

Key Aspects of Legal Due Diligence on an AI Company in Germany

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1. Introduction

▶ The development of artificial intelligence (AI) by a target company raises far-reaching and detailed questions in the context of legal due diligence. In many cases, the outcome of the review determines whether the target company's business model is viable or whether it is exposed to significant risks due to legal issues, which can range from fines to jeopardizing the business model as such. The following article is dedicated to the key regulatory, copyright and data protection issues in Germany that must be answered in a legal due diligence.

2. Artificial intelligence at the target company of an M&A transaction

AI has been on everyone's mind since the release of ChatGPT in November 2022 at the latest. Even within the corporate finance community, no conference, panel or podcast can avoid discussing the impact of these developments. This is fueled by the fact that AI is probably the most rapidly developing technology of all time, meaning that the results of yesterday's discussion may already be outdated today.

However, AI naturally plays a key role in M&A not only because of its impact on the industry, but also as a

future technology that is being used or even developed by more and more target companies.

In this respect, three types of target companies can be distinguished:

- (a) The target company tends to use external AI systems only marginally and subordinately. For example, Microsoft's Copilot is available, but is by no means used by all employees. For such companies, it is primarily a matter of internally regulating the use of AI systems, particularly with regard to data and trade secret protection.
- (b) The target company uses third-party AI systems systematically at the core of its own value creation. An example would be a marketing agency that makes extensive use of AI systems to develop campaigns for its customers. In addition to the topics mentioned under (a), the provisions in the customer contracts (on data protection, IP, confidentiality) in particular should be examined for such target companies as part of due diligence.
- (c) The target company develops and/or distributes AI systems.

This article focuses on the main aspects of a legal due diligence on a target company from the third group, i.e. one that develops AI itself. The focus is on the areas of new, AI-specific regulation as well as copyright and data protection law in Germany.

In addition, other areas of law regularly play a role that are not covered within this article, such as labour law (e.g. acquisition of ownership of the developed AI by the target company) and contract law (e.g. liability regulations for the AI systems sold to customers).

3. The EU AI Act as the focus of the due diligence

3.1 Scope of application of the AI Act

The AI Act, which came into force in August 2024, is characterised by its broad scope:

- **Material Scope:** The AI Act applies whenever a system falls under the - intentionally broad - definition of AI.
- **Personal Scope:** The AI Act targets not only „providers“, but also at so-called „deployers“ of AI systems. These are companies that use AI systems commercially.
- **Territorial Scope:** Its territorial reach is similar to that of the EU GDPR (General Data Protection Regulation) - meaning companies outside the EU are also covered if they offer AI systems within the EU.

While companies in categories 2(a) and 2(b) primarily act as „deployers“ and are therefore subject to a comparatively limited set of obligations, companies in category 1(c) are fully affected by the AI Act as „providers“.

3.2 Buyer's interest in proper compliance

When examining a German target company that develops AI systems, a buyer will assess the extent to which it is prepared for the AI Act. It is true that the AI Act will not become fully applicable until August 2026. Although the Act will not be fully applicable until August 2026, certain provisions will come into effect earlier – some as early as six or twelve months after its entry into force in August 2024. These deadlines make it necessary for companies to implement appropriate compliance processes in good time, as their implementation often involves considerable effort.

If the due diligence reveals that a target company has not yet made preparations for the AI Act, the buyer

should be aware that further investment will likely be necessary post-closing to meet the AI Act's requirements on time. The situation is comparable to the position of data-driven companies shortly before the GDPR came into force if they had not yet initiated a GDPR compliance project.

3.3 Key aspects of the due diligence process


The aim of due diligence should be to provide the buyer with a comprehensive factual and legal overview of the AI systems developed by the target company. An essential part of this analysis should be the provision of a complete list of all developed AI systems. This list should at least answer the following questions, for each system:

- What technical infrastructure do the AI systems run on?
- Who are the customers of AI systems?
- What are they designed for?
- Are these „general-purpose“ systems within the meaning of the AI Act?
- Where does the data used to train the AI systems come from?

Building on this, it is essential to ask what specific measures the target company has already taken to prepare for the AI Act.

Moreover, it can be assumed that a company developing its own AI systems will also rely significantly on third-party AI systems, particularly those used in the development process of its own systems. This aspect should not be overlooked during due diligence. While the regulatory responsibilities for „own AI systems“ are significantly higher, the obligations arising from the use of third-party AI systems (in the role of a „deployer“) should not be underestimated.

