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BUSINESS LAW UPDATE

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BUSINESS PERSPECTIVES

(A)I, Robot
By Frank D. Chaiken, Practice Group Leader, Corporate Transactions & Securities

Artificial intelligence (AI) is heavily in the news these days, as well as in this current installment of the *Business Law Update.* As with any new business or technologies, there are myriad legal questions surrounding AI. We certainly will be covering these developments in future publications and events.

What is AI? I have been reminded lately of a comment attributed to Gandhi. When asked for his opinion about Western Civilization, he responded that he thought it "would be a good idea." That tongue-in-cheek answer perhaps also applies to AI. Artificial "intelligence" likewise would seem to be a good idea. In reality, AI, at least currently, is a technology for using computers to process, sort and reassemble information generated by people – human intelligence – and made available in a digitized information network. The "intelligence" of the output of an AI system therefore depends on the information created and placed on the network in the first place, by human beings, and on the operations of the algorithms, created by human beings, embedded in AI systems. In the early days of the computer revolution, this sometimes was referred to as "GIGO" – garbage in, garbage out! So, as the ancients well knew, there still is nothing new under the sun.

For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

Beyond GIGO, the algorithms used by the AI systems have a tendency to process information in unexpected and, frankly, sometimes "unintelligent" ways. In the world of law firms, AI systems are being used to find and summarize court decisions that are published online covering particular legal issues. We have seen some bizarre results from the subset of AI systems called "generative AI" (ChatGPT is an example of generative AI), which are designed to write ("generate") content using a limited set of sources. For example, these systems have reportedly cited court decisions that do not exist! Some have referred to this as the "hallucination" phenomenon in AI.

Thompson Hine is committed to innovation. We are keeping up to date on this technology and taking from it the valuable, and reliable, elements that can enhance our practices and work for our clients. We have built AI-powered tools for limited purposes as a way of enhancing the speed, efficiency and cost-effectiveness of our services. For example, we have created award-winning systems to aid our dealmakers and litigators in the process of budgeting and estimating the cost of legal matters, and allocating work efficiently among our associates, partners, and other professionals.

We will continue to monitor developments in the more advanced AI applications, such as research and document generation, and apply them thoughtfully in our work for our trusted clients.

And no – this column was not written by a generative AI chatbot. I take full responsibility. Unless, of course, I am hallucinating …

Stay safe,

- F r a n k

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Frank Chaiken leads the firm's highly regarded Corporate Transactions & Securities practice, which comprises more than 100 professionals who represent clients of all sizes across virtually every industry. If you have questions or would like to share your thoughts, please contact Frank at 312.998.4249 or Frank.Chaiken@ThompsonHine.com.

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MERGERS & ACQUISITIONS

The Future Is Now – Artificial Intelligence and Transactional Law Practice

By Courtney Flowers and Will Henry

The public release of ChatGPT by OpenAI in late 2022 brought with it a profound mix of emotions and excitement not seen since the advent of the internet, and some even more dramatic would suggest, since Gutenberg's printing press. Artificial intelligence (AI) technologies, including ChatGPT's "large language models," or LLMs, are potential catalysts to change both society generally, and law specifically, because in both cases they vastly increase the quality of access to various areas of knowledge as well as the speed of using that access. With regard to law, despite the best efforts of the occasional Luddite attorneys, we expect that AI will quickly—over the next five to 10 years—improve the practice of law for client and practitioner alike. This article provides a high-level overview of some currently available tools and use cases, particularly in M&A transactions, and discusses how they are implemented and raises issues that do (and may soon) arise.

Due Diligence

Due diligence is vital for the buyer to learn about a prospective seller's business, but it is expensive, time-consuming and, some would argue, boring. AI can help with at least the expense and time costs as of today. Software programs including Kira, eBrevia and Ansarada can perform this high-volume repetitive task via AI. First, the lawyer simply uploads diligence files to the program and inputs the types of provisions he or she would like summarized. From there, the program makes it a snap—within minutes, even seconds, the program "reads" the files and produces reports identifying applicable provisions such as change of control, term and termination, all in chart form. The makers of these programs advertise the high accuracy rates of the software's review compared to traditional methods (i.e., an associate reviewing a contract at 2 a.m.). These programs possess an amazing ability to review and synthesize information and, as impressively, are capable of "learning" new provisions from time to time or being taught which provisions do or do not apply. Human lawyers still have some role in this analysis in guiding and checking results and then summarizing them in the form of diligence memoranda or schedules, as the client may deem appropriate, but ultimately the AI programs can do an initial, increasingly accurate review of a high volume of contracts in far less time.

