TECHNOVA AI SYSTEMS INC. INTERNAL LEGAL MEMORANDUM

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DATE: September 18, 2024

RE: Risk Assessment - DataSure Allegations and Potential Legal Exposure

CLASSIFICATION: ATTORNEY-CLIENT PRIVILEGED - CONFIDENTIAL

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I. PURPOSE AND SCOPE
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This memorandum provides legal analysis of TechNova's potential liability and risk exposure arising from allegations made by DataSure regarding our InsightPredict Analytics Platform's compliance with the EU Artificial Intelligence Act (Regulation (EU) 2024/1689) and the General Data Protection Regulation (Regulation (EU) 2016/679).

This assessment is prepared in anticipation of litigation and regulatory investigation, and is intended to facilitate legal advice and strategic decision-making by senior management and counsel. This document is attorney work product and subject to attorney-client privilege.

EXECUTIVE SUMMARY OF RISK ASSESSMENT:

REGULATORY RISK: HIGH - Material exposure to enforcement action
CIVIL LIABILITY RISK: MEDIUM-HIGH - Significant discrimination claim exposure
CONTRACTUAL RISK: MEDIUM - Client indemnification obligations triggered
REPUTATIONAL RISK: HIGH - Substantial brand and market damage potential
CRIMINAL RISK: LOW - No identified criminal exposure

OVERALL RISK RATING: HIGH

RECOMMENDATION: Immediate settlement negotiations with DataSure combined with accelerated compliance remediation program.

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II. FACTUAL BACKGROUND
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A. DataSure Allegations Summary

On September 5, 2024, DataSure (a data protection advocacy organization with history of strategic litigation against technology companies) sent formal complaint letter alleging:

1. TechNova's InsightPredict Analytics Platform violates EU AI Act requirements for high-risk AI systems, specifically:
- Article 9 (inadequate risk management system)
- Article 10 (biased training data violating data governance requirements)
- Article 14 (insufficient human oversight)
- Article 43 (lack of conformity assessment and CE marking)

2. GDPR violations including:
- Article 5(1)(a) (unlawful processing - fairness principle)
- Article 9 (unlawful processing of special categories of data)
- Article 22 (solely automated decision-making)
- Article 35 (inadequate Data Protection Impact Assessment)

3. Discriminatory outcomes affecting protected groups:
- Gender-based discrimination in recruitment recommendations
- Age discrimination in performance evaluations
- Potential nationality/ethnicity-based bias in candidate screening

DataSure threatens:
- Formal complaints to market surveillance authorities in Germany, France, Netherlands, Spain, and Ireland
- Complaints to data protection authorities in same jurisdictions
- Public campaign and media engagement
- Support for class action litigation by affected individuals
- Coordination with labor unions and employee advocacy groups

B. Evidence Cited by DataSure

DataSure claims to have conducted independent testing revealing:

1. GENDER BIAS IN RECRUITMENT:
- Identical resumes with male vs. female names received significantly different algorithmic scores
- Average score differential: 8.3 points (0-100 scale)
- Male candidates 23% more likely to receive "high potential" classification
- Effect most pronounced in technical roles and senior positions

2. AGE DISCRIMINATION IN PERFORMANCE ASSESSMENT:
- Employees over 50 rated systematically lower than younger employees with comparable objective performance metrics
- Career longevity negatively weighted after 15-year tenure
- Older workers 31% less likely to receive "promotion ready" designation

3. PROXY DISCRIMINATION:
- Names associated with non-Western European origins correlated with lower scores
- Educational institutions from Southern/Eastern Europe weighted lower than Western European institutions with comparable academic reputation
- Language complexity in application materials (potential proxy for non-native speakers) negatively correlated with recommendations

4. DATA GOVERNANCE FAILURES:
- Training data includes performance evaluations from periods when client organizations had documented gender pay gaps and discrimination issues
- Insufficient geographic diversity in training dataset
- Special categories of data (biometric - facial recognition, voice analysis) processed without adequate Article 9 GDPR legal basis

5. INADEQUATE TRANSPARENCY AND OVERSIGHT:
- Employees subjected to algorithmic assessments often unaware of AI system use
- HR personnel using system lack training on algorithmic bias and oversight responsibilities
- High correlation between algorithmic recommendations and final decisions (78%) suggests nominal rather than meaningful human oversight

C. Source of DataSure's Evidence

CONCERN: DataSure claims evidence obtained through:
- "Audit testing" with synthesized test cases (potentially legitimate research)
- Leaked internal documents from TechNova (MAJOR CONCERN - potential insider, breach, or discovery in other proceeding)
- Testimonial evidence from affected employees and HR personnel at client organizations
- Statistical analysis of aggregated outcomes (source unclear - potentially

problematic data acquisition)

LEGAL ISSUE: If DataSure obtained evidence through unauthorized access to TechNova systems or client data, evidentiary admissibility questions arise. However, publicity and regulatory attention damage occurs regardless of eventual admissibility. Additionally, whistleblower protections may shield sources.

D. TechNova's Preliminary Investigation Findings

Internal technical team review (conducted September 8-15, 2024) reveals:

FINDINGS CORROBORATING DATAURE'S ALLEGATIONS:

1. Gender bias testing confirmed:
- Reproduced DataSure's testing methodology with synthetic resumes
- Confirmed statistically significant score differential (average 7.1 points, slightly lower than DataSure's findings but still material)
- Root cause analysis identified:
* Historical training data reflects gender imbalances in technical hiring
* Certain linguistic features correlate with gender and impact scoring
* Job tenure patterns (career gaps) negatively weighted, disparate impact on women due to maternity leave

2. Age-related bias confirmed:
- Performance scoring model includes experience/tenure features with non-linear relationships
- Diminishing returns to tenure after ~15 years, negative trajectory after 20
- Correlation with age is indirect but statistically significant
- Likely violates Age Discrimination Directive principles

3. Proxy discrimination plausible:
- Name-based features not explicitly used BUT:
- Natural language processing of application materials may capture language patterns correlating with national origin
- Educational institution embeddings reflect historical prestige measures that correlate with geography
- No explicit testing for nationality/ethnicity proxy discrimination conducted previously (significant oversight)

FINDINGS CONTRADICTING OR MITIGATING ALLEGATIONS:

1. Human oversight more substantial than DataSure suggests:
- Override rates higher than DataSure implies (3.2% documented overrides, but

additional ~15% of cases show evidence of human adjustment of algorithmic recommendations)
- Client training materials emphasize human decision-making authority
- System presented as decision support, not decision automation

2. GDPR Article 22 defense viable:
- Genuine human involvement in final decisions
- System provides recommendations, not binding determinations
- Article 22 likely not violated if human oversight effectiveness demonstrated

3. Special categories processing more limited than alleged:
- Facial recognition integration optional module not used by all clients
- Voice analysis limited to specific use cases (call center quality)
- May be able to disaggregate problematic special category processing from core system

OVERALL ASSESSMENT: DataSure's core allegations are substantially accurate. TechNova faces material liability exposure.

