

THE AI PLAYBOOK: REGULATING AI IN MERGERS AND ACQUISITIONS

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I. INTRODUCTION

In 2012, Hewlett Packard's (HP) acquisition of Autonomy, a high stakes deal worth \$11.1 billion, promised to be a benchmark in strategic corporate acquisitions.¹ Yet, this seemingly astute business move soon unfolded into a financial nightmare.² Serious financial misrepresentations that slipped through the cracks of traditional due diligence methods resulted in a \$4 billion loss to HP.³ Now, imagine introducing Artificial Intelligence (AI) into this complex equation. While AI might promise unmatched efficiency in data analysis, its current inability to verify the accuracy of the information it processes could heighten such risks even further.⁴ If AI had been a player in the aforementioned scenario, identifying where the responsibility for these oversights lie could become an even more daunting challenge. This introduces a provocative question: In the evolving landscape of mergers and acquisitions (M&A), how do we harness AI's potential without falling prey to its limitations?

This Note delves into the emerging role of AI within the M&A landscape, spotlighting the efficiencies it brings, alongside the challenges and ethical considerations it poses. As law firms increasingly lean on AI to sift through vast data troves, the need for clear regulatory frameworks and ethical guidelines becomes apparent,⁵ ensuring that this technological leap forward does not outpace the legal profession's foundational principles of trust, transparency, and client protection.

Part II.A of this Note outlines the basic structure and types of M&A transactions, from mergers and acquisitions to asset and stock purchases, setting the stage for a deeper exploration of the due diligence process.⁶ It is here that AI's impact offering tools that automate data extraction, enhance financial analysis, and streamline legal document review.⁷

1. See *HP Claims \$4 Billion Losses in London Lawsuit Over Autonomy Deal*, YAHOO! FIN. (Feb. 12, 2024), <https://finance.yahoo.com/news/hp-claims-4-billion-losses-143107630.html> [<https://perma.cc/D2YE-Z5PA>].

2. *Id.*

3. *Id.*

4. See *How AI is Changing M&A Due Diligence*, DATARAILS (Sept. 13, 2023), <https://www.datarails.com/ai-changing-m-and-a-due-diligence/> [<https://perma.cc/53C9-BMRX>].

5. Nigel Wellings, *AI is Beginning to Transform M&A Due Diligence*, DATASITE (May 19, 2022), <https://www.datasite.com/en/resources/insights/ai-is-beginning-to-transform-m-a-due-diligence> [<https://perma.cc/6W2S-EAJ4>].

6. See *infra* Part II.A.

7. See *AI Due Diligence*, ANSARADA, <https://www.ansarada.com/due-diligence/ai> [<https://perma.cc/YRM7-HFYM>] (last visited April 6, 2024); Jessica Donohue, *A Comprehensive Guide to M&A Due Diligence with a 20-point Checklist*, DILIGENT (Dec. 23, 2022), <https://www.diligent.com/resources/blog/mergers-acquisitions-due-diligence->

Part II.B of this Note transitions into a focused discussion of AI itself, defining its role within the context of M&A transactions and highlighting its transformative benefits.⁸ However, this technological advancement is not without its pitfalls. This Note critically assesses the limitations and risks associated with AI, from data integrity and security concerns to the ethical quandary of replacing human judgment in legal processes.⁹

Part II.C scrutinizes the inherent risks and limitations of deploying AI in such high-stakes transactions.¹⁰ Through the lens of a notable case and several regulatory gaps, Part II.C paints a vivid picture of the potential for algorithmic errors, misrepresentations, and the unique challenge of attributing liability when AI tools fail.¹¹

Building on this foundation, Part II.D surveys the current regulatory landscape, drawing from international models such as the European Union's General Data Protection Regulation (GDPR)¹² and professional guidelines such as the Model Rules of Professional Conduct.¹³ The discussion culminates in an analysis of ABA Resolution 604, which, while a step in the right direction, highlights the advisory limitations of existing frameworks and the pressing need for enforceable regulations.¹⁴ As we navigate through this new terrain, the absence of comprehensive legislation governing AI's use in legal practice becomes a glaring gap, necessitating a closer examination of the inherent risks and ethical dilemmas.

This Note advocates for a nuanced approach to integrating AI in M&A due diligence—a journey that balances innovation with accountability, ensuring that the march towards efficiency does not eclipse the legal profession's ethical obligations to clients. As AI reshapes the M&A landscape, this Note calls for a harmonized stride forward, where

checklist# [<https://perma.cc/5FSP-J3YC>]; John F. Cohan & Zane Fernandez, *Artificial Intelligence and Its Impact on Corporate Mergers and Acquisitions*, GESMER UPDEGROVE, LLP (Jan. 29, 2024), <https://www.gesmer.com/intellectual-property/artificial-intelligence-and-its-impact-on-corporate-mergers-and-acquisitions/> [<https://perma.cc/YZQ6-9XZV>].

8. See *infra* Part II.B.

9. See *Modern Deal Series Part 5: The Evolution of Due Diligence*, ANSARADA (June 24, 2021), <https://www.ansarada.com/blog/modern-deals-5-due-diligence> [<https://perma.cc/V4QG-8Q67>].

10. See *infra* Part II.C.

11. *Id.*

12. *What the GDPR Shows Us About the Future of AI Regulation*, VISIER, <https://www.visier.com/blog/what-the-gdpr-shows-us-about-the-future-of-ai-regulation/> [<https://perma.cc/XP7M-DJUQ>] (last visited Nov. 17, 2023).

13. MODEL CODE OF PRO. CONDUCT (A.B.A. 1983).

14. *Resolution 604*, A.B.A. (Feb. 6, 2023), <https://www.americanbar.org/content/dam/aba/directories/policy/midyear-2023/604-midyear-2023.pdf> [<https://perma.cc/PB8T-9KXL>].

technology enhances legal practice without compromising the bedrock of trust, client consent, and client protection that defines the profession.

