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The Impact of AI in Contract Formation and Enforcement

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ABSTRACT

Artificial Intelligence (AI) is revolutionizing various facets of modern life, and its influence on contract formation and enforcement is increasingly profound. This abstract explores how AI technologies are reshaping traditional practices, both in the creation and execution of contracts, highlighting key benefits, challenges, and ethical considerations. In the realm of contract formation, AI facilitates efficiency and accuracy through automated drafting and review processes. AI-powered tools analyse vast repositories of legal data, extracting relevant clauses and precedents to aid lawyers in crafting contracts tailored to specific needs. This not only accelerates the drafting phase but also enhances the quality by minimizing errors and inconsistencies. Moreover, AI's ability to predict outcomes based on historical data helps parties anticipate potential disputes, thereby enabling proactive risk management strategies. Furthermore, AI enhances contract enforcement mechanisms by streamlining monitoring and compliance processes. Smart contracts, enabled by blockchain technology and AI, automatically execute contractual terms when predefined conditions are met, reducing the need for intermediaries and ensuring transparency. This automation minimizes delays and disputes, offering parties greater confidence in the enforceability of agreements. However, the integration of AI in contract practices also presents challenges. Ethical concerns arise regarding the accountability and bias of AI algorithms used in contract drafting and decision-making processes. Ensuring transparency and accountability in algorithmic decision-making is crucial to maintaining fairness and trust in contractual relationships. Moreover, the proliferation of AI raises legal questions about liability in cases of AI errors or failures. Who bears responsibility when an AI-powered contract drafting tool generates flawed terms or when autonomous systems execute contracts erroneously? Addressing these legal ambiguities requires careful consideration and potentially new regulatory frameworks to adapt to the evolving landscape of AI technologies. This abstract provides a foundational overview of the impact of AI on contract formation and enforcement, setting the stage for deeper exploration into specific implications and considerations in the legal and technological realms.

Keywords: AI, Contract Formation, Accuracy, Efficiency, Historical Data, Streamlining, Monitoring, Blockchain Technology, Smart Contracts.

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I. INTRODUCTION

Only few companies do contracting efficiently and effortlessly even though contracting is a very common activity. Depending on circumstances it has been estimated that firms may incur losses between 5% to 40% if the contracting is insufficient. These challenges can be overcome with the help of technological developments like (Artificial Intelligence) AI². AI's influence on contract formation can be traced back to the late 20th century when early AI applications began automating repetitive tasks in legal document preparation. These systems, often rule-based and reliant on structured data inputs, helped streamline the drafting process by generating standard contract clauses and templates. However, their capabilities were limited compared to contemporary AI systems.

The innovation of blockchain technology has resulted in the smart contracts to self-execute the programmable agreements when the predefined conditions are met. Potential of Smart contracts is quickly recognized by the financial service industries for streamlining process and reducing transaction cost.³ While presenting openings, the use of AI to draft, form, or apply contracts presents numerous pitfalls or regulators for Attorneys and especially for vulnerable parties. While these social justice issues aren't new, AI further amplifies shafts and further polarizes asymmetrical connections.⁴

II. THE IMPACT OF AI IN CONTRACT FORMATION

(A) Capacity and intent of parties to the contract:

a. Demerits:

- In a traditional contract law, the conformation of a contract requires that parties have legal capacity to enter into an agreement and collect assent. With AI determining capacity and intent becomes problematic as these systems are programmed to make opinions but don't retain legal personhood or independent intentions.⁵
- One of the fundamental requirements for a valid contract is that all parties must have the legal capacity to enter into it. AI-driven contract enforcement raises questions

² *How AI is changing contracts* (2020) *Harvard Business Review*. Available at: <https://hbr.org/2018/02/how-ai-is-changing-contracts> (Accessed: 28 July 2024).

³ Ofori, D.A. (2023) *Navigating the AI and web3 revolution: Emerging frontiers in contract law, Revolutionizing Contract Law: The Impact of AI and Web3*. Available at: <https://www.linkedin.com/pulse/navigating-ai-web3-revolution-emerging-frontiers-law-asare-ofori> (Accessed: 28 July 2024).

⁴ Martin-Bariteau, F. and Pavlovic, M. (2020) *Ai and contract law*, *SSRN*. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3730385 (Accessed: 28 July 2024).

