

Evolution of AI Washing Enforcement: DOJ Enters the Picture

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On April 9, the US Department of Justice and Securities and Exchange Commission announced parallel cases against the founder and former CEO of an artificial intelligence startup for allegedly misleading investors about his former company's product capabilities. The cases are the latest salvo in regulatory focus on AI companies and their public statements about the products they offer.

Background

Last week, the DOJ charged the founder and former CEO of an AI startup with securities fraud and wire fraud for allegedly making false and misleading statements about the company's use of proprietary artificial intelligence and its operational capabilities.¹ This new AI prosecution follows our previous predictions that regulators are becoming increasingly consequential in circumstances where they believe companies make public statements to investors or customers about AI products. As attorneys at the DOJ and the SEC sharpen their understanding of AI, it is becoming clearer where lines can be drawn in developing cases in connection with statements about AI products.

This outcome is also notable because it seeks a meaningfully harsher result in a case that bears many similar facts to another recent investigation into public statements concerning an AI-based product, where only the SEC acted and on more modest terms. Just four months earlier, the SEC settled a matter alleging similar conduct and similar facts on the basis of negligent fraud, with no fines or financial penalties.² Four months later, both the DOJ and the SEC are pursuing criminal and civil fraud charges against the founder and former CEO of a company for allegedly similar conduct. These differences reflect the emerging confidence of DOJ to pursue criminal cases involving AI.

The New Case

The Saniger case concerns an e-commerce company, Nate Inc., which allegedly claimed to provide a simplified online shopping experience by way of an app powered by AI technology, whereby consumers could place orders across other e-commerce sites by using an app that could intelligently and quickly complete transactions across a number of platforms. According to the indictment, as the defendant told investors the company's shopping application used AI technology to intelligently and autonomously complete merchandise orders, the product instead relied on both bots and human contractors located in the Philippines and Romania, who manually completed the transactions.

The Saniger indictment specifically points to statements by the company and its former CEO describing the product as "fully automated and scalable" as misleading and alleges that at the same time the defendant made these representations, he was instructing employees to keep the product's reliance on overseas employees a secret and to take steps to prevent investors from discovering the nature of the technology. The indictment alleges that venture capital firms and other investors relied on the former CEO's statements that the product was "fully automated" and has a success rate ranging from "93% to 97%." It further claims that the defendant purchased the AI technology from a third party and hired a team of data scientists to develop it, but was unable to effectively improve it.

The DOJ alleges that Saniger "understood that the disclosure of" manual teams located abroad and processing orders would reveal his statements about the AI product to be false, and that the former CEO accordingly took steps to conceal information about those teams from investors. Specifically, the former CEO allegedly directed the contractor employees to remove any reference to the company from their social media, and also directed the manual teams to prioritize test transactions by potential investors so that investors experienced quick and reliable services. Finally, when public reporting by a trade journal exposed the use of human contractors to manually enter transactions, the former CEO claimed to investors that these were merely "human-in-the-loop" contractors retained for payments risk, data labeling, reinforcement learning, and edge cases. According to the DOJ, in truth, the company had failed to develop or deploy functional AI to automate customer purchases. The defendant has entered a plea of not guilty.

A Significant Escalation

As noted above, just a few months ago the SEC settled an investigation³ into a restaurant-technology company based on similar allegedly inaccurate statements about its own AI product. According to the Presto settlement, which Presto settled on a neither admit nor deny basis, despite telling investors that the company owned technology which was "fully automated" and eliminated the need for human intervention, the company failed to disclose that a third party owned some of the technology on which its product relied and failed to disclose that human beings were necessary for the product to complete transactions.⁴ The SEC investigation was later closed on a basis of negligent fraud, with no financial penalty or disgorgement required.⁵

The new case demonstrates an emerging pattern of increased seriousness with which the DOJ and the SEC are approaching cases involving AI products. It also suggests that when regulators feel they have sufficient evidence about ownership of technology, human intervention in AI products, and statements to investors that omit or fail to disclose those facts, they are more likely to pursue allegations of fraud against a company or individual. Companies that offer technological products promoted as having an AI component—or as being entirely comprised of AI—should retain experienced counsel when facing regulatory inquiries regarding the product's property ownership, the degree of automation, or the degree of human being interaction needed to operate such products. We will continue to cover developments related to regulatory interest in the AI industry.

1 United States v. Saniger, 25-cr-____, available here.

2 Press Release, SEC Charges Restaurant-Technology Company Presto Automation for Misleading Statements about AI Product (Jan. 14, 2025) available here [hereinafter Press Release].

3 In the Matter of Presto Automation, Inc., File No. 3-22413 (Jan. 14, 2025) available here.

4 Press Release, *supra* note 2.

5 Upon learning of the inquiry, the Company retained counsel, White & Case, which represented Presto in this matter.

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