II. BACKGROUND

A. *Introduction to Mergers and Acquisitions*

Mergers and acquisitions is a practice area of the law that focuses on transactions aimed at combining two or more companies.¹⁵ This practice encompasses diverse methods, such as mergers, acquisitions, stock purchases, asset purchases, and share exchanges.¹⁶ In the domain of M&A, legal experts navigate the intricacies of crafting these transactions to ensure the smooth integration of the businesses.¹⁷

1. *Simplified Types of Business Combination Transactions*

A merger is when two companies combine into one company.¹⁸ State law governs the procedural aspects of these transactions.¹⁹ When two companies combine, one company “survives the merger and continues to exist,” while the other company dissolves.²⁰ There are two types of merger transactions: direct and indirect mergers.²¹ In a direct merger, the buying company and the target company combine to form a single entity.²² In an indirect merger, the target company merges with a subsidiary of the buying company.²³

Next, an acquisition is when a buying company purchases a target company.²⁴ Several types of acquisitions exist, which may vary depending on the buying company’s motivations.²⁵ Horizontal acquisitions are the

15. *Mergers & Acquisitions*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/mergers_acquisitions [https://perma.cc/H4YZ-QH2J] (last updated July 2021).

16. *Id.*

17. *Id.*

18. Lemuel J. Lim, *Basic Structures in Mergers and Acquisitions (M&A): Different Ways to Acquire a Small Business*, GENESIS LAW FIRM, PLLC, <https://www.genesislawfirm.com/asset-acquisition-stock-purchase-and-merger-structures> [https://perma.cc/BL75-P2FV] (last visited Nov. 11, 2023).

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. See Jeanine Skowronski, *What is an Acquisition? Definition, Types, and Examples*, FORAGE (Mar. 17, 2023), <https://www.theforage.com/blog/skills/acquisition> [https://perma.cc/9G7U-FVC8].

25. *Id.*

most notable of the various acquisitions.²⁶ In a horizontal acquisition, a buying company purchases a target company that offers a similar product or service.²⁷ In a vertical acquisition, a buying company acquires a target company that produces a product in its existing supply chain.²⁸ Another type of acquisition is a congeneric acquisition, where a buying company purchases a target company that offers different products or services to the same customer base.²⁹ Finally, in a conglomerate acquisition, a buying company purchases a target company that is in a completely different industry.³⁰

One of the most common ways that a buying company executes an acquisition is through a stock purchase.³¹ Stock purchases occur when a buying company acquires the target company's outstanding stock from the target's shareholders.³² These transactions are generally more accessible to smaller companies, providing the buying company with a relatively smooth transition to continue the operations of the target company.³³

Another common way for a buying company to execute an acquisition is through an asset purchase.³⁴ Asset purchases occur when a buying company purchases all, or substantially all, of a target company's assets.³⁵ In an asset purchase, the buying company may also agree to assume certain liabilities of the target company.³⁶ These transactions typically entail significant challenges, given the critical need for precision and the complexity involved in transferring assets.³⁷ Although these transactions are difficult in practice, they provide significant benefits to the buying company because the buying company can essentially pick and choose which assets and which liabilities it would like to acquire, if any.³⁸

Another type of business combination transaction is a share exchange.³⁹ Share exchanges are entirely a function of state corporate law

26. *Id.*

27. *Id.*

28. Skowronski, *supra* note 24.

29. *Id.*

30. *Id.*

31. See Thomas Cockriel & Shelby Faubion, *Stock vs. Asset Purchase – Considerations for M&A*, TRENAM LAW (July 14, 2023), <https://www.trenam.com/stock-vs-asset-purchase-considerations-for-ma/> [<https://perma.cc/D45X-XHVV>].

32. *Id.*

33. *Id.*

34. *Id.*

35. Lim, *supra* note 18.

36. *Id.*

37. *Id.*

38. *Id.*

39. Sandra Feldman, *The Different Types of Methods of Mergers and Acquisitions*, WOLTERS KLUWER (Jan. 26, 2024), <https://www.wolterskluwer.com/en/>

and require approval from the target company's shareholders.⁴⁰ In these transactions, the buying company obtains the target company's outstanding stock by using its own stock as the form of consideration.⁴¹ In other words, the buying company uses its own shares as payment in kind, in place of cash, to the target company.⁴²

Various industries use mergers and acquisitions transactions to allow businesses to grow in strategic manners.⁴³ The company's motive behind these transactions may vary from needing to acquire new technology and expertise to obtaining a larger market share.⁴⁴ The usual stages involved in any M&A transaction are the preliminary discussions, the assessment and evaluation of the target company, due diligence, contract negotiations, and post-deal integration.⁴⁵ During the preliminary discussions, potential buyers and sellers have exploratory conversations to assess compatibility and suitability.⁴⁶ Similar to the due diligence phase, the buying company actively seeks to identify all potential risks or issues that may arise during the sale process through the assessment and evaluation of the target company.⁴⁷ Performing a meticulous analysis in the due diligence process is vital in any M&A transaction, as it represents one of the most intensive evaluations of risks and opportunities that a business can undergo.⁴⁸ A successful due diligence phase allows a buying company to comfortably move onto the final parts of the deal.⁴⁹ After these steps are complete, the two companies engage in a series of negotiations to finalize the terms of

expert-insights/the-different-types-and-methods-of-mergers-and-acquisitions [https://perma.cc/H978-GVSR].

40. See Tiffany Chin, *The Uses of Share Swaps in Mergers & Acquisitions*, DONOVAN & HO ADVOCS. & SOLICS. (Feb. 23, 2023), <https://dnh.com.my/the-uses-of-share-swaps-in-mergers-acquisitions/> [https://perma.cc/NTT6-K42G].

41. *Id.*

42. *Id.*

43. *Mergers & Acquisitions*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/mergers_acquisitions [https://perma.cc/H4YZ-QH2J] (last updated July 2021).

44. Kison Patel, *The 10 Biggest Reasons to Pursue M&A (with Examples)*, DEALROOM, <https://dealroom.net/blog/why-do-companies-merge-with-or-acquire-other-companies> [https://perma.cc/TEK5-RTDD] (last updated Feb. 20, 2023).

45. See *The M&A Process, Steps, Key Players & Timeline*, ANSARADA, <https://www.ansarada.com/mergers-acquisitions/process> [https://perma.cc/56BC-X5NF] (last visited Jan. 25, 2024).

