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BUSINESS LAW UPDATE

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MERGERS & ACQUISITIONS

Hallucinations and Integrations: Generative AI Challenges in M&A

By Courtney Flowers and Will Henry

In M&A, clients are increasingly asking about how Generative AI ("GenAI") can be used to make dealmaking easier, both as a means of analyzing the operations of target businesses and to optimize the deal process. As with any fast-developing technology, GenAI risks go beyond traditional IP and cybersecurity, affecting how we conduct diligence, negotiate terms, and plan deal timelines. Below are a few of the more critical near-term challenges GenAI presents to M&A practitioners, as well as some protective considerations.

Hallucinations in Critical Outputs

Generative systems can be wrong, and often persuasively so. At the time of writing this, using the "free" tier, it took the authors three tries to convince ChatGPT that there are, in fact, three Rs in the word "strawberry" and not just one or two. By contrast, ChatGPT identified three Rs when using the "pro" tier, indicating troubling variances in accuracy depending on one's GenAI subscription. The potential risk of inaccuracy (called "hallucinations" in GenAI-parlance) is vital to remember when using GenAI to help you conduct or produce diligence, draft deal documents, and administer a deal, and when assessing and planning for the risks of buying a business.

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.

A. Use by M&A Lawyers. Many law firms are using sophisticated GenAI tools that are tailored to legal practice to help them serve their clients more efficiently and, hopefully, more effectively. Services like Harvey (which is a GenAI tool similar to ChatGPT, but closed-system), Dealcloser (a transaction management system), and Kira (a diligence tool) can save time and money and even increase accuracy. They have outputs more closely calibrated to what lawyers would expect to see than general tools like ChatGPT or Gemini can provide. However, even these highly-tuned systems make mistakes – especially depending on the prompts and data they are fed.

Accordingly, you can protect yourself with a few simple rules.

1. Adopt and enforce a GenAI policy based on the advice of specialists in this area.
2. Set clear guidelines for the use of GenAI throughout the project and track usage.
3. Require training to prevent disclosure of confidential information.
4. Review all outputs as though they are the work of a first-year associate who is doing their best but makes mistakes.

B. Use by Targets. When GenAI is used in the administration or operations of a business, hallucinations can also create liabilities the buyer may inherit. Courts have enforced AI-made promises and misinformation as company commitments. In 2024, the British Columbia Civil Resolution Tribunal decided that Air Canada had to honor a nonexistent "bereavement fare" its chatbot invented when asked about policy by a customer, which resulted in the airline having to pay that customer $812.02 in damages and tribunal fees—illustrating apparent-authority, contract, and consumer-protection risks that won't vanish at closing. Judges have sanctioned lawyers for briefs with AI-fabricated case citations. *Mata v. Avianca, Inc.*, 2023 WL 4114965 at *1 (S.D.N.Y. June 22, 2023) is among the most well-known, but these sanctions are being issued in the United States and abroad in increasing number. Further, public sector and enterprise chatbots have dispensed advice that was actually illegal (such as denying anti-discrimination obligations of landlords in New York City), which could expose the target (and post-closing, the buyer) to sanctions, investigations, and follow-on litigation.

Hallucinations can and do have real-world consequences beyond those to the user. In 2023, Google's parent company's shares dropped $100 billion after its new AI chatbot made embarrassing errors. In late 2024, Deloitte had to refund the Australian government after delivering a $290,000 report to the country's Department of Employment and Workplace Relations that included AI-fabricated citations. Though GenAI is still relatively new, headline-grabbing calamities resulting from bad AI outputs have been plentiful enough that we should be wary of these leaking into disclosures, forecasts, and deliverables, forcing restatements, refunds, clawbacks, or goodwill impairments after a deal closes.

