Building Bridges CLE Symposium
New York

September 25, 2024

Agenda

1. **Debt 101**

2. **Market Update**

3. **Applicability: The Role of a General Counsel**
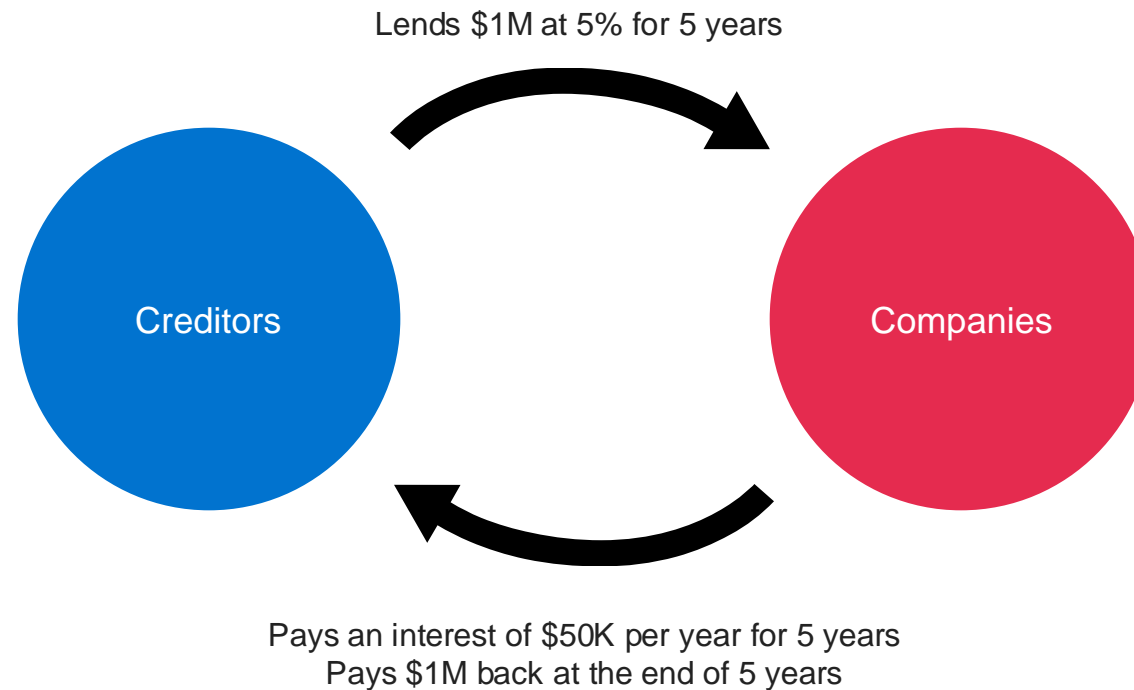
4. **Scenarios and Discussion**

Debt 101

What is debt?

What makes something debt?

Debt, like equity, is a source of capital.

- What differentiates it is that the **principal** amount lent has an **interest rate** and a **maturity date,** when the principal (plus interest) is paid back.

Lends $1M at 5% for 5 years

Creditors

Companies

Pays an interest of $50K per year for 5 years
Pays $1M back at the end of 5 years

Debt Finance Transactions

Types of Financings and Financing Structures

| Types of Financings	Financing Structures
• Leveraged loans: term loans, revolving loans, bridge loans • Asset-based financing • Venture debt • Hybrid loans • Acquisition financings; leveraged buyouts • Mezzanine and "second-lien" debt • Real estate loans • ESOP loans • Public and 144A debt financings (including high-yield and convertible debt) • Debtor-in-possession financings • Incremental loans • Swingline loans • Letter-of-Credit facility • Delayed draws • Green/Social loans • Sustainability-linked loans	• Secured or Unsecured • Bilateral credit facility • Syndicated credit facilities • Multiple tranche facilities • Senior ABLs with Mezzanine financings • Loan participations and assignments • Early stage/venture-backed company financings • Capital call bridge facilities • Co-invest facilities • Net asset value facility

Debt Finance Transactions

Typical Debt Features

Debt Type	Leveraged loans		Bonds		
	Revolver	Term Loan A (Bank Debt); Term Loan B/C/D (Institutional)	Senior secured	Senior unsecured	Subordinated
Lender	Institutional investors & banks		Institutional investors		
Coupon	Floating, i.e. SOFR + 300 bps		Fixed, i.e. 8.00% coupon paid semi-annual		
Cash/PIK interest	Cash interest				Cash or PIK
Interest rate	Lowest	<--->			Highest
Principal repayment schedule	None	Some principal amortization	Bullet at end of term		
Secured/ unsecured	Secured (1st and 2nd liens)		Unsecured		
Priority in bankruptcy	Highest <---> Lowest				
Term	3-5 years	5-7 years	5-10 years		
Covenants	Mostly incurrence ("covenant lite"); Some maintenance (strictest)		Incurrence		
Call protection	No		Yes		

Open Discussion
Market Update

Current Leveraged Finance Market (US)*

US Leveraged Finance: Quarterly Volume

- US High Yield Corporate Bonds
- US Leveraged Loans
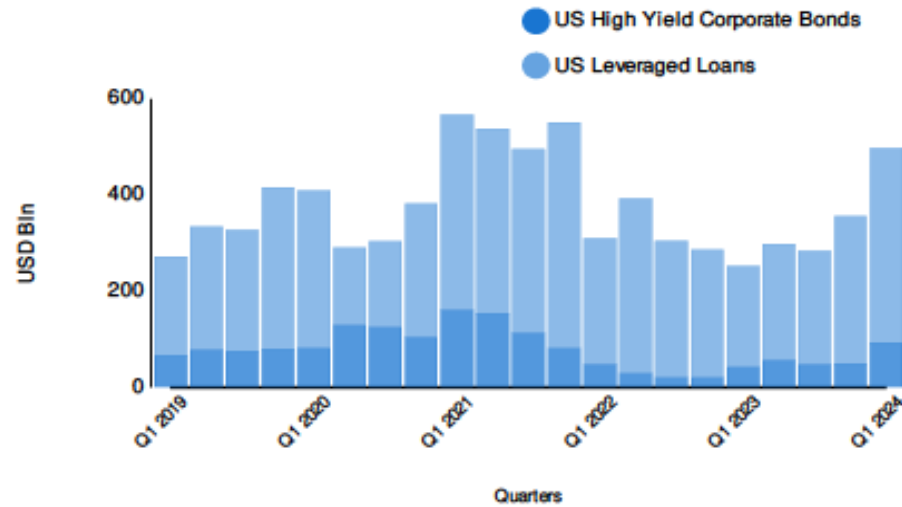
Leveraged Loan Yields Are Above Historical Averages
Morningstar LSTA US Leveraged Loan Index yield to maturity

Yield-to-maturity

10.04%
as of 9 February 2024

Average yield-to-maturity
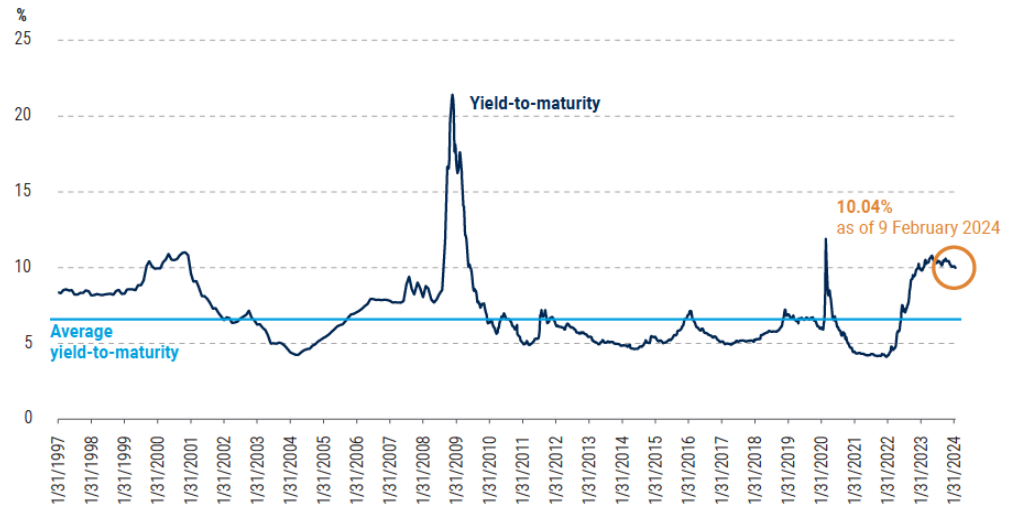
Source: Pitchbook/LCD as of 16 February 2024.

- Quarter 1 2024 total US Loans volume increased 34.61% to USD 719.5 Billion while the total number of deals decreased 8.02% to 757 deals year-on-year. Total US Leveraged Loans volume increased 92.63% year-on-year to USD 404.3 Billion while the total number of deals increased 8.48% to 537.

- Interest rates remain relatively high which is attractive for investors but not for borrowers.

- Traditional financial institutions are facing steep competition from private credit lenders offering competitive pricing to borrowers and private credit lenders are currently subject to less governmental regulations.
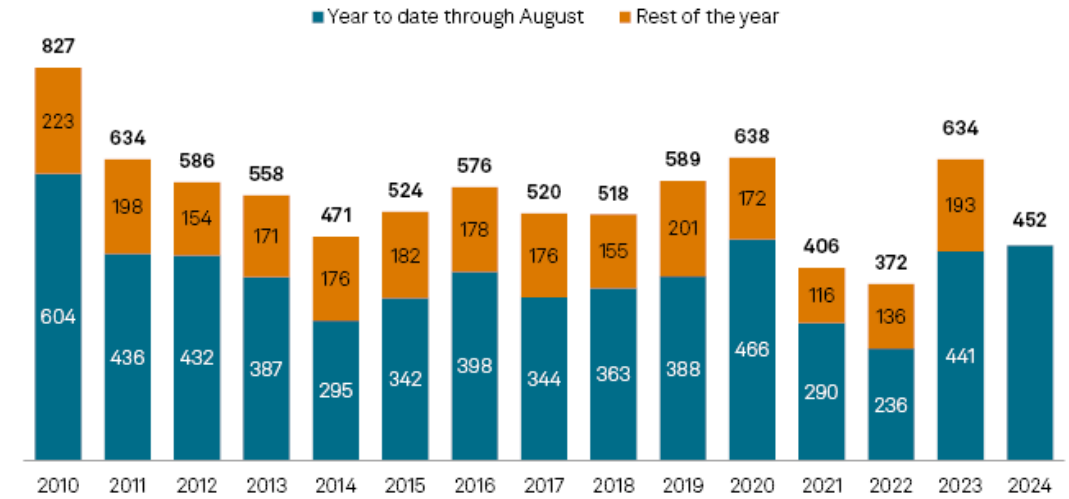
Financial Distress: 2024 Market Update*

Uncertainty continues and bankruptcy remain high

Highlights

- While the US economy has proven its resiliency, some US companies continue to struggle with inflation and geopolitical uncertainty.

- US corporate bankruptcy filings have increased significantly since 2022.

- With the exception of 2020, the first 8 months of 2023 have resulted in the highest number of bankruptcy filings in 13 years.

- Sectors leading corporate filings: consumer discretionary, healthcare, and industrials.

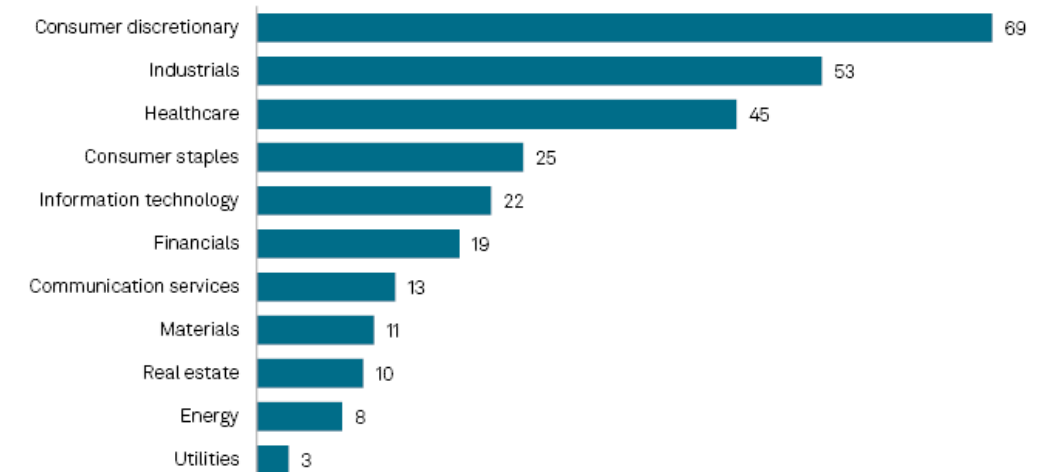- Lenders looking to out of court remedies, including exercising pledges to reconstitute board of directors.

*Data updated as of September 10, 2024; credit to S&P Global Market Intelligence.

US bankruptcy filings by year

■ Year to date through August   ■ Rest of the year

Year	Year to date through August	Rest of the year	Total
2010	604	223	827
2011	436	198	634
2012	432	154	586
2013	387	171	558
2014	295	176	471
2015	342	182	524
2016	398	178	576
2017	344	176	520
2018	363	155	518
2019	388	201	589
2020	466	172	638
2021	290	116	406
2022	236	136	372
2023	441	193	634
2024	452		452

Includes S&P Global Market Intelligence-covered US companies that announced a bankruptcy between Jan. 1, 2010, and Aug. 31, 2024.

2024 bankruptcy filings by primary sector

| Sector	Filings
Consumer discretionary	69
Industrials	53
Healthcare	45
Consumer staples	25
Information technology	22
Financials	19
Communication services	13
Materials	11
Real estate	10
Energy	8
Utilities	3

Data compiled Sept. 2, 2024.
Includes S&P Global Market Intelligence-covered US companies that announced a bankruptcy between Jan. 1, 2024, and Aug. 31, 2024.

Open Discussion
Applicability

Why Are We Talking About Debt? Why is it important to stay apprised of the financial health of your company? What is the Role of the General Counsel with respect to a Company's Debt?
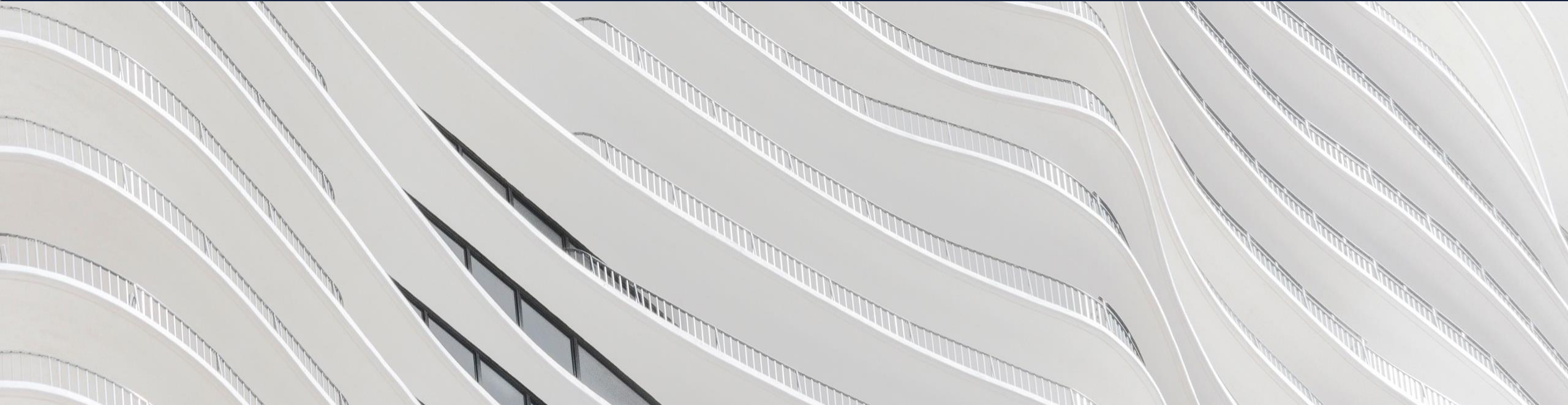
Scenarios

The Term Sheet

Scenario 1:

- You are the general counsel of a parent company that has global operations.

- The parent company desires to finance the acquisition of another Target.

- The Target has generated EBITDA for the last twelve months of approximately $24 million.

- Once acquired the parent company wants the Target to be able to operate and fund its own expenses, working capital and inventory.

- The parent company does not want to guarantee or provide any security for the Target's debt.

What terms should you focus on in the Term Sheet? What advice will give to the business team on the proposed financing? How involved will you be in negotiating the financing? How will you describe the financing to the Board of Directors to obtain approval of the financing?

Operating Under Debt Documents

Scenario 2:

- You are the general counsel of a parent company that has global operations.

- It is now August 2024. And congratulations! The Target has been acquired with funding from the debt proceeds of the term loan credit facility.

- The Target has a first-time Chief Financial Officer that was appointed to the position right after the closing. The Chief Financial Officer and his team have requested a meeting with you and your legal team to discuss operating under the new debt documents.

What guidance will you give to the Chief Financial Officer? How involved will you and/or a member of your legal team be as the Target is operating under the debt documents? How will you and your legal team monitor the Target's compliance under its new credit facilities?

Company In Distress
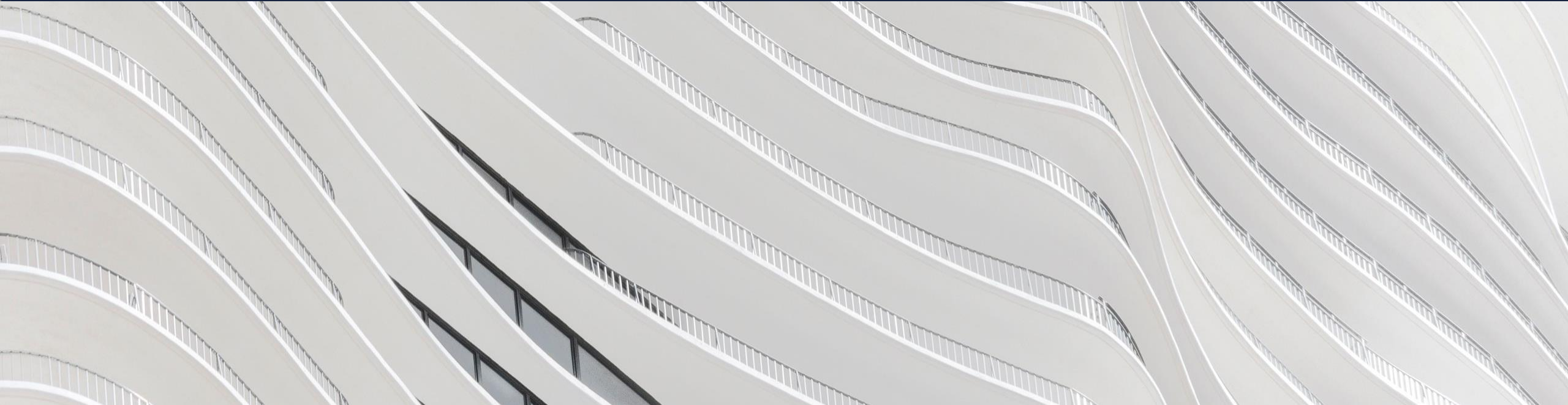
Options and Opportunities: Limiting Business Disruption

What you need to know

Important Insolvency Concepts

Chapter 11 vs. Chapter 7

The Automatic Stay

ipso facto Clauses

Executory Contracts

Proofs of Claim

Section 363 Sales

Tips to limit business disruption:

1. *Act early.*

2. *Collaboration is key.*

3. *Outside of court, you live and die by your contracts.*

Options

How can you tell a company is in financial distress?

Select Warning Signs

Industry Trends	Shrinking Footprint	Significant Litigation	Reduction in Labor Force
Bond Pricing	Anticipated Liquidity Crunch	Credit Agency Rating Downgrade	Upcoming Maturity Date

In Distress

- You are the chief legal officer of a global fashion brand ("Brand").

- In February 2018, Brand signed a multi-year global license agreement with Global Brands Group, that gave it the right to design, manufacture and market accessories (shoes and perfume) under the Brand brand.

- It is now June 2021. Global Brands Group has started making royalty payments later and later. Currently, Brand is owed $1,500,000. Despite repeated conversations, full payment has not been made. In a public filing, Global Brands Group issues a warning to investors that it may not be able to continue as a going concern.

- The accounts receivable and business team want to commence litigation to recover the amounts owed. They've requested a meeting with your team to discuss.

What questions do you ask? How do you prepare for the meeting? What strategies might be available to protect Brand and the business relationship?

In Chapter 11

Scenario 4:

- You are the chief legal officer of a multinational pharmaceutical corporation ("PharmaCo").

- In April 2023, PharmaCo entered into a global collaboration agreement with a small biotherapeutic company called BIND Therapeutics to develop and commercialize certain therapies. The collaboration seems to be going well and PharmaCo believes it will be highly profitable in 15-20 years.

- BIND's major debt is contingent upon certain financial covenants and clinical testing results. After an unsuccessful clinical test, BIND's lender sends a demand letter, accelerating the loan and demanding repayment in full within 15 days. BIND files for chapter 11.

