GRUENSTEIN LAW

NOVEMBER 11, 2026

LESSONS FROM CHARACTER.AI

A Compliance Blueprint for Consumer AI Companies

Benjamin Gruenstein
Isaac Gelbfish

A bipartisan coalition of 40 state attorneys general has notified the bankruptcy court overseeing Character.AI's Chapter 11 case that any buyer of the company or its user data should be "prepared to implement appropriate processes and procedures to comply with regulatory requirements," including nine specific conditions.[1] Those conditions are the most detailed statement yet of what state regulators expect from consumer AI chatbots, in particular "companion" chatbots, and they are relevant well beyond this case.

BACKGROUND

Character.AI is a companion and role-play chatbot app that had, at its peak, more than 20 million monthly active users. Users could talk to, and create, AI "characters": figures from TV shows, celebrities, historical people, tutors, "therapists," romantic partners, among others. Two former Google researchers, Noam Shazeer and Daniel De Freitas, founded it in November 2021. Shazeer was the co-author of the 2017 paper that introduced the transformer architecture behind today's large language models. In August 2024, Google reportedly paid about $2.7 billion to license Character.AI's technology and rehire Shazeer and De Freitas.

The product was designed for engagement and the company said users averaged about two hours a day on it. The minimum age in the U.S. was 13, and by the company's own records more than 2.1 million U.S. accounts had a declared age under 18 as of March 2025. Persistent personas, romantic role-play, user-created "therapists" and a young, highly engaged user base made the company an unusually clear target for plaintiffs and regulators.

PRIVATE LITIGATION AND STATE ENFORCEMENT

Between October 2024 and September 2025, families filed five lawsuits against Character.AI over the suicide, attempted suicide or serious harm of six children. In the lead case, *Garcia v. Character Technologies*, a federal court in Florida declined in May 2025, at the pleading stage, to hold that the bot's output is protected speech and further allowed the product-liability and design defects claims to proceed. In January 2026, Character.AI, its founders and Google agreed to settle all five cases. Meanwhile, states took their own action, including Kentucky's first-of-its-kind consumer-protection suit in January 2026 and a Pennsylvania medical-board suit in May 2026 over a bot posing as a psychiatrist licensed in Pennsylvania.

[1] *See* Notice of Interest and Reservation of Rights by the Coalition of the State Attorneys General Regarding the Debtor's Outstanding Regulatory, Safety, and Privacy Issues, *In re Character Techs., Inc.*, No. 26-11603 (BLS) (Bankr. D. Del. Oct. 14, 2026), Dkt. 33.

Character.AI responded to the pressure. In October 2025 it announced it would end open-ended chat for users under 18 (effective November 2025) and add age assurance. By then its user base was shrinking, and the changes cut off some of its most engaged users. Several other states had also opened investigations, issuing subpoenas and civil investigative demands, and worked with the company toward agreed terms but did not reach a resolution before the bankruptcy.

THE BANKRUPTCY

On October 12, 2026, Character.AI filed for Chapter 11 in the U.S. Bankruptcy Court for the District of Delaware. Two days later, the bipartisan coalition of 40 attorneys general filed its Notice of Interest.

The notice describes the states' findings as "chatbots posing as licensed professionals; minor exposure to explicit sexual content, self-harm, violent, and other harmful Chatbot conversations; insufficient age assurance practices; misrepresentations concerning product safety; and failure to comply with state comprehensive privacy laws," all of which the states say "may constitute violations" of state law. (Dkt. 33 ¶ 23.) These are allegations that have not been proven in a judicial or consensual process.

The notice further states the company marketed Character.AI "as a harmless interactive entertainment platform" while "knowing that its chatbots posed serious safety risks" and that it built its characters "to create emotional bonds with users, and to induce users to divulge their most private thoughts and emotions." (*Id.* ¶ 2.)

THE NINE CONDITIONS

In light of these allegations, the states listed nine "processes and procedures" that any purchaser of the company, the app or the user data should "be prepared to implement." (*Id.* ¶ 25.) **In substance, the nine conditions resemble the forward-looking terms the states would likely have sought in a settlement had the bankruptcy not intervened.**

Together these conditions are the closest thing yet to a state regulators' checklist of compliance requirements for "companion" AI products, and many of them apply to consumer chatbots more broadly. Companies would be well served by studying these conditions, quoted below, and adopting measures to ensure compliance with them.

STATE AG CONDITIONS	KEY TAKEAWAYS
1. "Age assurance. Implementing and maintaining effective age-verification or age-assurance measures that do not rely solely on self-declared birthdates."	If minors are a foreseeable part of your user base, **a birthdate field alone may not satisfy regulators**. Choose an age-assurance approach suited to your product's risk.
2. "Protections for minors. Maintaining restrictions on minors' access to open-ended chats and safeguarding minors from sexual, violent, and other harmful content in Stories and non-chat product offerings."	Regulators may judge restrictions by the **weakest entry point**. For example, the Attorneys General point to testing in which teen users circumvented the under-18 chat ban (e.g., by switching to voice mode).
3. "Removal of misleading chatbots. Removing characters that hold themselves out as therapists, psychologists, doctors, attorneys, or other licensed professionals."	Implement controls to **prevent chatbots from holding themselves out as licensed professionals**, particularly medical and mental-health providers.

STATE AG CONDITIONS	KEY TAKEAWAYS
4. "Crisis safeguards. Maintaining content moderation and crisis-response protocols that detect and respond to self-harm, suicide, eating-disorder, and substance-abuse content and that cannot be defeated with a simple click-through."	Regulators expect **safeguards that work across a whole conversation, not a single keyword trigger**. Expect regulators to scrutinize these safeguards, in particular as they relate to self-harm or conversations with minors.
5. "Privacy Program. Implementing and maintaining a Privacy Program that includes reasonable safeguards, accurate disclosures, risk assessments, and required consent requirements, including prior to the processing of sensitive data such as health information disclosed in chats."	**Treat chat logs as presumptively sensitive** where users volunteer health and intimate information. A company's privacy program, consent flows and risk assessments should be proportionate to the sensitivity of what users actually share with the chatbot and the risks it creates, not only to the data fields the company collects.
6. "Advertising opt-outs. Disclosing any sale of personal data or disclosure for targeted advertising, providing functional opt-out mechanisms that apply at the account level rather than device by device, and honoring opt-outs consumers previously exercised."	As personal AI assistants use connectors to reach users' email, calendars, files and other accounts, the volume and sensitivity of the data they handle grow dramatically. Regulators may continue to expect **explicit, easy-to-use opt-outs and opportunities to delete data that attach to the person** and survive device changes, product changes and a change of ownership. Expect similar focus by regulators on disclosures and consents regarding the collection and use of such data.
7. "Limits on secondary use. Refraining from using chat content and related data to train or fine-tune models, or for advertising or other commercial purposes, beyond the uses to which consumers and parents validly consented."	
8. "Access and deletion. Maintaining consumers' ability to access the data held about them and allowing all consumers the opportunity to delete their data prior to any sale of that data."	
9. "Truthful marketing. Refraining from false or misleading representations about the product's safety, its suitability for minors, whether its characters are human, or any character's professional credentials."	Regulators treat **what your bots say, and what your executives say about safety, as what your company says**. Test what bots say about privacy, safety and credentials against your actual policies.

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