Integration – The Value of Consulting Specialists

GenAI has already been integrated into many companies from top to bottom and inside and out. Unsurprisingly, lawyers are playing Whack-A-Mole with the legal challenges popping up. M&A lawyers have to be great at issue-spotting generally, so they can lean on specialists to make sure they identify red flags across diligence and build out appropriate representations and warranties or line item indemnities to protect their clients. A few areas where GenAI has caused unforeseen (or at least unintentional) liability involving specialists include:

A. Information Technology and Intellectual Property. Lawyers in these technology subspecialities are deepest in the trenches on GenAI. Consult your in-house or external counsel IP and IT attorneys about developing case law and statutes regarding output ownership, including novel questions regarding copyrights and other protections. Make sure to flag any contracts that might include IP licenses or development of products or IP that uses GenAI. Experienced counsel can help ensure the buyer will actually own or have rights to what it thinks it is purchasing.

B. Data Privacy. GenAI can pose risks not only due to the data that companies are inputting into systems, but also because bad actors are increasingly leveraging GenAI as an aid to cyberattacks. In November 2025, Anthropic (developer of the Claude family of models) released a report that it had detected a "highly sophisticated cyber espionage operation … target[ing] roughly 30 entities" and demonstrating "unprecedented integration and autonomy of AI throughout the attack lifecycle." Collaborate with your data privacy specialists to determine how well-protected a target's systems are and find ways to secure the assets you are purchasing as you draft the acquisition agreements.

C. Labor and Employment. Consult labor and employment specialists to plan for discrimination risks when employers use generative AI in hiring and management, because laws like Title VII, the ADA, and the ADEA apply to algorithmic tools. There is also a proliferating patchwork of state and local regimes to consider, including NYC Local Law 144, and Colorado and Illinois' state-level laws. In *Mobley v. Workday, Inc.*, 2025 WL 1424347 (N.D. Cal. May 16, 2025), the plaintiffs alleged that Workday's AI software played a role in age discrimination and the court asserted, "Nothing in the language of the federal anti-discrimination statutes or the case law interpreting those statutes distinguishes between delegating functions to an automated agent versus a live human one." Also, consider how privacy issues overlap with labor laws, wage/hour reclassification issues as duties shift with the use of GenAI, and other issues these lawyers can help analyze.

Rest assured, the challenges associated with GenAI will continue to evolve as rapidly as the technology itself. By staying diligent, you can make GenAI work for you, managing hallucinations and integrating specialist review with your use of this amazing technology. There may be hallucinations in GenAI, but its value is not a mirage – you can integrate this technology into your practice with great success if you stay diligent.

Please contact Courtney Flowers or Will Henry with any questions.

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- Ninth Circuit Clarifies Standing Requirements for Absent Class Members
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CORPORATE GOVERNANCE

Avoiding Tripwires: A Practical Playbook for Delaware Director Removal

By Edward G. "Ned" Babbitt

One of a director's primary responsibilities is providing oversight of management and ensuring officers act in a manner consistent with their fiduciary duties. But what about when a fellow director fails to meet that same standard? Or, worse yet, actively seeks to harm the same company they oversee as a director?

When interim governance measures fail, options for the other directors are more limited than one might assume. Generally speaking, stockholders—and stockholders alone—hold the power to remove rogue directors. But that doesn't mean the board has no role to play. An overview of Delaware law serves as a helpful reminder of what can (or cannot) be done in these situations. And a recent Delaware case overturning a director's removal provides some helpful guidance on pitfalls to avoid.

Only Stockholders Have the Power to Remove Directors. Under Delaware law, replacing or removing a sitting director requires a stockholder vote. In other words, directors cannot unilaterally remove other directors from office. This holds true regardless of the reasons for removal. Even if a majority of directors concludes that another director poses an immediate and irreparable harm to the company—and the evidence of that misconduct is clear and compelling—a stockholder vote is still required to remove the director.

The Board Can Initiate a Stockholder Vote and Present a Case to the Stockholders. That is not to say a board has no role in removing directors. Directors still have fiduciary obligations to act in the best interests of the company, including in addressing misconduct by other directors. That could mean causing the company to file suit against the wayward director. But it can also include less adversarial (and less expensive) measures, like calling for a special meeting of stockholders to vote on whether to remove the director. 8 *Del. C.* § 141(k). Directors at the meeting can explain to stockholders the reasons for the vote and basis for the allegations of misconduct. And, absent a contrary provision in the charter or bylaws, a vacancy caused by the removal can be filled by the remaining directors. 8 *Del. C.* § 223(a)(1). So while the ultimate decision of whether to remove lies with stockholders, directors still play a critical role in effectuating removal.