- The collaboration team receives an official chapter 11 notice and does not know what to do. They have asked for a meeting with your team.

What questions do you ask? How do you prepare for a meeting to advise the collaboration team? What strategies might be available to avoid business disruption?

Fiduciary Duties for a Distressed Company

Fiduciary Duties Primer

Fiduciary Duties - Generally

- Under Delaware Law, when a corporation is solvent, the corporation's directors, officers, majority shareholders, and controlling shareholders owe fiduciary duties to the corporation and its shareholders. These fiduciary duties include:

  - **Duty of Care:** duty to act with the level of care that an ordinary, prudent person would exercise under the same circumstances.

  - **Duty of Loyalty**: duty to act in the best interests of the company. The focus of the duty of loyalty is to ensure that management acts in good faith with the honest belief that their actions put the interest of the company first. The duty of loyalty also includes disclosure obligations to equity holders, oversight obligations, and a duty to avoid actions that may injure the company and its constituents or that personally benefit management at the expense of the company.

    - Duty of good faith/duty of oversight/duty of disclosure

- **Other Jurisdictions**: Although many jurisdictions follow the Delaware corporate law and have similar fiduciary duties, certain jurisdictions have subtle differences that need to be reviewed.

- **Other Entity Forms**: Limited Liability Companies can disclaim all fiduciary duties (except the **implied covenant of good faith and fair dealing).**

Fiduciary Duties Primer – Standards of Review

Business Judgment Rule vs. Entire Fairness Standard

- **Business Judgment Rule:** Corporate law presumes that business decisions are made on an informed basis, in good faith and with honest belief that decision is in the corporation's best interests (the business judgment rule).

  - Fraud, bad faith, gross negligence and self dealing are not protected by the presumption of the business judgment rule.

- Without sufficient independence or if board members find themselves on both sides of the transaction, the directors will lose the protection of the business judgment rule.

- **Entire Fairness Standard:** If you lose the protection of the business judgment rule (i.e. the plaintiff successfully rebuts the business judgment rule), the entire fairness standard applies, under which the court will review the process and price related to the transaction to determine if it was fair to stockholders.

  - The entire fairness standard is a much more difficult standard to meet.

Fiduciary Duties Primer - Beneficiaries

Fiduciary duties are <u>always</u> owed to the corporation. But who can enforce?

- A director owes fiduciary duties to the company he or she serves and certain stakeholders may be able to assert derivative claims on behalf of the company (i.e. obtain standing) for any purported breach of those duties.

  - When a corporation is **solvent**, the directors' fiduciary duties are owed to the corporation and those duties may be enforced derivatively by its shareholders because shareholders are the ultimate beneficiaries of the solvent corporation's growth and increased value.

  - When a corporation is **insolvent** (whether or not in formal insolvency proceedings), fiduciary duties continue to be owed to the corporation but creditors have standing to bring derivative claims against the board of directors on behalf of the corporation.

  Best Practice: Maximize the value of the enterprise, which benefits all stakeholders.

In Distress (II)

Scenario 5:

- You are the chief legal officer of a large public company that has been experiencing reduced cash flows due to industry-wide headwinds and supply chain issues.

- In a meeting, the senior management team is advised that the company's cash position needs attention. The company (1) is at risk of a financial covenant default under its revolving credit agreement and (2) does not have sufficient liquidity to meet its current obligations and pay a principal and interest repayment in four months. Non-payment will trigger cross-defaults under indenture agreements, which bonds trade at $0.50. The CFO mentions that the profile of bondholders has changed and more aggressive hedge funds have begun to take a significant position in the unsecured bonds.

- A board of directors meeting is scheduled for next week.

What questions do you ask? How do you prepare for the board meeting? How do you prepare for the anticipated default and cross-defaults?
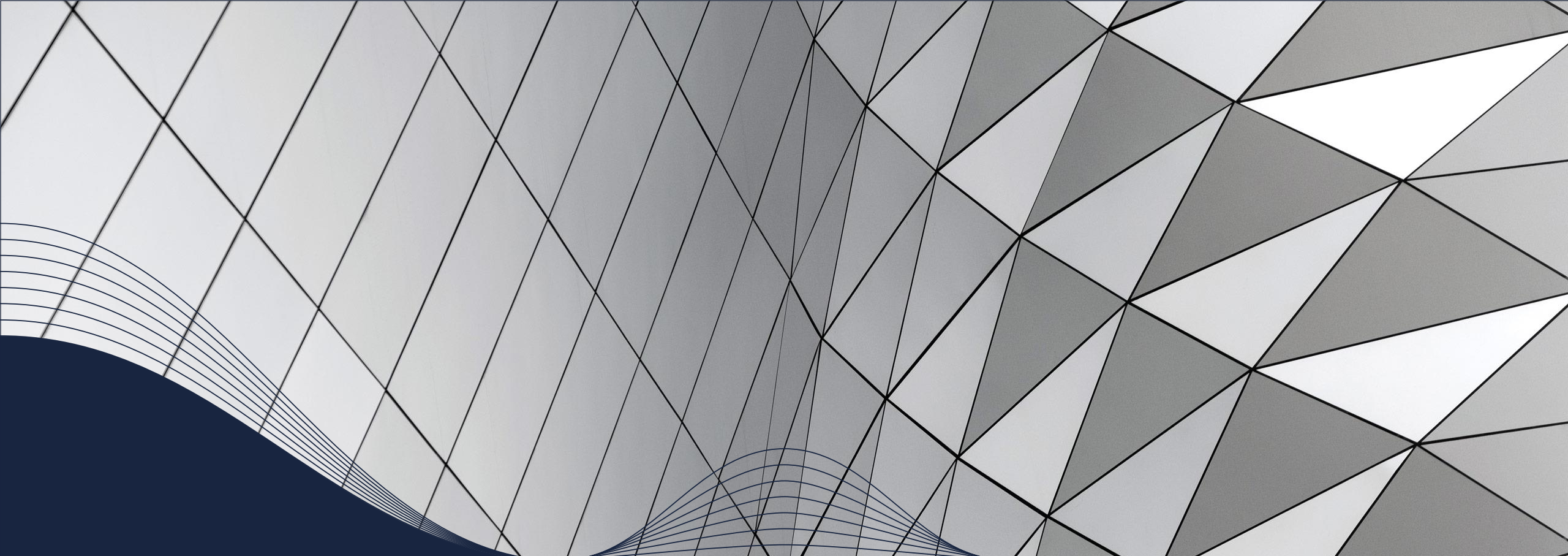
In Distress (II)

Scenario 5 (cont'd):

- The board of directors have asked to be advised with respect to their fiduciary duties, and the turnaround efforts and go-forward business plan of the senior management team.

- Members of the senior management team meet to discuss:
    1. Hiring advisors
    2. Requesting a waiver and/or forbearance
    3. Potential liability management transactions
    4. Restructuring

How do you prepare for this conversation? Do you have a recommendation for the go-forward plan?

Thank you

Building Bridges: CLE Symposium
MDL and State Coordinated Proceeding
Basics
Mass Torts and Multi-Plaintiff Claims

DLA PIPER

Agenda

- Introductions

- Overview

- MDLs and State Coordinated Proceedings

- Key Defenses

- Practical Tips for Discovery

Introductions: Who We Are

Grant C. Wright
Con Edison
Assistant General Counsel

Cara Edwards
DLA Piper LLP
Partner

Dani Morrison
DLA Piper LLP
Senior Associate

Overview & Introduction

- Mass Torts and Multi-Plaintiff Claims Cover a Broad Range of Cases and Affect a Variety of Industries

CASES
Product Liability
Antitrust
Class Action & Consumer Fraud
IP Litigation
Securities

INDUSTRIES	
Life Sciences	**Banking**
Consumer Goods, Food, Beverage, and Retail	**Labor and Employment**
Insurance	**Communications**
Automotive	**Construction**

- These cases often proceed as Multidistrict Litigations (MDLs) or State Coordinated Proceedings

Types of Cases

Single plaintiff ("one-off") cases

- Typically driven by plaintiff's injury

- Not necessarily a widespread issue

- Follows traditional litigation procedure

- Example: EpiPen failure

Types of Cases (cont.)

Coordinated proceeding: class action, mass tort,

- Typically driven by broad event (medical literature, regulatory action, recall)

- Many plaintiffs allege same/similar injury

- Cases coordinated for efficiency

- Examples: Zantac recall and Camp Lejeune Lawsuits

Litigation Triggers

Varies by Industry

Energy

Life Sciences

Consumer Goods, Food, Beverage, and Retail

Massive pipeline fire burning near Houston began after a vehicle struck a valve, officials say

The pipeline fire forced evacuations, sparked grass fires, damaged a park.

By JUAN A. LOZANO Associated Press
September 16, 2024, 12:08 PM

Viagra May Boost Risk of Deadly Skin Cancer, Study Finds

FDA U.S. FOOD & DRUG ADMINISTRATION

Medtronic Recalls HeartWare HVAD System Batteries for Electrical Faults That Cause Battery Failure

FOX 4 NEWS

Overland Park attorneys file lawsuit against L'Oréal over liquid makeup containers
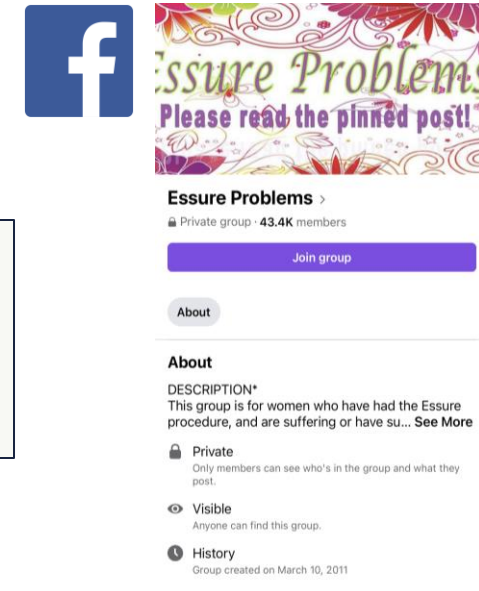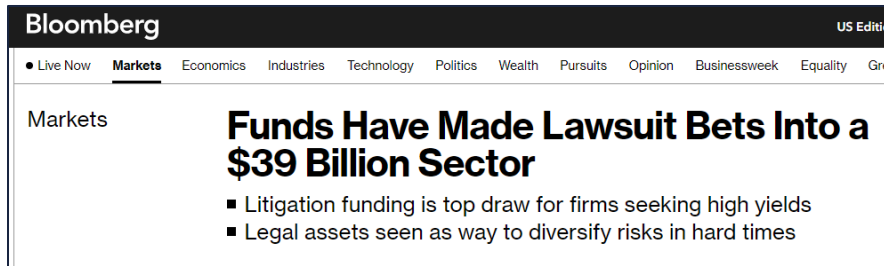
OVERLAND PARK, Kan. — An Overland Park Law firm is suing popular cosmetics brand, L'Oréal in a California class action lawsuit.

Recent Developments Leading to Increased Litigation

Increasing availability of information = increasing availability of triggers

- Litigation Funding
- Increase in Attorney Advertising
- Social media/click bait
- Increase in government litigations and investigations
- Copycat lawsuits
- News coverage

Bloomberg US Edition

● Live Now **Markets** Economics Industries Technology Politics Wealth Pursuits Opinion Businessweek Equality Gree

Markets

Funds Have Made Lawsuit Bets Into a $39 Billion Sector

■ Litigation funding is top draw for firms seeking high yields
■ Legal assets seen as way to diversify risks in hard times

Girlfriend Believes Chantix Contributed to Texas Musician's Death

abc NEWS

NBC NEWS

CBS NEWS

Department of Justice

Office of Public Affairs

FOR IMMEDIATE RELEASE   Tuesday, February 1, 2022

Justice Department's False Claims Act Settlements and Judgments Exceed $5.6 Billion in Fiscal Year 2021

Second Largest Amount Recorded, Largest Since 2014

Essure Problems
Please read the pinned post!

Essure Problems ›
🔒 Private group · 43.4K members

Join group

About

About

DESCRIPTION*
This group is for women who have had the Essure procedure, and are suffering or have su... See More

🔒 Private
Only members can see who's in the group and what they post.

👁 Visible
Anyone can find this group.

🕐 History
Group created on March 10, 2011

Overview – Product Liability Litigation

Applicable to Multiple Industries and Types of Cases

- Pharmaceutical and medical device litigation may also be called "**personal injury**" or "**mass tort**" litigation where a plaintiff alleges a **medicine or medical device caused a physical injury**

- The case typically is based on three strict liability/negligence theories:
  - The manufacturer **failed to warn** of the risk of the injury
  - The manufacturer **designed the product defectively**
  - The manufacturer **manufactured the product defectively**

- Plaintiffs may also pursue **breach of warranty, fraud, or unfair and deceptive trade practices** claims

- Increasing theory based on **failure to report** mandatory adverse event reports to FDA
  - Need to report from any source (patient/doctor reports, social medial, medical literature, lawsuits)

What is a coordinated proceeding?

Multi-district litigation (MDL)

UNITED STATES
Judicial Panel on Multidistrict Litigation
Karen K. Caldwell, Chair | Thomasenia P. Duncan, Panel Executive
John W. Nichols, Clerk of the Panel

Coordinated state proceedings, e.g.:

Cal. Code Civ. Proc., § 404
Judicial Council
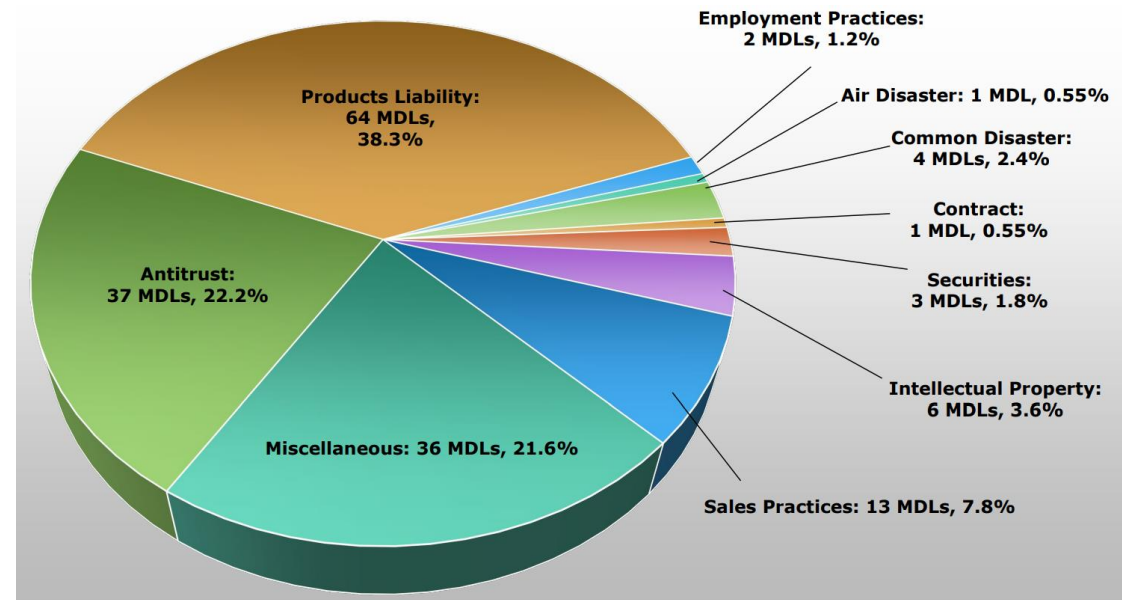**Coordination Proceedings**

231 Pa. Code § 213.1
Multicounty Litigation

Rules of the Chief Judge
Section 53.1
Litigation Coordinating
Panel

New Jersey Court Rule 4:38
Multicounty Litigation

The Stats Don't Lie....

MDLs Cover Multiple Areas of the Law and Industries

MDL Basics

- **What is an MDL?**
  - Cases proceed in MDL to resolve and predict common issues, then go back to original courts for trial
- **What is the purpose of an MDL?**
  - The goal is to enhance efficiency and consistency
  - Who decides if a case will be coordinated into an MDL?
  - The Judicial Panel on Multidistrict Litigation (JPML)
  - 7 sitting federal judges, no two panel members from same federal judicial circuit
  - Current panel members are Judge Karen Caldwell (E.D. Ky.), Nathaniel Gorton (D. Mass.), Matthew Kennelly (N.D. Ill.), David Norton (D.S.C.), Roger Benitez (S.D. Cal.), Dale Kimball (D. Utah), and Madeline Arleo (D.N.J.).

MDL Basics (cont.)

- **How is an MDL created?**
  - Party petitions the JPML or JPML can do so on its own
- **What types of cases are coordinated?**
  - Similar types of claims
  - Common questions of fact
  - Panel previously centralized cases involving similar product(s)
  - Eliminate duplicative discovery
  - Prevent inconsistent pretrial rulings
  - Conserve the resources of the parties, their counsel, and judiciary
- **How is the judge or court selected?**
  - Parties advocate for a particular jurisdiction(s)
  - JPML chooses a location based on (1) the number of cases pending, (2) where the case has progressed the furthest, (3) location where most of the common facts occurred, (4) cost and inconvenience being minimized, and (5) experience and skill of the available judges.

Federal Court Coordination: Organizing the Chaos

- **No one size fits all for leadership roles**
- **Typical positions and committees**
  - Lead Counsel
  - Liaison Counsel
  - Executive committee
  - Plaintiff steering committee
  - Defense steering committee
- **Proposed Rule 16.1**
  - Recommend initial case management report addresses the potential need for leadership counsel, as well as the roles, responsibilities, and compensation of any such leadership counsel

Federal Coordinated Proceeding: Process Overview

Master Complaint

Motion To Dismiss / Answer

Early Case Management Orders

Science Day

Company Discovery

Expert Discovery

Rule 702 (Daubert) Hearing

Bellwether Trials

Remand

State Coordinated Proceedings: Similar Story, But Different Rules

- **Similar process at the state level** for coordination of related actions

- In determining if coordination is appropriate, **state courts consider similar factors**

- **Some key differences**: for example, Rule 702 v. state court standards for experts

- **Consult local counsel and the rules**

- **Coordinate state & federal proceedings**

Defenses

- **Attack the science**
- **Causation**
- **Tariffs**
- **Preemption**
- **Statute of limitations**
- **Learned intermediary**

Good ole fashioned lawyering

ViCTOZA®
liraglutide injection 1.2 mg | 1.8 mg

Federal appeals court bats back claims Novo Nordisk's diabetes drug triggers pancreatic cancer

Amiodarone Hydrochloride
Tablets
Each tablet contains 100mg Amiodarone Hydrochloride PhEur.
Also contains lactose.
28 tablets
100mg
Crescent

California Appellate Court Reaffirms Federal Preemption, Learned Intermediary Doctrine in Amiodarone Cases

Important Note: Legal Hold

- In the US, as soon as **litigation is reasonably anticipated** (and certainly once a lawsuit has been filed), the company has a duty to preserve potentially relevant information

- To satisfy the obligation to preserve, all routine document destruction practices must be suspended, like **turning off auto-delete** of emails for relevant employees

- Both the company and the employees who have relevant materials need to **actively preserve those documents** and information

Legal Hold & How It Relates to Discovery

- Discovery is the litigation procedure where each party must disclose relevant evidence to the other side; it is very broad and contemplates full transparency

- Parties must keep all past and current documents/emails/IMs/texts concerning the subjects identified in the legal hold to ensure all parties have fair access

- Not everything that gets maintained pursuant to a legal hold will be produced in litigation, but must be preserved

- EXAMPLE: In the Actos litigation, Takeda employees deleted documents after a legal hold was issued, and the judge instructed the jury that "…you are free to infer these documents and files would have been helpful to the plaintiffs or detrimental to Takeda…"

Careless Communications Lead to Unintended Consequences

- **Litigation often occurs many years later:**
  - Original context of a communication may be long forgotten
- **Communications often are taken out of context**
  - Every word is scrutinized and often interpreted in worst possible light
  - Author is not given the benefit of the doubt
  - Snarky comments may have seemed witty when written, but rarely age well when they show up years later in litigation

Don't let this…   **…turn into this**

Virtually Every Communication Is Discoverable

Voicemails

Handwritten/typed notes

Emails (even if deleted)

Email attachments

Microsoft Teams IMs & chats

Meeting notes/summaries (electronic & hard copies)

PowerPoint Presentations

Drafts

Text messages

Photos

Determine Best Way to Communicate

Consider confidentiality

Talk live when communicating confidential or highly sensitive information or when you think there may be concern about risk

Avoid misunderstandings

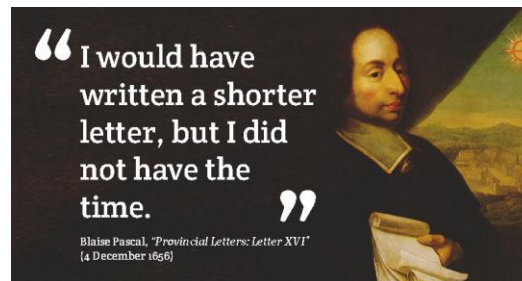Live communication allows us to provide immediate clarification and feedback when needed

Don't assume privacy

Emails can and often will be forwarded without your approval or knowledge

Be concise, accurate, and organized

Get to the point, don't bury key information, and use tools to communicate efficiently and effectively

> " I would have written a shorter letter, but I did not have the time. "
>
> Blaise Pascal, *"Provincial Letters: Letter XVI"* (4 December 1656)

Q&A

Legal Practice + AI

Ethical Uses of Generative AI in the Practice of Law

DLA PIPER

Agenda

New York, NY

- Introductions

- Key assumptions

- Demystifying AI & LLMs

- Today's AI

- Applying legal ethics to today's AI
  - ABA Model Rules
  - State bar rules
  - Individual judge rules

- AI and the Corporate World
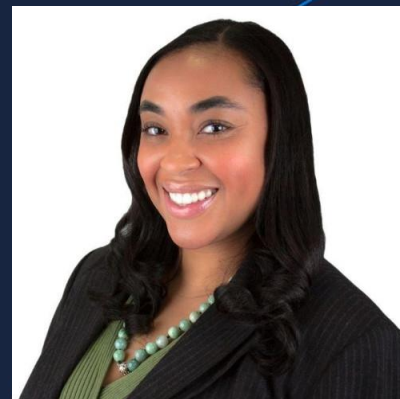
Nubiaa Shabaka
VP, Global Chief Cyber Legal & Privacy Officer, Data Governance Co-Chair, AI Governance Adobe

Lisa LeCointe-Cephas
Partner, Compliance & Investigations
Global Co-Chair, Life Sciences Sector

1. Foundational rule of legal ethics and AI

If you remember anything, let it is be this…

Key Assumption

Ethical uses of generative AI share a common assumption:

AI is a legal assistant, not a lawyer.