46. *Id.*

47. *Id.*

48. See *Modern Deal Series Part 5: The Evolution of Due Diligence*, ANSARADA (June 24, 2021), <https://www.ansarada.com/blog/modern-deals-5-due-diligence> [https://perma.cc/V4QG-8Q67].

49. *Id.*

their agreement.⁵⁰ Once the two companies have closed the deal, they can finally begin the integration process.⁵¹

2. The Due Diligence Process

The due diligence stage is crucial in any M&A transaction.⁵² The due diligence stage enables the acquiring company to pinpoint dealbreakers, evaluate risks, and make well-informed decisions.⁵³ During this phase, it is standard practice for the target company to provide the buying company with all organizational documents and corporate records.⁵⁴ This information allows the buying company to identify all the target company's important legal and financial information, among other things.⁵⁵ The primary goal of the due diligence phase is to ensure that the buying company is making the best possible decisions to maximize its chances of adding more value to its company.⁵⁶ A buying company verifying the provided information's accuracy is essential to the success of any M&A transaction.⁵⁷

In any M&A transaction, there are five primary types of due diligence: tax, legal, financial, operational, and information technology.⁵⁸ For tax due diligence, the buying company analyzes the target company's tax affairs and aims to ensure that the target company has settled all tax liabilities.⁵⁹ Additionally, tax due diligence assesses the implications of a business combination transaction on the post-deal entity's tax obligations, and explores options for post-deal tax structuring.⁶⁰ For legal due diligence, the buying company examines all the target company's legal aspects and contractual obligations.⁶¹ The typical areas under intense review are licensing, regulatory issues, contracts, and the target company's pending

50. *The M&A Process, Steps, Key Players & Timeline*, *supra* note 45.

51. *Id.*

52. Louis Lehot & Eric Chow, *The Importance of Due Diligence in M&A Transactions*, FOLEY & LARDNER LLP (Aug. 29, 2023), <https://www.foley.com/en/insights/publications/2023/08/importance-due-diligence-m-a-transactions> [<https://perma.cc/QCD3-GLN5>].

53. *Id.*

54. Donohue, *supra* note 7.

55. *Id.*

56. *M&A Due Diligence – Everything You Need to Know*, SYNOPTIK (June 12, 2023), <https://synoptek.com/insights/it-blogs/due-diligence-in-mergers-and-acquisitions/> [<https://perma.cc/3Q2T-9W82>].

57. *How AI is Changing M&A Due Diligence*, *supra* note 4.

58. *M&A Due Diligence – Everything You Need to Know*, *supra* note 56.

59. *Id.*

60. *Id.*

61. *Id.*

legal issues.⁶² In the financial due diligence phase, the buying company examines the target company's historical financial performance to ensure that the financial documents' numbers are accurate.⁶³ In the operational due diligence phase, the buying company examines the target company's operations.⁶⁴ In this phase, lawyers investigate the target company's business model, operational structure, supply chain, and logistics strategy to ensure that the target company is a good fit for the buying company.⁶⁵ Finally, during the information technology (IT) due diligence phase, lawyers investigate the target company's IT infrastructure and operations.⁶⁶ This type of due diligence helps the buying company evaluate the target company's current IT structure to recognize any potential security threats.⁶⁷

The due diligence costs associated with the typical stages of an M&A transaction are substantial.⁶⁸ These expenses typically range anywhere from one to four percent of the total deal size.⁶⁹ In 2022, the global average value of an M&A deal was \$68 million.⁷⁰ Thus, the average transaction cost arising from the due diligence process was anywhere from \$680,000 to \$2,720,000.⁷¹

B. Artificial Intelligence

Law firms have already been using artificial intelligence for a variety of matters, ranging from e-discovery, legal research, and contract drafting.⁷² Artificial intelligence use is continuing to expand, as M&A

62. *M&A Due Diligence – Everything You Need to Know*, *supra* note 56.

63. *Id.*

64. *Id.*

65. *Operational Due Diligence: Meaning, Importance & Checklist*, ANSARADA, <https://www.ansarada.com/due-diligence/operational> [<https://perma.cc/2A4K-PQRS>] (last visited Nov. 15, 2023).

66. *M&A Due Diligence – Everything You Need to Know*, *supra* note 56.

67. *Id.*

68. *How AI is Changing M&A Due Diligence*, *supra* note 4.

69. *Id.*

70. *Average Value of Merger and Acquisition (M&A) Deals Worldwide from 1985 to 2022*, STATISTA, (May 30, 2023), <https://www.statista.com/statistics/951203/average-value-of-merger-and-acquisitions-worldwide/> [<https://perma.cc/6UMR-UTX8>].

71. *Id.*; 1% of \$68,000,000 is \$680,000; 4% of \$68,000,000 is \$2,720,000.

72. *What is AI and How Can Law Firms Use it?*, CLIO, <https://www.clcio.com/resources/ai-for-lawyers/lawyer-ai/> [<https://perma.cc/Q86F-VWCL>] (last visited Apr. 7, 2024); *Artificial Intelligence for Lawyers Explained*, BLOOMBERG LAW, <https://pro.bloomberglaw.com/insights/technology/ai-in-legal-practice-explained/#whatAI> [<https://perma.cc/4JYG-DXTZ>] (last visited Aug. 1, 2023).

attorneys are increasingly using artificial intelligence throughout the M&A process.⁷³

1. What is Artificial Intelligence?

Artificial Intelligence (AI) is a focus area within computer science that merges vast datasets with iterative algorithms.⁷⁴ This integration allows users to solve complex problems and perform intricate tasks in a manner that closely resembles human thought and action, achieving these tasks almost instantaneously.⁷⁵ AI aims to replicate human cognitive abilities through computer programming, demanding a sophisticated setup of complex algorithms.⁷⁶ This setup is vital for creating and improving these machine learning algorithms, empowering AI to consistently produce accurate and precise results.⁷⁷ As a result, businesses across various sectors highly value AI for its ability to improve decision making and operational efficiency.⁷⁸ Following its broad adoption, numerous fields have applied AI, showcasing AI's adaptability and capacity to revolutionize industries.⁷⁹

2. Benefits of the use of Artificial Intelligence

The introduction of Artificial Intelligence (AI) is changing almost every aspect of the legal due diligence process.⁸⁰ Not only has it sped up the process of analyzing documents, but it can also identify potential risks

73. Lani E. Medina, *Navigating AI in M&A: Contractual Insights for In-House Counsel*, BARTON, (Nov. 29, 2023), <https://www.bartonesq.com/news-article/navigating-ai-in-ma-contractual-insights-for-in-house-counsel/> [https://perma.cc/HZN4-9JGT].

