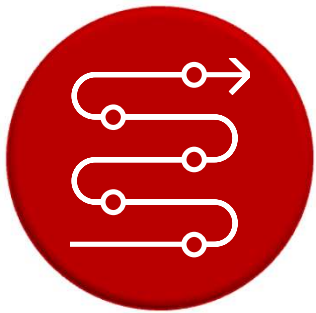
Contractual liability is likely to be very fact specific.

Potentially a significant amount of litigation time based on deciding what the root cause of the AI issue was.

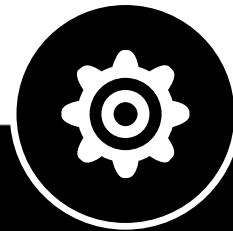Morgan Lewis

Who is potentially liable?

Who has legal responsibility for issues resulting from AI use?

The Organization?

The AI Provider?

The AI Itself?

Is a third-party data provider involved?

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Who is potentially liable? – The Organization

In the UK an All-Party Parliamentary Group on Artificial Intelligence concluded that organizations must be accountable for the decisions made by the algorithms they use.

Primary Liability?

- Uses the AI tool

- May develop the algorithm itself or contract with a third party for development

- Responsible for the principles of how the AI tool works?

- May be responsible for the input data

- Makes decisions based on the outputs

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Who is potentially liable? – The AI Provider

- Provides the AI tool (off-the-shelf or bespoke)
- Responsible for the code of the algorithm
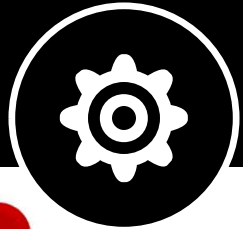- May also provide input data

Two key potential sources of liability

- Liable contractually to the customer it supplies the AI solution to?
- Vicarious liability to end users?
- The impact of decisions at the time of development may not be known – issues with liability for unknown issues!

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Who is potentially liable? – The AI Itself

!

Can (and should) AI have a legal personality itself?

Recent case law, including the 'DABUS' decisions in the UK, EU and US, suggests not.

→

- AI is not a legal person and so cannot be held liable at law.
- If there is harm then one or more legal persons connected to the AI must have liability – Fair?
- Some issues left open!

At present, only natural and legal persons can have liability.

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Considerations when Contracting for AI

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Contract Provisions to Consider

- ✓ Requirements
- ✓ Pricing
- ✓ Service descriptions
- ✓ Service changes
- ✓ Service levels
- ✓ Risk transfer
- ✓ IP issues
- ✓ Use of data
- ✓ Personnel provisions
- ✓ On prem or Cloud

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Documenting Requirements

Internal teams often struggle with documenting functional and technical requirements, making it difficult for providers to submit meaningful fee proposals.

It is important as part of the RFP process, and even more so in the actual contract document, to define what is in-scope for solutioning and pricing.

The solution may need further refinement during blueprint and design – but unless the pricing is all in (regardless of scope changes) – **the baseline of what is in scope is key to determining what constitutes a change** and potentially an adjustment to the fees.

In many implementations, the solution is based on, incorporates or integrates with third party software.

➢ Who is responsible for identifying and selecting the third party components and dependencies? Are the costs built into the provider's costs or to be paid by the company? What are the remedies if the usage, capacity or entitlement assumptions are incorrect?

➢ Will any third party software or services be retired? Have the impacted contracts been reviewed to assess termination rights? What are the financial and contractual implications if the implementation timelines is not achieved and the legacy contracts needs to be kept in place longer than contemplated?

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Documenting Pricing

- Base case should include incremental one time and ongoing costs, and consider customer commitments and supplier funds.

- Think of committed pricing "tiers" linked to automation.

- Document
  - Anticipated savings with method to assess actual savings.
  - Anticipated productivity and output with method to assess actual productivity and output.

- One impact of automation may (or may not) be the reduction of required headcount. If there is a reduction in headcount because less people are needed to provide a service that is not "automated," will there be an adjustment to the fees?
  - What are the adjustments?
  - Will there be an adjustment regardless as to whether the service provider can actually reduce the headcount?
  - Consider including a requirement that headcount cannot be reduced until the service provider can demonstrate that the documented benefits have been realized.