⁵ Williamgalkin (2024) *AI impact on contract law*, *GalkinLaw*. Available at: <https://www.galkinlaw.com/blog/2024/05/ai-and-contract-law-navigating-new-challenges-in-the-digital-age/> (Accessed: 28 July 2024).

about whether AI systems can truly understand the legal implications and obligations of a contract. Current AI lacks the ability to fully comprehend complex legal nuances, which could undermine the validity of consent if one or more parties are AI entities.⁶

- Contracts often involve entities acting through human agents, such as corporations represented by officers or individuals with power of attorney. When AI acts autonomously to enter into contracts, questions arise about the authority and representation of these AI systems. Determining whether an AI agent has the legal authority to bind its creator or operator can be complex and varies significantly across jurisdictions.
- Contracts frequently involve commitments that require human capabilities, such as providing services or delivering goods. While AI can automate many tasks, there are limits to its physical and practical capacities. For example, an AI system promising real-time customer support might fail to meet human expectations during peak demand or when facing complex inquiries.
- Contract law often relies on the subjective intent of the parties to determine their obligations and interpretations. AI lacks subjective consciousness and cannot form intentions in the way humans do⁷. This raises concerns about whether AI can genuinely manifest the intent necessary for contractual agreements, potentially leading to disputes over the interpretation and enforcement of contract terms.
- AI decision-making can be influenced by biases embedded in algorithms or data sets used for training. If AI systems are tasked with interpreting or enforcing contracts, these biases could lead to unfair outcomes. For instance, AI systems might favour certain contractual interpretations or penalize certain parties based on historical data trends, without considering the broader context or equitable principles. Human intentions can evolve over time due to changing circumstances or new information. AI systems, however, typically operate based on predefined rules and data sets. This static nature may not adequately accommodate changes in the intent or expectations of the parties after the contract is formed, potentially leading to conflicts over performance or interpretation.

⁶ *Background, definition & basic principles* (no date) *Background, Definition & Basic Principles | Office of General Counsel*. Available at: <https://ogc.asu.edu/contracts/contracts-background-definition> (Accessed: 28 July 2024).

⁷ Harrison, P. (2024) *Is Claude Self aware, DEV Community*. Available at: <https://dev.to/cheetah100/is-claude-self-aware-1cgj> (Accessed: 28 July 2024).

b. Merits:

Even though there are various demerits, the impact of AI on capacity and intent of the parties to contract also have merits

- AI has streamlined the process of contract creation, making it more accessible to parties with varying levels of legal expertise. Tools like AI-powered contract generators can help individuals and businesses draft contracts that are legally sound and tailored to their specific needs. This enhances the capacity of parties to enter into contracts by reducing barriers related to legal knowledge and complexity. AI enables efficient due diligence processes by quickly analysing vast amounts of data. This capability enhances the capacity of parties to assess the viability and risks associated with potential contracts. AI tools can analyse financial statements, legal histories, and other relevant data points, providing parties with comprehensive insights into the capacity of their counterparts to fulfill contractual obligations.⁸
- AI helps parties maintain compliance with legal and regulatory requirements throughout the contract lifecycle. By continuously monitoring changes in laws and regulations, AI systems can alert parties to potential compliance risks. This proactive approach strengthens the capacity of parties to adhere to contractual obligations and mitigate legal liabilities.
- AI-powered NLP algorithms enhance the understanding of contractual terms and conditions, reducing ambiguity in interpretation. This capability is crucial for determining the intent of parties when disputes arise. AI can analyse language nuances and contextual clues to infer the intended meaning behind contractual provisions, thereby facilitating fair and accurate contract enforcement.
- AI-driven predictive analytics assess historical contract data and outcomes to anticipate potential disputes. By identifying patterns and trends, AI can predict the likelihood of disputes based on deviations from typical contract performance metrics. This capability enables parties to proactively address issues and resolve conflicts before they escalate, preserving the original intent of the contract.
- Smart contracts, facilitated by blockchain technology and AI, execute predefined terms automatically based on real-time data inputs. These contracts self-enforce

⁸ (No date) *Risk allocation and pricing approaches*. Available at: https://assets.publishing.service.gov.uk/media/60a388a9e90e07357baa83da/Risk_allocation_and_pricing_approaches_guidance_note_May_2021.pdf (Accessed: 28 July 2024).

through coded conditions, ensuring compliance without manual intervention. This innovation aligns with the original intent of parties by reducing the reliance on subjective interpretation and human error in enforcement. AI transforms contract enforcement by enhancing the capacity of parties to enter into agreements and clarifying the intent behind contractual obligations, ultimately promoting more efficient, reliable, and fair business transactions.