Stockholder Votes on Removal Must Be Fully Informed. If a board does seek stockholder approval of a director removal, it should be mindful of the company's disclosure obligations. A recent decision in the Delaware Court of Chancery illustrates this principle. In *Dalby v. Kastner*, C.A. No. 2025-0136-NAC (Del. Ch. Aug. 29, 2025), the court overturned the removal of a director where material facts about behind-the-scenes machinations leading to the director's removal were not disclosed to stockholders. Specifically, the board failed to disclose to stockholders that management and the company's outside counsel played a much larger role in pushing for the director's removal than previously disclosed. In fact, disclosures suggested a neutral stockholder was calling for removal, when, in reality, the stockholder was merely a front for a board faction and the company's management. The court ultimately concluded that this sleight of hand could have been material to stockholders and found the removal invalid, notwithstanding stockholder approval.

Do Stockholders Need "Cause" to Remove a Director? Another oft-asked question in these circumstances is what, if anything, needs to be established or proven in order to justify the removal of a director by stockholders. In most cases, the answer is nothing. Directors of most companies can be removed by stockholders at any time, for any reason, with or without cause. There are only two limited exceptions to this rule. *See* DGCL § 141(k). First, if a board is classified, directors are removable only for cause unless the certificate of incorporation provides otherwise. Second, for corporations with cumulative voting, removal without cause is limited to situations in which a majority of stockholders with the ability to elect the director at issue approves the removal. Absent classified boards or cumulative voting, however, Delaware courts have repeatedly invalidated corporate bylaws or charter provisions that purport to restrict removal to "for cause." *See, e.g.*, *In re Vaalco Energy, Inc. Stockholder Litig.*, C.A. No. 11775.

Are There Any Other Ways to Remove a Bad-Actor Director? There is one limited exception to the general rule that stockholder approval is necessary to remove a director. If a director commits a felony in connection with their duties, or is found by a court to have breached their fiduciary duty of loyalty to the company, a corporation (or any stockholder derivatively on behalf of the corporation) can initiate a summary proceeding in the Delaware Court of Chancery to have the director removed to avoid irreparable harm. Of course, this only applies if there has been a prior conviction or judgment against the director, so, while a powerful tool, its applicability is fairly limited.

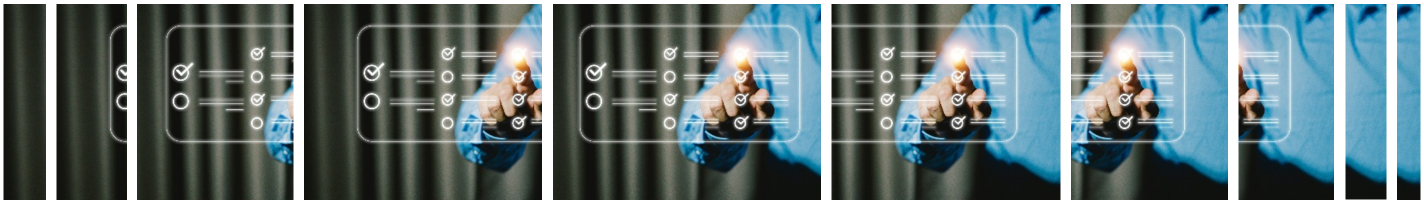
Practice Points for Addressing Director Removal:

- Review the company's governing documents to develop a plan for removal. This includes ascertaining the company's particular requirements for special meetings, notice, written consents, and how vacancies are filled. These provisions will often dictate the mechanics and pace of the removal process.
- Determine whether cause is required. For example, if a board is classified or if cumulative voting applies, seek guidance on whether "cause" is required and what must be shown to establish "cause."
- Be mindful of the company's disclosure obligations in connection with a stockholder vote on removal. If company management or counsel is involved, make sure the scope of their involvement is appropriate and disclosed to stockholders.
- Removal can be a drastic remedy. Before proceeding, evaluate alternatives. In many cases, the mere threat of going to stockholders with the alleged misconduct or a lawsuit over a breach of fiduciary duty is enough to convince a director to step down. The board may also consider interim governance measures, like a special committee, to investigate and address the alleged malfeasance.
- Finally, the company and its counsel would be wise to review the company's governing documents to ensure they remain consistent with Delaware law on these issues.