74. John Paul Mueller & Luca Massaron, *What is AI Technology*, FOR DUMMIES (May 26, 2023), <https://www.dummies.com/article/technology/information-technology/ai/general-ai/4-ways-define-artificial-intelligence-ai-254174/> [https://perma.cc/H3MZ-5T2J].

75. *Id.*

76. Nicole Laskowski & Linda Tucci, *Artificial Intelligence (AI)*, TECHTARGET (Nov. 2023), <https://www.techtargget.com/searchenterpriseai/definition/AI-Artificial-Intelligence> [https://perma.cc/Z47X-45AG].

77. *Id.*

78. Katherine Haan, *How Businesses are Using Artificial Intelligence in 2024*, FORBES ADVISOR, <https://www.forbes.com/advisor/business/software/ai-in-business/> [https://perma.cc/M6LP-FBDP] (last updated Apr. 24, 2023).

79. Laskowski & Tucci, *supra* note 76.

80. Chris O'Leary & Raees Nakhuda, *How AI for M&A Due Diligence is Changing Every Aspect of the Deal Process*, THOMSON REUTERS (Apr. 16, 2023), <https://legal.thomsonreuters.com/en/insights/articles/how-ai-and-document-intelligence-are-changing-the-legal-tech-game#how-is-ai-transforming-the-due-diligence-process> [https://perma.cc/4N8B-WMA7].

almost immediately.⁸¹ AI deepens the searches, increases the thoroughness of the analysis, and quickens the entire process.⁸²

Historically, the due diligence process was characterized by its time-intensive, complex, and costly nature, often extending for at least 60 days, and in some instances, spanning over several months.⁸³ The volume of information that a company needs to verify and examine, and the information's varying accessibility, contributes to the process' lengthy duration.⁸⁴ Companies usually store a majority of the required information in physical format, which requires the time-consuming task of manual reviews.⁸⁵ This process' associated costs are directly proportional to its duration.⁸⁶

At present, artificial intelligence is revolutionizing the due diligence process in two primary areas.⁸⁷ In legal due diligence, AI is streamlining the document review processes, leading to notable time reductions.⁸⁸ Moreover, AI is significantly improving both efficiency and accuracy in examining a target company's financial history and performance during the financial due diligence phase.⁸⁹

In legal due diligence, a company's considerable time invested in document review and analysis is a prominent challenge confronting legal teams.⁹⁰ This obstacle often consumes thousands of hours, leading to delays in the overall deal-making process.⁹¹ AI tools that can efficiently analyze documents, pinpoint pertinent information, and extract crucial data are helping to address this challenge.⁹² Consequently, these AI tools significantly curtail the time that companies allocate to the legal due diligence phase while upholding precision and uniformity.⁹³ For example, Document Intelligence, an AI tool that companies use primarily in M&A transactions, allows legal teams to thoroughly analyze thousands of documents, in just a fraction of the time that traditional methods require.⁹⁴ These efficiencies enable legal teams to redirect their focus toward other

81. *Id.*

82. *Id.*

83. *How AI is Changing M&A Due Diligence*, *supra* note 4.

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *How AI is Changing M&A Due Diligence*, *supra* note 4.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. O'Leary & Nakuhuda, *supra* note 80.

vital objectives, including high leverage activities, strategic decision making, and client engagement.⁹⁵

AI is also playing a key role in the financial due diligence process.⁹⁶ In this due diligence phase, the buying company performs a thorough examination of a target company's financial documents to gain insights into its performance.⁹⁷ AI tools that automate the extraction of critical data from documents and generate detailed financial reports highlighting key areas of interest have largely streamlined this entire process.⁹⁸ Moreover, AI tools can execute complex calculations and forecasts in a fraction of the time a human can, not only enhancing efficiency, but also eliminating human error.⁹⁹ This use of AI results in a more precise and reliable evaluation of the target company, enabling financial analysts and legal teams to promptly identify potential issues or risks that require immediate attention.¹⁰⁰ However, despite its many advantages, the application of AI in M&A transactions is not without its risks.¹⁰¹

C. Inherent Risks and Limitations of Using Artificial Intelligence

Although the use of AI has its benefits, it is not without any limitations.¹⁰² Any algorithmic failure may result in mistakes or misrepresentations to the client.¹⁰³ Further, AI tools rely on the quality of the inputted data, so incomplete or erroneous data inputs can lead to inaccurate AI outputs.¹⁰⁴ Additionally, the risk of confidential information being leaked in the event of a cyber security breach is heightened because data servers typically hold the companies' highly confidential information.¹⁰⁵ Furthermore, critics have raised concerns that AI would essentially be performing a lawyer's duties without the requisite

95. *How AI is Changing M&A Due Diligence*, *supra* note 4.

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. Thato Mashishi, *Due Diligence Incorporating AI – The Pros and Cons*, KPMG, <https://assets.kpmg.com/content/dam/kpmg/za/pdf/pdf2020/due-diligence-incorporating-ai-the-pros-and-cons.pdf> [<https://perma.cc/V7DY-72VY>] (last visited Apr. 7, 2024).

102. Scott Preece, *AI and M&A: A Breakdown of the Challenges and Benefits*, ASHFORDS (Aug. 9, 2023), <https://www.ashfords.co.uk/insights/articles/ai-and-ma-a-breakdown-of-the-challenges-and-benefits> [<https://perma.cc/AJ54-7UDK>].

103. Soniya Khanna, *Use of AI in M&A Due Diligence – Its Benefits and Drawbacks*, ENTERSLICE (July 6, 2023), https://enterslice.com/learning/use-of-ai-in-ma-duediligence/#Difficulties_arising_from_the_use_of_AI_in_M_A_Due_Diligence [<https://perma.cc/N9KP-Z4PR>].