(B) Transparency and understanding to the contract:

a. Challenges faced :

- AI algorithms used in contract formation often operate as black boxes, meaning their decision-making processes are not readily understandable by humans. This opacity can lead to uncertainty about how decisions are reached, especially regarding complex legal matters and nuanced contractual terms. AI systems can inherit biases from the data they are trained on, leading to biased outcomes in contract formation. This is particularly concerning in sensitive areas like employment contracts or financial agreements, where fairness and equity are crucial. Ensuring AI systems are free from bias requires transparency in both the data used and the algorithms deployed.
- AI tools that generate contract language might produce verbose or overly technical terms that are difficult for non-experts to understand. This complexity can obscure the true meaning and implications of contractual clauses, potentially leading to misunderstandings or disputes. Legal contracts require precise language to convey rights, obligations, and responsibilities accurately. AI-generated contracts may inadvertently introduce ambiguities or inconsistencies that could undermine the enforceability of the agreement or lead to unintended consequences. Based on vast amount of data and predefined rules AI can generate complex contracts quickly.⁹ While this efficiency is beneficial, it can also result in contracts that are overly complicated or include unintended clauses. Understanding these contracts becomes crucial but challenging, especially when AI's involvement in drafting is not explicitly clear. Determining accountability for errors or failures in AI-generated contracts is complex. If a mistake is made by an AI system in drafting and interpreting a contract who bears the responsibility leaves as a question to all the AI users.¹⁰

⁹ Wolf, K. (1970) *Are you ready for the AI-powered law firm?*, *Filevine*. Available at: <https://www.filevine.com/blog/are-you-ready-for-the-ai-powered-law-firm> (Accessed: 28 July 2024).

¹⁰ *Artificial Intelligence and liability laws* (2024) *LAW Notes*. Available at: <https://lawnotes.co/artificial-intelligence-and-liability-laws> (Accessed: 28 July 2024).

- Integrating AI-driven contract management systems with existing legal and business processes poses technical and operational challenges. Careful planning and execution is required for ensuring seamless compatibility and interoperability with legacy systems.¹¹

b. Benefits Enjoyed:

- Transparency in AI contracts fosters trust between parties. When each party understands the terms and the AI's role, it becomes easier to collaborate effectively. Clear communication about AI capabilities and limitations ensures that all parties have realistic expectations, reducing potential conflicts and fostering a cooperative environment. Compliance with legal and regulatory requirements is made easier by having a clear understanding of the AI-related contractual terms.¹²
- Transparent contracts detail responsibilities and accountability measures, which are crucial for monitoring AI actions and outcomes. This clarity helps in holding parties accountable and ensures that the AI operates within agreed-upon boundaries. Transparent contracts help in identifying and mitigating risks associated with AI use. By understanding potential risks and explicitly stating them in the contract, parties can develop strategies to manage these risks. This proactive approach contributes to smoother contract enforcement by reducing the likelihood of unforeseen issues.¹³ A clear understanding of AI-related contractual terms aids in informed decision-making. Parties can assess the potential benefits and drawbacks of using AI, evaluate the feasibility of its implementation, and make strategic decisions accordingly. Transparency ensures that all parties are on the same page, leading to more effective and aligned decision-making processes.
- Transparency in AI contracts enhances performance by setting clear benchmarks and performance indicators. When parties understand what is expected, they can better align their efforts to meet these expectations. This clarity helps in monitoring AI performance and ensuring that it meets the contractual standards. In the event of a dispute, transparent contracts with well-understood terms provide a solid foundation

¹¹ ValueLabs (2024) *Legacy modernization: A comprehensive guide*, ValueLabs. Available at: <https://www.valuelabs.com/resources/blog/modernization/legacy-modernization> (Accessed: 28 July 2024).

¹² Pimentel, B. (2024) *How to responsibly use AI to address ethical and risk challenges*, Thomson Reuters Law Blog. Available at: <https://legal.thomsonreuters.com/blog/how-to-responsibly-use-ai-to-address-ethical-and-risk-challenges> (Accessed: 28 July 2024).

¹³ Lin, P. (2024) *The role of Generative AI in contract management*, *The Role of Generative AI in Contract Management*. Available at: <https://www.getaccept.com/blog/contract-management-generative-ai> (Accessed: 28 July 2024).

for resolution. Clear definitions and expectations reduce ambiguities, making it easier to identify the root cause of disagreements and resolve them efficiently. This not only saves time and resources but also helps in maintaining positive relationships between parties. Straightforwardness in agreements advances moral and dependable utilization of artificial intelligence.¹⁴ When the ethical considerations and responsibilities are clearly outlined, it encourages parties to adhere to ethical standards and use AI responsibly. This is particularly important in sensitive areas such as data privacy, bias, and discrimination.

