

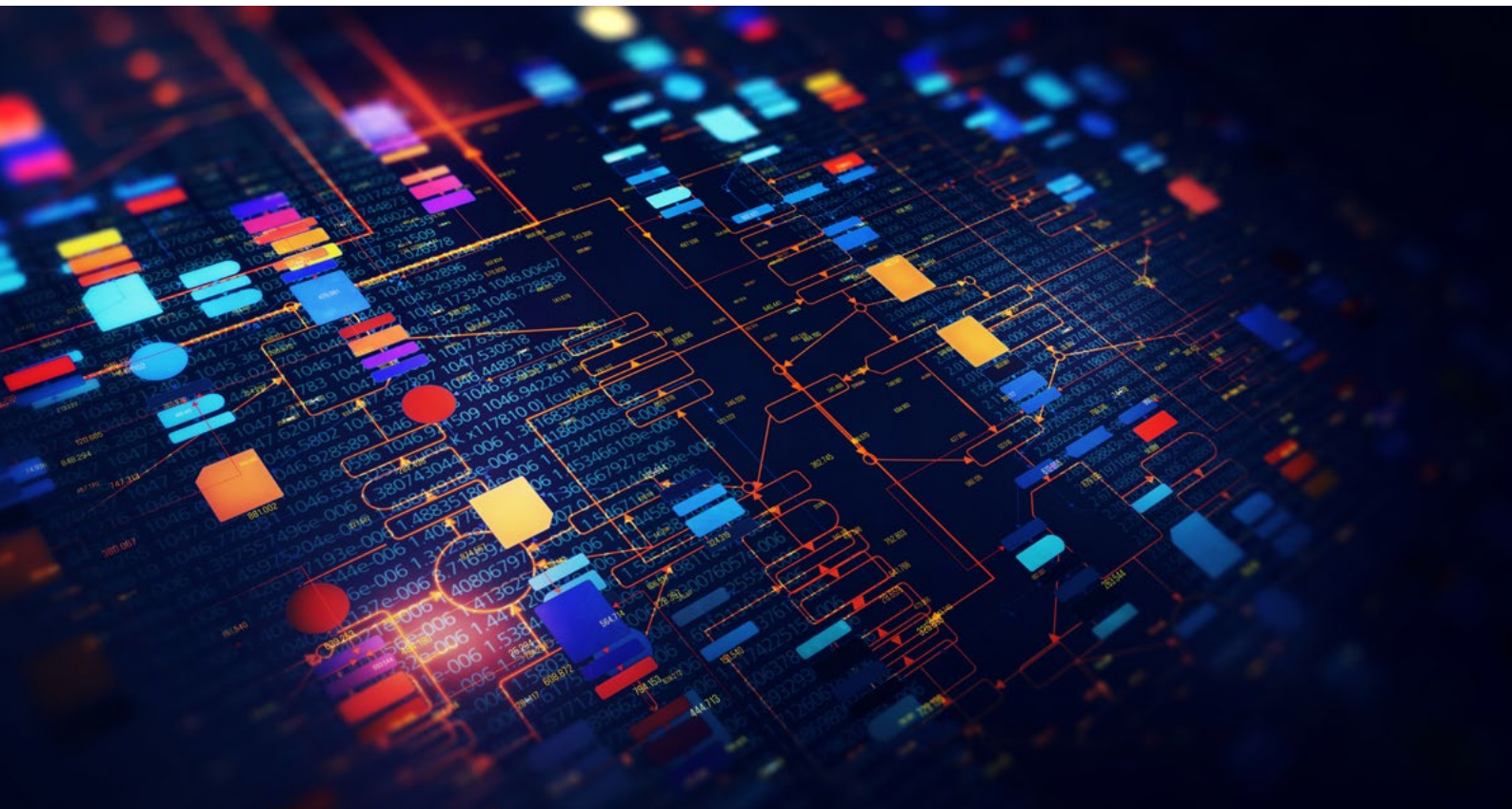


HERBERT
SMITH
FREEHILLS

SMART LEGAL CONTRACTS

DEVELOPING THE NEXT
GENERATION OF CONTRACTING

JULY 2020



Why smart legal contracts are the next step

Herbert Smith Freehills is working to pioneer and roll-out smart legal contracts (SLCs). SLCs are a cutting edge legal technology that will digitise contracts, enabling them to effectively automate, administer and record contractual events in real time.

This is an emerging area of digital law and the concepts explored here are evolving. We invite our clients to join us on the journey of exploring the potential of SLCs.

What is a smart legal contract?



A **legal contract**, parts or the entirety of which are intended to operate on a digital platform.

It may contain both:

natural language clauses, as in a traditional contract

and

'**smart clauses**', which are codified, machine-readable expressions of contractual obligations, that enable them to be **automated**.

What are the problems that SLCs will solve?

