WILSON SONSINI

AI/ML
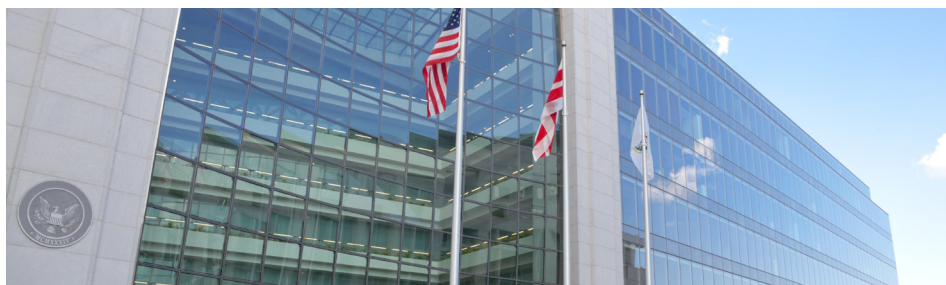### ARTIFICIAL INTELLIGENCE AND MACHINE LEARNING

ALL EYES ON AI: REGULATORY, LITIGATION, AND TRANSACTIONAL DEVELOPMENTS

Securities and Exchange Commission Regulatory Agenda Includes New AI Rules for Broker-Dealers

The Securities and Exchange Commission's (SEC's) Spring 2023 Regulatory Agenda included the introduction of a rule proposal addressing broker-dealer conflicts of interest in the use of predictive data analytics, artificial intelligence (AI), machine learning, and similar technologies to interact with clients. In a statement accompanying the release of the Regulatory Agenda, SEC Chairman Gary Gensler highlighted changing technologies, noting that the SEC's work must evolve with changing markets and technology. Chairman Gensler has previously expressed concerns about AI and the potential risk that the use of AI may pose to the financial system. While the rule proposal was included in the Regulatory Agenda, this does not mean that the SEC will ultimately issue a new rule, and there is not yet any detail as to the form the rule, if proposed, would take or what it may include.

SEC Investor Advisory Committee Releases Recommendations on Ethical Standards for AI-Based Programs

The SEC's Investor Advisory Committee (IAC) released recommendations (the Recommendations) regarding the importance of ethical guidelines for AI in the investment industry. The IAC focused on algorithmic models that are utilized by investment advisers and financial institutions and the importance of testing those algorithms for bias and discrimination. In encouraging the SEC to further develop guidance for investment advisers on the ethical use of AI, the Recommendations focused on three tenets: i) equity and the importance of understanding the context of the data, ii) consistent and persistent testing, including continually monitoring algorithm inputs and outputs for potential bias and discrimination, and iii) governance and oversight to ensure a robust risk management framework.

The Recommendations also suggested three action items for the SEC: i) continue to add staff with AI and machine learning expertise, ii) use the information and input from the request for comment on broker-dealer and investment adviser digital engagement practices, as well as observations from inspections of investment advisers using AI to draft best practices

SEC Investor Advisory Committee Releases Recommendations . . . *(Continued from page 1)*

regarding the ethical use of AI, and iii) task the Division of Examinations to monitor compliance with the IAC's recommended ethical AI framework. The IAC encouraged the SEC to look to several other sources when drafting guidelines, including the National Institute of Standards and Technology's draft artificial intelligence framework and frameworks put forth by other institutions and regulatory authorities in other countries. The Recommendation release noted that it was not a formal IAC recommendation, and it remains to be seen whether the SEC will establish the suggested guidelines.

Courts Cracking Down on AI Misuse by Lawyers

On June 26, 2023, two New York lawyers were sanctioned related to their use of AI in preparing a brief. Allegedly unbeknownst to the lawyer at that time, the cases provided by the AI platform were not real. Indeed, when the lawyer asked the AI whether the cases were real, it responded in the affirmative. When asked to submit the cases to the court by the judge, the counsel submitted the made-up cases to the court without checking their veracity from any other source. The lawyer argued he had no idea that the AI could produce false information and was not at fault. The judge disagreed with the lawyers' assertions and imposed monetary sanctions on them.

Judges are starting to take affirmative steps to keep AI out of their courtrooms. A federal judge in the Northern District of Texas, Judge Brantley Starr, has announced that lawyers with cases before him must certify that they did not use AI to draft their filings without additional verification. The announcement came a few days after the New York case hit the newsstand, though the judge said that case was not the reason for the new requirement. Judge Starr has said that he is considering a ban of the use of AI in his courtroom altogether. The requirement puts lawyers on notice to conduct a human review of any work done using AI tools.