104. *How AI is Changing M&A Due Diligence*, *supra* note 4.

105. *See How AI is Changing M&A Due Diligence*, *supra* note 4.

credentials.¹⁰⁶ Finally, using AI in such transactions raises issues as to the allocation of liability in the event of any of the aforementioned risks coming to fruition.¹⁰⁷

Although researchers have yet to identify errors specifically related to law firms using AI in M&A transactions, some instances highlight the limitations of AI applications. In *Park v. Kim*,¹⁰⁸ Steven A. Schwartz, a New York based attorney, encountered a sobering experience when he attempted to utilize AI to write a legal brief for his case.¹⁰⁹ Schwartz filed the ChatGPT-generated brief in court, which was filled with fictitious judicial opinions and legal citations.¹¹⁰ Schwartz admitted that he was unaware “that ChatGPT could fabricate cases,” as his ten-page brief cited more than half a dozen fake court decisions.¹¹¹ This case illustrates several risks associated with using AI in the legal profession, ranging from accuracy, reliability, accountability, and ethical considerations.¹¹²

D. Current Regulatory Landscape Governing the Use of AI

AI currently operates in a regulatory vacuum at the federal level, with no comprehensive legislation exclusively dedicated to its oversight.¹¹³ However, lawyers integrating AI into their practice must ensure that its use aligns with the Model Rules of Professional Conduct (MRPC), underscoring the profession’s ethical standards.¹¹⁴ Additionally, despite the absence of direct governance, the application of AI must adhere to existing laws and regulations related to privacy and security to ensure that its deployment respects both legal and ethical boundaries.¹¹⁵ To address the lack of regulation, various entities have issued advisory guidelines applicable to a lawyer’s use of AI.

106. Vincent J. Syracuse, *Using AI in Your Practice? Proceed with Caution*, N.Y. STATE BAR ASS’N (Aug. 7, 2023), <https://nysba.org/using-ai-in-your-practice-proceed-with-caution/> [https://perma.cc/BUG5-XXX9].

107. Khanna, *supra* note 103.

108. *Park v. Kim*, 91 F.4th 610, 614 (2nd Cir. 2024).

109. Benjamin Weiser & Nate Schweber, *The ChatGPT Lawyer Explains Himself*, N.Y. TIMES (June 8, 2023), <https://www.nytimes.com/2023/06/08/nyregion/lawyer-chatgpt-sanctions.html> [https://perma.cc/6EZU-M2UQ].

110. *Id.*

111. *Id.*

112. *Id.*

113. Victor Li, *What Could AI Regulation in the US Look Like?*, A.B.A. (June 14, 2023), <https://www.americanbar.org/groups/journal/podcast/what-could-ai-regulation-in-the-us-look-like/> [https://perma.cc/3JTA-4DAK].

114. *Highlight of the Issues*, A.B.A., https://www.americanbar.org/groups/leadership/office_of_the_president/artificial-intelligence/issues/ [https://perma.cc/7QWM-HJ9V] (last visited Nov. 16, 2023).

115. *Id.*

1. *The European Union General Data Protection Regulation*

The European Union General Data Protection Regulation (GDPR) outlines four principles — accountability, fairness, data minimization and security, and transparency — that companies with global operations must adhere to when developing or utilizing AI.¹¹⁶ The first principle, accountability, mandates that companies proactively approach privacy compliance and assume full responsibility for the systems they deploy.¹¹⁷ The GDPR's second principle, fairness, asserts that companies using AI for information analysis must refrain from processing data in an unexpected, undisclosed, or malicious manner.¹¹⁸ The third principle, data minimization and security, stipulates that AI systems should only process the minimal amount of data necessary to achieve their specific objectives, and sound security measures should accompany the process to prevent AI from compromising data.¹¹⁹ Lastly, the principle of transparency asserts that the use of data must be transparent, requiring individuals' informed knowledge and consent regarding the use of an AI system handling their information.¹²⁰ This consent should not only involve awareness that an AI system will process their data, but also entail information about the purposes and logic of the processing, presented in a clear, concise, and comprehensible format.¹²¹

2. *The Model Rules of Professional Conduct*

Lawyers employing AI tools must also adhere to the broadly applicable Model Rules of Professional Conduct (MRPC).¹²² MRPC Rule 1.1 requires attorneys to offer competent representation, necessitating legal knowledge, skill, thoroughness, and preparation reasonably essential for effective representation.¹²³ This duty includes the responsibility of attorneys to make informed decisions regarding whether AI is a suitable tool for its intended use in delivering legal services, and to determine

116. *What the GDPR Shows Us About the Future of AI Regulation*, VISIER, <https://www.visier.com/blog/what-the-gdpr-shows-us-about-the-future-of-ai-regulation/> [<https://perma.cc/XP7M-DJUQ>] (last visited Nov. 17, 2023).

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. Linda Henry, *The Intersection of Artificial Intelligence and the Model Rules of Professional Conduct*, JDSUPRA (Feb. 5, 2019), <https://www.jdsupra.com/legalnews/the-intersection-of-artificial-87577/> [<https://perma.cc/XK7F-LH4Q>].

123. *Id.*

whether the AI tool performs as advertised.¹²⁴ MRPC Rule 1.6 obligates lawyers to exert reasonable efforts to prevent the unauthorized access to or disclosure of client information.¹²⁵ Consequently, if an attorney grants a third party technology vendor access to confidential client information, the attorney is obligated to understand the third party vendor's security practices and determine that its policies are reasonable.¹²⁶ This determination involves an extensive review process, including a thorough examination of the vendor's service agreements and an assessment of their track record with respect to data breaches.¹²⁷

3. ABA Resolution 604

The American Bar Association (ABA) stands as a voluntary organization dedicated to supporting legal professionals by offering practical resources, establishing model ethics codes, and providing guidance to attorneys.¹²⁸ Periodically, the ABA publishes resolutions on specific topics to serve as advisory guidelines.¹²⁹ Although a direct regulatory scheme governing AI use is lacking, the ABA adopted Resolution 604 to address how attorneys, regulators, and other organizations should approach issues of accountability, transparency, and traceability in AI.¹³⁰

Resolution 604 advocates for entities utilizing AI to adopt guidelines ensuring human control over AI systems.¹³¹ Additionally, it seeks to

124. *Id.*

125. *Id.*

126. *Id.*

127. Jim Ballowe, *Exercising Due Diligence in the Selection of a Tech Vendor*, ESQUIRE SOLUTIONS (Dec. 14, 2021), <https://www.esquiresolutions.com/exercising-due-diligence-in-the-selection-of-a-tech-vendor/> [<https://perma.cc/4E5Z-WNTR>].

