AMERICAN BANKRUPTCY INSTITUTE

Winter Leadership Conference

The Role of Artificial Intelligence in Consumer Debt and Bankruptcies

Hosted by the Consumer Bankruptcy & Secured Credit Committees

Hon. Martin R. Barash
U.S. Bankruptcy Court (C.D. Cal.); Woodland Hills

Jan Duke
A360inc; San Antonio

Randy Nussbaum
Sacks Tierney P.A.; Scottsdale, Ariz.

Gregory M. Taube
Nelson Mullins Riley & Scarborough, LLP; Atlanta

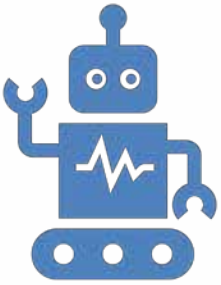
CONCURRENT SESSION

2023

Artificial Intelligence and Debt Servicing

What is "Artificial Intelligence"?

- Artificial Intelligence (AI)
- Machine Learning
- Robotic Process Automaticion (RPA)



Past Uses of AI and Related Technology

- Origins
- Preparation of bankruptcy forms

Lessons Learned

- Privacy
- Signatures on forms

Current Uses of AI and Related Tech

- Generative
- Machine Learning
- RPL

Current Concerns

- Privacy
- Billing and Fees
- Incorrect material
- Other Ethical Issues
- Usefulness

Predictions for the Future

PRACTICAL OVERVIEW OF LAWYER'S USE OF AI AND BILLING

I. INTRODUCTION

Consumer bankruptcy lawyers will be using AI more and more in the future. It therefore is incumbent on them to develop procedures and policies for its use and in billing for such services. Doing so will be a combination of art and science controlled by both ethical and practical considerations. Because its use is still in an embryotic phase, standards are still being developed and the area is plagued by a dearth of both case law and statutory guidelines. The practitioner also has to be cognizant that AI is a rapidly and ever changing tool characterized by advances on a constant basis.

This outline is designed to highlight the issues which need to be addressed and provide an impetus for discussion and additional analysis.

II. WHY USE AI

The benefits of AI are numerous but many of them are not as evident as others. The expertise of the user can play a significant role in the efficacy of its use. In the hands of a skilled user, those benefits include:

A. Reduced cost.
B. Consistency in work product.
C. Accuracy of work product.
D. Speed of production.
E. Freeing up time.
F. Widespread access to sources of material

III. PREREQUISITES OF AI USE

In the hands of a skilled professionals, AI's usefulness may be unlimited. However, it is fraught with risks and dangers when used irresponsibly. It therefore is crucial that the following considerations be considered when promulgating an AI policy.

A. Need to provide proper training for the user.
B. Need to set firm policies as to how it is used.
C. Need to decide on billing policies.
D. Need to consider ethical considerations.
E. Need to stay updated on products available.
F. Need to promulgate policies for oversight of the AI work product.
G. Be aware of your court's rules and procedures regarding AI use.
H. Recognition of AI options.
I. Review insurance coverage for its use.

IV. RISKS OF ITS USE

Everyone is aware of the sanctions assessed against the New York lawyer who irresponsibly relied upon AI in an unwitting manner. Because his misuse occurred in the relative infancy of AI's use, the court exhibited some sympathy for the respected lawyer. One can assume that the court's attitude will become far less forgiving as attorneys become far more aware of AI's shortcomings.

The following is a summary of the risks of its use.

A. Improper charging.

B. Inaccurate information.
C. Actual cost of its use exceeds traditional legal work not using AI.
D. Lawyer complacency.
E. Unskilled user triggering an erroneous response.
F. Misplaced client expectation by its use.
G. You may violate your court's rules and procedures regarding AI use.

V. CONSIDERATIONS IN BILLING FOR IT

Without question, lawyers appreciate that AI should expedite the production of legal work product at a reduced cost. Otherwise, its usefulness would be limited.

This of course leaves the law firm facing a quandary as to how to bill for AI work.

The firm needs to assume it cannot pass on the cost of designing and implementing AI procedures and use nor can it charge for training costs. Those expenses are the cost of doing business. Consequently, law firms have to consider how to maximize the benefits of AI while not chipping away at the bottom line since AI could very well decrease the time need to provide a variety of legal services.

So, the firm should consider alternative forms of billing starting with the necessity that whatever is offered is clearly spelled out in the firm's fee agreement with all clients.

Those options include as follows:

1) Normal hourly billing-The firm will probably need to confirm that certain services can be provided for less cost. Obviously, the AI product needs to be reviewed and edited to ensure accuracy, but if the final work product was more expensive than work produced by traditional means, little reason exists to utilize AI.
2) Set fee billing-This option focuses on the overall cost of the final product and shifts part of the economic risk of the representation to the law firm.
3) Contingency billing-In certain cases, representation can be handled on the basis of the law firm accepting a percentage of the recovery. As in the case of set fee billing, any efficiency and economic savings may justify the law firm reducing its charges.
4) Hybrid fee arrangement-The law firm can combine different options which would divide the risk and cost savings between the client and law firm. Depending on the outcome of the case, the client could save money and the law firm may be able to recoup some of the lost revenue triggered by the use of AI.
5) Set monthly charging-This is similar to set fee billing but is a negotiated amount for agreed upon services to be provided for a set monthly fee. Once again, both the client and the law firm would be absorbing a certain amount of risk and cost savings by the use of AI.

From a consumer debtor's lawyer's perspective, some of the above options may not be practical or feasible but a consumer creditor's lawyer may quickly realize that AI may be the impetus for that lawyer to consider alternative billing strategies.

No one knows how prevalent AI may be in the near future. Since it is constantly evolving, it may be impossible to now anticipate its application in the coming years, but a practitioner would be foolish not to understand and utilize AI now.

[City, State, Zip]
[Phone Number]
[Email Address]
Attorney for [Bank Name], Creditor

Dated: [Date]

CERTIFICATE OF SERVICE

I hereby certify that on [Date], I served a true and correct copy of the foregoing Motion for Relief from Automatic Stay upon the Debtor, Debtor's Attorney, and the Trustee overseeing this bankruptcy case via [describe the method of service in accordance with local rules, e.g., "First Class Mail, postage prepaid"].

[Attorney Name]

Please note that this is a basic template and might need additional information or documentation attached, such as evidence of the security agreement, proof of the value of the vehicle, proof of the outstanding debt, and any correspondence regarding the default. Additionally, some jurisdictions may require a preliminary hearing on the motion or stipulate specific service requirements. Ensure all local rules and procedures are followed accurately.

XpertHR.com

How to Create an Artificial Intelligence (AI) Policy

Author: XpertHR Editorial Team

The use of artificial intelligence (AI) by employees is growing rapidly, and so are the number of AI tools available in the market.

To successfully leverage AI and protect the organization from risk, an employer must ensure AI is used properly and safely within the workplace. An employer can do this through an AI policy that meets its specific needs and aligns with organizational goals related to AI.

To craft an AI policy, an employer should consider taking the following steps.

Step 1: Consult Key Stakeholders

An AI policy will impact employee work across the organization. To ensure smooth adoption of the new policy, consult key stakeholders to obtain recommendations, feedback and buy-in.

Stakeholders can shed light on what risks are associated with AI and how the employer would like to use AI to enhance the organization's work. These conversations will guide the scope of the new AI policy. More importantly, gathering information about how AI will fit into the organization's work will ensure that the policy is aligned with the organization's business goals and prevent it from creating unnecessary hurdles to AI adoption and management.

In addition to providing information, stakeholders may be able to play a larger role in creating the new policy. Consider how involved stakeholders should be in process and clearly communicate their roles. Clearly defined roles will help avoid confusion as to who has ownership and decision-making responsibilities over the policy.

Finally, when consulting key stakeholders, keep lines of communication open, and obtain feedback on policy drafts when appropriate.

Step 2: Audit Current Policies and Practices

Before drafting a new policy, audit current policies and known practices that may impact AI in the workplace to avoid conflicts or too much overlap. The following are examples of policies that may have provisions impacting AI:

- Code of conduct;
- Equal Employment Opportunity;
- Cybersecurity;
- Workplace security;
- Proper use (of the organization's computers, network, etc.); and
- Privacy.

Step 3: Define the Purpose and Scope of the AI Policy

AI use in the workplace continues grow and evolve. An AI policy should be able to grow with these changes without becoming outdated. To ensure that the AI policy remains evergreen, carefully define the purpose and scope of the policy to encompass both current and future AI use at work.

Purpose. The purpose of the policy should state that the policy is intended to provide clear guidelines for the consistent and responsible use of and continued adoption of AI in the workplace.

Scope. In the scope of the policy, determine how the organization intends to use AI and what type of AI the policy should regulate. For example, an organization may plan to adopt only generative AI in their marketing department, or it may adopt several AI tools to enhance multiple business practices. Some organizations may decide to create their own AI for internal use.

Once AI's role within the organization is clear, define which types of AI the organization plans to adopt, and in some cases, which vendors it will use.

Also, ensure that the policy's scope includes any type of AI that employees may choose to use at work independently, with or without permission from their employer. This may include publicly available generative AI like ChatGPT, Bard or art generators.

The purpose and scope of the policy should align with the employer's mission, vision, and goals. Alignment of the AI policy with these broader goals will ensure that AI integrates seamlessly into the organization's business.

Step 4: Include Definitions for Important Terminology

Currently, there are several - and sometimes conflicting - definitions of AI and related terms. To ensure consistent application of the policy, include definitions for important terminology so that employees can identify and understand what is covered by the policy.

Terms to consider defining include, but are not limited to:

- Algorithm;
- Analytics;
- Artificial intelligence;
- Augmented reality;
- Chatbots;
- Generative AI;
- Hallucination;
- Large language models;
- Machine learning;
- Natural language processing;
- Predictive analytics;
- Robotics; and
- Supervised vs. unsupervised learning.

Additionally, an employer should be aware that jurisdictions like Illinois and New York City have passed laws regulating the use of AI by employers. If an organization is subject to these laws, ensure that the policy and its definitions do not conflict with them. This is especially important if the law defines AI or other related terms.

Step 5: Draft Authoritative Ethics Guidelines

AI continues to present new and important ethical issues for an employer to navigate. If unchecked, employees may use AI for improper purposes. To ensure AI is used ethically in the workplace, draft authoritative AI ethics guidelines that employees must follow. This will inform employees of the organization's ethical standards and set clear expectations.

Ethics guidelines may include the following:

- AI should improve organizational performance and must not create or increase bias or discrimination. The organization is committed to ensuring a fair and equitable workplace;
- All employees, including leadership, must exercise high levels of transparency as to which types of AI are adopted and used, who is using AI and for what purposes;
- Privacy and security are a priority, and the use of AI tools should never endanger the privacy or security of the organization or its employees, customers or the public;
- AI's role in the organization is to enhance, not replace, human work. Accordingly, all AI outputs must be monitored by humans and fact-checked to ensure accuracy;
- Good AI auditing practices, which include regular audits of any AI data, outputs and decision-making processes, are necessary to prevent breakdowns in quality, accuracy and protections against bias and discrimination; and
- AI should never create an unsafe environment.

Beyond the Policy

Consider establishing other means of ensuring ethical use of AI. This may include:

- Creating or referring to an ethics reporting and investigation process;
- Establishing a council to monitor AI's impact the workplace, and in particular, on diversity, equity, inclusion and belonging (DEIB);
- Developing AI training programs; and
- Setting standards for the in-house development of AI.

Step 6: Protect Privacy, Security and Intellectual Property

Though AI's high-powered automation and decision-making capabilities can push an organization above its competition, what AI needs to function - data, and lots of it - increases an organization's exposure to privacy and security dangers.

For example, an organization that invests in AI-powered software to enhance its DEIB efforts will need to allow AI access to the organization's demographic data. While some AI vendors will offer certain measures of data security, others expressly disclose that information provided to them is not

confidential.

Aside from privacy concerns, AI has proven to be highly capable of creating effective malware, phishing emails and other cybersecurity threats.

To protect the organization against privacy and security risks, include standards for privacy, security and intellectual property as they relate to AI in the policy.

At minimum, a policy should:

- Comply with federal, state and local privacy laws. Privacy laws generally regulate the collection, storage and sharing of private information. They may regulate employee data, consumer data or data collected through advertising efforts.
- Prohibit the disclosure of personal information to an AI tool (i.e., personal identifying information and personal health information). This includes information belonging to employees, customers and the public.
- Prohibit the disclosure of trade secrets and other proprietary information.
- Include provisions specific to AI that align with the organization's existing cybersecurity policy.
- If necessary, include an appropriate chain of approval for employees who wish to disclose information generally prohibited by the policy.

Step 7: Formalize a Process for Adopting AI at Work

A consistent organization-wide process for reviewing new AI tools and their proper uses helps an organization adopt AI strategically, safely and in alignment with the organization's broader goals. It also allows the organization to have vision over AI practices across business functions.

To create a formal process, include in the policy who must be involved, what steps employees must take to begin using AI and who will be the organization's trusted vendors.

Action Items for Establishing a Formal AI Adoption Process:

Determining who is involved	Approving new AI	Choosing trusted vendors
• Determine who may have the expertise required to make determinations about AI quality and safety. • Determine who has ownership over the approval process and who has authority to approve AI use. • Determine who will monitor the continued use of AI.	• Create a formal chain of approval. • Draft documents to support the approval process, such as request forms or letters of approval. • Establish clear criteria that must be met to gain approval (i.e., security and privacy standards, data quality, compliance with Title VII, the NLRA and other laws).	• Establish criteria for selecting trusted vendors. • Consider maintaining a list of trusted vendors separate from the AI policy.