AI as Legal Assistant

Lawyers use their own independent judgment before finalizing any work product.
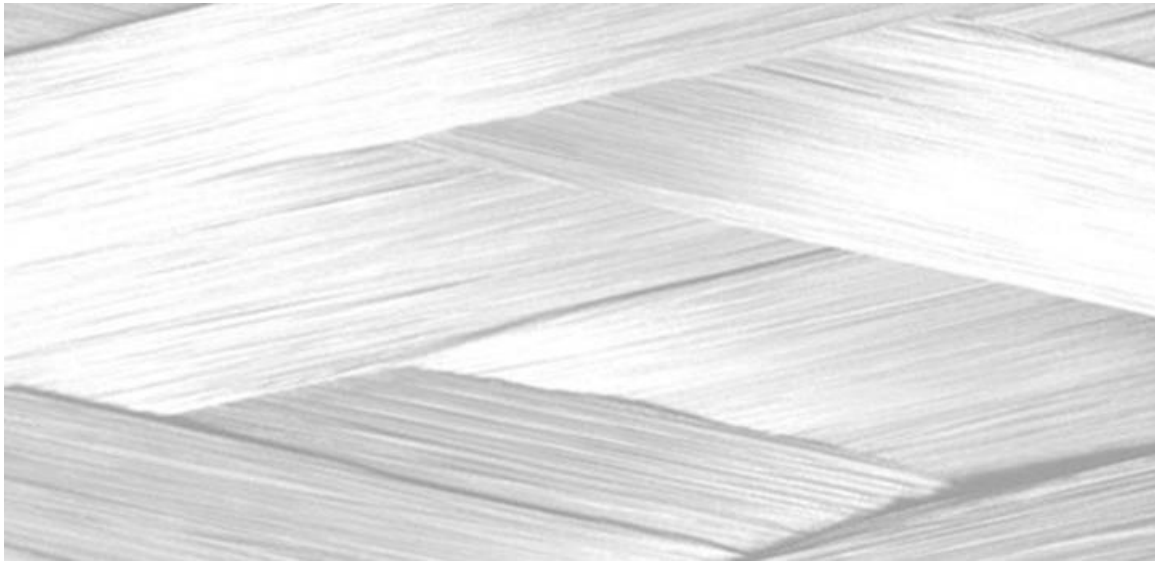
Legal technology (e.g., billing, legal research, accounting, communication, drafting, etc.)
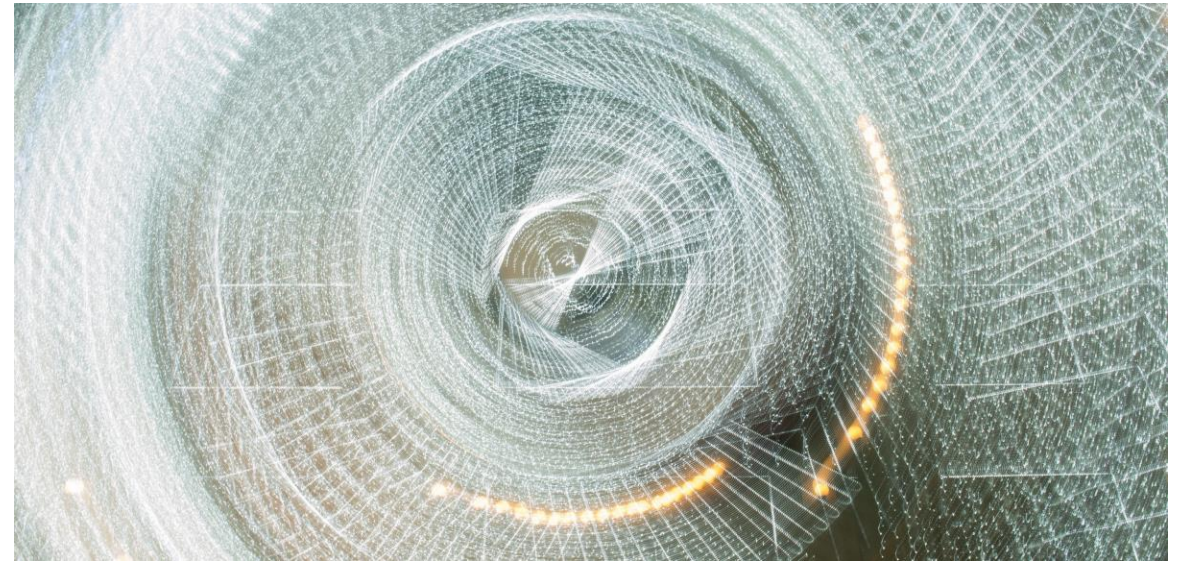
Assistance from human or AI legal assistants

Legal ethics themes

Legal Ethics Themes

- Fees
- Competence
- Overseeing legal assistance
- Diligence
- Candor
- Communication
- Confidentiality

Source: See generally, ABA Model Rules

Foundation for ethical uses of AI

User is in control	User is accountable	AI is built responsibly by developers	**Understand:** How AI works *Developer + User* What AI can (and cannot) do *Developer + User*

2. Demystifying AI and LLMs

GPT technology is not the beginning

From searching words...

Keyword guesswork and Boolean codes help you search for words

Example: False Negatives

There's only one "soda" in this fridge
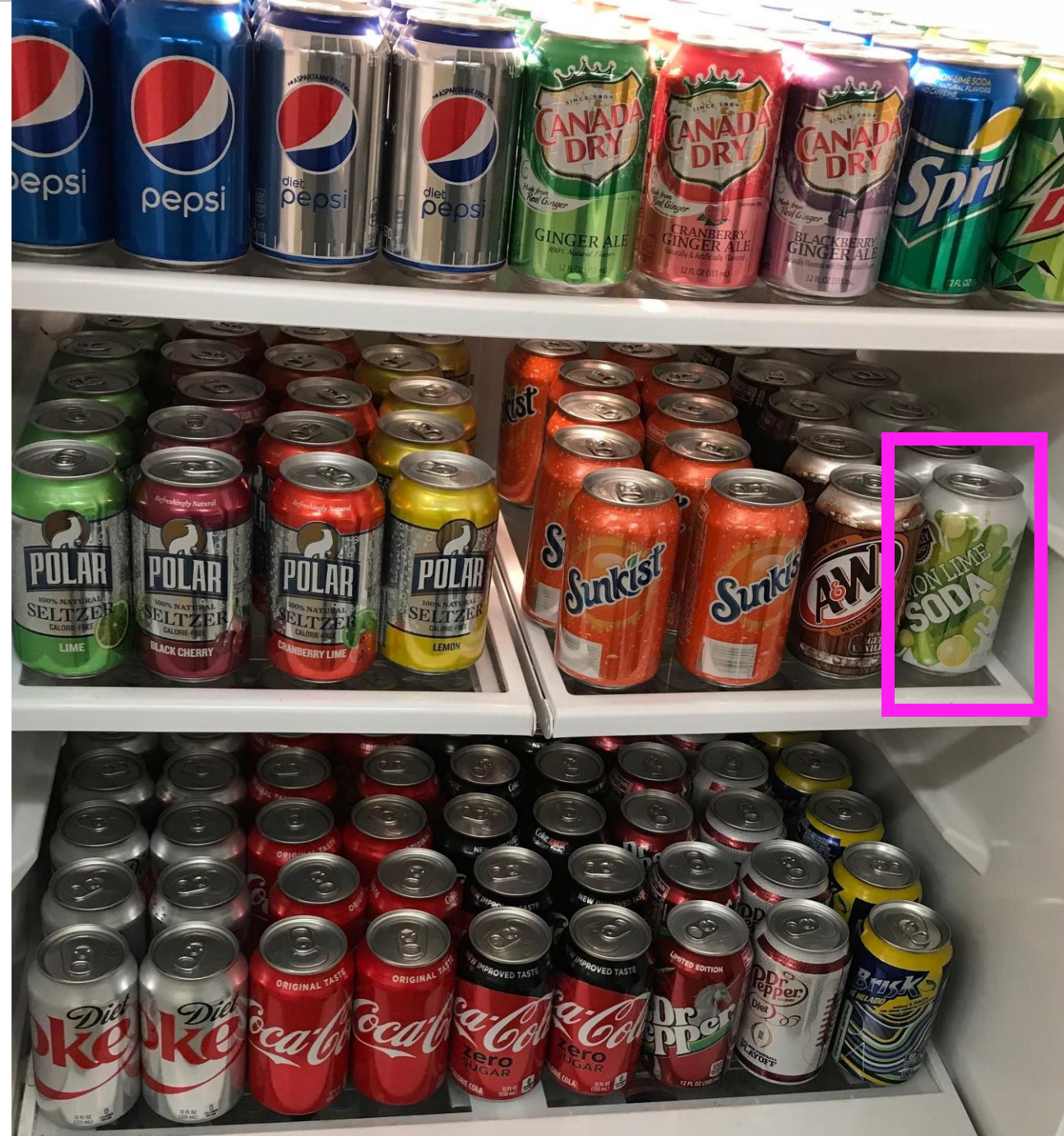
Example: False Positives

These are all photos of "bunny"

Keyword searches "have long been recognized as appropriate and helpful for ESI search and retrieval," but "there are well-known limitations and risks associated with them." Victor Stanley, Inc. v. Creative Pipe, Inc., 250 F.R.D. 251, 260 (D. Md. 2008). "Chief among [those limitations] is that such a search necessarily results in **false positives** (irrelevant documents flagged because they contain a search term) and **false negatives** (relevant documents not flagged since they do not contain a search term)." Makowski v. SmithAmundsenLLC, No. 08-C-6912, 2012 WL 1634832, at *1 (N.D. Ill. May 9, 2012).

*Advanced Magnesium Alloys Corp. v. Dery, 1:20-cv-02247-RLY-MJD, at *5 (S.D. Ind. Aug. 5, 2022)*

...to finding concepts

Neural networks have brain-like connections that can find terms that match concepts and context
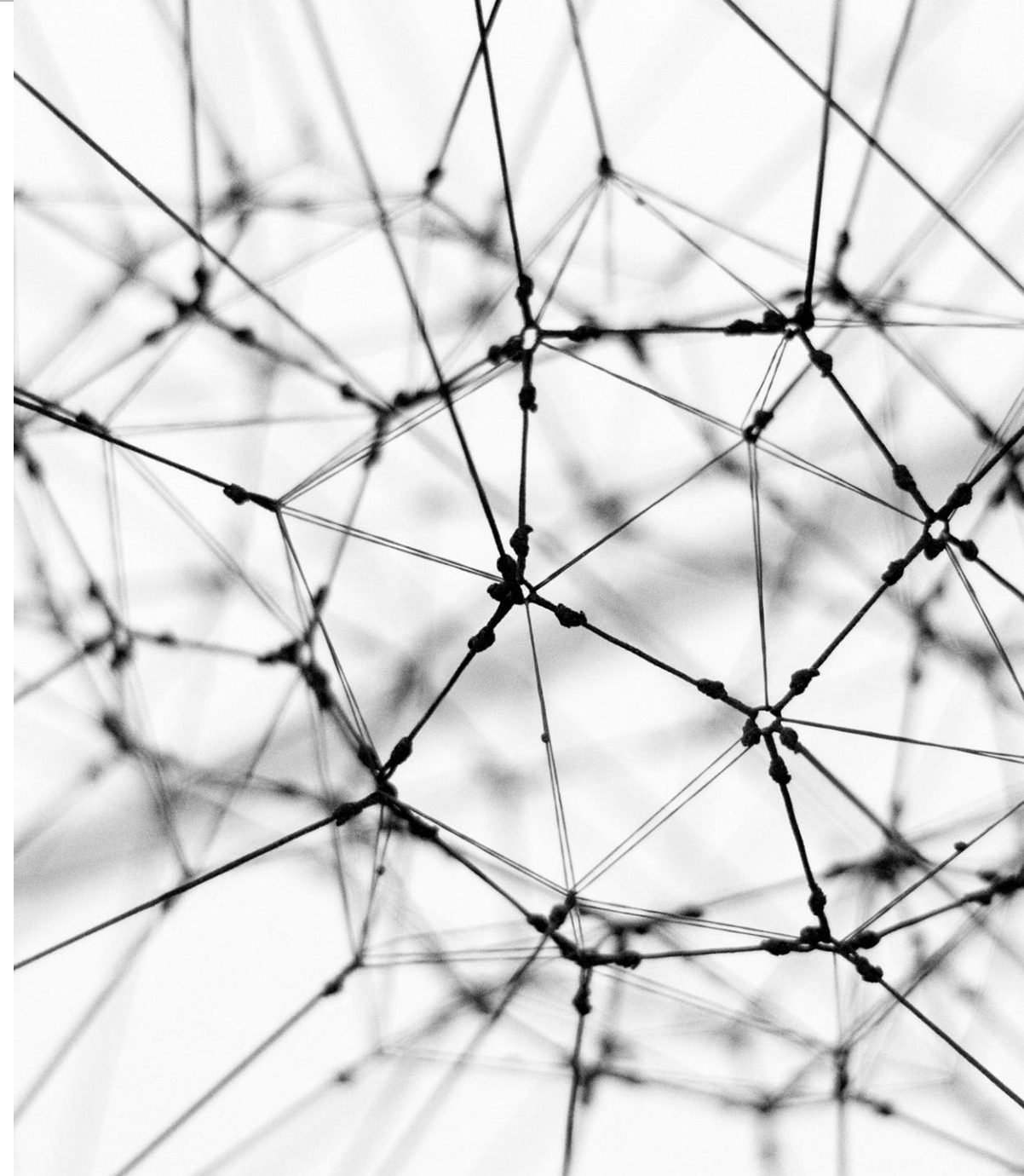
How do LLMs work?

- Every sentence becomes a numeric "vector"
- Vectors map ideas across dimensions
- "How animal is this sentence?"
- Dimensional similarities have values
- "Sheep" and "dog" have high "animal" values "Violin" and "chair" would not

Search	Results
Sheep	Dog

Credit: Stable Diffusion. Images fall under the CC0 1.0 Universal Public Domain Dedication.
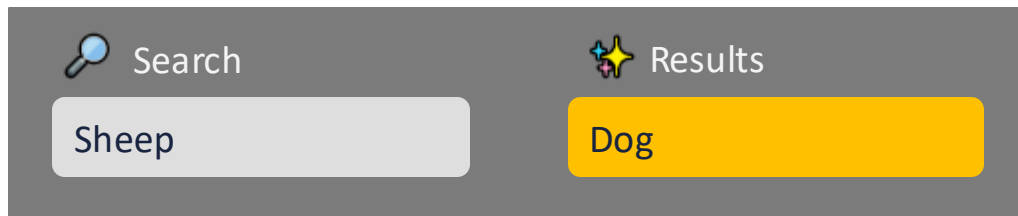
When used in machine learning and large language models, vectors represent the mapping of words, sentences, documents, or any object into a mathematical space. The relationships and distances between objects can then be computed by comparing their vector representations.

How do LLMs work?

The man went to the store to buy a [????] of milk.

A model's responses start random…

sheep
=

justice
=

carton
=

University
=

arrest =

...but become "trained"!

justice =

carton =

sheep =

University =

arrest =
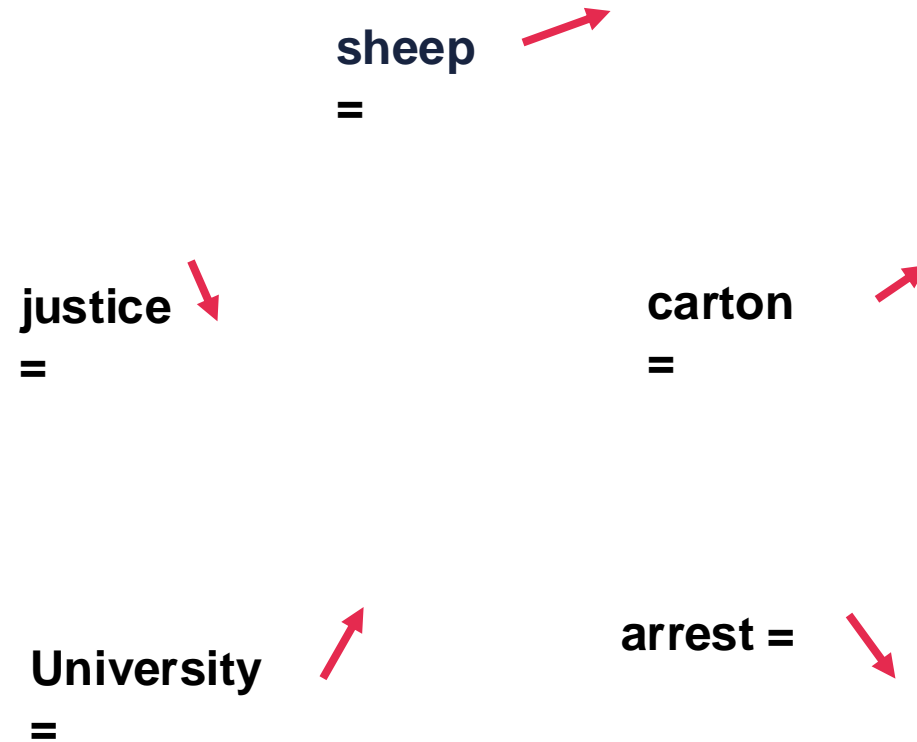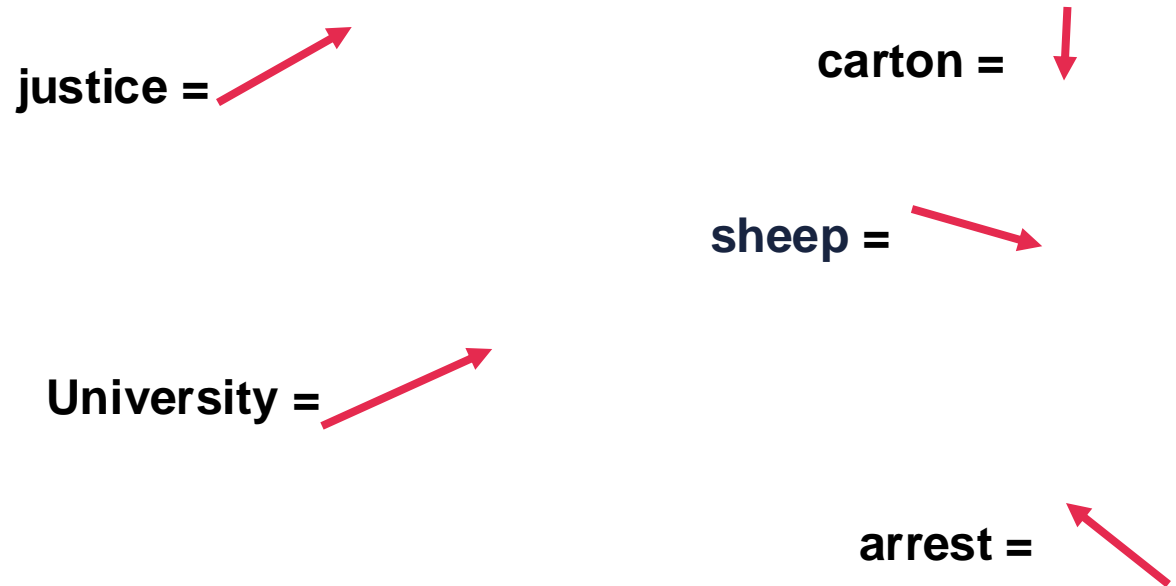
- The first layer of the network will learn representations for parts of sentences like words and phrases.
- Further layers start to build more complex concepts by combining those lower-level parts.

- The result is that each message can be deeply analyzed as a complex mathematical vector in a higher layer of the network.

- The network learns to extract meaning from language and make connections without any hard-coded rules or grammar.