Closing Documents

Another facet of transactions that can monopolize legal professionals' time is coordinating the closing process, including gathering signatures and producing closing binders. Gathering signatures has in recent years become easier as programs like DocuSign (not really AI, but software nonetheless) has made soliciting signatures much easier. Regarding closing binders, AI programs on the market now, like DealCloser, bundledocs and Closing Folder, can likewise prepare binders in a matter of minutes. Here, the associate will manage the various agreements as the deal progresses toward closing, so that once all documents are finalized and executed (indeed usually through DocuSign or its progeny), it requires little more than pushing a button to produce an interactive table of contents linked to all applicable documents (and again, of course, confirming that the AI generated the correct closing binder). Here again, AI creates substantial fee and time savings.

Purchase Agreements

Lest we think AI is only coming for the junior associates and paralegals, it is also emerging as a drafting tool for more sophisticated documents, like purchase agreements. Software such as Spellbook uses GPT-4 (the technical descriptor for ChatGPT) integrated into Microsoft Word to make drafting suggestions by comparing contracts with precedents, looking for conflicting terms, fixing formatting issues, identifying potential risks and omissions, and creating redlines. Again, this still requires humans who understand business priorities, client preferences, leverage, and other elements that are more art that science to synthesize and analyze the software's suggestions. AI drafting tools are newer than diligence or closing binder tools—think the last year rather than the last five—and as such, are not yet ubiquitous among law firms. However, these tools too represent the real near-term likelihood that AI drafting can increase the quality of work product using this technology and improve the speed of drafting.

Research

The classical—and true—perception of lawyers is that they are, as a class, trained to synthesize complex information well and apply law to facts to help clients make decisions. Again, AI tools are developing to improve the speed at which this fundamental task is done. The emergence of ChatGPT, Bard and, perhaps most intriguingly, law-specific platforms like Harvey, to provide substantive responses to legal questions is the most recent, but perhaps the most disruptive, to law practice. These tools require the user (the lawyer!) to input ("prompt" being the current AI lingo) the right legal questions, interpret the output from the tools, and apply the answers in the correct context—no easy task, but far easier than traversing to the law library or spending hours looking for the right provision. For instance, 50-state surveys may be a thing of the past. It is reasonable to think that in the coming three to five years, AI will be able to provide accurate, thoughtful output requiring little revision, all virtually instantaneously.

Sounds Great, But …

The greatest blessing of AI is, as many blessings are, a curse in some sense. AI will profoundly change the practice of law, and will likely do so within the next five to 10 years (at most). As such, there will be a sprint by firms and lawyers alike to embrace these technologies. We expect that practitioners that do not employ AI techniques and technologies will fall behind quickly, finding themselves unable to deliver the efficient, high-quality—and AI-supplemented—services clients will come to expect, and at the potentially diminishing costs they will demand. Our firm recognizes this and is already leveraging software in the above categories to help streamline processes and prepare more timely and better work product.

Importantly, we expect that this growth will need to be thoughtful and purposeful. First, while the outputs of AI will improve over time as the AI "learns," lawyers will be fundamental to understanding those outputs, managing them efficiently and producing the ultimate work product, which not only can vary from client to client, but deal to deal. Second, lawyers that simply rely on AI as a crutch, to essentially replace the efforts of other lawyers, are prone to overreliance and lost critical thinking. Those lawyers will expose their practices to mistakes, to falling competitively behind lawyers that balance the use of AI with human experience and, worst of all, to malpractice and other ethical errors.

