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## ARTIFICIAL INTELLIGENCE IN RELATION TO M&A PROCESSES (PART I)

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### SOME GENERAL AND EXTRAORDINARY ASPECTS OF ARTIFICIAL INTELLIGENCE

Artificial Intelligence ("AI") is very much the new hype, but not only a hype. Finding a verified definition has not been an easy task, since the AI has evolved through the years, in fact since 1950's.<sup>1</sup>

Now, in year 2024 we have finally some legal definitions, most notably in the European Union AI Act draft:



"Article 3(1) of the draft act states that '**artificial intelligence system**' means:

**software** that is developed with [specific] techniques and approaches [listed in Annex 1] and can, for a given set of human-defined objectives, generate outputs such as content, predictions, recommendations, or decisions influencing the environments they interact with.<sup>2</sup>

Perhaps the best guarantee of this definition is that nobody is perfectly content with it, but most stakeholders do agree that it is a good compromise. Still, there are those holding Ph.D. in Technology claiming that one should remove the "intelligence" from the concept of artificial intelligence.

An advisor to parties planning any kind of reorganization, merger or acquisition may hear very different estimates about potential AI held by the target company or companies.

Many other countries and regions are pushing for AI regulation e.g. USA and China<sup>3</sup>, and unfortunately the definitions are not uniform. This brings additional challenges for cross-border transactions covering AI.

One point of relief is the very first word in the AI Act draft definition, namely "software". An approach therefore should be the same as if with any software. AI simply has some specific features and functionalities in addition to the basic layout and functionality as software.

Bearing this in mind, one could state that any M&A or related activity is at least as challenging as any with software. Since there is probably only an extremely small, nearly non-existent number of cases that do not have one byte of technology in them, in practice this applies to all cases.

The omnipresence of software in organisations and its tools means that estimating the value and risks means every branch of the activities and their documentation must be carefully investigated. It is very much the weakest link impact – one line of contaminated code may mean that the target organisation's core product is unusable.

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<sup>1</sup>Max Roser (2022) - "The brief history of artificial intelligence: The world has changed fast – what might be next?" Published online at OurWorldInData.org. Retrieved from: '<https://ourworldindata.org/brief-history-of-ai>'

<sup>2</sup>European Commission, Proposal for a regulation of the European Parliament and of the Council laying down harmonised rules on artificial intelligence (artificial intelligence act) 2021/0106 (COD)

<sup>3</sup><https://techmonitor.ai/technology/ai-and-automation/the-state-of-ai-regulation-around-the-world>

A typical question list in any due diligence covering AI is almost identical to software risks and dependencies:

1. If the AI is included in the product that the target organisation is offering to its customers, is it developed inhouse, or is it licensed, or is it developed on top of licensed technology?
2. Is the usage of AI dependent on other technologies that are in-licensed? What is the term and conditions for renewal for such an essential license?
3. Does the applicable license language contain restrictions for usage or distribution, or obligations to share the results of any further development?
4. Is there maintenance and support available after changes in ownership, and at what price?
5. If the provider of AI goes bankrupt, what are the options for the licensee to continue their own operations?
6. Is any of the AI licensed or acquired under "click wrap" terms, for example by pressing "I Agree" online? Are those license terms printed on the day the acceptance was given?
7. Is any of the AI licensed under "Open Source"-licenses, and if yes, under which one?

In case the AI utilized in the target is licensed under terms that heavily restrict the usage, or block the transfer of such license rights, it is similar to any IP – it cannot be utilized by new owner.

Typically, in most technology license agreements, the assignment of the agreement is not allowed without prior written approval from the other party. There may be language which allows assignment to an entity in the same corporation, or assignment is without restriction if it is to an entity owned by the assignee. Threshold for such ownership is 50% of shares or 50% of voting rights, or both. Even sublicensing can be strictly limited to disclosed companies, or it is not allowed where the sublicensee would be a direct competitor of the licensor.

