# AI and Emerging Technologies

CONTRACTING AND VENDOR MANAGEMENT

Evolving AI Vendor Perspectives on Risk Allocation, Indemnification, and Limitations of Liability

2023 brought widespread adoption of generative AI technologies by technology vendors and their customers. As customers scrambled to draft and adopt policies governing their use of generative AI, technology vendors raced (and, in some cases, stumbled) to develop contractual mechanisms to govern such usage. In an effort to analyze and mitigate the risks introduced by generative AI, we organized an interdisciplinary team comprised of several of the other authors in this *2023 Year in Review*, focusing on enhanced contractual protections as well as policies and procedures for AI risk mitigation.

The technology transactional and IP teams focused primarily on the various approaches and contracting models offered by technology vendors in the AI space. Our contributions ranged from identifying and countering technology vendors attempting to strong-arm their customers into taking on the risk of AI adoption, to casting a more accepting, but cautious, eye on technology vendors purporting to offer more customer-friendly terms. Regardless of the approach taken, the material issues have related primarily to risk allocation, indemnification and the limitations of liability governing both. The allocation of risk depends upon the approach taken by the technology vendor and is vendor- and contract-specific, while understanding the current landscape of IP infringement claims is key to drafting appropriate indemnification and limitation of liability clauses. In addition, there has been and will continue to be extensive dialogue and negotiation on protection of customer proprietary data, including permitted use by the technology vendor of input data (e.g., to improve and train their generative AI models) and the generated output (which may also contain customer proprietary data).
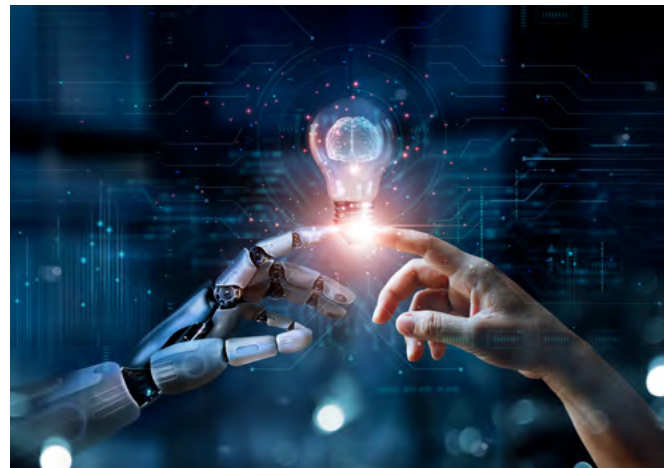
The following bullets touch on the points made above:

- 2023 began with some AI vendors attempting to unilaterally require customers to accept vendor-favorable AI terms: https://www.huntonak.com/en/insights/generative-ai-in-contract-terms-and-conditions.html

- Lawsuits for copyright infringement and related claims began to pile up (*J. Doe 1 v. GitHub*; *Andersen v. Stability AI*; *Getty Images v. Stability AI*; *J.L. v Google*; *Silverman v. OpenAI*; *Authors Guild v. OpenAI*; *Kadrey v. Meta*; *NY Times v. Microsoft*; etc.)

- With customers pushing back, a number of AI vendors began to adopt a more customer-friendly approach (e.g., Microsoft Copilot Copyright Commitment, Adobe Firefly IP indemnity, IBM client protections for Watsonx Granite models, AWS indemnity for Indemnified Generative AI Services, Google Cloud

generative AI indemnification), but the devil is in the details. As with any contractual document, a close read of the document, *including any hyperlinked documents*, is required.

- Key aspects of IP indemnification clauses to consider include the types of legal claims that are covered, whether the indemnification covers both the use of the AI system and use and distribution of the output generated by the AI system, required use of content filters, and how the limitation of liability terms may limit the vendor's indemnification obligation.

- Terms for protecting the customer's proprietary data may also be critical to ensuring safe use of generative AI. The most important aspects to consider include whether technology vendor's confidentiality obligations apply to the input and/or the output of the generative AI system, and the restrictions on the technology vendor's use of the input and output. Keep in mind that a technology vendor may be able to comply with its confidentiality obligations while *using* a customer's data to train its AI model, which may then generate improved output for a third party reflecting the customer's proprietary data.