New York City Adopts Rules on AI in Hiring and Promotion Decisions

In May 2023, the New York City government adopted rules regarding the use of AI in the employment context. The rules clarify Local Law 144, which the city government passed in 2021 and which goes into effect in July. That law prohibits the use of AI tools in some hiring and promotion decisions, unless the tool has been subject to a bias audit within one year of its use, information about the audit is publicly available, and notice has been provided to job candidates or employees. The new rules elaborate on the requirements, such as requiring the bias audit to calculate the selection rate for each race, ethnicity,

and sex category reported to the U.S. Equal Employment Opportunity Commission.

Some critics have claimed that the law does not go far enough, as its definitions create a narrow scope, and the law does not cover discrimination on the basis of age or disability. Others have said that the law's audit requirements are unworkable. Although this law only applies to companies with workers in New York City, some anticipate that similar provisions may be enacted nationwide.

Gonzalez and the Applicability of Section 230

On May 18, 2023, the U.S. Supreme Court vacated the Ninth Circuit's judgment in *Gonzalez v. Google LLC* and remanded the case for reconsideration. *Gonzalez* was the first Supreme Court case to consider the scope of Section 230 of the Communications Decency Act of 1996 (Section 230) and had potential to significantly reshape the protections afforded by Section 230 to internet-based platforms. The Court's opinion ultimately did not address Section 230, holding instead that the plaintiffs failed to state a claim for relief. However,

oral arguments offered insight into how courts might (or might not) apply Section 230's protections, including comments from Justice Neal Gorsuch suggesting that the law does not protect outputs of generative AI platforms.

Section 230's co-authors, U.S. Representatives Christopher Cox and Ron Wyden, have suggested the same. In March 2023, the two representatives said in an interview that they believe generative AI platforms should not expect to enjoy the protections of

Section 230 since, unlike other internet-based platforms protected by the law, generative AI platforms contribute directly to the creation of the content at issue. Similarly, U.S. Senators Josh Hawley and Richard Blumenthal proposed a bipartisan bill in June 2023 that would amend Section 230 and clarify that Section 230 would *not* immunize a provider against civil and criminal liability arising from the use of or provision of generative AI.

Congressional Appetite for AI Legislation Grows

The Senate is eyeing the development of bipartisan AI legislation. In early efforts to develop a comprehensive approach to the growing role of AI, Senate Majority Leader Chuck Schumer and a bipartisan group of four senators met to discuss an orderly path forward. Majority Leader Schumer remarked on the Senate floor that "Congress must move quickly," noting that he and his staff had also

met with "close to one hundred CEOs of companies who do AI, scientists, AI academics, leaders in the industry of many different viewpoints, and critics of AI," remarking that such engagement will continue.

Separately, Senators Michael Bennet (D-CO), Todd Young (R-IN), and Mark Warner (D-VA) introduced legislation

creating a new government entity to perform a holistic analysis of the U.S.'s relative strength in emerging technologies. The bill would establish an Office of Global Competition Analysis in order to provide assessments and recommendations for supporting U.S. leadership in innovative technologies, such as AI and Quantum Computing.

Executive Branch Brokers Agreement with AI Companies as Part of Continued Focus on AI Policy

These congressional engagements come on the heels of continued White House efforts to leverage existing authorities and resources to inform the policy approach to addressing AI. In May, the National Science Foundation announced that $140 million would be going towards seven new National AI Research Institutes, and the White House has received commitments from leading AI companies in the U.S. to open their respective models to threat actor simulations at this year's DEF

CON Conference. In July, the White House announced that seven leading AI companies have made voluntary commitments to help move towards the safe, secure, and transparent development of AI technology. In the same announcement, the White House stated that it is developing an executive order related to these issues and supports the passage of bipartisan legislation related to AI.

The U.S. Office of Management and Budget is also set to release draft policy

guidance on the use of AI systems within the federal government this summer. This guidance is coming against a backdrop of the mounting security concerns posed by AI, with Director of the Cybersecurity and Infrastructure Security Agency Jen Easterly voicing worries that AI technologies could make the information environment difficult for voters to navigate ahead of the 2024 Presidential Election.

FTC Crafts Public Stance: AI in the Crosshairs

Over the past several months, key Federal Trade Commission (FTC) officials have taken public positions on the benefits and harms of AI technology and have highlighted issues that the FTC is tracking closely as applications of AI technology proliferate.