128. *Consumer FAQs*, A.B.A., https://www.americanbar.org/groups/professional_responsibility/resources/resources_for_the_public/consumer_faqs/ (last visited Apr. 7, 2024).

129. *See generally Resolution 604*, A.B.A. (Feb. 6, 2023), <https://www.americanbar.org/content/dam/aba/directories/policy/midyear-2023/604-midyear-2023.pdf> [<https://perma.cc/PB8T-9KXL>]; *Resolution 102*, A.B.A. (Aug. 10, 2021), <https://www.americanbar.org/content/dam/aba/directories/policy/annual-2021/102-annual-2021.pdf> [<https://perma.cc/V9LY-HFUP>]; *ABA Resolution 115B*, A.B.A. (2019), <https://www.americanbar.org/content/dam/aba/images/news/2019/08/am-hod-resolutions/115b.pdf> [<https://perma.cc/WYR6-LSCJ>].

130. Glenn Gordon, *The Use of Artificial Intelligence in the Legal Profession*, LEXIS NEXIS (Apr. 27, 2023), <https://www.lexisnexis.com/community/insights/legal/practical-guidance-journal/b/pa/posts/the-use-of-artificial-intelligence-in-the-legal-profession> [<https://perma.cc/4E9M-3LDT>].

131. *Id.*

establish individual and enterprise accountability regarding the outcomes arising from their use of AI services, encompassing any legally recognizable injury or harm resulting from such use.¹³² Further, the ABA highlights the existing legal framework of the United States, which requires that entities possess a specific legal status, such as being an individual or a corporation, for the law to hold them accountable.¹³³ The ABA then draws a distinction between an entity's legal status and AI, asserting that because AI is comparable to property and lacks legal status, it is imperative for legally recognizable entities to bear the responsibility for the consequences of AI services.¹³⁴

Moreover, Resolution 604 requires organizations that use AI products or services to ensure the transparency of their AI systems.¹³⁵ The ABA places an emphasis on disclosing when AI is being used, due to its growing ubiquity.¹³⁶ This guideline aims to promote responsible disclosure, ensuring entities and individuals comprehend when they are engaging with an AI product or system.¹³⁷ Further, the ABA notes that transparency also means informing consumers of how AI systems are developed and deployed so they can make informed decisions.¹³⁸ This transparency enables those, who AI systems may affect, to better understand and challenge the outcomes of its use.¹³⁹

Finally, Resolution 604 requires AI developers to thoroughly document critical decisions made with respect to the design, risk assessment of data sets, procedures, and outcomes underlying the AI system.¹⁴⁰ Ultimately, the ABA asserts that traceability is an essential requirement for dependable AI, facilitating a comprehensive understanding of the entire reasoning process behind AI determinations.¹⁴¹

Unfortunately, despite the ABA's proposed guidance regarding a lawyer's use of AI, the current regulatory framework, characterized by a patchwork of security, transparency, and professional conduct guidelines,

132. *Id.*

133. *Resolution 604*, A.B.A. (Feb. 6, 2023), <https://www.americanbar.org/content/dam/aba/directories/policy/midyear-2023/604-midyear-2023.pdf> [<https://perma.cc/PB8T-9KXL>].

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Resolution 604*, A.B.A. (Feb. 6, 2023), <https://www.americanbar.org/content/dam/aba/directories/policy/midyear-2023/604-midyear-2023.pdf> [<https://perma.cc/PB8T-9KXL>].

140. *Id.*

141. *Id.*

offers limited direct oversight of AI's role in M&A.¹⁴² Artificial Intelligence's integration into Mergers and Acquisitions transactions represents a paradigm shift in how legal teams conduct due diligence, enhancing efficiency, accuracy, and strategic decision-making capabilities.¹⁴³ However, this technological advancement is not without its challenges and risks, including data integrity issues, security vulnerabilities, and ethical concerns regarding the replacement of human judgment in legal processes.¹⁴⁴ This reality underscores the need for more stringent, mandatory regulations specifically tailored to govern AI's use within this context. Such measures are crucial for preserving the transactional process' integrity, ensuring a company's use of AI tools adheres to both legal and ethical principles, and protecting the individual clients' interests.

III. ANALYSIS

A. Resolution 604: A Positive Step Forward with Recognizable Gaps

Resolution 604 marks an important step in regulating Artificial Intelligence's (AI's) use within legal practices, by advocating for human oversight, accountability, and transparency in AI applications.¹⁴⁵ Although it sets forth crucial principles, Resolution 604 is still only advisory in nature.¹⁴⁶ Implementing a mandatory framework is necessary to effectively address the complexities and associated risks inherent in AI technology.

1. The Accountability Shortfall in Resolution 604

Resolution 604's first guideline advocates for entities utilizing AI tools to guarantee that AI's operation remains within human oversight, authority, and control.¹⁴⁷ Furthermore, it aims to solidify accountability for

142. Pia Jarantilla, *AI in the M&A Landscape: Insights from 5 Five Must Read Articles*, INST. FOR MERGERS, ACQUISITIONS & ALLS. (Dec. 29, 2023), <https://imaa-institute.org/blog/top-5-articles-on-ai-in-mergers-and-acquisitions/> [https://perma.cc/V7HW-BH69].

143. *How AI is Change M&A Due Diligence*, *supra* note 4.

144. *Id.* at 9 nn.92–96.

145. Gordon, *supra* note 130.

146. *Law and Artificial Intelligence Resources*, A.B.A. (Aug. 28, 2023), https://www.americanbar.org/groups/leadership/office_of_the_president/artificial-intelligence/resources/ (“Urges organizations that design, develop, deploy, and use artificial intelligence systems and capabilities to follow certain guidelines.”).