Muffin or Chihuahua

Poodle or Fried Chicken

Date

Generative Pre-trained Transformers

Generative AI can produce unique, novel, human-like content	**Pre-trained on massive datasets with billions of inputs**	**Transformer neural networks learn faster with less computation**

A few broad categories

From general to specific applications

LLM model

Model + a source

Model + source + domain engineering

General use AI
ChatGPT by OpenAI, Bard by Google, Claude by Anthropic

General use AI with search
Bing Chat by Microsoft, Perplexity

Specific use AI
CoCounsel by Casetext
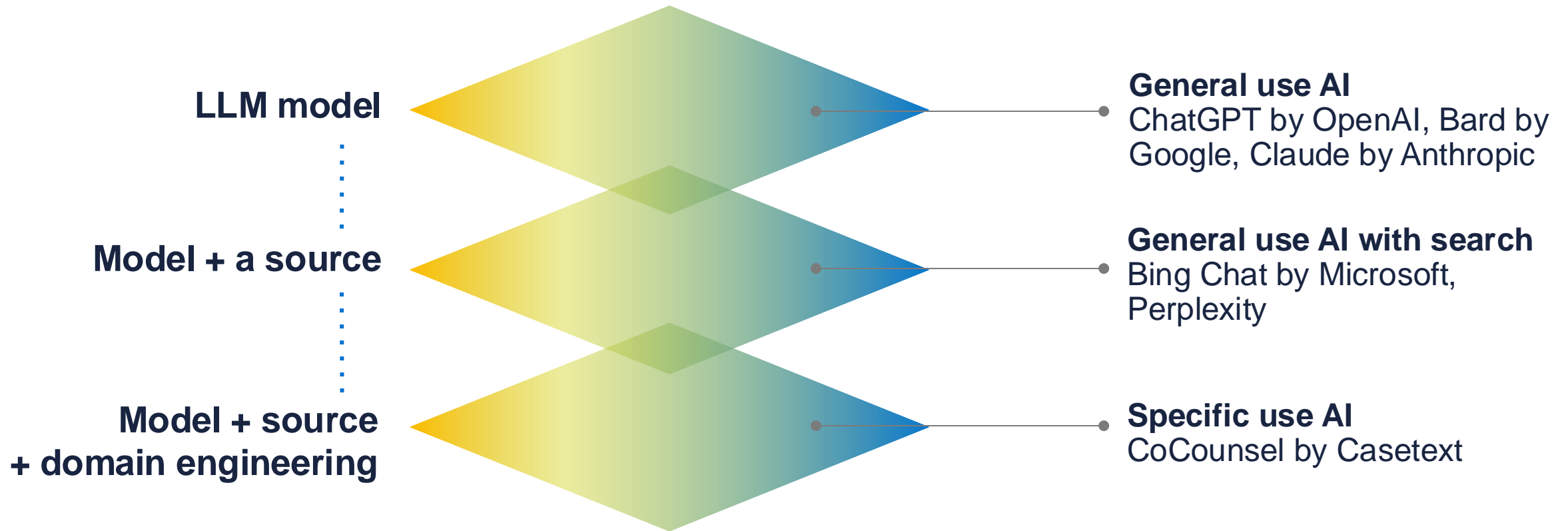
General use AI

ChatGPT by OpenAI, Bard by Google, Claude by Anthropic

Applications: Good for creative tasks where the result is subjective

Phrasing and tone

Lists of preferences (e.g., what to pack for a trip, what to cook for dinner)

General use AI

ChatGPT by OpenAI, Bard by Google, Claude by Anthropic

Bad for "anything important" (Sam Altman, CEO of OpenAI, 12/10/2022)

- When the result must be accurate

- Questions related to any discipline requiring a license (e.g., construction, architecture, electrical, plumbing, medicine, finance, law)

Note: This slide focuses on the free, basic version of these applications

General use AI with search

Bing Chat by Microsoft, Perplexity, ChatGPT Plus/Ent. features

Application: Good for initial, conversation-level and idea-generating searches

- Analogous to getting started with Wikipedia (i.e., you can quickly follow sources through a range of related ideas)
- Identifying various sources on a particular topic

General use AI with search

Bing Chat by Microsoft, Perplexity, ChatGPT Plus/Ent. features

Bad as a final source of information, without verification

- Any situation where you need to show your work (e.g., academic coursework, scholarly and other professional publications, legal research)

Specific use AI

CoCounsel by Casetext

| AI that reads and understands domain-specific content | AI that accesses current sources of information | AI that provides unique, refinable, and verifiable responses | AI that is private and secure | AI that is developed responsibly |

Result? This AI can be used for substantive legal tasks

Specific use AI

CoCounsel, Harvey

Bad for uses outside of its intended purposes

- Researching legal issues in a database of discovery documents

- Researching witness transcripts in a legal database

- Using traditional keyword and Boolean research techniques with AI technology that expects plain language instruction and interaction

- Results lack the creativity of more general tools because of the additional guardrails

4. Applying legal ethics to today's AI

ABA MODEL RULES

New technology is assumed

*There is no
"AI exception"*

The phrase "including the benefits and risks associated with relevant technology" would offer **greater** clarity regarding this duty and emphasize the growing importance of technology to modern law practice. As noted in ethics opinions, such as those relating to cloud computing, this **obligation is not new**. Rather, the proposed amendment emphasizes that a lawyer should **remain** aware of technology, including the benefits and risks associated with it, as part of a lawyer's general ethical duty to remain competent in a digital age.

ABA Commission on Ethics 20/20, August 2012

New technology is assumed

ABA Rule 1.1

"Competent representation requires the **legal knowledge, skill,** thoroughness and preparation reasonably necessary for the representation."

Comment 8

"**to maintain the requisite knowledge and skill**, a lawyer should…"

- **keep abreast** of **changes** in the law and its practice

- including the benefits and risks associated with relevant technology

And AI was already added

Rule 5.1
Responsibilities of a Partner or Supervisory Lawyer

Rule 5.3
Responsibilities Regarding Nonlawyer Assistance

- Resolution 112 (2019) notes that, in 2012, Rule 5.3 was changed from "Assistants" to "Assistance" to clarify that the rule "encompasses nonlawyers whether human or not. Under Rules 5.1 and 5.3, lawyers are obligated to supervise the work of AI utilized in the provision of legal services, and understand the technology well enough to ensure compliance with the lawyer's ethical duties."

- **Application**
  - Nonhuman legal assistance is within the scope of the ABA's rules
  - Lawyers must supervise AI legal assistants just like any other legal assistant

Rule 1.3 - Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

- Comment 1, in part: "...a lawyer may have authority to exercise professional discretion in determining the means by which a matter should be pursued. See Rule 1.2."

- Comment 2: "A lawyer's work load must be controlled so that each matter can be handled competently." See also, Rule 3.2 (expediting litigation).

- **Application**

  - Technology, like AI, may assist lawyers in maintaining their workload

  - AI is not expected… yet.

Rule 1.4 - Communication

A lawyer shall (a)(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished; (a)(3) keep the client reasonably informed about the status of the matter; (a)(4) promptly comply with reasonable requests for information…

- Comment 1: "Reasonable communication between the lawyer and the client is necessary for the client effectively to participate in the representation."

- Comment 3, in part: "In some situations… this duty will require consultation prior to taking action."

- **Application**
  - Explain your use of AI to clients (e.g., from ready answers to policy listings)
  - If AI is not secure, private, or cannot show its work, clients will be concerned

Source: ABA Model Rule 1.4 and Comments

Rule 1.4 - Communication

A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law…

- Comment 2, in part: "What is required of lawyers, however, is that they **inform themselves** about the facts of their clients' cases and the applicable law and determine that they can make **good faith** arguments in support of their clients' positions."

- **Application**
  - AI must be able to cite to real cases, statutes, regulations
  - AI must be able to cite to relevant portions of litigation records

Rule 3.3 - Candor

(a) A lawyer shall not knowingly (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer; (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or (3) offer evidence that the lawyer knows to be false…

- Comment 2, in part: "What is required of lawyers, however, is that they inform themselves about the facts of their clients' cases and the applicable law and determine that they can make good faith arguments in support of their clients' positions."

- **Application**
  - Using AI that limits its investigation to a real, domain-specific source of information, and that shows its work, will help lawyers "avoid conduct that undermines the integrity of the adjudicative process."

Rule 1.6 - Confidentiality

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent… (c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

- Comment 2, in part: "A fundamental principle in the client-lawyer relationship is that, **in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation.**"

- **Application**
  - Carefully evaluate the underlying, enabling software that AI is built with and uses (e.g., cloud storage, third-party processing agreements, etc.)
  - Choose AI built by experienced developers for legal practitioners

Source: ABA Model Rule 1.6 and Comments.

Rule 1.1 - Competence

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

- Comment 8, in part: "...**keep abreast of changes in the law and its practice…**"
  - **"the benefits and risks associated with relevant technology"**
  - **"engage in continuing study and education"**

- **Application**
  - Attend relevant learning opportunities, like CLE presentations
  - Make time to understand new technology your firm/company adopts

4. Applying legal ethics to today's AI

STATE BAR GUIDANCE

California Bar Guiding Principles

- Duty of Confidentiality

- Duties of Competence and Diligence

- Duty to Comply with the Law

- Duty to Supervise Lawyers and Nonlawyers, Responsibilities of Subordinate Lawyers

- Communication Regarding Generative AI Use

- Charging for Work Produced by Generative AI and Generative AI Costs

- Candor to the Tribunal; and Meritorious Claims and Contentions

- Prohibition on Discrimination, Harassment, and Retaliation

- Professional Responsibilities Owed to Other Jurisdictions

Florida Bar Advisory Opinion

Advisory opinion to addresses client consent, supervision of AI, ethical limitations on attorneys' fees and costs, advertising rules and reliance on AI generated due diligence reports

Florida Bar Ethics Opinion OKs Lawyers' Use Of Generative AI, But With Cautions

FLORIDA BAR ETHICS OPINION
OPINION 24-1
January 19, 2024

Advisory ethics opinions are not binding.

Lawyers may use generative artificial intelligence ("AI") in the practice of law but must protect the confidentiality of client information, provide accurate and competent services, avoid improper billing practices, and comply with applicable restrictions on lawyer advertising. Lawyers must ensure that the confidentiality of client information is protected when using generative AI by researching the program's policies on data retention, data sharing, and self-learning. Lawyers remain responsible for their work product and professional judgment and must develop policies and practices to verify that the use of generative AI is consistent with the lawyer's ethical obligations. Use of generative AI does not permit a lawyer to engage in improper billing practices such as double-billing. Generative AI chatbots that communicate with clients or third parties must comply with restrictions on lawyer advertising and must include a disclaimer indicating that the chatbot is an AI program and not a lawyer or employee of the law firm. Lawyers should be mindful of the duty to maintain technological competence and educate themselves regarding the risks and benefits of new technology.

By *Bob Ambrogi* on January 25, 2024

A new ethics opinion from **The Florida Bar** says that lawyers may ethically use generative AI technologies, provided they are careful to adhere to their ethical obligations.

The opinion also urges lawyers to continue to develop competency in the use of new technologies such as AI and the risks and benefits inherent in those technologies.

New Jersey Supreme Court Committee on AI and the Courts

Notice to the Bar from the New Jersey Supreme Court providing preliminary guidelines on the use of artificial intelligence by New Jersey lawyers.

NOTICE TO THE BAR

LEGAL PRACTICE: PRELIMINARY GUIDELINES ON THE USE OF ARTIFICIAL INTELLIGENCE BY NEW JERSEY LAWYERS

Artificial intelligence (AI) includes a variety of rapidly evolving technologies with significant capabilities as well as significant risks. In furtherance of its responsibility to uphold the highest level of professionalism among lawyers, the New Jersey Supreme Court seeks to balance the benefits of innovation while safeguarding against the potential harms of misuse. To that end, the Court here provides preliminary guidelines on the use of AI to support lawyers who practice in New Jersey and the clients who depend on those lawyers.

Supreme Court Committee on AI and the Courts

The Supreme Court Committee on Artificial Intelligence and the Courts, which includes private and public lawyers, as well as judges, Judiciary leaders, technologists, and experts in academia and media, recommended these initial guidelines to support lawyers in continuing to comply with the existing Rules of Professional Conduct (RPCs) and the Rules of Court.

The attached preliminary guidelines are intended to inform and assist lawyers in navigating their ethical responsibilities in light of the current and anticipated effects of AI -- in particular generative AI -- on legal practice.

Questions and Suggestions

Lawyers with specific questions about their own prospective conduct related to the use of AI should continue to seek direction from the Attorney Ethics Hotline at (609) 815-2924 or in writing to Court-Use-of-AI.mbx@njcourts.gov. As always, the identity of lawyers who pose such specific questions will remain confidential. However, the issues raised by such inquiries may inform the development of future, more detailed guidance regarding the ethical use of AI in the practice of law.

New York Bar Report and Recommendations

New York State Bar Association's (NYSBA's) Task Force on Artificial Intelligence released a Report and Recommendations to the NYSBA House of Delegates in April 2024 consisting of the following four recommendations:

1. Adopt the AI guidelines outlined in the Task Force's report and create periodic updates for these guidelines.

2. Focus on educating judges, lawyers, law students, and regulators on how AI technology works so that it can be applied, regulated, and monitored correctly.

3. Identify risks that are not currently addressed by existing laws.

4. Examine the function of law in AI governance.

NEW YORK STATE BAR ASSOCIATION
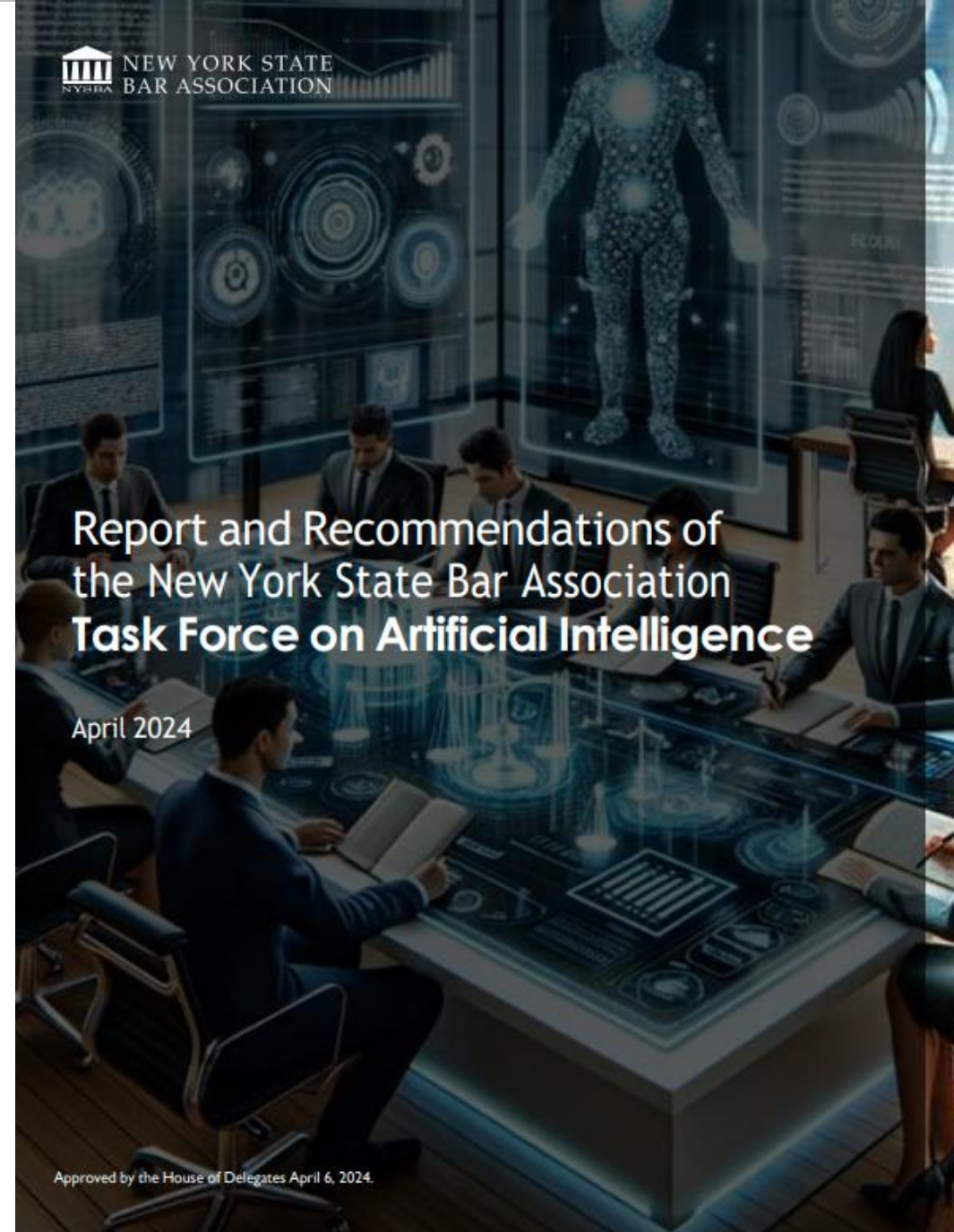
Report and Recommendations of the New York State Bar Association Task Force on Artificial Intelligence

April 2024

Approved by the House of Delegates April 6, 2024.

Mata v. Avianca

The court's reasoning for sanctions

- The filing of papers "without taking the necessary care in their preparation" is an "abuse of the judicial system" that is subject to Rule 11 sanction. (p.22)

- "Rule 11 creates an "incentive to stop, think and investigate more carefully before serving and filing papers." (p.22)

- "Rule 11 'explicitly and unambiguously imposes an affirmative duty on each attorney to conduct a reasonable inquiry into the viability of a pleading before it is signed.'" (p. 22-23)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
--x
ROBERTO MATA,

                Plaintiff,   22-cv-1461 (PKC)

      -against-

                                   OPINION AND ORDER
                                    ON SANCTIONS
AVIANCA, INC.,

                Defendant.
--x

CASTEL, U.S.D.J.

        In researching and drafting court submissions, good lawyers appropriately obtain assistance from junior lawyers, law students, contract lawyers, legal encyclopedias and databases such as Westlaw and LexisNexis. Technological advances are commonplace and there is nothing inherently improper about using a reliable artificial intelligence tool for assistance. But existing rules impose a gatekeeping role on attorneys to ensure the accuracy of their filings. Rule 11, Fed. R. Civ. P. Peter LoDuca, Steven A. Schwartz and the law firm of Levidow, Levidow & Oberman P.C. (the "Levidow Firm") (collectively, "Respondents") abandoned their responsibilities when they submitted non-existent judicial opinions with fake quotes and citations created by the artificial intelligence tool ChatGPT, then continued to stand by the fake opinions after judicial orders called their existence into question.

Park v. Kim

The court's reasoning to refer an attorney to the Court's Grievance Panel

- "At the very least, the duties imposed by Rule 11 require that attorneys read, and thereby confirm the existence and validity of, the legal authorities on which they rely."

- "[A] submission of a brief relying on non-existent authority reveals that [the attorney] failed to determine that the argument she made was "legally tenable."

- An attempt to persuade a court or oppose an adversary by relying on "non-existent precedent generated by ChatGPT" is an " 'abuse of the adversary system.'" (*quoting Mata v. Avianca*).

Another NY lawyer faces discipline after AI chatbot invented case citation

By Sara Merken

January 30, 2024 3:42 PM EST · Updated 8 months ago

The Thurgood Marshall courthouse is pictured in New York, New York, U.S., March 25, 2019. REUTERS/Carlo Allegri *Purchase Licensing Rights*

Colorado v. Crabill

Order approving stipulation to discipline

- Before a hearing on the motion, the discovered that the cases from ChatGPT were either incorrect or fictitious. But the did not alert the court to the sham cases at the hearing. Nor did he withdraw the motion.

- When the judge expressed concerns about the accuracy of the cases, the attorney falsely attributed the mistakes to a legal intern.

- Court found that the attorney violated his duty to his client to **act competently** and with **diligence**, and **knowingly** lied to the court in violation of professional rules, according to the disciplinary opinion.

SUPREME COURT, STATE OF COLORADO
ORIGINAL PROCEEDING IN DISCIPLINE BEFORE
THE OFFICE OF THE PRESIDING DISCIPLINARY JUDGE
1300 BROADWAY, SUITE 250
DENVER, CO 80203

Complainant:
THE PEOPLE OF THE STATE OF COLORADO

Case Number:
23PDJ067

Respondent:
ZACHARIAH C. CRABILL, #56783

ORDER APPROVING STIPULATION TO DISCIPLINE UNDER C.R.C.P. 242.19(c)

Before the Presiding Disciplinary Judge ("the Court") is a "Stipulation to Discipline Pursuant to C.R.C.P. 242.19" filed on November 21, 2023, by Justin P. Moore of the Office of Attorney Regulation Counsel ("the People") and Arthur J. Kutzer, counsel for Zachariah C. Crabill ("Respondent"). In the stipulation, the parties waive their right to a hearing.

Under C.R.C.P. 242.19(c), the Court may either approve or reject the parties' stipulation, using discretion and in accordance with the considerations governing imposition of disciplinary sanctions. The Court has reviewed the stipulation and finds that the parties' agreement as to the facts, rule violations, applicable mitigating and aggravating factors, and sanction is consistent with the American Bar Association *Standards for Imposing Lawyer Sanctions*. The Court therefore **APPROVES** the stipulation and **ORDERS**:

1. ZACHARIAH C. CRABILL, attorney registration number 56783, is SUSPENDED from the practice of law for a period of **ONE YEAR AND ONE DAY, WITH NINETY DAYS TO BE SERVED AND THE REMAINDER TO BE STAYED** upon the successful completion of a **TWO-YEAR** period of **PROBATION**, subject to the conditions set forth in paragraph 19 of the stipulation.

