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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.[1]

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[2] 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?

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

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

- 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[3]. 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.

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[4] (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

[3] Szabo, N. (1996). *Smart Contracts: Building Blocks for Digital Markets*.
[4] Trimex International FZE Ltd. Dubai v. Vedanta Aluminium Ltd. (2010) 3 SCC 1

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[5] 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.

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.

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

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.

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