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Documenting the Services

- Automation sounds great, but what are the real service benefits?

- As with any implementation, it is important to document the intended benefits of a project and the impact on the existing scope e.g.:

    – Will there be a change in the scope and /or delivery of the services?

    – Enhanced services?

    – Enhanced monitoring?

    – Better self-help?

    – Enhanced data and reporting?

Morgan Lewis

IP issues

Ownership of Software / Algorithms / Process Automations

Customer-specific process automations and learning methods
- Difficulty in distinguishing from automated tool
- Competitor use issues
- Removal upon termination of agreement vs. license
- Continued right to use settings, preferences and methods – for use with next software/algorithm

General purpose algorithms
- Ownership vs. license rights
- Competitor use issues
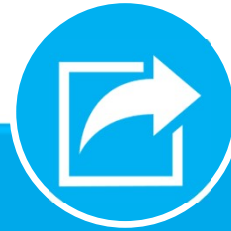- Cost issues

Third Party Tools

- Review contracts
- Direct contracting

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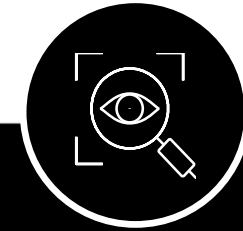
Use of Data as an Asset

Permissions

Ensuring sufficient permission is given by data subjects to derive conclusions from their data, potentially for commercial use.

Outputs

Ensuring there are no, or limited, restrictions by the AI vendor on the firm's use of any outputs.

Transparency

Ensuring that the AI vendor agrees to algorithm transparency with regulators of how it processed the data, which could be vital to understanding processes behind AI-powered conclusions for the purposes of any approvals.

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Use of Data as an Asset

Protection of Trade Secrets

Competition within results in a culture of extremely limited information sharing among firms. Firms may wish to prevent any competitive uses of the data or derivations thereof by AI vendors and/or cloud providers.
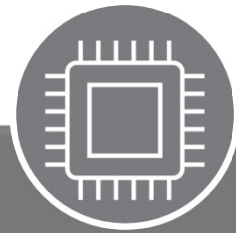
Multiple AI Solutions

If the data was licensed to more than one AI vendor in a firm's supply chain, e.g., one system to structure the data and another for predictive analysis, firms should check whether any flow-down terms are required (e.g. structured data must be held in a certain way).

Data Quality

AI vendors may seek relief events where the data quality from the firm turns out to be poor. Consider an obligation on AI vendors to notify them of obvious or systematic errors in data sets.

On Prem or Cloud?

Many modernization projects include the requirement that transformed applications be "cloud native" and hosted in a cloud environment or as a SaaS-based offering.

➢ Is the solution a dedicated, customized solution that will be hosted in a 3rd party cloud, or is the solution a 1-to-many model where the client will leverage an existing platform that is used to service other users?

➢ If 1-to-many, is there a dedicated instance or is it a multi-tenant offering? Is the solution managed by the client going forward or is the ongoing management part of a SaaS offering?

➢ If the application layer is custom (and proprietary), who is responsible for setting up and configuring the 3rd party hosting solution?

➢ How are specific security and compliance requirements cared for in the cloud environment? Do they meet the company's InfoSec guidelines?

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Adoption Challenges – Partnerships and Collaborations

Effective governance and oversight of AI vendor's data security procedures, including post-expiry / termination.

Financial stability of start-up AI vendors.

Objectives and KPIs of the AI vendor must be clear.

Ensuring the vendor agrees to algorithm transparency with regulators, which could be vital to understanding processes behind AI-powered conclusions, for granting any approvals.