Please contact Ned Babbitt with any questions.

SECURITIES QUARTERLY UPDATE

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 the SEC potentially allowing public companies to opt for semiannual reporting instead of quarterly reporting, and some of the actions that companies making such an election should consider.



NEW VENTURES

SBIC Program Rule Changes Usher in Modernization, Alignment, and a Faster Path to Licensing

By Lindsay Karas Stencel

On February 2, 2026, the U.S. Small Business Administration (SBA) finalized rules revising regulations for the Small Business Investment Company (SBIC) program. The amendments are best understood as a targeted modernization and cleanup of obsolete programs and provisions. As part of these updates, the SBA eliminated provisions tied to legacy SBIC structures, clarified how certain investments fit within the program's eligibility framework, and streamlined aspects of the licensing process while maintaining SBA's supervisory and diligence standards.

Regulatory Modernization Removes Friction

The central tenet of the modernizing provisions is the removal or consolidation of requirements that are obsolete, redundant, or otherwise inefficient. The SBA explained that it aimed to remove multiple regulations and definitions that no longer serve a practical purpose or reflect current program operations.

Of the numerous changes to the SBIC program, legacy "Subsidized Leverage" rules and terminology have been revised to remove multiple provisions tied to "Subsidized Leverage" for Section 301(d) licensees, a structure that the SBA describes as no longer relevant to the SBIC program's modern leverage framework. The SBA noted that no Section 301(d) licensee has subsidized leverage outstanding and, following statutory changes, such leverage is not authorized for future use. In the same vein, the SBA deleted the definition of "Preferred Securities," a concept associated with legacy 301(d) licenses.

Early Stage SBIC licensing provisions have also been retired. The final rule removed regulations governing "Early Stage SBIC" licensing procedures because the SBA states it no longer licenses Early Stage SBICs, a program that the SBA began to transition away from nearly two decades ago.

The SBA also identified and removed certain duplicative requirements aiming to make the regulations more streamlined and understandable. For example, the SBA removed a regulation on common control/ownership restrictions that the SBA viewed as duplicative of other approval provisions already applicable to SBICs, thereby making the regulations clearer to any fund manager aiming to comply with them.

Collectively, these changes should make the SBIC program's regulatory schema easier to navigate and reduce the risk that applicants or licensees spend time complying with requirements that do not meaningfully affect the SBA's evaluation or oversight.

Clarifying Investment Alignment with Current Businesses

A second major focus of the amendments is clarifying how SBIC capital can align with macro federal industrial priorities, particularly in critical minerals and critical technologies. The SBA frames the goal of this focus and alignment as reducing barriers to SBIC investments aligned with industrial priorities and encouraging investments in small businesses engaged in advanced technologies and critical minerals.

The SBA also added additional definitions and provisions to modernize the regulations to align them to the current business world. Specifically, the SBA has defined "Critical Technology" as an investment type that may be permitted under an additional exception to certain project finance restrictions when made by a Critical Technology SBIC. The prior rules may have prohibited this type of investment altogether.

The rules around project finance duration were also clarified to address timing concepts relevant to long-term projects. In discussing investments tied to critical minerals and critical technologies, the SBA explains how projects anticipated to exceed a specified duration would be treated under the relevant exception framework. For SBIC fund managers, the practical takeaway is not that the SBIC program has become an industrial policy vehicle, but that the SBA is explicitly smoothing edges in the regulatory text that previously could be read to constrain certain investments in these categories or to require more interpretive gymnastics to justify them.