There is no question that these are exciting times. Leaning in to AI and the promise it presents, learning about how to balance one's own practice with AI's assistance, and managing transactions using this unique, emerging technology will undoubtedly improve the practices (and lives!) of those lawyers that do embrace it. While we do not yet subscribe to the certainty of AI as a printing press-level of invention, the possibility cannot be discounted, which itself is remarkable.

Please contact Will Henry or Courtney Flowers with any questions.

How to Use Rising Interest Rates to Your Company's Advantage
By Kelsey Smith and Tony Kuhel

For the tenth consecutive time, the Federal Reserve raised the federal funds rate on May 3 (this time from 5% to 5.25%). Since March 2022, consumers have felt the strain of ever-increasing interest rates. That same stress has infiltrated its way into conversations regarding the future of M&A and what companies can do to keep M&A transactions moving forward. However, instead of only looking at the negative (which is admittedly not hard to do with the constant threat of economic slowdown), are there approaches M&A attorneys can use to take advantage of rising interest rates?

Higher Interest Rates = Less Debt and More Equity

In 2021, M&A experienced a historical high in the number of completed transactions. With low interest rates, businesses were able to easily (and cheaply) borrow money. Unfortunately, increasing interest rates have made borrowing money more expensive and riskier. Many businesses have started to shy away from taking on debt in order to complete M&A transactions, and the debt that is secured for deals is more expensive, which either impacts valuations or requires buyers to commit more equity to complete the deals. M&A attorneys can leverage a buyer's desire to take on less debt by encouraging a mixed cash and stock transaction (including a rollover of a portion of the seller's equity). In this way, sellers can continue participating in the achievements of a company they helped build, while also capitalizing on its success. For buyers this could mean preserving cash and borrowing power for future growth. Instead of taking on additional debt and reducing cash flow in the future, buyers can offer more stock in order to protect future cash availability.

Does Caution Mean Better M&A Transactions?

While it is true that rising interest rates have caused increased caution throughout the M&A world, this caution could be beneficial for all parties. For the past several years, market forces have resulted in buyers agreeing to higher purchase prices and valuations in order for their offers to be competitive. Buyers were eager to utilize low interest rates and the relative ease of borrowing to encourage fast (but in certain instances, unsustainable) growth and expansion. Now looking back at the "M&A transaction boom," it is not surprising to hear buyers question the deal terms and valuations in certain acquisitions. Even if rising interest rates have put pressure on valuations and slowed the pace of some M&A transactions, M&A attorneys can use this relative slowdown as leverage to negotiate better deal terms for their buy-side deals. Buyers can return to more traditional metrics and multiples to value potential targets. Although buyers may remain eager to "buy, buy, buy," rising interest rates can be used as a tool to reevaluate quick spending and negotiate deal terms that may ultimately mean more successful transactions in the long run.

Moving Forward

Even if rising interest rates make buyers and sellers more nervous to consummate a transaction, there are ways in which M&A attorneys can utilize the higher interest rates to benefit both their buy- and sell-side deals. Attorneys should remain mindful of all the effects of higher interest rates, including the negative, but should continue to develop creative and tailored solutions to keep their M&A transactions moving forward.

Please contact Kelsey Smith or Tony Kuhel with any questions.

BUSINESS DECISION MAKING

They Are Coming and You Need to Be Prepared – Regulations and the Use of AI and Machine Learning in Business Decision Making

By Robert Ansehl

Background

Historically, albeit not that long a history, regulators have been concerned about how businesses collect and safeguard individual, personal non-public information. Now, that focus has markedly shifted as companies of all sorts welcome next-generation technology and data mining tools into daily business functions. The current intensive spotlight is on consumer-facing commercial enterprises that use consumer data sets and artificial intelligence (AI)- and machine learning (ML)-enabled analytical models to make business decisions. It is now clear that regulators in the United States, European Union and around the globe believe that well-defined guardrails are needed to ensure the ethical use of AI- and ML-powered data and analytics in decision making. As those regulations are enacted, businesses need to conform their operations and functions and comply with those legal guardrails – starting now.

