



# Putting the “Artificial” in “Artificial Intelligence”? Problems with “AI Washing” in Corporate Disclosure

Usman M. Sheikh (Chair, AI, Blockchain & FinTech Practice) (Toronto)

Jerome Tomas (Co-Chair, North American Government Enforcement Practice Group) (Chicago)

# Securities

## Securities “AI Washing” Cases

- Trend –
  - Uptick in SEC / DOJ enforcement relating to “AI washing” cases – prosecutions against companies that are making misleading (often inflated) claims to the public about their AI use and capabilities.
  - To date, 8 prosecutions (3 within the last 30 days or so) – most recent on November 12, 2024.
  - 2 of the SEC prosecutions were accompanied by parallel DOJ action; 1 standalone DOJ prosecution.
- SEC / DOJ Cases –
  - *Sewell and Rockwell Capital* – February 2, 2024 (SEC only)
  - *Delphia (USA) Inc.* – March 18, 2024 (SEC only)
  - *Global Predictions Inc.* – March 18, 2024 (SEC only)
  - *Ilit Raz* – June 11, 2024 (SEC and parallel US criminal prosecution)
  - *Roberts, Weiss and Coen* – September 16, 2024 (SEC and parallel US criminal prosecution)
  - *Rimar Capital USA, Liptz et al* – October 10, 2024 (SEC only)
  - *Destiny Robotics Corp. and Kavtaradze* – October 15, 2024 (SEC only)
  - *Kanen Flowers* – November 12, 2024 (US criminal prosecution only)

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- **Additional Enforcement Expected –**
  - **Ontario Securities Commission Press Release (May 15, 2024)** – “The [OSC Whistleblower] Program is seeking more tips containing non-public information, including from whistleblowers who may be involved in misconduct, and is also appealing for tips about novel and emerging issues in securities regulation. Issues of interest include greenwashing, misconduct by accounting firms related to their audits of reporting issuers, and misuse of both algorithms and artificial intelligence.”
  - **SEC Director, Division of Corporation Finance (June 24, 2024)** – Highlighted artificial intelligence as a disclosure priority. Noted that, in 2024, Division staff will consider how companies are describing AI opportunities and risks, including, to the extent material, whether or not the company:
    - **clearly defines what it means by artificial intelligence** and how the technology could improve the company’s results of operations, financial condition, and future prospects;
    - provides **tailored, rather than boilerplate, disclosures**, commensurate with its materiality to the company, about material risks and the impact the technology is reasonably likely to have on its business and financial results;
    - focuses on the company’s current or proposed use of artificial intelligence technology **rather than generic buzz not relating to its business**;
    - has **a reasonable basis for its claims** when discussing artificial intelligence prospects.

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## Securities “AI Washing” Cases

- **CSA Staff Notice 51-365 – [CD] Review Program Activities (November 7, 2024)**
  - Summarized key findings and outcomes of the CD Review Program for fiscal years ended March 2024 and March 2023. Regarding AI:
    - CSA Staff noted that they “have identified AI washing in CD disclosure and in prospectus filings”. Reminded issuers that they must not make false, misleading, exaggerated claims about their use of AI systems (must be factual and balanced, whether disclosure is required or voluntary).
    - Issuer should disclose how it defines AI in its offerings; will allow an investor to understand what the issuer means when referring to AI.
    - Issuers adopting new tech must consider whether disclosures regarding its use and the related evolving risks is necessary. E.g., if an issuer began using AI in its offerings, it should only disclose the use with a reasonable basis for doing so; otherwise considered overly promotional.
    - CSA Staff expect investors would generally consider the following information material:
      - the source / providers of the data for the AI systems; whether the AI system is developed by the issuer or supplied by a third party; impact that the use, development or dependency on the AI system is likely to have on the issuer’s business, results of operations and financial condition; any incidents where AI use has raised any regulatory, ethical or legal issues; and any other concerns that arose with the adoption of the AI systems.
      - Issuers should establish clear governance structures relating to AI use – e.g., related to accountability, risk management, and oversight.
  - Cautioned against overly promotional disclosure – e.g., the company uses “the most advanced AI technology”, its “warehouse [uses] the most sophisticated AI robotics”, the company “uses AI to solve world issues”. Highlighted the need for balanced disclosure.