With the AI there are further issues to be considered, namely the 3rd party IP, if that would have used in development of the AI technology in question. Most often there are no remains of that 3rd party IP in the code itself, but there is a risk that this AI technology could be banned, if a successful 3rd party owner obtains an injunction. It is challenging to get a warranty covering this into the documents, but personally I warmly recommend asking.

The warranty as such does not really bring any additional value into the balance of risks, but if the other party fiercely refuses, it is sensible to start discussions on the topic "why do you refuse to give warranty?".

In an ideal outcome the warranty for AI ownership, sufficient license rights, non-dependability and non-infringement of 3rd party IP rights should naturally be backed by consequences for breach, often liquidated damages, or impact on purchase price (on escrow or not).

This is very common approach in any transaction documents, but I would recommend considering something in addition. Namely, in case there would be a successful claim from a 3rd party, or a crucial license (to exploit AI technology in question) is lacking or will not be renewed – what can be done? The money is of small relief, if the AI technology in case is unusable, and the main driver is to have functioning product(s).

It may be more practical to give the seller/licensor a possibility to replace or circumvent the (allegedly) infringing components or blocks of code, and as a last resort, to acquire the missing usage rights at their cost.

One should consider ensuring sufficient support for work arounds, adaptations, amendments, or any corrective development with the help from the owner or main licensee of the AI.

Putting the source code into escrow service is one solution, but anyone familiar with software knows that it is far from an easy task to fix anything simply by looking at a source code. Still, it is better than nothing and gives some protection and starting point for further attempts.

If the target continues to function on its own, i.e. it is still operational or merged into new operations, they should have personnel capable of providing such maintenance and support services, or one should try to ensure that the relevant personnel will transfer to new company, or the remaining one would offer appropriate and necessary services.

Paradoxically the best way to evaluate, analyse and assess the risks of AI, is not to use AI in the due diligence. It may be also near difficult to find relevant documentation, if the R&D has utilized lot of code, tools and documentation available "free" online. Personally, I have extremely rarely seen anything "free". There has always been at the very least notifications, restrictions, credit requirements. In most cases also links to general and specific terms and conditions, sometimes to pages of license agreements – all accepted by default in case anyone downloads the materials.

The technology may be cutting edge, but the evaluation tools are ancient. One must discuss with the people, who in fact developed products. They must provide the entire list of any text, document, code, materials, picture they have obtained from elsewhere. If not already included in the documentation, they must create a chart or description, what the technology consists of: what has been developed inhouse, what has been taken from the web or any other sources or licensed under relevant license terms.

As to the tools, they are generally defined as any technology used in development, but from which not a single byte is included in the results: like a breadmaking machine, that shapes the dough, but there is no part of the machine in the final bread to be distributed.

The nastiest restrictions to be found out later are the ones that will effectively block the acquirer from continuing the business. Very restrictive license or usage terms are not usual, but when they impact your operations, they become crucial. For example, some license terms may allow any usage of the technology to develop, adapt, modify, and make copies. But as a total shock, there may be a restriction that the licensee cannot distribute any products made with that technology, that is licensor' sole privilege.

Additional legal risk comes from the actual or intended usage of the AI technology that may be restricted per se, because the technology is declared too intrusive. Therefore, the interplay between AI and fundamental rights is of utmost importance to determine, if a certain AI technology can be developed further, combined with any other technology, or included in any other services, even partly. There should be no dramatical surprises since any endangerment of fundamental rights is never a lasting option.

The result of using any technology is more determining than the technology itself. If the results of AI for example would lead to discrimination, it will not be allowed. The fundamental rights cannot be overridden, independent of what kind of tool or technology endangers them.

The draft legislation to regulate AI seems to have this intention to be technology neutral and not to create any blacklists of any technologies as such. The changing regulatory landscape is one of the aspects to consider with any transaction including new technologies, including AI. Such risk can be managed with sufficient warranties, and the reasonable consequences of breaching any of those, and dividing the regulatory risk between the parties.



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