Current Law and Other Initiatives

Colorado's Division of Insurance initially planted the flag in 2021 (§§10-1-109, C.R.S. and 10-3-1104.9, C.R.S.) and then recently issued draft supporting regulations. The law goes into effect this year and, at this point, regulates life insurers' use of external personal data and information sources (e.g., electronic chart display and information system (ECDIS)) or employment of algorithms and models that use ECDIS, where the resulting impact of such use is deemed to result in unfair discrimination against consumers on the basis of race, color, national or ethnic origin, religion, sex, sexual orientation, disability, gender identity or gender expression. The draft regulation, that the industry largely views as overbroad, takes the statute one step further by encompassing any data or information source that is used to supplement or supplant traditional underwriting factors, including credit scores, social media habits, purchasing habits, home ownership, educational attainment, licensures, civil judgments, court records, occupations that do not have a direct relationship to mortality, morbidity or longevity risk, and any insurance risk scores derived by the insurer or third party from a similar information source. The regulation may be subject to change, but nonetheless it is indicative of the increased regulatory focus on AI/ML data-based decision making that, no doubt, will migrate to environments beyond insurance, such as credit-scoring and lending and academic admissions criteria, labor and employment decisions, and employee benefits assessments.

California, Connecticut, Louisiana, New York, Rhode Island and Washington, D.C. all have weighed in by adopting similar legal governance guidance and protocols, as has the White House with its "Blueprint for an AI Bill of Rights" released in October 2022, followed by the U.S. Department of Commerce's National Institute of Standards and Technology's "AI Risk Management Framework" in January 2023. United Kingdom and EU regulators have their own sets of policies and legal frameworks to address potential, perceived AI-driven bias (intentional or not) and to enable transparency of model-driven consumer-related decisions. It is noteworthy that almost all of the state, federal and international legal guardrails not only require companies to comply with a robust set of rules, but also attribute direct responsibility for any failures to boards of directors and senior management. The regulators are coming, and businesses need to step ahead now.

Measuring Bias

Thus far, there is no standard measurement for bias (intentional or not). Instead, current laws and other requirements often require the company to determine if the AI/ML-driven decision making results in "disproportionate negative outcomes" that have a detrimental impact on a protected group (including race, color, national or ethnic origin, religion, sex, sexual orientation, disability, gender identity, or gender expression). Companies may include some combination of "neutral" factors in making business decisions, as long as they are considered for all other similarly situated individuals. But aggressive regulatory enforcement will follow once the prohibited factors are breached and bias (or perceived bias) results, and it will be vital for companies to have compliant, standard procedures and protocols firmly entrenched throughout the enterprise.

What to Do Now

Below are a few suggestions for companies and their data technology teams to address and stay ahead of the evolving AI/ML requirements. The new rules will require more resources.

1. Stay aware of ongoing legislation, laws, and guidance frameworks in order to stay compliant.
2. Build a surveillance monitoring system with the capability to assess AI outputs to ascertain whether unfair bias could occur.
3. Evaluate your AI systems and, to the extent there is third-party vendor involvement, their AI systems as well. Evaluations should be continuous.
4. Respond to consumer complaints, including those that will inevitably be made to regulators, about any perceived or real potential bias with transparent communications and the ability to easily demonstrate data processes and decision making.
5. Build in systemic flexibility to mitigate and address bias (real or perceived) when it is identified and ensure your vendors are on the ready.
6. Train, train, train on AI use, not just for those in the technology teams but throughout the company.
7. Ensure that the chief risk officer has the full support of and direct access to the board and C-suite decision makers.
8. Ensure that all business segments are aligned on an ongoing basis with the guiding principles of applicable law, NIST and the White House.
9. Be prepared to provide confidential access to regulators to address concerns. This process should be carefully considered in advance so the company can safeguard its AI/ML software and algorithms.
10. There is no substitute for a robust oversight and communication system, including for your vendors. Among other things, ensure those vendors are committed to responding to regulators about their predictive models and AI/ML use and decision-making outputs.
11. Establish a regularly updated company checklist to respond to inevitable regulatory examinations, securing robust AI and ML compliance that includes regular review of all of the above.

Now is the time to create and implement new internal systems to ensure responsible use of data and AI/ML-driven decision making and minimize legal risks for the company, the board and senior management.

If you have any questions, please contact Bob Ansehl.