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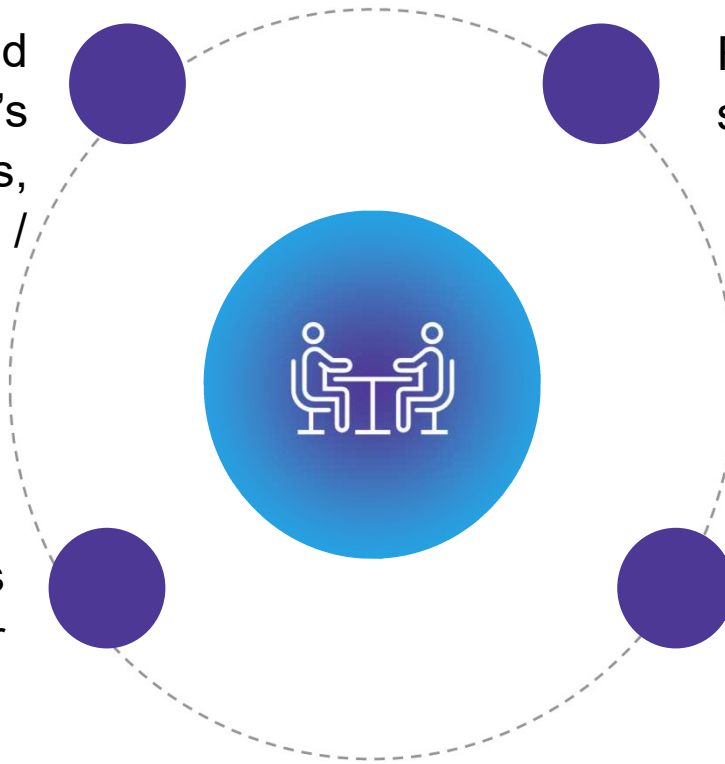
Adoption Challenges - Acquisitions

Embedding the AI vendor's acquisition into the firm's long-term operating model and digital strategy.
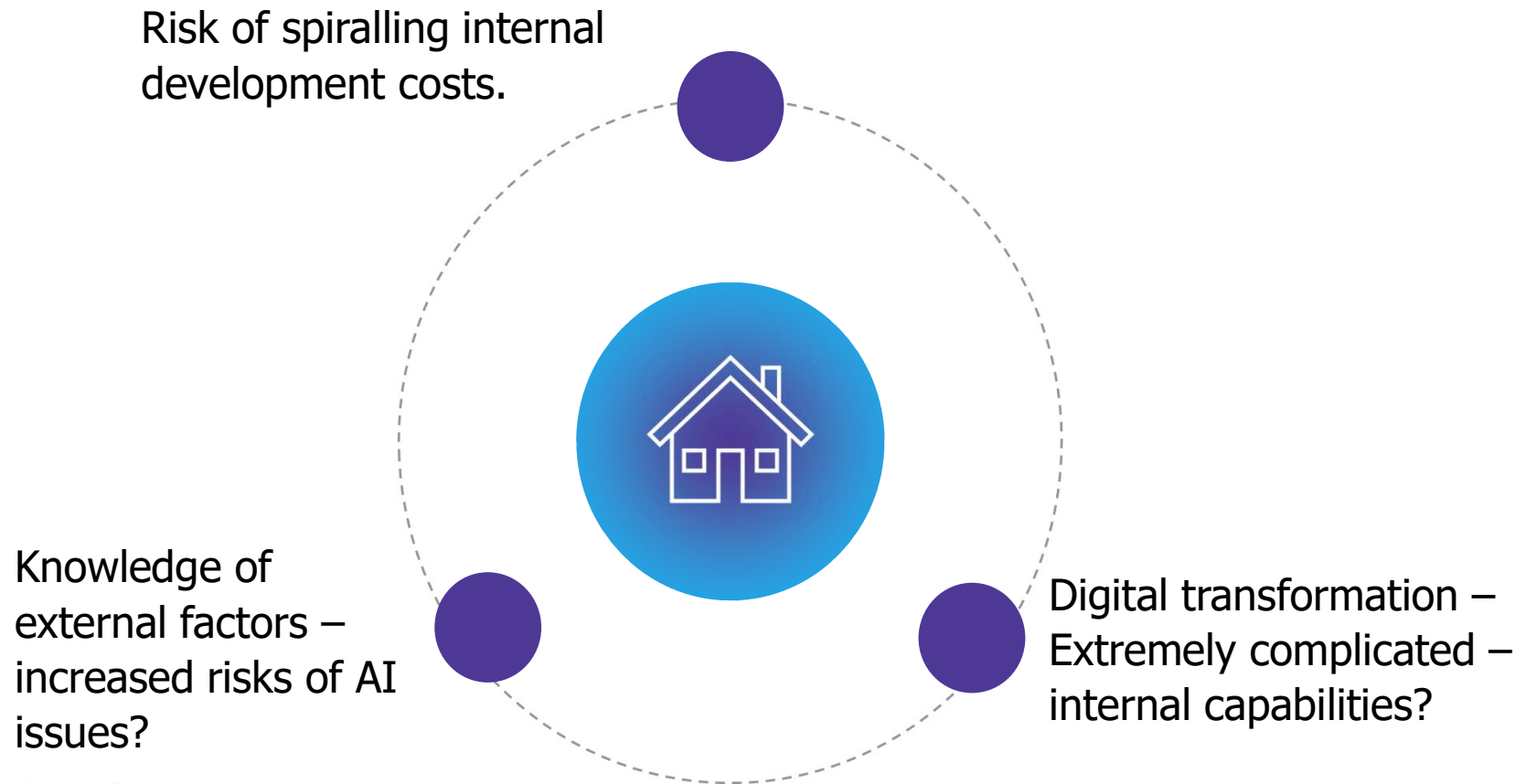
Ensuring IP rights in the AI product are fully owned.