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III. LEGAL RISK ANALYSIS
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A. EU AI Act Regulatory Enforcement Risk

RISK LEVEL: HIGH

1. Article 9 - Risk Management System Deficiencies

VIOLATION LIKELIHOOD: HIGH (70-80% probability enforcement action succeeds)

Article 9(2) requires risk management system addressing:
- Known and reasonably foreseeable risks to health, safety, fundamental rights
- Risks arising from reasonably foreseeable misuse
- Continuous risk assessment and mitigation throughout system lifecycle

EXPOSURE:
• Internal compliance assessment (August 2024) acknowledged risk management gaps, particularly inadequate bias risk assessment
• No documented Fundamental Rights Impact Assessment conducted despite clear fundamental rights implications (right to non-discrimination, worker rights)

• Bias testing protocols insufficient - gender and age bias not identified through internal processes but rather by external advocacy group
• Post-market monitoring inadequate to detect discriminatory patterns in production deployments

ENFORCEMENT LIKELIHOOD:
Market surveillance authorities take Article 9 violations seriously, particularly when resulting in fundamental rights harms (discrimination). Documented bias outcomes provide clear evidence of inadequate risk assessment and mitigation.

REGULATORY PRECEDENT:
While AI Act enforcement precedent limited (new regulation), analogous product safety enforcement demonstrates authorities prioritize cases involving:
- Vulnerable populations (employees in power-imbalance relationship)
- Fundamental rights (non-discrimination)
- Systemic failures (multiple client deployments affected)
- Public interest (DataSure campaign will generate attention)

All factors present in TechNova situation.

POTENTIAL PENALTIES:
Article 99(3): Up to €15,000,000 or 3% of total worldwide annual turnover (whichever higher) for violations of Article 9

TechNova annual revenue (2023): €87 million
Maximum potential fine: €15,000,000 (3% of turnover = €2.61M, lower than maximum)

LIKELY PENALTY RANGE (if violation found): €3,000,000 - €8,000,000

Aggravating factors increasing penalty:
- Multiple jurisdictions affected (5 countries threatened with complaints)
- Large number of individuals impacted (~450,000 employees)
- Systematic rather than isolated failure
- Failure to self-identify and remediate despite internal compliance assessment identifying gaps

Mitigating factors reducing penalty:
- No prior violations (new regulation, clean record)
- Cooperation with authorities if investigation initiated
- Voluntary remediation efforts if promptly undertaken
- No evidence of intentional or reckless disregard

2. Article 10 - Data Governance Violations

VIOLATION LIKELIHOOD: HIGH (75-85% probability)

Article 10(2) requires training data to be:
- Relevant, sufficiently representative, and free of errors
- Appropriate to intended purpose
- Subject to data governance and management practices ensuring data quality

Article 10(3) requires training data to be subject to appropriate data governance and management practices.

EXPOSURE:
• Training data incorporates historical performance evaluations from periods with documented discrimination (gender pay gaps, promotion disparities)
• Using biased historical labels to train predictive models perpetuates and potentially amplifies historical discrimination
• Geographic representation skewed toward Western Europe, inadequate diversity
• Data quality issues documented (missing values, inconsistencies)
• Insufficient processes for data curation, cleaning, and bias mitigation

LEGAL THEORY:
Article 10 embodies "garbage in, garbage out" principle - even technically sophisticated AI system produces discriminatory outputs if trained on biased data. Requirement that data be "appropriate" encompasses fairness and non-discrimination considerations.

This interpretation supported by:
- Recital 71 (high-quality datasets essential for AI performance and fairness)
- Article 10(3) explicit mention of "possible biases"
- Systematic interpretation with Article 9 risk management obligations

ENFORCEMENT LIKELIHOOD: VERY HIGH

Article 10 violations directly causally linked to discriminatory outcomes. DataSure has evidence of biased outputs traceable to training data quality issues. Clear violation with strong evidentiary support.

POTENTIAL PENALTIES:
Article 99(3): Up to €15,000,000 or 3% of total worldwide annual turnover

LIKELY PENALTY RANGE (if violation found): €2,500,000 - €7,000,000

Article 10 violations may be charged cumulatively with Article 9 violations, potentially increasing total penalty exposure.

3. Article 14 - Human Oversight Deficiencies

VIOLATION LIKELIHOOD: MEDIUM-HIGH (60-70% probability)

Article 14(1) requires high-risk AI systems to be designed and developed with appropriate human oversight measures to prevent or minimize risks.

Article 14(4) specifies measures enabling humans to:
(a) Fully understand AI system capacities and limitations
(b) Remain aware of automation bias tendency
(c) Correctly interpret AI system output
(d) Decide not to use system or override/reverse output
(e) Intervene or interrupt system operation

EXPOSURE:
• 78% correlation between algorithmic recommendations and final decisions suggests limited human intervention
• HR personnel training on algorithmic bias and oversight responsibilities inconsistent across client organizations
• System explainability limited - numerical scores without detailed reasoning
• Override rates low (3.2% documented)
• No systematic processes ensuring human reviewers exercise independent judgment rather than defer to algorithmic recommendations (automation bias risk)

COUNTERARGUMENTS (stronger defense than Articles 9-10):
• Article 14 obligations shared between provider (TechNova) and deployer (client HR departments)
• TechNova provides decision-support recommendations, not automated decisions
• Human decision-makers retain authority and do make final determinations
• Some level of agreement between human and AI recommendations expected if system provides valuable insights (correlation doesn't prove rubber-stamping)
• Client training materials emphasize human oversight responsibility

ENFORCEMENT LIKELIHOOD: MODERATE-HIGH

More complex causation than Articles 9-10. Requires demonstrating that human oversight measures are inadequate in design, not merely that humans sometimes agree with algorithmic recommendations.

