**Gazing through
the legal lens**

The AI-ESG nexus - redefining
legal and regulatory strategies

TELESCOPE

ESG (Environmental, Social, and Governance) and AI (Artificial Intelligence) are critical considerations for modern corporate governance, and corporate strategies as a whole. Balancing AI innovation with legal compliance and ethical considerations is crucial for successful ESG integration. We have highlighted a number of legal trends in the ongoing convergence of ESG considerations with AI.

Welcome to the latest edition of Telescope.

As Artificial Intelligence (AI) and Environmental, Social and Governance (ESG) considerations continue to shape the global landscape, our latest edition of Telescope, "Gazing through the Legal Lens: The AI-ESG Nexus," delves into the intricate interplay between these two transformative forces.

We explore how AI innovations, ESG and sustainability principles are converging to redefine legal and regulatory strategies. We discuss the importance of robust data quality and governance for AI systems, highlighting best practices, risk-mitigation strategies and legal implications. The integration of AI in sustainability reporting, driven by directives like CSRD and CSDDD, is examined, along with the challenges and legal frameworks involved.

The environmental impact of data centers and the important role of green technologies in this regard are discussed at length. Also, the rise of AI in the workplace is analyzed, focusing on regulatory measures and workers' rights. We address the use of AI in ESG-related reporting, and issues such as greenwashing and the legal strategies to prevent it.

We explore the use of AI for ESG and sustainability risk management amidst a dynamic geopolitical landscape and the influence of political changes on regulatory approaches.

Finally, we highlight how AI, ESG and sustainability can drive growth through green IP protection, M&A and investor diligence.

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We hope you will find the attached articles insightful and helpful. Please don't hesitate to reach out to us should you wish to discuss any of these elements further.
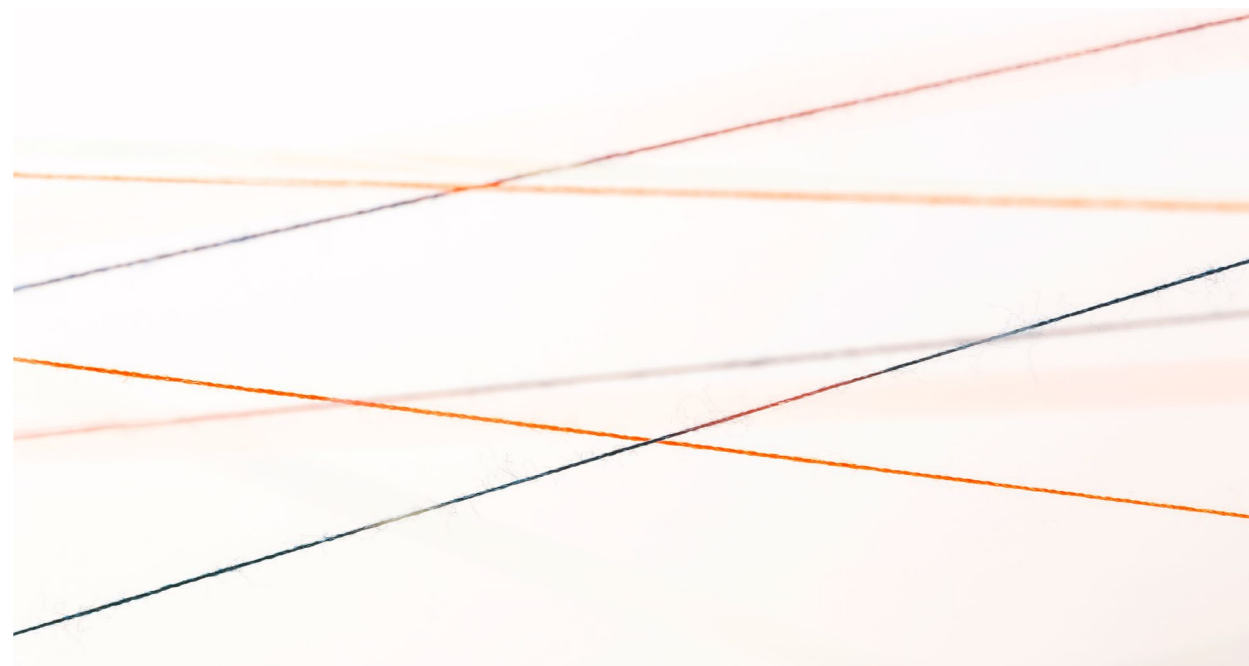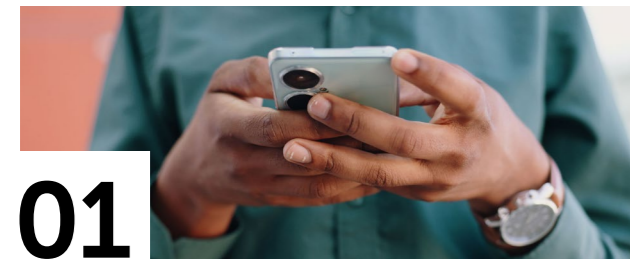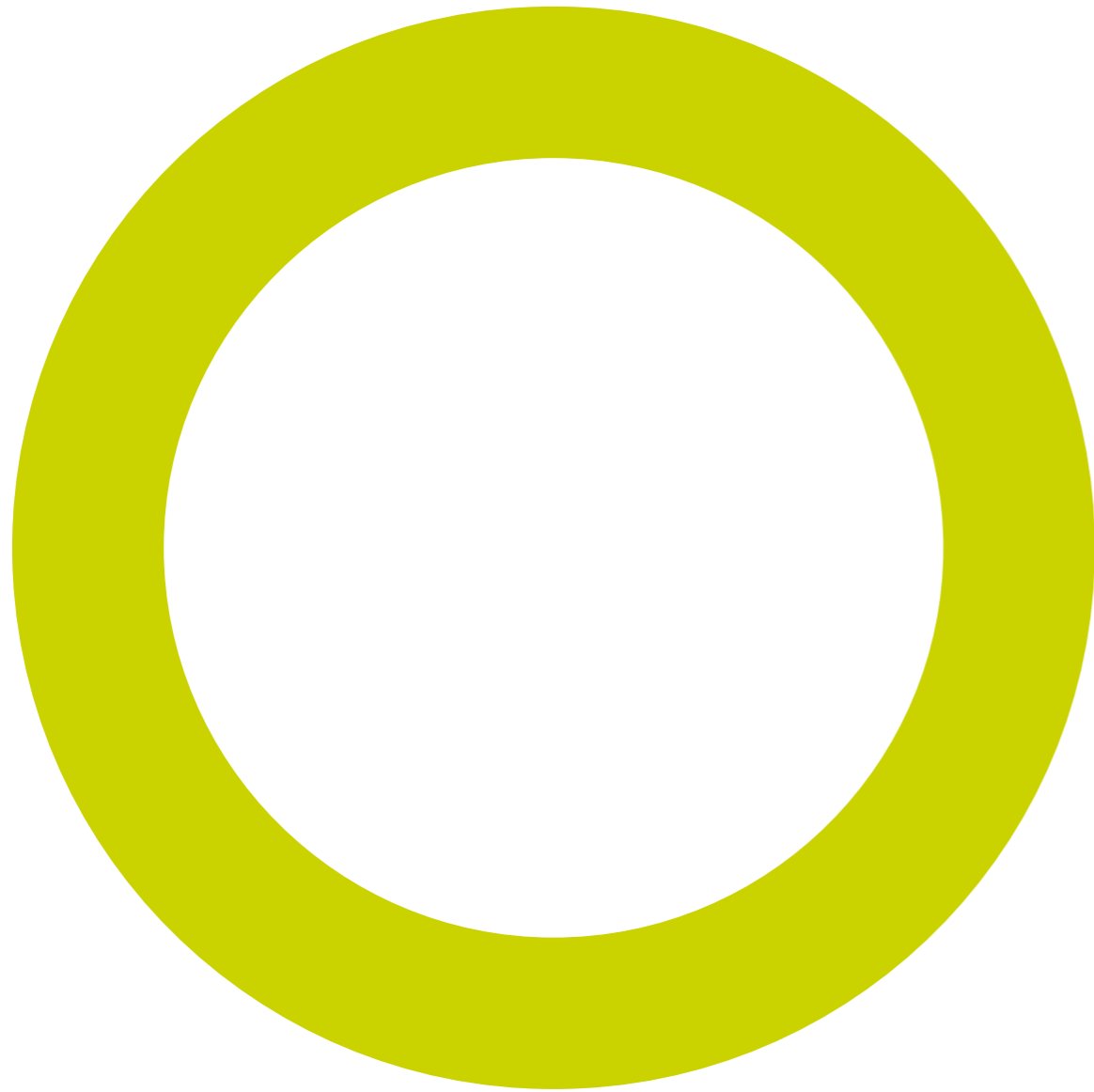
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If you'd like any more information regarding anything in this publication or if you need advice on legal issues in the technology, media and telecoms sector, please contact our legal team.

COMPLIANCE & GOVERNANCE

By prioritizing compliance and governance, organizations can ensure that their AI and ESG initiatives are not only effective but also ethical and sustainable. It can enhance decision-making, mitigate risks, and promote transparency and accountability. Fostering innovation while maintaining ethical standards gives organizations a competitive edge.