3.4 „AI Literacy“ and AI Use Policy

Another important aspect is the „AI literacy“ required by the AI Act, meaning a company's ability to develop an adequate understanding of AI technologies – relevant for both, „providers“ and „deployers“. During due diligence, it is essential to evaluate the extent to which the target company has provided its employees with the necessary knowledge to meet the requirements of the AI Act. It is not only the delivery of training that matters but also verifying whether the acquired knowledge is being correctly applied in daily operations. Therefore, 

the due diligence process should include an evaluation of the target company's internal processes to ensure that training measures are effectively implemented. This evaluation should particularly focus on the company's AI Use Policy to confirm that it aligns with compliance requirements and supports proper AI usage.

3.5 Future significance of the AI Act for M&A transactions in Germany

The AI Act will gain increasing significance in the coming months and years. For companies that have not yet thoroughly addressed its requirements, there remains an opportunity to take the necessary compliance steps after closing. However, this window will narrow as the full applicability of the AI Act approaches in the summer of 2026. A target company that has failed to implement adequate compliance measures by this time poses a risk to buyers due to potential fines.

4. Key points of copyright due diligence

A key aspect of due diligence is determining whether the target company holds rights to critical intellectual property (IP), such as software or trademarks. For example, ownership of a unique code forming the foundation of a business model is essential for potential buyers.

The use of generative AI introduces new challenges to fundamental questions of IP law - and therefore impacts key areas of examination during due diligence. This section therefore specifically addresses the effects of generative AI on IP rights and the due diligence process. Critical questions include:

- Is AI-generated content (such as texts) protected by copyright at all? If not, are there workarounds? If yes, who owns the rights?
- Does AI output risk infringing on third-party works? If so, who bears liability?

The deeper AI is integrated into a company's operations, the more complex these questions become. It is also crucial to distinguish whether the target company uses AI exclusively internally (as discussed in Sections 2(a) and 2(b)) or whether it produces generative AI systems or AI-generated content as part of its product offerings (as in Section 2(c)) In detail:

4.1 What to Consider When the Target Company Develops AI Products?

If a company offers AI products (such as a front-end solution like a chat bot for retailers) or AI-generated

products (such as AI-generated marketing materials), IP due diligence becomes more complex.

For AI products, the first step is to determine whether the company holds adequate rights to key AI assets, such as training data, algorithms, and model architectures. If most content is developed internally, it is essential to verify copyright protection and ensure that all relevant rights—especially those of employees and freelancers—have been transferred (either by operation of law or by contract). For licensed content, license agreements must be thoroughly reviewed to confirm they cover the intended usage scope, including the territorial, substantive and temporal extent. This also applies to training data, where license agreements must explicitly permit use for training purposes.

If a company makes use of the legal text and data mining exception, which allows the use of third-party works for training purposes without a licence agreement, compliance with legal requirements must be thoroughly assessed during due diligence. Failure to meet these requirements could in particular lead to claims for cease-and-desist and/or damages. Companies must ensure they respect rights holders' opt-out options, as any rights holder may object to their works being used for training purposes.

This legal review is closely tied to compliance with the AI Act. In Germany, for example, providers of general-purpose AI systems must disclose information about the datasets used for training (without revealing individual data on a work-by-work basis) and implement a copyright policy that ensures compliance with EU copyright law.

4.2 What special considerations need to be made when using AI-generated content?

Business models involving the distribution of AI-generated content require additional scrutiny.

If, for example, marketing materials are automatically generated and licensed to customers, it must be verified that the company holds the necessary rights of use. Without these rights, the company may fail to fulfill its contractual obligations if the promised rights cannot be transferred.

Quality management is another critical focus during due diligence to prevent potential legal risks:

- Is AI-generated content reviewed before distribution?

- Are checks in place to avoid infringements of existing IP rights, such as trademarks or copyrighted works?

Transparency obligations, whether under current advertising laws or forthcoming under the AI Act, must also be considered. If content includes deceptively realistic representations of individuals or locations, it may need to be labeled as a deep fake—either under existing advertising rules or, at the latest, when the AI Act comes into effect.

4.3 What needs to be checked for purely internal AI use?

Companies in Germany must have clear internal guidelines to ensure that employees use AI systems in a legally compliant manner.

For example, from an IP perspective, the AI compliance guidelines should include:

- Employees must avoid using prompts to generate copies of third-party, unlicensed works or inputting copyright-protected content (e.g., images) without proper licensing.
- If the buyer is interested in whether a work product (e.g., a critical product design) is protected, due diligence should assess whether the company has policies regulating AI usage in such areas or at least mandates documentation of the creation process.