However, automation bias research literature supports argument that nominal human involvement insufficient without specific design measures to counteract human tendency to defer to automated recommendations.

High correlation + limited explainability + inadequate training = arguably inadequate oversight measures.

POTENTIAL PENALTIES:
Article 99(3): Up to €15,000,000 or 3% of total worldwide annual turnover

LIKELY PENALTY RANGE (if violation found): €1,500,000 - €4,000,000

4. Article 43 - Conformity Assessment Absence

VIOLATION LIKELIHOOD: HIGH (80-90% probability if continuing to market system)

Article 43 requires high-risk AI systems to undergo conformity assessment before being placed on market.

Article 48(4) prohibits placing on market high-risk AI systems not bearing CE marking (issued following conformity assessment).

EXPOSURE:
• No conformity assessment conducted to date
• No CE marking affixed
• System actively marketed and deployed across EU

TIMING DEFENSE:
AI Act Article 113 establishes transition periods. High-risk AI systems placed on market before regulation application date have 24-36 months to comply depending on specific category.

InsightPredict Analytics Platform launched 2021, substantially predates AI Act.

ANALYSIS:
During transition period, continuing to market existing system without conformity assessment may not constitute violation IF:
- System placed on market before AI Act application date (August 2, 2026 for most provisions)
- Provider working toward conformity assessment completion within transition timeline
- No substantial modifications that would constitute new placing on market

However:
- Market surveillance authorities may take dim view of providers not proactively pursuing compliance
- Other violations (Articles 9, 10, 14) may undermine good faith compliance argument
- Substantial system updates since 2021 may constitute new placing on market

ENFORCEMENT LIKELIHOOD (near-term): MODERATE

Unlikely to face Article 43 enforcement action before transition period expires IF actively working toward compliance.

However, after transition deadline, extremely high enforcement risk if no conformity assessment completed.

POTENTIAL PENALTIES:
Article 99(3): Up to €15,000,000 or 3% of total worldwide annual turnover

LIKELY PENALTY RANGE (if violation found post-transition): €4,000,000 - €10,000,000

Failure to obtain conformity assessment viewed as serious violation indicating provider circumventing entire compliance framework.

5. Cumulative AI Act Penalty Exposure

TOTAL POTENTIAL AI ACT FINES: €11,000,000 - €29,000,000

Authorities may pursue multiple violations simultaneously, though cumulative penalties consider proportionality and total worldwide turnover cap.

REALISTIC WORST-CASE SCENARIO: €8,000,000 - €15,000,000 total AI Act penalties across all violations if multiple enforcement actions in multiple jurisdictions.

B. GDPR Regulatory Enforcement Risk

RISK LEVEL: MEDIUM-HIGH

1. Article 5(1)(a) - Lawfulness, Fairness, Transparency

VIOLATION LIKELIHOOD: MEDIUM-HIGH (65-75% probability)

Article 5(1)(a) requires personal data processing to be lawful, fair, and transparent.

"Fairness" principle interpreted to prohibit discriminatory processing.

EXPOSURE:
• Demonstrated gender and age bias constitutes "unfair" processing
• Employees often unaware of extent of algorithmic profiling (transparency issue)
• Discriminatory outcomes disproportionately burden protected groups

EDPB GUIDANCE:
European Data Protection Board emphasizes fairness encompasses non-discrimination. Processing that produces discriminatory outcomes violates fairness principle even if technically "lawful" under Article 6.

ENFORCEMENT LIKELIHOOD: MODERATE-HIGH

DPAs increasingly scrutinizing algorithmic fairness. High-profile case provides opportunity for DPA to establish precedent on AI discrimination as GDPR violation.

POTENTIAL PENALTIES:
Article 83(5): Up to €20,000,000 or 4% of total worldwide annual turnover (whichever higher)

LIKELY PENALTY RANGE (if violation found): €2,000,000 - €6,000,000

2. Article 9 - Special Categories of Data

VIOLATION LIKELIHOOD: MEDIUM (50-60% probability)

Article 9(1) prohibits processing special categories including biometric data, health data, and data revealing racial/ethnic origin.

EXPOSURE:
• Facial recognition constitutes biometric data processing
• Voice analysis may reveal health information
• Inference of gender, age, ethnicity from names and application materials constitutes special category processing
• Inadequate Article 9(2) legal basis for special category processing

LEGAL ANALYSIS:

Biometric data (facial recognition):
- Clearly Article 9 special category
- Employment context legal basis likely Article 9(2)(b) (employment law) or Article 9(2)(f) (legal claims)
- Consent problematic due to power imbalance (GDPR Recital 43)
- Article 9(2)(b) requires processing "necessary" for employment law purposes
- Necessity questionable if facial recognition optional feature

Inferred special categories (gender, age, ethnicity):
- Whether inference of special categories from non-special category data

constitutes Article 9 processing remains somewhat unsettled
- EDPB Guidelines suggest purposeful inference to create special category data triggers Article 9
- If algorithmic model specifically uses gender/age/ethnicity predictions as features, strong Article 9 argument
- If model merely processes data that correlates with protected characteristics without explicit inference, weaker Article 9 argument (though still fairness principle issue)

COUNTERARGUMENTS:
• Facial recognition optional module not universally deployed
• Voice analysis limited to specific use cases
• No explicit inference of protected characteristics (correlation vs. causation)
• Article 9(2)(b) employment law basis potentially adequate where applicable

ENFORCEMENT LIKELIHOOD: MODERATE

DPAs may pursue Article 9 violations for biometric processing without robust legal basis. Inference question more legally complex, potentially test case.

POTENTIAL PENALTIES:
Article 83(5): Up to €20,000,000 or 4% of total worldwide annual turnover

LIKELY PENALTY RANGE (if violation found): €1,500,000 - €4,000,000

3. Article 22 - Automated Decision-Making

VIOLATION LIKELIHOOD: LOW-MEDIUM (30-40% probability)

Article 22(1) establishes right not to be subject to solely automated decision with legal or similarly significant effects.