# Securities

## Securities Class Actions

- Securities class actions involving AI are on the rise. According to Stanford's Securities Class Action Clearinghouse, there are **38** AI-related class action filings in total since 2020.
  - As of today's date, there were **13** AI securities class action filings in 2024.
  - Compared to **6** in 2023, **6** in 2022, **8** in 2021, and **5** in 2020.
- Underlying themes: involve allegations that the defendants overstated the capabilities of their AI technologies, failed to inform the market of risks or costs inherent in their use of AI, failed to issue prompt disclosures when their technologies did not perform as expected, or were not using or developing the AI models as previously represented.
- **Examples:**
  - *Xiao* – October 15, 2024
  - *GitLab* – Sept 4, 2024
  - *Oddity* – July 19, 2024
  - *Vicor* – July 11, 2024
  - *UiPath* – June 20, 2024

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## Shareholder Proposals

- Trend of increasing number of shareholder proposals urging companies to disclose more information on the risks associated with the deployment of AI and their efforts to mitigate the risks.
- According to FTI Consulting, there were **16 proposals** were filed between January to June 2024, compared to **7** in 2023 and **4** in 2022.
- **Targeted Industries** – Trend of expansion to other targeted industries:
  - **2023** – All 4 proposals filed at Big Tech companies.
  - **2024** – Proposals were targeted toward tech and entertainment companies (e.g., Microsoft, Apple, Amazon, Meta, Alphabet, Disney, Warner Brothers, Netflix), but healthcare and food services companies as well (e.g., United Health Group, Chipotle).
- **Proposal Requests** – Largely related to (i) transparency reports and (ii) improved oversight.
  - **Transparency Reports** – Reports on: (i) AI use and ethical guidelines; (ii) board oversight; (iii) social implications for the workforce, and (iv) report on human rights risks, etc.
  - **Improved Oversight** – Shareholders requested (i) amendments to Charter of Audit and Compliance Committee to clarify that it is responsible for the oversight of AI activities and (ii) creation of new Board committee dedicated to addressing AI issues.
- **Outcome** – Proposals have been met with growing support, but not majority backing. Some corporations unsuccessfully attempted to exclude the proposals from their AGM ballots by engaging the SEC. Others agreed to improve disclosures (leading to withdrawal of proposals).

# Securities

## Disclosure

### ■ AI-Related Disclosures Have Increased

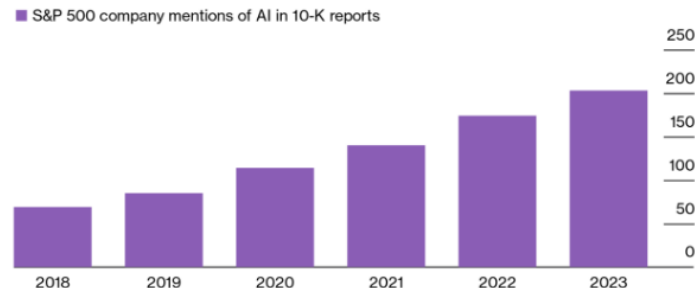
- According to Bloomberg, over 40% of S&P 500 companies mentioned AI in most recent 10-K reports (vs 35% in 2022; 28% in 2021).

### ■ Types of AI-Related Disclosures –

- Majority focused on AI risks, others focused on benefits
- **Risk Factors** – *Regulatory Risks* (evolving AI laws, regulations and standards creates increased compliance and legal risks); *Competition Risks* (delays in investing, adopting or integrating AI could erode market share); *Cybersecurity Risks* (exposed to novel cyber threats – e.g., prompt injection attacks), *Ethical Risks* (AI's implications for human rights / discrimination / bias, employment, privacy), *Third Party Risks* (risks of reliance on third-party vendors – disruption, reputation).
- **Governance** – AI risk oversight (Board or committee delegation); adoption of responsible AI frameworks, AI policies / codes of conduct / ethical guidelines; Board expertise.
- **Acquisitions** – Acquisition of AI technologies or platforms.

### Artificial Intelligence Disclosures on the Rise

The number of Form 10-Ks filed by S&P 500 companies mentioning artificial intelligence has increased every year since 2018.



Source: Bloomberg Law search of 10-K filings

Bloomberg Law

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