2024 Trends for Technology Transactions

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Announcer
Welcome to Mayer Brown's Tech Talks Podcast. Each podcast is designed to provide insights on legal issues relating to Technology & IP Transactions, and keep you up to date on the latest trends in growth & innovation, digital transformation, IP & data monetization and operational improvement by drawing on the perspectives of practitioners who have executed technology and IP transactions around the world. You can subscribe to the show on all major podcasting platforms. We hope you enjoy the program.

Julian Dibbell
Hello and welcome to Tech Talks. Our topic today is 2024 trends for technology transactions. I'm your host, Julian Dibbell. I'm a senior associate in Mayer Brown's Technology & IP Transactions practice.

With this episode, we begin our fifth season of the Tech Talks podcast. As we like to do in each of these season openers, we have gathered a dream team of practitioners from across our Technology & IP Transactions practice for a look ahead at the coming year. I'm joined today by our partners, Brad Peterson, Scott Young, Joe Pennell, Rohith George, Anna Bruder, Oliver Yaros, Rich Assmus, and Marina Aronchik. Welcome all of you.

Brad, let me turn to you first and ask for the outlook on technology services generally. I want to focus particularly on the outlook for customers of those services. From that perspective, what are you seeing as the leading trends for 2024?

Brad Peterson
Thank you, Julian. For technology services customers, the predominant trends today seem almost back to pre-pandemic normal. The pandemic and the great resignation are behind us. Customers are turning to specialist providers primarily for better, faster and cheaper solutions. Automation continues to be the primary way for specialist providers to deliver those benefits. Data privacy and security remain primary challenges. The primary value drivers are outsourcing and digital transformation.

As a result, we see continued strong activity in managed services deals, and particularly in managed services outsourcing deals where the provider can use RPA and IT to drive down cost.

Similarly, we see continued strong activity on cloud migrations, platforms, data analytics and other digital transformation projects. We see a general belief among our clients that those projects are producing differentiating business value and competitive advantage, and thus are worth the risk.

There are a couple of key differences, though, from the pre-pandemic normal.

One—and I'm deeply gratified by this—is a greater spirit of collaboration. Companies and the providers they rely on worked together to make it through the past three years surprisingly effectively, and that's built a lot of trust and understanding.

A second key difference is a greater focus on being ready for what comes. Before the pandemic, we were developing a sense that we'd got this; that there was a list of risks, you knew what they were, and you managed the risks based on probability and impact. Those risks are still there and we're still managing them, but we are doing more to prepare for uncertainties. By uncertainties, I mean what people call "the unknown unknowns" or what you might call "the doubts." We were surprised by the pandemic. We'd been surprised many times since then. People feel great around certainty.

To address uncertainty, our clients are focusing on adaptability. We are thus seeing more focus on adaptable deal models, agile, outcome-based, strategic partnerships, gain sharing, managerial, relational, etc.

In contract terms, being ready for what comes means a focus on flexibility, resilience and quality. Companies are contracting for flexibility with rights to change volumes and requirements as needed in changing circumstances. Companies are contracting for resilience with obligations to maintain, test and implement business continuity and other contingency plans if unexpected events happen. Companies are contracting for quality with obligations to deliver products and services that work under more conditions.

The good news in all of this for technology and outsourcing lawyers in 2024 is that we're well trained to think about unlikely scenarios and address them with deal structures and language. As an example, when the data security challenges came up, we found ways to address them. We added security commitments for the foreseeable risks. We added options to require providers to support customers in unexpected circumstances like data breaches and cyberattacks. To back that up, we added financial incentives sharing the risk of data breaches, and thus aligning the interests of the party to keep data secure. We also added governance clauses to make sure that the parties shared information and were ready for what comes by being aligned on the current circumstances. We will see those skills put to good use in 2024 for a wide variety of complexities and possibilities. I'm looking forward to the year ahead.

Julian Dibbell
Scott, let me turn to you now, because where Brad was talking a lot about technology services customers, in your practice, you work with a lot of technology providers and startups. From their perspective, what are you seeing for 2024?

Scott Young
Thanks, Julian. First of all, I did think Brad's comments were really interesting. And, as you mentioned, I come at this from a little different perspective, as my practice does focus primarily on tech providers and startups. One area where things aren't quite back to normal is venture capital and other financings for these tech startups. In 2023, we saw the collapse of Silicon Valley Bank. We really saw a frozen IPO market.