Jeffrey L. Harvey
Partner, Richmond

Tyler Maddry
Partner, Washington, DC

Global Privacy Laws for AI Security

We saw significant regulatory developments worldwide in the field of AI during the course of 2023. To date, privacy laws have been a key source for AI regulation, particularly in the EU, UK and US. Both the EU and the UK have highly developed privacy rules, specifically the General Data Protection Regulation (GDPR) and the GDPR as incorporated into the laws of the UK. In the US, there are 13 comprehensive state privacy laws, with more likely to follow. However, privacy laws alone are not sufficient to fully regulate the use of AI. In 2023, significant advances were seen in the approaches proposed in the EU, UK and US for regulating the use of AI, and in 2024, this looks set to continue.

The EU, UK and US have taken different approaches with regards to regulating AI. While the EU opted for prescriptive legislation through the AI Act, the UK's preferred approach is a non-statutory principle-based framework. AI regulation in the US remains in the early stages, but an Executive Order for federal agencies offers a blueprint for possible US regulations to come in the private sector.

EU Approach
2023 saw major advancement regarding the AI Act with political agreement being reached on December 8, 2023. However, technical discussions are still ongoing and, thus, the final text of the AI Act is still not available. It is likely that the AI Act will be formally approved in early 2024. While the text is not yet available, the key provisions and approach are known:

- The AI Act will introduce a risk-based legal framework for AI governance in the EU, meaning obligations will vary in accordance with the risk level given to a use of AI. Most obligations will fall on providers of AI systems, with a more limited set applying to those deploying AI and other players such as importers.

- The AI Act prohibits deployment of the harmful AI used in the EU including, for example, AI systems used in social scoring for public and private purposes.

- High-risk AI systems are subject to detailed obligations, including an obligation on providers to

perform a conformity assessment to ensure that the systems it places on the market comply with the provisions of the Act.

- AI systems that may give rise to transparency risks are subject to light obligations and AI systems that are not considered prohibited, high-risk or a transparency risk are not regulated.

- General purpose AI systems are also subject to risk-based requirements. All such systems, and the models they are based on, must adhere to transparency requirements, with a set of more stringent requirements only applicable to the most advanced systems.

- Non-compliance with the AI Act may lead to significant fines of up to €35 million or seven percent of an organization's annual global turnover.

- Following formal approval, the AI Act will become applicable after a transition period, the length of which will vary depending on the type of AI system.

UK Approach

The UK Government announced its "pro-innovation approach" to regulating AI last year and issued further details in its Policy Paper. The UK proposes to develop a framework of principles to guide and inform responsible development and use of AI in all sectors. It does not, at this stage, propose to enact legislation. The principles will be issued on a non-statutory basis and implemented by existing regulators, allowing their "domain-specific expertise" to tailor implementation to the specific context in which AI is used. Regulation will be based on the outcomes of AI as opposed to any specific sector or technology. Existing regulators will be expected to implement the framework underpinned by the following principles: (i) safety, security and robustness; (ii) appropriate transparency and explainability; (iii) fairness; (iv) accountability and governance; and (v) contestability and redress.

While the UK is primarily proposing a non-statutory approach, the draft Artificial Intelligence (Regulation) Bill was introduced to UK Parliament in late 2023. It is limited in scope with its key provisions proposing to create a new body, the "AI Authority," the functions of which are defined in the Bill and placing several obligations on the UK Secretary of State to issue further regulations.

During 2024, it is expected that the UK will progress further with the "pro-innovation approach." The Policy Paper sets out a range of next steps, such as further engagement with industry, issuing principles to regulators and publishing an AI Regulation Roadmap, which are likely to take place during 2024. In addition, while in the early stages of review, the Bill will also likely progress during 2024.