Use of any contingent consideration related to structuring, legal and tax issues.

Acquisition costs and time required, including to address the AI vendor's existing licensing and collaborations within industry.

Regulatory scrutiny

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Adoption Challenges – In-House Development

Risk of spiralling internal development costs.

Knowledge of external factors – increased risks of AI issues?

Digital transformation – Extremely complicated – internal capabilities?

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Control and ownership – use of open source software.

Mitigating liability risks: ensure processes and procedures are in place to mitigate potential AI issues such as bias. Where personal data is involved ensure the right to process using AI or automation.

Protecting IP rights in AI technologies: obtaining assignments from all contributors.

Compliance with multiple regulatory regimes: e.g. Financial Services Regulations and GDPR.

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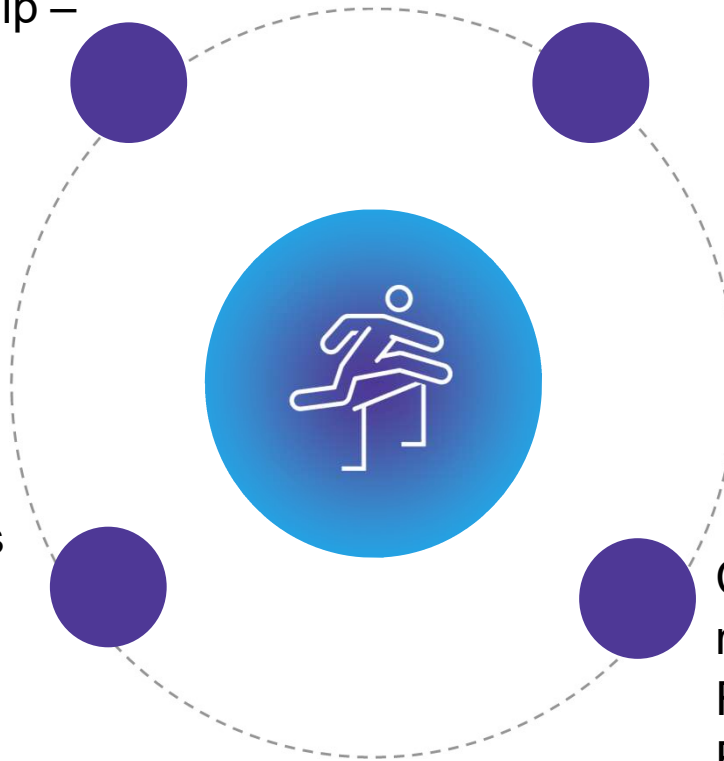
Impacts of AI Use

- Base case should include incremental one time and ongoing costs.