In a *New York Times* op-ed, FTC Chair Lina Khan made it clear that she believes that the FTC's existing tools are sufficient to address issues related to AI. She expressed concerns that AI tools can be used to facilitate harmful practices such as price collusion, targeted price discrimination, fraud, and extortion. Chair Khan also highlighted that AI data training practices may violate user privacy and automate discrimination, noting that these practices will be subject to existing laws prohibiting discrimination and proscribing the exploitative collection of use of personal data.

FTC Commissioner Alvaro Bedoya similarly emphasized the view that existing laws and regulations can address potential concerns posed by AI. In a keynote presentation at the International Association of Privacy Professionals' Global Privacy Summit, Commissioner Bedoya noted that he

does not see AI as an existential threat for society, but that it does present "new and substantial risks to the American public." Commissioner Bedoya argued that public discourse on buzzworthy attributes of AI, such as whether or not it has achieved sentience, can obscure the most meaningful metric used by the FTC: how a "regular" person will experience interacting with AI. He urged companies to think twice before deploying products that could be mistaken for an interaction with a human or that could lead

consumers to feel that there is a trusted relationship with the AI product. He urged companies with AI technologies to take reasonable measures in addressing reasonably foreseeable risks.

Lastly, FTC staff published a business blog post in May warning companies about the potential for generative AI tools to be misused to manipulate consumers. This guidance, along with guidance issued previously this year, warns companies 1) not to make unsubstantiated claims about their AI products (e.g., "100% accurate"); and 2) to implement measures to address reasonably foreseeable risks (e.g., use of voice-cloning technology for impersonation scams). For companies placing ads within generative AI products, the FTC notes that companies should clearly distinguish between advertisements and organic content, refrain from using ad design choices that trick people into making harmful choices, and clearly disclose if an AI product is steering consumers to a particular website, service provider, or product because of a commercial relationship. In addition, people should know if they're communicating with a real person or machine.

Congressional Hearings on AI

U.S. Senate Judiciary Committee Subcommittee on Privacy, Technology, and the Law: Hearing on "Oversight of AI: Rules for Artificial Intelligence"

As concerns around the use and regulation of AI continue to grow, the U.S. Senate Judiciary Committee's Subcommittee on Privacy, Technology, and the Law held the first in a series of hearings on the need for oversight of AI. The hearing opened with Subcommittee Chairman Richard Blumenthal (D-CT) playing an audio clip of "himself" that

had been generated by AI voice cloning software, with the text drafted by generative AI.

Samuel Altman (CEO of OpenAI), Christina Montgomery (Chief Privacy and Trust Officer at IBM), and Gary Marcus (Professor Emeritus at New York University) testified at the hearing. Committee members and witnesses focused on risks related to the broader adoption of AI, including the potential impact on elections, intellectual property infringement risk, privacy concerns

resulting from the use of AI, and the lack of competition among AI companies.

Throughout the hearing, speakers and senators focused on the importance of not repeating the same mistakes they view as having been made with social media (e.g., lack of regulation and transparency). In addition to discussing the risks of AI, the hearing explored existing regulatory frameworks that could be used to regulate AI. There was general bipartisan support among committee members and witnesses for

Congressional Hearings on AI . . . *(Continued from page 4)*

some type of regulation. Proposals raised during the hearing included requiring disclosures in connection with training data and models; requiring safety testing or creating a set of safety standards; applying risk-based regulation for the use of AI in specific cases; and forming a new agency to license AI providers.

The hearing also touched on the use of Section 230 of the Communications Decency Act of 1996 ("Section 230") to regulate AI providers. Altman stated that he did not think that Section 230 was the right framework to apply to generative AI; however, he did think some framework similar to Section 230 would need to be implemented for AI companies.

The subcommittee has scheduled its next hearing on AI oversight for July 25th.

U.S. House Committee on Science, Space, and Technology: Hearing on "Artificial Intelligence: Advancing Innovation Towards the National Interest"

On June 22, 2023, the U.S. House Committee on Science, Space, and Technology hosted a full committee hearing on the topic, "AI: Advancing Innovation Towards the National Interest," to discuss ways that the federal government can advance AI in a trustworthy and beneficial manner for Americans.