US Approach

On October 30, 2023, President Joe Biden signed the EO on Safe, Secure and Trustworthy Artificial Intelligence, which is designed to promote a coordinated approach across the federal government for the safe and responsible development and use of AI. While the EO is applicable to the federal government, its requirements will indirectly affect both developers and downstream users of AI systems. Most notably, the EO invokes the Defense Production Act to direct the Secretary of Commerce to implement federal government reporting requirements for companies developing certain "foundational" AI models that pose a serious risk to national security, national economic security or national public health and safety. The EO also directs or encourages federal government agencies to take a series of actions across eight domains, including safety and security, privacy and calls upon various federal agencies to evaluate AI-use in their respective sectors and to establish guidelines or best practices to minimize related risks.

The deadlines for federal agencies to fulfill their respective EO obligations vary by agency and sector, ranging from 30 to 540 days from the date of the EO, meaning many will be implemented in 2024. Because the EO calls for AI-specific guidance and enforcement from a number of different federal regulators across a variety of domains, private sector companies developing or otherwise using AI should continue to monitor for regulatory developments in 2024.

Bletchley Declaration

In addition to country-specific activity, 2023 also saw nations working together to regulate the use of AI and we will

likely see other similar collaborations and the development of international standards continue into 2024 and beyond. In November 2023, 29 nations globally, including the UK, US and EU, reached a world-first agreement known as the Bletchley Declaration at the AI Safety Summit 2023. The Declaration sees a shared understanding of the opportunities and risks posed by AI and the need for governments to work together to meet the most significant challenges. Further information on the Declaration and what to expect for the AI Safety Summit in 2024 can be found here.

Hunton Andrews Kurth LLP is already helping clients gear up to comply with their obligations under the AI Act, often leveraging their existing data privacy compliance programs to build AI governance programs, including the preparation of policies and procedures. We continue to monitor the approaches taken to regulating the use of AI in the EU, UK, US and globally.

Michael La Marca
Partner, New York

Sarah Pearce
Partner, London

Key AI Cases in the Intellectual Property Space to Monitor in the New Year

The first wave of litigation involving generative AI and/or machine learning began several years ago but is really starting to heat up now.

Just over six months ago, we gave you Five Reasons Why You Should Be Monitoring These Four Artificial Intelligence Cases in *LegalTech News*. Then, in early December, we described in our *Celesq® AttorneysEd Center* webinar, Why Should You Be Monitoring Artificial Intelligence Cases?, that the number of AI-related cases we were monitoring had jumped from four to at least fifteen. And as you likely know, the very close of 2023 saw *The New York Times* (NYT) filing a copyright suit against Microsoft and OpenAI for alleged use of the newspaper's articles to train ChatGPT and Copilot.

Below, we briefly highlight a number of these cases and the themes and issues that tie them together and make them worthy of attention in the coming year.

Most, but Not All, Involve Copyright Infringement Allegations

Ten of the fifteen cases, as well as the NYT suit, allege some kind of copyright infringement. Examples include: *Thomson Reuters Enterprise Centre GmbH v. ROSS Intelligence Inc., 1:20-cv-00613-SB (D. Del.)*, filed in May 2020 (a machine learning case focused on the issue of using copyrighted work as a training set for an AI generator); *Andersen v. Stability AI Ltd., 3:23-cv-00201-WHO (N.D. Cal.)*, filed in January 2023 (focused on the use of copyrighted images to create an "AI" image generator); and *Authors Guild v. OpenAI, Inc., 1:23-cv-08292, (S.D.N.Y.)*, filed in September 2023 (focused on the use of authored works to create ChatGPT).

The cases present a variety of copyright issues, including the human authorship requirement, whether (certain) output from an AI generator qualifies for copyright protection, and how an individual can protect anything he or she generates using AI. We expect the concept of intermediate copying and the fair use doctrine to be important tools for courts deciding these matters.