01

ENSURING AI INTEGRITY:
THE VITAL ROLE OF DATA QUALITY AND GOVERNANCE

In the fast-paced AI landscape, data is crucial for innovation, especially in generative AI. High-quality data and strong governance are essential for effective AI tools in legal and other sectors. This article examines the importance of data in generative AI, its impact on legal tech and data governance, and how robust policies can turn data into a strategic asset for leadership and competitive advantage.

Generative AI models, which create new content based on existing data, rely heavily on the quality of the data they are trained on.

Data Quality: The Foundation of Effective AI

Generative AI models, which create new content based on existing data, rely heavily on the quality of the data they are trained on. Crap in, crap out! Poor data quality can lead to inaccurate outputs, undermining the trust and reliability of AI applications in legal contexts. As highlighted by McKinsey, managing data quality is one of the main barriers to scaling generative AI solutions. Ensuring that data is accurate, comprehensive and up-to-date is essential for AI to provide valuable insights and support decision-making processes in legal tech as well as truly intelligent insight, forecasting, improvement and innovation. In short, be wary of investing in an AI magic beanstalk without preparing your soil, seeds, soil preparation, climate control, nutrients and water. Sift, prepare, nourish, secure and orchestrate your data soil foundation before licensing and planting your machine learning model and GenAI application.

Data Policies: Ensuring Governance and Compliance

Implementing robust data governance and classification policies is crucial for filtering, maintaining data quality and ensuring compliance with legal, regulatory and ethical standards. This applies equally to data egress, ingress and derivative data, applying a holistic approach to data management, classification, governance and audit. These policies should cover data collection, licensing, collation, storage, processing and sharing, ensuring that all data made available and released for use in AI applications is handled responsibly (eliminating, as far as possible, bias, confidential, personal and sensitive information). Effective data governance frameworks are essential priorities to mitigate risks associated with discrimination, misinformation, unjustified weighting, cybersecurity, privacy violations and bias in AI outputs. By establishing clear data policies, law firms and both public and private sector industries can enhance the reliability and accountability of their AI-driven tools.
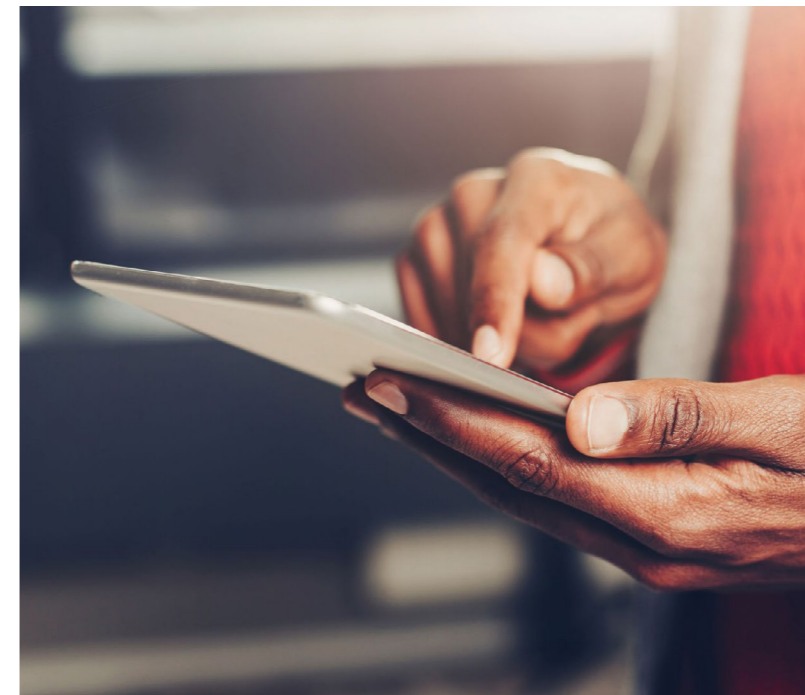
Implications for Legal Technology

The integration of generative AI in legal technology offers numerous benefits, including improved efficiency, reduced costs and enhanced decision-making. For instance, AI-driven document automation can streamline the creation and management of legal documents, while predictive analytics can forecast legal outcomes based on historical data. However, these applications are only as good as the data they are built on. Ensuring high data quality and robust governance is essential for maximizing the potential of AI applications.

Data as a Strategic Asset for Leadership

AI clearly offers huge productivity benefits and improves internal workflows and services. Using high quality data as the foundation for generative AI will serve to improve efficiency, reduce costs and enhance decision-making for the purposes of legal functions. If managed correctly, data can be an asset to those in leadership positions, assisting with making informed decisions, driving innovation and maintaining a competitive edge.

For strategic leadership, data is not just a resource but a core, essential, strategic asset. High-quality data can provide valuable insights into client needs, market trends and operational efficiencies. By leveraging data effectively, leaders can make informed decisions, drive innovation and maintain a competitive edge. As noted by NickRichards.io, data is the lifeblood of AI, powering its capabilities and enabling transformative outcomes. Moreover, the growing demand for data centers, as highlighted by Jefferies, underscores the importance of sustainable data management practices.

Accessing the right data for AI can be a significant challenge, particularly when dealing with sensitive, incomplete or domain-specific information. Often, data is not in the right place, lacks accessibility or is fragmented across various systems, making it difficult to consolidate and use effectively in AI applications. Additionally, sensitive and confidential data may be restricted.

To address these challenges, synthetic data is playing an increasingly important role. Synthetic data refers to artificially generated datasets that mimic real-world data while avoiding privacy concerns and restrictions. This approach helps fill gaps where high-quality or diverse real data is unavailable, offering a way to train AI models without compromising on ethical or regulatory standards.

The demand for data centers has surged dramatically and remains a key driver for global economies, raising concerns about whether supply can keep up. Data centers are essential for storing and processing the vast amounts of data required by AI systems, but the energy-intensive operations face challenges relating to infrastructure constraints, scarce raw materials, labor shortages and lagging power generation. As part of this, there is a growing trend for regulators to require both operators and customers to share and be transparent as to the level of energy consumption and cooling requirements in data centers and associated digital infrastructure.

Ensuring data quality, implementing robust data policies, and recognizing data as a strategic asset are critical steps for to harness the full potential of AI. By doing so, they can enhance their services, improve client outcomes, and lead the way in legal technology innovation.

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THE EU AI ACT:
THE ROLE OF AI LITERACY IN SHAPING ESG FRAMEWORKS

The EU AI Act (the "AIA") requires companies and public sector actors to implement regulatory guardrails and act in accordance with extensive regulation. In order to do this effectively, Article 4 of the AIA mandates that providers and deployers need to ensure a sufficient level of understanding of AI technology and the regulatory environment within their companies. AI literacy under the AIA is legally defined as the "skills, knowledge and understanding that allow providers, deployers and affected persons, taking into account their respective rights and obligations in the context of this Regulation, to make an informed deployment of AI systems, as well as to gain awareness about the opportunities and risks of AI and possible harm it can cause."

Creating an Information Strategy on AI and ESG

In general, deployers and providers need to establish an information strategy on how to communicate the necessary level of information to the relevant people. This requires (i) identifying the people who need training, (ii) creating the training, and (iii) conducting it in regular intervals. The training should include the teaching of basic notions and skills about AI systems and their functioning, including the different types of products and uses, their risks and benefits. Since the training needs to enable the relevant people to comply with the AIA, the training would also need to provide a general understanding of the AIA and how its regulations apply to the individual actors. With proper AI literacy, companies can ensure their AI applications comply with these laws, mitigating legal risks while tackling other parts of an ESG strategy as well.

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Purpose of AI Literacy

As one can see from the definition, AI literacy is not only there to obtain the greatest benefits from AI systems. A core purpose of AI literacy is to protect fundamental rights, health and safety and to enable democratic control at the same time. AI literacy should, therefore, equip providers, deployers and affected persons with the necessary notions to make informed decisions regarding AI systems.

The purpose of AI literacy is further elaborated in Recital 20 of the AIA: AI literacy should provide all relevant actors in the AI value chain with the insights required to ensure the appropriate compliance and its correct enforcement.

The concept of AI literacy has also been incorporated in Art. 20 of the Council of Europe's Framework Convention on AI, Human Rights, Democracy and the Rule of Law, which will not only be implemented by the Council's 46 member states but also many of the observers that participated in the negotiations of the convention, which include the USA, Canada, Mexico, Japan, Israel, Australia, Argentina, Peru, Uruguay and Costa Rica. Hence, it is to be expected that AI literacy requirements will be implemented in further national AI legislation far beyond the EU AI Act.

AI Literacy Impact on ESG

AI literacy plays a pivotal role in shaping and reinforcing, in particular, compliance and governance efforts within an ESG strategy, as it helps organizations navigate the ethical, legal, and regulatory challenges posed by AI technologies.

AI literacy ensures that leaders, decision-makers, and employees understand AI's capabilities, limitations and potential risks, which is essential for maintaining compliance and strengthening governance frameworks.

At the same time, AI literacy helps governance teams integrate AI-related risks and opportunities into their ESG disclosures. This includes reporting on the ethical use of AI, data privacy, cybersecurity measures and AI-driven environmental impacts. Transparency in these areas builds trust with investors, regulators and stakeholders. As AI systems rely heavily on data, AI literacy is also essential for understanding data management best practices.

Proper governance ensures that the data-feeding AI models is high quality, ethically sourced and complies with privacy regulations.

