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Generative Artificial Intelligence Representations and Warranties Emerge in Venture Financing Transactions

Emerging growth companies and founders should take note that implementing policies regarding company use of generative artificial intelligence tools (GenAI tools) and being able to attest to certain GenAI tool-related representations and warranties may become the norm in venture financing transactions. A growing trend in the venture capital sector is that investors are interested in knowing whether investee companies have adequate GenAI tool-related policies and controls in place, including to (i) guard against the exposure of confidential information and trade secrets when a company uses GenAI tools, (ii) ensure that the use of GenAI tools aligns with the company's intellectual property strategy, and (iii) to "future-proof" the company with respect to anticipated GenAI tool-related legislation. This trend is best evidenced by recent changes to the model stock purchase agreement of the National Venture Capital Association (NVCA).[1] NVCA's Model Stock Purchase Agreement notably contains a recently added subsection on GenAI tool usage in the intellectual property representations and warranties section, requiring the investee company to represent and warrant that:

1. It uses GenAI tools in compliance with applicable license terms, consents, agreements and laws.
2. It does not include any sensitive personal information, trade secrets or confidential information as GenAI tool input data, except if the relevant GenAI tool does not use input data to further train its machine learning or algorithm or to improve the services of the GenAI tool provider.
3. It has not used GenAI tools to develop any company intellectual property that it intends to maintain as proprietary in a manner that it believes would materially affect the company's ownership or rights therein.[2]

To be in a position to attest to such representations and warranties, the investee company must first comply with the license terms for any GenAI tools its personnel use and stay abreast of GenAI-related regulatory and legislative developments. Second, the investee company must have controls in place to prohibit personnel from using proprietary or confidential information as GenAI tool input data unless it is certain the GenAI tool to be used does not further train itself on input data, which likely requires purchasing a paid version. Third, the investee company must consider the impact of using GenAI tools to assist in developing intellectual property, such as the risk that GenAI tool-generated content is not authored by a human and thus may not be copyrightable.[3] Such GenAI tool representations and warranties point toward an expectation of responsibility, accountability and transparency consistent with the direction in which legislative developments are headed. The new NVCA representations and warranties are likely to be required in venture capital transactions with increasing frequency, and you should expect to see similar representations in private equity and public company merger and acquisition transactions. To be prepared, companies should consider taking the following steps: (i) adopt a policy on the use of GenAI tools, (ii) maintain records of the use of GenAI tools, (iii) monitor the use of GenAI tools by personnel and permit access on company systems only to approved GenAI tools, and (iv) require representations and warranties from service providers that provide software development and maintenance services. Day Pitney's multidisciplinary AI practice group members are always available to provide guidance to clients that who are employing or incorporating GenAI tools in their products or services.

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[1] NVCA is a nonprofit association that publishes a set of publicly available model documents maintained by a national coalition of attorneys who specialize in venture capital financings; the model documents are intended to enhance the venture ecosystem by reducing transaction costs, establishing industry norms and avoiding bias toward the venture capitalist or the

company. *See* NVCA, *https://nvca.org/model-legal-documents/* (last visited April 8, 2024). [2] *See* NVCA Model Stock Purchase Agreement, § 2.8(l), available at https://nvca.org/recommends/nvca-stock-purchase-agreement-updated-april-2024/ (last visited April 8, 2024). [3] See, e.g., *Thaler v. Perlmutter*, 2023 WL 5333236 (D.D.C. Aug. 18, 2023) (holding artwork created by GenAI tools is not copyrightable as human authorship is a "bedrock requirement of copyright").

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