To manage the adoption process, consider using the policy to establish a cross-functional AI committee to review AI adoption and use. Members may include senior leadership, stakeholders from departments that use or oversee AI in the workplace and representatives from management and employee groups.

Step 8: Define How and When AI Tools Will Be Audited for Quality and Compliance

Auditing AI prevents bias and ensures safety, compliance and overall quality. In some jurisdictions, regular audits are required by law to prevent discrimination.

In the policy, define how audits will be carried out at the organization. This includes the frequency of audits, the purposes for the audit, specific standards the AI tool must meet to pass the audit and what happens if the AI does not pass the audit.

In addition to defining internal audit processes, address how the organization will ensure that third-party AI vendors conduct appropriate audits. If the organization is subject to regulatory requirements that mandate audits or other standards for AI, the third-party audit procedures should also comply with these requirements.

Step 9: Prohibit AI From Interfering With DEIB

Early use cases have shown that AI can inadvertently make biased decisions that discriminate against employees belonging to certain demographics. This can expose the organization to liability and undermine its DEIB efforts.

To prevent AI from interfering with the organization's DEIB efforts:

- Include a policy statement that reaffirms the organization's commitment to furthering DEIB in the workplace;
- Include safeguards specifically intended to prevent bias and discrimination, such as vetting third-party vendors, auditing and employee training;
- Set standards for data quality to ensure that it does not have biases of its own;
- Prohibit employees from using AI in a way that increases chances of bias or discrimination in the workplace; and
- Ensure compliance with antidiscrimination laws, regulations and guidance (e.g., EEOC's guidance on AI and Title VII).

Step 10: Communicate Proper and Improper Uses of AI

Though powerful, AI cannot do it all. AI tools are each designed for a specific purpose, and they vary in their capabilities and best uses. If employees use an AI tool improperly, the results can be poor quality and damaging to the organization.

For example, generative AI tools provide outputs that may violate copyright protections. Though this area of copyright law is still evolving, using generative AI outputs in a way that would violate copyright law if the output had been created by human may expose the user to liability. Additionally, whether AI outputs have copyright protections themselves, and who owns the copyright, is less than clear. Depending on the law and the vendor's terms of usage, an AI output may not receive copyright protection, or the AI vendor may own the copyright either solely or jointly with the organization.

To help employees understand what a given AI tool should and should not be used for, provide guidance for proper uses for AI. A policy provision should clearly define the tasks or projects for which AI tools can be used and what type of information may be shared with an AI tool.

Guidance may also expressly prohibit employees from using AI for specific tasks. For example, a policy may prohibit employees from using AI for drafting compliance documents or for any purpose that would require copyright permission from a creator.

Beyond the Policy

Promote the proper use of AI by refering employees to training materials explaining leading practices for using AI tools. Training materials may provide guidance on how to create prompts or analyze data and AI outputs.

Step 11: Set Standards for Human Oversight

In addition to defining what AI should be used for, set standards in the policy for human oversight of AI tools at work. At minimum, require that all AI outputs be independently reviewed by the human AI user for accuracy and compliance. This is particularly important if an employee is using a chatbot, which does not provide sources or explanations about how it comes to its conclusions.

Consider requiring employees to track and disclose when they are using AI to complete work tasks. This will promote transparency and help an employer monitor the purposes for which employees are using AI at work.

Step 12: Establish Disciplinary Actions for Violations

Adopting unsafe AI or using AI in an unsafe manner can expose an organization to cybersecurity threats, lawsuits and other costly liabilities. Deter violations of the AI policy by establishing disciplinary actions that the organization is prepared to enforce.

Step 13: Include a National Labor Relations Act Disclaimer

Section 7 of the National Labor Relations Act (NLRA) provides several protections to employees, including the protected right to engage in concerted activities.

New AI tools, if used improperly, may violate the NLRA if they interfere with these rights. For example, according to the National Labor Relations Board general counsel, AI-powered employee monitoring software may interfere with an employee's right to engage in protected activities and keep those activities confidential.

In addition to ensuring best practices for the use of AI are followed, include a compliant NLRA disclaimer stating that the organization's AI policy is not intended to interfere with any rights provided to employees by the NLRA.

Step 14: Continue to Review the Policy on a Regular Basis

AI is rapidly changing as more vendors enter the market and existing AI continues to advance. Also, government bodies in various jurisdictions continue to propose and pass new laws to regulate AI and its use by employers.

An organization must be prepared to adjust the AI policy to ensure that it accounts for any new technological developments and regulatory requirements. Reviewing the policy on a regular basis will keep the policy current and help the organization continue to develop and enhance its integration of AI into its business practices.

Additional Resources

EEOC Warns Employers About AI Discrimination Risk

Safeguards For Using ChatGPT and Other Bots for HR

If You're Using AI for Layoffs, Read This First

Prevent Your AI From Causing Unintentional Disability Discrimination

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

PARTY, *Plaintiff*, v. PARTY, *Defendant*.	§ § § § § § § § § §	CASE NUMBER

CERTIFICATE REGARDING JUDGE-SPECIFIC REQUIREMENTS

I, the undersigned attorney, hereby certify that I have read and will comply with all judge-specific requirements for Judge Brantley Starr, United States District Judge for the Northern District of Texas.

I further certify that no portion of any filing in this case will be drafted by generative artificial intelligence or that any language drafted by generative artificial intelligence—including quotations, citations, paraphrased assertions, and legal analysis—will be checked for accuracy, using print reporters or traditional legal databases, by a human being before it is submitted to the Court. I understand that any attorney who signs any filing in this case will be held responsible for the contents thereof according to applicable rules of attorney discipline, regardless of whether generative artificial intelligence drafted any portion of that filing.

_____
ATTORNEY NAME(S)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
MISSOULA DIVISION

DAVID BELENZON, Plaintiff, vs. PAWS UP RANCH, LLC d/b/a RESORT AT PAWS UP and JOHN DOES 1-10, Defendants.	CV 23–69–M–DWM ORDER

Plaintiff moves for the admission of Ellen Levin to practice before this Court in this case with Angie Miller to act as local counsel. Ms. Levin's application appears to be in order.

Accordingly, IT IS ORDERED that Plaintiff's motion to admit Ellen Levin *pro hac vice* (Doc. 7) is GRANTED on the condition that *pro hac* counsel shall do his or her own work. This means that *pro hac* counsel must do his or her own writing; sign his or her own pleadings, motions, and briefs; and appear and participate personally. Use of artificial intelligence automated drafting programs, such as Chat GPT, is prohibited. Counsel shall take steps to register in the Court's

electronic filing system ("CM-ECF"). Further information is available on the Court's website, www.mtd.uscourts.gov, or from the Clerk's Office.

IT IS FURTHER ORDERED that this Order is subject to withdrawal unless *pro hac* counsel, within fifteen (15) days of the date of this Order, files a notice acknowledging counsel's admission under the terms set forth above. In that notice, counsel shall also designate a single attorney with the authority to make any and all decisions related to the administration of this case as the primary point of contact for the opposing party.

DATED this 22nd day of June, 2023.

Donald W. Molloy, District Judge
United States District Court

UNITED STATES COURT OF INTERNATIONAL TRADE

THE HONORABLE STEPHEN ALEXANDER VADEN, JUDGE

ORDER ON ARTIFICIAL INTELLIGENCE

Parties must conform to many rules when they file briefs in a case before the Court of International Trade. For instance, briefs must state with particularity the grounds for seeking a desired order and make "the legal argument necessary to support it." USCIT Rule 7(b)(1)(B). They must follow certain requirements of form, including those that govern the use of captions, exhibits, and paragraphing. USCIT Rule 7(b)(2); USCIT Rule 10. However, perhaps the most important of these rules are those that concern confidential or business proprietary information. The Court has taken special care to ensure that bringing a claim will not result in the disclosure of sensitive non-public information owned by any party before it. Accordingly, the Court requires that briefs containing confidential or business proprietary information "must identify that information by enclosing it in brackets," that parties must file a non-confidential version of such a brief and redact the bracketed information, and that recipients of the confidential brief may not disclose its contents to any party not authorized to receive such information. USCIT Rule 5(g). In particular, an attorney may only receive confidential or business proprietary information if he or she has filed a Business Proprietary Information Certification and received an order from the Court granting access to such information. USCIT Rule 73.2(c)(2).

Generative artificial intelligence programs that supply natural language answers to user prompts, such as ChatGPT or Google Bard, create novel risks to the security of confidential information. Users having "conversations" with these programs may include

confidential information in their prompts, which in turn may result in the corporate owner of the program retaining access to the confidential information. Although the owners of generative artificial intelligence programs may make representations that they do not retain information supplied by users, their programs "learn" from every user conversation and cannot distinguish which conversations may contain confidential information. In recognition of this risk, corporations have prohibited their employees from using generative artificial intelligence programs. *See, e.g., Samsung Bans Staff's AI Use After Spotting ChatGPT Data Leak*, Bloomberg, https://www.bloomberg.com/news/articles/2023-05-02/samsung-bans-chatgpt-and-other-generative-ai-use-by-staff-after-leak (last visited June 8, 2023).

Because generative artificial intelligence programs challenge the Court's ability to protect confidential and business proprietary information from access by unauthorized parties, it is hereby:

ORDERED that *any* submission in a case assigned to Judge Vaden that contains text drafted with the assistance of a generative artificial intelligence program on the basis of natural language prompts, including but not limited to ChatGPT and Google Bard, must be accompanied by:

(1) A disclosure notice that identifies the program used and the specific portions of text that have been so drafted;

(2) A certification that the use of such program has not resulted in the disclosure of any confidential or business proprietary information to any unauthorized party; and it is further

ORDERED that, following the filing of such notice, any party may file with the Court any motion provided for by statute or the Rules of the Court of International Trade seeking any relief the party believes the facts disclosed warrant.

SO ORDERED.

Judge Stephen Alexander Vaden

Dated: June 8, 2023
New York, New York

The following constitutes the ruling of the court and has the force and effect therein described.

Signed June 21, 2023

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

IN RE:	§	
	§	
PLEADINGS USING GENERATIVE	§	**GENERAL ORDER**
ARTIFICIAL INTELLIGENCE	§	**2023-03**
	§	

If any portion of a pleading or other paper filed on the Court's docket has been drafted utilizing generative artificial intelligence, including but not limited to ChatGPT, Harvey.AI, or Google Bard, the Court requires that all attorneys and pro se litigants filing such pleadings or other papers verify that any language that was generated was checked for accuracy, using print reporters, traditional legal databases, or other reliable means. Artificial intelligence systems hold no allegiance to any client, the rule of law, or the laws and Constitution of the United States and are likewise not factually or legally trustworthy sources without human verification. Failure to heed these instructions may subject attorneys or pro se litigants to sanctions pursuant to Federal Rule of Bankruptcy Procedure 9011.

IT IS SO ORDERED.

###END OF ORDER###

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STANDING ORDER RE: ARTIFICIAL INTELLIGENCE ("AI") IN CASES ASSIGNED TO JUDGE BAYLSON

If any attorney for a party, or a *pro se* party, has used Artificial Intelligence ("AI") in the preparation of any complaint, answer, motion, brief, or other paper, filed with the Court, and assigned to Judge Michael M. Baylson, **MUST**, in a clear and plain factual statement, disclose that AI has been used in any way in the preparation of the filing, and **CERTIFY**, that each and every citation to the law or the record in the paper, has been verified as accurate.

DATED: 6/6/2023

BY THE COURT:

/s/ MICHAEL M. BAYLSON

MICHAEL M. BAYLSON, U.S.D.J.

Practical Law™

Resource ID: w-015-0046

Expert Q&A on Artificial Intelligence and Bankruptcy

PRACTICAL LAW BANKRUPTCY

Search the Resource ID numbers in blue on Westlaw for more.

An Expert Q&A with Janet M. Weiss of Dorsey & Whitney LLP discussing her views on the legal protections available for artificial intelligence and the potential treatment of artificial intelligence licenses in bankruptcy.

Artificial intelligence (AI) is a term used to describe computer technology that simulates human intelligence to analyze data so that it can:

- Reach conclusions.
- Make informed judgments.
- Recognize patterns.
- Predict future behavior.

The technology uses algorithms to learn responses to new input by collecting and analyzing the data, including past responses created by use of the software. AI is already being used in many ways in homes and businesses. For example, in the home, voice-activated devices like the Amazon Echo and Google Home can organize a consumer's schedule, create and play a consumer's music playlist, or control other smart home devices. Another example is smart phone technology that suggests words based on inputting a few letters and predicting the word the user intends to spell determined by an algorithm analyzing frequently used words.

AI is one of several areas of digital innovation that is developing increasingly rapidly and where the legal consequences are challenging to foresee. The considerable and continued growth of AI technology is likely to provide a significant impulse for developments in intellectual property (IP) law. As IP law evolves and advances to protect AI, the rights and interests of licensors and licensees are likely to be impacted both in and out of bankruptcy.

Practical Law asked Janet M. Weiss of Dorsey & Whitney LLP to discuss her views on the legal protections available for AI and the potential treatment of AI licenses in bankruptcy.

HOW CAN AI BE USED TO ASSIST THE PRACTICE OF LAW?

Innovative legal departments and law firms are using AI to automate a variety of time consuming and repetitive tasks, including:

- E-discovery.
- Contract review and analysis, including performing due diligence for a variety of corporate transactions.
- Legal research.
- Developing litigation strategy.
- Predicting which companies are likely to file bankruptcy cases.

By using AI in the practice of law, attorneys can:

- Become more efficient at performing legal tasks involving large data sets.
- Make data-driven decisions.
- Save costs on outside counsel and other alternative legal service providers.
- Foster increased collaboration with outside counsel.
- Reduce risk because AI helps with the review of large data sets, and not just sub-sets of available data.