TRANSPARENCY IN THE VALUE CHAIN:
IMPLICATIONS OF THE EU CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE

The EU's Corporate Sustainability Due Diligence Directive (CSDDD) represents a pivotal effort in tackling some of today's most urgent global issues. As the effects of global warming escalate—through more frequent extreme weather events, deforestation and intensive farming practices—the urgency for responsible corporate behavior grows significantly. These environmental crises threaten not only natural habitats but also have profound impacts on local communities, leading to displacement, loss of livelihoods, health crises and large-scale migration. In an era where sustainability and ethical standards are becoming increasingly crucial, the CSDDD stands out as a key legislative milestone within the broader EU Green Deal framework. It enhances value chain transparency while mandating rigorous human rights and environmental due diligence.

Understanding the CSDDD

The CSDDD applies to both EU-based and non-EU companies that meet specified criteria. For EU companies, this includes large companies and partnerships with over 1,000 employees and worldwide net turnover exceeding EUR 450 million. Non-EU companies fall under its scope if they generate more than EUR 450 million in net turnover within the EU. While many smaller companies are not directly affected, they must still evaluate and report on their operations and those within their supply chains linked to entities directly covered by the directive.

Effective from July 25, 2024, the directive will be phased in, with EU Member States given two years to transpose CSDDD into national law, leading to full implementation by the end of 2026 and reporting starting in 2027. The CSDDD mandates businesses to identify, prevent, mitigate, and disclose adverse human rights and environmental impacts arising from their operations and supply chains. For companies using AI, this means they need to ensure that their AI systems do not contribute to such adverse impacts, including third-party AI solutions.

Due Diligence Obligations

Companies must conduct comprehensive due diligence to pinpoint potential risks in their supply chains, including evaluating environmental and human rights impacts of their operations and those of their suppliers.

Preventive Measures

Upon identifying risks, companies are required to enact measures to prevent, mitigate and eliminate these adverse impacts. This might involve altering business practices, collaborating with suppliers to elevate their standards or severing ties with non-compliant partners.

Key Components of the CSDDD

Reporting and Transparency

Businesses must publicly report their due diligence activities, ensuring stakeholders can see their commitment to upholding sustainability standards.

Remediation

When negative impacts occur, companies are obligated to undertake effective remediation actions.

CSDDD also requires companies to draft and implement a climate transition plan that must ensure that the company's business model and strategy are compatible with limiting global warming to 1.5°C, in line with the Paris Agreement.

Improving Value Chain Openness

Through comprehensive reporting and disclosure requirements, the CSDDD aims to shed light on often-hidden practices within global supply chains. This increased openness serves several purposes:

Accountability: Companies are held accountable for their own actions and those of their suppliers, reducing the risk of unethical behaviors going unnoticed.

Consumer Trust: Transparency fosters consumer trust. As consumers become more conscious of the ethical aspects of their purchases, they are more likely to support companies that are dedicated to sustainability.

Investor Confidence: Investors are increasingly factoring in Environmental, Social and Governance (ESG) considerations. Transparent reporting equips them with essential information for making informed decisions.

Impact on Supply Chain Diligence

The CSDDD raises the bar for supply chain due diligence, requiring companies to adopt proactive management strategies, which include:

Risk Assessment: Conducting regular and thorough risk evaluations to identify potential human rights and environmental issues.

Supplier Engagement: Actively engaging with suppliers to ensure compliance with required standards, potentially involving training, capacity-building and frequent audits.

Continuous Improvement: Establishing mechanisms for ongoing monitoring and enhancement of supply chain practices.

Consequences of Non-Compliance

Failure to comply with the CSDDD can lead to serious consequences for companies, such as:

Legal Penalties

Companies may face substantial fines and legal actions, with penalties designed to serve as strong deterrents against non-compliance. Aside from financial penalties, this may also exclude companies from being eligible to participate in public tenders.


Reputational Damage

In today's digital era, news of non-compliance can spread quickly, causing significant reputational harm. This can result in lost consumer trust, reduced sales and a damaged brand image.

Investor Withdrawal

As investors increasingly prioritize ESG factors, non-compliance can lead to divestment and diminished investor confidence, jeopardizing a company's financial stability.
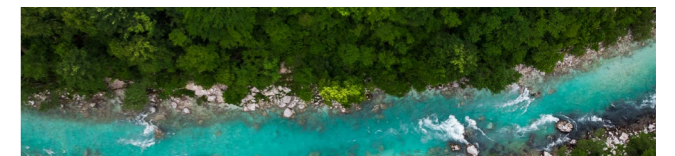
Operational Disruptions

Non-compliance may necessitate severing ties with non-compliant suppliers, leading to delays, higher costs and operational inefficiencies.

The CSDDD marks a significant step forward in promoting value chain transparency and enhancing supply chain diligence. Through stringent due diligence, preventive actions, and transparent reporting, the directive fosters accountability and sustainability within global supply chains. Companies adhering to these standards stand to gain increased consumer trust, investor confidence and operational resilience, whereas non-compliance could result in severe legal, reputational and financial repercussions.

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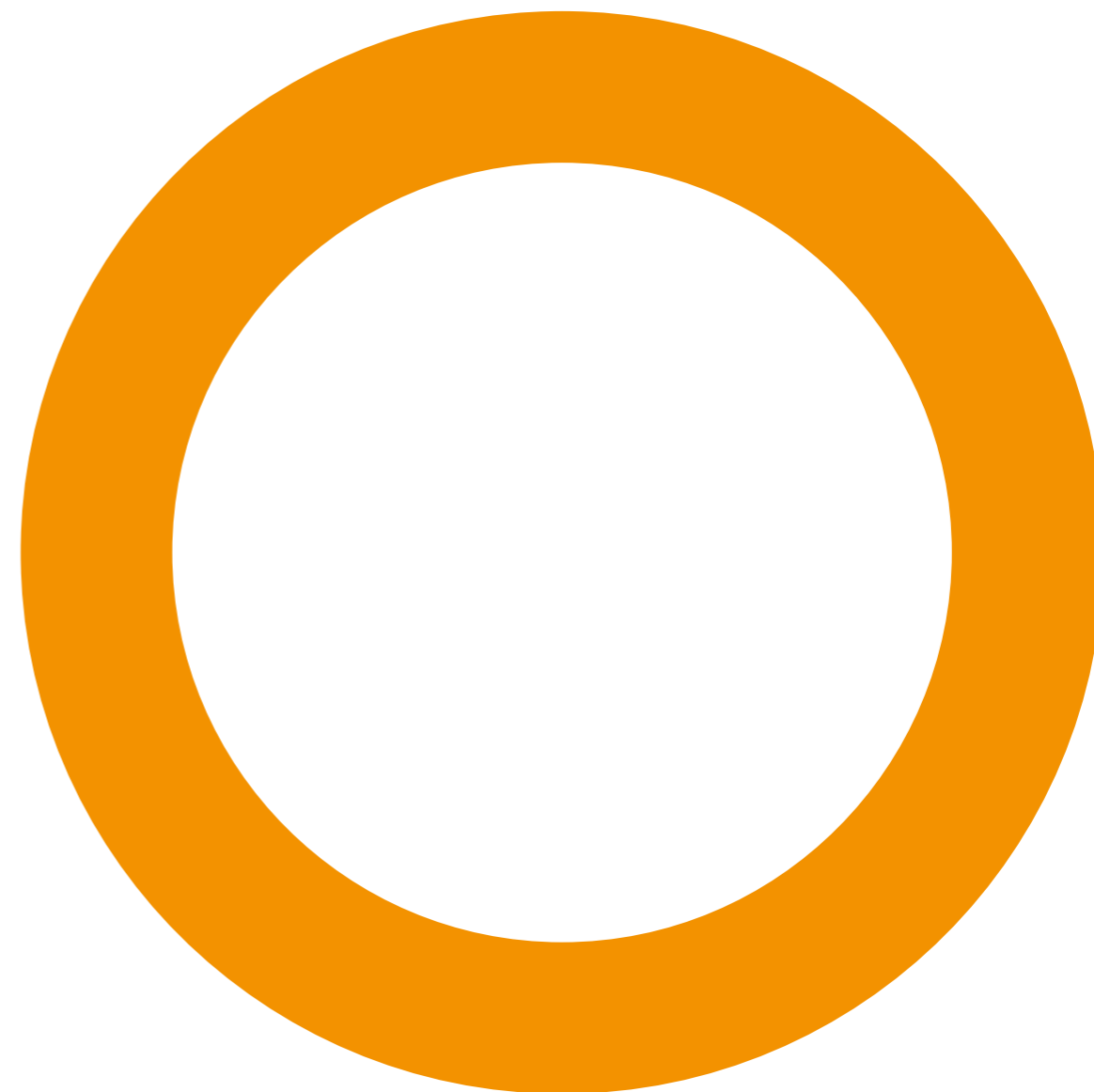
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RISK MANAGEMENT

Risk management in AI and ESG is essential to identify, assess, and mitigate potential threats, ensuring ethical standards, regulatory compliance, and long-term sustainability. This helps protect organizations from unforeseen challenges and enhances trust and transparency.

02

AI IN THE WORKPLACE:
FRIEND OR FOE? RISE OF THE TRADE UNIONS

Across the globe, the use of AI systems in employment is increasing rapidly – to recruit and select candidates, manage performance, monitor workers and more. While AI can provide benefits for all, it is a growing area of sensitivity for workers and trade unions.