Committee Chairman Frank Lewis' (R-OK) opening statement highlighted the need for the U.S. to create a "robust innovation pipeline that supports fundamental research, all the way through to real-world applications," and called out a recent Stanford University study finding that of the top ten universities which publish the greatest volume of AI papers, nine are based in China—the only U.S. institution being the Massachusetts Institute of

Technology. He went on to explain that "Congress needs to make strategic investments, build our workforce, and establish proper safeguards without overregulation," and any regulation will require substantial input from public and private stakeholders.

Five witnesses specializing in AI in academia and industry testified: Dr. Jason Matheny (CEO of RAND Corporation); Dr. Shahin Farshchi (General Partner of Lux Capital); Clement Delangue (CEO of HuggingFace); Dr. Rumman Chowdhury (Responsible AI Fellow at Harvard University); and Dr. Dewey Murdick (Director of Georgetown University's Center for Security and Emerging Technology). Throughout the hearing, the witnesses pointed to safety as a differentiator for the U.S.'s approach to AI and ability to gain public trust, likening the current state of AI technology to the early aviation, automotive, and pharmaceutical industries, which also required U.S. regulation for safety purposes.

Dr. Matheny explained that in his view, the security vulnerabilities in current AI systems could easily dissolve the U.S.'s lead in AI, and government involvement in a safe approach to AI stands to build consumer trust and strengthen the U.S.'s position as a leader in AI technology.

To that end, he recommended Congress bolster resources granted to National Institute of Standards and Technology within the U.S. Department of Commerce to support its creation of a technical standard for mitigating AI bias and an AI risk management framework, which in turn would guide the AI ecosystem in the U.S.

Delangue credited much of AI's current progress in the U.S. to the open source community and testified that open science is critical to accelerating the success of research and development initiatives in the space: "Open science and open source prevent black-box systems, make companies more accountable and help [solve] today's challenges like mitigating biases, reducing misinformation, promoting copyrights and rewarding all stakeholders including artists and content creators in the value creation process."

Chairman Lewis indicated that the hearing would likely be the first of multiple hearings before the Committee relating to AI regulation, in addition to other ongoing hearings on the topic at the federal level.

A recording of the hearing can be viewed here.

The EU and AI

EU Regulators Investigate the Use of Generative AI

While the EU moves forward with omnibus AI legislation, national data protection authorities have turned to existing legal authority to take action against potential risks posed by generative AI, the use of which has been rapidly growing in popularity since late 2022.

Over the past four months, various data protection authorities have initiated investigations into generative AI applications. In April, the European Data Protection Board announced that it created a specific task force to further the exchange of information on possible enforcement actions conducted by the different data protection authorities.

What's Next After the EU Parliament's Position on the Draft AI Act?

A significant milestone in the legislative process of the AI Act has been reached with the vote of the European Parliament (EP) on June 14, 2023. The text now enters a new phase, during which all three EU institutions (the Council of the EU (Council), the EU Commission (EC), and the EP) will work towards an agreement on the final text.

The legislative process to pass the AI Act started more than two years ago, when the EC published its proposal (the "draft AI Act") in April 2021. The EC adopted a horizontal, cross-sector, and risk-based approach to regulating AI. On December 6, 2022, the Council finalized its proposed amendments to the draft AI Act and followed a more business-friendly approach to regulating AI than the EC's proposal. The EP has now taken a strict, if not overly cautious, approach, proposing a number of significant amendments and additional obligations.

5 Key Changes Proposed by the EP

1. Introduction of general principles applicable to all AI systems. The EP introduces a new set of six high-level general principles applicable to all AI Systems. The general principles include 1) human agency and oversight, 2) technical robustness and safety, 3) privacy and data governance, 4) transparency, 5) diversity, nondiscrimination, and fairness, and 6) social and environmental well-being. The precise legal consequences of the general principles remain, however, ambiguous.

2. Expanded list of prohibited AI practices. The EP's position significantly expands the list of prohibited AI practices to include, for example, a ban of predictive policing, a ban of the creation or expansion of facial recognition databases through the untargeted scraping of facial images from the internet or CCTV footage, and a ban of emotion recognition systems in particular areas (such as in law enforcement, the workplace, and educational institutions).

3. Expanded list of high-risk AI systems. The EP also broadened the scope of high-risk AI systems to include, for instance, AI systems to be used by very large online platforms to recommend user-generated content.