For more information, see Article, Use of Artificial Intelligence within the Legal Industry (W-012-1157).

HOW DO AI DEVELOPERS PROTECT NEW DEVELOPMENTS?

Patents provide the primary legal protection for AI software developers. The grant of a patent protects developers by empowering them to prevent other parties from using the new technology. The AI software developer therefore has the exclusive right to control the use of the technology for a limited period of time. In exchange, the AI software developer must sufficiently disclose the technology to enable competitors to recreate the technology after the patent protection period expires. Copyrights also provide protection for AI software, but only for the unique formulation of source code.

Neither patents nor copyrights protect abstract ideas. Because abstract ideas, laws of nature, and natural phenomenon "are basic

tools of scientific and technological work," the US Supreme Court expressed concern that monopolizing these tools by granting patent or copyright protection may impede, rather than promote innovation (see *Alice Corp. Pty. Ltd. v. CLS Bank Int'l*, 134 S. Ct. 2347 (2014)). The law is somewhat subjective regarding which inventions may be patented and which ones cannot because they represent abstract ideas, which creates challenges for applicants seeking patents in software.

A complicating factor in protecting AI software also lies in the fact that patent and copyright law have not kept pace with new issues created by the rapid AI advances. As AI technology continues to advance, several issues arise regarding protection of AI under patent or copyright law, including that:

- Neither patents nor copyrights fully protect both the source code and the functionality of the software:
  - copyrights extend protection to the original expression of the source code, but not to the methodology by which software achieves its functionality, such as algorithms, formatting, and output results; and
  - patents protect some aspects of AI, including some portions of the source code and hardware components used in the AI system, but not abstract ideas.
- Protection granted by both copyrights and patents is based on the identity of the person creating the relevant section of code, which creates a problem when trying to protect the large portions of source code generated automatically by the AI software (AI software uses results obtained by on-going use of the software to create new source code).
- AI software is frequently built using multiple open software resources. While open source software can generally be freely used, the ability to exclude others from using or licensing the open source code is not uniform. Some open source code prevents users from protecting new technology incorporating the open source code. Therefore, the ability to protect AI software may depend on the restrictions contained and incorporated in the open source code embedded in the software.
- Large sources of data are required for AI software to function and data is often collected and formatted by third party providers. The data providers may restrict new technology incorporating this data from receiving patent protection.
- Patents can take three to five years to obtain. During this period, rapid developments in the field can create new issues that the patent application did not address.

Treating AI programs as trade secrets may offer an alternative to employing patent and copyright law. Trade secrets generally receive legal protection based on a two-part system:

- The owner of the trade secret must take reasonable steps to protect the trade secrets, such as:
  - providing confidentiality agreements for all users of the trade secrets;
  - controlling access to the information;
  - conducting training for those with access; and
  - continually updating the procedures.
- If an owner has taken reasonable steps to secure its trade secrets, it can assert a cause of action against people or entities that misappropriate these trade secrets.

State law governs protection of trade secrets. While almost all states have enacted a form of the Uniform Trade Secrets Act, New York has not enacted the uniform statute. In New York, a cause of action can be brought for misappropriation of trade secrets based primarily on common law.

Each of these legal methods (patents, copyrights, or trade secrets) for protection of AI developments has different requirements, provides different levels of protection, and endures for a different time period. Because of these limitations, AI developments typically cannot be fully protected and developers of AI software must decide which legal method or combination of methods affords them the greatest protection.

HOW DOES THE BANKRUPTCY CODE TREAT AI SOFTWARE?

The Bankruptcy Code's treatment of AI software is straightforward when the debtor owns the software and does not license it to a third party. If the debtor owns the AI software, then the software is property of the debtor's estate under section 541 of the Bankruptcy Code. If the software is not subject to a valid license, a debtor can sell the software free and clear of all claims by third parties. However, developers of AI software are typically not the end users and, therefore, a significant portion of AI software is licensed to third parties. The cost to incorporate AI software into practical uses, produce the end product, market it, and arrange for distribution and sales can be prohibitive. Therefore, developers of AI software often monetize their new technology by licensing the AI software to a third parties that have the resources and expertise to create, market, distribute and sell the product to end users.

HOW DOES THE BANKRUPTCY CODE TREAT LICENSES OF AI SOFTWARE?

The Bankruptcy Code does not define AI. However, the Bankruptcy Code defines IP to include, patents, copyrights, trade secrets, and other forms of IP (§ 101(35A), Bankruptcy Code). The Bankruptcy Code does not include trademarks and foreign-owned IP within the definition of IP. Because AI software typically is protected by either or both patents and copyrights, bankruptcy courts may treat a license for AI software as if it were a license for the underlying patented or copyrighted code.

Section 365(n) of the Bankruptcy Code affords special protection to non-debtor IP licensees, so that if the debtor rejects an IP license, the non-debtor licensee may either:

- Treat the IP license as terminated and collect rejection damages, which are typically cents on the dollar.
- Retain its rights under the license for the duration of the license term plus any extensions that may be exercised by the licensee.

If a licensee chooses to retain its rights under the license, the debtor must allow the licensee to use the license in exchange for:

- Any past due and continuing royalty payments due under the license.

- A waiver of any setoff rights of past or future royalties against the damages resulting from the rejection.
- A waiver of any administrative claim it may have resulting from performance under the license.

The non-debtor licensee is also protected from the debtor-licensor's interference with the licensee's rights to exploit the license. However, after rejection, the debtor-licensor cannot be compelled by specific performance to perform obligations under the license. For more information regarding the retention by a licensee of an IP license under section 365(n), see Practice Note, IP Licenses and Bankruptcy: Rights and Obligations When a Non-Debtor Licensee Retains a License (1-504-3602).

Also, a non-debtor's rights under section 365(n) are not curtailed merely because the debtor-licensor has ceased operations. Where a debtor-licensor has stopped operating after filing a bankruptcy case, the non-debtor licensee must ensure that its rights under section 365(n) are protected. A liquidating debtor (or its trustee) typically seeks to reject all of its licenses and other executory contracts at one time, so the non-debtor licensee must be vigilant in ensuring it responds timely and appropriately to a motion to reject its license to preserve its section 365(n) rights.

Although several AI developers have filed bankruptcy cases, bankruptcy courts have not yet explicitly addressed the treatment of AI licenses. While courts are likely to hold that section 365(n) applies to AI software licenses because AI systems typically incorporate patents and copyrights, it remains to be seen how rejection of AI licenses may ultimately affect a debtor's ability to sell AI software and the effect on non-debtor licensees. The challenge for bankruptcy courts lies in how to address the gaps in protection of AI software under patent, copyright laws, and a combination of the two (see How do AI developers receive protection for new developments?). Although these gaps are present regardless of the AI developer's financial condition, the issues become more focused in bankruptcy cases when the enterprise value of the AI developer is not sufficient to repay all creditors.

Patent and copyright laws also have fundamentally different policy goals than those of bankruptcy law. While patents and copyrights seek to foster the creative process and technological development, bankruptcy seeks to maximize the value of the debtor's estate, which may be accomplished by re-licensing technology to new, higher-paying licensees. Courts must address how to balance these two competing policy goals.

CAN A DEBTOR-LICENSOR SELL ITS AI PATENTS AND COPYRIGHTS FREE AND CLEAR OF EXISTING LICENSES?

Asset sales in bankruptcy can be a tremendously efficient way to maximize the value of the bankruptcy estate while freeing the estate from the cost of operating an underperforming business. A clear advantage to a section 363 sale is the ability to buy and sell assets "free and clear" of the seller's pre-petition liabilities and burdensome contracts and leases. For more information on section 363 sales, see Practice Note, Buying Assets in a Section 363 Bankruptcy Sale: Overview (1-385-0115).

Courts have typically held that if a debtor is the licensor of a patent or non-exclusive copyright, the debtor cannot sell the IP free and clear of the rights retained by patent and non-exclusive copyright licensees after rejection of their licenses (see *In re Sunbeam Prods. V. Chi. Am. Mfg., LLC*, 686 F.3d 372, 377-8 (7th Cir. 2012); *In re Dynamic Tooling Sys., Inc.*, 349 B.R. 847, 856 (Bankr. Kan. 2006)). This means that debtors may sell their own patents and copyrights but the non-debtor licensees are entitled to continue exploiting the licensed IP under the terms of their prepetition licenses. Because AI technology is typically protected using patents and copyrights, or a combination of the two, bankruptcy courts are likely to treat the sale of AI systems that are subject to licenses in the same manner.

CAN A DEBTOR-LICENSEE ASSIGN ITS LICENSES FOR AI SOFTWARE ABSENT CONSENT OF THE LICENSOR?

When the debtor licenses IP from a third-party, the Bankruptcy Code generally prevents assignment of these licenses absent express consent of the licensor. Courts are likely to treat licenses of AI software in the same manner. Therefore, courts may apply section 365(c) of the Bankruptcy Code, which creates an exception to the general rule that anti-assignment clauses are not enforceable in bankruptcy cases where applicable non-bankruptcy law excuses the non-debtor from accepting or performing for an entity other than the debtor (see Practice Note, IP Licenses and Bankruptcy: Applicable Law under Section 365(C) (1-504-3602)).

Courts have consistently held that patent licenses and non-exclusive copyright licenses are like personal service contracts, which are not assignable under state common law because they involve a special relationship, knowledge, or skill. Courts have reasoned that assignment of patent licenses without the owner's consent deprives the patent owner of control over the patent. In that case, patent owners would be unable to prevent competitors from licensing its technology, which undermines the rewards bestowed by patents for the development of new inventions.

Therefore, debtors seeking to assign their rights under a patent or non-exclusive copyright license must obtain consent from the patent or copyright owner. Courts have held that both exclusive and non-exclusive patent licenses cannot be assigned without consent (see *In re Hernandez*, 285 B.R. 435 (Bankr. D. Ariz. 2002)). Courts are likely to apply this treatment to licenses of AI software, particularly where AI software has been patented.

While courts agree that patent and non-exclusive copyright licenses cannot be assigned without consent, courts have differed whether this treatment also applies to exclusive copyright licenses. Most courts reason that because an exclusive copyright license transfers all of the protections of owning a copyright to the licensee, an exclusive copyright license may be assigned in bankruptcy without the consent of the licensor (see *Golden Books Family Entm't*, 269 B.R. 311 (Bankr. D. Del. 2001); *Patient Educ. Media*, 210 B.R. 237, 243 (Bankr. S.D.N.Y. 1997)).

By extension, if AI software is protected solely by an exclusive copyright, AI licenses may be treated similarly. While it is unlikely that a developer's AI software is protected only by an exclusive copyright license, practitioners should be aware that the US Court of Appeals for the Ninth Circuit reached the opposite conclusion, holding that exclusive copyright licenses cannot be transferred without consent of the licensor (see *Gardner v. Nike Inc.*, 279 F.3d 774 (9th Cir. 2002)).

For a detailed analysis of assignability of IP licenses, see Practice Note, IP Licenses: Restrictions on Assignment and Change of Control: Assignability of License (3-517-3249).

CAN A DEBTOR-LICENSEE ASSUME PATENT AND NON-EXCLUSIVE COPYRIGHT LICENSES FOR AI ABSENT CONSENT OF THE LICENSOR?

While courts generally agree that patent licenses and non-exclusive copyright licenses cannot be assigned without consent of the licensor, courts are split regarding whether a debtor-licensee can assume these licenses and perform under them after exiting bankruptcy. Depending on the circuit, courts generally take one of three primary approaches:

- The "hypothetical test," adopted by the majority of circuit courts, including the Third, Fourth, Ninth, and Eleventh Circuits.
- The "actual test," favored by courts in the First and Fifth Circuits.
- A third approach adopted by the US Bankruptcy Court for the Southern District of New York in *In re Footstar*, 323 B.R. 566, 569 (Bankr. S.D.N.Y. 2005)

Courts in the majority of circuits have adopted the "hypothetical test" holding that a debtor cannot assume an IP license as a debtor-in-possession if it cannot assign the license to a hypothetical third party under applicable law, even if the debtor does not intend to assign its license rights to a third party (see *In re Sunterra Corp.*, 361 F.3d 257 (4th Cir. 2004); *In re Catapult Entm't, Inc.*, 165 F.3d 747 (9th Cir. 1999); *In re James Cable Partners, L.P.*, 27 F.3d 534 (11th Cir. 1994); *In re W. Elec. Inc.*, 852 F.2d 79 (3d Cir. 1988)).

These courts reason that the language of section 365(c) prevents assumption "or" assignment under certain conditions. Therefore, these courts hold that if a license cannot be assigned, the debtor also cannot assume it. A debtor licensing valuable IP rights that files a bankruptcy case in the Third, Fourth, Ninth, or Eleventh Circuits therefore faces an insurmountable obstacle to reorganizing without the IP licensor's consent. This result can have a significant impact on debtor-licensees of AI software.

The First and Fifth Circuits favor an alternative "actual test" in which the assignment limitations under applicable non-bankruptcy law are not triggered unless the debtor actually intends to assign the contract to a third party (see *In re Mirant Corp.*, 440 F.3d 238 (5th Cir. 2006); *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489, 493 (1st Cir. 1997)).

Under this test, the courts treat the debtor-in-possession as the same entity as the prepetition debtor for purposes of assuming a license, which cannot be assigned to a third party without the non-debtor licensor's consent. Courts in these Circuits are likely to apply this analysis to the assumption of AI licenses.