Many Other Allegations Are Also Included

Trade secret misappropriation, breach of contract, unfair competition, unjust enrichment and negligence, among others, are alleged in many of these cases. Examples include: *UAB "Planner5D" v. Meta Platforms, Inc., 3:19-cv-03132 (N.D. Cal.)*, filed in June 2019 (a machine learning case focused on scene-recognition technology; includes trade secret misappropriation allegations) and *DOE 1 v GitHub, Inc., 4:22-cv-06823-JST (N.D. Cal.)*, filed in November 2022 (the first so-called "AI" case, based on source code generation where the code came from GitHub; includes breach of contract, interference with economic relations, unjust enrichment, unfair competition and negligence allegations). Several implicate privacy concerns.

Right of publicity is also popular—it will be interesting to see how this plays out, as right of publicity (also sometimes called name, image and likeness) laws differ by state and generally relate to a plaintiff's monetary harm. *E.g., Young v. NeoCortext, Inc., 2:23-cv-02496 (C.D. Cal.)*, filed in April 2023.

And one, in which the AI generator at issue "hallucinated" a legal complaint, centers around a libel claim. *Walters v. OpenAI LLC, 1:23-cv-03122 (N.D. Ga.)*, filed in June 2023.

Most, But Not All, Are Class Actions

Ten of the fifteen cases are class actions. Examples include: *DOE 1, Andersen,* and *Young* (each noted above), as well as *Tremblay v. OpenAI, Inc.*, 3:23-cv-03223 (N.D. Cal.), filed in June 2023 (an "AI" case focused on the use of textbook works to train ChatGPT).

This raises (and may, in the future, answer) the question whether class actions make any sense for copyright suits, particularly in the context of AI.

None Have Been Finally Resolved

Many of these cases have already survived motions to dismiss and for summary judgment. This suggests they are here to stay and that at least some may well be decided on the merits, likely setting precedent and laying out a path for parties to follow in future complaints.

We will continue to monitor developments in these existing cases, as well as new suits that are filed, in 2024. We'd be happy to provide the full list and discuss the substantive issues with you in further detail. Should you desire more information, please do not hesitate to reach out to us anytime.

John Gary Maynard, III
Partner, Washington, DC

Matthew Nigriny
Associate, Richmond

Trending Upward – AI Impacts on Employment Law

Last year, public concerns about the potential impact of artificial intelligence (AI) in the workplace grew substantially. The increased availability and sophistication of AI search engines for public use certainly was a contributing factor. As lawmakers have responded, questions have emerged as to how employers should prepare to comply with what soon may be a patchwork of nuanced AI laws regulating the workplace. A New York City law regulating automated employment decision tools took effect in 2023. Several state legislatures introduced similar legislation. The federal government was vocal as well through agency actions and an executive order. The United States Equal Employment Opportunity Commission (EEOC) made a joint statement with three other federal agencies expressing AI concerns and released its own guidance addressing AI and Title VII of the Civil Rights Act, which prohibits various forms of employment discrimination. President Joe Biden also signed an executive order raising AI issues, including concerns about the use of AI by employers. The executive order followed the White House's release of a "Blueprint for an AI Bill of Rights" earlier in the year.

2023 Legislative Recap

In 2023, a New York City law regulating automated employment decisions tools took effect. Among other things, the law requires employers who use such technology to: have an independent third party audit the technology for bias; publish the results of the audit to the public; and provide employees and job candidates advance notice before subjecting them to the technology. There are several other pieces of legislation pending, federally and nationwide on a state level, that could impact AI in the workplace, including:

Federal
- Stop Spying Bosses Act (S.262)
- No Robot Bosses Act (S.2419)

State
- California (AB331)
- Massachusetts (H1873)
- New Jersey (A4909/S1926)
- New York (A00567/S05641), (A07859), (A08328/S07623-A)
- Vermont (H114)
- Washington, DC (B25-0114)

James J. La Rocca
Counsel, New York

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Are You Covered? Artificial Intelligence and Insurance

While artificial intelligence (AI) has been reshaping modern day businesses for some time, 2023 was a pivotal year for the intersection of AI and insurance. As we have explained in an earlier publication, AI portends many new risks for businesses, ranging from industry-specific risks to location-specific risks, to business organization-related risks. Each risk generates possible monetary and reputational exposures that a carefully calibrated insurance program can help mitigate. The sheer number and magnitude of these possible risks indeed ups the ante for risk managers and insurance professionals who want to make sure that their insurance program provides them with the coverage they want it to.

