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AI in Your Business

5 Legal Risks Nobody's Warning You About

AI tools are now embedded in nearly every part of business operations. Employees draft emails in ChatGPT, marketers generate copy in Claude, developers ship code written by Copilot, sales teams summarize meetings in Otter, and HR departments screen resumes with automated systems. Each of these is a productivity gain. Each of them is also a legal exposure that most business owners do not see—because the law has moved faster than the policy manuals. These are the five risks I see materializing in California business litigation right now, and what to do about each one before they become your problem.

1 Trade Secrets Walking Out the Door — Through an AI Prompt

When an employee pastes proprietary information into a public AI tool to "get help" with a task, that information may lose its protection as a trade secret. Under California's Uniform Trade Secrets Act (Civ. Code § 3426 et seq.), a trade secret must derive value from not being generally known and be subject to reasonable efforts to maintain its secrecy. Uploading source code, customer lists, financial models, or strategic plans into ChatGPT, Claude, Gemini, or similar consumer-grade AI tools may constitute disclosure to a third party—and may also feed your most valuable information into a training dataset that benefits competitors. The exposure compounds when employees leave: the same information they pasted into AI tools may now reside in their personal account histories.

What it costs you: A startup's lead engineer used ChatGPT to debug proprietary code for six months before leaving for a competitor. When the company sued for trade secret misappropriation, the defendant argued the code had already been disclosed to OpenAI and was no longer secret. The court denied summary judgment on the trade secret claim, citing the disclosure issue as a triable question of fact. The case settled for less than 20% of the company's damages model.

The fix:

Adopt a written AI use policy that prohibits employees from inputting confidential information, source code, customer data, or proprietary materials into any AI tool that is not contractually covered by an enterprise agreement with data-protection terms. Use enterprise-grade AI platforms (ChatGPT Enterprise, Claude for Work, Microsoft Copilot for Business) that include zero-data-retention and no-training provisions. Train employees on what counts as a trade secret and audit AI tool usage. Update employment agreements and NDAs to expressly prohibit unauthorized AI disclosure.

2 Who Owns AI-Generated Content? (Hint: Maybe Nobody)

The U.S. Copyright Office has consistently held that works generated entirely by AI without meaningful human creative input cannot be copyrighted. The 2023 ruling in Thaler v. Perlmutter confirmed that human authorship is required for copyright protection. This creates an immediate problem for businesses generating marketing copy, blog content, logos, design assets, and code with AI tools: the work product you paid an employee or contractor to produce may not be protectable. Worse, if your competitor uses the same prompts on the same AI model, they may produce nearly identical output—and you have no copyright claim against them.

What it costs you: A marketing agency built a content library of 400 AI-generated blog posts, infographics, and graphics for its retainer clients. When a competitor scraped and republished dozens of the AI-generated pieces verbatim, the agency had no copyright claim to assert—the works were not eligible for protection. The agency had to refund affected clients and rebuild its content library with human-authored work.

The fix:

For any AI-assisted work product that needs copyright protection, ensure meaningful human creative input: substantial editing, original arrangement of elements, or human authorship of the core creative expression with AI used only as a tool. Document the human contribution. For work product that does not require copyright (internal documents, drafts, ephemeral marketing), AI generation is fine—just understand the limits. Update contractor and employee agreements to require disclosure of AI use and to assign whatever rights do exist to your company.

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3 AI in Hiring — The Discrimination Lawsuit Waiting to Happen

Employers using AI-powered resume screening, interview analysis, or candidate scoring tools face a growing wave of discrimination litigation. The EEOC has taken the position that employers are liable for discriminatory outcomes produced by AI hiring tools, even if the discrimination is unintentional. California's Fair Employment and Housing Act (Gov. Code § 12940) extends this exposure under state law. The Civil Rights Department has issued draft regulations specifically addressing automated decision-making in employment, and they may take effect in 2026. If your AI tool screens out candidates over 40, candidates with disabilities, or candidates from protected groups at disproportionate rates, your company—not the vendor—is the defendant.