We saw down rounds everywhere we looked. According to PitchBook, VC funding fell by about 35% as compared to 2022 numbers. So as you would expect, this has had quite an impact on these tech startups who typically rely on these financing sources. So we're all hoping that the VC market will rebound at some point in 2024. I do think we're going to continue to have a bumpy ride as the impacts of this financing crunch will continue to be felt throughout 2024. Let me just highlight two specific trends that I think we're going to see.

First, we'll see these tech companies continue to cut costs. That's going to mean a lot of contract terminations. So customer attention will be critical for tech providers. If you're a tech provider, you'll need to make sure your customers see your product as mission critical. And that mission critical term, that's a term I'm hearing over and over. As customers look to cut costs, only the most essential products and services will survive.

These tech providers will need to be creative in finding ways to retain their customers. They're going to do this in a variety of ways. Maybe they'll provide their customers with some new modules or new services for free at a reduced cost in order to get them hooked on the latest and greatest technology and features. They may offer a term extension at no additional charge to help make their products more affordable. Or they'll take other creative steps to retain customers that would otherwise be looking to terminate that relationship.

The second trend I see is that revenue is going to be more important than ever for startups, because there will be stiff competition for the scarce and now even more scarce BC dollars. I think this means that there will be good deals to be had for technology buyers, and these buyers will continue to enjoy strong leverage with respect to their vendors. SaaS providers and other tech companies will have to make concessions they wouldn't have been willing to make even just 12 months ago.

So, Julian, in the bottom line, I think 2024 could continue to be bumpy for these tech startups. And, you know, as Brad mentioned, I think it's going to be a great time for companies who are looking to buy technology products and services or to add value through outsourcing, you know, digital transformation, and other similar deals.

Julian Dibbell
Thank you, Scott. That's a great overview between your perspective and Brad's. That really gives us the lay of the land for technology services transactions. I'm wondering though, and I'll turn to you now, Joe, are there any particular types of deals where you're seeing significant trends for 2024?

Joe Pennell
Yes, thanks Julian. So companies continued pursuing customer-facing, revenue-generating digital platform deals in 2023, and we fully expect that type of trend to continue in 2024. So we've seen companies across industries, including in transportation, insurance and banking, bringing these platforms to market to create more seamless customer experiences and drive revenue in a scalable way. There have been a couple of subtrends developing here that we continue to expect to see in 2024. So first, we're seeing more companies entering into SaaS reseller relationships. So instead of simply white-labeling a technology provider's platform, one company is actively reselling another company's products and services as a value add on top of or embedded into the first company's existing digital platforms. A second and related subtrend is the use of AI in these platform and reseller relationships. So, kind of

blurring the line between customer and provider that Brad and Scott were talking about. In the past year, we represented a non-tech client who had developed an in-house machine learning tool for use in its own back office operations. And it had proven useful enough internally that the company is now making the tool available in the Google Cloud Marketplace for other companies in its industry to use. This client also negotiated a SaaS reseller agreement with a platform provider to resell subscriptions to the AI tool is an added benefit to the platform provider's customers. This client currently has a very nascent sales organization and they're leveraging the platform provider sales team to resell these subscriptions and generate interest in the wider market.

Julian Dibbell
Okay, so digital platform deals, still a happening trend in 2024. What are some things that companies should be mindful of as they approach these deals?

Joe Pennell
So, in all these platform deals, there has to be a lot of careful consideration given to the parties' incentives, given the customer-facing nature of the platforms. And in this reseller context, the problems get more complex and are highly dependent on the structure of the deal. So, for example, what type of criteria are used to evaluate end customer eligibility to buy the resold services? You could either spell that out in the agreement between the reseller and the provider of the services that are being resold. Or, on the other hand, if the reseller wants full discretion to choose the customers without the provider's approval, the reseller may have to take on the risk of non-payment by the customer because the provider's not going to be willing to take that on if it doesn't have discretion over the customer selection. Similarly, the end customer, if they're entering into an agreement directly with the provider whose services are being resold, that will drive a lot of different incentives, too.