2. Respondent violated Colo. RPC 1.1; Colo. RPC 1.3; Colo. RPC 3.3(a)(1); and Colo. RPC 8.4(c).

3. Respondent **MUST** timely comply with C.R.C.P. 242.32(b)-(e), concerning winding up of affairs, notice to current clients, duties owed in litigation matters, and notice to other jurisdictions where he is licensed or otherwise authorized to practice law.

4. Within fourteen days after the effective date of the suspension, Respondent **MUST** file an affidavit with the Court under C.R.C.P. 242.32(f), attesting to his compliance with

5. AI in the Corporate World

TRANSFORMING INNOVATION

AI Risk is Not Simply Privacy/ Cyber Risk
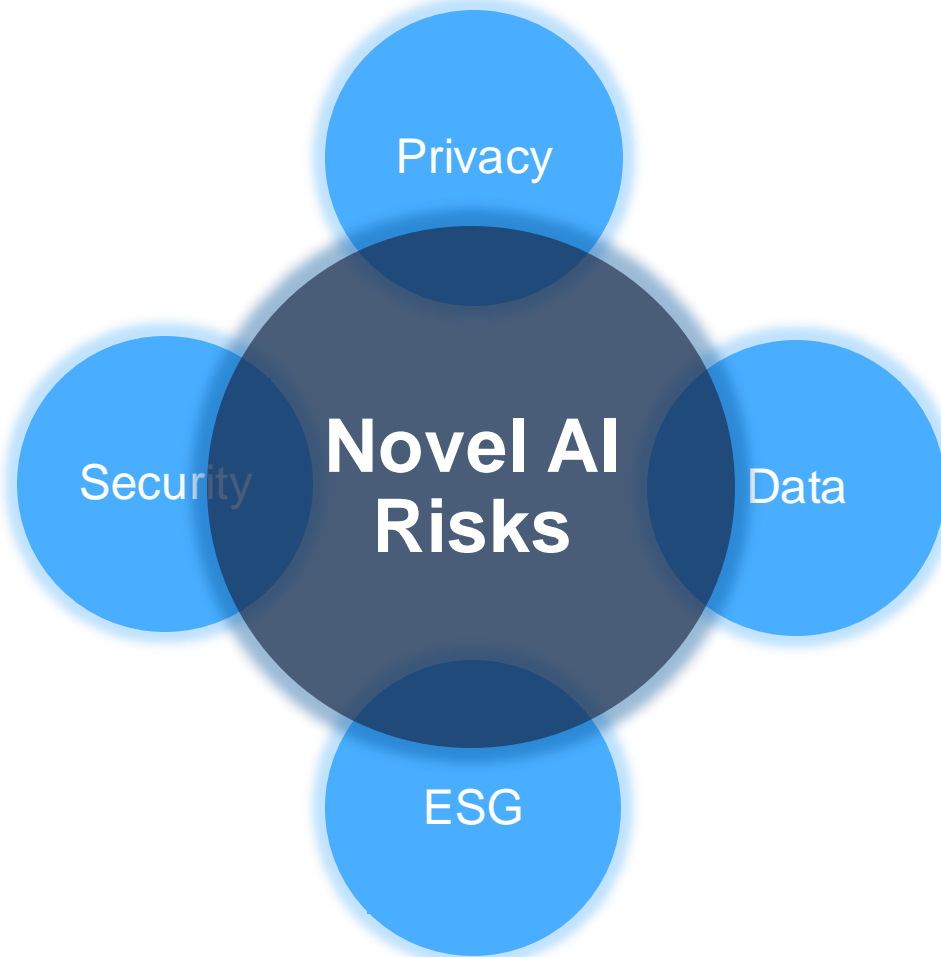
AI risks "unique" and "not comprehensively addressed by current risk frameworks and approaches."

- NIST RMF 1.0

AI Poses Unique Legal and Enterprise Risks

Uncertainty

Emerging regulatory and legal frameworks for AI are evolving and often vague or conflicting.

Security

Complexity and penetration of AI into vital services and systems poses new cybersecurity challenges.

Explainability

Complex algorithms are hard to decipher, which can lead to overreliance on machine recommendations.

Reliability

AI varies dramatically in quality and performance, raising issues of safety and efficacy.

Ownership

IP Concerns over inputs into the AI model as well as outputs from the model

Privacy

AI not only collects vast amounts of personal data but can infer additional protected characteristics and reidentify anonymized data.

Liability

AI can expose organizations to new duties and liabilities.

Bias

Training algorithms on historical data sets can propagate past unlawful or harmful bias and discrimination

Mismatch

AI trained in one environment can fail to achieve safety and efficacy in other contexts.

Validation

Lack of software expertise can lead to gaps in validation.

Drift

Continuously learning AI can veer off course, leading to new challenges in post-market vigilance.

Controversy Regarding the Use of AI in the Corporate World

Andersen et al. v. Stability AI Ltd.
- Artists filed a class-action lawsuit claiming Stability AI, Midjourney, and DeviantArt used copyrighted images to train AI models without consent.
- The court dismissed most claims, except for one direct copyright infringement claim against Stability AI.
- The case highlights the difficulty in proving AI models contain unauthorized content and the challenge of defining "compressed copies" in diffusion models.

Kadrey v. Meta Platforms
- Authors accused Meta of training its AI models on their copyrighted books.
- The court dismissed most claims, but allowed one related to unauthorized copying during training to proceed.
- The ruling questions whether outputs from AI models can be considered infringing derivative works.

Thomson Reuters v. ROSS Intelligence
- Thomson Reuters sued ROSS for using Westlaw content to train AI for legal research.
- The court ruled that disputes over fair use, including the transformative nature of AI training, must be resolved by a jury. This case will test how AI training fits within fair use doctrine.

These cases demonstrate the complexities of AI **copyright law**, particularly around **fair use, derivative works**, and the **training process**.

White House Executive Order on Safe, Secure, and Trustworthy AI

- On October 30, 2023, the White House signed into effect an Executive Order on Safe, Secure, and Trustworthy Artificial Intelligence.

- The Order requires the development (mostly within three to twelve months) of standards, practices, and new regulation for the development and use of AI across most aspects of the economy and in regulated areas such as consumer finance, labor and employment, healthcare, education, national security, and others.

- It makes clear that the resources and authority of the federal government will be focused on the safe, secure, and ethical use of AI in every major aspect of commerce and societal affairs.

AI is "among the great challenges posed to democracy today."
- The White House

White House Executive Order on Safe, Secure, and Trustworthy AI

- On March 28, 2024, Vice President Kamala Harris announced that the White House Office of Management and Budget (OMB) issued OMB's first government-wide policy to mitigate risks of artificial intelligence and harness its benefits—delivering on a core component of President Biden's landmark AI Executive Order.

- In line with the President's Executive Order, OMB's new policy directs the following actions:

  - address Risks from the Use of AI;

  - expand Transparency of AI Use;

  - advance Responsible AI Innovation;

  - grow the AI Workforce; and

  - strengthen AI Governance.

US and UK Partnership on Science of AI Safety

Following the AI Safety Summit last year, on April 1, 2024, the US and UK signed a memorandum of understanding that will see them develop common tests for testing advanced AI models.

They intend to perform at least one joint testing exercise on a publicly accessible model. They also intend to tap into a collective pool of expertise by exploring personnel exchanges between the Institutes.

"AI is the defining technology of our generation. This partnership is going to accelerate both of our Institutes' work across the full spectrum of risks, whether to our national security or to our broader society. Our partnership makes clear that we aren't running away from these concerns – we're running at them."

- US Secretary of Commerce Gina Raimondo

US Regulation is on the Rise

Actions in Congress

- **Artificial Intelligence Research, Innovation, and Accountability Act of 2023 (AIRIA)** – Bipartisan group of senators introduced the AIRIA designed to promote and regulate AI research and innovation while ensuring accountability and ethical standards in its development and use

- House established bipartisan AI task force to explore how Congress can ensure America's leadership in global AI innovation while also considering appropriate protections against emerging threats.

White House Actions

- *Executive Order to Limit Data Transfers to Foreign Adversaries (Feb. 28, 2024)* – *limits outbound data transfers that pose "an unacceptable risk to the national security of the United States."* Directs DOJ to restrict US companies from selling/transferring certain data to covered parties in 'countries of concern.' Does not presently limit data aggregation or processing within US.

- *Executive Order on Safe, Secure, and Trustworthy AI (Oct. 30, 2023)* – *Sweeping mandates to primary executive departments on AI.*

- *Blueprint for AI Bill of Rights* – Top 7 AI companies agreed upon voluntary safeguards for development on July 21, 2023

- DOJ appoints first Chief Science and Technology Advisor and Chief AI Officer.

State Regulatory Activity

- Increasing trend of proposed state legislation to regulate both development and deployment of AI tools around the country.

- Numerous states have passed laws and /or proposed bills that target **consumer disclosures, likeness rights, and hiring tools.**

Colorado

Signed SB205 (Consumer Protections for Interactions with AI), is the first US comprehensive regulation targeted towards high-risk artificial intelligence systems, **requiring developers and deployers to use reasonable care to prevent algorithmic discrimination**.

California

BOT Law **prohibits use of 'undeclared' bots** to communicate or interact with persons

Kentucky

Would give people **exclusive control over their names, voices, and likenesses**, and would not recognize disclaimers for digital clones.

New York

Local Law 144 **prohibits employers from using automated employment decision tools** without disclosure and conducting bias audit.

Louisiana

Would require **registration and disclosure of any large-scale models** used for adaptable ML to the secretary of state.

California Greenlights Two Significant AI Bills

In August 2024, the California legislature recently passed AB 2013 (**Artificial Intelligence Training Data Transparency**) and SB 1047 (**Safe and Secure Innovation for Frontier Artificial Intelligence Models Act**). Both bills are now pending Governor Gavin Newsom's final approval.

- **SB 1047** requires developers of the largest AI models to take significant safety measures to mitigate risks to safety that future development of their systems may pose to the public, which include the following:

- **Before Training**
  - Implement administrative, technical, and physical cybersecurity protections
  - Implement the capability to promptly enact a full shutdown
  - Implement a protocol that provides reasonable assurance that the developer will not produce a covered or derivative model that poses an unreasonable risk of critical harm
  - Conduct annual safety and security reviews

- **Before Commercial or Public Use**
  - Perform assessment and implement reasonable safeguards to prevent the cause of critical harm

- **Additional Responsibilities**
  - Annual certification of compliance from a third-party auditor
  - Report safety incidents affecting a covered model within 72 hours
  - Implement reasonable safeguards and requirements to prevent a third party from using the model, or creating a derivative model, to cause critical harm.

AB 2013, meanwhile, mandates transparency in the development of generative artificial intelligence systems.

Starting January 1, 2026, for any new or significantly updated generative AI systems released after January 1, 2022, developers are required to publish documentation on their public websites about the data used to train these systems. The documentation is to include information on, for example:

- The sources or owners of the training data sets;
- A description of how the data sets further the intended purpose of the artificial intelligence system or service;
- The number and description of data points in the data sets;
- Whether the data sets include any data protected by copyright, trademark or patent or whether the data sets are entirely in the public domain; and
- Whether the generative artificial intelligence system or service used or continuously uses synthetic data generation in its development, etc.

AI Enforcement

- The **FTC** is positioning itself as a leader in AI enforcement.

- Emphasis on failure to **test AI, establish quality standards, and train employees.**

- Recent settlements and public statements make clear that possible penalties include—

  1. **Multi-year bans** on use of certain types of technology;

  2. Data and **algorithmic disgorgement**;

  3. **Lengthy corporate monitoring** and third-party assessment programs.

- FTC Commissioner has publicly stated that documentation and testing are now the **"baseline"** of an algorithmic fairness program.

FTC v. Rite Aid (Jan. 2024)

- FTC alleged that Rite Aid's use of **third-party facial recognition software** created bias/discriminatory results and harmed consumers.

- Charges emphasized company's failure to:
  - **Test the technology's accuracy** before or after deployment;
  - Enforce image **quality standards**;
  - **Train and oversee the employees** charged with operating the technology in stores.

- Penalties include:
  - **5-year ban** on using this type of technology;
  - Deletion of all **data and models or algorithms derived** from that data;
  - **Corporate monitoring** and assessment program.

The EU AI Act – Overview

- World's first **comprehensive regulatory framework for artificial intelligence**.

- Negotiations concluded in December 2023; text unanimously agreed to by all 27 EU member states on February 2, 2024. On March 13, 2024, the EU Parliament voted in favor of enacting the AI Act, a comprehensive regulatory regime that will form the basis of AI governance and regulation across the EU and internationally. Signed into law in June 2024.

- **AI System defined:** *a machine-based system designed to operate with varying levels of autonomy and that may exhibit adaptiveness after deployment and that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments.*

- **Risk Based Approach.** Classifies AI and assigns obligations to organizations based on the potential risk of harm the AI may cause. Limited risk/high risk/prohibited use.

- **Extraterritorial Scope:**

  - applies whenever the impact of the AI system occurs within the EU (regardless of the location of the AI provider or user);

  - like GDPR (the EU privacy regulation), likely to have considerable application even to companies with a primarily ex-EU presence;

  - will apply to AI Systems that are produced, deployed, imported, or distributed in the EU; and

  - where an AI System interacts with parties or data in the EU, it is considered best practice to assume it falls within the scope of the AI Act.

Expect Some US States to Follow the EU's Lead

TECH+TIMES   TECH   SCIENCE   BUSINESS   HEALTH   CULTURE   DEALS &

California Says It will 'Learn' from Europe for AI Laws

California's AI laws could be similar to Europe's.

Aldohn Domingo, Tech Times | 26 March 2024, 10:03 pm

The California Initiative for Technology and Democracy is **reportedly** looking to both learn and work together with Europe in creating the state's **artificial intelligence regulation**.

According to David Harris, senior policy adviser at the California Initiative for Technology and Democracy, they are attempting to learn from and collaborate with the Europeans to decide how to implement AI rules.

California, home to some of the biggest **AI** firms, has seen its state legislators introduce at least 30 separate measures addressing various areas of AI.

> "What we're trying to do is actually learn from the Europeans, but also **work with the Europeans, and figure out how to put regulations in place on AI**…"
>
> David Harris, *senior policy advisor at the California Initiative for Technology and Democracy*

Common Elements of an AI Governance Program

Flexible But Effective Controls – best practice controls are tailored to level of risk, are supportive and enable innovation, and are top-down with increasing specificity from enterprise value statement and policy to unit/department procedures.

Targeted Testing – testing protocols should be tailored to use case needs, be benchmarked to industry standards, and be adaptive and evolutionary to meet changing regulatory and industry standards.

Routine Monitoring – clear reporting requirements and structures for monitoring AI higher-risk use after deployment should be in place to ensure continued compliance with evolving regulations and legal landscape.

AI Training – training is appropriate to level or role in oversight, business, and legal fields. Goal is issue-spotting fit to level, ability to risk stratify, and knowing when to escalate.

Distill Emerging Regulations Into Adaptable Governance

Must predict regulatory movement and fit business priorities and risk tolerance

NIST — *Leading Risk Management Framework*

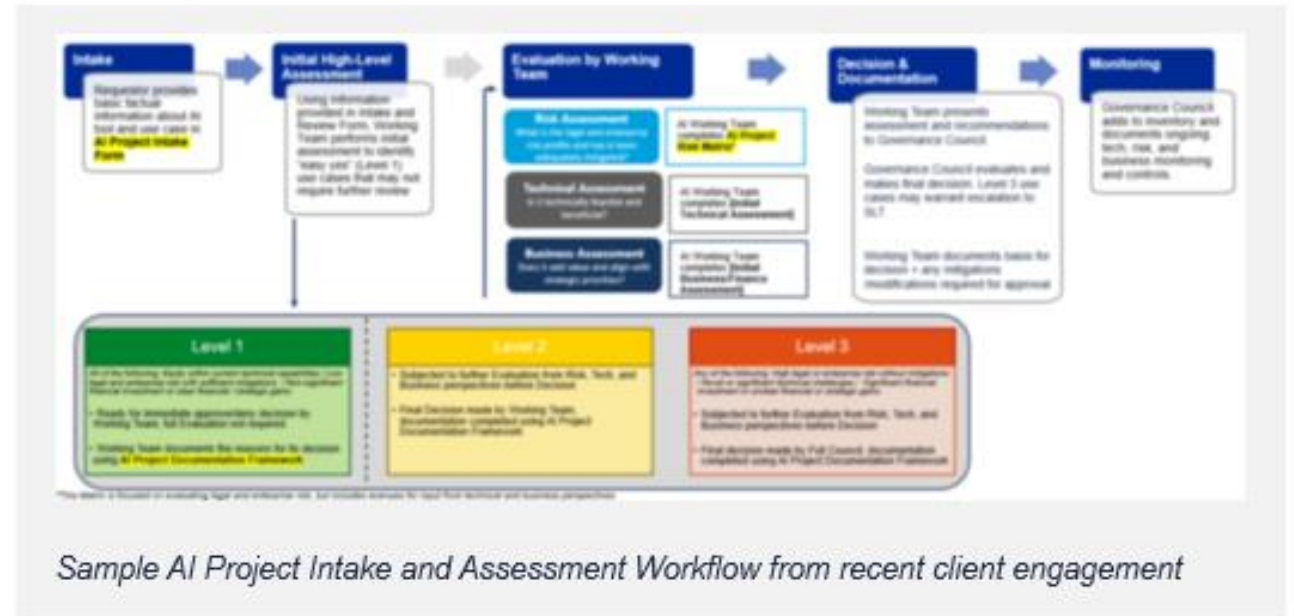**EU Artificial Intelligence Act** — *EU AI Act*

United States — *Executive Order on Safe AI*

G7 — *Global Consensus Principles*

FDA — *Sector-Specific Requirements*

Sample AI Project Intake and Assessment Workflow from recent client engagement

Benchmark Against Peers to Right-Size AI Governance

Phase I Deliverables

Phase II Deliverables

Overarching Policies and Charters

- Principles for Accountable AI
- Accountable AI Policy
- AI Governance Council Charter
- AI Governance Sub-committee Charter(s) (as needed)

Training Presentations

- Employee Training on AI Gov. Program
- Management Training on AI Gov. Program
- SLT/Board Training on AI Gov. Program
- Project Owner Training on Risk Assessment and Model Management
- Legal Team Training on AI Risks and Challenges
- Tech Team Training: What You Should Expect from AI Governance

Written Guidance

- Function-Specific Guidance 1-2 pagers (*e.g.*, Human Resources & AI; Intellectual Property & AI)
- Employee Dos and Don'ts
- Employee Communications (as needed)

Stage of Product Lifecycle

| Design/ Proof of Concept | → | Development | → | Deployment | → | Detect / Decommissioning |

Documentation

- AI Use Case Intake & Assessment Form
- Use Case Risk Matrix
- Use Case Doc. Framework
- Due Diligence Checklist

- Development & Deployment Review Workflow
- Pre-Launch Template Impact Assessment
- Bias Testing Plan

- Template Model Management Plan
- Post-Launch Template Impact Assessment

- Template Decommission Management Plan and Checklist

Let ETHICAL Use be your North Star

Human Control, Fairness, Privacy

Transparency & Explainability

Robustness, Security & Safety

Accountability

Inclusive, Sustainable & Trustworthy
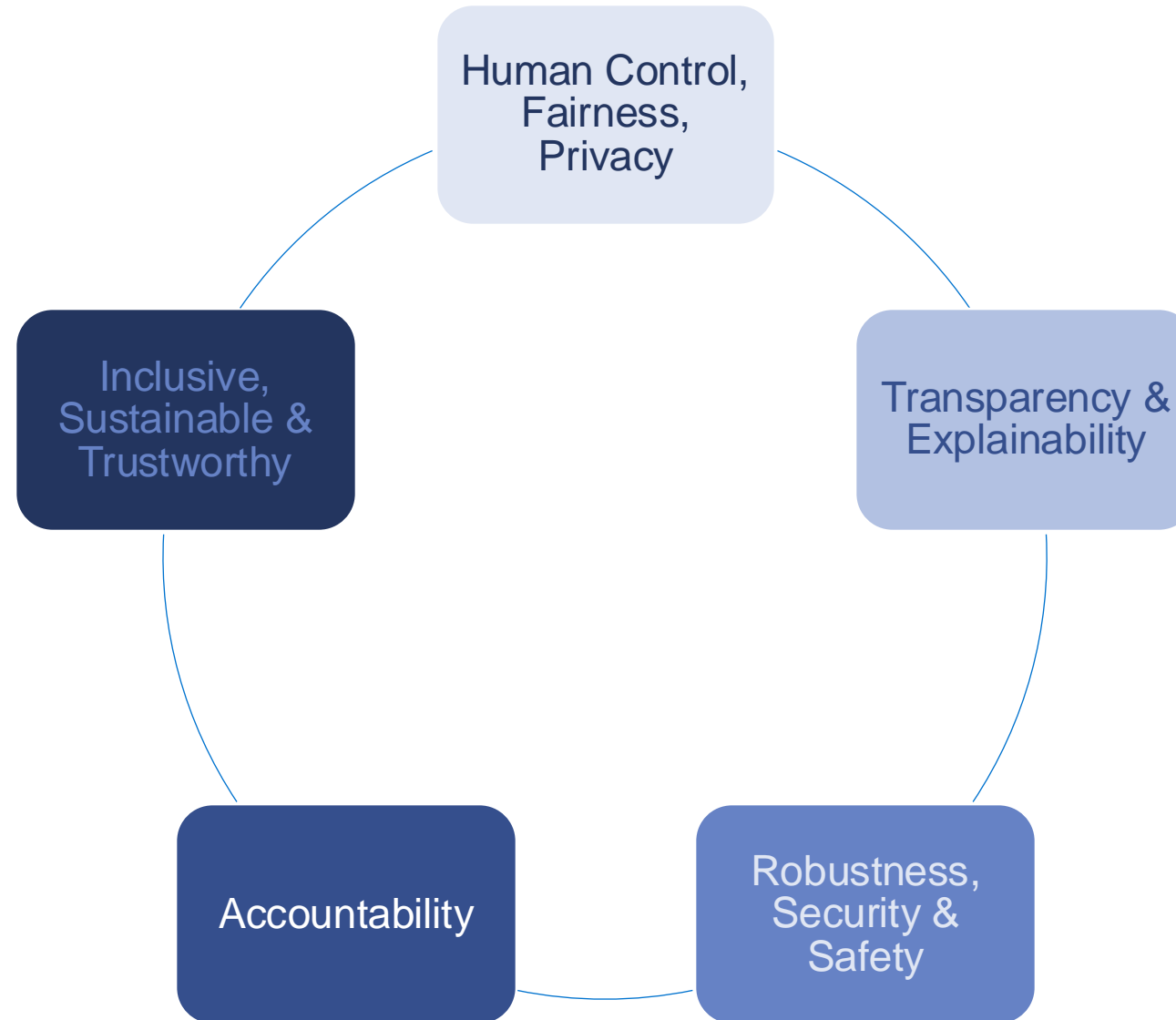
Thank You!