Worker and trade union concerns reflect potential issues over AI's use relating to fairness, privacy, security, accuracy and lack of transparency. AI's impact on jobs and the future of work is another area of focus as AI's capability grows.

Such concerns are further amplified against a backdrop of minimal workplace regulation of AI in many jurisdictions. The extent to which workers and unions currently have a legal right to information or consultation on the use, or implementation, of AI in the workplace is variable and, in many cases, non-existent.

As a result, in many locations, we are seeing a rising union response to the introduction of AI. Many unions are trying to plug the lack of existing regulation by placing pressure on employers to inform, consult, and, in some cases, enter into collective agreements about how employers are using or intend to use AI in the workplace.

The highest-profile example of this was the widely reported strikes in Hollywood, which resulted in a reported agreement between unions and film studios on the circumstances in which AI could be used and protections for its workers in terms of how AI could support and not replace, workers.

There are further reported global examples of large employers within the tech sector entering into collective agreements that cover a range of AI-related matters.

For example, to agree on a joint approach on how AI will be introduced into the organization or protections for workers.

A right to workforce information and consultation on AI is and is expected to be a feature of some new regulatory frameworks, including in the EU. For example, the EU AI Act requires employers to provide information to workers and their representatives on "high-risk" AI tools before they are put into use. In the UK, the new government has committed to requiring employers to negotiate the introduction of "surveillance" technology with unions and pledged to put worker voice "at the heart of" the digital transition. We await further details of what this may entail.

Even where there is no legal requirement to do so, ensuring that the workforce understands new AI applications can limit the risk of disputes, strikes (where applicable) and legal claims. Worker voice can also play an important practical role in the introduction of AI to help maximize efficiencies and mitigate any potential risks. Balanced with this, however, is a need for employers to remain flexible in their approach to innovation, particularly at a time when AI is still developing rapidly.

As further global regulation of AI emerges, it will be interesting to see how the global trade union response is shaping, or may shape, such future regulation. Employers should watch this space closely for further developments.

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CLEAN CLAIMS OR DIRTY LIES? THE BATTLE AGAINST CORPORATE WASHING

"Washing" occurs when companies make misleading claims about their products, practices and/or services to appeal to consumers, investors, workers and/or other potential stakeholders. For example, overstating their green and sustainability-related credentials ("greenwashing"), the nature and extent of their use of AI ("AI washing"), or their social responsibility and positive impact ("social washing"). Washing can be intentional or inadvertent.

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Although these forms of washing have existed for a number of years, they are becoming more frequent and significant in the context of both increasing global regulation and rapidly evolving technology. Potential risks for businesses include loss of reputation, loss of stakeholder trust and goodwill, employee brand damage, costly legal/regulatory action, and more. In all industries, but perhaps more so in the tech industry, green, AI and social washing can overlap.

For example, AI/greenwashing risks can arise if companies make misleading statements about AI tools' environmental impact. Particularly where some generative AI tools have the potential to consume far larger amounts of energy than other types of technology. For example, one recent study[1] suggested that a Generative AI system could use around 33 times more energy than machines running task-specific software.

Similarly, AI/social washing risks can arise in the context of AI tools where such tools have the potential for discrimination bias. Discrimination bias can occur (often unknowingly) where an AI tool is trained on data that contains bias. For example, a recruitment tool may select more candidates of a certain age or race if the data on which it has been trained contains bias towards those groups. In addition to potential discrimination claims, complaints of social washing could arise where any such discrimination bias conflicts with a company's stated equal opportunities position.

From a regulatory perspective, global sustainability and Environmental, Social and Governance (ESG) regulation is developing at a pace with varying disclosure, due diligence and reporting requirements across the world. Increased regulation of AI in some jurisdictions also requires a greater level of transparency.

1.   [2311.16863] Power Hungry Processing: Watts Driving the Cost of AI Deployment? (arxiv.org)

Washing risks can arise in these circumstances, for example, if companies provide information/data that is inconsistent with their earlier statements.

Consumer regulation is also increasing in some jurisdictions. For example new legislation in the UK gives regulators increased powers to issue enforcement notices and fines where companies provide consumers with false or misleading information relating to a product that is likely to deceive the average consumer (read more about this here). These new powers will apply to greenwashing, social and AI washing.

Although each form of washing has its own individual risks that companies must consider in the context of their jurisdiction, there are some governance and best practice measures that all companies can put in place to help mitigate some of the potential risks:

Finally, and perhaps as a direct consequence of companies' concerns about washing, a new concept is also emerging of which the sector should be mindful. Green/AI/social "hushing" involves companies minimizing or refusing to publish credentials for fear of being scrutinized. This may, in some circumstances, also open companies up to risks, particularly if it leads to misleading statements or the potential for non-compliance with legal reporting requirements.

Corporate Washing Best Practices
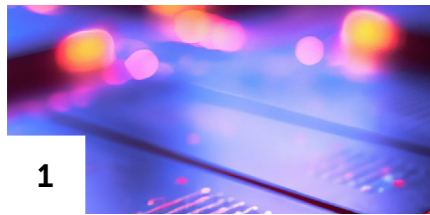
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Are relevant business terms clear about the correct definition of AI/generative AI, and are actual or proposed claims made about the use of AI, operationally or within products and services, accurate and supported by evidence.

2

Carrying out thorough due diligence on any new products/services before appointing suppliers and continually reviewing these as products/services develop (particularly in relation to rapidly developing AI).
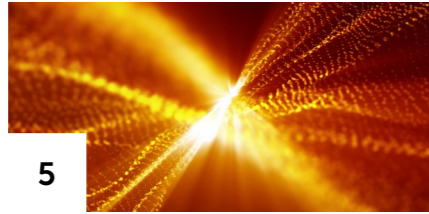
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Carefully considering external communications, e.g., adverts, to ensure claims are verified and substantiated, similarly, keeping this under review as products/services develop.
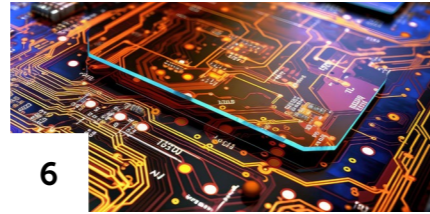
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Ensuring relevant terms and conditions (both for sale to customers and for use with third-party suppliers) comply with the relevant rules and requirements.

5

Putting in place effective global governance procedures to mitigate the risk of inconsistent statements to stakeholders and encouraging cross-organizational, "joined-up" thinking.

6

Keeping up-to-date with new and increasing ESG, AI and other regulations globally.

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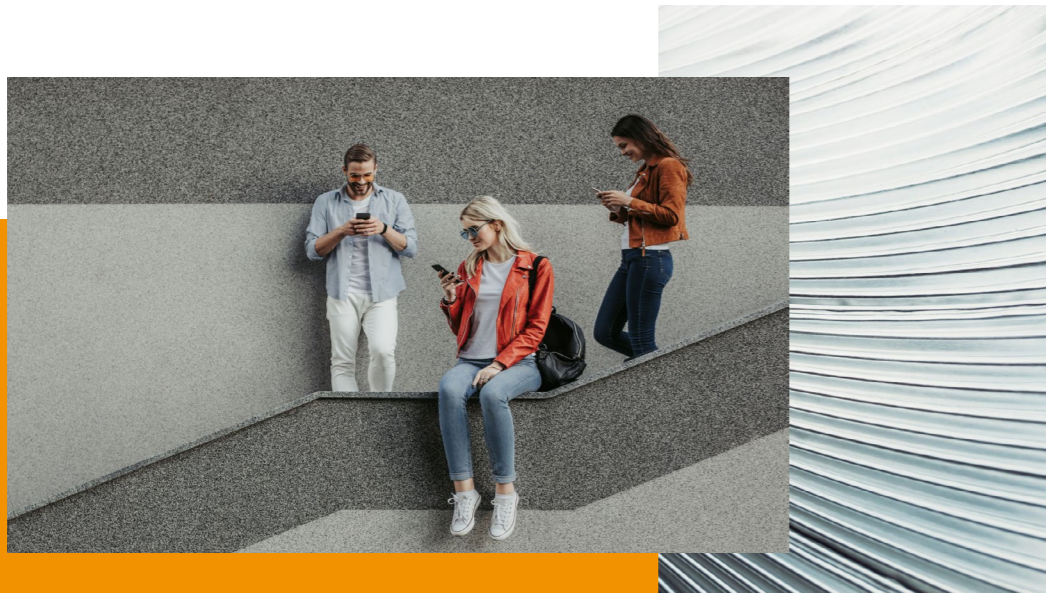*Partner*
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NAVIGATING THE GENAI REVOLUTION: BALANCING RISKS, REGULATIONS AND RESPONSIBLE USE

The market for GenAI is evolving, with vendors and customers identifying specific use cases for new applications and enhancing existing products and services. A recent Gartner survey indicated that around 30% of all businesses are using some form of GenAI, with many features regularly being incorporated into even the most commonplace and everyday applications and systems. The result is that you may already be procuring and deploying GenAI as more and more applications integrate GenAI features—and we are rapidly approaching a point where it will be difficult, if not impossible, to avoid using GenAI.

In the November 2023 edition of Telescope, we wrote about the key contractual issues when procuring or supplying both "traditional" AI solutions and GenAI, as well as discussing early indications of regulatory risk. In this edition, we consider three further issues:

Why does deployment of GenAI carry with it risk?

