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# AI IN CONTRACT LAW: NAVIGATING LEGAL CHALLENGES AND OPPORTUNITIES IN THE DIGITAL ERA

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## I. ABSTRACT

The use of Artificial Intelligence in contract law has had a profound change in the process of contract formation and enforcement. Thus, this research paper explores the dynamic nature of the adoption of AI in the context of contract law and specifically within the Indian legal system. Beginning with the historical evolution of contract law in India, the paper highlights the shift from manual to advanced AI-based approaches. AI has progressed basic automation tools to sophisticated systems for tasks such as like writing, negotiating, and reviewing contracts.

With the rise of smart contracts, particularly those propelled by Artificial intelligence, questions arise regarding their enforceability as contract, consent between the parties, and liability issues. The research focuses on the issues of enforceability of contracts concluded with the assistance of artificial intelligence, including the legal recognition of artificial intelligence as a contracting party and the legal validity of the contracts concluded with the use of artificial intelligence.

It also considers distribution of liability in AI-assisted contracts, looking at how blame is apportioned where AI is implicated in contract violation. Furthermore, the paper compares national and international jurisdictions to illustrate the landscape of AI-related contractual disputes and potential legal outcomes.

The paper concludes by analyzing the prospects and implications of Artificial Intelligence in the field of contract law. It emphasizes the need for changes in legal rules related to AI, ethical considerations, and judicial adaptations necessary to address AI-related issues. The consideration of AI in contract law emphasizes the necessity for

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legal innovations while AI requiring legal reforms that promote justice and fairness in contractual relationships. This paper provides a comprehensive analysis of how AI is progressively integrating into the legal framework of contract law and identifies key areas for further research and application.

In this research, we utilized a qualitative approach, conducting a thorough review of literature, case laws, and legal frameworks to assess the impact of AI on contract law and explore emerging legal challenges.

## II. KEYWORDS

Artificial Intelligence (AI), contract law, smart contracts, liability in AI Contracts, and enforceability of AI contracts.

## III. INTRODUCTION

In a world where there is a seamless stream of scientific breakthroughs, particularly in the areas of technology, Artificial Intelligence can be regarded as an innovation that heralds a new generation in computer technology. AI can be defined as a system's capability to emulate human beings or undertake tasks that require intelligence<sup>3</sup>, it is a machine's ability to perform the cognitive functions we associate with human minds, such as perceiving, reasoning, learning, interacting with the environment, problem-solving, and even exercising creativity<sup>4</sup>.

It has evolved over time in its repertoire to be among the essentials" of contemporary state-of-the-art technology. The work of AI is explained in detail in the course of its development from the original rule-based systems with predefined responses to numerous self-learning models<sup>5</sup>. Prior to such exemplifications, similar to Google's Assistant, demonstrated AI's implicit by handling a shortage of queries through pre-designed algorithms. As opposed to its predecessors, Gemini AI relies on machine

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<sup>3</sup> EUROPEAN COMMISSION, AI WATCH DEFINING ARTIFICIAL INTELLIGENCE 2.0, (JRC Technical Reports, 2021), <https://publications.jrc.ec.europa.eu/repository/handle/JRC126426>.

<sup>4</sup> MCKINSEY & COMPANY, <https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-ai#/> (Aug. 15, 2024).

<sup>5</sup> Michael Haenlein & Andreas Kaplan, *A Brief History of Artificial Intelligence: On the Past, Present, and Future of Artificial Intelligence*, 61 CAL. MGMT. Rev. 4, 2-6 (Aug. 2019), [https://www.researchgate.net/publication/334539401\\_A\\_Brief\\_History\\_of\\_Artificial\\_Intelligence\\_On\\_the\\_Past\\_Present\\_and\\_Future\\_of\\_Artificial\\_Intelligence](https://www.researchgate.net/publication/334539401_A_Brief_History_of_Artificial_Intelligence_On_the_Past_Present_and_Future_of_Artificial_Intelligence).

learning to reanalyze and answer questions in real time while improving its answers based on the relations it learns<sup>6</sup>.

This progression suggests that AI is getting better and better at emulating other mental mortal functions that were earlier thought to be exclusive to human beings and are not only restricted to static program literacy but also include dynamic, data-driven literacy.