The provider in that case would be in a position to manage risks with the customers, including misuse of the provider's platform or violation of associated license rights. But if the agreements are strictly between the end customer and the reseller, the provider may need third-party beneficiary rights under those agreements, or at least some type of a commitment by the reseller to enforce those contracts on behalf of the provider. So obviously, there's lots of complex permutations here. The provider may be looking for an indemnity for the reseller for claims from the end customers relating to the reseller’s platform or other reseller breaches of the end customer agreement, and a lot of different things that companies need to think through as they enter these relationships. And then just finally, if your company is providing some type of an AI component to these platforms, you'll have to think through AI-specific issues from the provider perspective. So, for example, you may not be able to give a standard performance warranty on the performance or the accuracy of the AI tools, but you could offer some type of additional human in the loop type services to identify and correct performance issues as they occur.

Julian Dibbell
Thanks. Rohith, how about you? Are there any particular types of deals where you're seeing meaningful trends?

Rohith George
Thanks, Julian. So I think for cloud, 2023 was an interesting year for cloud and particularly for deals with the big hyperscale cloud providers, which I think is what I want to focus on today. In some ways, what we saw last year was a continuation of years past, companies across industries were still looking to modernize

their IT infrastructure, still move to cloud-based applications still execute on, you know, necessary digital transformation initiatives. And as a result, you know, bottom line revenue, total market size, these numbers continue to grow for the hyperscale cloud providers in 2023. But what we also had was a choppy macroeconomic environment with increased rates, fears of a recession, just greater economic uncertainty. As a result, what we saw, and what a number of our consultant friends said they saw too, is that companies decided to cut back on their tech services spend, cut back especially on discretionary tech services spend, tighten their belts, which resulted in a slowdown in the kind of rapid growth in cloud that we had seen in years past. Now for 2024, with easy economic conditions, what we anticipate is a return ultimately to that rapid growth kind of trend line with, you know, with cloud migration is not complete. There are a lot of companies who will be shifting focus back from cost trimming to transformation. On top of that, you know, we do these trend podcasts every year and I think two or three years ago, I talked a bit about how we were seeing the hyperscalers competing for market share, offering value add services, locking in customers to long-term deals, basically committing them to big minimum spend targets. We expect that to continue in 2024, but with an added emphasis on AI as a differentiator. You know, all of the major providers are betting big on AI. Everyone of course knows about how Microsoft has invested in OpenAI and is closely tying OpenAI services into Azure, into Microsoft 365. Well, they're not the only one. AWS has Bedrock, through which it offers different AI models, has its own model. Google has Vertex AI, through which it does the same. What we're seeing and what we're going to see is that as companies validate use cases, as they look to test AI solutions, put AI to use in production, they'll need to partner with a cloud provider who provides the right infrastructure for them to execute. For that, they'll be going back to their major cloud infrastructure providers. And we've already seen that in 2023, and we're expecting that to continue in force in 2024. As a result, I think we think it's going to be a big year for cloud.

Julian Dibbell
Okay. All right, so Rohith, you're sitting, of course, in our Northern California office. We heard from Scott in Salt Lake City, Joe and Brad that are based in Chicago. Broad perspective from around the US, I want to shift the geographic focus a little bit now and go over to Europe. To Ana, who – you're based in Frankfurt and Oliver in our UK office – what's going on in Europe and UK right now for the technology transactions landscape? It seems like every month there are new regulations being announced or adopted in Europe these days. How are these new regulations likely to impact tech transactions in 2024?

Ana Bruder
Thanks, Julian. From an EU perspective, I expect two major areas of new regulations are likely to impact tech transactions this year, cybersecurity and, of course, AI. On the cyber front, new rules will start applying this year or early next year in certain specific sectors. So, first, critical infrastructure sectors like water, energy, transportation – they will need to comply with new cyber requirements starting October this year with the entry into force of the NS2 directive and implementing legislation in the member states. And, interestingly, there are some sectors that were not subject to these rules. They weren't considered critical infrastructure before, and now they will be, meaning a bunch of new cyber rules for them. So medical devices manufacturing, chemicals, basic pharmaceuticals, food processing and distribution, among others.