With any publicly available GenAI, you will have spotted the disclaimer below every output that the GenAI "may display inaccurate information" and "can make mistakes," so "double-check the output" and "check important information", or words to that effect. This is all true, and it is good advice. This will apply similarly to applications that utilize and combine their own corporate data with an LLM in a private instance. This means that careful consideration needs to be given to how you will regulate, monitor and control their use. It also means that careful consideration needs to be given to the allocation of risk, remediation, and remedies in agreements between vendor and customer.

The wider regulatory picture must also be taken into account: we discussed in our November 2023 edition of Telescope the emerging regulatory picture in the European Union and UK, a picture which is continuing to develop as the EU AI Act beds-in and as the new UK Government considers whether to depart from the more indirect, hands-off approach adopted by the previous Government. The recently delivered first King's Speech of the new Labour Government included a statement that the UK would *"seek to establish the appropriate legislation to place requirements on those working to develop the most powerful artificial intelligence models,"* reflecting a pledge in the Labour Party's 2024 election manifesto to

"ensure the safe development and use of AI models by introducing binding regulation on the handful of companies developing the most powerful AI models" – but to date the UK Government has not explained what concrete steps it intends to take, nor has any draft legislation been published. While it is likely that the UK will adopt a new regulatory approach in the future, for now, your use, development or supply of AI-enabled products may fall within the scope of a wider range of national and international regulations outside of AI-specific law.

Taking one example, incorporating connected services into a consumer product (including AI features) and then manufacturing, importing or distributing that product in the UK or EU is likely to bring the product into the scope of the UK's recently-enacted Product Security and Telecommunications Infrastructure Act 2022, which is similar to the EU's proposed Cyber Resilience Act (which is expected to come into force later this year). These statutes impose specific obligations in relation to the security features of relevant products, with sanctions for non-compliance. The potential impact of the proposed EU AI Liability Directive, intended to provide consumers adversely affected by AI systems with a fault-based right to redress, is also one to pay close attention to – progress of the Directive has been stalled but recent indications are that the EU will continue working on these rules into 2025.

Why does this matter?

Take the example of a self-serve HR advice platform deployed in an organization calling on that organization's HR policies and procedures using prompts by HR professionals and a private LLM – errors here could lead to incorrect procedures and decisions being made and expose the company to claims from employees. Or the example of the development and deployment of a GenAI system by an

IT-managed services provider to certain corporate customers – to what extent does it meet good industry practice, fitness for purpose, satisfactory quality or similar contractual obligations? Similarly, if a company director uses GenAI to assist them with making decisions around business strategy or hiring decisions, will that be consistent with their statutory and fiduciary duties as a director?

There is no one-size-fits-all answer to the questions raised by GenAI.

So, what can you do about it?

There is no one-size-fits-all answer to the questions raised by GenAI. Responsible use will depend on any number of factors, from the GenAI tool being used, to the application it is being put to, to the nature of the business and person using it. But there are common themes.

Before you use GenAI yourself, take a step back and ask first: do I know what GenAI tools I am actually using and the purposes for which they are being put? After that, ask: do I believe this a responsible way to use the technology, and can I justify and defend that use? This should include consideration of what the consequences would be if the output is wrong, what reliance you intend to place on the output, and what steps you will take to

identify inaccurate output and mitigate that risk. It should also include consideration of what data or information is likely to be used as input into the system – and whether or not it may include personal, confidential or otherwise sensitive data.

If your employees have access to tools, which include GenAI systems, you should put in place policies and procedures to manage and control their use and define what your organization considers to be a responsible use of the tools. As noted above, your organization's answer to this question is unlikely to be the same as another organizations and real thought and consideration should be given to this process.

Any policy or process you put in place should then be tested against how GenAI systems are actually being used by employees in practice: a policy which says that employees should not use GenAI for a particular purpose is of limited benefit and utility if, in practice, employees are regularly using GenAI for that purpose. Your organization is better served ensuring that appropriate safeguards and regulation are being applied to what is actually happening than adopting policies that assume a different state of affairs.

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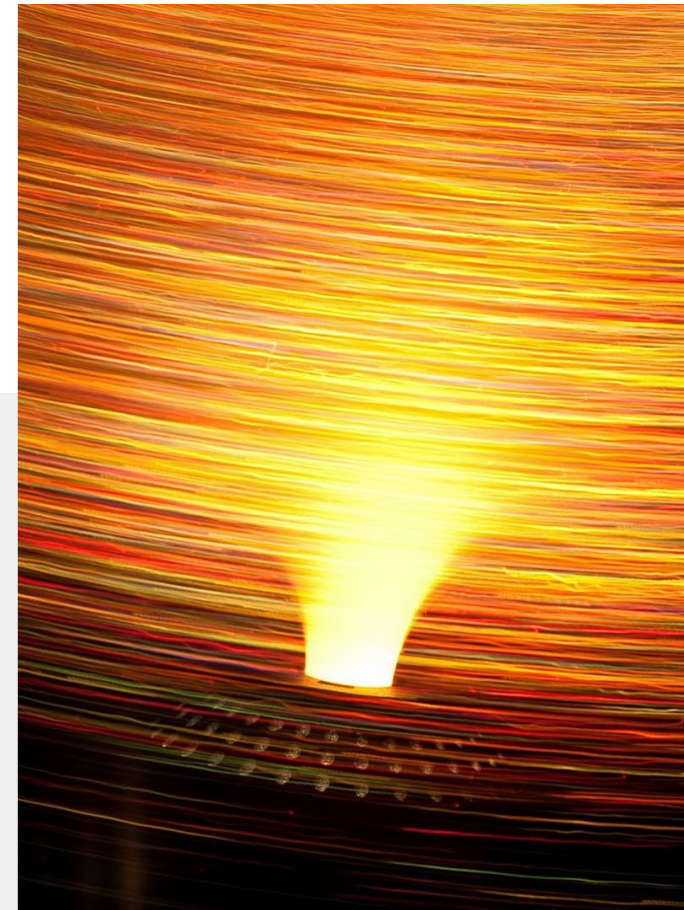@eversheds-sutherland.com

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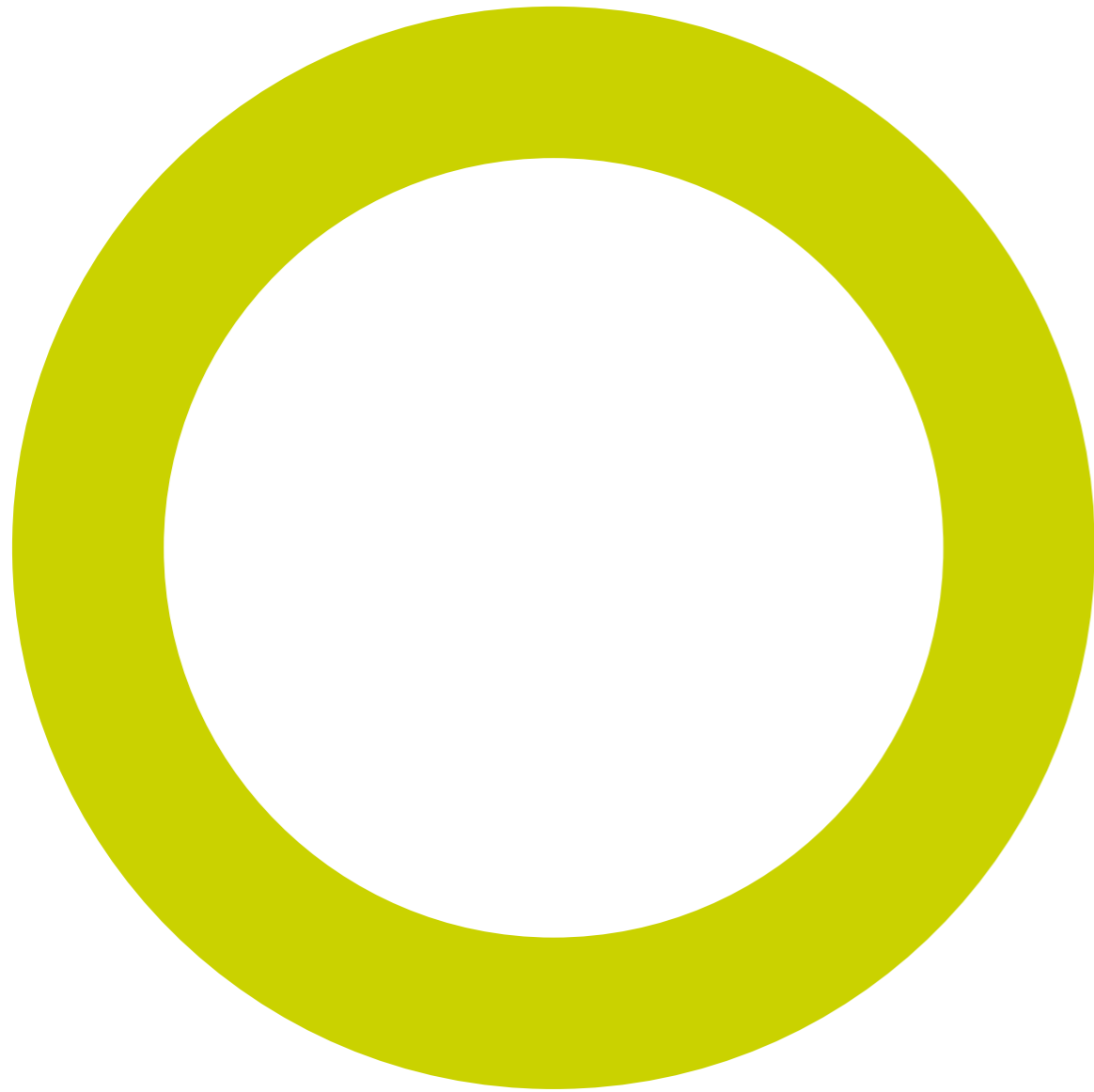jameshyde
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IMPACT OF POLITICAL EVENTS

Political events play a critical role in shaping the landscape of AI development, regulations, and ESG practices globally. They influence the creation of regulatory frameworks, international cooperation, ethical considerations, legislative changes, geopolitical risks, public sentiment, and the alignment of AI and ESG policies.