EXPOSURE:
• Employment decisions clearly have "legal or similarly significant effects"
• Question: Are decisions "solely automated" if human formally involved but largely defers to algorithmic recommendations?

LEGAL ANALYSIS:

TechNova position: Article 22 not violated because:
- Human HR professionals make final decisions, not algorithm
- System provides recommendations only

- Humans retain authority to override
- Evidence of human intervention (overrides, adjustments)

DataSure argument: Substantive solely automated processing despite formal human involvement because:
- High correlation (78%) between algorithmic recommendation and final decision
- Automation bias means humans defer to algorithmic recommendations
- Limited explainability prevents meaningful human assessment
- Time pressure and workload incentivize following recommendations

CASE LAW:
Limited directly applicable precedent. Article 29 Working Party Guidelines (WP251) emphasize need for meaningful human intervention, not token involvement.

Recent commentary suggests automated decision-making exists where:
- Human cannot practically deviate from algorithmic output
- Human does not understand algorithmic reasoning
- Human lacks time, resources, or incentives for independent assessment

RISK ASSESSMENT:
TechNova has stronger defense here than Articles 5 or 9. Evidence of human involvement exists. However, automation bias arguments gaining traction in policy discussions.

If Article 14 AI Act human oversight violation found, strengthens Article 22 GDPR argument (regulatory consistency - if human oversight inadequate for AI Act, supports solely automated conclusion for GDPR).

ENFORCEMENT LIKELIHOOD: MODERATE

DPAs may pursue Article 22 claim opportunistically in conjunction with other violations, particularly if seeking to establish precedent on automation bias theory.

POTENTIAL PENALTIES:
Article 83(5): Up to €20,000,000 or 4% of total worldwide annual turnover

LIKELY PENALTY RANGE (if violation found): €1,000,000 - €3,000,000

4. Article 35 - Data Protection Impact Assessment

VIOLATION LIKELIHOOD: LOW-MEDIUM (35-45% probability)

Article 35(1) requires DPIA when processing likely to result in high risk to rights and freedoms.

Article 35(3)(a) specifically triggers DPIA for "systematic and extensive evaluation of personal aspects relating to natural persons which is based on automated processing, including profiling."

EXPOSURE:
• DPIA conducted in 2022 but not updated
• Significant system evolution since initial DPIA
• DPIA did not adequately address discriminatory bias risks
• DPIA not updated to reflect AI Act requirements

LEGAL ANALYSIS:

Violation theory: DPIA inadequate if:
- Not updated to reflect material system changes
- Did not identify significant risks (discrimination) that subsequently materialized
- Not sufficiently comprehensive in risk assessment

Defense:
- DPIA was conducted, demonstrating good faith compliance
- Article 35 requires DPIA but does not specify quality standards
- Enforcement typically focuses on absent DPIAs rather than inadequate ones
- System evolution gradual rather than discrete triggering event for DPIA update

ENFORCEMENT LIKELIHOOD: LOW-MODERATE

DPAs unlikely to pursue Article 35 violation as primary theory. May be included as secondary violation in comprehensive enforcement action, but lower priority than substantive violations.

POTENTIAL PENALTIES:
Article 83(4): Up to €10,000,000 or 2% of total worldwide annual turnover (lower tier than Article 5, 9, 22 violations)

LIKELY PENALTY RANGE (if violation found): €500,000 - €1,500,000

5. Cumulative GDPR Penalty Exposure

TOTAL POTENTIAL GDPR FINES: €5,000,000 - €14,500,000

REALISTIC WORST-CASE SCENARIO: €4,000,000 - €8,000,000 total GDPR penalties

Multiple DPAs across jurisdictions may pursue parallel enforcement actions. Lead supervisory authority coordination under Article 56 (one-stop-shop mechanism) may consolidate enforcement, but DataSure threatening complaints in five jurisdictions complicates coordination.

C. COMBINED REGULATORY EXPOSURE: €12,000,000 - €23,000,000

This represents substantial financial risk requiring immediate senior management attention and comprehensive risk mitigation strategy.

C. Civil Liability Risk - Discrimination Claims

RISK LEVEL: MEDIUM-HIGH

1. Legal Bases for Discrimination Claims

Multiple legal frameworks prohibit employment discrimination:

EU LEVEL:
- Equal Treatment Directive 2000/78/EC (age, disability)
- Race Equality Directive 2000/43/EC (race, ethnic origin)
- Gender Equality Directive 2006/54/EC (gender)
- Charter of Fundamental Rights Article 21 (non-discrimination)

NATIONAL LEVEL:
- Member state implementations of EU directives
- National constitutional equality guarantees
- National employment discrimination statutes

LIABILITY THEORIES:

Direct discrimination:
Treating protected group less favorably. Difficult to prove for algorithmic systems without explicit use of protected characteristics.

Indirect discrimination:
Applying apparently neutral criterion that disadvantages protected group unless objectively justified. More applicable to algorithmic discrimination.

Evidence:
- Statistical showing of disparate impact
- Lack of objective justification for discriminatory criterion
- Burden shifts to defendant to prove justification (proportionality)

2. Plaintiff Universe and Class Action Risk

POTENTIAL PLAINTIFFS: Up to 450,000 employees across client organizations

More realistically: Subset adversely affected by algorithmic bias
- Women not hired/promoted due to gender bias
- Older workers subjected to negative performance assessments
- Candidates of non-Western European origin screened out

CLASS ACTION MECHANISMS:

EU lacks US-style class action procedures, but collective redress mechanisms exist:
- Representative actions under Representative Actions Directive (EU) 2020/1828
- National collective redress procedures (varying by Member State)
- Trade union or NGO representative actions
- Opt-in group litigation

DataSure's involvement suggests potential for organized collective litigation. Advocacy organizations may serve as representative plaintiffs or coordinate individual claims.

3. Damages Exposure Assessment

Damages vary significantly across jurisdictions but generally include:

MATERIAL DAMAGES:
- Lost wages (difference between actual compensation and what employee would have earned absent discrimination)
- Lost benefits
- Career advancement setbacks

IMMATERIAL DAMAGES:
- Emotional distress and dignity harm
- Reputational harm
- Pain and suffering

EU jurisdictions generally award more modest damages than US punitive damage system, but non-material damages can be substantial in discrimination cases.