- Document
  - Anticipated savings with method to assess actual savings.
    - Will there be a savings commitment?
  - Anticipated productivity and output with method to assess actual productivity and output.

- One impact of automation may (or may not) be the reduction of required headcount. If there is a reduction in headcount because less people are needed to provide a service that is not "automated," will there be an adjustment to the fees?
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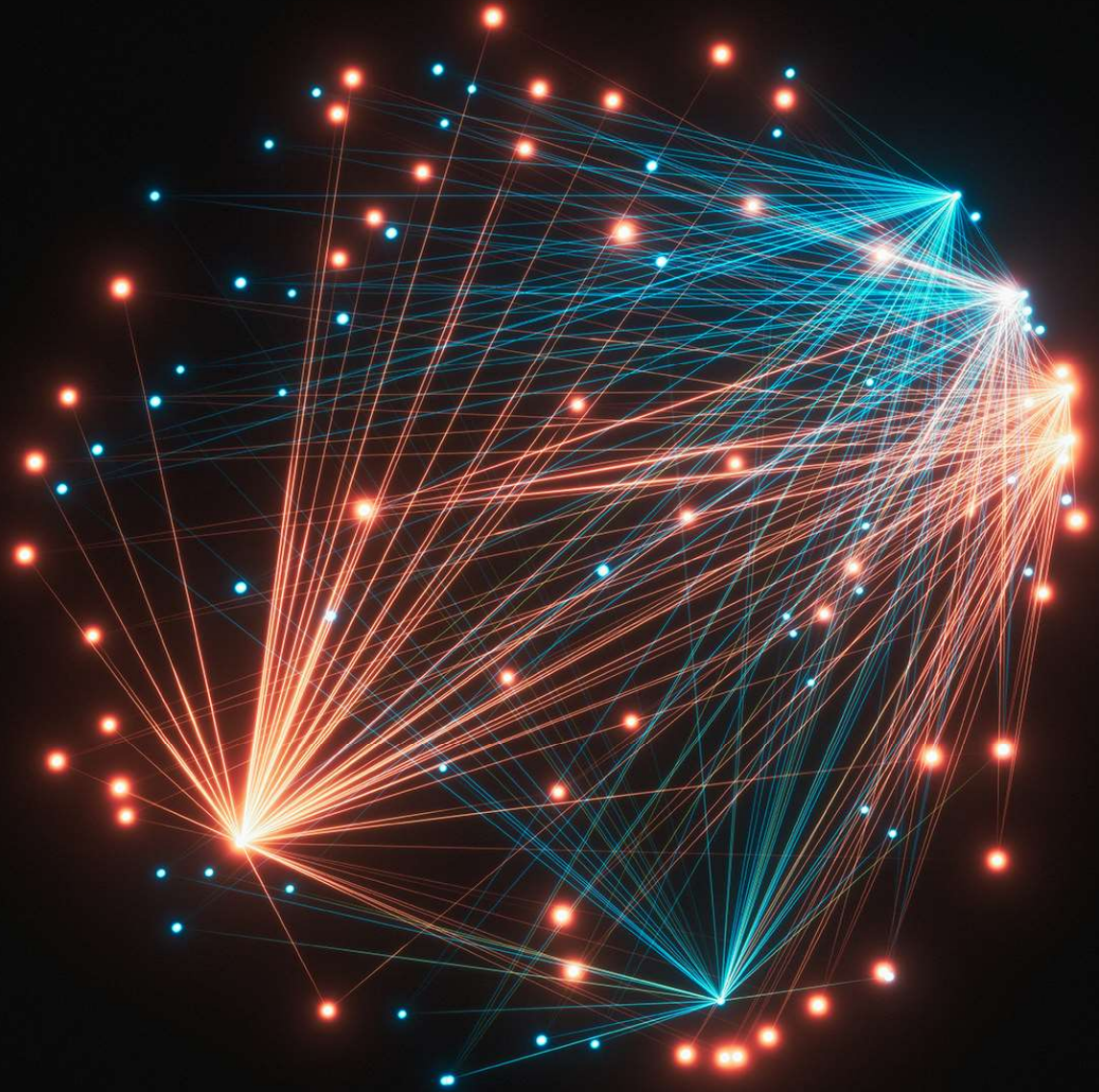
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Off-the-Shelf AI Products