5. Key due diligence areas under data protection law

Data protection due diligence of a company that develops AI poses particular challenges, especially if publicly available data is used as training data, as is customary in the market.

5.1 Training with publicly accessible data

Publicly accessible data plays a central role in the development of AI systems, providing a rich and cost-effective basis for training and improving the underlying models and algorithms. Such data is often more up-to-date and relevant, which is crucial in the dynamic environment of AI development.

However, publicly accessible data frequently contains personal and sensitive information, such as names, contact details, health information, or political views, often sourced from social media posts, forums, and

blogs. Due to the unstructured nature of this data, it is technically challenging to completely filter out or anonymize personal data. Consequently, it becomes necessary to justify the use of this data for AI training and development purposes under data protection law.

5.2 Challenges and risks

The use of publicly accessible data for AI training is often based on Art. 6 para. 1 sentence 1 lit. f GDPR, which allows processing to safeguard legitimate interests, provided that the rights of the data subjects do not prevail (so-called balancing of interests' justification). This usually (but not in any case) applies to freely accessible data, as the data subjects have often deliberately made this data public.

Stricter requirements apply to special categories of personal data pursuant to Art. 9 para. 1 GDPR (e.g. health data, biometric data) and the balancing of interests does not apply. Since the use of such sensitive data in AI training cannot be ruled out, the data protection compliance of using publicly accessible data for the training and development of AI is questionable. The argument that this data is considered unwanted „by-catch“ is untenable. The authorisation via Art. 9 para. 2 lit. e GDPR („personal data which the data subject has manifestly made public“) is also problematic, as the mere presence of this data in the public domain is not sufficient. Other arguments, such as Art. 9 para. 2 lit. j GDPR in conjunction with Section 27 of the German Federal Data Protection Act (use of data for scientific research or statistical purposes), have not been sufficiently tested and carry risks.

Against this backdrop, data protection authorities in Germany and beyond are currently investigating the practice of training AI models with publicly accessible data. The challenge is that special categories of personal data are technically difficult to exclude. If a target company in Germany does not comply with the legal requirements, there are considerable risks, as violations of the GDPR can result in severe fines and other measures, including the prohibition of data processing, i.e. not offering the AI on the market any longer.

5.3 Recommendation and best practices

Given the issues associated with the use of special categories of personal data for the training of AI models, the due diligence should assess whether the target company is taking proactive measures to act in a data protection-compliant manner. Otherwise, the balancing of interests' justification is often not sufficient

to justify the use of any personal data and in particular special categories of personal data. Technical and organisational measures should therefore be implemented to minimise the use of such sensitive data in particular.

Recommended measures that a target company should have in place include the implementation of filtering mechanisms to remove sensitive data from datasets prior to training. Natural language processing (NLP) techniques should be used to automatically scan texts for sensitive information and anonymise or remove it. Market-leading AI providers use these techniques to be GDPR-compliant. Transparency towards users is also crucial. The target company should disclose which data is used and explain the measures taken to safeguard the privacy rights of concerned individuals. The relevance of these measures to achieve data protection compliance for AI-developing companies has already been emphasised by the European Data Protection Board, the body of European data protection authorities whose statements often have a certain precedent, in its interim report on the ChatGPT Task Force.

5.4 Conclusions

The data protection due diligence of a company developing AI systems requires particular attention, especially with regard to the use of personal (including sensitive) training data. It is essential to verify whether the target company has taken technical and organisational measures to ensure compliance with the GDPR and minimise risks. Filtering mechanisms and data reduction techniques should contribute to the target company's compliance with data protection regulations and minimisation of regulatory risks.

6. Summary

Legal due diligence on a target company that develops AI systems itself is a major challenge. This is particularly true as the legal framework to be analysed is largely dynamic. The AI Act is a new EU regulation that will have a similar impact on AI systems covered by it as the GDPR has on the processing and use of data and is currently still terra incognita. In established areas of German and European law such as copyright and data protection law, the main task of due diligence is to categorise the target company's processes and business model within the existing regulatory framework and to check that the target company's business operations are legally permissible and do not pose any sensitive risks for the seller. When conducting legal due diligence on a target company that is deve-

loping AI, the same principles that otherwise contribute to a good legal due diligence apply even more: The experts from the different legal fields must proceed in a well-coordinated and closely interlinked manner in order to grasp the business model and operations of the target company and to exclude or recognise and assess legal risks. ■



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