HYPOTHETICAL SCENARIOS:

Scenario A: Moderate individual claim
- Applicant not hired due to algorithmic bias
- Would have earned €50,000 annually
- Secures alternative employment at €45,000
- Claims 2 years lost earnings differential: €10,000
- Non-material damages: €15,000
- Total: €25,000 per plaintiff

Scenario B: Substantial individual claim
- Employee denied promotion due to age bias
- Lost €25,000 annual salary increase
- Career trajectory permanently impacted
- Claims 5 years economic loss: €125,000
- Non-material damages: €40,000
- Total: €165,000 per plaintiff

COLLECTIVE DAMAGES EXPOSURE:

Conservative estimate:
- 1,000 plaintiffs in organized collective action
- Average €30,000 per plaintiff
- Total exposure: €30,000,000

Moderate estimate:
- 3,500 plaintiffs across multiple proceedings
- Average €45,000 per plaintiff
- Total exposure: €157,500,000

Aggressive estimate (worst case):
- 10,000+ plaintiffs in coordinated litigation
- Average €50,000 per plaintiff
- Total exposure: €500,000,000+

REALISTIC RISK ASSESSMENT:

Most likely scenario: €20,000,000 - €60,000,000 total civil damages exposure across multiple proceedings and settlements over 3-5 year period.

4. Causation and Attribution Challenges

PLAINTIFF BURDEN:
Plaintiffs must prove:
1. Protected characteristic (e.g., gender, age)
2. Adverse employment outcome
3. Causal connection between characteristic and outcome
4. Lack of legitimate justification

EVIDENTIARY CHALLENGES FOR PLAINTIFFS:

Algorithmic opacity:
- Difficult to demonstrate how algorithm processed individual case
- Black box problem limits ability to show discriminatory reasoning
- TechNova may resist disclosure of proprietary algorithmic details

Multiple decision-makers:
- Employment decision involved both algorithm and human
- Causation attribution between algorithmic recommendation and human decision complex
- Humans may have reached same decision without algorithmic input (causation break)

Indirect relationship:
- TechNova is provider, not employer
- Actual employer (client organization) made final decision
- TechNova may argue no direct liability, only potential contribution claim from employer

EVIDENTIARY ADVANTAGES FOR PLAINTIFFS:

Statistical evidence:
- Disparate impact shown through statistical analysis of outcomes
- Statistics shift burden to defendant to justify discriminatory pattern
- DataSure's testing provides ready-made statistical evidence

AI Act violations as evidence:
- Regulatory findings of Article 9, 10, 14 violations admissible as evidence of fault/negligence in civil proceedings
- Violation of protective statute supports tort liability
- Article 10 finding (biased training data) directly supports discrimination causation

Disclosure in litigation:
- Civil procedure discovery/disclosure rules may compel TechNova to produce:
* Training data and algorithmic details

* Internal communications showing awareness of bias
* Testing results and bias audits
- Privileged compliance assessment may be subject to disclosure depending on jurisdiction and waiver issues

ASSESSMENT:
While causation presents challenges for plaintiffs, statistical evidence combined with regulatory violations findings creates viable discrimination claims. Not all 450,000 employees will have viable claims, but substantial subset likely does.

5. Joint and Several Liability with Clients

ISSUE: Allocation of liability between TechNova (AI system provider) and client organizations (employers/deployers)

Under employment discrimination law, direct liability falls on employer. However:

TECHNOVA DERIVATIVE LIABILITY THEORIES:

Contribution/indemnification:
- Clients sued for discrimination may bring third-party claims against TechNova
- Contractual indemnification obligations (see below)
- Tort contribution for TechNova's role in discriminatory outcome

Aiding and abetting discrimination:
- Providing tool that facilitates discrimination
- Knowledge (actual or constructive) that system produces discriminatory outcomes
- Substantial assistance to primary discriminator

Product liability:
- Defective product causing harm (discrimination as harm)
- Strict liability or negligence depending on jurisdiction
- AI system with discriminatory bias as "defect"

STRATEGIC CONSIDERATION:
Even if TechNova's direct liability limited, exposure through client claims (indemnification, contribution) may be substantial. Clients facing discrimination liability will seek to shift costs to TechNova.

D. Contractual Risk - Client Indemnification

RISK LEVEL: MEDIUM

1. Contractual Provisions Review

Standard TechNova client agreement includes:

REPRESENTATIONS AND WARRANTIES (Section 8.2):
"Provider represents and warrants that the InsightPredict Analytics Platform:
(a) complies with all applicable laws and regulations including data protection and anti-discrimination laws;
(b) does not and will not discriminate on the basis of protected characteristics including gender, age, race, ethnicity, disability, or other protected status;
(c) incorporates appropriate safeguards against algorithmic bias and discriminatory outcomes."

INDEMNIFICATION OBLIGATIONS (Section 11.3):
"Provider shall indemnify, defend, and hold harmless Client from and against any and all claims, damages, liabilities, costs, and expenses (including reasonable attorneys' fees) arising from or related to:
(a) Provider's breach of representations and warranties;
(b) Provider's violation of applicable laws or regulations;
(c) Discriminatory outcomes produced by the AI system;
(d) Third-party claims arising from use of the AI system in accordance with this Agreement."

EXPOSURE ANALYSIS:

Breach of warranty:
- If system produces discriminatory outcomes, violates Section 8.2(b) warranty
- If non-compliant with AI Act or GDPR, violates Section 8.2(a) warranty
- Breach of warranty triggers indemnification obligation

Indemnification scope:
- Section 11.3(c) specifically addresses discriminatory outcomes
- Section 11.3(d) covers third-party claims (employee discrimination claims)
- "All claims, damages, liabilities, costs, and expenses" - very broad
- Includes "reasonable attorneys' fees" - defense costs in addition to damages

POTENTIAL CONTRACTUAL LIABILITY:

Direct breach of warranty damages:
- Client may claim economic harm from contract breach
- Lost productivity, reputational damage, remediation costs
- Difficult to quantify but potentially €500K - €2M per major client

Indemnification for third-party claims:
- TechNova obligated to defend and indemnify clients for employee discrimination claims
- If 1,000 employees sue across various clients claiming €30M total damages, TechNova indemnification exposure = €30M
- Plus defense costs (attorneys' fees for defending clients)

Indemnification for regulatory penalties:
- Section 11.3(b) covers "violation of applicable laws or regulations"
- If client faces GDPR or AI Act penalty as deployer, may seek indemnification from TechNova
- Article 26 AI Act establishes deployer obligations - deployer penalties possible
- Client argument: deployer penalty caused by provider's non-compliant system

TOTAL POTENTIAL CONTRACTUAL EXPOSURE: €30M - €80M

This overlaps with civil liability exposure (same underlying claims, but contractual obligation to defend/indemnify clients adds layer of exposure).