In the Southern District of New York, the bankruptcy court applied a different approach in *Footstar*, holding that the term "trustee" as used in section 365(c)(1) should not be read to mean "debtor-in-possession." Based on this reading, the court held that section 365(c)(1) is limited to situations where the trustee, rather than the debtor-in-possession, seeks to assume a contract.

In a bankruptcy case in a jurisdiction where the circuit court has not yet adopted any of these approaches, the parties face substantial litigation risk. In these jurisdictions, as a matter of strategy:

- A debtor-licensee of AI software is likely to press the court to adopt the actual test or the Footstar approach to permit assumption of an otherwise non-assignable contract.
- A non-debtor licensor of AI software is likely to seek application of the hypothetical test so that the debtor-licensee cannot assume the AI license agreement.

LOOKING AHEAD, WHAT CAN DEVELOPERS AND LICENSEES OF AI DO TO PROTECT THEIR RIGHTS AND INTERESTS IN ANTICIPATION OF A BANKRUPTCY FILING?

While bankruptcy courts have not yet formally opined on cases where the ownership, licensing, or value of AI software is disputed, both AI software developers and licensees can take several steps to protect their interests and rights:

Licensors may take certain measures to protect themselves, including:

- Agreeing on a date certain when the license terminates, rather than an automatic renewal. This may protect a licensor when a licensee file for bankruptcy because the licensor is prevented from terminating the license under the automatic stay.
- Incorporating a provision in the license agreement that grants the licensor the right to terminate the license within a specific number of days after the licensee fails to pay the license fee. The licensee is often late on making payments when it faces financial difficulty. However, many software licenses do not specify the conditions by which the licensor can terminate the AI software license. If the software license is terminated for a valid cause prior to the filing of a debtor-licensees bankruptcy case, the bankruptcy case does not revive the terminated license.
- Ensuring that the license agreement specifies that the new code created by AI software is owned by the licensor.
- Vigilantly monitoring the licensee's financial condition and ability to timely pay royalty payments as this may allow the licensor to protect itself in the event of a default. While a licensor may terminate the license before the bankruptcy of the licensee if there is sufficient cause, a licensor cannot terminate a license after the licensee files a bankruptcy, even if the licensee is in default under the license.

Licensees may take certain measures to protect themselves, including:

- Ensuring that the data collected by use of the AI software remains the licensee's property, subject to appropriate confidentiality terms.
- Requesting a security interest in the license. This may support the argument in a debtor-licensor's bankruptcy case that the license cannot be rejected as an executory contract under section 365 of the Bankruptcy Code. However, this strategy requires the licensor to incur some form of indebtedness to the licensee, which it may be resistant to do.

Both the licensor and the licensee can also agree on language in the license agreement regarding the treatment of the licensee's rights if there is a breach by the licensor. While treatment of AI software cannot be completely controlled by private agreements, the more specific the license is regarding post-breach treatment, the more likely a court may consider enforcing the provisions after rejection of the contract. Both the AI software licensor and the licensee benefit by knowing the possible outcome if the other party files a bankruptcy case.

AI Chatbots Are Useless for Bankruptcy Lawyering

Josiah M. Daniel, III*

revised August 13, 2023

Lawyers have been inundated in 2023 with press articles and social-media posts by tech commentators heralding the near perfection of artificial intelligence (AI) and raving about newly available—free of charge, so far—applications (apps) of AI known as *chatbots*. Only seven months ago, in December 2022, a *New York Times* reporter touted the arrival of *ChatGPT* from OpenAI, an AI research and deployment company, as "quite simply, the best artificial intelligence chatbot ever released to the general public."[1] In July 2023 Google issued its chatbot, *Bard*.[2]

Although the developers label these apps as "experimental," some commentators suggest that AI be put to work now in the real world of business and commerce. Some even contend that AI applications *can do the job of lawyers*, implicitly jeopardizing law practice as a career. A March 2023 *Reuters* article headlined "Bar exam score shows AI can keep up with 'human lawyers,' researchers say,"[3] and it quoted a study posted on SSRN as stating, "large language models can meet the standard applied to human lawyers in nearly all jurisdictions in the United States by tackling complex tasks requiring deep legal knowledge, reading comprehension, and writing ability."[4]

Is it true? My answer is no.

---

* The author is a Retired Partner in Residence of Vinson & Elkins, LLP, who practiced bankruptcy law in its Dallas, Texas office. He is a Fellow, Emeritus, of the American College of Bankruptcy and is a Visiting Scholar, Department of History, College of Liberal Arts, of The University of Texas at Austin. All statements about the law do not necessarily reflect the views of the law firm from which he is retired or its clients or of any organization with which he is affiliated. This essay is revised and extended from the version published in *Texas Lawbook*, texaslawbook.net/ai-chatbots-are-useless-for-bankruptcy-lawyering/, on August 9, 2023.

[1] *The Brilliance and Weirdness of ChatGPT*, NY TIMES, Dec. 5, 2022.

[2] My project to test the two chatbots began July 3, 2023, when Google sent an email inviting me to "get started" and become "an early experimenter with Bard!" Google to author, July 3, 2023.

[3] *Bar exam score shows AI can keep up with 'human lawyers,' researchers say*, REUTERS, Mar. 15, 2023.

[4] Daniel Martin Katz1, Michael James Bommarito, Shang Gao & Pablo David Arredondo, *GPT-4 Passes the Bar Exam*, SSRN-id4389233.pdf (revised Apr. 5, 2023).

I'm a retired business-bankruptcy lawyer now writing legal history, and I've recently finished articles on bankruptcy-law topics based on case law combined with archival research. So I drew on my experience and expertise to test these two AI applications. I began with Bard, then turned to ChatGPT, asking identical questions. The results were not gratifying. Indeed I found those two AI apps unreliable and unhelpful for lawyering in bankruptcy matters.

First, I asked Bard to *"prepare a bankruptcy proof of claim for the amount of $4,675.98 as a claim secured by a security interest in chattel paper."* The chatbot created a short, 114-word document that was formatted oddly but titled "Proof of Claim." It required only the barest information for me to fill in. Under the heading "Description of Chattel Paper," it went ahead to specify a "Promissory note dated March 8, 2023, for the amount of $4675.98. . . . secured by a security interest in"—*inexplicably*—"a 2022 Ford F-150 pickup truck"! The next paragraph, "Security Interest," duplicated that information. Happily, Bard did get the dollar amount correctly. Its form then required only "Your signature" and a date.

Curiously, that question posed to ChatGPT yielded a form of a *letter to the clerk* of the bankruptcy court. At triple the length of Bard's, this document contained more information items to fill in but ChatGPT went ahead to state the "Basis of Claim" as: "This claim *represents* a *secured interest* in chattel paper, *as defined by the Uniform Commercial Code (UCC) § 9-102(a)(11)*, which *includes* a *security interest in a tangible medium on which information is inscribed*. The verb "represents" would be more conventionally stated as "is secured by," and the correct term is "security (not 'secured') interest." Its verbosity is not a good thing here. The form's recitation of a specific UCC section number and definition of "chattel paper" are unnecessary, and, what's more, ChapGPT botched its own explanatory clause, that chattel paper "includes a security interest in a *tangible* medium on which information is inscribed." The applicable definition of "records" in UCC § 9-102(a)(70) covers both tangible *and electronic* information.

Most importantly, as bankruptcy lawyers well know, the Judicial Conference has prescribed and placed online, and regularly updates, the Official Form B 410 for proofs of claim in all bankruptcy cases.[5] Section 502(b) of the Bankruptcy Code (the Code) provides that a claim described and

[5] www.uscourts.gov/sites/default/files/form_b_410.pdf.

not disputed in the Debtor's schedules is "deemed allowed," unless objected to; but I do not fault either AI device for not mentioning the predicate *legal decision to file* a claim in the first place. I do criticize both of them for not requiring all of the discrete items of information that Code § 502, Bankruptcy Rules 3001-3005, and the Official Form require. After all, the Official Form is easily available and fillable online.

The missing information in both chatbots' forms was substantial and would likely provoke an objection to the claim by the debtor or an interested party. The additional facts *required* by the Official Form include these: whether all or just part of the claim is secured, the basis for perfection of the security interest, the value of the collateral and the amount of the claim that is secured, the amount necessary to cure any default, the interest rate, whether the claim is based on a lease, the amount of the claim entitled to any priority, an acknowledgment that all credits to the debtor have been applied, and identifying information about the signer.[6] Those are important lacunae.

Last, Bard's claim form omitted a *verification* of the claim by the creditor, and ChatGPT's letter formulated a muddled version of it: "accurate and complete *to the best of [my] knowledge*." But, due to the federal false-claims statute, 18 U.S.C. § 152(4), the Official Form requires an unequivocal declaration "under penalty of perjury that the foregoing *is true and correct*.[period!]" Neither chatbot found that.

My second query was: "In bankruptcy, what is the test for 'single asset real estate'?" In relevant part, Bard's response included:

> 1. The real property must constitute a single property or project, other than residential real property with fewer than four residential units.
> 2. The real property must generate substantially all of the gross income of the debtor.
> 3. The debtor must not be involved in any substantial business other than the operation of its real property and the activities incidental thereto.
>
> The term "substantially all" is not defined in the Bankruptcy Code, but it is generally interpreted to mean at least 80%. The debtor's aggregate non-contingent liquidated secured

[6] Id.

> debt must also be less than $4,000,000, but this requirement was removed as part of the 2005 Bankruptcy Code revisions. . . .

Bard's answer failed to provide the statutory citation, Code § 101(51B)[7], and was incorrect in substantial respects.

Bard's recitation of the three enumerated elements accurately paraphrased the statutory definition *except that* it omitted an important point: "who is *not a family farmer*." Second, Bard asserted that the statutory term "substantially all" with respect to gross income is "generally interpreted to mean at least 80%." But I find no such percentage test in the case law. And why even mention the $4 million limitation on the SARE debtor's secured-debt amount when—as this AI app then acknowledged—Congress removed it from the Code two decades ago? Finally, Bard's attempt (not quoted above) to explain the purpose of this part of the Code was grossly oversimplified and subject to exception.[8]

ChatGPT's response to the same query also failed to identify the relevant statute and to exclude family farmers but provided a slicker, longer exposition. In pertinent part:

> In bankruptcy, the "single asset real estate" (SARE) test is a crucial factor that . . . . primarily comes into play when a debtor who owns a single property (the "single asset") files for bankruptcy protection . . . .
>
> . . . . To qualify as a single asset real estate debtor, the property in question must meet the following criteria:
>
> . . . . The debtor must own only one property (real estate asset). This property is typically used for generating income, such as a commercial building, rental property, or a multifamily residential complex.

---

[7] The statutory definition is:

> The term "single asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto.

Bankr. Code § 101(51B).

[8] Another disconcerting aspect of Bard's responses is that the app provides an option for the questioner to receive two alternative responses. The extra responses, in some respects, are unsettlingly divergent.

> . . . . The property must generate substantially all of the debtor's gross income. This means that the debtor's primary source of income comes from the property in question.
>
> . . . . The debtor's other business activities, if any, must be relatively minimal. The Bankruptcy Code does not provide an exact definition of what . . . "relatively minimal" mean[s] in this context, leaving it to the courts to decide on a case-by-case basis. . . .
>
> It's important to note that bankruptcy laws can be complex and can vary from jurisdiction to jurisdiction, so debtors considering bankruptcy should seek advice from qualified bankruptcy attorneys to understand their specific situation and options.

ChatGPT's inaccuracies are multiple.

To begin, it should not have mentioned "small business debtors" who have their own chapter in the Code from which SARE debtors are excluded.[9] Second, as noted, there is no size limit to a single-asset debtor—the definition can cover even a massive real-estate *project* encompassing multiple properties and employing numerous employees, if owned by only a single debtor. Next, this chatbot's sentence about the "substantially all of the gross income" element was just meaningless. Last, ChapGPT asserted that the element "no substantial business . . . other than the business of operating the real property and activities incidental thereto" means "relatively minimal," a phrase that the chatbot *invented* and put *in quotation marks* but then *laments* is not "exact[ly] defin[ed]" in the Code!

The best things about ChatGPT's offering were its acknowledgment that "bankruptcy laws can be complex" and its admonition that "debtors considering bankruptcy should seek advice from qualified bankruptcy attorneys"!

---

[9] The term "small business debtor" means:

> . . . a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and *excluding a person whose primary activity is the business of owning single asset real estate*) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,000,000 [with certain exclusions].

Bankr. Code § (51D) (emphasis added).

I followed up with five bread-and-butter requests of a Chapter 11 lawyer:

- "a debtor's objection to a stay-relief motion in a Chapter 11 case"
- "a disclosure statement for a Chapter 11 plan in a bicycle-manufacturer case"
- "a motion to extend the time for assumption of grocery-store leases"
- "a motion to approve a settlement in a Chapter 7 case in a specific district, the Bankruptcy Court for the Northern District of Texas"
- "a plan support agreement for a Chapter 11 bankruptcy plan on which the ABL lender, the ad hoc group of partially secured term lenders, and the trade creditors committee agree providing for a section 363 sale process and a waterfall for distributions"

In each instance, the chatbot produced a draft document that was missing important categories of factual statements or legal assertions.