147. *Id.*

AI usage by recommending that the entity or individual responsible for its deployment bears any liability resulting from its use.¹⁴⁸

Although Resolution 604 emphasizes the importance of entity accountability while using AI, it does not prescribe how to achieve this objective. The American Bar Association (ABA) acknowledges that for accountability within the United States' legal framework to apply to an entity, the entity must possess a distinct legal status.¹⁴⁹ The ABA further acknowledges that algorithms lack a legal status because they are similar to property, suggesting instead that entities deploying AI tools in their operations should bear responsibility for its outcomes.¹⁵⁰ Despite identifying the shift in liability towards these entities, the ABA does not detail how the law should determine this accountability.¹⁵¹ Nonetheless, there are multiple strategies, such as a modified strict liability regime, that could refine and enforce this guideline more effectively, ensuring clear accountability measures are in place when legal teams use AI within the mergers and acquisitions (M&A) setting.

2. Resolution 604: Encouraging Transparency without Mandating it

Resolution 604's second guideline strongly recommends that entities deploying AI products prioritize the AI product's transparency.¹⁵² The American Bar Association (ABA) emphasizes this principle's significance, advocating for the provision of adequate information to individuals, enabling them to make well-informed decisions, especially when engaging with AI tools.¹⁵³ While the ABA advises entities to maintain transparency with their clients about AI usage, it stops short of outlining specific consequences for those that neglect to disclose the deployment of AI tools in their business engagements. This omission highlights a crucial area for further development in ensuring accountability and informed consent in a legal team's use of AI within M&A transactions.

148. *Id.*

149. *Id.*

150. *Resolution 604*, A.B.A. (Feb. 6, 2023), <https://www.americanbar.org/content/dam/aba/directories/policy/midyear-2023/604-midyear-2023.pdf> [https://perma.cc/PB8T-9KXL].

151. *Id.*

152. *Id.*

153. *Id.*

3. The Advisory Nature of Resolution 604: A Barrier to its Full Potential

While serving as a pivotal step towards ethical AI usage in legal practices, Resolution 604 remains nothing more than an advisory manual.¹⁵⁴ This distinction highlights a significant gap in the current regulatory landscape, because the resolution offers recommendations without enforceable obligations.¹⁵⁵ Resolution 604's advisory nature underscores the pressing need for more stringent regulations that go beyond mere guidelines to establish mandatory compliance measures.¹⁵⁶ Enforceable regulations are essential to ensure that AI's integration in legal practices, more specifically, in M&A transactions, strictly adheres to the principles of accountability, transparency, and ethical conduct. Without these enforceable measures, the potential for lawyers to use AI in ways that could undermine legal processes' integrity and client trust remains relatively unmitigated, making the call for mandatory regulatory frameworks more critical than ever.

B. Advocating for Federal Legislation: Building on Resolution 604 with Comprehensive Enhancements

1. Implementing a Strict Liability Regime for Enhanced Accountability

While the principle of strict liability appears stringent, it may serve a useful purpose in this context. Strict liability mandates legal responsibility for damages caused by one's actions, irrespective of intent.¹⁵⁷ Within the broader scope of strict liability lies the niche of strict products liability, which assigns liability to manufacturers or distributors of defective products for any resulting harm to consumers.¹⁵⁸ Despite the requirement of a transactional relationship for strict products liability to apply, a tailored version of this principle could suitably apply to M&A transactions.¹⁵⁹ This adaptation would address the unique dynamics of

154. *Law and Artificial Intelligence Resources*, *supra* note 146.

155. *Id.*

156. *Id.*

157. *Strict Liability*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/strict_liability [https://perma.cc/5TY2-NAH8] (last visited Feb. 2024).

158. *Id.*

159. *Product Liability*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/product_liability [https://perma.cc/3KDR-TQH4] (last updated Aug. 2020).

M&A activities and legal teams' role in deploying AI tools,¹⁶⁰ ensuring accountability for any adverse outcomes linked to a company's use of AI.

In the context of M&A transactions, when a buying company considers a deal, the target company typically uploads its corporate documents and financial records to a virtual data room (VDR).¹⁶¹ Legal teams then deploy AI tools to analyze these documents, providing rapid summaries and insights.¹⁶² A company's decision to utilize AI for efficiency, rather than conducting manual analysis, implies a responsibility that should extend to the legal teams in the event of inaccuracies or damages caused by the AI's output, which should, in turn, give rise to liability.¹⁶³

Even though legal teams do not directly transfer a product to clients during the due diligence phase, their use of AI tools constitutes the application of a product that could, if flawed, result in damages.¹⁶⁴ This scenario justifies the proposal to hold entities strictly accountable for choosing to deploy AI to expedite their review processes, especially if it leads to harm.

Building on Resolution 604, Congress has the opportunity to elevate these foundational principles from advisory guidelines to binding regulations.¹⁶⁵ There is a pressing need for federal legislation that creates a robust framework governing AI's use within the legal field, integrating strict liability principles to bolster accountability and prevent technological misuse. Such legislative efforts would inject much-needed clarity into the legal landscape, establishing definitive boundaries that safeguard all stakeholders engaged in M&A transactions against AI tools' potential risks posed.

Though seemingly stringent, this modified concept of strict liability is not unprecedented. In fact, academics have proposed a strict liability regime regarding AI's use.¹⁶⁶ Dr. Silvia De Conca, an Assistant Professor of Law at the University of Amsterdam, has advocated for a narrowly

160. Yavar Bathaee, *Artificial Intelligence Opinion Liability*, 35 BERKLEY TECH. L.J. 113, 162 n.248 (2020).

161. *Virtual Data Rooms*, ANSARADA, <https://www.ansarada.com/virtual-data-rooms> [https://perma.cc/Q7RZ-HXZJ] (last visited Feb. 29, 2024).

162. Marc Vogelsang, *How AI Will Impact Due Diligence in M&A Transactions*, ERNST & YOUNG (Jan. 17, 2024), https://www.ey.com/en_ch/strategy-transactions/how-ai-will-impact-due-diligence-in-m-and-a-transactions [https://perma.cc/TWC8-W27B].