AI concerns are relevant to a wide range of industries, including the legal profession, which is often slow to change<sup>7</sup>. In contract law, AI is now playing a crucial role and adopting a central position in contract creation, negotiating, and signing<sup>8</sup>.

#### IV. HISTORICAL CONTEXT: MERGING CODE WITH CODE

The Indian Contract Law has come a long way in terms of its development in order to meet the diverse needs of the people of the country over the ages. The initial legal characteristics of contractual customs stemmed from the archaic religious and customary laws; however, they were regional and albeit, irregular<sup>9</sup>. The British colonizers introduced the change in legal structures because it was difficult to do business with previous irregular laws resulting in adoption of English common law and the standardization of legal system.<sup>10</sup>

The Indian Contract Act was passed in the year 1872 by the British Government, creating a single and comprehensive Act that dealt with the legal contractual laws in India. It Replaced the traditional Chinese practices in contracts with a peculiar set of European ideas. This legislation, which was most influenced by British law, overthrew the piecemeal customary law with a legal framework underpinned by the concepts of offer, acceptance, consideration, and enforceability. Over time, this legislation has

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<sup>6</sup> GOOGLE CLOUD, <https://cloud.google.com/vertex-ai> (Aug. 12, 2024).

<sup>7</sup> Daniel Faggella, *AI in Law and Legal Practice – A Comprehensive View of 35 Current Applications*, EMERJ (Mar. 17, 2023), <https://emerj.com/ai-sector-overviews/ai-in-law-legal-practice-current-applications/>.

<sup>8</sup> MARTIN EBERS, ARTIFICIAL INTELLIGENCE, CONTRACTING, AND CONTRACT LAW: AN INTRODUCTION, IN CONTRACTING AND CONTRACT LAW IN THE AGE OF ARTIFICIAL INTELLIGENCE 19, 19-40 (Martin Ebers, Cristina Poncibo & Mimi Zou eds., 2022).

<sup>9</sup> M.P. Jain, *The Law of Contract Before Its Codification*, JOURNAL OF THE INDIAN LAW INSTITUTE 178, 178-204 (1972), <http://www.jstor.org/stable/43950179> (Aug. 16, 2024).

<sup>10</sup> Ganesh Prasad, *Law and Colonialism*, 25 THE INDIAN JOURNAL OF POLITICAL SCIENCE. 76, 76-84 (1964), <http://www.jstor.org/stable/41854017> ( Aug. 17, 2024).

been modified to incorporate increasing international legal norms and indigenous customs to more effectively meet the needs of India's society and changing economic circumstances.

The Information Technology Act 2000 revolutionized Indian contract law by recognizing the validity of electronic contracts, allowing agreements to be formed and executed digitally<sup>11</sup>. Section 10A of the Act ensured that contracts made through electronic communication, such as emails or online platforms, were legally enforceable<sup>12</sup>. By introducing digital signatures, the Act addressed concerns over authenticity and security, laying the groundwork for advanced technologies like AI in contract law. This legislative shift enabled the evolution of AI-driven smart contracts, though further legal reforms are needed to address the complexities AI introduces in areas like consent and liability.

Concurrent with these legal advancements, artificial intelligence (AI), initially introduced by John McCarthy in 1956, has progressed from rudimentary automation instruments to intricate systems that possess the ability to make decisions and perform intricate analyses<sup>13</sup>. AI is now used in law practice for more tasks than just document analysis; it is now used for contract drafting, negotiation, and management<sup>14</sup>. Automating contractual conditions and minimizing the need for human oversight, AI-driven smart contracts are self-executing agreements based on blockchain technology and represent a new frontier in contract law<sup>15</sup>.

By fusing legal concepts with programmable code, this "Merging Code with Code" represents the convergence of legal codes with AI-driven algorithms, changing traditional Contract Law. While there is a potential for increased accuracy and

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<sup>11</sup> Jaswant & Kale, *Smart contracts and blockchain: legal issues and implications for Indian contract law*. INTERNATIONAL REVIEW OF LAW, COMPUTERS & TECHNOLOGY, 36, 312 - 329. <https://doi.org/10.1080/13600869.2021.1999312>

<sup>12</sup> Basu & Jones, *E-commerce and the law: a review of India's information technology act, 2000*, CONTEMPORARY SOUTH ASIA, 12, 24 - 7. <https://doi.org/10.1080/0958493032000123344>

<sup>13</sup> MELANIE MITCHELL, THE ROOTS OF ARTIFICIAL INTELLIGENCE, IN ARTIFICIAL INTELLIGENCE: A GUIDE FOR THINKING HUMANS (Farrar, Straus & Giroux 2019).