I gave each chatbot a final bankruptcy-lawyer request to "draft a brief with citations of legal authorities in support of cramdown of a plan of reorganization in a Chapter 11 bankruptcy case in the Bankruptcy Court for the Southern District of Texas." Bard prepared a short *memo* with a partial statutory citation and two bogus judicial decisions! The statute was cited as "11 U.S.C. § 1129(b)(1)—without including the key subsection (b)(2).[10] Its first purported case citation was "*In re Delta Airlines*," said to have been issued by the Second Circuit in 2001,[11] and the second case, allegedly from the Fifth Circuit, styled *In re Texaco*."[12] Neither case exists! Bard's first volume-and-page citation was to the seventh page of a Seventh Circuit decision, *Dressler v. McCaughtry*, 238 F.3d 908 (2001), a habeas corpus case, and the second to the second page of *Channel Star Excursions, Inc. v. Southern Pacific Transp. Co.*, 77 F.3d 1135 (1996), a Ninth Circuit case and also not a bankruptcy case! The use in court proceedings, or, really,

[10] Collectively, the *two* key subsections, (b)(1) & (2), of section 1129 constitute the cramdown provisions of Chapter 11.

[11] Bard's fictional citation here is: "*In re Delta Airlines*, 238 F.3d 915 (2d Cir. 2001)." Delta did file and pursue its Chapter 11 case in the Southern District of New York from 2005-2007 but no Second Circuit case resulted from that bankruptcy.

[12] Bard's made-up citation is: "*In re Texaco*, 77 F.3d 1136 (5th Cir. 1996)." I find only one Fifth Circuit case in which Texaco was a party and that, at least tangentially, mentioned plan confirmation, noting that Texaco's plan in its 1977 Chapter 11 case in the Southern District of New York barred later-asserted prepetition claims. See Texaco Inc. v. Duhe, 274 F. 3d 911 (5th Cir. 2001) (dispute about post-confirmation oil and gas royalties in Louisiana). But no Fifth Circuit case with Texaco as a party at any time concerns confirmation of a plan of reorganization by way of cramdown.

anywhere, of fictitious judicial decisions provided by chatbots can incur serious consequences.[13]

ChatGPT generated a longer document—again in the form of a *letter*, not a brief or memorandum of law, this time *to the court*—and with just two citations. Both were *bankruptcy* decisions of the Supreme Court, *Till v. SCS Credit Corp.*,[14] and *United Savings Ass'n v. Timbers of Inwood*.[15] Happily, the two cited cases *do* exist! Unfortunately, ChatGPT grossly misunderstood both cases, claiming that *Till* was a Chapter *11* case when it was a Chapter 13 case, and that the holding in *Timbers* was that "the cramdown provisions in Chapter 11 of the Bankruptcy Code are constitutional." *Timbers* is not a confirmation case.

Throughout my questions and requests, both chatbots missed something important about bankruptcy process and practice that must be imperceptible as their algorithms, in formulating their responses, scanned the surfaces of all the texts and words in their giant databases.[16] They failed to sense the persistent and real imperative that all bankruptcy lawyers *feel* and *understand*, and that bankruptcy judges *expect* and *nudge and even urge* lawyers to do, and that is to compromise and settle most if not substantially all of the issues, large and small, arising between the parties in bankruptcy cases.[17] Bankruptcy lawyers of course know it, breathe it, and live it, continually.

Lawyers *could* fix the chatbots' products by *very heavy editing. Or* the lawyers could avoid such exertions and save a lot of time by doing their own lawyering—researching the statute, rules, and cases and retrieving prior forms from other files and prior usage or by using form books, in print or

---

[13] Recently one poor lawyer unthinkingly filed with a Manhattan federal judge a brief with chatbot-generated citations to cases that proved nonexistent; the judge haled him in for a show-cause hearing. Mata v. Avianca, Inc., 2023 U.S. Dist. Lexis 94323 (S.D.N.Y., May 4, 2023, order); *Here's What Happens When Your Lawyer Uses ChatGPT*, NY Times, May 27, 2023 ("ChatGPT had invented everything"). See also Ex Parte Lee, No. 10-22-00281-CR n.2 (Tex. App.—Waco, July 19, 2023).

[14] *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

[15] *United Savings Ass'n v. Timbers of Inwood,* 484 U.S. 365 (1988).

[16] One inherent limitation in all the chatbots' responses is that they have worked from a database that was fixed as of a couple of years ago.

[17] See, generally, Josiah M. Daniel, III, *"Even If a Party Has a Change of Heart": A Framework for Enforcement of Courthouse-Steps Settlements in Cases and Proceedings in the Texas Bankruptcy Courts*, 52 TEX. TECH L. REV. 199 (2020), available at papers.ssrn.com/sol3/papers.cfm?abstract_id=3330367.

online, from reputable legal publishers—and by thinking as a lawyer and adapting those materials to advance the client's situation and goal.

> In 2009 I published an essay defining the term "lawyering" as
>
> > the work of a specially skilled, knowledgeable, or experienced person [a lawyer] who, serving by mutual agreement as [the client]'s agent, invokes and manipulates, or advises about, the dispute-resolving or transaction-effectuating processes of the legal system for the purpose of solving a problem or causing a desired change in, or preserving, the status quo for his or her [client].[18]

The essence of lawyering is finding a way, ethically, to accomplish the client's objective.

In lawyering, attorneys call upon all of their experience, common sense, and finesse to customize their stances on the issues and their presentation of those assertions in legal papers, seeking desired ends and positioning for possible settlement negotiations. Perceptive and knowledgeable of judges'—and their opponents'—preferences, inclinations, and idiosyncrasies, lawyers use their human judgment to sensitively and sensibly shape their work products in order to achieve the result for the client. Lawyering is a dynamic process of human[19] interactions.

And bankruptcy judges are no fools. For a lawyer to file inadequate and inaccurate pleadings and documents and to cite to judges spurious judicial decisions, such as the chatbots generated for me, would bring judicial scorn, or worse, sanctions.[20] Indeed one federal judge has already taken this precautionary step:

---

[18] Josiah M. Daniel, III, *A Proposed Definition of the Term "Lawyering,"* 101 LAW LIBR'Y J. 207, 215 (2009), available at papers.ssrn.com/sol3/papers.cfm?abstract_id=2296240. The leading law dictionary has substantially adopted my definition. BLACK'S LAW DICTIONARY, *lawyering* 1063 (Bryan A. Garner, ed., 11th ed. 2019).

[19] David Brooks, *'Human Beings Are Soon Going to Be Eclipsed'*, NY TIMES, July 13, 2023 (expressing amazement at what AI can do but holding on to "the deepest core of my being—the vast, mostly hidden realm of the mind from which emotions emerge, from which inspiration flows, from which our desires pulse—the subjective part of the human spirit that makes each of us ineluctably who we are").

[20] See n. 13 *supra*.

> All attorneys . . . must . . . file . . . a certificate attesting either that no portion of any filing will be drafted by generative artificial intelligence (such as ChatGPT, Harvey.AI, or Google Bard) or that any language drafted by generative artificial intelligence will be checked for accuracy, using print reporters or traditional legal databases, by a human being. These platforms are incredibly powerful and have many uses in the law . . . . But legal briefing is not one of them. Here's why. These platforms in their current states are prone to hallucinations and bias. On hallucinations, they make stuff up—even quotes and citations. Another issue is reliability or bias. . . . [T]hese systems hold no allegiance to any client, the rule of law, or the laws and Constitution of the United States (or, as addressed above, the truth). Unbound by any sense of duty, honor, or justice, such programs act according to computer code rather than conviction, based on programming rather than principle. . . . A template Certificate Regarding Judge—Specific Requirements is provided here.[21]

This can only become ubiquitous in the federal courts.

Have I been too harsh in my critique? For a reality check, before posting this essay on SSRN, I gave each chatbot a final, *very simple* query: "*Who is Josiah M. Daniel, III?*" After all, I am fairly easy to "google" on the internet. But Google's Bard pegged my age incorrectly by 14 years, said I was a "former ambassador to Mexico," and placed me, a fully retired lawyer, presently practicing with the Morgan, Lewis law firm in New York. ChatGPT's response was equally preposterous, that I am "an American . . . politician, and businessman" who as of the chatbot's "last knowledge update in September 2021, . . . served as the President of the Texas State Board of Education," all of which is just false. Such responses confirmed my evaluation.

These two AI apps are said to able to code computer chips, make intricate graphics, and perform remarkable electronic functions. I cannot evaluate those matters. But the outputs of Bard and ChatGPT in response to my *legal-task* requests were *not* lawyering and were *not even helpful* to lawyering.

---

[21] *Mandatory Certification Regarding Generative Artificial Intelligence*, United States District Court, Northern District of Texas (Hon. Brantley Starr), www.txnd.uscourts.gov/judge/judge-brantley-starr (2023).

JOINT STATEMENT ON ENFORCEMENT EFFORTS AGAINST DISCRIMINATION AND BIAS IN AUTOMATED SYSTEMS

Rohit Chopra, Director of the Consumer Financial Protection Bureau,
Kristen Clarke, Assistant Attorney General for the Justice Department's Civil Rights Division,
Charlotte A. Burrows, Chair of the Equal Employment Opportunity Commission, and
Lina M. Khan, Chair of the Federal Trade Commission
issued the following joint statement about enforcement efforts to protect the public from bias in automated systems and artificial intelligence:

America's commitment to the core principles of fairness, equality, and justice is deeply embedded in the federal laws that our agencies enforce to protect civil rights, fair competition, consumer protection, and equal opportunity. These established laws have long served to protect individuals even as our society has navigated emerging technologies. Responsible innovation is not incompatible with these laws. Indeed, innovation and adherence to the law can complement each other and bring tangible benefits to people in a fair and competitive manner, such as increased access to opportunities as well as better products and services at lower costs.

Today, the use of automated systems, including those sometimes marketed as "artificial intelligence" or "AI," is becoming increasingly common in our daily lives. We use the term "automated systems" broadly to mean software and algorithmic processes, including AI, that are used to automate workflows and help people complete tasks or make decisions. Private and public entities use these systems to make critical decisions that impact individuals' rights and opportunities, including fair and equal access to a job, housing, credit opportunities, and other goods and services. These automated systems are often advertised as providing insights and breakthroughs, increasing efficiencies and cost-savings, and modernizing existing practices. Although many of these tools offer the promise of advancement, their use also has the potential to perpetuate unlawful bias, automate unlawful discrimination, and produce other harmful outcomes.

Our Agencies' Enforcement Authorities Apply to Automated Systems

Existing legal authorities apply to the use of automated systems and innovative new technologies just as they apply to other practices. The Consumer Financial

Protection Bureau, the Department of Justice's Civil Rights Division, the Equal Employment Opportunity Commission, and the Federal Trade Commission are among the federal agencies responsible for enforcing civil rights, non-discrimination, fair competition, consumer protection, and other vitally important legal protections. We take seriously our responsibility to ensure that these rapidly evolving automated systems are developed and used in a manner consistent with federal laws, and each of our agencies has previously expressed concern about potentially harmful uses of automated systems. For example:

- The **Consumer Financial Protection Bureau** (CFPB) supervises, sets rules for, and enforces numerous federal consumer financial laws and guards consumers in the financial marketplace from unfair, deceptive, or abusive acts or practices and from discrimination. The CFPB published a circular confirming that federal consumer financial laws and adverse action requirements apply regardless of the technology being used. The circular also made clear that the fact that the technology used to make a credit decision is too complex, opaque, or new is not a defense for violating these laws.

- The **Department of Justice's Civil Rights Division** (Division) enforces constitutional provisions and federal statutes prohibiting discrimination across many facets of life, including in education, the criminal justice system, employment, housing, lending, and voting. Among the Division's other work on issues related to AI and automated systems, the Division recently filed a statement of interest in federal court explaining that the Fair Housing Act applies to algorithm-based tenant screening services.

- The **Equal Employment Opportunity Commission** (EEOC) enforces federal laws that make it illegal for an employer, union, or employment agency to discriminate against an applicant or employee due to a person's race, color, religion, sex (including pregnancy, gender identity, and sexual orientation), national origin, age (40 or older), disability, or genetic information (including family medical history). In addition to the EEOC's enforcement activities on discrimination related to AI and automated systems, the EEOC issued a technical assistance document explaining how the Americans with Disabilities Act applies to the use of software, algorithms, and AI to make employment-related decisions about job applicants and employees.

- The **Federal Trade Commission** (FTC) protects consumers from deceptive or unfair business practices and unfair methods of competition across most sectors of the U.S. economy by enforcing the FTC Act and numerous other laws and regulations. The FTC issued a report evaluating the use and impact of AI in combatting online harms identified by Congress. The report outlines significant concerns that AI tools can be inaccurate, biased, and discriminatory by design and incentivize relying on increasingly invasive forms of commercial surveillance. The FTC has also warned market participants that it may violate the FTC Act to use automated tools that have

discriminatory impacts, to make claims about AI that are not substantiated, or to deploy AI before taking steps to assess and mitigate risks. Finally, the FTC has required firms to destroy algorithms or other work product that were trained on data that should not have been collected.