- As the use of AI continues to increase, more off-the-shelf solutions will become available
- These solutions may be desirable for organizations, as the track record of the solution can be assessed
- Appropriate due diligence should be undertaken

Ensure the product is fit for purpose

Heavy scrutiny of legal terms – try to negotiate

Are any guarantees given about AI issues?

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Contractual Protections

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Contractual Protections

A significant amount of the risks presented by AI technologies cannot realistically be dealt with at a contractual level. However, some core issues can be addressed:

Responsibilities	• Need to clearly set out who is responsible for issues with AI. • Code issues – solely AI provider? • Raw data input – Organisation using the AI? Could be provided by a third party and/or the AI provider. • Include data set parameters to mitigate errors in inputs.
Obligations	• Consider obligations on each party and mutual obligations – need to work together to mitigate any issues arising from the AI. • Monitoring of results and ability to override. • Requirements for AI provider to evidence or undertake training for all personnel engaged and to have a diverse team – this is particularly important if there are risks of AI bias. • Obligations to comply with applicable laws and good industry practice – high level but may help if there are disputes.

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Contractual Protections

Specifications	• Clear descriptions of the AI system's specifications – avoid ambiguity if possible. • Description of controls in place to mitigate AI issues.
Service Commitments	• Any automated results of the AI system will be actively monitored by an employee of the AI provider. • Regular monitoring, updating and cleansing of the AI issues – proactive mitigation. • Service levels for rectifying any issues with the AI before they spiral – reactive mitigation.
Representations and Warranties	• Warranty that the datasets used are correct, accurate and diverse. • The AI provider represents and warrants that the AI tool is free of general or specific issues (such as bias and discrimination). • AI tools will function and be maintained in accordance with industry standards.

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Contractual Protections

Indemnities	• Indemnification obligations to cover third party claims that the AI system caused discrimination/damage/loss and any fines for breach of laws. • May be one way or mutual – depending on specific circumstances and negotiating power.
Liability Exclusions	Consider excluding or limiting liability for certain events: • Use of the AI tool outside of a designated scope. • Inputting information outside of specified fields or parameters.
Rectification Plan Process	• Include a clear process for rectifying any issues that arise and ensuring that such issues don't arise again. • Agree who is responsible for the costs.
Transparency and Reporting	• Requirements to provide detailed data about how the AI tool works – this will be essential for good compliance and having transparent documentation. • Obligations to ensure accurate recording keeping and reporting at all stages - a paper trail is key to show the right things were being done if any issues arise.

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Data Privacy

GDPR requires data subjects to be informed of any automated decision making used in respect of their personal data – organizations will need to update their privacy policies to reflect their use of AI and may want to consider reputational issues when considering using AI tools for decision making!

Even where such transparency is not a legal requirement, organizations should be working to ensure transparency of data use as far as possible.

Undertake Data Privacy Impact Assessments – this may be a legal requirement in certain jurisdictions (e.g. Europe and the UK).

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Data Privacy

If subject to GDPR then you must ensure that:

The AI system is sufficiently statistically accurate and avoids discrimination.

You consider the impact of individuals' reasonable expectations.

There is a lawful basis for processing (avoid consent).

If the use of AI creates automated decisions that have legal effects, an exemption to the restriction on such processing applies.

If Things Don't Go As Planned ...

- AI projects can be complex and go sideways for a number of reasons – from poor provider performance and missed deadlines to changes in company's internal requirements.

- When this happens, the company may be a good way into a project and then need to switch gears with respect to the provider.