2. Contractual Defenses and Limitations

LIABILITY CAPS (Section 11.5):
"Notwithstanding any other provision, Provider's total cumulative liability under this Agreement shall not exceed the greater of (i) amounts paid by Client to Provider in the twelve months preceding the claim, or (ii) €1,000,000."

ISSUE: Liability cap may not apply to indemnification obligations.

Section 11.6 states: "Section 11.5 limitation shall not apply to: (a) Provider's indemnification obligations under Section 11.3; (b) Provider's gross negligence or willful misconduct."

CONSEQUENCE: Indemnification obligations unlimited. If gross negligence found (e.g., deploying system with known bias), other liability also unlimited.

LIMITATION PERIOD (Section 13.7):
"No action arising under this Agreement may be brought more than two years after the cause of action accrues."

ISSUE: When does cause of action accrue?
- When discriminatory decision made (potentially ongoing for years)?
- When discrimination discovered by affected individual?
- When Client becomes aware of potential claim?

Ambiguity may limit effectiveness of limitations period.

PRACTICAL ASSESSMENT:

Contractual liability caps provide minimal protection due to indemnification carve-out. Indemnification obligations represent substantial exposure requiring proactive mitigation.

E. Reputational Risk

RISK LEVEL: HIGH

1. Media and Public Relations Exposure

DataSure's sophistication in media engagement and public campaigns well-documented. Previous DataSure campaigns generated:
- Front-page coverage in major European media (Der Spiegel, Le Monde, The Guardian)
- Trending social media topics and viral content
- Investigative journalism deepdives
- Op-eds from prominent voices on technology and civil rights

LIKELY MEDIA NARRATIVE:
"AI Discrimination: How TechNova's Algorithm Denied Opportunities to Women and Older Workers"

This narrative combines:
- Sympathetic affected individuals (employees discriminated against)
- Villainous technology (opaque biased algorithm)
- Broader societal concerns (AI accountability, algorithmic discrimination)
- David vs. Goliath framing (advocacy group vs. tech company)

REPUTATIONAL HARM CONSEQUENCES:

Customer/client impact:
- Existing clients may terminate contracts to avoid association with discrimination scandal
- Prospective clients unwilling to contract with company under discrimination cloud
- Particularly acute for HR technology where trust and ethical reputation essential
- Client renewals at risk (annual contract value: ~€52M, 60% renewal rate typically, could drop to 30-40% in crisis = €10-15M annual revenue loss)

Investor confidence:
- TechNova Series B valuation: €320M (2023)
- Discrimination scandal likely to depress valuation for Series C or exit
- Investor concerns about regulatory exposure and litigation costs
- Potential valuation impact: 20-40% reduction (€64M - €128M)

Talent recruitment and retention:
- Difficulty attracting top talent to company associated with discrimination
- Existing employees may seek opportunities elsewhere
- Particularly acute for AI/ML talent concerned about ethics and reputation
- Turnover costs and productivity impacts

Partnership and ecosystem impacts:
- Integration partners may distance themselves
- Industry association memberships or leadership roles at risk
- Conference speaking invitations and thought leadership opportunities diminished

2. Quantifying Reputational Harm

Reputational damage difficult to quantify precisely but material financial impacts include:

NEAR-TERM (Year 1):
- Revenue loss from client churn: €10-15M
- Legal and crisis management costs: €3-5M
- Marketing and brand rehabilitation: €2-3M
- Total Year 1 impact: €15-23M

MEDIUM-TERM (Years 2-3):
- Reduced growth rate (new client acquisition impaired): €8-12M annually
- Valuation impact affecting capital raising: €64-128M
- Talent costs (premium to attract talent, replacement costs): €2-4M annually
- Total Years 2-3 cumulative impact: €74-148M

LONG-TERM (Years 4+):
- Partial recovery but permanent reputation scarring
- Continued market position erosion relative to competitors
- Cumulative opportunity cost: difficult to quantify but substantial

TOTAL REPUTATIONAL HARM: €89M - €171M over 3-year period

This substantially exceeds direct legal/regulatory exposure and represents most significant component of total risk.

F. Criminal Risk

RISK LEVEL: LOW

Criminal exposure unlikely but not entirely absent.

POTENTIAL THEORIES:

Fraud (misrepresentation to clients):
- If TechNova knowingly misrepresented compliance or non-discrimination characteristics to induce client contracts
- Requires proof of intentional deception, scienter
- Current facts do not suggest criminal fraud

Data protection criminal offenses:
- Some Member States criminalize serious GDPR violations
- Typically requires intentional or reckless violation
- Administrative enforcement far more likely than criminal prosecution

Corporate criminal liability:
- Limited corporate criminal liability in most EU jurisdictions
- Individual executive liability more typical
- Would require proof of knowing participation in violations

ASSESSMENT:
No current evidence suggesting criminal exposure. Regulatory and civil enforcement overwhelmingly more likely. However, if investigation reveals intentional concealment of known discrimination or fraudulent misrepresentations, criminal exposure could emerge.

RECOMMENDATION: Ensure legal hold and document preservation to avoid obstruction allegations if investigation initiated.

