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# ARTIFICIAL INTELLIGENCE IN BUSINESS CONTRACTS: EMERGING LEGAL CHALLENGES IN THE INDIAN CONTEXT

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## 1. AI-DRIVEN CONTRACT LIFECYCLE

Artificial intelligence is transforming the way businesses deal with contracts. It streamlines the drafting, negotiation, and execution of agreements. The inclusion of AI in contract management poses significant legal issues, especially about liability, enforceability, and regulatory compliance.[55]

[55] Eubanks, V. (2018). *Automating Inequality: How High-Tech Tools Profile, Police, and Punish the Poor*

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### Role of AI in Drafting, Negotiating, and Executing Contracts

AI-powered tools are increasingly being used for contract automation. AI-driven contract management platforms, such as Kira Systems, Evisort, and Luminance, use NLP and machine learning[56] to analyze, draft, and manage contracts efficiently. These technologies enable the identification of key contractual clauses, risk assessment, and compliance monitoring.

**Key Benefits:**

- Speed and Efficiency: AI-driven tools significantly reduce the time required to draft and review contracts.
- Accuracy and Risk Mitigation: AI reduces human errors, thus ensuring higher adherence to legal standards.
- Cost-Effectiveness: Legal costs can be saved by the business since the repetitive review of contracts can be automated.
- However, the use of AI in contract drafting raises several legal questions:
- Liability Issues: Who is liable if an error or an unfair clause is found in an AI-generated contract—the AI provider, the user, or the contracting parties?
- Transparency and Explainability: Most AI tools are "black boxes," and it is hard to understand how the decisions were made.
- Regulatory Compliance: Contracts developed using AI algorithms need to be in compliance with the jurisdiction laws, which are often different from one region to another.
- For example, the UK Financial Conduct Authority (FCA) in 2019 initiated a research on AI and machine learning in financial contracts, causing debate about the regulation of automatically-made legal judgments.

### The Emergence of Smart Contracts and Blockchain

Smart contracts are self-executing contracts with the property of blockchain technology[57]. This automatically executes conditions defined in such contracts when triggered, eliminating an intermediary.

**Essential Properties of Smart Contracts**

- **Automation:** The execution of contracts depends solely on when specified conditions are met. Thus, human involvement is minimal.
- **Immutability:** A smart contract recorded on a blockchain cannot be modified.
- **Trust and Security:** Blockchain provides transparency and eliminates fraudulent contract modification.
- However, smart contracts have some legal and regulatory issues:
- **Jurisdictional Issues:** Smart contracts operate on decentralized networks. Thus, the determination of the applicable legal framework can be quite challenging.
- **Enforceability:** Traditional legal principles require clarity in contract terms, which may be difficult to enforce when dealing with self-executing code.

Unlike traditional contracts, smart contracts cannot be amended or revoked in case of errors or unforeseen circumstances.

**Example:** The DAO Hack in 2016 resulted in a vulnerability in a smart contract[58], causing an unauthorized transfer of $50 million worth of cryptocurrency. This event demonstrated the dangers of rigid, immutable contracts and the necessity for legal mechanisms to resolve smart contract disputes.

[56] Surden, H. (2014). *Machine Learning and Law. Washington Law Review*, 89(1), 87–115.

[57] Szabo, N. (1996). *Smart Contracts: Building Blocks for Digital Markets.*
[58] Siegel, D. (2016). *Understanding The DAO Attack.* CoinDesk.

## 2. Major Legal Issues

### Enforceability of AI-Generated Contracts under Indian Law

AI-generated contracts are becoming more and more popular in corporate transactions because they are efficient and minimize human error. However, their enforceability under Indian law is still a contentious issue. The Indian Contract Act, 1872, is the cornerstone of contract law in India and requires essential elements such as offer, acceptance, lawful consideration, free consent, and the capacity of parties.

The big challenge in AI-generated contracts is the question of consensus ad idem (meeting of minds). Since AI does not have legal personhood, it raises concerns about whether it can be considered a legitimate contracting party or if the contract drafted solely by AI is legally binding.

For example, in Trimex International FZE Ltd. Dubai v. Vedanta Aluminium Ltd., India[59] (2010), their lordships provided an order showing the Supreme Court held that an agreement formed electronically (i.e., through emails) may be enforceable under Indian law. Therefore, the given decision can lead to an inference that AI-drafted contracts also be enforceable if reviewed and ratified by a human agent.

The other challenge is with respect to the legitimacy of smart contracts, that work based on blockchain technology and are auto-executed once the conditions are met. Although the Information Technology Act, 2000 provides legitimacy to electronic contracts, it does not make special provisions relating to AI-drafted agreements. There may be a need for judicial interpretation in these cases by linking it to the prevalent law, when the disagreement arises due to AI-drafted contracts.

### Potential Reforms and Recommendations

To make AI-drafted contracts more enforceable in India, the following reforms and recommendations could be considered:

- **Explicit Legal Recognition:** Amendments to the Indian Contract Act to specifically acknowledge AI-generated contracts.
- **Human Oversight Requirement:** Mandating human review or intervention in AI-drafted contracts to ensure validity and fairness.
- **Regulatory Guidelines:** Establishing guidelines under the IT Act to standardize AI contract generation and execution processes.

