The Smart Contract Alliance, an initiative of the Chamber of Digital Commerce, defines smart contract as “computer code that, upon the occurrence of a specified condition or conditions, is capable of running automatically according to pre-specified functions. The code can be stored and processed on a distributed ledger and would write any resulting change into the distributed ledger.” Smart contracts can be used in various contexts, but they are an integral part of blockchain and distributed ledger technologies; the latter has seen a dramatic rise in mainstream
commercial use. This increased use in distributed ledger technology has necessarily led to an attendant increase in smart contract use and development. With this latter increase comes confusion around the differences between smart contracts and legal contracts.

While many aspects of legal contracts are as yet incapable of being represented by functions used in smart contracts, a more fundamental difference between a smart contract and a legal contract is the authority that dictates enforcement of the contract. Simply put, a smart contract automatically enforces a relationship specified in code, whereas, a judicial system, arbitrator, or some other authority enforces the terms of a legal contract. One of the appeals of smart contracts is the ability to obviate the need for third-party intermediaries, who are often costly and slow moving.

Somewhere in the middle of a smart contract and a legal contract is a smart legal contract, which the Smart Contract Alliance defines as “a smart contract that articulates and is capable of self-executing, on a legally-enforceable basis, the terms of an agreement between two or more parties.” There are obvious efficiency and cost advantages to such contracts, and many in the legal industry have started to capitalize on these. New companies, like OpenLaw, have sprung up to take advantage of this opportunity and drive advancements in smart legal contracts. OpenLaw is a commercial operating system, and the company builds tools and application programming interfaces to help enable smart legal contracts to be incorporated into blockchain-based applications. The company maintains an open source library that is readily usable by companies and legal service providers alike. Many other organizations operate in a similar space to OpenLaw. The Accord Project is a non-profit focused on developing open source tools to enable anyone to build smart legal contracts. Others, like Clause, are building services to automate business processes and contract management by connecting the two. For instance, they have built a tool that allows companies to receive payments automatically upon execution of a contract, eliminating the need to chase after payments. DocuSign joined Clause’s Series A financing round, and the Clause Platform is connected to DocuSign. All of these companies aim to develop smart contracts that are legally enforceable as code.

Law firms have begun to partner directly with major players in the blockchain industry to develop smart legal contracts. Six Canadian law firms collaborated with GenesisB to create a smart legal contract on the Ethereum blockchain that automates a merger and acquisition escrow agreement. The nature of an escrow agreement is such that it demands that an escrow agent hold money in escrow until the terms of the agreement are satisfied. This agreement is ripe for the application of smart legal contracts, because escrow agents are third-party intermediaries that act with little discretion. Smart contracts can automate the functions of escrow agents, eliminating the need for an intermediary.

In the United States, Latham & Watkins has teamed up with ConsenSys to develop a smart legal contract that automates convertible note agreements. This effort is a wonderful acknowledgment of future applications of blockchain. It provides a great basis for companies seeking knowledge about convertible note agreements. Beyond that, this effort, like all efforts to create legally enforceable code, necessitates the
engagement of an attorney. Counsel is necessary to determine the parameters of a specific deal and move beyond a standard suite of documents. Additionally, the United States Security and Exchange Commission’s growing interest in and lack of guidance on whether a digital token is a security raises the need to evaluate engaging whether issuing digital tokens in conjunction with a smart legal contract would be prudent.

Certain applications of smart legal contracts, like the escrow agreement mentioned above, provide tangible evidence of the concrete advances of the industry. There is potential for applications of smart legal contracts in the energy industry as well, for example with Virtual Power Purchase Agreements (“VPPAs”). VPPAs have costs associated with settlement periods that occur when the difference between the floating market price, which is the sale price on the wholesale market, and the fixed price from the agreement is determined. While the use of smart contracts for VPPAs would affect the energy industry as a whole, they are of particular importance to the renewable energy industry. VPPAs have become a preferred method of procurement for large corporations looking to purchase renewable energy. As new applications for the use of blockchain in the renewable energy space emerge, there will be an attendant emergence of smart legal contract applications. Nevertheless, the use of smart legal contracts is just a first step. These contracts will provide powerful baseline tools and act as excellent resources for those interested in building off of these contracts. However, simply sticking blockchain technology into a new venture does not make that venture useful, and, when it does, counsel is still necessary to help move beyond this first step.