Morgan Lewis

UNLOCKING AI AND OUTSOURCING
STRATEGIES FOR SUCCESS

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In today's dynamic business landscape, outsourcing has become an indispensable tool for organizations seeking to streamline operations, cut costs, and access specialized expertise. Yet, as technology advances at an exponential pace, the integration of artificial intelligence (AI) into outsourcing arrangements introduces a new dimension of complexity and opportunity. From predictive analytics to virtual assistants, generative AI (GenAI) applications are reshaping traditional outsourcing models, promising unprecedented opportunities but also raising novel legal challenges.

In this roundup of a four-part series from Morgan Lewis's Tech & Sourcing blog, we take a high-level look at the challenges of requiring outsourcing providers to drive innovation through GenAI while also complying with an outsourcing customer's AI policies; the conundrum of balancing a company's need for enhanced quality checks with the desire to realize savings when leveraging GenAI solutions; the complexities of determining where and how GenAI is currently being used by a company's outsourcing provider and whether there is appropriate disclosure and understanding of such use; and certain top-of-mind issues arising in connection with ownership and use rights when leveraging GenAI.

PART 1: WHEN A PUSH FOR INNOVATION AND AI POLICY COLLIDE

All companies want their outsourcing providers to be at the forefront, whether accomplished by proposing ideas, implementing solutions as part of their business-as-usual services, or offering savings based on productivity commitments or other demonstrable business impact. Some outsourcing providers may even use innovation as a key differentiator during the sales cycle, putting real dollars at risk if innovation projects don't realize promised savings. And what innovation is more top of mind presently than the use of AI?

Companies are now looking to their outsourcing providers to design and explore AI use cases in IT and business process outsourcing arrangements to bolster security monitoring (thus lowering the risk of data breach and ransomware attacks), enable more efficient capacity management (less excess capacity = less costs), streamline business processes (less duplicative resources), and enhance user experience (more productivity, more revenue).

Senior management may be demanding to know how their teams are accelerating the use of AI to get out ahead of competitors. The process may hit the ground running and move very quickly—all to come to a screeching halt when compliance and legal enter the picture.

While business units are rushing to leverage AI (particularly GenAI), compliance and legal teams are rushing to understand the risk implications of AI usage, from confidentiality and intellectual property issues to quality and implicit bias concerns, and put guardrails in place to ensure "responsible" use of AI. And here lies the first conundrum: How can companies best require their outsourcing providers to leverage generative AI within their AI policy guidelines without stifling innovation?

To consider the conundrum, some common components of AI policies:

Definition of AI

What is considered AI? While the current discussions around AI largely focus on GenAI, many policies' AI definitions include a wide range of automation/AI solutions and technology, some of which may have been around for years. A broad definition may be a good (and responsible) feature and may call attention to issues with the use of automation that have not been addressed to date. However, in doing so, certain

other requirements such as disclosure and quality checks may be challenging or at least require diligence and work, i.e., resources and time.

Disclosure and Approval of AI Use

Depending on the definition of AI, the outsourcing provider's willingness to disclose all of its use of AI in the provision of the services may be an issue. Some providers now claim that they use AI in all aspects of their business. This raises various questions: do they need to disclose that use and obtain customer approval? Do they need customer approval if they want to change their office collaboration tools?

There are many reasons why a company must understand where and how AI is used in its services and environments, particularly in such cases where the AI processes train large language models (LLMs) using company data or a company's customer data. But are there tools where approval may not be necessary or cause inherent risk?

As companies are understanding the risks and implications of AI, broad policies may be the best defense, but as providers demonstrate safe use cases the requirements may soften. Regarding concerns of security in the cloud, we are seeing some providers looking ahead and proactively offering terms that demonstrate how they use AI in a responsible manner (attempting to allay at least some concerns).

Noninfringement and Ownership of Training Algorithms and Output

Many company policies and/or contract terms require that the outsourcing provider ensure that the use of any AI tools is not infringing and that the training algorithms and output generated from the AI tools are not infringing and can, in fact, be owned by the company. The ability of a company to demonstrate chain of title to input and output is critical for a number of reasons, including in situations where a company wants to sell a product, asset, or potentially its business.

