

Addressing Legal Challenges in Utilizing AI

BY DANIEL H. ENNIS AND DREW STEVENS

Since its 2022 release, ChatGPT has revolutionized industries, but its integration into legal and business operations raises critical concerns. This article explores pressing AI legal issues, such as compliance with evolving laws, data protection, and the consequences of AI errors in real-world applications. Understanding these concerns is essential for businesses to navigate AI adoption successfully.

ChatGPT was first released to the general public in November 2022. Generally accepted as the first mass-market, large language model artificial intelligence (AI) program, ChatGPT and its competitors have rewritten how many industries envision integrating (or integrate) technology into their operations. Suddenly, outcomes that were only the realm of science fiction appeared achievable; however, the use of AI in practice comes with a myriad of legal issues to address, and some are more novel than others. This article discusses some of the most pressing AI legal issues.

Hallucinations and Accuracy

One of the primary concerns with AI is its propensity to provide incorrect or untrue responses, often referred to as hallucinations. Studies have put the hallucination rate for some prominent AI programs, depending on task and complexity, in excess of 25%, with some solutions achieving a lower error rate only through refusing to answer some questions. In the legal field, hallucinations have been a significant issue with the usage of AI, and there have been multiple cases where the use of AI (and subsequent hallucinations) in court filings led to adverse consequences:

- A lawsuit in a New York court was dismissed as a result of hallucinated citations and the relevant lawyer was sanctioned \$5,000 and required to write letters of apology to judges cited in the (hallucinated) cases.
- Attorneys in a Wyoming court were sanctioned a total of \$5,000 and agreed to pay legal fees and expenses of opposing counsel in responding to a brief that contained eight cases entirely created by AI.
- An attorney in an Indiana court faced aggregate sanctions of \$15,000 for providing false case citations in three separate legal briefs.

As a result, some courts have begun to require attorneys to provide affidavits as part of their court filings that their work product was either created entirely without the benefit of AI or that any case citations generated by AI were manually checked by the attorney. As an example of how an AI hallucination could impact a non-legal business, Air Canada was required to honor an inaccurate discount promised by an AI-driven online chatbot hosted on its website despite the correct (and less favorable to the customer) discount policy being displayed elsewhere on the website.

Vendor Contract Concerns

Fundamentally, AI is a software product, with all the related contract procurement issues associated with purchasing software. A non-exhaustive list of issues to consider when contracting for any AI product would include:

- Service level agreements, providing for minimum product standards, uptime requirements, product support, and end-of-life treatment
- Agreements on data ownership, access, and usage
- Provisions setting forth the initial term of the contract and the process for renewals and termination, along with the amount and cadence of pricing increases (if any)
- Clauses addressing the impacts of data breaches and related notification requirements
- Indemnities by the AI product provider for, among other things, any copyright violations related to training the AI model

Privacy and Confidentiality

Another major headline issue with the introduction of AI is data privacy and confidentiality. Most publicly

available AI programs retain all user data, which is then used to further train the AI and potentially incorporate findings into future responses provided to different users. As an example, Samsung banned its employees in 2023 from using public AI products after multiple instances of proprietary Samsung source code were being entered into those AI products for editing purposes and subsequently being reproduced for other users. Subsequent developments in “closed” AI models (where user inputs are encrypted and not used to train the AI tool) have reduced this concern, although this approach may not allow for the AI model to grow by including those inputs in potential outputs. A closed AI model also often comes with significantly increased costs and maintenance concerns.

Users of AI products also may have independent contractual duties not to use data otherwise in their possession to train potential AI programs. As examples only, some companies require their vendors (including law firms) to acknowledge that



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the company (and not the vendor) owns all data associated or developed by that vendor in connection with matters for that company. Agreements between a company and its customers also may contain confidentiality clauses that may not allow the company to use any customer information to train the company's AI program due to the risk of disclosure of customer confidential information to a third party as part of the AI model's output.

Applicable Law

AI-related enforcement and regulation is in flux and highly dynamic at this time. Shortly after taking office, the current administration revoked the former administration's 2023 Executive Order that had previously set federal policy on AI and, in its place, issued its own Executive Order directing the creation of an AI action plan. According to the new Executive Order, the new action plan should achieve the stated goal of "sustain[ing] and enhance[ing] America's global AI dominance in order to promote human flourishing, economic competitiveness, and national security." On February 6, 2025, the current administration then issued a request for information from interested parties on this proposed AI action plan.

Separately, in January 2025, the current administration deleted from agency websites the multi-agency Joint Statement on Enforcement Efforts Against Discrimination and Bias in Automated Systems, which had been jointly issued by the Department of Justice, Federal Trade Commission, and Consumer Financial Protection Bureau in April 2023. The current administration removed the former Director of the Consumer Financial Protection Bureau—which, under the prior administration, had been active in releasing regulatory guidance on the use of AI in the financial services industry.

Meanwhile, the Department of the Treasury released a December 19, 2024, report titled "Uses, Opportunities, and Risks of Artificial Intelligence in the Financial Services Sector." This report summarized six categories of risks associated

with AI, including data privacy, bias, consumer protections, concentration-related risks, third-party risks, and illicit finance risks. The report then identified potential next steps for financial services firms, including reviewing AI use cases for compliance with existing laws and regulations before deployment and identifying enhancements to existing risk management frameworks.

Against the backdrop of this change in federal policy, state law continues to create a patchwork of compliance obligations. The broadest state AI law enacted in 2024 was Colorado's "Consumer Protections for Artificial Intelligence." The law defines high-risk AI systems as those that make "consequential decisions" (which include, by definition, decisions related to financial services or lending). The law also

requires AI developers to provide information on AI systems to "deployers," the Colorado attorney general, and the public; develop an AI risk management program; notify consumers when high-risk AI systems are used; and provide information on the high-risk AI systems used to make consequential decisions.


States also have been increasingly active in introducing new legislation to regulate the use of AI, including California, Georgia, Hawaii, Illinois, and Washington, and in issuing guidance outlining how existing law applies to certain industry sectors' use of AI. For example, on January 13, 2025,

the California Attorney General issued two legal advisories on the application of existing laws to AI, including statutes on disclosure obligations. The New Jersey Attorney General and Division of Civil Rights also jointly issued "Guidance on Algorithmic Discrimination and the New Jersey Law Against Discrimination" to clarify how the state's anti-discrimination laws apply to automated decision-making tools. This included those driven by AI technologies such as how bias can be introduced and mitigated in AI systems.

While AI continues to promise major changes to how many businesses function, it is important to remember that "the AI did it" is an excellent horror plot, but an unlikely legal defense. Careful



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consideration of the legal issues surrounding AI as part of adopting an AI solution is therefore necessary to enable users to capture more of the benefits (and fewer of the drawbacks) of AI. 

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Having a concentration in lending work, Dan helps his clients through transactions with a wide range of size and complexity. His deals include single-lender and syndicated credit facilities, often secured by real and personal property.

Dan is committed to the business of his clients and helping them achieve their objectives. His drive and experience help him to see transactions through on time and with favorable terms. Dan's responsiveness, manner, and focus on the latest developments in commercial finance serve his clients well in closing their deals and retaining their customers.

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