Automated Systems May Contribute to Unlawful Discrimination and Otherwise Violate Federal Law

Many automated systems rely on vast amounts of data to find patterns or correlations, and then apply those patterns to new data to perform tasks or make recommendations and predictions. While these tools can be useful, they also have the potential to produce outcomes that result in unlawful discrimination. Potential discrimination in automated systems may come from different sources, including problems with:

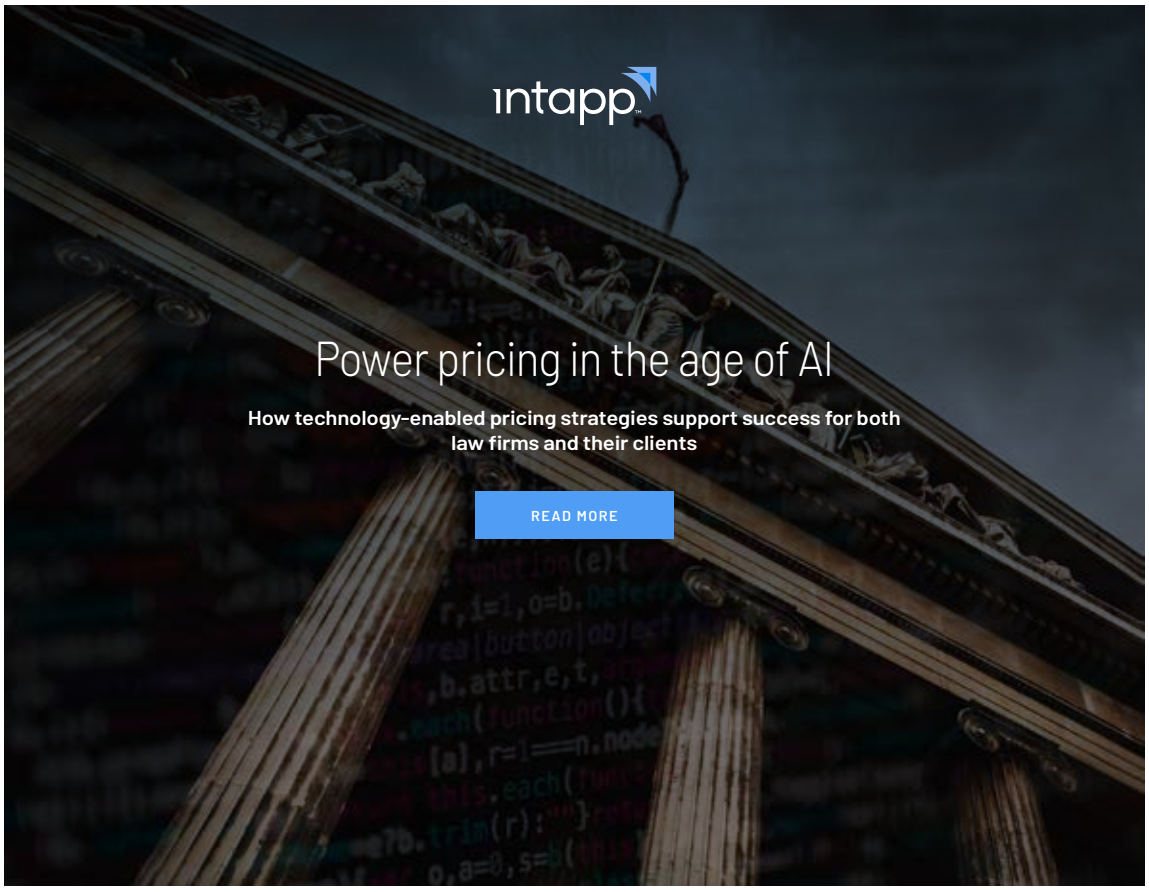
- **Data and Datasets:** Automated system outcomes can be skewed by unrepresentative or imbalanced datasets, datasets that incorporate historical bias, or datasets that contain other types of errors. Automated systems also can correlate data with protected classes, which can lead to discriminatory outcomes.

- **Model Opacity and Access:** Many automated systems are "black boxes" whose internal workings are not clear to most people and, in some cases, even the developer of the tool. This lack of transparency often makes it all the more difficult for developers, businesses, and individuals to know whether an automated system is fair.

- **Design and Use:** Developers do not always understand or account for the contexts in which private or public entities will use their automated systems. Developers may design a system on the basis of flawed assumptions about its users, relevant context, or the underlying practices or procedures it may replace.

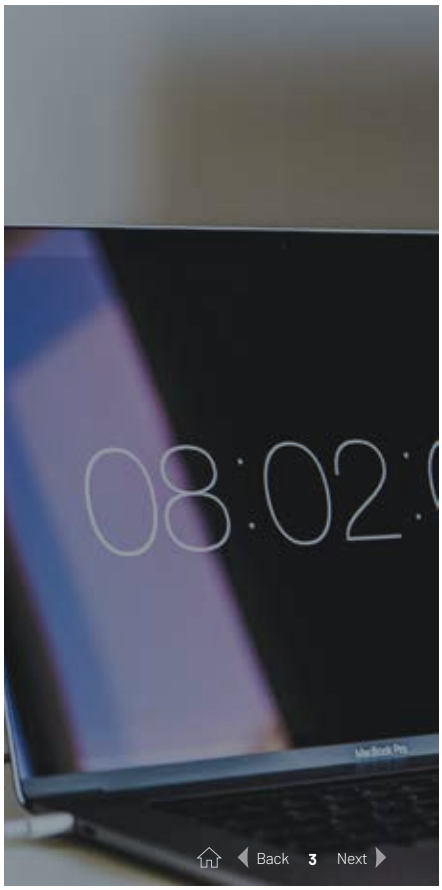
Today, our agencies reiterate our resolve to monitor the development and use of automated systems and promote responsible innovation. We also pledge to vigorously use our collective authorities to protect individuals' rights regardless of whether legal violations occur through traditional means or advanced technologies.

Note: This document is for informational purposes only and does not provide technical assistance about how to comply with federal law. It does not constitute final agency action and does not have an immediate and direct legal effect. It does not create any new rights or obligations and it is not enforceable.



Contents

1. Introduction



If there was one tradition that seemed unshakable in the legal world, it was billable hours. Whether a standalone lawyer in a small town or a major firm in New York City, lawyers charged by the hour for their services. That's how it was for decades — but then, times changed.

The Great Recession struck. A new era of competition for legal services arrived and with it a greater client demand for transparency. Today, clients are asking professional services firms — especially in the legal realm — to provide more value and clarity in their engagements. This new, marketplace-driven structure means firms need to create different ways of billing for their services to keep clients happy.

The result? Alternative fee arrangements (AFAs) — pricing and fee agreements that go beyond the traditional hourly billing model. What's more, lawyers are also requesting the change, according to reports including the Altman Weil *Law Firms in Transition Survey*. Savvy lawyers know that AFAs help them remain competitive and grow business.

But while the idea of AFAs appeals to both clients and lawyers, the reality of pricing matters accurately and profitably poses a challenge to many firms. Forward-looking firms are embracing a technology-based approach to meeting that challenge. By leveraging artificial intelligence (AI), firms can mine and analyze their existing data to derive accurate pricing strategies. The outcome is greater value to both clients and the business.

intapp

2. The shift in pricing

For decades, the legal field saw sustained growth. Firms enjoyed high demand from large corporations — some employing as many as 200 firms at a time — and lawyers could consistently bill 2,000 hours a year. The result: an overwhelmingly profitable industry.

Then came the 2009 recession. The major economic downturn affected many industries. Hoping to boost their bottom lines in a failing economy, corporate clients reduced their demand for legal work. They increasingly turned to in-house counsel while demanding reductions in the hourly rates outside firms charged for standing projects. Consequently, law firms found themselves competing not just with one another but also with clients' salaried lawyers.

That supply-and-demand shift shows no signs of reversing. According to *Law Firms in Transition*, 95.8% of law firms view price competition as a permanent trend.

If firms are to grow in this environment, they must secure more of a client's portfolio or win work away from competitors. They can only do this by acknowledging the changes in pricing trends and altering traditional billing models.

Realization rates dropping

Just as firms expect price competition to remain, the majority — 60.3%, according to *Law Firms in Transition* — also believe realization rates will continue to decrease. Of those surveyed, only 37.5% saw their firms' realization rates increase against the standard rates from 2016. Looking further back, the average firm's billing realization rate fell over the last decade from 94% to 87%, according to the *2016 Report on the State of the Legal Market*. Unfortunately, a realization rate drop often means a profitability dip, too.

To combat the problem, firms must work to increase their realization rates, a goal directly correlated to pricing. The ability to understand the true effort required — what it actually takes to deliver the work — helps firms understand how to optimize their resourcing. Cue AFAs: A properly constructed alternative fee structure allows firms to set a more realistic price for a matter, ultimately boosting realization.

Pushback from clients demanding more transparency and value

Since the recession, clients have increasingly turned to in-house counsel for legal services, creating an obvious problem for outside firms looking to grow business. With so much internal legal expertise, companies are holding their outside legal firms more accountable and scrutinizing the firms' bills and work effort with an expert eye.

As a result, pricing is now an ever-growing, two-way conversation. Per *Law Firms in Transition*, 85% of law firms report having proactive discussions with their clients around pricing and budgets, while 67% are collaborating with clients on creative alternative pricing options.

The economy, competition, and traditional ways of calculating profitability all play into the push for pricing changes. Ultimately, though, client demand is the driving force behind it all. If it weren't for the shift in needs and wants on the client side, firms may have preferred to stick to the old hourly billing model.

The recent economic shifts have created a trend for vigilance. Clients are now better equipped to be more discerning. They have the tools and knowledge to understand how much time and effort it takes to do the work.

While the long-term ramifications of AFAs on law firms' overall profitability remain an open question, *Law Firms in Transition* found that most lawyers believe the changes will not harm their bottom lines. Unfortunately, 69% of law firms also say that partners are hesitant to change, and only 38%of firms are actively engaged in experiments to test innovative pricing methods.

The resistance is futile, though. The pre-recession demand level for legal services seems unlikely to return. The only way to stay competitive is to adapt.

Back 5 Next

Types of AFAs

Alternative fee arrangements for legal work have existed for years but certainly were not the norm. However, today's clients seek new service models, prompting law firms to explore different ways to engage commercially. AFAs encompass a wide range of options, including the following:

- **Blended hourly rate:** A firm offers a single hourly rate regardless of which lawyers work on the project. The client benefits from dealing with one pricing structure, while the firm can control how it should allocate its resources.
- **Capped fees:** The firm still employs an hourly rate model but with a maximum amount the client will spend. Both the firm and the client agree the total bill will not exceed that amount, often agreeing upon a minimum as well.
- **Fee collars:** This arrangement rewards efficiency. Lawyers benefit if they complete the work under the budgeted time, while the client receives a discount if the firm goes over.
- **Fixed fees:** Fixed-fee arrangements come in many different flavors: fixed fee plus success fee, fixed fees for single engagements, portfolio fixed fees, and so forth. These combinations keep pricing simple for clients and can help avoid back-and-forth negotiations.
- **Holdbacks:** This contingency arrangement ensures firms receive a large percentage of their usual hourly rate no matter the outcome. They receive the full rate if they are successful. Clients are happy because there is an incentive for the firm to do well.
- **Hourly rate plus contingency:** Both the client and the firm share the risk with this arrangement. The firm is guaranteed a minimum amount with the hourly structure and can only stand to make more if it is successful in winning a case.
- **Portfolio fixed fees:** Firms can provide a fixed fee for a portfolio of many services, creating another avenue for gaining more business.
- **Subscriptions:** A subscription service may enable a firm to capture more business from a client, as it is more malleable in its application than a retainer.
- **Success fees:** Together, the firm and client determine what success looks like for a particular project (for example, an early resolution or lower settlement) and determine a fee for that achievement.
- **Task billing:** A firm can work with the client to create a list of tasks or components, then price out what each piece will cost. The expectations are clear and can help a client with a budget.

3. The rise of the pricing team

Forward-looking firms recognize the growing urgency of transparency, visibility, and responsiveness when it comes to pricing. Many — especially the larger ones — have responded to the pressure by creating roles for a pricing director and team.

Per *Law Firms in Transition*, nearly a third (31%) of firms have established a formal pricing role. These team members are becoming critical in at least two ways: helping win new business and ensuring the business the firm takes on is profitable.

Pricing teams help firms become more effective in addressing client needs while ensuring the practice's strength and profitability. How do the teams accomplish this? By focusing on several areas:

Analyzing past matters to help create pricing strategies for new engagements

When a firm assesses a potential engagement, it's important to look at similar past work to understand the quantitative resources (time, distribution of personnel) and qualitative resources (resolution of the matter, whether the outcome was favorable) necessary to complete the work. Having this knowledge helps the firm accurately price out the matter. It sounds simple, until one considers the time and effort involved.

That's why firms see value in pricing professionals. Working in conjunction with lawyers, pricing teams can evaluate data from past engagements and use this information to determine how the firm should accurately price future engagements with clients. The more evaluation, the better a firm gets at ensuring it prices its services to generate both the highest value for the client and the most profitable outcome for the firm.