Looking back to 2023, the AI and insurance field saw many developments, including the four discussed below, but all of these developments still fall short of a comprehensive regulatory framework:

1. **State Regulation:** States across the country, like California, Colorado, Connecticut, New York and Washington, DC, have either adopted regulations or expressed interest in laws that would regulate AI's use in the insurance industry. These policy changes—and the future changes they signal are forthcoming—will provide an essential backdrop guiding insurers' activities going forward.

2. **Lawsuits:** Health insurers are facing lawsuits alleging that they have improperly used AI to deny coverage to policyholders. As these cases progress, we may see published judicial opinions that further shape the permissible bounds of insurer conduct in this area.

3. **National Association of Insurance Commissioners (NAIC) Model Bulletin:** NAIC issued a model bulletin on the use of AI systems in insurance. The bulletin is one step among many to create a comprehensive set of regulatory standards to ensure the responsible deployment of AI in the insurance industry.

4. **Judicial Standing Orders:** Courts across the country have adopted standing orders about the use of AI in preparing court filings. While this impacts all litigants equally, insurance coverage lawyers will still want to pay special attention to them to avoid inadvertent noncompliance and the costs attendant to it.

Together, these four developments underscore the rapidly developing discipline at the intersection of AI and insurance. They also reflect how and why 2024 will likely be an even greater year of change. That is, regulatory and judicial bodies are likely to continue defining the parameters of acceptable conduct in this space at an even greater pace.

As businesses consider how their insurance assets can best protect them from the wide array of AI-generated legal risks, they may want to consider the adequacy of their current insurance programs. They also may want to evaluate whether to solicit AI-specific insurance products like one offered by MunichRe. And because this area is rapidly developing and not governed by any hard-and-fast rules, consultation with experienced coverage counsel may be more important than ever. Through such consultations, businesses can evaluate their own unique exposures and how insurance can help them go from 2024, to infinity and beyond.

Michael S. Levine
Partner, Washington, DC

Alex D. Pappas
Associate, Washington, DC

Digital Assets and Crypto Regulatory Landscape

The early months of 2023 were tumultuous for crypto and digital asset firms in the wake of the banking collapses with concentrated impacts on entrepreneurs and tech companies. Directly impacting crypto markets in a variety of ways, even USDC, a stablecoin pegged to the US dollar, untethered from its $1.00 trading value as a result of its parent company's cash reserves being tied up in a failing bank. Perhaps emboldened by the banking crisis and in the aftermath of the FTX collapse at the end of 2022, regulators at both the state and federal level were very active in proposing and adopting crypto-related regulations 2023.

Federal Regulators

At the federal level, in June 2023, the SEC filed charges against major cryptocurrency exchanges, Coinbase and Binance, alleging a number of violations of federal securities laws, including unregistered offers and sales of securities. And in November 2023, Binance settled for $4 billion to resolve DOJ charges alleging a variety of violations of the Bank Secrecy Act. Shortly after these law suits were made public, in July 2023, a judge in the Federal District Court for the Southern District of New York struck a blow to the SEC's battle to regulate cryptocurrencies as securities with a split decision in favor of Ripple Labs. The judge in that case held that XRP, Ripple's cryptocurrency, is a security with respect to institutional sales, but not with respect to other types of transactions like certain individual sales or when used as compensation. Unsurprisingly, other federal judges have declined to follow the holding in the Ripple decision, which has been praised by crypto-enthusiasts and criticized by regulators and others.

In August 2023, the SEC settled its first NFT enforcement case against a Los Angeles-based media and entertainment company for conducting an unregistered offering of non-fungible tokens (NFTs). The case represents the SEC's first step into the NFT space. The SEC's order cites the DAO Report to conclude that the NFTs here were investment contracts under the Howey test. The NFTs here contained various combinations of digital graphics. But the SEC alleged that, in effect, purchasers acquired the NFTs not for their underlying collectability, but rather as an investment and to fund expansion of the NFT issuer's business. While it remains possible to structure an NFT sale so that no security is created, the SEC's case here serves as a cautionary tale and a benchmark for future SEC actions.