- It will be important to lay out a clear transition plan for the replacement provider (which will be smoother if the IP rights are in good order!).

➢ Access to hosted environment
➢ Access to code
➢ Good documentation
➢ What does the contract say?

Biography

Mike Pierides

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Mike Pierides' practice encompasses a wide breadth of commercial and technology transactions. Deputy leader of the firm's technology, outsourcing & commercial transactions practice and co-leader of the digital solutions working group, Mike advises on major outsourcings, strategic restructurings following divestments or acquisitions, and technology-specific transactions such as licensing and "as a service" arrangements. He is also active advising on new technologies such as blockchain and artificial intelligence.

Biography

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Oliver Bell focuses his practice on large-scale IT and business process outsourcing arrangements. Oliver advises multinational clients on all aspects of their sourcing requirements from initial scoping of requirements through to negotiation, completion, and day to day contract management. He also advises clients on the disaggregation and exit of complex agreements.

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Biography

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Serving as the leader of the firm's semiconductor practice and as a member of the firm's fintech and technology industry teams, Andrew J. Gray IV concentrates his practice on intellectual property litigation and prosecution and on strategic IP counseling. Andrew advises both established companies and startups on AI, machine learning, Blockchain, cryptocurrency, computer, and Internet law issues, financing and transactional matters that involve technology firms, and the sale and licensing of technology. He represents clients in patent, trademark, copyright, and trade secret cases before state and federal trial and appellate courts throughout the United States, before the US Patent and Trademark Office's Patent Trial and Appeal Board, and before the US International Trade Commission.
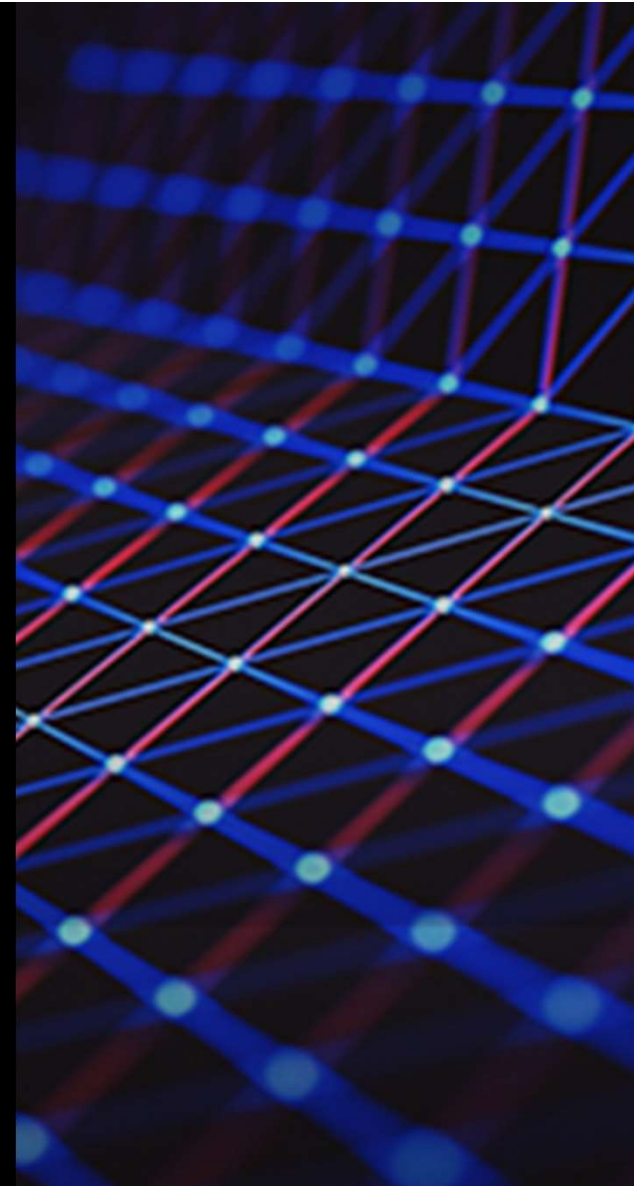
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Coronavirus COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at **www.morganlewis.com/topics/coronavirus-covid-19**

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to **subscribe** using the purple "Stay Up to Date" button.