SECURITIES QUARTERLY UPDATE – SPRING 2023

Check out the latest edition of *Securities Quarterly Update*, our newsletter that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at recent developments impacting disclosure controls and procedures, insider filings, and quarterly and other SEC reports.

BUSINESS SUCCESSION PLANNING

Held Hostage After an Owner's Life Event – The Importance of Buy-Sell Agreements and Business Succession Planning

By Daniel A. Perry

In the context of executors and trustees whom we represent in the administration of an estate following the death of a loved one, we often see a lack of planning regarding the disposition of a business owner's share in a privately held company prior to their death. This lack of planning unfortunately typically requires the surviving family, as well as the other business owners involved, to incur unnecessary legal costs and expenses to ensure the proper disposition and sale of the individual business owner's share. This is often also coupled with possible liquidity and business continuity issues for the company.

In many instances, a formal business valuation of the company is required in order to adequately value the interest of the deceased business owner for estate administration purposes. Further, following the valuation of the deceased business owner's interest, the purchase of the deceased business owner's share from their estate or trust may be equally difficult due to the unavailability of liquid funds. The failure to plan ahead can sadly cause significant financial uncertainty for both the surviving family and the company as a whole, which is why a buy-sell agreement is such a critical planning mechanism.

Generally, a buy-sell agreement is a contractual agreement between co-owners of a business which governs what will happen to the ownership of the business in the event of a co-owner's death or other event that causes a co-owner to leave the business, either voluntarily or involuntarily.

Although the death of a business owner is often the most common reason one may think of in the context of succession planning, there are a host of other reasons why a privately held company needs to engage in succession planning. Some of these other possibilities include an owner:

- being forced out of the business or otherwise terminated,
- retiring,
- suffering a permanent disability in which he or she is unable to return to work full-time,
- going through a divorce in which the business interest is considered marital property, and
- filing for personal bankruptcy.

The concerns outlined above can bring about a multitude of business succession issues which, without the proper planning, could result in business continuity issues for the company. For instance, the remaining business owners could find themselves partnered with new owners with whom they would not otherwise want to share and operate their business. They may face liquidity issues in purchasing a departing owner's share in the business, and/or there may be no concrete mechanisms and terms in place for the purchase of the share of the departing co-owner of the company.

Therefore, special consideration should be paid to the terms and provisions to include in a buy-sell agreement. Some of the terms and provisions that a business may want to consider include:

- the conditions which will trigger a mandatory buy-out, e.g., death of an owner, disability of an owner, divorce of an owner, etc.,
- the purchase and sale structure which will be followed upon the triggering of a buy-out condition,
- the valuation of the company and what conditions will require future valuations of the company,

- what source(s) of funding will be utilized to buy out the departing business owner, e.g., insurance proceeds, promissory note, etc., and
- what are the anticipated tax considerations of the buy-out.

Each one of these considerations should be discussed among the business owners and their respective counsel in order to ensure a proper and orderly transition of the business from one business owner to the next upon the occurrence of each possible condition. For instance, will the buy-out of an owner's share be funded with life insurance purchased by the company, or will the buy-out be funded through a down payment followed by a promissory note in which the company pays out the departing owner, or his or her estate, as the case may be, over a certain number of years?

Further, tax considerations should always be a part of every succession planning discussion. The failure to consider tax consequences of a disposition of the owner's interest in the business could result in tax consequences for the company. By way of example, a business which is recognized as an S corporation would want to avoid the possibility of any action which could jeopardize the company's S corporation status following the disposition of an owner's share.

This impacts the final consideration we will highlight in this article, that being the individual estate planning considerations of each owner of the business. Each owner will want to review their existing estate plan to ensure their plan will work in conjunction with the succession plan of the business. A particularly important point is to ensure that an owner's trust would be able to be considered an eligible shareholder under the Internal Revenue Code so as to avoid any inadvertent violations of the S corporation rules that could jeopardize the company's S corporation status.

A privately held company should routinely review and address changes in its succession plan so as to ensure liquidity to fund its current succession plan, business continuity, and avoidance of unnecessary tax consequences.

Please contact Dan Perry if you have any questions.