Streamlined Licensing Processes

The SBA's licensing process has long been considered unnecessarily cumbersome and a deterrent to fund managers seeking SBIC licensure. The new changes to the SBIC program are particularly meaningful for fund managers seeking to license successor vehicles, a process which previously often took just as long to accomplish as a first-time licensure. In the final rule's section-by-section discussion, the SBA describes revisions intended to modify and streamline criteria for determining whether an applicant is eligible for the expedited process, while maintaining appropriate benchmarks for evaluation by the SBA reviewers.

The SBA also clarifies that applicants meeting criteria for expedited evaluation, including fund managers currently operating an active SBIC, may be permitted to submit a "Short-Form" subsequent fund Management Assessment Questionnaire (MAQ), while reserving authority to request the full MAQ where needed to adequately evaluate the application. This is an important operational point for fund managers because the rule changes do not eliminate the SBA's discretion or diligence expectations, but do give the SBA clearer authority to right-size submissions for qualified subsequent funds, which could potentially shorten time-to-license, reduce application burden, and encourage participants to apply if they had previously been deterred from doing so due to the previous often slow and arduous process.

Conclusion

The February 2026 SBIC amendments are not a wholesale redesign of the SBIC program. Instead, they are a pragmatic modernization focused on cutting obsolete rules, clarifying investment fit in priority areas, and simplifying licensing steps for repeat, qualified managers. For market participants, the changes should reduce unnecessary process drag and make the rules more readable, all while maintaining strong SBA oversight in the process. These revisions make the SBIC program more appealing and attainable in reasonable timeframes from talented fund managers interested in having the federal government as a partner for the life of their fund.

Please contact Lindsay Karas Stencel with any questions.

EMPLOYEE BENEFITS

Trump Accounts: Opportunities and Considerations for Employers, Financial Institutions, and Philanthropic Organizations

By Dominic DeMatties and Eric D. Slack

Trump Accounts are tax-advantaged investment accounts for U.S. children under age 18. Eligible children born after 2024 and before 2029 are eligible for a $1,000 pilot program contribution from the Department of the Treasury. Older eligible children are not eligible for the pilot program contribution but otherwise are eligible to have Trump Accounts established for them to which employer and other contributions may be made. Contributions may begin July 4, 2026. Initial guidance has been published, and additional guidance is expected before contributions may be first made.

Opportunities

Stakeholder	Opportunity
Employers	• May determine that employees are interested in establishing Trump Accounts for eligible children and if so may wish to facilitate their doing so with an employer program • Employer programs may permit employees to make pre-tax salary reduction contributions to dependents' Trump Accounts through a cafeteria plan and/or may provide for tax-free nonelective contributions to Trump Accounts for employees or their dependents • Total Trump Account employer program contributions limited to $2,500 per employee annually (limit to be adjusted after 2027)
Financial Institutions	• Although Treasury selects the initial trustee(s), it may be desirable to consider whether to serve as a trustee of rollover Trump Accounts including due to the opportunity to ultimately gain new wealth management clients and assets under management • Any person approved by the IRS as of December 31, 2025 to be a nonbank trustee of an IRA is automatically approved to be a nonbank trustee of a rollover Trump Account • Although employer program and certain contributions are subject to separate annual limits ($2,500 and $5,000, each adjusted after 2027), pilot program and eligible contributions made pursuant to charitable or governmental arrangements are unlimited
Eligible Tax-Exempt Organizations and Governmental Entities	• May decide to apply to Treasury to make a qualified general contribution to Treasury that if approved Treasury would divide evenly by the number of eligible children in the qualified class and contribute that amount to each of their Trump Accounts • Qualified class generally refers to eligible children with Trump Accounts (account beneficiaries) in a geographic area (the entire country, a state, or other area in which at least 5,000 account beneficiaries reside) that is designated by Treasury • There is no annual or other limit on the amount of a qualified general contribution and accordingly no limit on the resulting amounts that may be contributed to each account beneficiary resulting from one or more qualified general contributions