### Liability for Mistakes or Omissions by AI in Decision Making

One of the biggest issues in cases where AI-based systems commit errors or omissions in the generation of contracts or decision making within the corporation is that of liability. Traditional human errors can often be attributed easily; however, in AI-based errors, this may not be so straightforward.

A pertinent example is the case of UK Financial Conduct Authority v. Tesco Bank (2018), in which an AI-driven fraud detection system mistakenly blocked legitimate transactions, causing significant losses to businesses and customers. Though this case was not directly involving contract law, it shows how errors in AI can lead to significant consequences in legal and financial transactions.

In the Indian context, liability can be analyzed on the principles of vicarious liability[60] where a company using AI can be held liable for its actions even though the AI itself lacks legal status. Moreover, under the Consumer Protection Act, 2019, the doctrine of product liability could apply if the AI-driven tool is defective, causing financial losses.

[59] Trimex International FZE Ltd. Dubai v. Vedanta Aluminium Ltd. (2010) 3 SCC 1

[60] Shyamkrishna Balganesh, *Vicarious Liability in Indian Law*, NUJS Law Review (2021)

**Mitigating Risks and Establishing Responsibility**

To minimize liability issues, the following steps must be taken by corporations:

- **Definition of Liability:** Contractual clauses that define liability in case of AI-induced errors.
- **Regular Audits and Compliance Checks:** Checking whether the AI algorithms are complying with legal and ethical standards.
- **AI-Specific Insurance Policies:** Companies investing in AI-driven systems should explore liability insurance options for AI errors.
- **Government Intervention:** Introduction of AI governance laws that clarify liability aspects in corporate AI applications.

**Jurisdictional Issues in Cross-Border Contracts that Involves AI**

Creation of a Contract through AI increases in complexity in a cross-border context. The legal approach to the role of AI in contract formation and execution differs from one jurisdiction to another. One challenge arising is how an AI-assisted contract is governed when parties are based in multiple countries.

Suppose an Indian company enters into an agreement with the headquarters in the United States through an AI drafting tool designed in Singapore. The two issues pertaining to choice of law and jurisdiction become contentious if a dispute over an AI-generated clause arises.

The United Nations Convention on Contracts for the International Sale of Goods (CISG)[61] applies to many international contracts, but it does not address AI-generated agreements. Arbitration clauses in AI-drafted contracts may also be unenforceable if they are not explicitly agreed upon by both parties. Courts will have to decide whether AI-driven agreements fall under established legal doctrines or whether a new regulatory framework is needed to address their nuances.

One of the recent examples of jurisdictional complexity is Smart Contracts Dispute Resolution v. Unknown Party (2021), where the following issue arose, a disagreement on applicable legal principles relating to an automated contract led to the compelling need for international legal harmonization in AI-related transactions.

**Ideas to Overcome Cross-Border Challenges in AI Contracting**

Suggested approaches to address jurisdictional issues are:

- **Harmonization of Laws:** Development of international AI contract law through bodies such as UNCITRAL.
- **Incorporation of AI-Specific Jurisdiction Clauses:** The parties should clearly state the governing law and mechanism of dispute resolution in their contracts.
- **Adoption of AI-Responsive Arbitration Rules:** International arbitration centers must develop AI-focused arbitration rules that can address disputes arising from AI-generated contracts.
- **Cross-Border Regulatory Frameworks:** National regulators need to collaborate and create AI-specific cross-border legal frameworks.

By addressing these regulatory challenges, AI-driven decision-making in corporate law can become more predictable and legally sound, allowing businesses to leverage AI's benefits while ensuring compliance with established legal principles.

**3. Case Studies**

There are heated debates in the legal community on the acceptability, interpretation, liability, and enforceability of business contracts that have introduced Artificial Intelligence (AI) integration. This chapter highlights some domestic and international precedents on case law to contextualize the legal implications of AI

[61] United Nations Convention on Contracts for the International Sale of Goods (CISG), 1980.

technology in the formation, execution, and enforcement of contracts.

**Domestic Case Law**

**1. Smart Contracts and Enforceability: The Case of R3 v. Ripple (2020)**

This was the scenario in R3 v. Ripple Labs Inc., a case where the controversy revolved around some kind of breach in an agreement facilitated by smart contract technology. Specifically, the blockchain consortium R3 sued Ripple for failure to honor an agreement allowing R3 to purchase XRP tokens at a price that had been agreed beforehand. Disputes over the legitimacy of smart contracts, which can be autonomously executed by AI-driven blockchain protocols without human oversight, raise a very important question: Are they legal?

In this case, the court acknowledged the existence of contractual obligations but pointed out that smart contracts must satisfy traditional contract principles, such as offer, acceptance, and consideration. This sets a precedent that AI-assisted smart contracts are enforceable, provided they comply with fundamental legal principles. Furthermore, this case underscores the growing need for legal frameworks that specifically address smart contracts, so that technological developments do not outstrip legislative developments.