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IV. STRATEGIC RESPONSE OPTIONS
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A. Option 1: Aggressive Defense and Litigation

APPROACH:
- Reject DataSure's allegations

- Refuse settlement negotiations
- Contest regulatory enforcement actions vigorously
- Defend all civil litigation
- Public relations campaign defending TechNova

ADVANTAGES:
- Avoid admission of wrongdoing
- Preserve litigation leverage
- May deter opportunistic plaintiffs
- Signals confidence in product and compliance

DISADVANTAGES:
- High likelihood of adverse regulatory findings based on internal testing corroborating DataSure allegations
- Protracted litigation expensive (legal fees €5-10M+)
- Discovery will likely reveal additional damaging evidence (internal communications, testing results)
- Reputational harm amplified by adversarial posture
- Regulatory penalties may be higher without cooperation credit
- Foregoes opportunity for negotiated resolution on more favorable terms

RISK ASSESSMENT: HIGH RISK

Aggressive defense viable when underlying allegations meritless or evidentiary weaknesses exist. Here, internal investigation confirms core allegations. Fighting likely regulatory loss wastes resources and exacerbates harm.

RECOMMENDATION: NOT RECOMMENDED

B. Option 2: Comprehensive Settlement with DataSure

APPROACH:
- Engage settlement negotiations with DataSure
- Acknowledge compliance gaps and commit to remediation
- Structured settlement including:
* Financial payment to DataSure (litigation fund or advocacy funding)
* Binding compliance commitments with independent monitoring
* Transparency measures and public reporting
* Affected individual compensation fund
- Conditional regulatory cooperation (settlement contingent on regulatory forbearance or reduced penalties)

ADVANTAGES:
- Resolves DataSure threat of regulatory complaints and litigation support
- Demonstrates good faith and responsibility
- May secure DataSure agreement not to pursue or support complaints/litigation
- Compliance commitments provide roadmap and accountability
- Independent monitoring provides credibility
- Potentially reduces regulatory penalties (voluntary remediation, cooperation)
- Reputational benefit from taking responsibility and committing to improvement

DISADVANTAGES:
- Settlement payment (likely €2-5M to DataSure)
- Compliance costs (€1.75M-3M per internal estimate)
- Binds TechNova to specific remediation measures with oversight
- Settlement may not prevent regulatory action (authorities act independently)
- Settlement may not prevent all civil litigation (cannot bind non-parties)
- Could be perceived as admission of liability

SETTLEMENT NEGOTIATION CONSIDERATIONS:

DataSure objectives:
- Institutional reform and compliance (primary goal for advocacy organization)
- Affected individual compensation
- Transparency and accountability
- Advocacy funding (secondary)

TechNova objectives:
- Finality and certainty
- Regulatory penalty mitigation
- Civil litigation exposure reduction
- Reputational rehabilitation
- Operational continuity

Potential settlement structure:
1. Compliance remediation commitments:
- Complete AI Act conformity assessment within 12 months
- Implement comprehensive bias testing and mitigation
- Enhanced human oversight measures
- Quarterly reporting to independent monitor for 3 years
- Annual third-party algorithmic audits for 3 years

2. Affected individual compensation:
- Establish €5-10M compensation fund administered by neutral party
- Eligible individuals can claim without litigation
- Claims process with DataSure input on design
- TechNova funds but does not control distribution

3. Transparency measures:
- Public algorithmic audit reports
- Transparency reporting on system performance and bias metrics
- Academic research access to anonymized data

4. DataSure forbearance:
- Agreement not to file regulatory complaints (with compliance conditions)
- Agreement not to support or fund civil litigation
- Retains right to public commentary but not active campaign

5. Financial payment:
- €2-3M to DataSure for advocacy and research on AI accountability
- Structured as grant, not settlement payment per se
- Tax and optics considerations

REGULATORY COORDINATION:
Settlement should be coordinated with regulatory authorities where possible. Approach market surveillance authorities and DPAs to present voluntary compliance program and seek:
- Credit for self-initiated remediation in penalty calculation
- Opportunity to achieve compliance before formal enforcement
- Regulatory forbearance during good-faith compliance period

Not all authorities will agree (legally independent), but proactive engagement demonstrates good faith.

RISK ASSESSMENT: MEDIUM-LOW RISK

Settlement provides certainty and control over outcome. Compliance commitments are obligations TechNova should undertake regardless. Payment (~€7-13M total including compensation fund) is manageable relative to litigation exposure.

However, no guarantee authorities forbear or all litigation prevented.

RECOMMENDATION: PREFERRED APPROACH

Engage settlement negotiations immediately as primary strategy while preparing for regulatory proceedings as backup.

C. Option 3: Voluntary Compliance Program Without Settlement

APPROACH:
- Decline settlement with DataSure

- Unilaterally implement comprehensive compliance remediation
- Proactive engagement with regulatory authorities
- Offer remediation to affected individuals without formal settlement
- Public transparency about gaps and remediation

ADVANTAGES:
- Avoid payment to DataSure (saving €2-3M)
- Maintain control over remediation process without external oversight
- Regulatory credit for voluntary compliance
- Demonstrates responsibility without negotiation

DISADVANTAGES:
- DataSure proceeds with regulatory complaints and litigation support
- No forbearance or cooperation from DataSure
- Unilateral remediation may be viewed skeptically without independent verification
- No protection from civil litigation
- Reputational benefits limited without third-party validation

RISK ASSESSMENT: MEDIUM RISK

Achieves compliance objectives but foregoes regulatory and litigation risk mitigation from settlement. May make sense if settlement negotiations fail but not recommended as primary strategy.

RECOMMENDATION: FALLBACK OPTION if settlement negotiations unsuccessful

D. Option 4: Product Withdrawal from EU Market

APPROACH:
- Discontinue InsightPredict Analytics Platform sales and deployment in EU
- Wind down existing client contracts
- Focus on non-EU markets
- Avoid AI Act and EU regulatory exposure

ADVANTAGES:
- Eliminates EU regulatory compliance burden and costs
- Avoids AI Act conformity assessment requirements
- Reduces regulatory penalty exposure (though existing violations may still be pursued)

DISADVANTAGES:
- Foregoes ~€52M annual EU revenue (60% of business)
- Existing client contracts may have termination costs

- Reputational harm persists and affects non-EU business
- Does not resolve civil liability for past discrimination
- Signals defeat and retreat
- Non-EU markets may follow EU regulatory approach (international AI governance convergence trend)

RISK ASSESSMENT: HIGH RISK to business continuity

Market withdrawal represents existential threat to business. Only viable if compliance costs truly prohibitive or regulatory/liability risk catastrophic. Current assessment suggests neither condition met.

