The EU AI Act's extra-territorial scope — Part 2

In their second series of articles on the EU AI Act, Tim Hickman, Partner, and Thomas Harper, Associate, at White & Case LLP, explore the broad scope of the AI Act and its impact on the data processing activities of organisations based outside of the EU

The EU's Artificial Intelligence Act (the 'AI Act') has recently been approved by European lawmakers and is subject to final checks before publication in the Official Journal. In Part 1 in this series, we explored the AI Act's definition of 'AI systems', and concluded that the uncertainties arising from that definition are likely to pose a major challenge for organisations seeking to understand whether their data processing activities fall within the scope of the AI Act or not. In that article, we noted that Article 2 (5b) of the AI Act states that the AI Act 'shall not affect' the GDPR, but the AI Act nevertheless imposes potentially substantial compliance obligations on data processing activities that involve the use of AI systems.

In this article, we explore the scope of the AI Act, and examine its impact on the data processing activities of organisations based outside of the EU.

Regulated roles

The GDPR primarily imposes compliance obligations on two categories of defined roles: controllers and processors. The AI Act, on the other hand, imposes compliance obligations on a much larger range of defined roles or entities, each of which has a complex definition:

Providers: The organisation that first develops an AI system or general purpose AI ('GPAI') model, under its own name or trademark, is the 'provider'. A provider falls within the scope of the AI Act where it:

- makes an AI system or GPAI model available on the EU market for the first time;
- supplies an AI system or GPAI model for a deployer to use or for its own use in the EU market; or
- where the output of its AI system is used in the EU.

Providers that meet any of these criteria must comply with the AI Act irrespective of their place of establishment and location, and whether the AI system or GPAI is provided for payment or free of charge.

Deployers: Any organisation that uses an AI system (except where the AI system is used in the course of a personal non-professional activity) is a 'deployer'. A deployer falls within the scope of the AI Act where it is established or located in the EU.

Importers: Any organisation located or established in the EU that places an AI system on the market which bears the name of an entity established outside of the EU is an 'importer'.

Distributors: Any organisation, other than a provider or importer, which provides AI systems or GPAI models for distribution or use on the EU market, is a 'distributor'. The distributor does not need to be the first organisation in the AI value chain that releases the AI system or GPAI model to the EU market.

Product manufacturers: The concept of a 'product manufacturer' is not explicitly defined in the AI Act, but is instead defined in the EU harmonisation legislation listed in Annex I to the AI Act. Product manufacturers are caught under the AI Act's scope of applicability where they provide, distribute or use AI systems in the EU market together with their products and under their own name or trademark.

Authorised representatives: Authorised representatives function as intermediaries between providers outside of the EU, and EU authorities and consumers. An 'authorised representative' is any organisation in the EU that has accepted a written mandate from the provider, to carry out the provider's obligations with respect to the AI Act.

Extraterritorial effect

The concept of extraterritorial application will be familiar to anyone who has encountered Article 3 of the GDPR. Article 3(2) is reasonably tightly focused on entities that are established outside the EU, and that are either 'offering' (i.e., targeting or customising their services) to individuals in the EU, or monitoring the behaviour of such individuals. The AI Act, on the other hand, has a much broader approach. Recital 11 states:

"[…The AI Act] should also apply to providers and deployers of AI systems that are established in a third country [i.e., outside the EU], to the extent the output produced by those systems is

intended to be used in the [EU]."

Article 2(1)(c) of the AI Act then explains the same concept using slightly (but materially) different language:

"[The AI Act] applies to: […] providers and deployers of AI systems that have their place of establishment or who are located in a third country [i.e., outside the EU], where the output produced by the system is used in the [EU]."

Recital 11 to the AI Act indicates that a provider or deployer outside the EU is subject to the AI Act if it intends that the output of its AI systems will be used in the EU. However, Article 2(1)(c) of the AI Act removes any element of intent, and instead states that a provider or deployer outside the EU is subject to the AI Act if the output of its AI systems is used in the EU (seemingly regardless of whether this was intended or not). While the AI Act does not explicitly define 'output', it provides the example of 'predictions, content, recommendations, or decisions'.

Whereas the GDPR applies to an entity outside the EU in circumstances in which that entity has attempted to do something that is at least partly aimed at the EU, the AI Act appears to apply even were the provider/deployer has made no attempt to aim its activities at the EU. Instead, it appears (on a literal reading of Article 2(1)(c) of the AI Act) that a provider/deployer outside the EU may be subject to the AI Act if the output of that provider/deployer's AI systems is used in the EU, even where the provider/deployer does not intend such use.

It may be helpful to illustrate this with a practical example: Company A is a graphic design company based in the UK. Company A uses commercially available AI image generation tools as part of its creative process for generating logos and artwork for customers. Customer B is based in Morocco, and decides to hire Company A to create a logo for its business. After the logo is provided by Company A, Customer B opens an office in France, and uses the logo to market its services in France.

Applying the AI Act: Company A is a 'deployer' of the AI system that it uses to produce the logo; the logo seemingly amounts to 'content' (within the definition of 'AI system' in Article 3(1) of the AI Act) and therefore appears to be 'output'; and the logo is used in the EU by Customer B. Therefore, applying Article 2(1)(c), the AI Act applies to Company A in this example, even though Company A did not know that the output of the relevant AI systems would be used in the EU.

It also does not appear that there is any way for Company A to prevent this outcome. For example, Company A could contractually prohibit Customer B from using the logo in the EU. However, if Customer B breached that contractual obligation, and used the logo in the EU, a literal reading of Article 2(1)(c) of the AI Act unavoidably leads to the conclusion that Company A would automatically fall within the scope of the AI Act (even though it had done everything it reasonably could do to avoid this outcome).

The net effect appears to be that every organisation that acts as a provider or deployer of an AI system anywhere in the world is at risk of falling within the scope of the AI Act, based on factors that will (in many cases) be beyond that organisation's control. As a result, the AI Act appears to have exceedingly broad territorial scope, and until further clarification is provided, it will be very hard for non-EU organisations to assess the extent to which they are subject to the AI Act.

Conclusions

Recital 11 explains that the AI Act is intended to acknowledge the borderless opportunities of AI, prevent circumvention, and ensure effective protection of natural persons located in the EU. In this light, the AI Act is intended to ensure that organisations at all levels of the AI value chain are subject to the AI Act's requirements, often irrespective of jurisdiction.

However, the application of Article 2 (1)(c) of the AI Act is at best uncertain, and at worst aggressively expansive. In particular, it is not yet certain how the term 'output' will be interpreted. It is also uncertain whether the concept of 'intention' referenced in Recital 11 will play any part in the interpretation of Article 2(1)(c) (this would at least narrow the scope of Article (2)(1)(c), though it would also raise a number of new questions regarding the level of intent that was needed, and how such intent would be evidenced). Barring any further clarifications in the final text of the AI Act, such uncertainty appears unlikely to be resolved until further guidance is provided by relevant EU regulators and courts on this issue. In the meantime, non-EU based organisations using AI systems should adopt a cautious approach and keep an eye on developments in this space. This journal will continue to track the developments closely.

In Part 3, we consider enforcement and penalties under the AI Act.

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