Potential Bribery & Corruption at Piper Corp.

An Internal Investigations Primer

DLA PIPER

Introductions: Who We Are

Lisa LeCointe-Cephas, Partner

DLA Piper

Naana Frimpong, Partner

DLA Piper

Melanie Babb Wilmoth,

Director, US Ethics & Investigations

Merck

Agenda

- Why are investigations important?

- Key questions for the investigator(s).

- **TIPS**: A roadmap for conducting investigations explored through a case study:
  - **T**riage
  - **I**nvestigate
  - **P**resent
  - **S**trengthen

Why are Investigations Important?

1. Fundamental part of an Effective Compliance Program
    - DOJ Guidelines
    - Address internal issues before they go 'external' – whistleblower

2. Healthy investigations process = healthy culture of compliance

3. Builds Trust & Confidence
    - Internal - colleagues, management, leadership, Board
    - External – regulators, law enforcement, business partners, customers, public

4. Findings inform efforts to strengthen/ evergreen the compliance program
    - Investigative findings are powerful measures of the effectiveness of program
        - Trends inform gaps, updates, help with evolution of program.
        - Speak up culture, self-reports, proactive, collaborative.
        - Awareness and ability to operate within policies

TIPS: Your Investigation Roadmap

Do you have an SOP for complaint handling?

- **T**riage:
  - Assess and Categorize the complaint.
  - Decide whether to proceed to full-scale investigation.
  - Appoint an investigator or investigative team

- **I**nvestigate:
  - Put together a plan of action based on the SOP.
  - Gather documents and information
  - Conduct interviews.

- **P**resent:
  - Analyze findings – data.
  - Present your findings to internal stakeholders.
  - Consider self-reporting and disclosure obligations to external stakeholders.

- **S**trengthen your compliance program.
  - Determine discipline and corrective action.
  - Assess need / opportunities for systemic change(s) to policies, controls, etc.
  - Finalize and retain the files.

STANDARD OPERATING PROCEDURES (SOP) TEMPLATE

SOP TOPICAL OUTLINE *(Sample Only)*

(ACTIVITY NAME AND ADDRESS)

APPROVED: _____ (PSO) _____ (YYMMDD)

Jul 13, 2011 5:05 PM

Jul 13, 2011 6:06 PM

Jul 13, 2011 6:20 PM

Ms. Constance Duct, Investigations Sr. Dir. at Piper Corp., receives a text from Ann O. Ying, in Finance:

"Hey Con, I'm just wrapping up an investigation by my team and wanted to let you know that certain employees who work in sales at one of our subsidiaries have been paying bribes to foreign officials in exchange for government permits. I'm going to send my memo to management. Thanks!"

Con takes a deep breath and calls Ann. Ann tells her:

- "This may cut across subsidiaries. We have reviewed emails from several employees."

- "Things appear to be a mess and highly irregular and likely illegal. I prepared a full memo detailing the issues."

Con is silent. Ann continues….

- "The email that I received detailing the bribes was really helpful. Oh, and the person mentioned something about calling the cops."

Before Con can ask, Ann continues…

- "I don't know who sent the email, but I think it was a finance employee in Prague. She's been complaining a lot and we recently put her on a performance improvement plan."

Polling Question

What should Con do next?

1. Call management to let them know what happened.

2. Ask Ann to forward her the complaint email, memo and anything else she has.

3. Tell Ann to stand-down.

4. Hang up and quit.

TIPS - Triage

- **ANSWER**: Ask Ann to forward her the complaint email, memo and anything else she has.

The first step is to triage the complaint. This consists of:

- Assessing if the complaint needs a formal investigation.
  - What type of issue(s) are you dealing with?
  - What are the basic facts? Are the facts too vague?
  - Is an investigation needed? Has one commenced already? Resolved already?
  - Do you need immediate measures – Physical, or IT security to preserve data or safeguard witnesses?
- Asking follow up questions or closing the investigation as needed.
  - Some communication – even acknowledgement that the complainant has been heard.
- Taking a detailed record of the intake.
- Deciding who should lead and staff the investigation.

And so it begins...

Con receives a call from Salt and Pepa, attorneys at the SEC and the DOJ respectively.

Salt and Pepa tell Con that an unidentified source revealed that some sales employees at Piper Corp's subsidiary may have been paying bribes to foreign officials in exchange for government permits.

Con tells them that she intends to begin an internal investigation immediately.

Pepa asks her to interview the sales employees in question first and says they will send her a list of questions to pose to the witnesses. Salt and Pepa state that they would like to receive periodic updates on the investigation.

Polling Question

Con says…

1. I can also send you a summary of the investigation that was already conducted.
2. I want you to "push it back", Salt and Pepa. We refuse to cooperate.
3. I'll have my outside counsel call you back.
4. Can I do a voluntary disclosure?

TIPS - Triage

ANSWER: I'll have my outside counsel call you back.

Who should lead or manage the investigation?

- Advisable to have one or two internal leads to oversee the investigation of the complaint from intake through resolution

- Reps from other departments can be added to a cross functional team– Legal, HR, Accounting – chaired by the lead who should ideally be from Compliance , Ethics and/or Legal

- Add other functions as needed – Security, IT, Privacy

- Meet consistently = timeliness = importance

- Transparency = trust

- Consider appointing Outside Counsel

TIPS - Triage

Assemble the Team - Role of Investigators

- **Primary investigator – (and possibly Secondary Investigator(s))**.
  - All properly trained.
  - Pedal together but only one direction.
  - Redundancy / note taker / set of eyes & ears.
  - Example: Compliance (PI), HR, Outside Counsel.

- **Internal investigators are impartial/neutral fact-finders –**
  <u>not</u> advocates, <u>not</u> judges/decision-makers, <u>not</u> prosecutors.
  - Gather and analyze the relevant information
  - Assess credibility – if asked for perceived veracity

- Investigators must be effective but also:
  - Moral/ Ethical; Polite; Professional; Legal; Efficient/Not Unduly Disruptive; Consistent; Impartial; Culturally sensitive.

TIPS - Triage

When do you need outside counsel?

Attorney-Client Privilege

A working understanding and consistent approach is key.

"I figure this attorney client privilege goes both ways, so if there's anything you'd like to get off your chest..."

Where purpose of investigation is to obtain or provide legal advice, and the Company wishes to maintain the Attorney-Client Privilege, investigation should be conducted by, or at the direction of, an attorney.

(If attorneys are conducting investigative interviews, they will also need to provide Upjohn warnings to establish/preserve the Attorney-Client Privilege.)

Escalation

Con decides it is time to tell her Management and the Board. When she tells her CEO, the CEO demands to know who the complainant is.

Ann is present, along with IT, and they share that based on email monitoring, the complainant is probably Sue Compagnie in Prague. Sue has been moving information off company servers.

Polling Question

What action, if any, should Con take with respect to Sue?

1. Shut off Sue's systems access.
2. Call Sue and ask her to share everything she knows.
3. Terminate Sue.
4. Take no action which would be obvious to Sue.

TIPS - Investigate

ANSWER: None of the Above

Complainant/ Whistleblower/ Subject engagement is key to the integrity of any investigation.

- Revealing a complainant or whistleblower's identity without their consent may a) dissuade the complainant from providing additional information; b) Be illegal

- It is difficult to communicate with a complainant whose identity is unknown. Whistleblowing hotlines and communication channels can facilitate communication and collection of information.

- Although Sue is a whistleblower, she is also moving information off company servers, which is likely a breach of company policy and law. The nature of your engagement with a whistleblower is important. Notwithstanding the ongoing breach of company policy, you should engage in a manner that makes the whistleblower feel safe and encourages the whistleblower to share information.

But so is data preservation…

- Risk of loss of data necessary for investigation.

- Risk of disclosure of sensitive, confidential and proprietary business records.

Sue is based in Prague and the company has to comply with Works Council, GDPR and other data privacy laws when processing her personal data.

Solution: Legal Hold Notices and/or Back-end Legal Holds, Data Loss Prevention Tools

TIPS - Investigate

Developing an Initial Investigative Work Plan

The primary investigator (usually after having conferred with the secondary investigator and, company / outside counsel) will develop an initial investigative Work Plan. The Work Plan should address:

- **Staffing** – Who has primary responsibility for the investigation? Who are the other key members.

- **Scope**
  - Determine the specific allegations to be investigated
  - Determine what facts need to be established or disproven.
  - Identify and review applicable laws, regulations or policies.

- **Evidence**
  - Identify relevant documentary and other forms of physical evidence to be obtained from the Company and third-parties.
  - Identify custodian/location of such evidence.
  - Do you need any assistance from I.T, HR, others in gathering the evidence?

- **Investigative Steps/ Tasks**
  - Determine the methods of investigation to be employed. E.g., Audit/Review of Company Records; Research of Public Records; and Interviews.
  - Decide the order of these steps.

TIPS - Investigate

Start the investigation – planning and execution

There are three typical methods of investigation in the internal workplace

1. Audit/Review of Company Records – including in this case emails.
2. Interviews.
3. Forensic Analysis/AI.

   These three are by far the most frequently used in connection with workplace internal investigations

   Others include: Research of Public Records, Surveillance (Physical and Electronic), Undercover

Interviews Commence

Con lines up interviews with Ann and Sue and the sales colleagues allegedly involved. Con is wondering if she needs to fly to Prague to conduct the interviews herself…

She considers the need to provide *Upjohn* warnings to the employees. She is concerned that the warnings may scare people off. She settles on the following *Upjohn* language to be delivered orally at the start of each interview:

"I need to say this to everyone. This is a confidential discussion that you should not share with anyone else. This is covered by privilege—and everything you told Ann is privileged. All the company's lawyers share an interest with you to make sure we get all the necessary facts in this confidential setting. Basically, we need to prove – if it ever comes to it – that we did not break any laws.

If you tell me what I need to know, this will be quick and painless. Let's get started."

Polling Question

Con's *Upjohn* was…

1. Perfect! Finally, she gets something right.
2. Unnecessary.
3. Ok, but could be better.
4. Not a real *Upjohn*.

TIPS - Investigate

ANSWER: Not a real UpJohn!

An UpJohn warning should address the following points:

1. You are Piper Co's attorney. You are not the employee's attorney.

2. The interview is part of an internal investigation. The purpose is to gather facts to advise the company.

3. The interview and communications with the interviewee are covered by attorney-client privilege. That privilege belongs to the Company, it does not belong to the interviewee.

4. The Company may choose to waive the privilege by revealing the discussion to third parties, including government agencies. Because the privilege belongs to the Company it can do so without notifying the employee.

5. To preserve attorney-client privilege, the employee must keep the conversation confidential. The employee should not reveal the contents of the interview with anyone other than his/her own attorney (if one has been retained). If anyone asks about the interview, the employee can direct them to the primary investigator.

6. Ask if the employee understands or has any questions.

The employee panics, stops the interview and retains an attorney.

TIPS - Investigate

How you deliver an UpJohn is almost as important as **what** you say:

- Deliver the UpJohn in a calm, measured tone.
- Point out that it is a notice you are required to give by law and is not an indicator of suspicion or guilt or otherwise.
- Clarify that you administer the UpJohn to everyone you speak to.
- Allow the interviewee to ask questions.

General interview etiquette:

- Be polite and professional.
- Probe, but remember the interview is not a cross-examination.
- Remember the interviewee may remain an employee after the investigation.

Communications During the Investigation

Con finally asks to see Ann's memo. When she sees it, Ms. Con Duct retains outside counsel.

The memo summarizes the results of a two day "investigation" and contains a factual analysis that appears to show a concerted effort by the three sales employees to pay bribes to members of various governments. Con marks the memo as privileged and emails it to Piper's outside counsel for review.

Counsel for the three sales employees, Mr. Pool, asks for a copy of the memo.

Polling Question

Con should:

1. Give Pool the memo.
2. Tell Pool that she already represents the sales team.
3. Send the memo to Salt and Pepa.
4. Direct Pool to Piper's outside counsel.

TIPS - Investigate

ANSWER: Direct Pool to Piper's Outside Counsel

Key considerations:

- (If the documents are privileged) Attorney-Client Privilege may be waived if the documents are shared with Pool.

- Can Pool obtain the documents by court order if you refuse to share them with him?

- Where employees are not implicated in the wrongdoing consider entering into a Joint Defense Agreement.
  - Joint Defense Privilege would apply and may be an exception to a privilege waiver when sharing documents with a third party.

The Plot Thickens

Sue calls Con and tells her that she has been raising concerns around potential bribes for a while and Sue feels she was put on a performance improvement plan because of it.

She also shares that Ann has made derogatory statements about different ethic groups in the finance organization.

How should Con handle these concerns?

Polling Question

Con should:

1. Put Sue or Ann on garden leave.

2. Inform outside counsel and let them investigate.

3. Consider whether some of these allegations can be handled in an internal investigation.

4. Pinch herself to make sure she isn't sleeping and having a terrible nightmare.

T<u>I</u>PS - Investigate

ANSWER: Inform outside counsel and let them investigate

Whistleblower/ Complainant protection is key to the integrity of any investigation.

- The Sarbanes-Oxley Act (SOX) protects employees of public companies and non-public companies with publicly-traded shares against retaliation for disclosing information they reasonably believe indicates a violation of federal securities law, SEC rules or any federal laws related to defrauding shareholders.

- The Dodd Frank Act, False Claims Act, other U.S federal laws, and the EU Whistleblower Directive, also protect against retaliation.

- Placing a complainant or whistleblower on a performance improvement plan because of their complaint would be considered retaliation.

Independence and impartiality of the investigator is also key

- The integrity of the investigation would be compromised if Ann is viewed as biased against Sue.

NB: Complainants may make allegations to cover up their own wrongdoing

Communications with the Government Regarding Factual Information/Conclusions

Months have passed. Outside counsel has taken control, and it is time to meet with the SEC and DOJ. Salt and Pepa ask Piper to be as detailed as possible, identify key documents and provide a complete download of significant witness interviews. Salt also asks Piper to produce emails sent or received by the witnesses who have been interviewed. Piper provides the government with copies of its "Hot Documents" binder and presents oral downloads of witness interviews using a detailed outline.
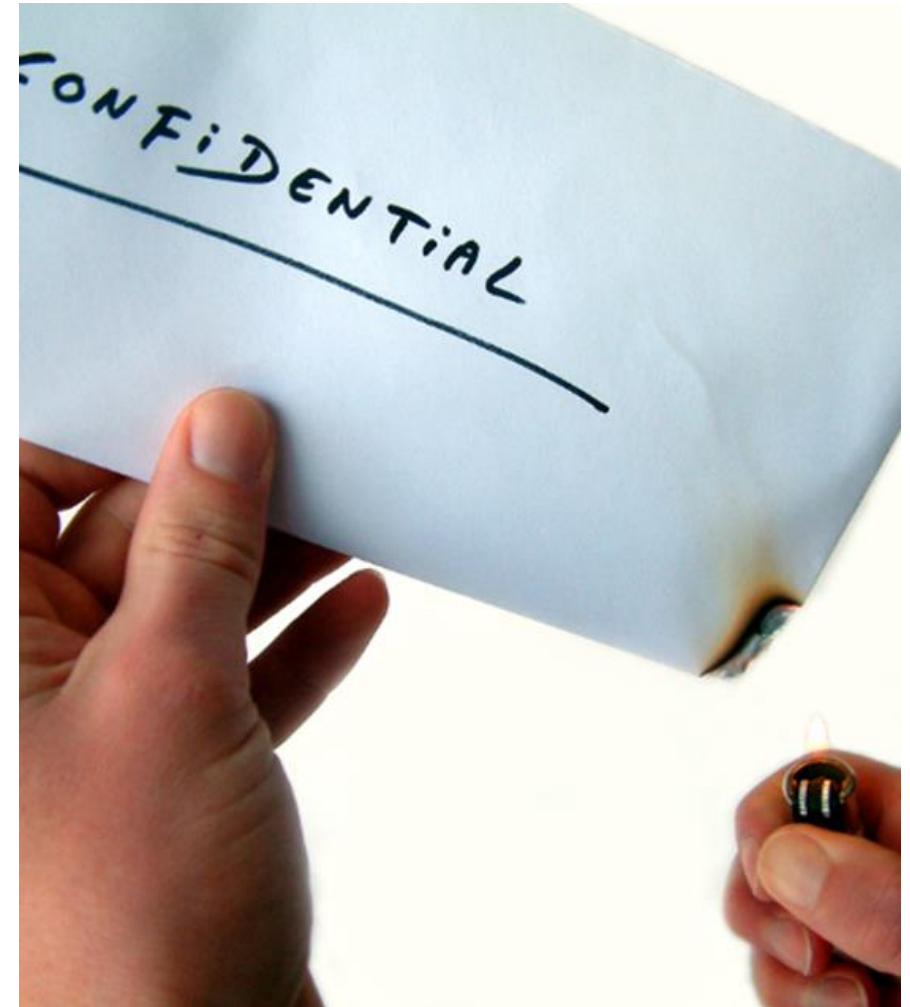
TIPS – Present your findings

Preparing an Investigative Report

Suggested contents for an investigative report include:

- Executive Summary

- Background
  - The Complaint
  - Investigative Steps Taken (e.g., documents reviewed, individuals interviewed, etc.)

- Summaries of Interviews

- Investigative Findings – detailed for each matter.

- Conclusions and outcomes (to be added after meeting with senior management).

- Do Not include recommendations as to disciplinary or remedial action.

TIPS – Present your findings

Preparing an Investigative Report (cont'd)

- Assemble the materials, facts, present impartially

- Findings of the investigation

- Executive summary

- The length and detail of the investigative report will depend, in part, upon the complexity of the investigation.

- Do <u>not</u> include recommendations in the report.
  - When the government is involved, consider whether to prepare written complete report or a presentation with high-level points.
  - Available for discussion by investigative team and senior management.

TIPS – Present your findings

Presenting to the government

- Focus on key facts and findings.

- Outline investigative steps taken to show thoroughness of review.

- Highlight efforts made to communicate and cooperate with the government.