- Transparent and well-understood contracts can be more flexible and adaptable to change. As AI technology evolves, the need for contract modifications may arise. Clear contracts facilitate smoother transitions and updates, allowing parties to innovate and adapt without significant disruptions. Companies that prioritize transparency and understanding in AI contracts can enhance their reputation and gain market confidence. Stakeholders, including customers, investors, and partners, are more likely to trust and engage with organizations that demonstrate a commitment to clear and fair AI practices. Clear and transparent contracts can prevent costly legal battles and financial losses. By minimizing ambiguities and ensuring mutual understanding, parties can avoid litigation and associated expenses. Additionally, clear terms help in securing financial agreements and investments by demonstrating reliability and foresight.

III. THE IMPACT OF AI IN CONTRACT ENFORCEMENT

(A) Attribution of liability:

- Attributing liability when using AI for contract enforcement presents significant legal ambiguities and challenges. AI's capacity for autonomous decision-making is frequently ignored by traditional legal frameworks.¹⁵ As AI systems can act without direct human intervention, determining who is responsible for errors, breaches, or other issues becomes complex. In order to clearly define liability in the context of AI, it is necessary to update existing laws and regulations to address this legal grey area.¹⁶ The complexity of AI systems, which often

¹⁴ *Benefits of a proactive enforcement strategy* (no date) *FasterCapital*. Available at: <https://fastercapital.com/topics/benefits-of-a-proactive-enforcement-strategy.html> (Accessed: 28 July 2024).

¹⁵ *Is it ethical to use AI for decision making in the legal system?* (no date) *Quora*. Available at: <https://www.quora.com/Is-it-ethical-to-use-AI-for-decision-making-in-the-legal-system> (Accessed: 28 July 2024).

¹⁶ Buhler, E. (2024) *G2's comments to the U.S. Copyright Office: Artificial Intelligence & Copyright*, *G2 Research Hub*. Available at: <https://research.g2.com/insights/g2s-comments-to-the-u.s.-copyright-office> (Accessed: 28 July 2024).

function as black boxes, complicates fault determination. If an AI system incorrectly enforces a contract or misses critical compliance requirements, tracing the root cause can be challenging. This complexity stems from the intricate algorithms and machine learning processes that drive AI decisions. Understanding whether the fault lies in the initial programming, data input, or unforeseen AI behaviour is crucial yet difficult. In many cases, liability for AI errors might need to be shared among multiple parties, including AI developers, providers, users, and possibly third parties. Each of these stakeholders plays a role in the AI system's functionality and application. Shared liability models, while fairer, can lead to intricate and prolonged legal battles as each party's level of responsibility is assessed.

- Contracts involving AI use may include specific clauses to address liability and indemnity issues. These clauses can outline the responsibilities of each party and provide mechanisms for resolving disputes related to AI errors. For instance, contracts might stipulate that AI providers indemnify users against certain types of losses, or vice versa. Creating such clauses necessitates careful consideration of potential dangers and precise boundaries for liability.¹⁷
- AI developers and providers might be held accountable for the reliability and performance of their systems. If an AI system fails to enforce a contract correctly due to flaws in its design or programming, developers could face liability claims. Ensuring that AI systems undergo rigorous testing and validation before deployment is essential to mitigate these risks. However, this also increases the burden on developers to prove the robustness and safety of their AI products. Users of AI systems, typically businesses or legal professionals, are also responsible for ensuring the proper use of these technologies. They need to understand the capabilities and limitations of AI systems and provide appropriate oversight. If users fail to monitor AI performance or rely on AI for tasks beyond its intended scope, they might be held liable for any resulting enforcement failures.
- Regulatory bodies are likely to respond to the challenges of AI liability with new

2024).

¹⁷ (No date) *Ai and insurance: Managing risks in the business world of ...* Available at: <https://www.herbertsmithfreehills.com/notes/insurance/2024-posts/ai-and-insurance-managing-risks-in-the-business-world-of-tomorrow> (Accessed: 28 July 2024).

guidelines and regulations. These regulations could mandate transparency in AI decision-making, requiring developers to provide explanations for AI actions. Additionally, regulators might impose standards for AI system testing and validation to ensure reliability. Proactive regulatory measures can help prevent legal disputes and promote responsible AI use. Insurance can assume a significant part in dealing with the dangers related with man-made intelligence responsibility.¹⁸ Ethical considerations play a crucial role in attributing liability for AI errors. Ensuring that liability models are fair and just is essential to maintain trust in AI systems. This involves addressing issues such as bias in AI decision-making, where certain parties might be unfairly disadvantaged due to inherent biases in AI algorithms. Ethical frameworks and standards can guide the development and implementation of AI systems to promote fairness and accountability. The way liability is attributed can significantly impact innovation in AI technology. Strict liability regimes might deter developers and companies from investing in AI due to the high risk of legal repercussions. Conversely, well-balanced liability frameworks that provide clear guidelines and reasonable protections can encourage innovation by offering a predictable legal environment. Striking the right balance is key to fostering technological advancement while ensuring accountability.