As attention heightens as to the treatment of AI and copyright, some providers are raising concerns regarding their ability to ensure ownership of, and therefore the transfer to company of, output using AI tools. This tension is the focus of much negotiation in the current AI intellectual property allocation landscape.

Data Sources and Using Company Data to Train Large Language Models

Perhaps one of the most important considerations when using AI is understanding what data sources are being used to train the LLMs and produce the output. Are the sources all considered company data and does the company have the right to use its data for the intended purposes? Will the LLM instance trained using company data be used for other purposes? Again, many providers are getting ahead of the questions and describing how the LLMs are using data to train and create data in an effort to be transparent. Not all solutions may be acceptable to a company, but there may be ways to modify the offering to mitigate risks.

Output Quality

When using LLMs to answer a question, the answer may sound good at first pass, but it may not always be correct on precise details. Many companies' policies require the provider to verify and monitor the security of, and the quality (including anti-bias) and accuracy of, any output of any AI tools. Some providers are pushing back on grounds that, if they need to retain headcount to monitor quality and output, then that is diminishing the productivity benefits of such tools. Depending on the criticality of the output and the use of the tools for business operations, the requirement to monitor and confirm quality and accuracy will likely continue, at least for now.

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PART 2: ENHANCED QUALITY CHECKS VS. SAVINGS COMMITMENTS

One of the challenges identified was that many outsourcing agreements impose aggressive savings commitments, to be realized through the implementation of technology solutions that enable headcount or other cost reductions.

When implementing and managing GenAI technology solutions, most companies are in the early adoption stage and requiring providers to have robust quality programs in place to verify and monitor the quality and accuracy of the training models and the output of the Gen AI tools. Some providers are pushing back on the need to implement and maintain these programs on the grounds that, if they need to retain or add headcount to monitor quality and output, the productivity benefits of such tools diminish. Companies on the other hand are generally not comfortable lifting quality reviews as they navigate the application of increased regulation and potential data governance, security, and financial risks—noting that providers should not be offering ambitious solutions that are not fully compliant with regulations as well as internal and customer and user requirements.

Gating Questions

Not all GenAI solutions are the same or at the same stage of maturity. Examples range from enhanced security monitoring (to supplement other solutions and resources) to replacement of manual financial control checks (such as duplicate pay). The appropriateness of the applicable quality program will differ based on the solution.

Some key questions to consider include:

- What functions and processes are at issue

- What data is at issue and how critical it is

- Whether any regulations are implicated

- If any internal or customer policies are affected

- Whether low quality data will impact the current or future training models, data lakes, and/or output

- The impact to the company if the output is incorrect

- The party responsible for low quality or inaccurate output

- The reliability of the tools and how much testing has been done of their accuracy

- Results/benchmarks that would allow for reduced quality checks

Realizing Benefits Beyond Headcount Reduction

Just as not all GenAI solutions are alike, the potential benefits of GenAI solutions differ as well. For example, a GenAI security solution may improve identification of security gaps or potential incidents, resulting in reduced data breach risk. A GenAI fraud detection solution may promise reduced financial leakage, or a customer experience solution may deliver more focused customer outreach and lead to increased sales. The benefits are less targeted on reducing headcount than on providing other meaningful business impact.

Considerations include:

- The promised benefits of the AI solution

- Benchmarks for the committed benefits, and whether actual benefits can be documented, tracked, and quantified

- What quality controls should be implemented

- Whether additional headcount or different skillsets will be required or any headcount can be reduced

- Whether additions or reductions in headcount are included in the business case

PART 3: ARE YOU SURE YOU KNOW WHERE AND HOW YOUR PROVIDERS ARE USING GenAI?

Many companies' AI policies state that service providers are not permitted to use GenAI tools, LLMs, or technologies (whether proprietary or licensed from or otherwise made available by a third party) in performing the services without the prior written consent of the company.

Some go further, requiring that the service provider must give the company prior notice of any capabilities added to or used to provide or administer the services that include GenAI technology and shall reasonably cooperate with the company's reasonable requests for information regarding such capabilities. The disclosure requirements—driven by the company's desire to know where GenAI is being used to understand the data and intellectual property implications as well as the quality and reliability of the output—are pretty clear.