Second, there is some new sectoral legislation in the financial sector that will start applying January 2025 with substantial new cyber obligations, in particular applying to digital and data services. I'm talking about DORA, the Digital Operational Resilience Act. That will apply to banks, insurers, fund managers, and many more regulated entities in the EU. Some of these provisions actually specifically concern the relationship between those entities and their vendors or suppliers for a very broad range of technology services. So what I'm saying is that businesses in these sectors that I briefly mentioned that are operating in the EU, as well as providers that are targeting these businesses, will need to review their security schedules in tech transactions. For example, outsourcing, digital transformation, cloud, as just mentioned, and many other types of tech transactions and tech services transactions just to make sure that these cyber rules are properly reflected.

Then, on the AI front, you know, the EU AI Act is set to be adopted in the coming weeks, but we don't have a final text yet. We do expect the final text to have some provisions on the allocation of liability between the providers and the employers of AI systems.

I think the bulk of those obligations arising from the EU AI Act is actually likely to start applying in two years' time after adoption, meaning earliest 2026. So I actually don't think that this will have such a huge impact this year on tech transactions, even though specifically providers of AI systems would benefit from looking into it and taking early compliance steps. But I think it will be mostly the coming years that it will really have an impact on tech transactions.

Julian Dibbell
Thanks, Ana. So that's what's going on in the EU. How about in the UK, Oliver? Things look any different there?

Oliver Yaros
Thanks, Julian. Well, things do look a little bit different. So, in the UK, we're entering an election year. And, of course, that means the government is quite keen to show progress in a number of areas. As Ana said, AI is a big focus in Europe generally in terms of AI regulation, and that is one area. Data privacy and, in particular, data transfers is the second area.

So, starting with AI in particular, last year there was quite a lot of development internationally on AI regulation with the EU AI Act, as Ana has just explained. In the UK, we've tried to take a slightly different approach. The UK government has announced that it's not going to have an overarching piece of AI regulation, but, through its AI white paper last year, following on from its global AI regulation summits towards the end of the year in November, it is empowering regulators to regulate different sectors on the sectoral basis using guidance.

A trend for this year is going to be how we see that guidance unfold and why does it matter for people that are conducting tech transactions which affect the European operations of people's businesses. Well, it means that our clients and customers and suppliers can have to think very carefully about how they comply with the new pieces of guidance and new requirements that come out in the UK and how those are going to sync up with the obligations that are going to flow from the EU AI Act. So, looking at those agreements, looking at the operational requirements for AI in those territories and making sure they work in a way that complies with the guidance.

I also mentioned data protection reform. The UK has been pretty keen post-Brexit to differentiate the approach with respect to data privacy away from the EU GDPR approach and change the UK GDPR in a number of ways. And the government is in the final stages of passing what's known snappily as “the data protection and digital information bill," which proposes to make some changes, one of which we expect will be some changes in the way in which international data transfers are dealt with and are approved. So I think for our clients that are constantly worried about how they can transfer data within their organizations internationally and to customers and suppliers, that is a trend that is something to watch for this year, how those arrangements might need to change, depending on whether you're sending data to and from the EU or UK and elsewhere. So that's something else to watch for this year.

Julian Dibbell
Thank you, Oliver and Ana. Now back to Chicago, where I want to talk to Rich Assmus.

Rich, your practice focuses on IP, and I know you do a lot of work on both the transactional and the litigation side. I think one of the big stories both for tech transactions and litigation in this space for 2023 is AI, of course, and particularly generative AI or GenAI. Is that going to continue to be a big story for 2024? What do you see coming down the pike there?

Richard Assmus
Thanks, Julian. 2023 was the year of lawsuits being filed by content owners against AI tool providers. As you know, litigation moves very slowly, so 2024 is going to see more of the same with both new cases being filed and old cases working through initial motions and discovery. We've had a few motion to dismiss rulings in 2023. We'll get more and possibly even a trial in one of the cases we're tracking. So far, the AI companies have only succeeded in narrowing the cases against them, and it appears that at least some direct copyright infringement claims will enter discovery.

Talking about one case in particular, at the very end of 2023, *The New York Times* filed suit against OpenAI and Microsoft, and that case made a big splash then that rippled over into 2024. What I find most interesting about that case is that *The Times* alleges that the filing of the lawsuit was actually preceded by failed commercial negotiations for the license to use the *Times* content. As you know, that's a huge archive of well-written English. In addition, the complaint alleged some near-exact copying that I don't think many people expected out of a large language model like ChatGPT. For example, the complaint claims that ChatGPT memorizes – that's the term that the complaint uses – *Times* content and can actually be prompting to output that content nearly verbatim. I think that presages a couple of things that we'll see in 2024.

