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Acquisition Of AI Tech Poses Challenges For Media Industry

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The media and entertainment industry is seeing unprecedented disruption by both general-purpose artificial intelligence chatbots and bespoke systems developed for the film, TV, video game, music and other industries.

Recent years have seen exponential growth in the use of AI systems. AI chatbots have typified a wave of consumer-facing systems that use deep learning techniques to generate human-like text, images, video and other media from user prompts.

In the wake of these disruptions, media and entertainment companies are seeking to take controlling interests in promising AI systems or to license such systems.

This article outlines some of the AI applications that could revolutionize film production and video game design and considers the key legal matters that an organization should bear in mind when seeking to acquire AI technology through mergers and acquisitions or licensing.

AI Applications in Film and Video Game Industries

The recent 118-day U.S. Screen Actors Guild-American Federation of Television and Radio Artists strike highlighted the potential disruption that AI systems can inflict on the film industry.

One of the three factors prompting the strike relates to the potential use of AI in film production. Guild members sought provisions relating to the deployment of AI-generated content featuring their likenesses.

Startups in this space are disrupting both the process of capturing content and the role that actors play in film making. For example, new technology allows a film producer to synthesize video content using either a source video or text. Also, actors' likenesses can be altered and copied using automated photorealistic content creation with generative AI.

Mergers and Acquisition Activity

Due Diligence

Conducting due diligence on a target in the AI industry can be more challenging than in a conventional technology company. In particular, issues can arise regarding the provenance of the material upon which an AI system is trained.

Buyers should consider reviewing any license agreements for such material and should seek information regarding any scraping of websites that yield training material. The legal risk arising from the acquisition of a video synthetization tool that was trained on a large set of images will require careful analysis.

In particular, such a training set may contain personal data and thus may fall within the scope of the U.K. General Data Protection Regulation.

Buyers will need to verify that data protection impact assessments and legitimate interest assessments, where applicable, have been carried out in accordance with the U.K. GDPR and regulatory guidance.

Copyright and Intellectual Property

Copyright issues are particularly sensitive for the media and entertainment industry. An AI system will typically need to be trained on very large sets of materials in order to provide useful outputs in response to user prompts.

In the context of the film and video game industries, legal claims are being made that training materials may be protected by IP rights, in particular copyright.

For example, a generative AI tool that provides realistic video content may have been trained on large sets of images protected by copyright. This must be carefully evaluated for potential considerations such as infringement and licensing, and exceptions such as statutory fair use and fair dealing.

Some jurisdictions, like the European Union and Japan, offer exceptions to copyright infringement — subject to certain statutory requirements — for commercial text and data mining. This could potentially apply to many analyses of large sets of training material in developing a number of AI systems.

The application of a copyright exception will depend on the nature of the target and its operations.

Warranties in relation to any IP dispute that the target is engaged in relating to its training materials, and potentially indemnities in relation to third-party claims for copyright infringement, will be the subject of negotiations in M&A transactions.

Source Code

Ownership of source code is also an important consideration for buyers. In some scenarios, source code used by the target company to operate an AI system may be subject to an open-source license. In this case, those lines of open-source code should be identified, and the open-source licenses carefully scrutinized, as this could affect the value of the target's AI system.

Details of all open-source code used by the target, in addition to any relevant license agreements, will be the focus of the diligence exercise.

Regulatory Developments

Parties looking to acquire AI systems should also be wary of a changing regulatory landscape. On Dec. 9, 2023, European legislators reached a political agreement on the EU Artificial Intelligence Act, which will impose significant compliance requirements on providers of AI systems that it classifies as high risk.[1]

The final text of the act, due to be published in early 2024, could contain new compliance obligations relevant to a potential acquirer of an AI system.

For example, the EU Parliament announced that the EU AI Act will contain obligations on providers of general-purpose AI systems, which could affect some generative AI tools in the film and video game industries.[2]

Further, the act is expected to impose transparency requirements on deep fakes and other AI-generated content, and to require AI providers to "design systems in a way that synthetic audio, video, text and images content is marked in a machine-readable format, and detectable as artificially generated or manipulated."[3]

The EU AI Act will apply to providers and users of AI systems where the output produced by the system is used in the EU, and thus AI systems developed by companies outside of the EU, including the U.K., could be affected.

National Security and Investment Act

In the U.K., the National Security and Investment Act enables the government to assess and potentially intervene in transactions that could harm the U.K.'s national security.

If a buyer plans to proceed with an acquisition of a qualifying entity in one of 17 defined sensitive areas of the U.K. economy, then it must get preclosing approval from the U.K. government — described as a mandatory notification in the act. AI is one of the 17 affected sectors.

Three questions need to be asked in order to establish whether a target business is in scope of the act's mandatory notification requirements:

- Does the target business carry out relevant activities in the U.K.?
- Is the target business a qualifying entity with respect to AI, i.e., is the target undertaking relevant activities in relation to AI in the U.K. — broadly, these include research into AI — or does the target offer an AI service?
- Does the target develop its technology for one of three specific purposes?