03

GEOPOLITICAL DYNAMICS AND AI: THE TUG-OF-WAR OVER DEVELOPMENT AND REGULATION AROUND THE GLOBE

With 2025 on the horizon, the world stage is becoming increasingly complex, with a key emerging issue on the geopolitical order – the accelerated development of AI.

Today, the world's leading nations are battling for influence in the AI sector. Mastering the technology and spearheading its development has become vital for boosting economic growth, strengthening military capabilities, leading global standards and shaping the digital landscape. Against this backdrop, we see Europe, the US and China investing heavily in AI research and development and, at the same time, grappling with designing regulatory frameworks that reflect their national priorities and strategies for technology and governance.

EU

In the **EU**, the central theme in regulation is to balance innovation and ethics. In fact, the EU has been a frontrunner in data regulation and AI governance. Prior to the explosive development of AI, the EU General Data Protection Regulation (GDPR) (applicable since 2018) already served as the foundation for individuals' rights concerning the processing of their personal data, including data used in the development and application of AI. The newly introduced EU AI Act now fills the gap to regulate not just personal data but specifically AI systems. Adopting a risk-based approach, different compliance requirements apply to providers and deployers of AI systems of different risk levels. As one of the first comprehensive AI regulatory frameworks, the EU AI Act sets a precedent for global standards and practices.

On the other hand, while AI governance is on the key issues list of the US government, to date, there is yet to be a comprehensive federal AI regulatory framework in the country. That said, existing laws, such as the California Privacy Protection Act, regulate activities in which AI may be used. There are also new sector-specific frameworks intended to govern the technology. Alongside this, the government has been investing significantly in the development of the technology through public and private sectors, with major tech companies steering innovation. There is no doubt that the US will continue to be a leading competitor in the ongoing AI race. Another thing is clear, its tech policy will inevitably be influenced by the 2024 presidential election.

CHINA

Across the globe in **China**, while AI is also a national priority, the regulatory approach underscores a vivid contrast. The Chinese regulations are highly centralized and focus on establishing standards that ensure security, reliability and alignment with the government's policies and socialist values. China's AI laws encompass a range of regulations on algorithm recommendation, deep synthesis, generative AI and ethical review of technology. These AI regulations also go hand-in-hand with China's Personal Information Protection Law and cyber security laws governing the regulation of data and information systems.

As explored above, it has become clear that the global regulatory approaches for AI are inherently fragmented due to the variances in national strategies. These fundamental differences could potentially accelerate disintegration, especially under the current political climate. In addition, we also see countries controlling exports of resources and technology and establishing control over international data transfers. As we move into 2025, AI development is expected to continue to play an important role in shaping the geopolitical landscape. The stakes are high, as the outcome of the global AI race could determine the trajectory of human civilization.

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THE 2024 US PRESIDENTIAL ELECTION: SHAPING AI REGULATION AND ESG POLICIES

With one presidential candidate more inclined toward robust regulation and the other more inclined to loosen regulatory requirements, the outcome of the 2024 US election will significantly influence the direction of AI governance and ESG disclosure requirements at the federal level, with profound implications both domestically and globally.

Shaping AI Regulation and Governance

As AI's promise of revolutionary opportunities runs up against warnings of revolutionary risk, Congress has deadlocked on whether to foster a rapid and relatively unhindered pursuit of opportunity, especially in the face of competition from countries like China, or whether to move slower and break fewer things.

The current administration has met this legislative deadlock through both executive orders and sometimes aggressive interpretation of existing statutory authority, addressing key issues such as data privacy, algorithmic transparency and the ethical use of AI.

If Vice President Harris becomes president, we can expect continued executive action prioritizing risk mitigation, as well as calls for Congress to enshrine a more cautious approach in law, including through measures to prevent bias in AI systems, enforce transparency in AI decision-making processes and safeguard personal data.

If former President Trump returns to the Oval Office, we can expect executive action to minimize regulatory burdens and prioritize innovation, particularly in the name of global competition. That could include repeal of President Biden's executive orders on AI and greater investment in military AI capabilities.

Regardless of the presidential election, states are likely to fill the void, leading to a disparate patchwork of laws—and perhaps even more piecemeal than in the data privacy context, as states seek to tackle particular uses of AI, such as algorithmic underwriting, or to protect specific populations, such as children.
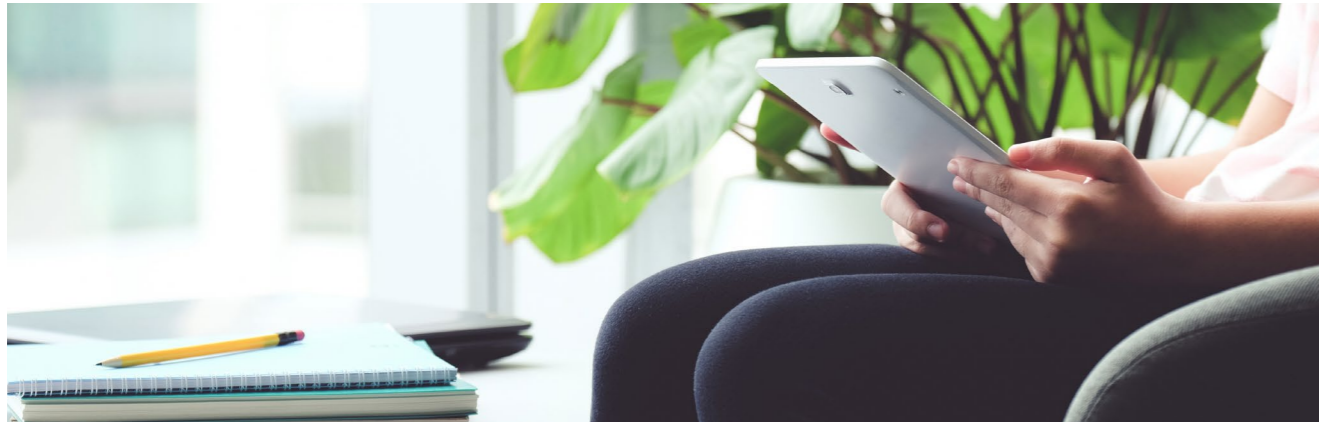
The 2024 US presidential election is poised to shape the future of both AI regulation and ESG policies.

Impact on ESG Policies

The election will also have a significant impact on ESG policies, which have gained increasing importance among investors and stakeholders. The direction of ESG policy and disclosure requirements will depend on the administration's stance on sustainability and corporate responsibility.

An administration committed to sustainability and social equity may introduce stricter ESG reporting standards. This could involve mandating greater transparency on issues such as carbon emissions, labor practices and board diversity. Enhanced disclosure requirements would push companies to adopt more sustainable and socially responsible practices, aligning with global ESG trends.

Conversely, an administration focused on economic growth and deregulation might relax ESG disclosure requirements. This could slow the momentum of ESG initiatives, potentially reducing the emphasis on sustainability and social responsibility in corporate strategies. The divergence in policy direction will influence how companies approach ESG issues and shape their long-term strategies.

Energy policies will also be a critical factor, as they directly impact ESG developments. The election outcome could determine the level of commitment to renewable energy, climate change mitigation, and clean energy transition. An administration prioritizing clean energy initiatives could accelerate the shift towards sustainable energy sources, influencing global energy markets and encouraging other nations to follow suit, but doing so may impose costs in the energy sector and beyond.

The 2024 US presidential election is poised to shape the future of both AI regulation and ESG policies. The direction of AI governance will depend on the administration's approach to balancing innovation and regulation, while ESG policies will reflect the government's commitment to sustainability and corporate responsibility. On both fronts, the election's outcome will also set the tone for international standards and cooperation, underscoring the interconnectedness of these critical issues.

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EVOLVING TRADE RULES:
USING AI TO INTEGRATE ESG GOALS INTO THE GLOBAL TRADING SYSTEM

International trade rules evolved in an earlier time when trade activity primarily involved the movement of goods and a relentless drive to ensure fair trading practices and economic efficiency. Today, the international trading system faces new challenges because it is being called on to serve environmental and social goals as well as commercial and economic ones. As ESG considerations have become matters of concern for the global supply chain, new pressures have been imposed on the global trading system as it is enlisted to serve social, as well as economic, goals.

The current geopolitical landscape is influenced by environmental and social pressures that were not considered when the rules of international trade first evolved. Global warming and efforts to decarbonize the energy system have added an environmental dimension to the commercial considerations that have traditionally been the focus of trade rules. At the same time, concerns over the character and resiliency of supply chains have triggered efforts to utilize trade rules for environmental and social ends. An example of this development is trade measures designed to penalize parties for failure to adhere to sound environmental practices that reduce carbon emissions. The result is a trading system of added complexity that no longer focuses simply on lowering trade barriers and facilitating a rules-based trading system.