4. Introduction of new requirements for "foundation models." The EP proposed new obligations for providers of "foundation models," such as:

   • assessing and mitigating all foreseeable risks to a broad range of issues (such as health, safety, fundamental rights, the environment, democracy, and the rule of law);

   • registering their models in an EU database; and

   • if foundation models are used to generate text, images, audio, or video ("generative AI"), the provider will be required to develop, design, and train its models to ensure adequate safeguards against the generation of illegal content.

5. Strengthening individual rights and increasing corporate liability. The EP also suggested a new chapter on remedies that will afford individuals more rights, such as a right to lodge a complaint with a national supervisory authority, a right to an effective judicial remedy, and a right to explanation in case of a decision based on a high-risk AI system with legal effects or significant adverse impacts on fundamental rights. The EP has also substantially increased the potential fines for noncompliance, ranging up to €40 million or, if the offender is a company, up to seven percent of the annual turnover, whichever is higher.

The three EU institutions aim at reaching an agreement by the end of 2023, ahead of the next European Parliament elections in June 2024. Discussions of the AI Act were scheduled for July 18, September 26, and October 26. For more information, please take a look at our recent blog post, "What's Next After the EU Parliament's Position on the Draft AI Act?"

Recent Deals Highlights

Wilson Sonsini Advises Mastercard on Privacy and Cybersecurity Aspects of Acquisition of Baffin Bay Networks

On March 20, 2023, Mastercard announced it acquired cloud-based cybersecurity company Baffin Bay Networks, which offers the latest in AI technology to automatically filter and counteract malicious internet traffic. Based in Sweden, Baffin Bay Networks will add to Mastercard's multilayered approach to cybersecurity with the goal of mitigating exposure to risk across the ecosystem. The acquisition further strengthens Mastercard's broader services offerings and value beyond the payment transaction.

As a result of this acquisition, Mastercard will integrate Baffin Bay's automated Threat Protection service into its existing RiskRecon data analytics. The combination of these services will enable organizations to preemptively identify vulnerabilities and stop attackers from penetrating or taking down cyber systems.

Wilson Sonsini Goodrich & Rosati advised Mastercard on privacy and cybersecurity aspects of the transaction.

Firm Advises Andreessen Horowitz on $100 Million Investment in Pinecone

On April 27, 2023, Pinecone, the vector database company providing long-term memory for AI, announced that it closed a $100 million Series B funding round at a $750 million valuation. The financing was led by Andreessen Horowitz (a16z) and included participation from ICONIQ Growth and previous investors Menlo Ventures and Wing Venture Capital.

The new financing is designed to allow Pinecone to maximize its ability to provide scalable solutions to the most pressing challenges in the AI infrastructure field and become a critical component of the modern AI stack.

Wilson Sonsini Goodrich & Rosati advised a16z on the deal.

Firm Advises Parabola on $24 Million Series B Financing

On June 28, 2023, Parabola, a collaborative data tool enabling nontechnical teams to automate solutions for manual, spreadsheet-based processes, announced a $24 million Series B funding round led by OpenView, with participation from existing investors Matrix and Thrive Capital. Additional new investors included Flexport, Webflow, and the founders of Harry's, Warby Parker, and Allbirds.

With this funding, Parabola will expand its product capabilities and grow its team in pursuit of empowering everyone to leverage automation and AI in their daily work, regardless of their technical capabilities. The proceeds will allow the company to double down on serving its ecommerce, retail, CPG, freight, and logistics customers while expanding to new verticals.

Wilson Sonsini Goodrich & Rosati advised Parabola on the transaction.

Wilson Sonsini AI Advisory Practice Highlights

Jordan Jaffe hosted a discussion with Daren Tang, Director General of WIPO regarding how start-ups and other technology and life sciences businesses are viewing intellectual property both at home and abroad. The conversation touched on hot topics such as generative AI, AI and inventorship, and standard essential patents.

Scott McKinney spoke to TechGC about some of the most pressing legal issues related to generative AI, such as whether AI-generated works are eligible for IP protection, and how to deal with

copyright issues associated with using copyrighted materials to train models. TechGC is an invitation-only network for general counsels at leading high-growth technology companies and venture capital funds.

Laura De Boel, Cédric Burton, and Tom Evans hosted a webinar where they provided an overview of how the evolving landscape of EU data regulations may impact businesses developing and implementing AI solutions.

Jess Cheng hosted a virtual discussion with former Ripple CEO where they discussed the lessons we could draw from the technological developments of previous decades, including use of blockchain protocols to facilitate payments, and offer insights on the potential changes AI could bring to existing business models and, more fundamentally, transform how the world innovates around the transfer of money.

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