Considerations

Stakeholder	Consideration
Employers	• DOL to specify how employer programs are exempt from ERISA • Treasury and DOL expected to specify whether employers may limit the Trump Account trustee(s) to which they will make contributions • Treasury to specify how employer contributions (including salary reduction) are made to Trump Accounts by the employer and the extent of employer reporting requirements, if any • Treasury to specify how employer programs are to be coordinated with applicable cafeteria plan requirements and how to meet applicable Internal Revenue Code nondiscrimination requirements
Financial Institutions	• Treasury will select the financial institution(s) to serve as trustees for initial Trump Accounts (every Trump Account must be opened with a selected institution as trustee) • Existing approved IRA trustees are eligible trustees of rollover Trump Accounts and are not subject to this selection process • Trustees must provide annual reporting on contribution sources, distributions, fair market value, and basis; transferring trustees must report that information to the receiving rollover Trump Account trustee • Trustees must select a default investment, must offer only eligible investments and must monitor whether an investment remains eligible • Trustees must enforce applicable contribution caps; Treasury is considering a staging safe harbor under which trustees accept contributions into a general account and remit to a Trump Account only to the extent determined to be a permissible contribution • Trump Account governing documents must meet certain requirements
Eligible Tax-Exempt Organizations and Governmental Entities	• Treasury to specify how to apply to make a qualified general contribution • Treasury to specify how the resulting Trump Account contribution will be made with respect to each account beneficiary

Next Steps

Proposed regulations and additional other guidance are expected to be issued in the near term, and likely will be published in discrete pieces during 2026 that in the aggregate will address, at a minimum, each of the considerations outlined above. At the time of publication, additional guidance regarding employer plans and other aspects of these accounts, such as special rules governing Trump accounts compared to traditional IRAs, has not been released.

Employers interested in making contributions to Trump Accounts or facilitating employee contributions to Trump Accounts may wish to begin planning now to identify open questions as well as internal resources and assistance that may be needed from service providers, in particular if there is a desire to have a program in place under a cafeteria plan in time for open enrollment near the end of 2026.

Existing IRA trustees considering whether to serve as rollover Trump Account trustees may wish to identify all open questions regarding trustee responsibilities in preparation for expected guidance and may wish to reach out to Treasury (either in writing or in a meeting) to discuss those questions and provide any feedback to Treasury before that guidance is published in particular to the extent that educating Treasury as to any practical considerations and/or proposed solutions may impact the desirability of serving as a rollover Trump Account trustee.

Eligible philanthropic organizations and governmental entities considering whether to make unlimited contributions to a qualified class of Trump Account beneficiaries may wish to start considering what the corresponding qualified general contribution might look like, both in amount as well as which account beneficiaries may be covered, and may wish to reach out to Treasury as part of that process.

Please contact Dominic DeMatties or Eric Slack with any questions. More information about Trump Accounts can also be found on Thompson Hine's ERISA Litigation & Compliance blog: *Trump Accounts on the Menu: A New Cafeteria Plan Option, Other Details from Initial Treasury Guidance*.

UPCOMING EVENTS

Please visit our website for details on a variety of upcoming in-person and virtual events, including:

- **Wednesday, April 22**, 5:30 – 7:30 p.m. ET, Columbus: The Midwest Advantage: Building and Scaling Startups Beyond the Coasts
- **Thursday, April 23**, 9:30 – 10:30 a.m. ET, Georgia: Building the Right Foundation: Governance for Cleantech Startups
- **Wednesday, April 29**, 4:00 – 7:00 p.m. ET, Atlanta: Hot Topics for Distressed Investors
- **Wednesday, April 29**, 3:00 – 7:00 p.m. PT, Los Angeles: RIA Merger Conference: Compliance, Regulation & Growth
- **Thursday, April 30**, 12:30 – 1:30 p.m. ET, Virtual: Real-World Mediation Strategies for Case Resolution
- **Wednesday, May 13**, 4:00 – 7:00 p.m. ET, Chicago: Hot Topics for Distressed Investors