

AI Is Now Generating Securities Litigation

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What is AI and Why Is It the Subject of So Many Lawsuits?

Today, AI is a buzzword. It is synonymous with investment, innovation, and cutting-edge technology. A company's claim to develop or use AI, whether real or imaginary, often translates to increased investment, client base, and opportunities – which favorably affect the company's revenue and bottom line. As a result, sugarcoating technology or software with AI, no matter how slight or insignificant the actual AI investment really is, becomes lucrative and attractive.

With the rise of generative AI – the ubiquitous chatbots – it is unsurprising that AI-related lawsuits are popping up all over the country. Most of those suits involve copyright and privacy claims. Copyright claims arise when AI models are trained on the creators' copyrighted content, such as songs, pictures, news articles, code, and books, to name a few, and without the creators' consent. Privacy claims arise when private and personal information belonging to people is collected from various sources, e.g., the Internet and without consent, and then used to train the AI models. A smaller number of lawsuits involve right to publicity claims. These lawsuits arise from AI software that can swap faces of users with those of celebrities or other public figures, thus violating the person's right to publicity. With Open AI's Sora and Google's Gemini AI that can turn text prompts into video, there is an expectation that the right of publicity suits will increase.

Why is *D'Agostino v. Innodata Inc.* Unlike Any of the Other AI Lawsuits?

On February 21, 2024, a class action complaint was filed against Innodata, Inc., and some of its officers and directors.¹ According to the Complaint, Innodata is data engineering company which, among other things, provides AI data preparation services as well as a range of data engineering support services. The Complaint alleges that Innodata made false and/or misleading statements and failed to disclose material facts regarding its AI technology.

The suit against Innodata appears to be the first securities suit alleging so-called "AI washing"—overstating the prospects of AI or understating the associated risks. It is unlikely to be the last. As SEC Chair Gary Gensler pointed out in recent comments, companies raising money from investors need to be truthful about their use of AI and the associated risks.² If they're making claims about the prospects of AI, they need to have a reasonable basis for those claims, and risk disclosures need to be particularized to each company, not boilerplate risk disclosures. Companies may even need to define what they mean by AI. Although it has garnered a lot of attention more recently, AI is not new, and it can be developed and deployed in a variety of ways for a variety of purposes. No doubt the SEC and investors will be watching company disclosures closely for any misleading statements or omissions related to this hot topic.

What's Covered?

For companies that could be facing such lawsuits, as well as their officers and directors, the defense of such actions, as well as payment of any resulting judgments or settlements, are likely to be covered by insurance.

Indeed, in addition to directors' and officers' insurance which is traditionally called upon to respond to securities litigation, other forms of insurance may also be responsive, including cyber, errors and omissions, and Tech E&O.

Insurance can also be helpful as increased regulatory scrutiny can lead to investigations as well as litigation which could also have a significant financial impact on business operations.

As the insurance market adapts to AI risks, companies should work closely with their brokers and insurers so that their insurers understand the nature of the risks that they are underwriting, and so that inappropriate exclusions are removed. After all, the law places the burden on insurers to make clear what they are excluding from coverage, and accordingly, construes such exclusions narrowly to avoid forfeitures of coverage.

What's Ahead?

- AI-related lawsuits are likely to continue apace, particularly as regards copyright and privacy claims;
- Now that the floodgates have been opened, AI-related securities lawsuits are likely to start to proliferate;
- Regulatory attention and scrutiny will focus on AI companies, particularly with regard to disclosures and representations regarding the development of AI and the associated opportunities and risks; and
- Increased attention will be placed on insurance coverage and whether insurers introduce new exclusions aimed at limiting AI-related risk.

¹ Complaint, Case No. 2:24-cv-00971 (D.N.J.) (Filed February 21, 2024, ECF No. 1).

² <https://www.sec.gov/news/speech/gensler-ai-021324>

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