- DO NOT:
  - Present or provide all "Hot Documents" at the same time – will draw attention to most damaging documents.
  - Provide data without a thorough review, including a privilege review.
  - Provide detailed oral downloads of witness interviews – could endanger privilege unless Company has decided to waive privilege.
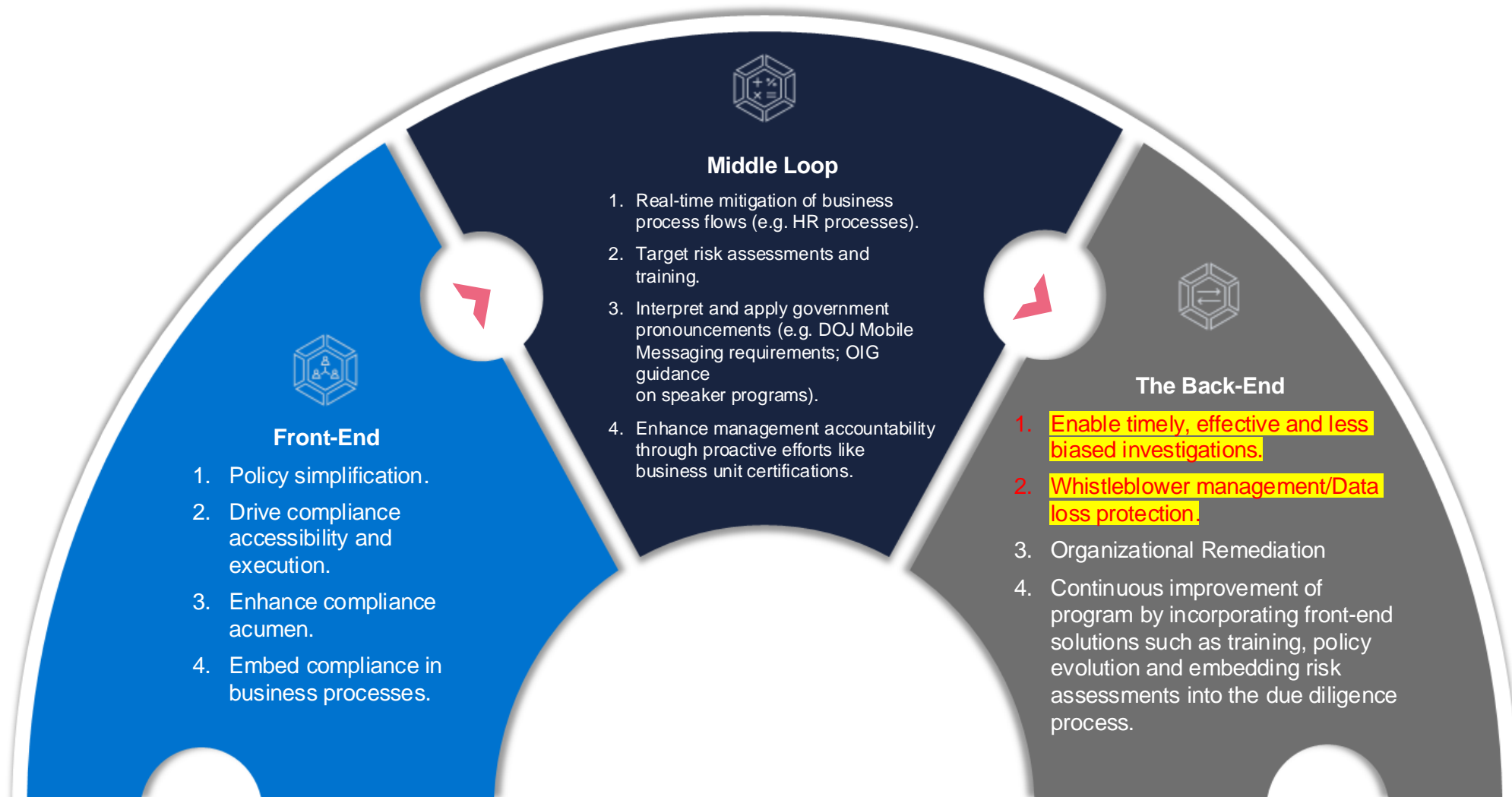
TIP<u>S</u> - Strengthen

Don't stop the investigation with the person

- Most investigations – resolve at individual level
  - Look at environment, circumstances, opportunity
  - Gaps in training or controls?
- Share findings – confidentially
  - Compliance Committee
  - Audit Committee
  - Leadership Team
  - Employees
  - Use deidentified examples to reinforce behavior
  - Use trends and findings to show progress
- Record of good governance and adherence for external parties

Investigations are a Critical Component of the Compliance Feedback-Loop

Middle Loop

1. Real-time mitigation of business process flows (e.g. HR processes).
2. Target risk assessments and training.
3. Interpret and apply government pronouncements (e.g. DOJ Mobile Messaging requirements; OIG guidance on speaker programs).
4. Enhance management accountability through proactive efforts like business unit certifications.

Front-End

1. Policy simplification.
2. Drive compliance accessibility and execution.
3. Enhance compliance acumen.
4. Embed compliance in business processes.

The Back-End

1. Enable timely, effective and less biased investigations.
2. Whistleblower management/Data loss protection.
3. Organizational Remediation
4. Continuous improvement of program by incorporating front-end solutions such as training, policy evolution and embedding risk assessments into the due diligence process.

QUESTIONS/ CLOSING REMARKS

Hot Topics for Boards of Directors 2024:

What We Expected Versus Where We Are

Overview: Perspectives from 2024 So Far

Top 5 Identified Priority Areas:

- Economic Conditions

- Capital Allocation

- Cybersecurity and data privacy

- Innovation and evolving technologies

- Talent agenda

Overview: Perspectives from 2024 So Far

Other Identified Priority Areas:

- Regulatory developments
- Political risk
- Supply chain matters
- Climate change and environmental stewardship

Economic Conditions:

The challenges and where Boards are providing guidance:

- Economic Conditions:
  - Cooling but persistent inflation
  - Interest rates
  - Labor market cooling
  - Consumer spending

  - What we're seeing from Boards:
    - Embrace agility and oversee flexible strategic planning
    - Require timely updates on macroeconomic developments
    - Help management focus on both the short and long term

Capital Allocation:

The challenges and where Boards are providing guidance

- Capital Allocation:
  - Financial discipline
  - Focus on long-term priorities

  - What we're seeing from Boards:
    - Encourage accelerated investment
    - Enable management to maximize profitability and position for business model transformation
    - Promote enhanced communication with investors

Cybersecurity and data privacy:

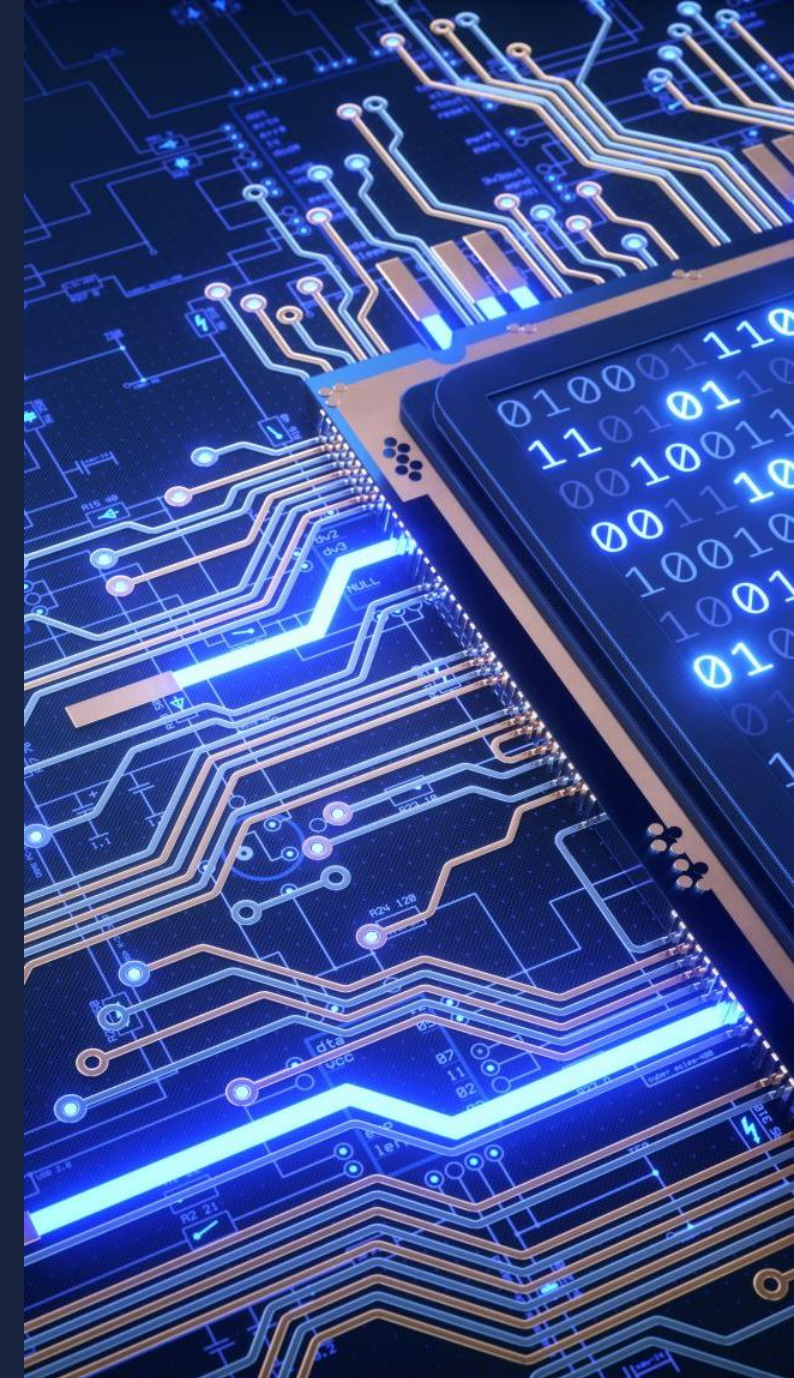**The challenges and where Boards are providing guidance**

- Cybersecurity and data privacy:
  - Macro developments reinvigorate the focus on privacy and cyber
    - New SEC rules
    - Changing geopolitical threats
    - Rapid growth in AI and machine learning
  - Confronting a more complex cyber landscape

  - What we're seeing from Boards:
    - Consider whether cybersecurity oversight is structured appropriately
    - Participate in complex cyber threat tabletop exercises
    - Maintain a wide variety of voices in the boardroom

Innovation and evolving technologies:

The challenges and where Boards are providing guidance

- Increased oversight of innovation and emerging technology
  - GenAI
  - Quick Action
  - Moving Responsibly
- Operational and ethical risks

  - What we're seeing from Boards:
    - Press management to be accountable for responsible AI
    - Ensure diverse perspectives and experiences in the boardroom
    - Look to external trends and capabilities
    - Agile decision-making process
    - Innovate the board room

Talent Agenda:

The challenges and where Boards are providing guidance

- Employee power perception

- Divergent perspectives between employers and employees

- People-centric approach

  - What we're seeing from Boards:
    - Listen directly to employees
    - People-first strategy
    - Enhance communications around board's oversight of employees
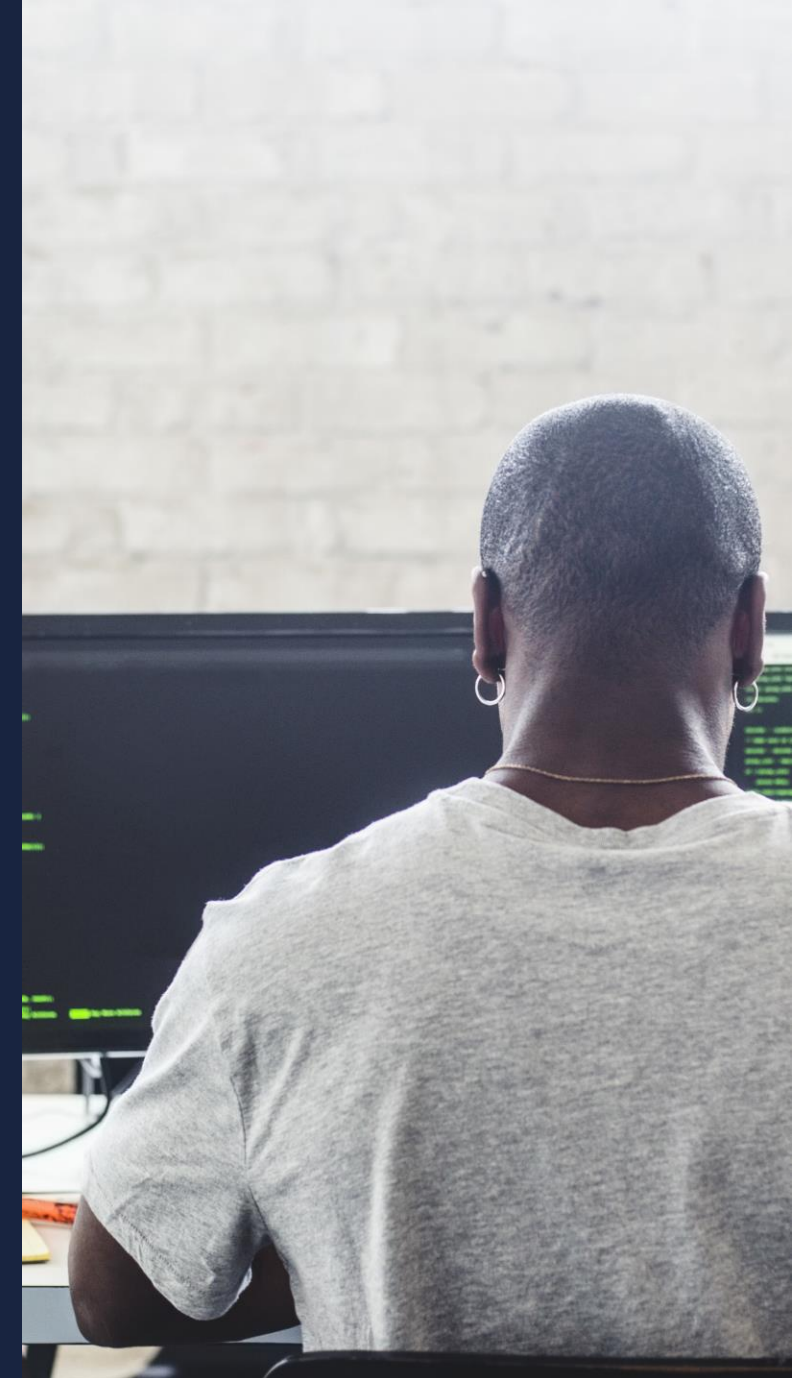
Other Areas:

The challenges and where Boards are providing guidance

- Regulatory developments

- Political risk

- Supply chain matters

- Climate change and environmental stewardship

Recent Headlines

CEOs Are Deprioritizing Sustainability as it Becomes More Important to Consumers, Corporate Buyers: Bain Survey

Mark Segal | September 10, 2024

Sustainability is falling behind other pressing issues on the prioritization list of CEOs globally, at the same time that consumers become increasingly focused on climate change and personal impact, and as corporate buyers are shifting their buying preferences to more sustainable products and suppliers, according to a new report released by global management consultancy Bain & Company.

For the report, Bain conducted surveys of more than 500 B2B buyers and sellers across a range of industries, and nearly 19,000 consumers across 10 countries.

Regulatory Developments

Align ESG regulations compliance with their geographical footprint.

Companies need to consider the intersectionality of

1) Global Regulations: EU – Corporate Sustainability Reporting Directive (CSRD), Corporate Sustainability Due Diligence Directive (CSDDD), EU Taxonomy, and EU Deforestation Regulation.

2) **US Federal Regulations:** SEC Climate Disclosure Rules (currently voluntary stayed)

3) **US State Regulations:**

- Californian climate Disclosure Bills :
  - US Businesses + ≥ $1 Billion (SB-253) or $ 500 million SB-261) + Doing business in CA
  - Scope 1-3 emissions (SB-253) and Climate-related financial risk report (SB-261)
- Pending New York and Illinois Climate Disclosure Bills requiring Scope 1-3 emissions.

Global Mandatory Sustainability Disclosure Laws August 2024
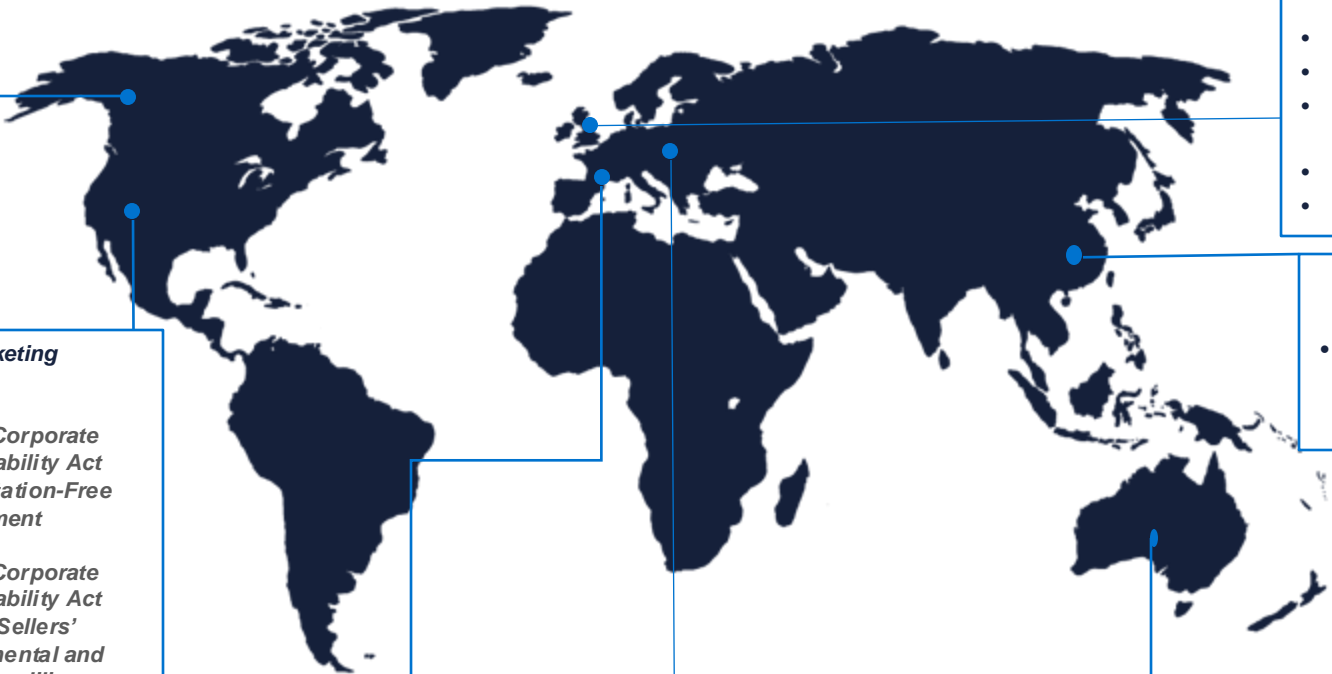
Canada
- *Canadian Securities Administrators (CSA) proposed National Instrument 51-107 Disclosure of Climate-related Matters*
- **The Fighting Against Forced Labor and Child Labor in Supply Chains Act**

UK
- **UK Corporate Governance Code**
- **Companies Act of 2006**
- **Climate-related Financial Disclosure Regulations 2022**
- **UK Sustainability Disclosure Standards**
- **Modern Slavery Act 2015**

China
- **Stock Exchange Mandatory Sustainability Reporting Laws**

US

Federal:
- *The Enhancement and Standardization of Climate-Related Disclosures for Investors, US SEC (voluntarily stayed)*
- **Uyghur Forced Labor Prevention Act (UFLPA)**
- *Proposed FAR Climate Disclosure Rule for Federal Contractors*
- *TASK Act*
- *Cosmetic Supply Chain Transparency Act of 2023*
- *COBALT Supply Chain Act*
- *Stop China's Exploitation of Congolese Children and Adult Forced Labor through Cobalt Mining Act*
- *EV Fair Trade Act of 2024*

State:
- **California Climate Disclosure Rules:**
  - **SB 253 (GHG Emissions)**
  - **SB 261 (Climate Related Financial Risk)**
  - **AB 1305 (Carbon Offsets/Marketing Claims)**
- *Illinois*
  - *Climate Corporate Accountability Act*
  - *Deforestation-Free Procurement*
- *New York*
  - *Climate Corporate Accountability Act*
  - *Fashion Sellers' environmental and social due diligence and fashion remediation fund*
  - *Deforestation-Free Procurement*
- *Massachusetts*
  - *Fashion sustainability and social accountability*
- *Washington*
  - *Fashion companies' environmental due diligence*
  - *Supply chain transparency*
- *Tennessee*
  - *UFLPA procurement restrictions*

EU
- *EU Corporate Sustainability Reporting Directive (CSRD)*
- **EU Taxonomy**
- *EU Corporate Sustainability Due Diligence Directive (CSDDD)*
- **EU Deforestation Regulation**

EU Countries
- **France Duty of Vigilance Act**
- **Germany Act on Corporate Due Diligence Obligations in Supply Chains**
- **Norway Transparency Act**
- **Swiss Due Diligence and Transparency in Relation to Minerals and Metals from Conflict-Affected Areas and Child Labor**

Voluntary Reporting Frameworks
- **The Global Reporting Initiative (GRI)**
- **The Sustainability Accounting Standards Board (SASB)**
- **The Task Force on Climate-related Financial Disclosures (TCFD)**
- **Carbon Disclosure Project**
- **Science Based Targets initiative (SBTi)**
- **UN Global Compact (UNGC)**

Australia
- *Disclosure of Climate Related Financial Information*
- **Australian Modern Slavery Act**

KEY

Passed
Proposed

Note: *Illustrative only to highlight major regulation globally*
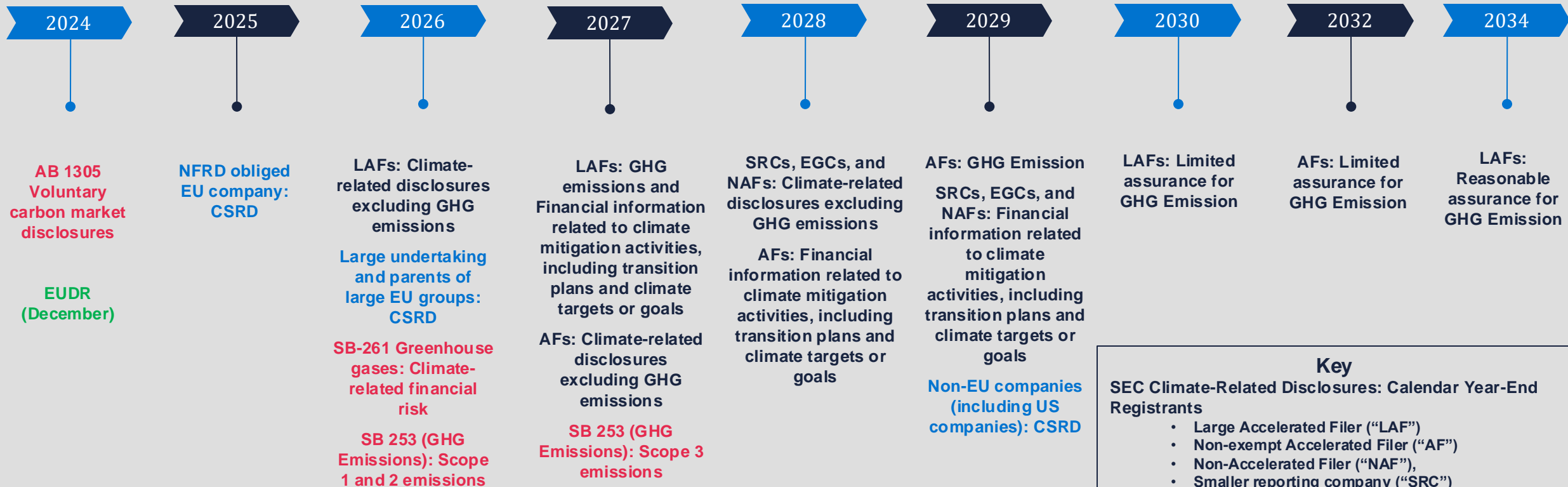
Regulatory Development

Stay informed with ongoing regulatory changes.