<sup>14</sup> CYRIL SHROFF & CO., <https://www.cyrilshroff.com/advanced-delivery/> (Aug. 18, 2024).

<sup>15</sup> T. T. ARVIND, AI-INFUSED CONTRACTING AND THE PROBLEM OF RELATIONALITY - IS TRUSTWORTHY AI POSSIBLE? IN THE CAMBRIDGE HANDBOOK OF PRIVATE LAW AND ARTIFICIAL INTELLIGENCE 71, 71-92 (Ernest Lim & Phillip Morgan eds., Cambridge Univ. Press 2024).

efficiency in working on contracts with the help of AI, there are also problems arising in connection with questions such as consent, liability, and enforceability that appear in practice and require ongoing adjustment by regulators and courts.

## V. AI AS A CONTRACT PLAYER

AI (Artificial Intelligence) is changing the roles of all the stakeholders involved in the formation and execution of contracts. Originally, contracts were legal relations between individuals, based on mutual consent, knowledge, and capacity to enter into the contract. However, due to the prominence of AI being used in drafting, negotiations, and performance, its characteristics now make it more than just a facilitator, but what can be termed as a 'player' or 'agent' in these transactions. Such a shift raises several questions regarding the enforceability of contractual terms made by artificial intelligence as well as liability in AI-assisted contracts.

### A. Enforceability Of Ai-Driven Contracts

The legal enforceability of contracts involving AI, especially those that originate and are performed by intelligent machines, is a challenge. While normal contracts involve the agreement of the parties and their voluntary assent to be bound to a lawful intention of a contract, AI-contingent contracts, for example, smart contracts, provide for the execution of terms when specified parameters are met.<sup>16</sup> Such contracts are usually built into blockchain platforms to allow for the transparency and security, yet they are legally questionable and enforceable.<sup>17</sup>

Whereas electronic contracts have been recognized in the legal system of India under the Information Technology Act, of 2000<sup>18</sup>, the legal framework for AI contracts is not well developed. Courts might face difficulties in considering and implementing such contracts as they need to satisfy the requirements of the offer, acceptance, and intent

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<sup>16</sup> Mari Sako, *Contracting for Artificial Intelligence*, COMMUNICATIONS OF THE ACM (Apr 1, 2023), <https://cacm.acm.org/opinion/contracting-for-artificial-intelligence/>

<sup>17</sup> AI-Driven Smart Contracts: Merging Intelligence with Automation, OODLES BLOCKCHAIN (Aug 25, 2023), <https://blockchain.oodles.io/blog/ai-driven-smart-contracts/>

<sup>18</sup> Information Technology Act, No. 21 of 2000, § 10A (India)

provided by the law courts rather than the AI system of a party.<sup>19</sup> In addition, the absence of a human element in creating these contracts may present difficulties in enforcement when and if a dispute arises over how the contract is to be implemented or if a party fails to fulfill the obligations specified in the contract.

Let's, consider a scenario where two parties, A and B, use an AI system to trade cryptocurrency on a decentralized platform. A coding error or system malfunction leads to the AI executing an unintended trade, resulting in significant financial losses for both parties. This situation highlights several enforceability challenges. Traditional contract law depends on clear mutual intent, but with the AI executing the contract without real-time human oversight, proving intent in the event of a dispute becomes difficult.

Additionally, determining liability whether it should fall on the AI developer, the deploying party, or the AI itself, is complex due to a lack of clear legal guidelines. Furthermore, if the contract operates across borders, identifying the appropriate legal jurisdiction and applicable laws adds another layer of complexity to enforcing the contract and resolving disputes.

