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5 Things Corporate Boards Need to Know About Generative AI Risk Management

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The use of artificial intelligence (AI) is booming. Investors and companies are pouring cash into the space, and particularly into generative AI (GAI), to seize their share of the market which McKinsey reports could add up to $4.4 trillion annually to the global economy. Some companies are investing tens or hundreds of millions of dollars or more into GAI. Whether companies are building their own AI technology and training their own AI models, or leveraging third party tools, there are significant legal issues and business risks that directors need to consider as part of their fiduciary obligations and corporate governance. Five of the top issues to understand and consider are addressed in this article. Many other issues can arise. A wave of litigations and enforcement actions has swelled. Boards should get educated on these issues and ensure appropriate policies and corporate governance are implemented to manage the business and legal risks.

Algorithmic Disgorgement

Many companies are sitting on a trove of customer data and are realizing this data can be valuable to train AI models. However, what some companies have not thought through, is whether they can actually use that data for this purpose. Sometimes this data is collected over many years, often long before a company thought to use it for training AI.

One of the potential perils is that companies rush to launch a GAI solution, without the proper planning, and the result is they are subject to "algorithmic disgorgement." This is a remedy the FTC has imposed several times (e.g., for improperly using data to train AI models) that requires deletion of the data and the models and algorithms built using that data. Algorithmic disgorgement can wipe out the entire value of those multi-million dollar investments. This remedy can be imposed, even if the data was properly obtained, albeit without proper disclosure that it would be used for training AI models.

This is exactly what happened to Everalbum. The FTC filed an administrative complaint against Everalbum Inc. in January 2021. Everalbum provided a photo album and storage application but used the customers' photos and videos for other purposes. The photos and videos were voluntarily uploaded by customers. However, Everalbum created new datasets, often without user permission, that it used to train its AI models to develop facial recognition technology to create a different application. It also did not delete photos and videos from users who deactivated their accounts. The FTC settled with Everalbum for AI and privacy violations, with the result being algorithmic disgorgement - Everalbum had to destroy the data, algorithms and models.

For more information on issues with using data, including your own customer data, to train AI models, see Training AI Models – Just Because It's "Your" Data Doesn't Mean You Can Use It.

Key Takeaway: Boards need to understand that GAI is a data intensive endeavor and before it authorizes multi-million dollar investments into a GAI solution, it should make sure that the company has policies and procedures to ensure that it properly obtains the data needed and that it has the right to use the data as intended.

Tainting of Proprietary Software Developed With AI Code Generators

Software developers are increasingly using AI code generators, which are a powerful application of generative AI. These tools leverage AI to assist code developers by using AI models to auto-complete or suggest code based on developer inputs. Various legal issues can arise with use of these tools. One of the most severe issues, which can adversely affect a company's investment in its software, is called "tainting." Tainting severely devalues software.

The AI models for these tools are typically trained on open source software. Open source (OS) software is typically free to use but that freedom is based on a license that accompanies the OS software. Most OS licenses permit the user to copy, modify and redistribute the OS code. However, these freedoms come with conditions. These conditions vary by license and can range from simple compliance obligations (e.g., maintaining copyright information) to more onerous, substantive requirements. The more substantive provisions can require that any software that includes or is derived from the OS software must be licensed under the OS license and the source code for that software must be made freely available. This permits others to copy, modify and redistribute the software for free. This is an example of tainting. For companies that develop software to license it for a fee, this is a huge problem and can cause inadequate return on the money invested to develop that software.

For more information on OS and other legal issues and solutions with AI code generators, see Solving Open Source Problems With AI Code Generators - Legal issues and Solutions.

Key Takeaway: Boards need to understand that while AI code generators offer tremendous assistance to developers, their use can cause "tainting" which can lead to significant loss on the investment in the software developed. All companies should have open source policies. See Open Source Software Policies – Why You Need Them And What They Should Include. Surprisingly, many companies still do not have one. Even if your company has such a policy, it needs to be updated to safeguard against tainting and other legal issues that can arise with AI code generators.

Inability to Obtain IP Protection for AI-generated Content

For companies that monetize content, strong IP protection is needed to protect that content. While GAI excels at cost-effectively creating new content, the problem is that little or no copyright protection is available for GAI content. The U.S. Copyright Office ("Office") has published guidance on registering works that contain AI-generated material. It states that copyright can protect only material that is the product of human creativity. If a work's traditional elements of authorship (the expressive content) were produced by AI, the work lacks human authorship and the Office will not register it. That a user created the prompt to cause the output does not change the result because prompts typically are deemed to be ideas rather than expression. Copyright only covers expression. Where a work containing AI-generated material also contains sufficient human authorship to support a copyright claim, copyright will only protect the human-authored aspects of the work, which are "independent of" and do not affect the copyright status of the AI-generated material itself. For example, a human may select or arrange AI-generated material in a sufficiently creative way that the resulting work as a whole constitutes an original work of authorship or an artist may modify material originally generated by AI technology to such a degree that the modifications meet the standard for copyright protection.

The guidance further indicates that applicants must disclose the inclusion of AI-generated content in a work submitted

for registration and to briefly explain the human author's contributions to the work. And AI-generated content that is more than *de minimis* should be explicitly **excluded** from the application.