First, *The New York Times* lawsuit certainly won't be the last. I think we'll see a steady drumbeat of new cases by additional high-profile plaintiffs. Second, I expect we'll see some interesting rulings on the underlying copyright issues, but it's still going to be too early to have definitive guidance on whether training – AI training – constitutes an exercise of one of the exclusive rights of a copyright owner or and, if so, whether such use is fair use. Ultimately, that's likely to need to be resolved by the Supreme Court. I also think we'll see some new concerns about the legal risks of using generative AI that arises from that legal uncertainty. In particular, this exact match between output and training data might change the calculus a little bit for some users, particularly with respect to assistive coding tools.

Finally, I think that the AI companies are going to need to react to that and may take additional steps to reassure users about the risks, including possibly announcing new indemnity policies. We saw a bit of that in 2023, and I think we'll see more of that in 2024.

Julian Dibbell
So let's drill down a little deeper into that, like how these issues are going to play out in the context of tech transactions themselves.

Marina, I know that, in your practice, you've been advising clients on AI transactions and issues in the context of outsourcing and other deals for well over a decade. And I know you've spent a significant portion of 2023 thinking about and advising clients on GenAI terms and related issues. What do you see on the horizon for 2024?

Marina Aronchik
Thanks, Julian. So AI and GenAI are, of course, here to stay. And we've heard from the team about all of these different issues that we're seeing and that are coming up in GenAI, ranging from traditional commercial contract and considerations for the cloud deals to platform deals that Joe talked about to IP infringement issues that Rich just described to governance and compliance issues that Ana and Oliver talked about.

In 2024, companies are going to start moving even faster away from the pilots and into broader commercial use of AI and particularly generative AI. This will probably be across industries, although, in some industries, we might see this movement happening faster than in others. What this means from the contracting perspective for tech transactions lawyers is, now that folks generally understand the issues and the risks that come up in connection with GenAI, we all will need to move quicker. The risk profile of these deals is changing materially. So, when you're thinking about the infringement risk, when you're thinking about cybersecurity and data privacy, you may have understood this risk in 2023, but, now as you're looking at a new use case in 2024, the way that you're classifying that risk both based on likelihood and the impact and the particular use case for the tool, will change dramatically. Organizations will need to be moving very quickly and triaging these risks.

The use and contracting for AI and GenAI will become a bit of a high-wire act with folks understanding which risks are involved, but triaging them carefully to balance the speed with which you're moving, the likelihood and the impact of the various risks. Are you going to try to address some of these laws that are coming down the pike in 12 months and 24 months today, or might you move faster and then defer consideration of some of these requirements that are not yet imminent but may need to be reconsidered? So this is adding quite a bit of complexity.

From a very high-level standpoint, there are five buckets of things to think about in AI, GenAI.

Certainly the technical aspects of the services – what are you procuring and how will you use it? We've all heard about ChatGPT, we've thought about Bard, but models –the way that you're using those models – some of what Rohith was describing earlier, is very, very complicated. And, in general, there may not always be perfect understanding and perfect clarity of a particular product or tool or service that you're using from a provider, which, of course, is key to contracting.

Traditional technology contracting risks that we've talked about, including data privacy, cybersecurity, reps and warranties, indemnities, unique GenAI issues dealing with the output that's not becoming any simpler and yet is, of course, key to some of these commercial use cases, regulatory and governance. How do you address compliance with the flows in the agreements and also from the operational perspective?

Finally, collaboration. I think that's really going to remain key to a lot of these deals, working not just in the context of a customer and a provider of technology, but figuring out how the two parties may need to work together to reach alignment to address a lot of these points, both again on the contract and from the operational perspective.

Julian Dibbell
Thank you, Marina. I see a lot of the themes that other folks were bringing up running through all of these. Really appreciate everybody's insights today for sharing your thoughts on the trends for 2024. We really appreciate you joining us on the podcast today.

Listeners, if you have any questions about today's episode or an idea for an episode you'd like to hear about anything related to technology and IP transactions and the law, please email us at techtransactions@mayerbrown.com. Thanks for listening.

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