So, all good then? The requirement is *simply* for the service provider to tell the company where the service provider plans to use GenAI in its services so that the company can make an informed decision as to whether the use meets the company's standards and is acceptable. A question that is starting to emerge is whether service providers are performing the necessary diligence to identify all of the potential areas where GenAI is being used to support the services.

Determining GenAI Usage

A particular area that may have been overlooked in the past but that is starting to get attention involves back-office and productivity software solutions that have or are starting to deploy GenAI capabilities, including those that may process or receive company or company client data. Other examples include the use of GenAI in help desks or customer contact centers (when the service provider is providing support directly or indirectly for its services).

Some considerations to keep in mind include the following:

- If a service provider uses a word processing tool that uses GenAI tools to produce documents or perform due diligence, are these solutions being disclosed?

- What other third-party tools are in use that include GenAI and may leverage LLMs?

- Is the company's data being used to build or train an LLM?

- Can the service provider say that the company owns the "deliverables" if these productivity tools were used to create them?

- Does the use of such tools violate any of the other terms of the agreement regarding confidentiality, privacy, data usage, or intellectual property?

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With the race to include GenAI in service and software offerings, it is important that the service provider demonstrate the due diligence it has performed with respect to the proprietary and third-party tools it uses, including those used on a dedicated basis for the company or ones used at an enterprise level.

PART 4: WHO OWNS—AND HAS THE RIGHT TO USE—WHAT

Concerns regarding ownership and use rights is one of the impediments to GenAI adoption, and, with the potential for GenAI tools to process sensitive business data or produce deliverables that will be embedded in critical operations, the concern is one that should be examined and addressed.

Not all GenAI tools are alike just as the use cases, data at issue, and outputs are not the same with respect to every GenAI solution. In order to understand and potentially mitigate the potential risks, business and legal teams will need to examine each tool and assess the appropriate ownership and use rights to the underlying GenAI technology, the input data, the data used to train the GenAI tools, and the training instructions and prompts as well as the output and other items such as requirements documents and the use cases themselves.

Set out below are some gating questions to consider when thinking about ownership and use rights:

The AI Technology

- What is the basis for the solution? Is it commercially available software that is used by many customers? Is it being developed specifically for the customer as a net new solution or is it modified or configured from preexisting software for use by the customer?

- Is the solution a multiclient tool or is it a separate instance that is trained and hosted specifically for the customer?

Input and Training Data

- Is the input data being used to create/prompt the output? Is the data being used to train the model for the customer only or for general users?

- Who provides the input data? Is the input data customer proprietary data or are there also third-party sources? Who provides the third-party data?

- Is the input data sensitive or personal information? Could it include downstream client or vendor data?

- Are there other uses for the input data or output data such as general provisions relating to the improvement of the services? What does improvement of the services mean in the context of GenAI—could it mean training the tool?

Output

- What is the intended output? How will it be used by the customer or the provider and is it critical to ongoing business operations?

- Can the provider say that the customer will own the output, under copyright law or otherwise? Is the right to use enough—could lack of ownership potentially impair title to critical items such as software or documentation?

- Will the use of GenAI inadvertently override the other IP provisions in the agreement such as transfer of ownership of deliverables to a customer?

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Instructions/Prompts?

- Who creates the instructions or prompts to the AI tool? Do they contain any competitive information or sensitive data?

- Can others see or use these instructions or prompts?

Other Considerations

- *Use cases and prototypes*: Are the use cases specific to the customer's business or could they provide a competitive advantage?

- *Requirements documents for the build of GenAI tools*: Who provided the requirements? Are they confidential to the customer or do they contain sensitive information?

Conclusion

The exploration of GenAI solutions has revealed both promise and peril within the legal landscape, with the consensus being that customers and providers of outsourcing services desire finding ways to implement GenAI in a compliant manner that enables the benefits while providing the appropriate level of transparency, privacy, and intellectual property protection. Business and legal teams will be tackling this lofty goal in the next year as the GenAI landscape continues to evolve.

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