163. See Bathaee, *supra* note 160.

164. *When an Attorney Fails to Assist with Pre-sale Due Diligence*, SCHWARTZ & PONTERIO, PLLC (Sept. 14, 2023), <https://www.splaw.us/blog/2023/09/when-an-attorney-fails-to-assist-with-pre-sale-due-diligence/> [https://perma.cc/9QMZ-SR8M].

165. See *Resolution 604*, *supra* note 150.

166. SILVIA DE CONCA, *LAW AND ARTIFICIAL INTELLIGENCE* 248 (Bart Custers & Eduard Fosch-Villaronga eds., 1st ed. 2023); see Bathaee, *supra* note 160.

scoped strict liability approach to specific AI applications.¹⁶⁷ Although the context surrounding this regime's applicability is limited,¹⁶⁸ such a narrow scope is exactly why it could work. Rather than blanketing all AI applications indiscriminately, this proposed legislation may be designed to specifically address legal teams' use of AI.¹⁶⁹ By doing so, it aims to safeguard against any violations of the attorney-client relationship, acknowledging the essential trust and service exchange inherent in legal dealings.

Further, in cases of computer data breaches, the law holds the data owner liable for any resultant losses, even if the breach results from a data custodian's security lapse.¹⁷⁰ This principle is rooted in the notion that those who benefit from data collection and storage must also bear the risk of its potential misuse or unauthorized access, even if the immediate cause of the breach lies with third-party actions beyond the data owner's direct control.¹⁷¹

Applying this rationale to the use of AI tools in legal practice, particularly for due diligence in M&A transactions, offers a compelling framework for accountability. Just as the law holds data owners strictly liable for breaches, legal teams employing AI tools should similarly bear responsibility for any inaccuracies or damages that these tools cause. This responsibility acknowledges that while AI can significantly enhance efficiency and insight, it also introduces new risks and potential for error that can impact transaction outcomes and client interests. This model of liability reflects a similar principle where the choice to use a certain tool or system—in this case, AI for due diligence—entails a responsibility for the outcomes of that choice. This methodology underscores the importance of ensuring that those who deploy AI to benefit from its capabilities also accept the inherent liabilities.¹⁷²

2. *Consequences for Non-Disclosure*

Implementing consequences for legal teams who fail to disclose their use of AI in M&A transactions is crucial, supported by the fundamental principles of trust, informed consent, and expectation management.¹⁷³ The breach of transparency undermines the trust that clients place in their legal

167. CONCA, *supra* note 166.

168. *See* Bathaee, *supra* note 160.

169. *Id.* at 163 n.251.

170. *When a Data Breach Hits a Business, Who is Liable?*, TRANSPARITY INS. SERVS., <https://www.transparencyinsurance.com/when-a-data-breach-hits-a-business-who-is-liable/> [https://perma.cc/6MJ9-YZP8] (last visited Feb. 2024).

171. *See* *When a Data Breach Hits a Business, Who is Liable?*, *supra* note 170.

172. BATHAE, *supra* note 160, at 162 n.248.

173. *See generally* MODEL RULES OF PRO. CONDUCT r. 1.4 (A.B.A. 1983).

representatives.¹⁷⁴ Trust is the cornerstone of the client-lawyer relationship; when lawyers withhold information about employing AI tools in their services, they erode this fundamental element, potentially compromising the integrity of the legal process and the outcomes achieved.

Moreover, informed consent is a legal and ethical requirement in client representation.¹⁷⁵ Clients have the right to fully understand the nature of the legal services that lawyers provide to them, including a lawyer's use of AI tools that might influence their matters.¹⁷⁶ A lawyer's failure to disclose the use of AI tools not only strips the clients of their agency in making informed decisions, but also exposes them to unforeseen risks, warranting the necessity for accountability measures.

The management of realistic expectations is another critical consideration. A lawyer's transparency about AI use allows clients to accurately gauge the due diligence process' scope and limitations. A lawyer concealing this information can lead to unrealistic client expectations and potential disputes, affecting the legal outcome and the client's interests.

Consequences of non-disclosure are justified to uphold the legal profession's ethical standards, protect client rights, and maintain the efficacy and integrity of legal processes. The obligation to disclose the use of AI should be explicitly integrated into the Model Rules of Professional Conduct to ensure its enforcement aligns with existing mechanisms for addressing violations within the legal profession. By formalizing this duty within the Model Rules, the legal community establishes a clear standard for transparency in the utilization of new technologies. This integration would enable the application of established consequences for violations, such as professional disciplinary actions, mandatory trainings, financial penalties, and compensation to impacted clients.¹⁷⁷ Embedding this requirement within the Model Rules would emphasize the critical role of honesty in embracing technological advancements, ensuring that the shift towards AI-enhanced legal practices upholds the profession's commitment to ethical integrity and client-focused service.

174. See generally MODEL RULES OF PRO. CONDUCT r. 1.8 (A.B.A.1983).

175. *Informed Consent*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/informed_consent [<https://perma.cc/GD8V-K4C8>] (last updated Dec. 2020).

176. *Id.*

177. MODEL RULES OF PRO. CONDUCT r. 8.4 cmt. (A.B.A.2023).

IV. CONCLUSION

Given AI tools' widespread deployment in M&A transactions,¹⁷⁸ it is imperative to impose strict accountability on entities that authorize its use, especially when it results in any form of harm. Legal teams' adoption of AI technologies is a strategic decision aimed at enhancing efficiency, not a fundamental necessity. While businesses across various sectors strive to leverage modern technology to maintain a competitive edge, this pursuit of innovation should not come without its share of responsibilities.¹⁷⁹ The goal of implementing a modified strict liability regime, along with consequences for non-disclosure is not to penalize forward-thinking practices but to safeguard individual clients' interests, ensuring that lawyers do not compromise their rights and interests by the rush towards technological advancement.

178. *AI in the M&A Context*, Dentons (July 7, 2023), <https://www.dentons.com/en/insights/articles/2023/july/7/ai-in-the-manda-context> [<https://perma.cc/5FHZ-29TH>].

179. *Use Technology to Stay Ahead of the Competition*, FASTER CAPITAL, <https://fastercapital.com/content/Use-Technology-to-Stay-Ahead-of-the-Competition.html> [<https://perma.cc/RFU6-YWWF>] (last updated Mar. 25, 2024).