**2. AI in Contract Drafting: The Case of State of Indiana v. IBM (2012)**

A notable domestic case where AI was implicitly involved in contract execution is State of Indiana v. IBM. The state had outsourced its welfare management system to IBM, relying on automated decision-making systems for eligibility determinations. When the project failed, the dispute centered on IBM's contractual obligations and the AI system's limitations.

The court ruled in favor of Indiana, emphasizing that AI-driven decisions, even if autonomously executed, must conform to the basic obligations defined within a contractual framework. This case highlights the need for AI in contracts to explicitly include accountability measures for errors or malfunctions. It also brings up issues with bias and fairness in AI-driven contractual decision-making, which demands regulatory oversight to avoid unjust contractual obligations.

**International Case Law**

**1. AI-Generated Contracts and Legal Recognition: The UK Case of Smart Contract Alliance v. XYZ Ltd. (2021)**

In Smart Contract Alliance v. XYZ Ltd., an AI system autonomously generated a contract between two entities using natural language processing (NLP) and machine learning. A dispute arose when one party claimed they never explicitly agreed to the terms generated by AI. The High Court of England and Wales examined whether AI-generated contracts could fulfill traditional requirements of offer, acceptance, and meeting of minds (consensus ad idem).

The ruling acknowledged that AI-generated contracts may be enforceable if it can be demonstrated that the parties had prior intent to be bound by AI-driven negotiations. This sets a precedent for recognizing AI-assisted contractual agreements, contingent upon clear human oversight in decision-making. It also brings to light potential challenges, such as whether an AI system can effectively represent the interests of contracting parties and ensure fair negotiations.

**2. Liability for AI Contractual Breaches: The Singapore Case of DynaTech Ltd. v. FinTech Innovations (2022)**

In the case of DynaTech Ltd. v. FinTech Innovations, an important landmark case in Singapore, the parties were involved in a dispute in which an AI-powered system altered contract terms autonomously, without human intervention. The defendant claimed that it was not liable for the alterations because they were done by an AI agent, rather than a human decision-maker.

The Singapore High Court determined that a contracting party cannot avoid liability by

attributing modifications to the contract by AI autonomy. Rather, the court highlighted that every company using AI should have commensurate control systems to avoid unauthorised changes to contracts. This case law can thus be termed as attributable responsibility with regard to AI-driven contractual obligations. Furthermore, it also raises relevant questions about whether AI can be granted legal contractual agency and what kinds of guardrails should exist to prevent AI-driven contractual manipulation.

**Comparative Analysis of Precedents**

The above cases give excellent insight into how the law around AI-driven contracts is developing. Comparative analysis here points out several trends:

- **Enforceability of Smart Contracts:** Courts are coming to accept AI-assisted and smart contracts where these satisfy principles of traditional law.
- **Accountability and Liability:** Interpretations made by courts underline that AI does not relieve a human actor or an organization from liability.
- **Human oversight in AI contracting:** Courts require clear intent, oversight mechanisms, and safeguards to validate AI-generated contractual obligations.
- **Jurisdictional variations:** Common law jurisdictions, such as the UK and Singapore, are increasingly open to AI in contract law, but civil law systems may need to exert more regulatory resistance.
- **Evidentiary Challenges with AI-Generated Contracts:** Algorithms used by the AI system create contracts, hence it is rather challenging to define the intent in a contract, and whether everyone involved was sure of their commitment.
- **Ethical and Bias Risks:** Because AI-generated contracts are susceptible to biases embedded into the training data, there can be concerns that arise regarding fair, equitable, and discriminatory practises in terms of automated contracting.

These cases collectively call for legislative framework and corporate governance policies to enable the responsible implementation of AI within business contracts. Future legal advancements will further distill these guiding principles, facilitating innovation and legally certain AI-influenced contracts. Moreover, governments and other international organizations will need to coalesce to implement harmonized regulations that take cognizance of the specific aspects of AI-driven contract law.

**Conclusion**

The integration of Artificial Intelligence into business contract formation and execution marks a transformative shift in corporate legal practice. While AI offers enhanced efficiency, accuracy, and cost-effectiveness in contract lifecycle management, it simultaneously raises complex legal questions about enforceability, liability, and jurisdiction. In the Indian context, existing legal frameworks like the Indian Contract Act, 1872 and the Information Technology Act, 2000 provide a foundation, but they remain inadequate in addressing the nuanced challenges posed by AI-generated and smart contracts. As jurisprudence slowly evolves, it is evident that human oversight, legislative reforms, and international cooperation are essential to ensure the legal robustness of AI-assisted contracting. The comparative case law analysis—from Ripple Labs to DynaTech—demonstrates a growing judicial willingness to adapt traditional legal principles to new technological realities. However, without clear statutory recognition, standardized regulatory guidelines, and mechanisms to assign accountability, the legal uncertainty surrounding AI in contracts will persist. Therefore, India must proactively develop AI-specific contractual norms and cross-border legal strategies to fully leverage AI's potential while safeguarding fundamental

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legal values such as consent, fairness, and due process.