In addition to its active docket going after crypto and digital asset companies in court, in October 2023, the SEC's Division of Examinations released a report detailing its 2024 examination priorities, which highlights a focus on crypto and digital assets. The document lays out the key risks, topics and priorities that the Division plans to focus on during its upcoming cycle of inspections and examinations of broker-dealers, investment advisers and other regulated securities intermediaries. Among the various areas of focus, once again risks related to crypto assets and blockchain will be an examination priority.

The CFTC also continued to focus on crypto and digital assets in 2023. In its November 2023 report describing its enforcement results for fiscal year 2023, the CFTC reported that 47 of its 96 actions involved conduct related to digital asset commodities. The CFTC is already hitting the ground running this year. On January 8, 2024, the CFTC's Technology Advisory Committee issued a detailed report on decentralized finance, or DeFi. The report, which was authored by the Subcommittee on Digital Assets and Blockchain Technology, notes that DeFi offers both promising opportunities and complex, significant risks to the US financial system, consumers and national security. More information on the CFTC's report is available here.

State Regulators

As Congress continues to be slow to coalesce around federal regulation of crypto and digital assets, state regulators continue to push forward legislation in 2023. State regulators were active in 2023 with a number of states proposing and adopting new rules and regulations related

to crypto and digital assets. The most notable is California's Digital Financial Assets Law (DFAL), signed by Governor Newsome in October 2023. The DFAL provides broad authority to California's Department of Financial Protection and Innovation (The Department) to license, regulate and examine certain businesses transacting in digital financial assets in California. The DFAL defines "digital financial asset" as a digital representation of value that is used as a medium of exchange, unit of account or store of value, and that is not legal tender, whether or not denominated in legal tender. It also broadly defines "digital financial asset business activity."

Pursuant to the DFAL, on or after July 1, 2025, a person may not engage in a digital financial asset business activity in California without a license from the Department. The DFAL lays out detailed criteria for minimum information that must be included in the license application and requires the payment of an application fee. The Department has broad authority to grant or deny a license. Notably, the Act also permits the Department to grant a conditional license to the holder of a New York BitLicense. More

information regarding the DFAL and its detailed requirements is available here.

Looking Ahead to 2024

Making predictions about the future of crypto and digital assets is a fraught exercise, but the first few weeks of 2024 were already active in the space. For starters, despite a false start with a hacked social media post, the SEC did, in fact, approve 11 Bitcoin Spot ETFs in January. While this is a complete reversal of policy for the SEC, commentary from the Commissioners regarding the decision and the SEC's continued enforcement activity warn against extrapolating the importance of this win more broadly. We expect 2024 to continue to be a difficult year for the digital asset industry before t he SEC and other federal and state regulators.

In the face of regulatory uncertainty at the state and federal level, the use of blockchain to deploy capital raising strategies in the private markets gained momentum in 2023, and we think 2024 will follow suit. Private funds and companies are able to raise money by issuing digital securities on blockchain-based systems without the same level of scrutiny

as public market participants. While the regulatory landscape for private transactions must still be navigated carefully, particularly with respect to broker-dealer regulations and FinCEN, the administrative advantages of blockchain securities has proven worthy of the effort. Private, blockchain-based securities have allowed funds to dramatically reduce the minimum investment in capital raises. In a late 2023 deal, for example, the minimum investment threshold dropped from as much as $50,000,000 to $20,000 as a result of the administrative efficiencies gained using digital securities.

We continue to help companies navigate the regulatory landscape to develop and deploy crypto and digital asset projects. As regulators focus their efforts and investors make increasingly discerning decisions on where to deploy their capital, we see mature companies with strong regulatory compliance regimes continuing to advance through uncertain markets.

Mayme Beth F. Donohue
Partner, Richmond

HUNTON
ANDREWS KURTH