What it costs you: A California technology company used an AI screening tool that ranked candidates based on resume keywords and video-interview analysis. A class of rejected applicants over the age of 40 sued under FEHA, alleging the tool systematically scored older candidates lower based on speech patterns and resume formatting. The company paid a seven-figure settlement and was required to discontinue the tool. The vendor's contract included an indemnification carve-out that left the employer holding the bag.

The fix:

Audit every AI hiring tool for disparate impact before deployment. Require the vendor to provide bias-testing data and to indemnify your company for discrimination claims arising from the tool. Keep a human in the loop for every adverse hiring decision—AI should rank or recommend, not reject. Document the human reviewer's rationale. Provide applicants with the disclosure required by California's draft automated decision-making regulations (notice that AI is being used and the right to request human review).

4 AI-Generated Contracts and the Hallucination Problem

Generative AI tools confidently produce contract clauses, statute citations, and case law that do not exist. The legal industry has already seen sanctions imposed on attorneys who filed AI-generated briefs containing fabricated authorities (Mata v. Avianca, S.D.N.Y. 2023). The same risk applies when business owners use AI to draft, review, or modify contracts. An AI tool may insert a non-existent statutory cross-reference, misstate the governing law, or generate a boilerplate clause that conflicts with another provision in the same document. These errors are not always obvious—they are often subtle and survive a casual review. When the contract is litigated, the errors become the case.

What it costs you: A small business owner used a popular AI tool to draft a non-compete agreement for a key employee. The agreement cited "California Business and Professions Code § 16601.5" as authority for the restriction. That section does not exist. When the employee left and the company tried to enforce the agreement, the court not only refused to enforce the non-compete (which is generally unenforceable under California law in any event under B&P; § 16600) but also referred the matter for review of the company's good-faith basis for filing. The company paid the employee's attorney's fees.

The fix:

Never deploy an AI-drafted contract without attorney review. AI is useful for first drafts, issue-spotting, and revision suggestions—but every statute citation, case reference, and boilerplate clause must be verified by a human attorney before the contract is signed. Build a workflow: AI drafts, human attorney reviews and verifies all legal authorities, then the contract is finalized. For high-stakes agreements, use AI to accelerate the process, not replace the lawyer.

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5 AI Conversations as Court Evidence

Every prompt your employees enter into ChatGPT, Claude, Copilot, or any other AI tool may be discoverable in litigation. Federal courts have already issued subpoenas requiring AI providers to produce conversation logs. Some providers retain prompts for 30 days, others indefinitely. Consumer-grade accounts often have no enterprise-grade data deletion or legal-hold capabilities. When your company is sued—for employment discrimination, trade secret theft, breach of contract, or fraud—the opposing party may obtain not just your company emails but every AI conversation your employees had that touches the dispute. The casual chat where someone asked an AI “how do I respond to this employee complaint” may become Exhibit A.

What it costs you: A company facing a wrongful termination claim discovered, during discovery, that the manager who fired the plaintiff had used ChatGPT to ask: “How can I document performance issues to terminate an employee who is also pregnant?” The prompt was produced in response to a subpoena. The case settled within 60 days for substantially more than the company’s pre-litigation estimate.

The fix:

Treat AI prompts the same way you treat business emails: assume they are discoverable. Adopt an AI use policy that addresses preservation, deletion, and legal hold. Use enterprise AI tools with administrative controls over data retention. Train managers that AI conversations about HR decisions, employee discipline, or business disputes are not private and may become evidence. When litigation is reasonably anticipated, issue a legal hold that expressly covers AI prompt histories—failure to do so may support a spoliation claim.

The Bottom Line

AI is not the risk. Unmanaged AI is the risk. The companies that get this right will move faster and more profitably than their competitors. The companies that do not will become case law—the kind future business owners read about when they Google “what went wrong.” A simple AI use policy, enterprise-grade tools with proper data controls, and a human in the loop for high-stakes decisions are the difference between leveraging AI and being leveraged by it.

AI-Forward. Litigation-Ready.

Kolmogorov Law, P.C. advises California businesses on AI policy development, trade secret protection, employment compliance, and contract review in an AI-driven workplace. We use AI tools in our own practice—which is why we know exactly how they create exposure.

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