

Drafting Considerations for AI Reps in Transactions

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Recently, we have seen a substantial increase in the number of target companies developing and purporting to own proprietary artificial intelligence (AI) or machine learning (ML) systems and models and licensing in or out datasets to train AI and ML models. We have also seen companies be rewarded for such efforts through higher valuations. We are helping many clients mitigate risk through diligence and the use of representations (reps), warranties and covenants in transaction agreements that explicitly address AI, including generative AI. AI-specific reps (AI reps) are becoming increasingly common—even the National Venture Capital Association updated its form Series A Preferred Stock Purchase Agreement Reps to include AI reps. While not yet a must-have in every deal, we do advise clients to consider AI reps in many circumstances.

What Should AI Reps Cover?

Our baseline for scoping AI reps is a broad definition of “AI system” that can be tailored to the business and diligence. Our definition typically includes general coverage based on the common understanding of AI—strategies and techniques to make machines more humanlike. This definition encompasses ML, a subset of AI that focuses on enabling machines to learn without explicit



programming. Generative AI is another subset of AI that can learn from large amounts of data to produce content, including text, images, music, videos and code, based on inputs or prompts. The AI system definition includes internal proprietary systems, tools/models built off existing commercial AI/ML products and general usages of commercial AI/ML products (i.e., noncustomized products in-licensed from an AI/ML SaaS vendors). However, the definition should typically exclude traditional, statistical models (e.g., financial modeling within Microsoft Excel, operating on manually inputted data and preset formulas) to avoid burdensome scheduling obligations and unintended consequences of reps.

- **Disclosure.** Target businesses should, in most cases, be obligated to schedule all AI systems they purport to own and should schedule whether each such system is solely for internal use or is licensed out or otherwise made available to third parties. Additionally, any licensed-in AI system should also typically be scheduled. Often datasets and tools for AI systems are licensed via click-through licenses or pursuant to open source licenses and, as such, are not required to be scheduled under traditional IP reps because many IP scheduling reps are focused on registered IP. Given the nascent controls at many target companies that are centered on AI/ML, disclosure reps are particularly useful for buyers and investors to conduct fulsome diligence and understand what AI systems have been developed internally, how all AI systems are used and, if applicable, the terms of the licenses governing such use. All of this supports assessment of the value of AI-related assets and a target's risk profile, and valuing the transaction.
 - **Sufficiency of Rights.** Target businesses should be able to represent that they have all valid rights in the AI systems used in, necessary and sufficient for the conduct and operation of the business—including data that the business uses to train or fine-tune such systems, and as inputs. Determining whether a company has valid data rights can get extremely nuanced due to the complexities around data scraping, incorporating customer or employee information and complying with contractual commitments (including obligations to only use certain data for internal purposes or to refrain from using certain data for commercial use). Given the potential liability associated with training AI systems on copyrighted information, trade secrets or personal information, buyers and investors should consider including a sufficiency rep when the acquisition of proprietary or fine-tuned models is contemplated.
 - **Compliance with Laws.** While this rep overlaps slightly with the sufficiency of rights rep, it addresses a distinct risk—compliance with the complex evolving landscape of AI laws. The EU AI Act imposes significant obligations on entities along every step of the AI value chain (including not only AI developers but also businesses that utilize AI systems). Notably, the EU AI Act's ban on prohibited systems entered into effect Feb. 2, 2025, with additional compliance deadlines rolling out in the coming months, and the penalties for non-compliance can be as much as €35 million or 7% worldwide annual turnover. Colorado has passed an AI-specific law, and at least twelve other states have introduced AI-specific bills. AI regulation typically imposes documentation, testing and transparency obligations, and a target company's awareness of these obligations and establishment of procedures to comply with them can be reviewed in diligence to give buyers and investors insight into the target's risk profile. While compliance is a moving target given the rapidly developing the landscape, best practices are becoming more established. Buyers and investors should consider including an AI-specific compliance with laws rep, given the risk of financial and reputational harm due to alleged or actual noncompliance.
- Coverage Under Existing Reps**
- Traditional IP and data privacy reps in transaction agreements provide coverage for many of the concerns presented by AI systems and models, but it can still be prudent to include AI-specific reps (despite some potential overlap) to drive disclosure and ensure a thorough understanding of the target business.
- **IP.** Typical IP rep coverage is focused on ownership, non-infringement and sufficiency. The IP ownership and noninfringements reps, when drafted properly, will cover the vast majority of concerns stemming from training, inventorship, deployment, and other potentially

problematic use of AI systems. Additionally, the IP sufficiency rep provides a buyer or investor with coverage that the target owns or has a right to use all IP that is required to operate the target business, which would ordinarily cover AI systems. However, a prudent buyer may wish to address AI-related risks explicitly through reps, tailoring those reps to drive disclosure in a more specific and comprehensive manner than the IP reps. Disclosure can be particularly valuable for buyers and investors to understand how and when the company is using AI and the target's level of sophistication with respect to AI, which may impact integration of the target and deal value.

- **Data Privacy.** Privacy reps are typically focused on compliance with specific privacy laws and regulations, as well as a target's own policies. There may be overlap with AI reps in the sense that privacy policies should generally disclose if a business is using personal information it collects under that policy in connection with any AI use cases. However, data privacy reps may not fully cover all potential data rights considerations (such as use of customer datasets that contain end user data that is not likely to be covered by the business's privacy policy). Further, reps concerning compliance with privacy laws will not cover compliance with AI-specific laws such as the EU AI Act or U.S. state AI legislation.

Overall, standard IP and data privacy reps provide partial, but incomplete, coverage for issues posed by AI systems. As such, buyers should evaluate the existing coverage and potential need for AI Reps based on the deal context.

Deal Context

Whether and to what extent to include AI reps in a given transaction will depend on a number of deal considerations, including the prominence of the use of AI across the target company, the

deal dynamics and what is uncovered during the diligence process. For example, disclosure reps can be useful to avoid disputes down the line, particularly in situations where indemnity coverage would be incomplete or could raise other issues, such as in venture investments (where indemnity claims against portfolio companies are uncommon) or where key employees remain liable for some portion of the indemnity (and could even be working for the buyer). We have also seen a marked increase in AI-specific covenants (e.g., interim operating covenants) to address concerns identified in diligence, such as compliance gaps impacting a company's ability to use certain datasets to train the seller's proprietary AI system. Even what a target business has represented that it does not develop or use AI systems, it can be useful to add a rep that the target company is not using AI, to ensure that sellers conduct internal due diligence to validate their compliance with this rep.

Conclusion

AI reps can be an extremely useful tool to drive diligence and disclosure for a buyer or investor to ensure the target company's reps about its AI usage are accurate. The concerns presented by AI in transactions are as varied as the use of AI, and each engagement should be examined with special attention paid to AI going-forward. Staying up to date on the rapidly evolving landscape surrounding AI is essential for successful transactions in today's market.

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