A number of issues arise in connection with the enforcement of AI-driven contracts regarding the jurisdiction for enforcement, the law to be applied, and whether there is a need for new legislation on the enforcement of contracts with the use of AI. As AI advances, the legal apparatus must pay adequate attention to ensure these contracts are legal and upheld while safeguarding the rights of the concerned parties.<sup>20</sup>

## **B. Liability in – Assisted Contracts**

One more acute problem concerning liability arising out of a contract in connection with the use of AI in contract-making is to ascertain who is responsible for the contract

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<sup>19</sup> Muskan Deora, *AI and Smart Contracts: Contract Law and challenges faced*, LEGALLY FLAWLESS (Aug 24, 2024), [https://legallyflawless.in/ai-and-smart-contracts-contract-law-and-challenges-faced/#\\_ftn13](https://legallyflawless.in/ai-and-smart-contracts-contract-law-and-challenges-faced/#_ftn13)

<sup>20</sup> STA Law Firm, *The Enforceability Of Smart Contracts In India*, MONDAQ (Dec 13, 2019), <https://www.mondaq.com/india/contracts-and-commercial-law/874892/the-enforceability-of-smart-contracts-in-india>

terms<sup>21</sup>. The ordinary principles of contract law impose responsibility based on the conduct of the players involved. But when AI engages in contracting, such as negotiating, drafting, or performing contracts, the issues of defects, oversights, or non-performance would be less clear<sup>22</sup>.

Misunderstanding of a contract or failure in the execution of a contract leads to a lot of confusion. If an AI system was involved in drafting a contract and something goes wrong, the determination of liability of the AI system becomes a tricky affair. Does the party that deployed the AI bear responsibility? Or should it lie at the doorstep of the developer of such AI systems? Further, what are the consequences if the AI system is completely autonomous and does not report to any human?<sup>23</sup> These questions raise the issue of the legal responsibility of AI inputs in contracts. This demonstrates that contract law needs clear rules for liability<sup>24</sup>.

Currently, the legal relations within contracts involving AI are clarified within the scope of traditional principles of liability such as negligence or breach of contract<sup>25</sup>. Nevertheless, owing to the increased AI self-analyzing and self-improving capacity, these principles might not be sufficient to address the problems related to AI-supporting contracts<sup>26</sup>. Policies may need to be changed to determine who is legally

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<sup>21</sup> Phillip Kelly & Marcus Walsh & Sofia Wzykiewicz & Simone Young-Alls, *Man vs Machine: Legal liability in Artificial Intelligence contracts and the challenges that can arise*, DLAPIPER, (Oct 6, 2021), <https://www.dlapiper.com/en/insights/publications/2021/10/man-vs-machine-legal-liability-artificial-intelligence-contracts>

<sup>22</sup> MARTIN EBERS, AN INTRODUCTION, IN CONTRACTING AND CONTRACT LAW IN THE AGE OF ARTIFICIAL INTELLIGENCE 37, 19-40 (Martin Ebers, Cristina Poncibo & Mimi Zou eds., 2022)

<sup>23</sup> Martin Ebers, *Liability For Artificial Intelligence And EU Consumer Law*, JIPITEC, (Dec 2, 2021), <https://www.jipitec.eu/archive/issues/jipitec-12-2-2021/5289>

<sup>24</sup> Muskan Deora, AI and Smart Contracts: Contract Law and challenges faced, LEGALLY FLAWLESS (Aug 26, 2024), [https://legallyflawless.in/ai-and-smart-contracts-contract-law-and-challenges-faced/#\\_ftn13](https://legallyflawless.in/ai-and-smart-contracts-contract-law-and-challenges-faced/#_ftn13)

<sup>25</sup> MIMI ZOU, AN INTRODUCTION, IN CONTRACTING AND CONTRACT LAW IN THE AGE OF ARTIFICIAL INTELLIGENCE 57, 41-58 (Martin Ebers, Cristina Poncibo & Mimi Zou eds., 2022).

<sup>26</sup> SILVIA DE CONCA, BRIDGING THE LIABILITY GAPS: WHY AI CHALLENGES THE EXISTING RULES ON LIABILITY AND HOW TO DESIGN HUMAN-EMPOWERING SOLUTIONS, IN LAW AND ARTIFICIAL INTELLIGENCE, 327 (B. Custers & E. Fosch-Villaronga eds., T.M.C. Asser Press 2022).



responsible in cases involving AI, so that the parties can sue and be sued, and to ensure that the AI systems function within the legal realm<sup>27</sup>.