Applicants who have already received registrations for works containing AI-generated material must check that the information provided to the Office adequately disclosed that material. If not, they need to correct their information so the registration remains effective. Applicants who fail to update the public record after obtaining a registration for material generated by AI risk losing the benefits of the registration. If the Office learns information essential to its evaluation of registrability "has been omitted entirely from the application or is questionable," it may take steps to cancel the registration.

For more information on copyright issues with AI, see Copyright Office Artificial Intelligence Initiative and Resource Guide.

Key Takeaway: Boards need to ensure that content-based businesses have effective polices in place that address when employees can use safely use GAI to create content, particularly when the company needs to ensure strong copyright protection for its content.

Loss of Valuable Trade Secrets

Employee use of public GAI tools is ubiquitous. What some employees do not realize is that with many such tools the inputs are not confidential. Even worse, some GAI tools' Terms of Use (TOU) expressly grant the tool provider a license to use that input. If the input includes trade secret or sensitive business information, this can lead to losing trade secrets or at least a diminution in the value of the information. Many employees routinely accept the TOU without reading it, thus they are unaware that they are putting the company's valuable information at risk.

This is one compelling reason why all companies should immediately adopt a corporate policy on employee use of GAI. One aspect of these policies involves a legal assessment of the TOU for different GAI tools and selective whitelisting of the tools that present less legal risk. Many other issues need to be addressed. For example, the TOU for some GAI tools require the user to indemnify the tool provider if the tool generates content that infringes third party IP. Conversely, some TOUs indemnify you if their tool produces infringing content for your employee.

These issues can extend beyond employee use. For companies that hire outside contractors to create content and other materials, it is important that your contractor agreements address issues with use of GAI tools on your projects. While many companies have well drafted independent contractor or work for hire agreements that address the traditional issues that need to be covered under these arrangements, these agreements need to be updated to address some of the GAI-related issues.

For more information on these policies see AI Technology – Governance and Risk Management: Why Your Employee Policies and Third-Party Contracts Should be Updated.

Key Takeaway: Boards need to ensure that their companies develop and enforce a corporate policy on employee and contractor use of GAI to protect corporate assets and avoid unnecessary liabilities.

Avoiding Bias and Other Issues On the FTC's Watchlist

The Federal Trade Commission (FTC) has been active in enforcements involving various AI-related issues, besides the data-related issues discussed above with its Everalbum enforcement. For example, it recently instituted an investigation into the GAI practices of OpenAI through a 20 page investigative demand letter. The FTC has also issued a report to Congress (Report) warning about various AI issues. The Report outlines significant concerns that AI tools can be inaccurate, biased, and discriminatory by design and can incentivize relying on increasingly invasive forms of commercial surveillance.

Regarding bias and discrimination in data used to train AI models and/or in AI algorithms, the Report notes that AI tools can reflect biases of its developers that lead to faulty and potentially illegal outcomes, provides analysis as to why AI tools produce unfair or biased results and includes examples of instances in which AI tools resulted in discrimination against protected classes of people or overblocked content in ways that can reduce freedom of expression. It also addresses various other issues. For more information on avoiding issues with the FTC when using AI, see You Don't Need a Machine to Predict What the FTC Might Do About Unsupported AI Claims.

Boards' obligations to ensure their companies avoid bias is not just good corporate citizenship, it is necessary to avoid illegal conduct. Some companies are not aware of the potential for bias in GAI tools, particularly if they rely on third party tool providers. In such cases, often companies are not aware of the data on which these tools are trained and whether the data contains or results in biased or discriminatory results.

Examples of some of the FTC-related issues that companies should include in their GAI-related corporate governance can be gleaned from the FTCs' investigative demand letter to OpenAI. Some of the topics about which the FTC asks include:

- What is the company's corporate governance model

- The accuracy and reliability of outputs generated by their products

- How the company retains or uses information collected by users of the products

- Disclosures and representations about the products

- The data used to train its models, how it is obtained, the sources of the data, whether it is derived from public websites, the extent to which the company assesses or reviews the data and other data related questions

- The individuals or departments responsible for training the models

- The process and circumstances under which the company retrains their models, including to remediate hallucinations or the revelation of personal information

- The policies and procedures the company follows to assess risk and safety before the company releases a new model or product based thereon, including the risks considered

- The policies and procedures relating to privacy and security of personal information including steps taken to prevent personal information from being used in the training data or outputting personal information or false or disparaging information about a person and how users or other individuals can to opt out of having their personal information used

- And many more

As should be apparent from these sample questions, if the company faces an FTC investigation and does not have the appropriate policies and procedures in place to address these and other questions, that will be an unpleasant experience.

Key Takeaway: Boards need to be aware of the potential bias, discrimination, privacy and other issues that can arise with GAI tools and ensure the company develops proper safeguards to avoid these and other issues on the FTC's radar. These safeguards should be included in the corporate policies and governance on use of GAI.

Conclusion

GAI does not alter the fiduciary duties directors owe to their companies as traditionally understood. The duty of care requires directors to take informed and deliberative actions based on all material information reasonably available. Directors have an obligation to inform themselves on the potential benefits and risks inherent with GAI so they can make responsible decisions.

Many boards have found it helpful to receive a presentation on the legal issues that can arise with GAI to help inform them of the potential risks and to assist them in ensuring their companies adopt policies and governance that foster responsible use of GAI while mitigating legal risks and waste of corporate assets.

For more information on GAI presentations or the legal issues and business risks that can arise with GAI use, or how to develop corporate policies on use of GAI, contact me at jgatto@sheppardmullin.com

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