Rule	In Scope	Reporting requirement	Reporting Framework	Deadline	Penalties	Update
US: SEC proposed climate disclosure rule *(Voluntarily Stayed)*	Large accelerated filers (LAFs) Accelerated filers (AFs) Smaller reporting companies (SRC)* *SRCs have more limited disclosure requirements	Climate-related risks and mitigation plans Climate-related targets or goals Board and management oversight of climate-related risks LAFs and AFs - GHG emissions (*material* Scope 1 and/or 2) Losses and expenses resulting from climate change	TCFD (partially)* GHG Protocol Standards** *May allow IFRS S1 **May allow IFRS S2 and/or ISO 14064 and related standards	**Scope I and II** LAFs – FYB 2026 AFs - FYB 2028 **S-K and S-X disclosures** LAF – 2025 AFs – 2026 SRCs – 2027	SEC enforcement action (criminal or civil) Private litigation	• Voluntarily Stayed pending judicial review by the Eighth Circuit Court of Appeals.
SB-253 Climate Corporate Data Accountability Act	US Businesses + ≥ $1 Billion + Doing business in CA	Scope 1,2,3 emissions	GHG Protocol Standards* *May allow IFRS S2 and/or ISO 14064 and related standards	Scope 1 and 2 emissions– 2026 (2025 FY) Scope 3 emissions – 2027 (2026 FY).	Administrative penalties not exceeding five hundred thousand dollars ($500,000) in a reporting year.	• Trailer Bill introduced changing the compliance deadline to 2028 did not get adopted. • SB 219 gave CARB 6 more months to finish its rulemaking.
SB-261 Greenhouse gases: Climate-related financial risk	US Businesses + ≥ $ 500 million + Doing business in CA	Climate-related financial risk report	TCFD IFRS standards	January 1, 2026, and thereafter biennially.	Administrative penalties not exceeding fifty thousand dollars ($50,000) in a reporting year.	
AB-1305 Voluntary carbon Market disclosures	Business and other entities: marketing or selling voluntary carbon offsets (VCOs) in CA, purchasing or using VCOs in CA, and making emissions-related marketing claims in CA	**Marketing or selling Voluntary Carbon Offsets (VCOs):** Information re: carbon offset project + accountability measures **Purchasing or using VCOs:** Information about associated projects **Entities making emissions related marketing claims:** GHG emissions + accuracy of the claims	N/A	January 1, 2024 and updated no less than annually	Civil action and civil penalty not to exceed $2,500 per day for each violation, not to exceed $500,000 in a reporting year	• AB2331 introduced amending compliance date to January 1, 2025.

Global ESG Disclosure Calander date

Reporting Year:

| 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2032 | 2034 |

AB 1305 Voluntary carbon market disclosures

EUDR (December)

NFRD obliged EU company: CSRD

LAFs: Climate-related disclosures excluding GHG emissions

Large undertaking and parents of large EU groups: CSRD

SB-261 Greenhouse gases: Climate-related financial risk

SB 253 (GHG Emissions): Scope 1 and 2 emissions

LAFs: GHG emissions and Financial information related to climate mitigation activities, including transition plans and climate targets or goals

AFs: Climate-related disclosures excluding GHG emissions

SB 253 (GHG Emissions): Scope 3 emissions

SRCs, EGCs, and NAFs: Climate-related disclosures excluding GHG emissions

AFs: Financial information related to climate mitigation activities, including transition plans and climate targets or goals

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AFs: GHG Emission

SRCs, EGCs, and NAFs: Financial information related to climate mitigation activities, including transition plans and climate targets or goals

Non-EU companies (including US companies): CSRD

LAFs: Limited assurance for GHG Emission

AFs: Limited assurance for GHG Emission

LAFs: Reasonable assurance for GHG Emission

Key
SEC Climate-Related Disclosures: Calendar Year-End Registrants
- Large Accelerated Filer ("LAF")
- Non-exempt Accelerated Filer ("AF")
- Non-Accelerated Filer ("NAF"),
- Smaller reporting company ("SRC")
- Emerging growth company ("EGC")

Corporate Sustainability Reporting Directive (CSRD)
EU Deforestation Regulation (EUDR)
California climate related disclosure regulations

NB: Please note the SEC Climate Disclosure Rule has been voluntarily stayed.

# Political Risk

Anti–ESG movement

- **Anti-ESG movement in the US** – **there are three major themes:**
  - **regulations and other initiatives restricting the use of ESG factors in investment decision making** – over 40 state have taken some type of initiative targeting ESG investment.
  - **regulations targeting businesses boycotting certain industries** - at least 31 states have introduced a bill targeting entities that boycott certain industries. prominent states is Texas, who have a boycott company list.
  - engaged in sending **petition or investigative letters** targeting SEC climate rules, ESG conscious companies or other ESG related initiatives.

- **Loper bright enterprises v. Raimondo –** overturns the long-standing precedent of deference to agencies, shifting power to the courts when it comes to interpreting ambiguous statutes. This will likely impact EPA and SEC climate related initiatives.

- **US general elections implications –** depending on who wins 2024 election, the impact on ESG and climate initiative will vary greatly.

- **Other competing geo-political and economic interests detracting the focus from ESG.**
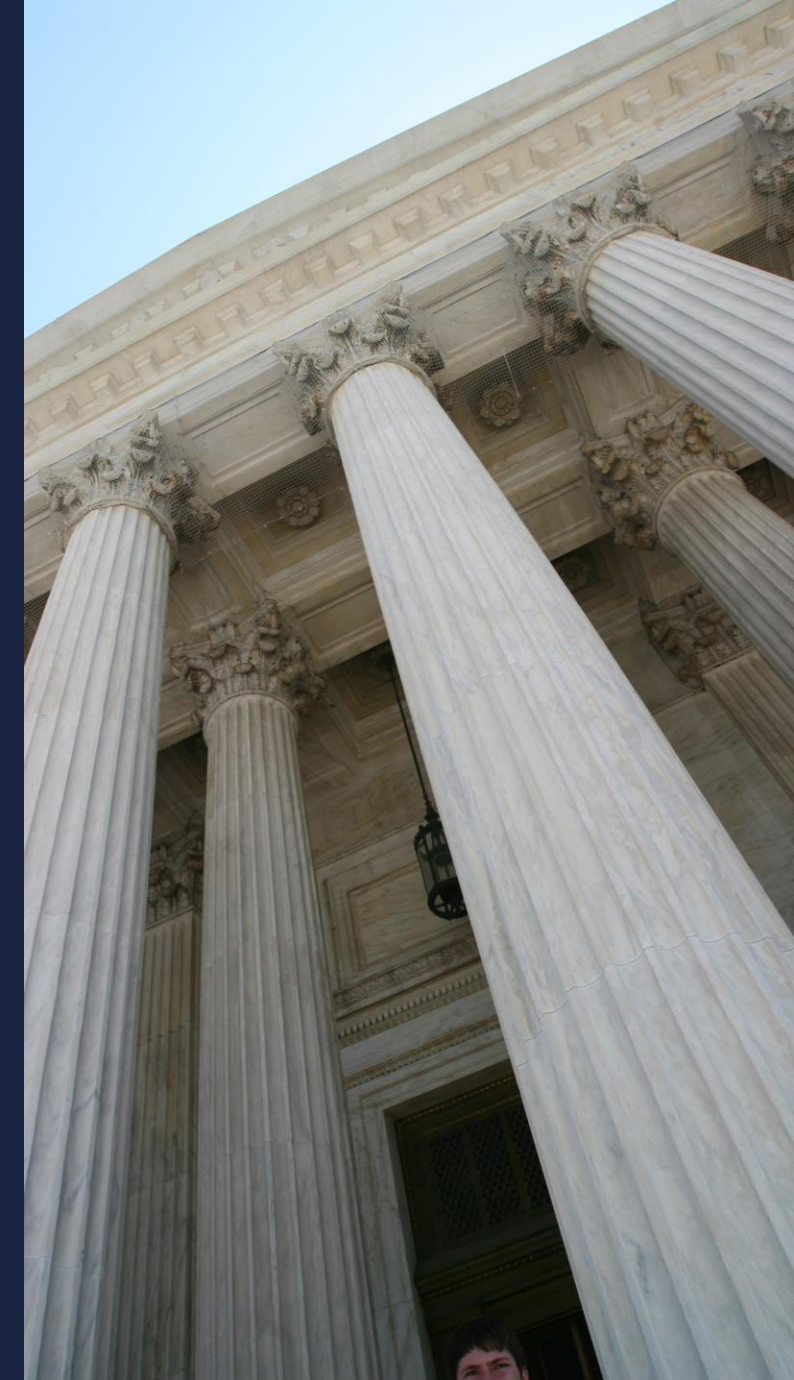
Supply Chain Matters

Align supply chain regulations compliance with their geographical footprint

1) **Global regulations: EU** – EU Forced Labor Ban and EU Deforestation Regulations (EUDR); UK and Australia Modern Slavery Act 2015; France Duty of Vigilance Act; Norwegian Transparency Act etc..

2) **US Federal regulations:** Uyghur Forced Labor Prevention Act (UFLPA), SEC Conflict Mineral rule, Pending COBALT Supply Chain Act.

3) **US State regulations:**

- <u>**California AB 3234 – awaiting signature by Governor**</u> require employers who have voluntarily undergone social compliance audits about the use of child labor in their business to post, on the company website, an online report detailing the latest audit's findings.

- <u>**Tennessee SB 2369**</u> - **pending** regulation prohibits public entities from entering into a contract with a company to acquire goods unless the contract includes a written certification that the company is not identified on the Uyghur Forced Labor Prevention Act (UFLPA) Entity List.
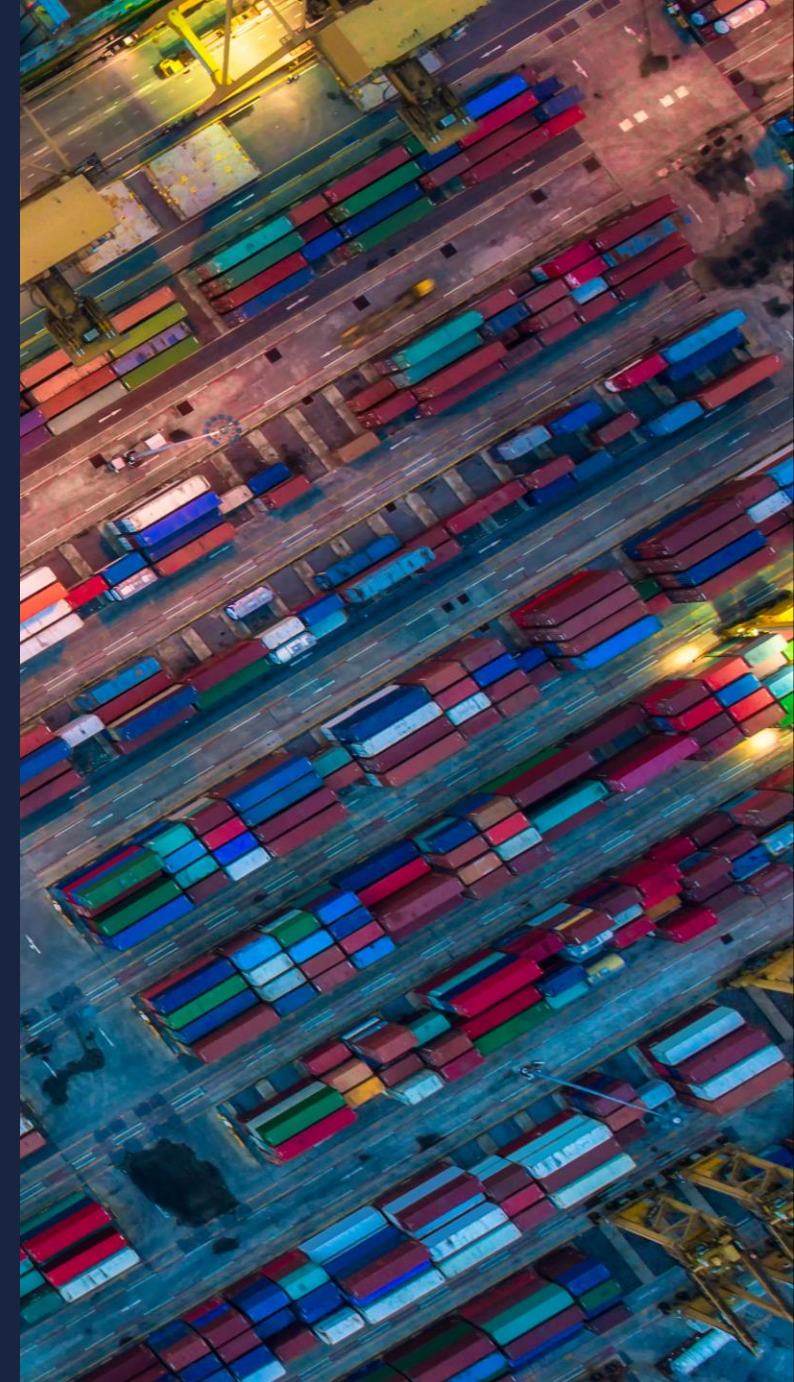
EU Deforestation Regulation (EUDR)

A special focus example

- Companies will be banned from importing or exporting the below listed products in the EU if they do not submit **a due diligence statement** demonstrating that the product is **deforestation-free** and **legally produced**

  - *cattle, cocoa, coffee, palm oil, soya, rubber, and wood; and*

  - *derivates of these products such as chocolate, furniture, leather, soybeans, beef, books, printed paper etc..*

- **Penalties:** may include fines of at least 4% EU turnover, confiscation of noncompliant products and associated revenues, temporary exclusion from public procurement and public funding, and in the event of serious or repeated infringements, prohibition from placing or making available on the market or exporting relevant commodities and relevant products, and prohibition from exercising simplified due diligence if applicable.
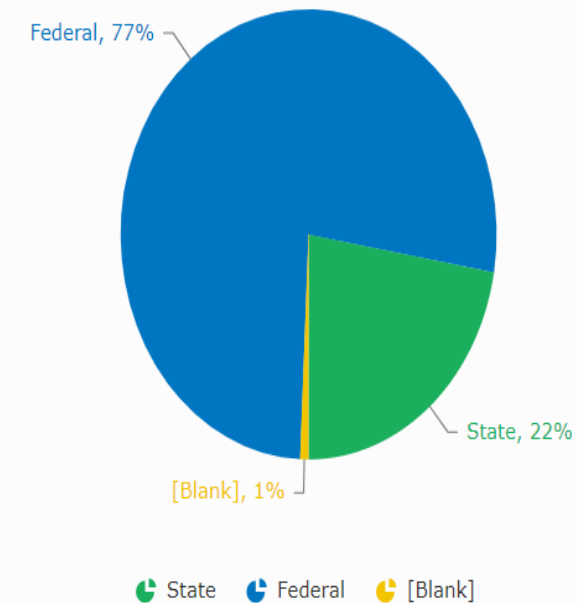
- **Deadline:** December 30, 2024

Climate Change and Environmental Stewardship

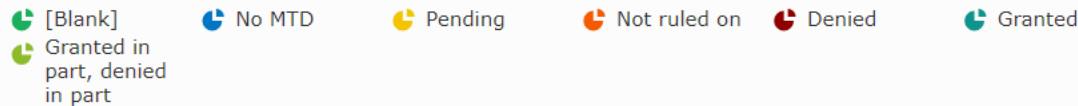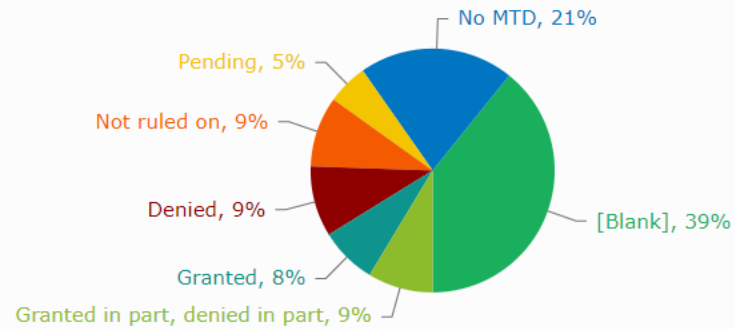Climate Change and Greenwashing Litigation – July 2024
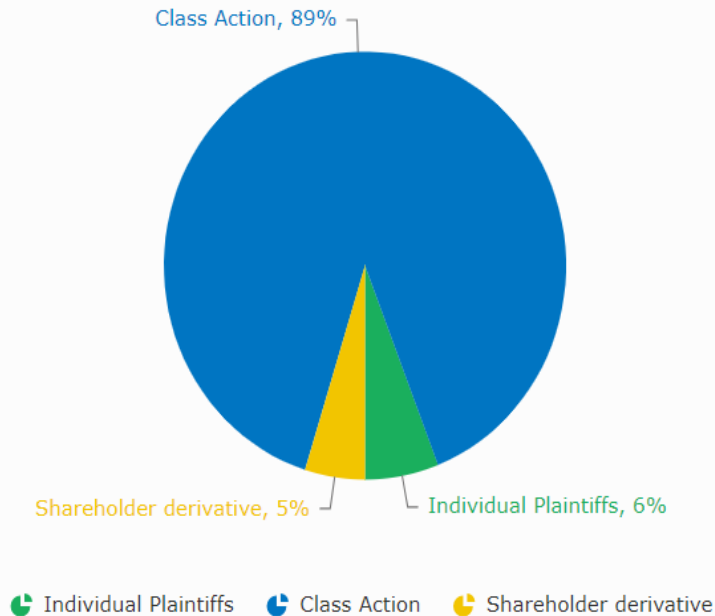
Disclaimer: These metrics and graphs, presented in draft <u>preliminary summary</u> form, are a <u>sample only</u> derived from a narrow focus on key terms associated with greenwashing and possess a limited scope.
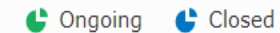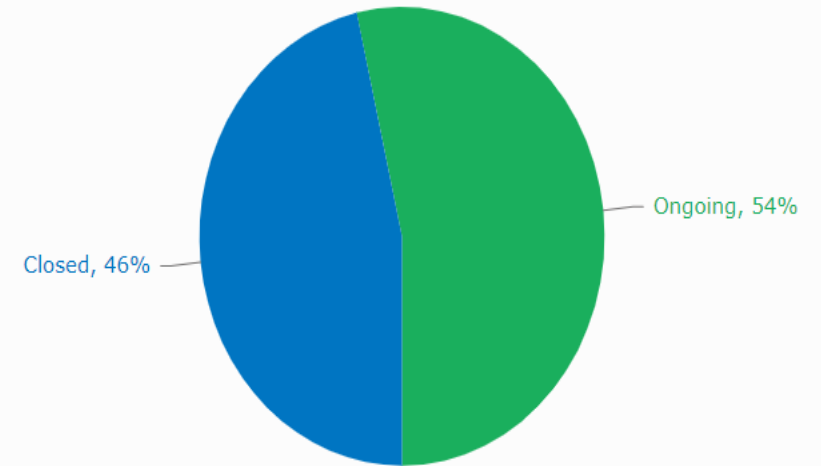
Climate Change and Environmental Stewardship

Climate Change and Greenwashing Litigation – July 2024

Motion to Dismiss Status

Case Status

Disclaimer: These metrics and graphs, presented in draft preliminary summary form, are a sample only derived from a narrow focus on key terms associated with greenwashing and possess a limited scope.

Overview: What We Thought 2024 Would Look Like

Questions?

Thank you