## VI. CASE STUDIES

### A. Indian Case Law Relevant to AI in Law

Although India is still in the process of shaping its laws on the use of AI in contract law. However, there are not many reported Indian cases directly anal on issues related to AI; however, there are several related cases that give an insight into how an Indian courts is likely to approach AI-related contractual disputes.

A relevant case is *Shafi Mohammad v. The State of Himachal Pradesh*, where the Supreme Court of India affirmed the use of technology in the legal process<sup>28</sup>. This case shows that Indian courts are willing to accept the implication of the technologies in their decision which may lead to decisions on AI in contract law.

*Trimex International FZE Ltd. v. Vedanta Aluminium Ltd.* of 2010 involved the enforceability of an agreement made through electronic communication<sup>29</sup>. This case did not involve AI, but it shows that the court will enforce technologically mediated contracts, which could set the stage for the future enforcement of AI-generated contracts.

### B. Comparative Analysis with International Jurisdictions

On an international level, courts have started to deal with new challenges that come from AI technology in contract law and these lessons may be useful for other countries.

One of such landmark case is *Quoine Pte Ltd v. B2C2 Ltd.*, where Singapore Court of Appeal discussed the issue of enforceability of contracts concluded on an algorithmic trading platform developed for bitcoin. It was a disagreement that occurred when B2C2 Ltd.'s algorithm made trades at extremely favorable prices because of a software

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<sup>27</sup> Praveen Kumar Mishra, *AI And The Legal Landscape: Embracing Innovation, Addressing Challenges*, LIVE LAW, (Feb 27, 2024), <https://www.livelaw.in/lawschool/articles/law-and-ai-ai-powered-tools-general-data-protection-regulation-250673>

<sup>28</sup> *Shafhi Mohammad v. The State Of Himachal Pradesh*, (2018) 2 SCC 801

<sup>29</sup> *Trimex International FZE Ltd. v. Vedanta Aluminium Ltd.*, (2010) 3 SCC 1

glitch in Quoine's system. Quoine later recorded a reversal of these trades on the grounds that the contracts were voidable for mistake.

However, the court held in favor of B2C2 by stating that contracts made with the software were valid and binding provided that the end result provided by the algorithms was reasonable and had been programmed as agreed into the system by the parties. This case also brings into focus the increasing use of AI and automated systems in contracts, the proposition again being that such contracts are equally valid or enforceable if they reflect the intention of the parties as any human-formulated contract irrespective of the usage of AI<sup>30</sup>.

## VII. CHALLENGES AND FUTURE PROSPECTS

When applying AI into contract law several challenges required to be considered. An important one lies in the legal regulation and validity of AI contractual terms and balances, including self-executing smart contracts on blockchain platforms.<sup>31</sup> The intention to form the contract legally, offer and acceptance form the foundation of the traditional contract law. These are axiomatic notions that are not easy to adapt to AI systems, which do not possess human consciousness.

Another issue is deciding who is on the wrong side or who is in violation of the contract every time AI technologies fail. Correspondingly, the more AI systems are being developed to be self-sufficient, the more complex the question of who is at fault when the system has failed becomes. This situation is made worse by the fact that interaction, in this case, is based on algorithms and data inputs that are often very hard for legal authorities or even the human users of the AI to understand.

Moreover, it also generates several questions of ethical importance, such as prejudice, accountability, and fairness, which are caused by the introduction of AI to the contract law field. Since AI systems act on an input and analysis of data, biased data may result in the AI simply building upon or even increasing bias present in the formulation and

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<sup>30</sup> Quoine Pte Ltd v B2C2 Ltd (2020) SGCA(I) 2

<sup>31</sup> Kinnari Solanki, *Artificial Intelligence in Contract Law*, 2 J. Legal Rsch. & Juridical Sci. 1138, 1144 (2023).

analysis of contracts.<sup>32</sup> Concern for the legal community remains on whether AI will work fairly to deliver justice to all stakeholders.

The future development of AI as utilized in legal practice and contract law will be responsive to the enhanced development of advanced AI systems representing more sophisticated roles intended for contract creation and negotiation, as well as for comprehensive transaction and litigation management. With regards to legal processes, one of the biggest benefits of AI, given its capability to process a massive amount of data and to analyze those to find out patterns, can significantly bring down the time and costs involved in contract management.