- As AI becomes more integrated into contract enforcement, case law and legal precedents will play a vital role in shaping liability standards. Early court decisions in disputes involving AI will set important precedents, influencing how future cases are judged. Legal professionals and policymakers need to closely monitor these developments to adapt legal frameworks and ensure they remain relevant and effective.

IV. LEGAL IMPLICATIONS

(A) Regulatory compliance:

AI-generated contracts must comply with existing legal frameworks, which may vary significantly across jurisdictions. Ensuring that AI systems adhere to laws governing contract validity, enforceability, and consumer protection is crucial. Regulatory bodies may need to

¹⁸ *Release of liability: The ultimate guide to crafting a solid release of liability* (no date) *FasterCapital*. Available at: <https://www.fastercapital.com/content/Release-of-Liability--The-Ultimate-Guide-to-Crafting-a-Solid-Release-of-Liability.html> (Accessed: 28 July 2024).

adapt laws to accommodate AI technologies, establishing guidelines for AI's role in contract formation and enforcement.

(B) Data privacy and security:

AI depends on immense measures of information to learn and decide.¹⁹ Protecting sensitive information within contracts and ensuring compliance with data privacy regulations (e.g., GDPR, CCPA) are critical. Safeguarding data integrity and preventing unauthorized access or breaches is paramount in AI-driven contract management systems.

(C) Liability and accountability:

Determining liability for errors or biases in AI-generated contracts poses challenges. If an AI system makes a mistake in drafting or interpreting a contract, who bears responsibility? Legal frameworks must clarify liability rules to protect parties affected by AI errors and ensure accountability among developers, users, and stakeholders.

V. Technological considerations:

(A) Data management and integration:

AI depends on enormous volumes of information to learn and pursue informed choices.²⁰ Ensuring quality data collection, storage, and integration from various sources is crucial for AI systems to generate accurate and reliable contract drafts. Data security measures must be robust to protect sensitive information within contracts.

(B) Scalability and performance:

In order to effectively manage varying volumes of contracts without sacrificing performance, AI systems ought to be scalable.²¹ Optimizing computational resources and leveraging cloud-based solutions can enhance scalability and adaptability to changing business needs.

VI. CONCLUSION

The integration of AI in contract formation and enforcement brings significant advantages, including enhanced efficiency, accuracy, cost savings, and improved compliance and risk management. AI's ability to automate repetitive tasks, analyse vast amounts of data, and provide

¹⁹ Sahota, N. (2024) *Leveraging AI for data-driven decision-making while safeguarding privacy and security*, *Forbes*. Available at: <https://www.forbes.com/sites/neilsahota/2023/12/06/leveraging-ai-for-data-driven-decision-making-while-safeguarding-privacy-and-security> (Accessed: 28 July 2024).

²⁰ Chimera, A. (no date) *How artificial intelligence can inform decision-making*, *The Enterprisers Project*. Available at: <https://enterpriseproject.com/article/2023/4/ai-decision-making> (Accessed: 28 July 2024).

²¹ Demchenko, M. and Borusiuk, Y. (2024) *AI software development: Tips for Scalability & Performance*, *nCube*. Available at: <https://ncube.com/ai-software-development-best-practices-for-scalability-and-performance> (Accessed: 28 July 2024).

data-driven insights transforms traditional contract processes, making them faster and more reliable. However, these benefits come with challenges such as legal ambiguities, complexities in determining fault, data privacy concerns, and ethical considerations. Effective management of these challenges requires clear legal frameworks, robust ethical standards, comprehensive training, and proactive regulatory measures.

As AI technology continues to evolve, striking a balance between leveraging its capabilities and addressing its risks is crucial. By fostering collaboration between legal professionals, AI developers, regulators, and users, the potential of AI in contract formation and enforcement can be maximized while ensuring accountability, fairness, and security. Ultimately, the thoughtful integration of AI in these processes promises to revolutionize contract management, driving innovation and efficiency while safeguarding legal and ethical integrity.