Secondary legislation that implements the notification requirements of the act specifies that transactions involving companies developing AI for the purposes of the identification or tracking of objects, people or events, and advanced robotics and cybersecurity, are subject to the mandatory notification procedure.[4]

In the media and entertainment context, some AI systems could be deemed to operate for the purpose of identifying people, e.g., an AI system used to identify which actor is speaking in any given scene.

While it is unlikely that the majority of M&A activity in the media and entertainment industry will require a mandatory notification under the National Security and Investment Act, it is important to be aware of this eventuality in each case.

It should be noted that a minority investment may also require a mandatory notification in many scenarios.

Allocation of Risk

AI systems typically govern business-critical functions, e.g., in the video game space, where AI systems are now being used to create 3D gaming assets and animations, replacing key stages of game development. Buyers will need to consider the business impact of a system failure and potential ways to mitigate this risk.

Antitrust

Competition among firms that provide AI technology to companies in the media and entertainment industry is frequently nascent and differentiated, and is likely to be of interest to competition agencies.

The U.K.'s competition regulator, the Competition and Markets Authority, for example, has published an initial report indicating that it is particularly interested in M&A activity involving foundation models, i.e., models that are trained on large amounts of data and can be adapted to a wide range of tasks and operations.[5]

To that end, the CMA has encouraged firms contemplating mergers or acquisitions between businesses involved in foundation models to contact the CMA prior to engaging in a merger or acquisition.

Talent

Recent years have seen an increase in so-called acquihire deals, where the primary motivation of the buyer in executing a deal is to acquire employees of the target.

AI researchers and engineers, especially in media and entertainment, are prized assets. Buyers will need to consider retention agreements and suitable incentives to retain key talent.

Licensing

Insurance

Given the potential negative effects of system failure, insurance coverage is likely to be available to cover categories of loss. In the media and entertainment context, errors and omissions insurance may be particularly helpful, as it protects filmmakers and streaming platforms from copyright and invasion of privacy claims.

These claims could arise, for example, in the context of an AI system that is trained on film scripts that benefit from copyright protection without a license or applicable exception.

As AI risks might not fit neatly into the language of these policies and insurers may argue that exclusions or gaps in policy wording apply, policyholders should consider gray areas and negotiate clarified wording

with insurers.

Some insurers have started promoting new AI-specific insurance products, which could also be explored.[6]

Limitation of Liability

Parties will typically negotiate limitation of liability provisions, which put an upper limit on a party's potential liability under a contract when licensing AI technology. For example, as mentioned above, the failure of an AI system can have a negative impact on a business in the short-term, and therefore the licensor will try to limit its liability for system failure.

Output Ownership

Outputs generated by a licensed AI system can be valuable. Most licensees will expect to own the outputs produced by a licensed AI system. However, license agreements for AI technology often include negotiated output ownership clauses.

The license agreement should clearly define the ownership of outputs generated by the AI system, including any limitations or exceptions.

Data Protection

Licensors may lack the technical expertise to safeguard personal data that is transferred pursuant to a data sharing or ownership clause. Licensees will seek to ensure that licensors take adequate steps to protect personal data.

Minimum Performance Metrics

The performance of an AI system is often unknown, and many systems in their infancy may vary in performance greatly over a given time frame. Variance in performance can impact the ability of licensees to execute media and entertainment-related projects with strict film and video production deadlines.

Licensees will seek warranties and indemnities in a license agreement to ensure that licensors bear responsibility if the licensed AI system underperforms.

Takeaways

Conducting due diligence on a target in the AI industry can be challenging and will require assessments of how the target's AI systems are trained, any license agreements that govern training material, and the ownership of any source code relating to AI systems. Each of these considerations can affect the value of a target.

The regulatory landscape for AI systems is changing quickly and could create new compliance requirements for acquirers of AI systems. New obligations in the EU AI Act, for example, will apply to many providers of AI systems based outside of the EU.

Licensees of AI systems should be mindful that some AI-specific insurance products exist on the market.

Traditional policies, such as errors and omissions insurance, can also be helpful in the media and entertainment context.

However, policyholders should review policy wording carefully to ensure that they are not exposed to gaps or exclusions in their coverage.

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[1] https://www.consilium.europa.eu/en/press/press-releases/2023/12/09/artificial-intelligence-act-council-and-parliament-strike-a-deal-on-the-first-worldwide-rules-for-ai.

[2] https://www.europarl.europa.eu/news/en/press-room/20231206IPR15699/artificial-intelligence-act-deal-on-comprehensive-rules-for-trustworthy-ai.

[3] https://ec.europa.eu/commission/presscorner/detail/en/ip_23_6473.

[4] https://www.legislation.gov.uk/uksi/2021/1264/schedule/3/made.

[5] https://www.gov.uk/government/publications/ai-foundation-models-initial-report.

[6] https://www.law360.co.uk/articles/1727566/how-insurance-policies-can-cover-generative-ai-risks.