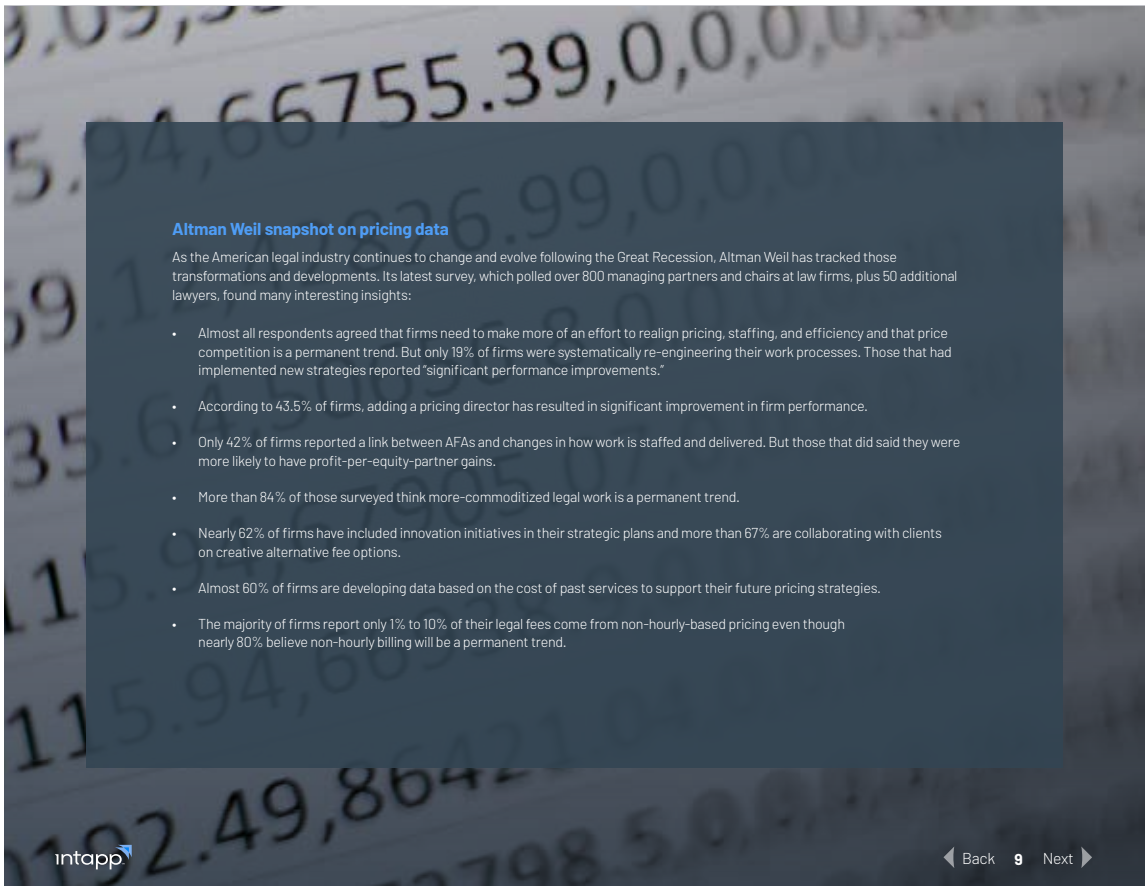
Helping scope and price engagements accurately

To support growth, firms are driven to seek new business, whether with an existing client or in taking on a new one. Determining pricing for new engagements is a challenge and several factors must be considered. The most important of these is scoping the matter or answering the question "What will it take to deliver this work?" Determining the work effort, distribution of personnel, and time required to complete the project successfully — on both the firm's and the client's terms — is key to figuring out the price tag on such an engagement.

How long will the engagement take? What resources does the firm need to leverage? Will the work require more senior associate hours? Pricing professionals help answer these questions, determine the staffing and resources necessary, and then work with lawyers and legal project management (LPM) teams to monitor the work as it progresses. On the firm's end, accurately scoping the work means achieving efficiency and profitability while meeting client expectations. For the client, it means feeling confident they'll receive work at a fair price that represents the value of the outcome. Scoping a project accurately protects profitability, serves the client, and guards the firm's reputation. This thoughtful approach also enables course correction if the parameters of the engagement shift; accurate scoping at the outset helps lawyers frame conversations with the client and changes in approach if circumstances change.

Modeling various options to assess profitability

Once a firm understands the client's needs and can price an engagement accurately, the pricing team can workshop various pricing models to determine the best option for both profitability and client service. Which alternative fee arrangements should the firm consider? What resources can it allocate differently? What happens to the bottom line with adjustments to the support staff? The ability to move levers quickly helps a firm determine what pricing option is the most profitable and also satisfies the client's needs. This is critical to remaining competitive.



4. Technology-enabled pricing strategies

Mining the data necessary to create the best possible pricing strategies or approaches can be difficult. The data is often siloed or stored without consideration for how it can be used strategically. That's where technology-enabled approaches to pricing provide a welcome assist. Technology solutions can find ways to draw insight from current data repositories in ways that human analysis can't. Pricing teams can use emerging technology in several ways.

Automatically sift, sort, and categorize past engagements

A significant aspect of determining profitable pricing strategies for new engagements is to research past data. Yes, a pricing team can try to take on such work. But having technology that reviews the relevant information with algorithmic analysis and deep inspection makes the process more efficient and accurate. Artificial intelligence (AI) can sort through like matters to find only the engagements that provide relevant insight into current pricing requirements. The pricing team can then spend more time developing accurate pricing strategies and optimal resourcing to further relationships with clients.

Model in real time

One of the biggest values of a pricing team is the expertise to model several different fee arrangements and resourcing assumptions for any given engagement. This arms firms with thoroughly researched knowledge of pricing options that will turn a profit. But again, completing such tasks takes time.

AI technology can support pricing teams by quickly delivering real-time information on how resourcing and staffing may impact profitability. The pricing team can adjust the different elements necessary to any given engagement to see how altering one — or many — will affect the margin. Such technology also helps pricing teams compare various models on the fly to determine the most profitable options and can provide insight into how adjusting leverage — changing the ratio of senior partner hours to associate hours — can impact margins. Having these capabilities helps firms maintain efficiency while also swiftly delivering flexible responses to clients.

Provide degree-of-confidence assessments

Having a dedicated pricing team gives a firm an edge when it comes to accurately determining a price range that can win specific business. Adding technology-enabled analysis provides an additional confidence boost through the knowledge that the models were created using appropriate past data. With the aid of intelligent technology, a firm can propose a fee structure, knowing it will meet the client's needs and expectations while enabling profitable execution. Presenting alternatives that are clearly client aware also helps strengthen the partnership between the firm and the client and further the firm's status as a trusted adviser.

Moving beyond a point solution

The benefits of AI are clear. For the best outcome, though, technology is most effective when implemented as part of an interoperable platform, to provide optimal functionality. It's vital that pricing teams look for software that integrates seamlessly with other solutions governing timekeeping, compliance with outside counsel guidelines, and other mission-critical steps in the client lifecycle.

This allows firms to gain insight into how they're functioning as a business, determine what changes need to be made to stay efficient and competitive, and ultimately track real-time matters to make decisions that benefit the firm and the client.

Types of AI used to leverage data

Data can be analyzed in many ways using AI. While beneficial on its own, combining several processes creates a more thorough understanding of past engagements and aids in decision-making for the future.

Natural language processing (NLP)

NLP can help firms understand the tasks involved in a matter based on the notes the lawyer writes. It's important to understand the nature of the matter (not just what has been billed) so that a firm can predict price as well as capture nuances that make engagements different and cause changes to pricing and staffing.

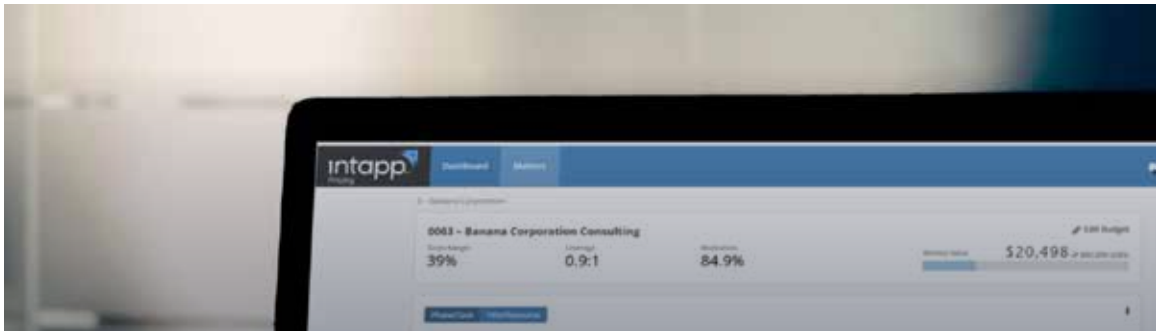
Machine learning (ML)

Machine learning works two ways in the context of pricing: data cleansing and feedback. The former, similar to NLP, helps get at the nature of the matter; to be useful, data must be prepared via structuring, organizing, categorizing, and tagging efforts. The latter is used as pricing decisions and changes are made. The model can learn and start to take those nuances into account.

Predictive analytics (PA)

This is where the magic happens. Once the data is collected (NLP) and cleaned (ML), technology can develop a robust set of attributes to predict the scope and price of a matter. By using clustering algorithms, PA can pool together a relevant sample of similar matters, understand their similarities, and pick up subtle differences. Firms can then understand how similar matters were staffed, what tasks were involved, and anything else needed to scope the matter and provide a price.

Back 11 Next



5. Pricing as a process

While a successful technology-based pricing strategy supports the bottom line for a firm, it can also do much more. Firms can leverage technology to make pricing more of a process, rather than a one-time effort, and also gain visibility into an engagement as it progresses from pricing and scoping to execution and delivery, with proactive management and alerting. Good pricing technology creates a seamless, closed-loop system that allows firms to stay on top of engagements throughout their lifecycles in several ways.

Monitor budget to actuals

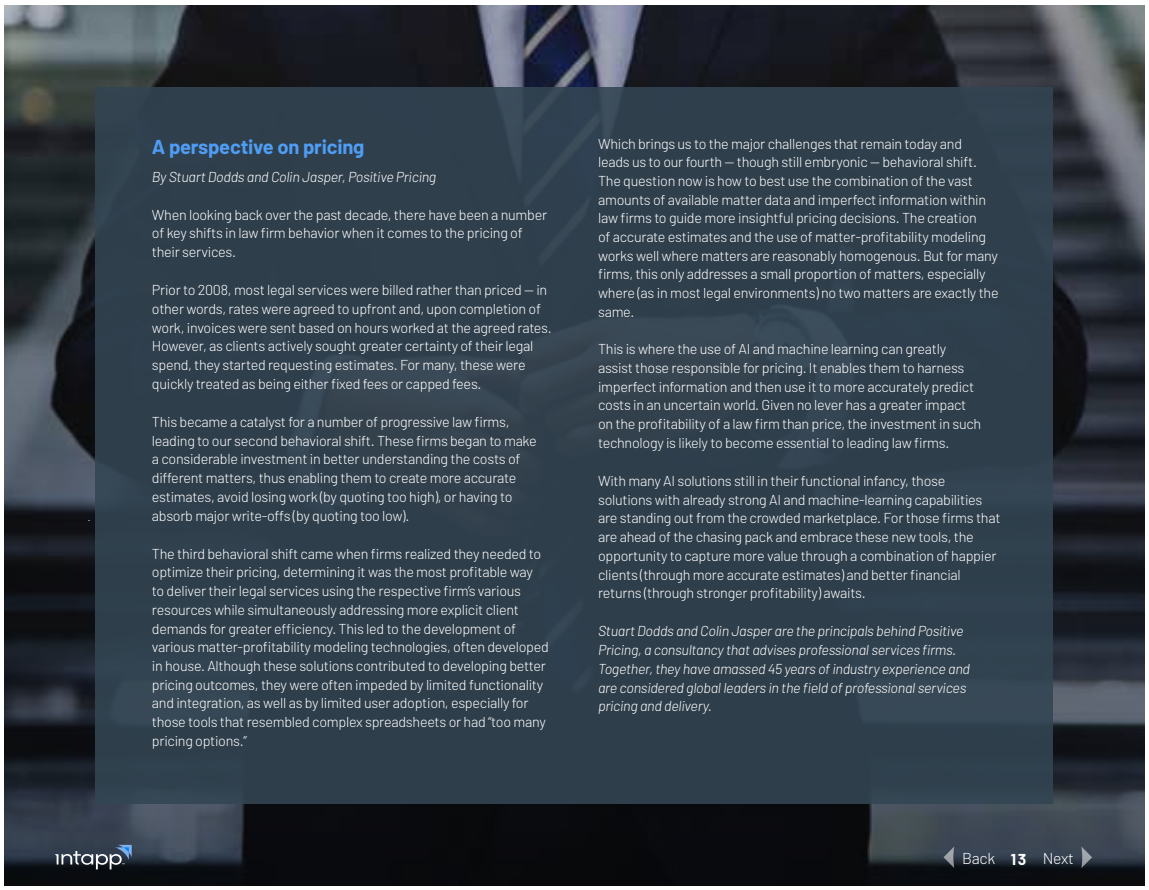
Often, a firm would set a budget for a matter but might only realize there was a problem later in the billing or reporting cycles. Technology that integrates across various platforms, including timekeeping and budgeting software, makes it easy for lawyers and pricing teams to track the work in progress: Has the scope changed? Are more (or different) lawyers working on the matter than originally scoped? Are certain tasks or phases taking more time? How is the work progressing overall based on the original plan? All of those questions can be monitored and answered in real time.

Avoid unexpected overages

Even if pricing professionals have access to some analytics, many lack the technology to track real-time changes. A major benefit of consistent technology-backed visibility into engagements is having threshold-based alerting. For instance, an alert might warn a firm that a matter has reached 70% of the budget. When that happens and the number seems "off," a point person can be notified to address the matter in minutes rather than days, weeks, or even months down the line. The technology acts as an early-warning system, mitigates unexpected overages, and gives the firm a chance to correct course, if need be.

Proactively communicate with your client

A system with interconnectivity, visibility, monitoring, and alerting provides insight into the engagement as it proceeds and allows lawyers to communicate proactively. How? Armed with information about scope changes or off-target budgets, a lawyer can communicate with clients and collaborate with them on a solution.



A perspective on pricing

By Stuart Dodds and Colin Jasper, Positive Pricing

When looking back over the past decade, there have been a number of key shifts in law firm behavior when it comes to the pricing of their services.

Prior to 2008, most legal services were billed rather than priced — in other words, rates were agreed to upfront and, upon completion of work, invoices were sent based on hours worked at the agreed rates. However, as clients actively sought greater certainty of their legal spend, they started requesting estimates. For many, these were quickly treated as being either fixed fees or capped fees.

This became a catalyst for a number of progressive law firms, leading to our second behavioral shift. These firms began to make a considerable investment in better understanding the costs of different matters, thus enabling them to create more accurate estimates, avoid losing work (by quoting too high), or having to absorb major write-offs (by quoting too low).