RECOMMENDATION: NOT RECOMMENDED

Reserve as last resort option only if all other strategies fail.

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V. RECOMMENDED ACTION PLAN
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Based on comprehensive risk assessment, recommend hybrid strategy combining elements of Options 2 and 3:

PHASE 1: IMMEDIATE ACTIONS (Week 1-2)

1. Executive crisis management committee
- CEO, General Counsel, CTO, CFO, Head of Compliance
- Daily briefings during acute crisis phase
- Unified messaging and decision-making authority

2. Engage specialized external counsel
- EU AI Act regulatory expertise
- GDPR/data protection enforcement experience
- Employment discrimination litigation capability
- Crisis management and settlement negotiation experience
- Estimate cost: €150-200K for initial engagement

3. Implement legal hold and document preservation
- Preserve all relevant documents, communications, data
- Litigation hold notice to all relevant personnel
- Ensure no destruction of evidence allegations

4. Preliminary outreach to DataSure
- Express willingness to engage in good-faith settlement discussions
- Request forbearance from immediate complaints pending negotiations
- Propose 30-day negotiation period
- No admissions of liability but acknowledge desire to address concerns

5. Public relations strategy
- Retain crisis PR firm with technology sector experience
- Develop holding statement and stakeholder communication plan
- Proactive outreach to key clients with reassurance and transparency
- Employee communication addressing situation and values commitment

PHASE 2: SETTLEMENT NEGOTIATION (Week 3-8)

1. Formal settlement negotiations with DataSure
- Propose mediation with experienced technology/civil rights mediator
- Develop settlement proposal incorporating compliance commitments, compensation fund, transparency measures
- Target settlement value: €8-12M total (compensation fund + payment)
- Negotiate forbearance from regulatory complaints and litigation support

2. Parallel regulatory engagement
- Courtesy notifications to likely lead supervisory authorities (Germany BfDI for GDPR, Germany market surveillance for AI Act given headquarters location)
- Present voluntary compliance program
- Seek informal guidance on penalty mitigation for cooperation
- Do not admit violations but acknowledge enhancement opportunities

3. Affected individual outreach
- Design compensation program for individuals potentially adversely affected
- Engage neutral claims administrator
- Develop eligibility criteria and claims process
- Coordinate with settlement negotiations

PHASE 3: COMPLIANCE REMEDIATION (Week 4-18 months)

1. Immediate technical remediation (Month 1-3)
- Emergency bias audit and mitigation
- Enhanced human oversight protocols
- Improved explainability features
- Client notification and training

2. Comprehensive compliance program (Month 3-12)
- Full AI Act Article 9 risk management system implementation

- Article 10 data governance remediation (training data cleaning, expansion)
- Complete technical documentation per Annex IV
- Quality management system per Article 17
- Post-market monitoring infrastructure

3. Conformity assessment (Month 10-18)
- Engage notified body
- Conduct conformity assessment procedures
- Achieve CE marking
- EU database registration

4. Independent monitoring and verification (Ongoing 3 years)
- Engage independent monitor (potentially agreed with DataSure in settlement)
- Quarterly compliance reporting
- Annual third-party algorithmic audits
- Public transparency reports

PHASE 4: BUSINESS RECOVERY (Month 12-36)

1. Client relationship restoration
- Transparency and communication on remediation
- Potentially enhanced service offerings or pricing adjustments for retention
- Proactive contract renewals with compliance commitments

2. Market repositioning
- Brand rehabilitation campaign
- Thought leadership on responsible AI
- Case study on compliance and remediation (turn crisis into credibility)
- Industry leadership in AI ethics and fairness

3. Operational improvements
- Integrate compliance into product development lifecycle
- Build organizational AI ethics and governance capabilities
- Develop competitive advantage from responsible AI positioning

ESTIMATED COSTS:

Settlement and compensation: €8-12M
Legal costs (external counsel, settlement, regulatory): €3-5M
Compliance program implementation: €1.75-3M
Crisis PR and communications: €500K-1M
Independent monitoring and audits: €400K-600K (over 3 years)
Potential residual regulatory penalties: €2-5M (mitigated from €12-23M)

TOTAL ESTIMATED COST: €16.15M - €26.6M over 3-year period

Compare to litigation/enforcement worst case: €50M-100M+ (penalties + damages + legal costs + reputational harm)

EXPECTED OUTCOME:

Probability of successful settlement: 65-75%
Residual regulatory exposure (some penalties likely despite settlement): 40%
Civil litigation exposure (some claims despite settlement): 30%
Business continuity maintained: 85-90%
Reputational recovery (partial): 60-70%

OVERALL ASSESSMENT:

Recommended strategy provides best risk mitigation relative to cost. Settlement with DataSure combined with proactive compliance and regulatory engagement provides controlled resolution with manageable financial impact and preserves business continuity.

No strategy eliminates all risk, but recommended approach minimizes exposure across all risk categories while positioning TechNova for long-term recovery and competitive advantage through responsible AI leadership.

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VI. CONCLUSION AND AUTHORIZATION REQUEST
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TechNova faces material legal and business risk arising from InsightPredict Analytics Platform's compliance gaps and discriminatory outcomes. Core allegations are substantially accurate based on internal technical investigation.

Recommended strategy: Comprehensive settlement with DataSure combined with proactive compliance remediation and regulatory engagement.

Estimated total cost: €16-27M over 3 years

Alternative of defending/litigating carries substantially higher expected cost (€50M+) and lower probability of favorable outcome.

REQUESTED AUTHORIZATIONS:

1. Authorize engagement of specialized external legal counsel (budget: €200K initial, €3-5M total anticipated)

2. Authorize settlement negotiations with DataSure with authority to settle up to €12M total (compensation fund + payment), subject to acceptable forbearance terms

3. Authorize budget of €2-3M for compliance remediation program implementation

4. Authorize engagement of crisis PR firm and implementation of communications strategy (budget: €500K-1M)

5. Authorize proactive engagement with regulatory authorities as described

TIME SENSITIVITY:

DataSure has indicated intent to file regulatory complaints by October 1 if no settlement discussions initiated. Immediate action required.

Respectfully submitted,

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Rebecca Zhang, Senior Legal Counsel

Reviewed and endorsed:
Sarah Mitchell, General Counsel

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