Although international trade rules were initially developed primarily to ensure fair economic competition among nations, they now also provide a framework for achieving other objectives, such as setting standards for supply chains. Consider, for example, the U.S. conflict minerals rules, prohibitions on imports derived from forced labor, and various emerging import bans promulgated under various US laws. The origin determination rules developed under historical trade rules facilitate the tracking of the origin of commodities traded around the world and can be used to document compliance with emerging trade restrictions. Likewise, new tools such as the European Union Carbon Border Adjustment Mechanism (CBAM) incentivize trading partners to reduce carbon emissions and serve global environmental goals by encouraging low-carbon industrial practices while ensuring that imports do not undermine the decarbonization objectives of the EU.

The question remains, however, whether a trading system developed to achieve economic efficiency and just-in-time production of goods can be adapted to other ends without undercutting the economic goals that have been its hallmark. Given the rapid rise of technological innovation over the last half-century, many believe that the answer lies in the adoption of new technologies that can make the system more efficient and thereby avoid the loss of productivity and delay that threatens to undercut the efficiency of global trade. For example, artificial intelligence can be used to support and enhance the effectiveness of a trading system facing new demands to serve global environmental, social and economic objectives.

AI has the potential to serve compliance and governance goals by enhancing corporate compliance proficiency, particularly in the areas of trade compliance and monitoring. AI solutions offer such capabilities in such areas as supply chain mapping, transaction monitoring and transaction analysis across multiple corporate platforms. By leveraging AI, companies can gain real-time visibility into their supply chains, identifying potential risks and alerting relevant personnel to activity that is inconsistent with ESG considerations. AI-driven transaction monitoring can detect anomalies and suspicious activities more efficiently than traditional methods, thereby reducing the risk of fraud, error and other non-compliant activity.

In short, AI's ability to analyze vast amounts of transaction data potentially offers trading partners valuable insights for decision-making and strategic planning. It provides companies new tools to adapt to the challenge of a trading system that is presently stressed by efforts to enlist trade principles and remedies to address social goals that go well beyond the economic realm for which trade rules were developed. New technologies such as AI have the potential to both serve ESG goals and enhance the ability of the trading system to achieve the efficiencies that have characterized its growth in the post-war era.
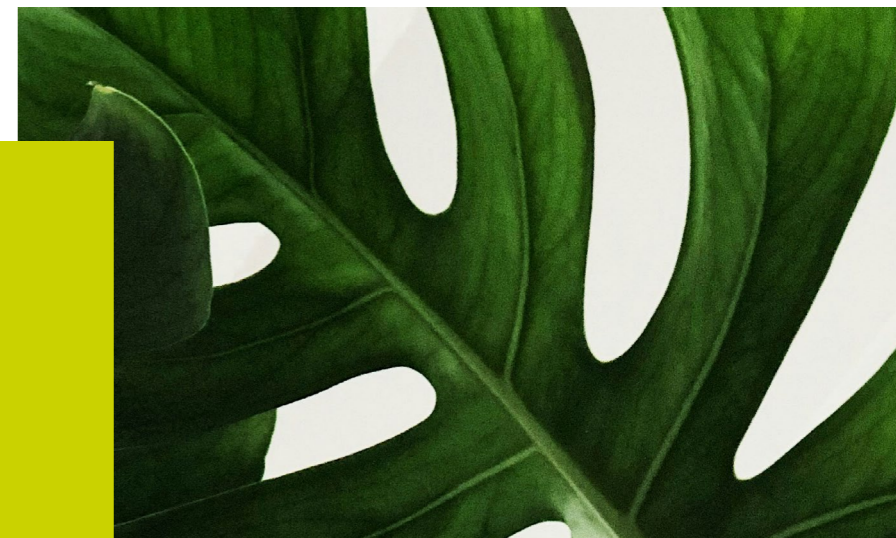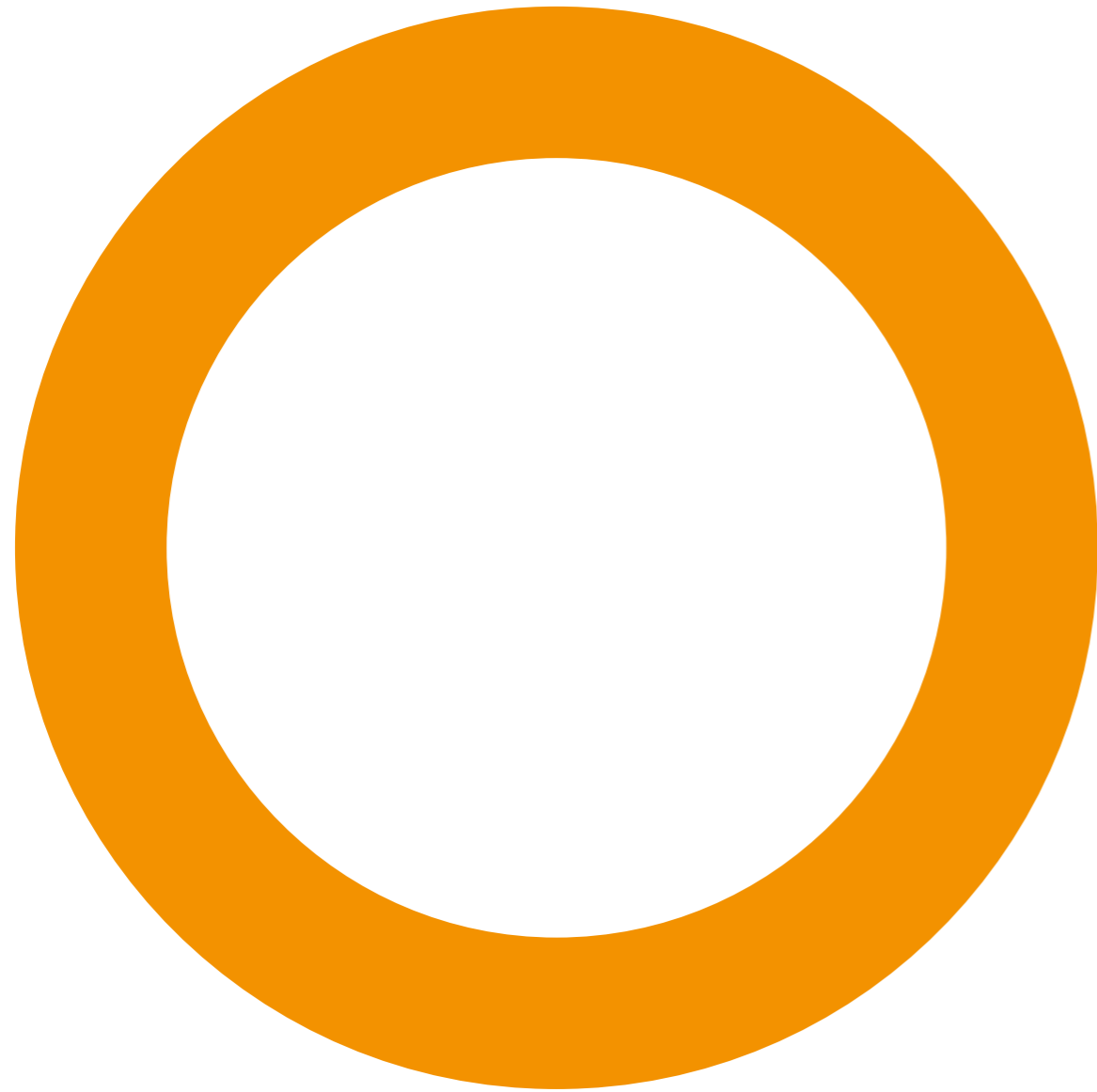
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SUSTAINABLE GROWTH

By emphasizing responsible development, minimizing environmental impact, and adhering to ethical practices, both AI and ESG can drive long-term sustainable growth. This approach fosters innovation, enhances efficiency, and brings significant benefits to businesses, society, and the planet.

04

AI AND ESG: EMERGING FORCES SHAPING GROWTH STRATEGIES AND M&A

AI is revolutionizing the business landscape by enabling companies to analyze vast amounts of data, automate processes and generate valuable insights. As AI continues to evolve, businesses must strategically position themselves to leverage its transformative potential while mitigating associated risks.

This challenge is compounded by increasing regulatory scrutiny, exemplified by the EU's AI Act, which came into force on August 1, 2024, and will be fully effective by August 2, 2026. Although the UK has not enacted similar horizontal AI regulations, existing regulatory bodies such as the Financial Conduct Authority, Information Commissioner's Office and Competition and Markets Authority are focusing on AI within their respective domains.

ESG factors, on the other hand, are becoming increasingly important as stakeholders demand more responsible and sustainable business practices. Investors, customers and regulators are increasingly focusing on ESG performance, and companies that fail to address these issues may face reputational risks and financial penalties. On the other hand, companies that excel in ESG can attract more investment, build stronger customer loyalty and achieve long-term sustainable growth. Again, regulatory intervention, particularly in terms of disclosure requirements, continues to increase alongside the rise of litigation for "greenwashing" in cases where the sustainability credentials of products or investments are believed to be overstated.

