# NAVIGATING AI IN M&A: CONTRACTUAL INSIGHTS FOR IN-HOUSE COUNSEL

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*"It's going to be interesting to see how society deals with artificial intelligence, but it will definitely be cool."* — Colin Angle, CEO and Founder, iRobot

## Introduction

In the fast-paced world of mergers and acquisitions (M&A), attorneys stand at a defining moment where tradition meets innovation. Artificial intelligence (AI), particularly generative AI, is revolutionizing M&A due diligence and contract drafting, offering in-house counsel new opportunities to add value to clients and assume a more strategic position within transactions.

However, the increasing use of AI in M&A also presents contractual risk and other implications that in-house counsel must consider. By understanding AI's legal ramifications and nuances, in-house counsel can safeguard their clients' interests in M&A transactions and commercial contracts.

## AI in M&A Due Diligence

AI can streamline in-house counsel's involvement in M&A deals by automating tasks, identifying risks, and providing deeper insights. Various AI-powered tools are available to facilitate M&A due diligence, such as SignalX, Imprima Due Diligence Platform, and Ansarada.

Examples of how AI is being used to improve M&A due diligence include:

- **Risk Identification.** AI can process large volumes of contracts to identify potential risks, such as onerous terms, legal violations, and compliance risks. AI can locate all instances of a particular contract term and assess the possible risks associated with that term.
- **Financial Data Analysis.** AI can analyze financial data to identify trends, forecast future performance, and detect potential fraud or irregularities. For instance, AI can identify unusual revenue, spending patterns, or potential conflicts of interest.
- **IP Asset Discovery.** AI can identify intellectual property assets, such as patents, copyrights, and trademarks owned by the target company. This information can be used to assess the target company's value and identify potential infringement risks.
- **Cultural Fit Assessment.** AI can help gauge the cultural fit between acquiring and target companies. For example, it can analyze employee surveys and other data to identify company cultural differences and anticipate potential integration challenges.

While AI is a powerful tool for enhancing efficiency and comprehensiveness, it cannot replace the vital role of human expertise in M&A due diligence. AI complements in-house counsel's expertise, enabling more effective due diligence.

However, it is crucial to be aware of AI's limitations. The risk of AI generating misleading or incorrect information, known as "hallucination," is a significant concern. Rigorous quality control measures are essential to validate AI outputs against reliable data. Moreover, using AI poses increased confidentiality risks, particularly in public-facing situations. Strict adherence to confidentiality protocols and robust data security measures are essential to protect sensitive information.

By recognizing and addressing these challenges, in-house counsel can effectively integrate AI into their work, complementing their expertise with its computational capabilities.

## Contractual Considerations in AI-Augmented M&A

As AI-powered products and services become more prevalent, more companies are seeking to acquire businesses that have developed or are using AI. Recent acquisitions like Databricks' $1.3 billion purchase of MosaicML, Thomson Reuters' $650 million acquisition of Casetext, and the announcement by Advanced Micro Devices last month of its plan to acquire Nod.AI illustrate this trend. This surge in AI-related transactions is leading to new contractual clauses and the revision of existing clauses to address the risks and challenges associated with AI.

***Well-defined representations and warranties*** are integral in purchase agreements with an AI component. These provisions serve as vital safeguards for both parties in case of disputes. For example, a seller could warrant that the AI

model is accurate and reliable and will perform as promised while acknowledging the potential for "hallucination" risk and committing to rigorous quality control measures. On the other hand, a buyer could warrant that it will use the data collected from the AI-powered product or service in compliance with all applicable laws and regulations and ensure the confidentiality of sensitive data.

***Robust indemnification clauses*** can also help protect the acquirer from liability for adverse consequences caused by the target company's AI-powered products or services. For example, an indemnification provision could require the target company to compensate the acquirer for any losses caused by defects in the AI model or misuse of data by the target company.

In addition to these general contractual considerations, several specific issues should be addressed in AI-augmented M&A transactions. These issues include:

- **Ownership and Licensing of AI Models.** Who owns and licenses the AI models used in the product or service?
- **Data Usage.** How does the acquiring company intend to use the data collected from the AI-powered product or service?
- **Liability and Insurance.** Which party is responsible for any harm or losses caused by the AI-powered product or service? Can the parties limit their liability, and should they be able to do so as a matter of public policy? Do the parties have adequate insurance for these losses in limits and scope?

By carefully considering these and related contractual issues, in-house counsel can play an instrumental role in ensuring the success of their clients' AI-augmented M&A transactions and mitigating AI-related risks.

## Practical Tips for Drafting Contracts with an AI Component

Below are some practical tips for in-house counsel to remember when drafting or negotiating M&A or commercial contracts with an AI component to ensure clarity, legal soundness, and readiness for future developments in the technology:

- **Be Specific.** When drafting representations, warranties, disclaimers, and indemnification provisions, be as specific as possible about the AI-powered products and their role in the services covered by the contract.
- **Use Clear and Concise Language.** Avoid using technical jargon that may not be understood by all parties to the contract.
- **Consider Data Ownership and Usage.** Since AI models are trained on data, it is essential to consider who owns and controls the data used to train and operate the AI model. Ensure representations include consent for data use and that its acquisition complies with applicable laws, particularly privacy laws. Additionally, draft indemnification clauses to address risks associated with the intellectual property of the data used in training algorithms.
- **Consider All Known and Reasonably Anticipated Potential Risks.** Thoroughly evaluate both the evident and the less obvious, yet reasonably foreseeable, risks and challenges of AI-powered products and services when drafting the contract. This includes considering who will be liable for damages caused by the AI model's functionality or misuse.
- **Be Flexible.** AI technology is rapidly evolving, so drafting your contract with language that can accommodate future changes without the need for multiple amendments is imperative.
- **Seek Outside Legal Advice.** Consult an outside attorney with experience in drafting contracts comprising technology-based services if you are unsure how to draft, review, or negotiate a contract with an AI component.

## Conclusion and Future Outlook

In summary, the partnership between AI tools and the demands of in-house counsel has ushered in a new era for M&A due diligence and contracts. It has demonstrated the potential for enhanced efficiency and perhaps resulted in profound insights. It has also identified risks that might elude human observation provided that its output is reviewed carefully for accuracy and potential privacy and confidentiality risks.

As generative AI technology evolves, AI's role in M&A is set to become even more prominent. In-house counsel will remain indispensable in shaping the M&A landscape by leveraging AI as a powerful ally to tackle the complexities of an ever-changing terrain.

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