The third behavioral shift came when firms realized they needed to optimize their pricing, determining it was the most profitable way to deliver their legal services using the respective firm's various resources while simultaneously addressing more explicit client demands for greater efficiency. This led to the development of various matter-profitability modeling technologies, often developed in house. Although these solutions contributed to developing better pricing outcomes, they were often impeded by limited functionality and integration, as well as by limited user adoption, especially for those tools that resembled complex spreadsheets or had "too many pricing options."

Which brings us to the major challenges that remain today and leads us to our fourth — though still embryonic — behavioral shift. The question now is how to best use the combination of the vast amounts of available matter data and imperfect information within law firms to guide more insightful pricing decisions. The creation of accurate estimates and the use of matter-profitability modeling works well where matters are reasonably homogenous. But for many firms, this only addresses a small proportion of matters, especially where (as in most legal environments) no two matters are exactly the same.

This is where the use of AI and machine learning can greatly assist those responsible for pricing. It enables them to harness imperfect information and then use it to more accurately predict costs in an uncertain world. Given no lever has a greater impact on the profitability of a law firm than price, the investment in such technology is likely to become essential to leading law firms.

With many AI solutions still in their functional infancy, those solutions with already strong AI and machine-learning capabilities are standing out from the crowded marketplace. For those firms that are ahead of the chasing pack and embrace these new tools, the opportunity to capture more value through a combination of happier clients (through more accurate estimates) and better financial returns (through stronger profitability) awaits.

Stuart Dodds and Colin Jasper are the principals behind Positive Pricing, a consultancy that advises professional services firms. Together, they have amassed 45 years of industry experience and are considered global leaders in the field of professional services pricing and delivery.

intapp

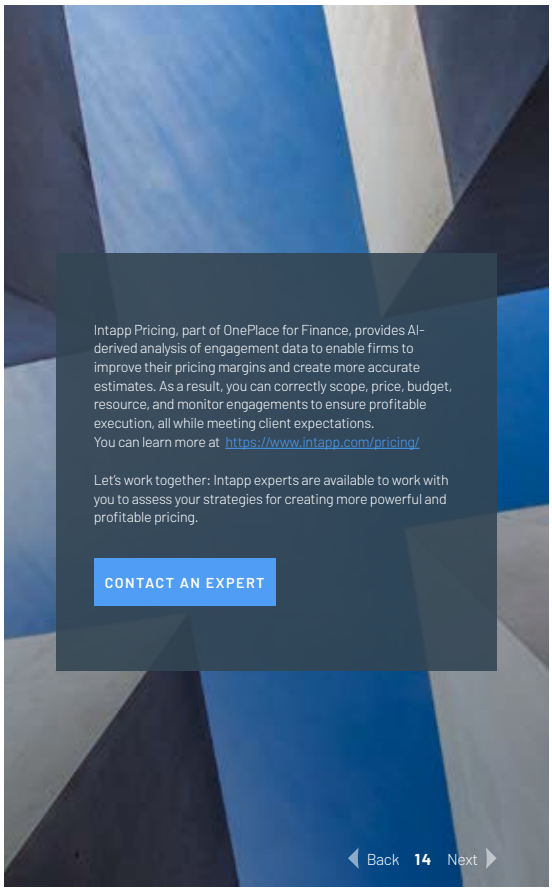
Back 13 Next

6. Winning more business

Growth-minded firms are seeking ways to broaden their footprints. Perhaps they handle the litigation work for a client but hope to manage its IP instead. Implementing more successful pricing strategies enables firms to go after — and win — profitable new business more effectively. Having a sophisticated, technology-based, integrated pricing solution allows a firm to look at how to price both current engagements and adjacent work quickly and accurately. It also helps the firm deliver its services more strategically. Additional benefits include:

- Ensuring the proposed pricing meets both the client's needs and the firm's profitability goals
- Providing firms with visibility into a proposed engagement's profitability
- Deriving learnings from past matters

With the powerful combination of pricing teams and a technology-supported pricing protocol, the question for firms changes from "What's the discount going to be?" to "What commercial options and resourcing can we explore that both satisfy the client and turn a profit for the firm?" Having that capability in the current client-driven economy puts power back in the hands of the firm. Firms can now go beyond winning the work with a strong pricing scheme to building and resourcing the strategy in a way that ensures profitability.



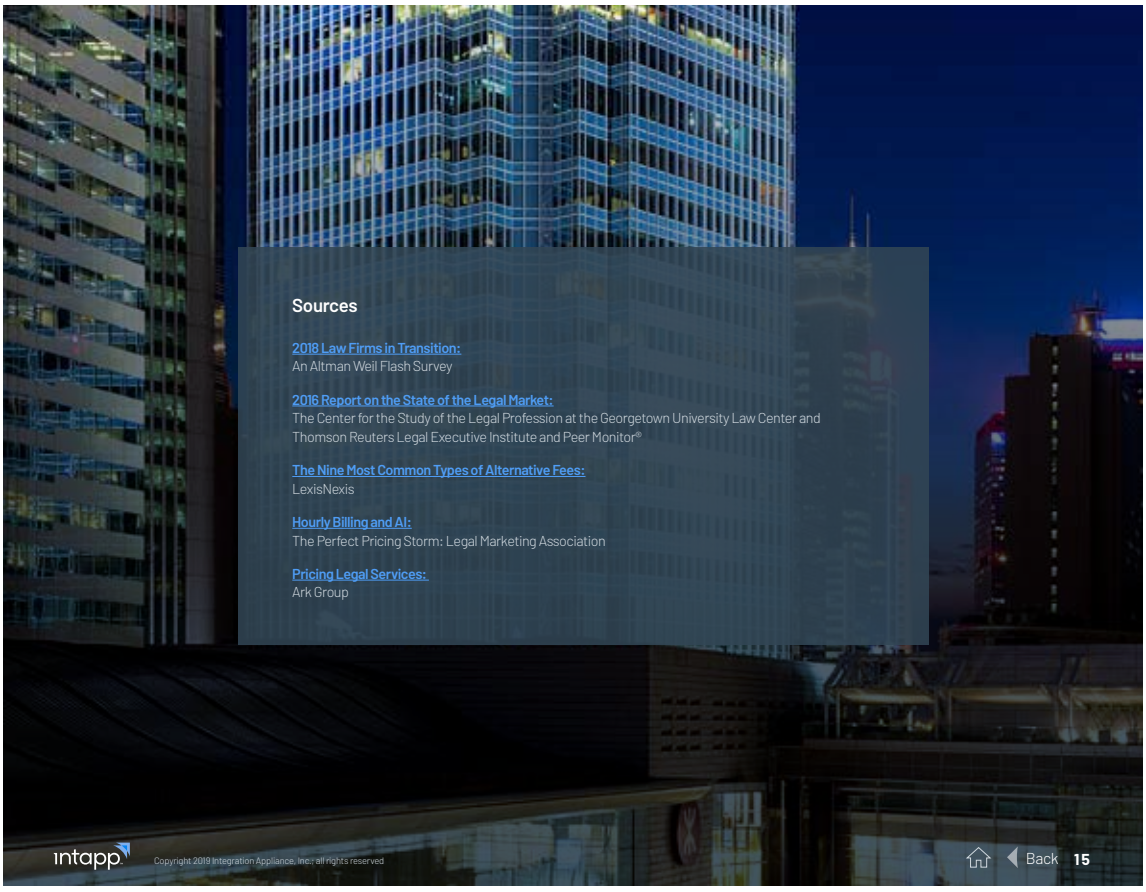
Intapp Pricing, part of OnePlace for Finance, provides AI-derived analysis of engagement data to enable firms to improve their pricing margins and create more accurate estimates. As a result, you can correctly scope, price, budget, resource, and monitor engagements to ensure profitable execution, all while meeting client expectations.
You can learn more at https://www.intapp.com/pricing/

Let's work together: Intapp experts are available to work with you to assess your strategies for creating more powerful and profitable pricing.

CONTACT AN EXPERT

intapp

Back 14 Next


Sources
2018 Law Firms in Transition:
An Altman Weil Flash Survey
2016 Report on the State of the Legal Market:
The Center for the Study of the Legal Profession at the Georgetown University Law Center and Thomson Reuters Legal Executive Institute and Peer Monitor®
The Nine Most Common Types of Alternative Fees:
LexisNexis
Hourly Billing and AI:
The Perfect Pricing Storm: Legal Marketing Association
Pricing Legal Services:
Ark Group
intapp
Copyright 2019 Integration Appliance, Inc. all rights reserved
Back 15

Faculty

Hon. Martin R. Barash is a U.S. Bankruptcy Judge for the Central District of California in Woodland Hills and Santa Barbara, sworn in on March 26, 2015. He brings more than 20 years of legal experience to the bench. Prior to his appointment, Judge Barash had been a partner at Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles since 2001, where he represented debtors and other parties in chapter 11 cases and bankruptcy litigation. He first joined the firm as an associate in 1999. Earlier in his career, Judge Barash worked as an associate of Stutman, Treister & Glatt P.C. in Los Angeles. He also has served as an adjunct professor of law at California State University, Northridge. Following law school, Judge Barash clerked for Hon. Procter R. Hug, Jr. of the U.S. Court of Appeals for the Ninth Circuit from 1992-93. He is a former ABI Board member, for which he served on its Education Committee and currently serves on its Committee for Diversity, Equity, and Inclusion, and he is a former member of the Board of Governors of the Financial Lawyers Conference. In addition, he is a judicial director of the Los Angeles Bankruptcy Forum and a frequent panelist and lecturer on bankruptcy law. He also is a co-author of the national edition of the *Rutter Group Practice Guide: Bankruptcy*. Judge Barash received his A.B. *magna cum laude* in 1989 from Princeton University and his J.D. in 1992 from the UCLA School of Law, where he served as member, editor, business manager and symposium editor of the *UCLA Law Review*.

Jan Duke is COO of a360inc in San Antonio, which incorporates, integrates and connects leading technology platforms across mortgage origination, servicing and default, while including process-driven efficiencies in ancillary transactional areas like claims handling, notary services, title search and title data information. She leads the company's Sales Operations team and oversees the implementation and support of CaseAware, the company's comprehensive case-management software, as well as a suite of servicer solutions that includes VendorScape, iClear and CMAX. Ms. Duke's expertise extends to the legal field, where she has held senior leadership positions in human resources, information technology, support services, operations management and compliance. She brings nearly 20 years of experience to her role.

Randy Nussbaum is an attorney with Sacks Tierney P.A. in Scottsdale, Ariz., and has assisted individuals and businesses with complex bankruptcy protection (debtor and creditor), transaction and litigation matters for more than 40 years. He has represented secured and unsecured creditors, surety companies, creditors' committees, lessors, professional athletes, doctors, lawyers, and trustees in chapter 5, 7, 11 and 13 proceedings, including adversary actions (bankruptcy litigation). The cases have involved such diverse matters as real estate, construction, manufacturing, trucking, asset-based lending, bankruptcy related to divorce, and high-value and complex individual bankruptcies. Mr. Nussbaum is a Certified Bankruptcy Specialist by the Arizona Board of Legal Specialization and is Board Certified in Business Bankruptcy Law by the American Board of Certification. He has been named to the *Super Lawyers* "Top 50" list of Arizona attorneys multiple times and has been listed in *The Best Lawyers in America* annually since 2010; he was selected as its "Lawyer of the Year" (Scottsdale) for Bankruptcy and Creditor Debtor Rights in 2019 and for Bankruptcy Litigation in 2021 and 2024. Mr. Nussbaum is a 1990 graduate of Scottsdale Leadership and has volunteered for the organization for nearly 30 years, serves on its advisory board, and is a recipient of the prestigious Frank W. Hodges Alumni Achievement Award. He also served as a Sterling Awards Jurist for

the Scottsdale Chamber of Commerce and received the Chamber's Volunteer of the Year Award for 2017. In 2018, he was inducted into the Scottsdale History Hall of Fame. Mr. Nussbaum received his B.A. *cum laude* and in 1977 his J.D. in 1980 from Arizona State University, graduating in the top 25 percent of his class.

Gregory M. Taube is a partner with Nelson Mullins Riley & Scarborough LLP in Atlanta, where he primarily represents creditors in disputes with debtors arising from both commercial and consumer loans, leases and other credit relationships. He has represented clients in litigation arising from disputes between creditors and debtors, landlords and tenants, franchisors and franchisees, buyers and sellers of real property, taxpayers and taxing authorities, and in other business and corporate governance disputes. Mr. Taube has defended residential mortgage lenders, loan-servicers, and other creditors in individual and class-action lawsuits filed by consumers involving claims such as wrongful foreclosure, wrongful repossession, fraud, conversion, intentional infliction of emotional distress, defamation, and alleged violations of federal and state laws such as FDCPA, FCRA, RESPA, TILA, HAMP and UDAP. He also has advised clients regarding maximizing recovery and mitigating losses in distressed business environments, including bankruptcy and other insolvency proceedings. Mr. Taube is an active member of ABI and has co-chaired its Ethics and Professional Compensation Committee. He also regularly writes and speaks on bankruptcy and creditors' rights issues, and currently serves as chair of the board of the Bankruptcy Section of the Atlanta Bar Association. Prior to joining Nelson Mullins, Mr. Taube clerked for U.S. District Judge Daniel H. Thomas of the Southern District of Alabama and U.S. Bankruptcy Judge James S. Sledge of the Northern District of Alabama. He received his B.A. *cum laude* in English in 1988 from the University of South Alabama, and his J.D. *summa cum laude* in 1993 from the University of Alabama School of Law, where he was admitted to the Order of the Coif, was on the Campbell Moot Court Board and Jessup Moot Court Team, and was editor of the *Journal of the Legal Profession*.