Investors in growth companies are increasingly focused on answering these two questions in their due diligence work. Specific questions on the use of AI (addressing intellectual property, data privacy and ethical concerns) are becoming standard in due diligence questionnaires, together with specific queries that address ESG as a standalone subject. This diligence work is then progressing into ongoing obligations on the part of businesses to develop and adhere to ESG frameworks and provide appropriate reporting, enabling financial investors to comply with their own investors' requirements, and equally ensuring that corporate investors' own ESG credentials are not damaged by the approach of the investee company.

AI, of course, is also being used in the diligence process itself, speeding up contract reviews and enabling dealmakers to get a view on a more comprehensive data set than would typically have been possible with traditional methods.

In both investment and M&A, the use of AI is becoming a key area for risk allocation through specific warranties, with businesses also pushing back in return and seeking to exclude liability for third-party large language models and the intellectual property issues arising from the use of third-party content to train artificial intelligence models or general artificial intellectual output.

AI and ESG are also, of course, key drivers for corporate activity in their own right. Corporates have been looking to reshape their portfolios of products and services to improve their ESG position (acquiring or investing in those that enhance their position while disposing of non-core businesses that are problematic from an ESG perspective), and many tech-enabled businesses have been created to fulfill ESG market needs.

AI has also given rise to a significant boom in corporate venture activity, given the size of the investment needed in development and computing resources to bring general-purpose AI models to market. M&A in the AI sector is also increasing as the technology and the ecosystem mature, posing unique legal and regulatory challenges, including potential anti-trust and/or national security reviews.

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ADDRESSING CARBON CHALLENGES IN AI DATA CENTERS

To meet the anticipated growth of AI, enormous investments in supporting infrastructure, data centers and graphics processing units are being made to provide the necessary computing power and data storage. As data centers host more high-power computing systems for AI, the strain on electrical grids increases, leading to a commensurate risk of higher carbon emissions and other environmental impacts.

According to some reports, it is projected that by 2030, the global data center industry's carbon emissions could triple. This risk has prompted the data center industry to focus increasingly on reducing the environmental impact of AI data centers, particularly in terms of water consumption, heat emissions, and especially carbon emissions.

However, despite concerns about the environmental impact of developing and using AI data centers, there is a growing recognition of their critical role in the modern economy, both in terms of public awareness and governmental support. On September 12, 2024, the UK government designated data centers as "Critical National Infrastructure." This means they will get more protection and support during incidents (such as outages and cyber-attacks), showing how important they are to the economy and society. The UK government held a consultation on a licensing regime for data center operators, aligning with global trends towards increased regulation due to their systemically important nature. Data centers are also anticipated to fall within forthcoming resiliency regimes for systemically important financial institutions, due to their integral role in IT infrastructure for financial transactions.

All this points to the fact that simply preventing AI data centers from being constructed is not going to be the right solution to the risk of increasing carbon emissions. However, the good news is that the sector has already made great progress, aided by an alignment of aims between users (lower wastage should reduce costs) and operators (margins and marketability can be improved).

Additionally, some of the largest occupiers and users of AI data centers (known as 'hyperscalers'), have sustainability targets, requiring suppliers to use renewable energy and adopt other measures. Similarly, alongside calls to improve sustainability from customers, data center operators have teamed up to enhance reporting and improve industry standards through initiatives like the iMasons Climate Accord (ICA). They also face increasing regulatory scrutiny. For example, the EU will require broad reporting on energy and water usage by data centers, and several jurisdictions are considering or implementing restrictions on permissible power usage efficiency ratings.

Nonetheless, more work is needed to reduce the impact of materials like concrete, which have high embodied carbon emissions. In July 2024, the ICA urged the data center industry to reduce embodied emissions and adopt Environmental Product Declarations for better Scope 3

emissions transparency and to lower the industry's carbon footprint. This is crucial due to the AI data center boom, which demands extensive use of concrete and other materials for high-density workloads. The challenge is that lower carbon concrete or alternatives have been difficult to procure at reasonable cost and quality.

Data centers are essential in today's AI landscape but face significant challenges related to energy consumption and minimizing their environmental impact. Despite the challenges, data centers are here to stay. An energy-efficient AI data center is one that will continue to invest in emission-reduction technologies and attract customers through its specific contractual terms, setting out clear sustainability commitments and obligations. Aligned with this, as regulatory scrutiny intensifies, new laws regulating AI data centers will further enforce energy efficiency, shaping a more sustainable industry.

The UK government has designated data centers as "Critical National Infrastructure".

INNOVATE. PROTECT. THRIVE: IP STRATEGIES FOR THE AI-ESG ERA

In the rapidly evolving landscapes of AI and ESG, businesses must strategically manage their IP to drive growth, attract investment and maintain a competitive edge. This article explores the interaction between AI and key IP issues implicated in green innovation that can be leveraged to foster sustainable innovation and support compliance and risk management.

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Using AI to drive sustainable development while preserving patentability

Patents are crucial for protecting technological innovations, especially in the green tech space. By securing patents, businesses can safeguard their inventions from unauthorized use, ensuring that they retain exclusive rights to their technological advancements. This protection incentivizes innovation by providing a competitive advantage, preventing competitors from replicating their unique solutions. In the context of ESG, patents can protect green technologies and sustainable practices, encouraging further development in these areas.

Green technologies typically seek to improve the efficiency of existing industrial and commercial processes to reduce their resource consumption, their harmful by-products, or both. AI's ability to manage vast stores of information at high speeds makes it extremely useful for testing hypotheses and models to speed up the innovation process.

Generally speaking, inventions that undergird AI tools are eligible for protection under patent law. There is more controversy, however, surrounding the treatment of inventions that result when AI tools, including generative AI, are used to support the invention process.

Traditionally, patents apply only to the discoveries of natural persons. In Europe and the US, artificial intelligence cannot be identified as an inventor on a patent application. Inventions developed with the assistance of AI tools generally can be patented, however, as long as a natural person significantly contributed to the claimed invention. This fact should not be difficult to establish, using ordinary care in documenting how the researcher interacted with the AI tool to support the inventive work.

By investing in sustainable innovation, businesses can contribute to the global ESG agenda while also creating new market opportunities and revenue streams.

Building a reputation for sustainable innovation with a branding strategy

Trademarks play a vital role in establishing and maintaining brand identity. In an era where consumers are increasingly conscious of ESG factors, a strong, recognizable brand can differentiate a business in the marketplace. Trademarks protect brand names, logos and slogans, ensuring that consumers can identify and trust the source of products and services. This trust is particularly important for businesses that prioritize sustainability and ethical practices, as it reinforces their commitment to ESG principles.

The same attributes that make AI useful for technological innovation also make AI useful for selecting and enforcing trademarks. A new trademark cannot be registered if it is likely to result in consumer confusion when viewed against existing trademarks. AI tools now exist to assist in analyzing the similarity issues presented by proposed word marks and logos much faster than traditional human review.

Facilitating Collaboration

Efficiently tackling the complex technical needs of green innovation frequently calls for collective action and shared expertise. IP protection can facilitate collaboration between businesses, research institutions and other stakeholders. Licensing agreements, for example, allow companies to share their patented technologies with partners, fostering innovation and accelerating the development of new solutions. Trademarks also can encourage collaboration by ensuring that all parties maintain their brand identities – and association with important new technologies – while working together.

Leveraging IP for Compliance and Risk Management

Proper IP management can assist businesses in complying with legal standards and mitigate risks associated with IP infringement. By securing patents and trademarks and being aware of those rights held by competitors, businesses can avoid costly legal disputes and potential reputational damage.

Additionally, a robust IP strategy can help companies navigate the complex regulatory landscape associated with AI and ESG, ensuring that they meet relevant standards and requirements. For example, when choosing a trademark in the AI and green tech space, proper governance and compliance require businesses to avoid "greenwashing" and "AI-washing." The branding must not create false impressions of goods or services that are not

actually powered by AI or do not appreciably improve efficiency or otherwise support environmental claims. Regulators that have been fighting against "greenwashing" are now also seeking and punishing practitioners of "AI-washing."

In conclusion, strategic IP management is essential for businesses operating in a dynamic landscape where AI and ESG interact. By using AI to speed up innovation and protect those innovations, businesses can leverage their IP to drive growth and maintain a competitive edge. As the AI and ESG sectors continue to evolve, effective IP strategies will be crucial in navigating these changes and achieving long-term success.

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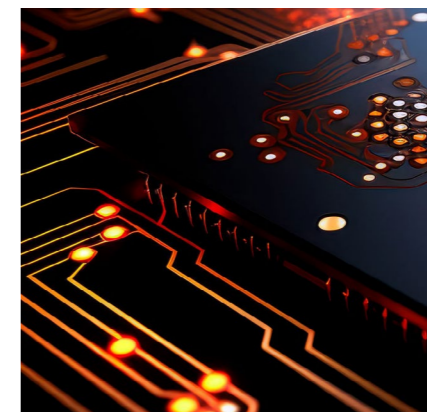
All AI-Board

Artificial intelligence is revolutionizing every industry and aspect of our lives. As more companies get on-board with new AI systems, it is important to carefully consider the risks associated with their development and use. Our legal guide to navigating AI offers bite-sized, Board-level insights. For more information, click here.

AI Risk Navigator

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Global Tech Series

Our Global Tech Series of events will begin in January 2025 and take place across the US, Europe, the Middle East, and Asia. The events will bring together industry leaders, regulators, in-house counsel, and partners from our global network to cover key themes relating to AI and ESG. Register your interest by clicking here.