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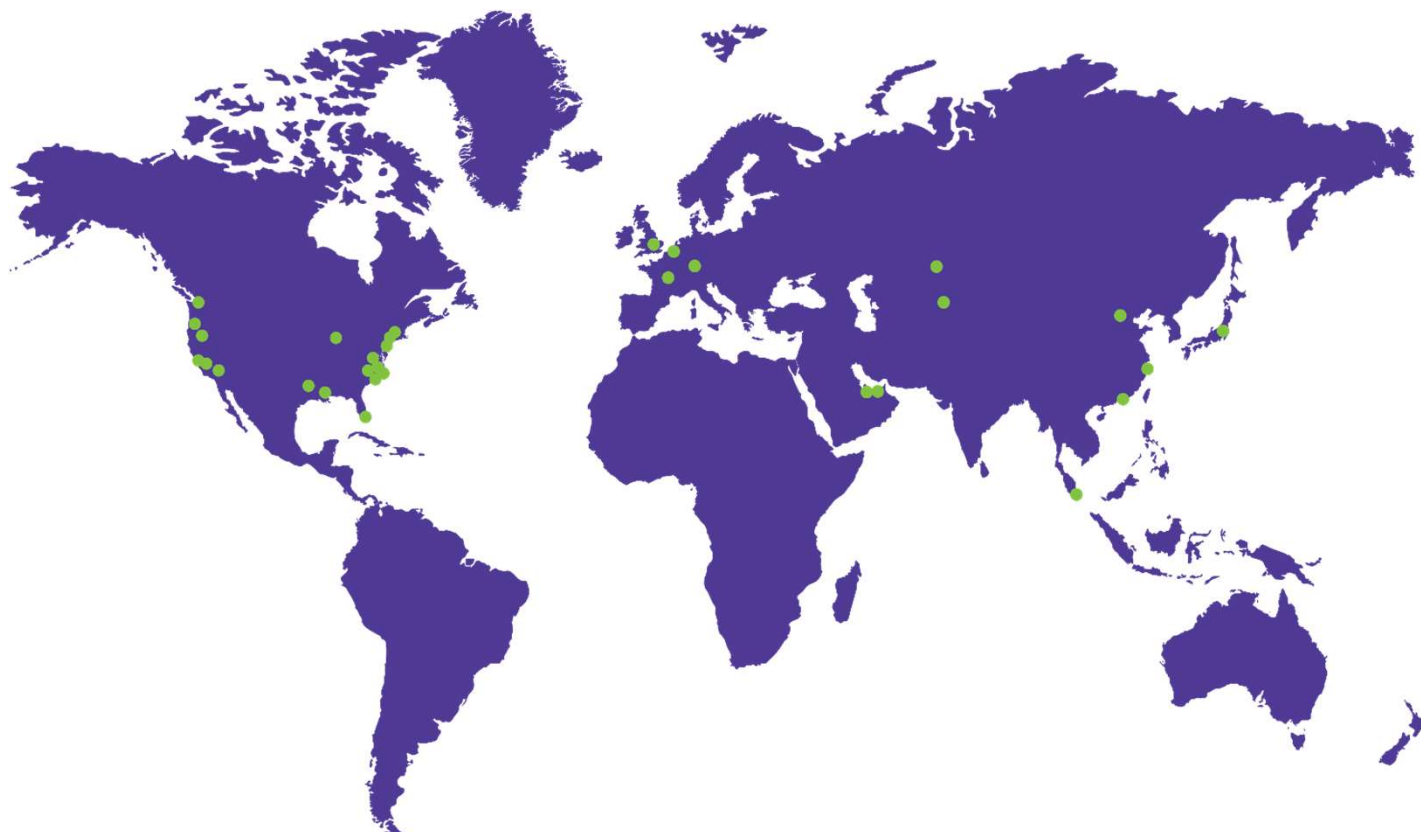
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