In the future, AI can be used to resolve disputes in a more proactive way, and it can be programmed to act as a middleman in disputes, or even be programmed to make decisions in simpler cases. Nevertheless, this would demand great progress in the enhancements of comprehending and applying legal rules by AI, and new legal regulation of such uses. In the long term, one can envision the situation when new types of contracts are formed based solely on AI's capabilities, wherein AI will be both concluding and enforcing contracts.

This could radically transform contract law and the legal system within which it works, but it is not without challenges as it would mean re-evaluating many aspects of the existing legal system and the elaborating of effective regulatory measures to ensure that these new forms of contracts really do benefit all the parties involved and conform to the legal and moral standards of society.

## VIII. CONCLUSION AND SUGGESTIONS

This study has investigated the revolutionary effectiveness of Artificial Intelligence (AI), especially concerning contract law in India and global legal systems. While AI has brought new prospects for the formation, execution, and enforcement of contracts on the one hand, it has also fueled risks on the other hand. Some of the insights are that AI is quickly becoming the go-to tool in contract management and automating

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<sup>32</sup> Muskan Deora, AI and Smart Contracts: Contract Law and challenges faced, LEGALLY FLAWLESS (Aug 26, 2024), [https://legallyflawless.in/ai-and-smart-contracts-contract-law-and-challenges-faced/#\\_ftn13](https://legallyflawless.in/ai-and-smart-contracts-contract-law-and-challenges-faced/#_ftn13)

contractual processes. Questions arise as to the enforceability of the terms generated by AI or issues of allocation of risk when self-learning systems contribute to a contractual breach.

The emergence and use of AI-driven smart contracts and their implementation in practice require lawyers and jurists to look at the traditional principles of contracts and possibly reassess them to cater to these new technologies. The study has also explained the legal and ethical issues connected with AI contracts, namely the problem of bias and the lack of clear transparency and accountability.

The advancement of AI in contract law is seen as a revolution in legal practice because it holds important values, but it also possesses possible risks. The increasing complexity of algorithms and levels of AI take them away from core concepts of contract law intention, consent, and liability in general. The law needs to adapt to these new changes and ensure that contracts created and administered through the use of Artificial Intelligence are efficient, equitable, and fair.

It may therefore be expected that AI is likely to take on more of a "contract player" as AI systems are increasingly included in the areas of contract formulation, signing, and even enforcement. However, this expansion has to go hand in hand with favorable legal provisions that safeguard the rights of the people and ensure compliance of Artificial Intelligence with acceptable benchmarks. The legal profession cannot afford to sit back and wait for AI to evolve on its own but rather needs to be at the forefront in observing the progression of the structures in AI and defining the legal framework governing its implementation.

In my opinion, providing solutions to the aforementioned challenges of AI in contract law will require major legal changes. Such measures could include amending the current laws to address roles for AI in contracts, coming up with new legal rules for matters concerning liability and enforceability standards, especially regarding AI issues, and formulating guidelines to ensure transparency and accountability of AI systems.

The judiciary will be a key deciding factor in determining AI's roles in the future of contract law. With the increasing number of cases involving AI in the legal sphere,

more cases will be brought before judges who will have to apply existing laws with implicit support for AI. Some of these cases may require extending conventional legal principles to cover AI or creating new legal categories to accommodate AI systems.

Aside from judicial interpretation, there may also be a need for other courts or tribunals to hear cases involving AI, as many AI systems are complex. Such courts could guarantee that people with such disputes get judges who have the capacity to understand the technology behind AI and how to solve disputes informed by the same.

In addition, initial and continuous judicial familiarization with AI and related technologies will be important to empower the judges with the knowledge required to deal with matters involving AI. It is apparent that the role of AI in legal practice is set to increase in the foreseeable future, and as such, the judiciary must stay abreast of the changes so that the legal system remains fair and serves its purpose in the era of AI.

The integration of AI into contract law heralds a new era where traditional legal frameworks will be reimagined and transformed. As AI takes on increasingly complex roles in contract formation and enforcement, the challenge will be to ensure that this technological revolution aligns with the enduring principles of justice and equity. The future of contract law lies at the intersection of human wisdom and artificial intelligence, where the contracts of tomorrow will be both innovative and resilient, shaped by a legal system that evolves alongside the technology it governs. This convergence will undoubtedly define the legal landscape of the future, leaving an indelible mark on how we understand and practice law in the digital age.

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