Traditional contracts cannot digitally interact with business systems, causing inefficiencies and costs

- Contract administration remains inefficient, time-consuming and manual
- Monitoring and ensuring contractual performance and compliance is often a burden, rather than a value-add
- Insufficient security and inefficient tools make it difficult to establish or automate cross-business processes and data sharing based on contractual or regulatory obligations

The economic burden of managing contracts and compliance

- There are approximately 1 million commercial contracts active in Australia
- \$155 billion: annual cost of administering and complying with compliance and contractual rules the private sector imposes on itself
- \$250 billion: annual burden on the Australian economy of administering and complying with the rules set by governments or between businesses

How smart legal contracts will work

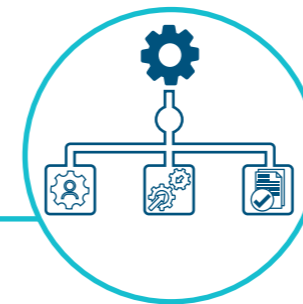
The SLC solution: increasing efficiency across business

How SLCs will work: bringing contracts to life

- Smart clauses are written in computer code to execute or implement specified rights and obligations automatically, as agreed between parties
- Smart clauses 'talk' to external data sources - which can range from industrial sensors to interest rates - detecting events that update contractual conditions, notify parties, or trigger execution
- This transforms the traditional analogue contracts into a piece of software that can seamlessly interact with the real world - including both physical objects and business logic

What is the value add of SLCs?

Enabling a contract to function digitally, either in part or in whole, will bring a new spectrum of capabilities into play.



Automating contract execution, management and regulatory compliance programs will reduce inefficiencies and costs and help realise the full value of contracts.

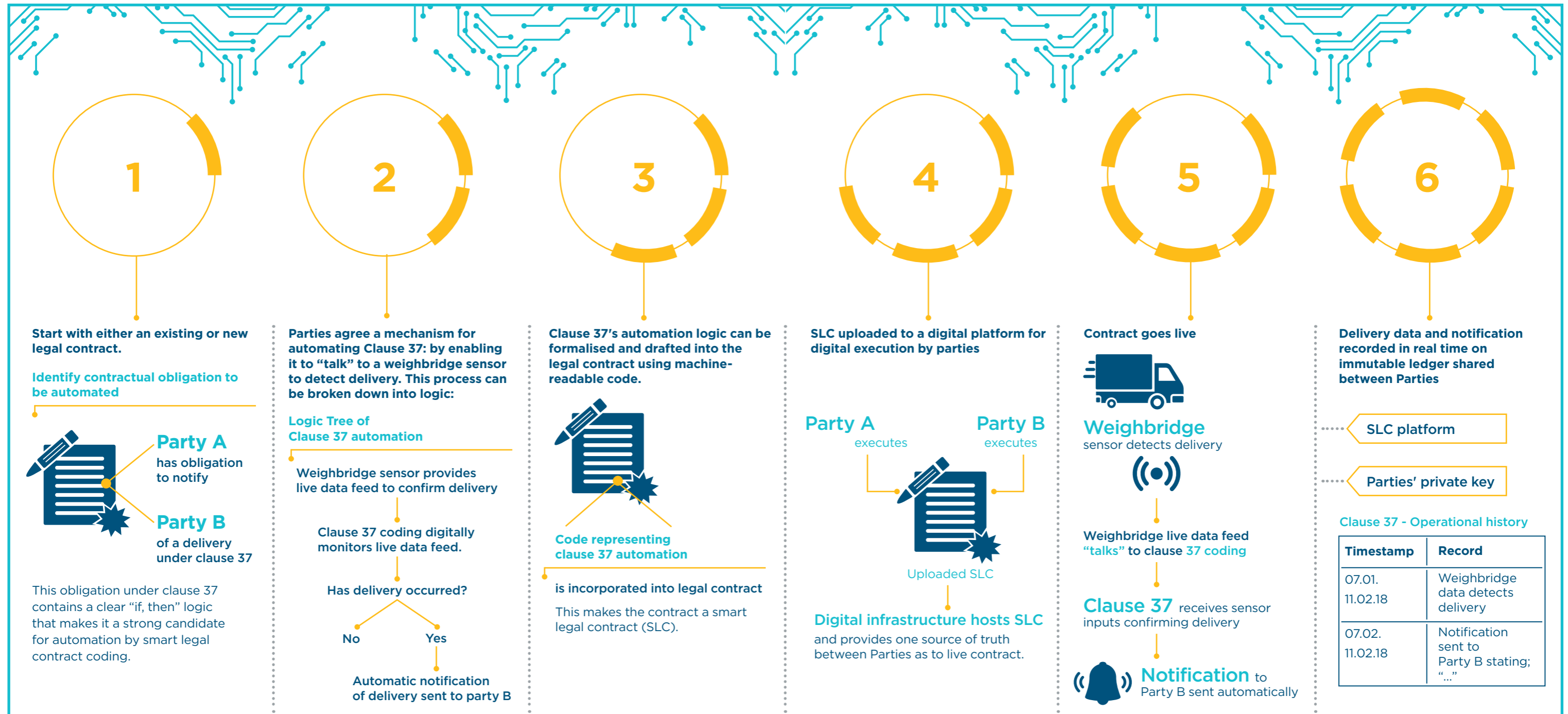


Digitisation of contracts will enable the application of AI tools, including risk modelling of contractual events and broad data analytics. This will enable quicker and greater insight into the state of play.



This will enable adoption of live, immutable databases of contractual events and data, which can be shared between parties. This will reduce friction and delays across the contract life-cycle.

What smart legal contracts will look like in practice



Summary

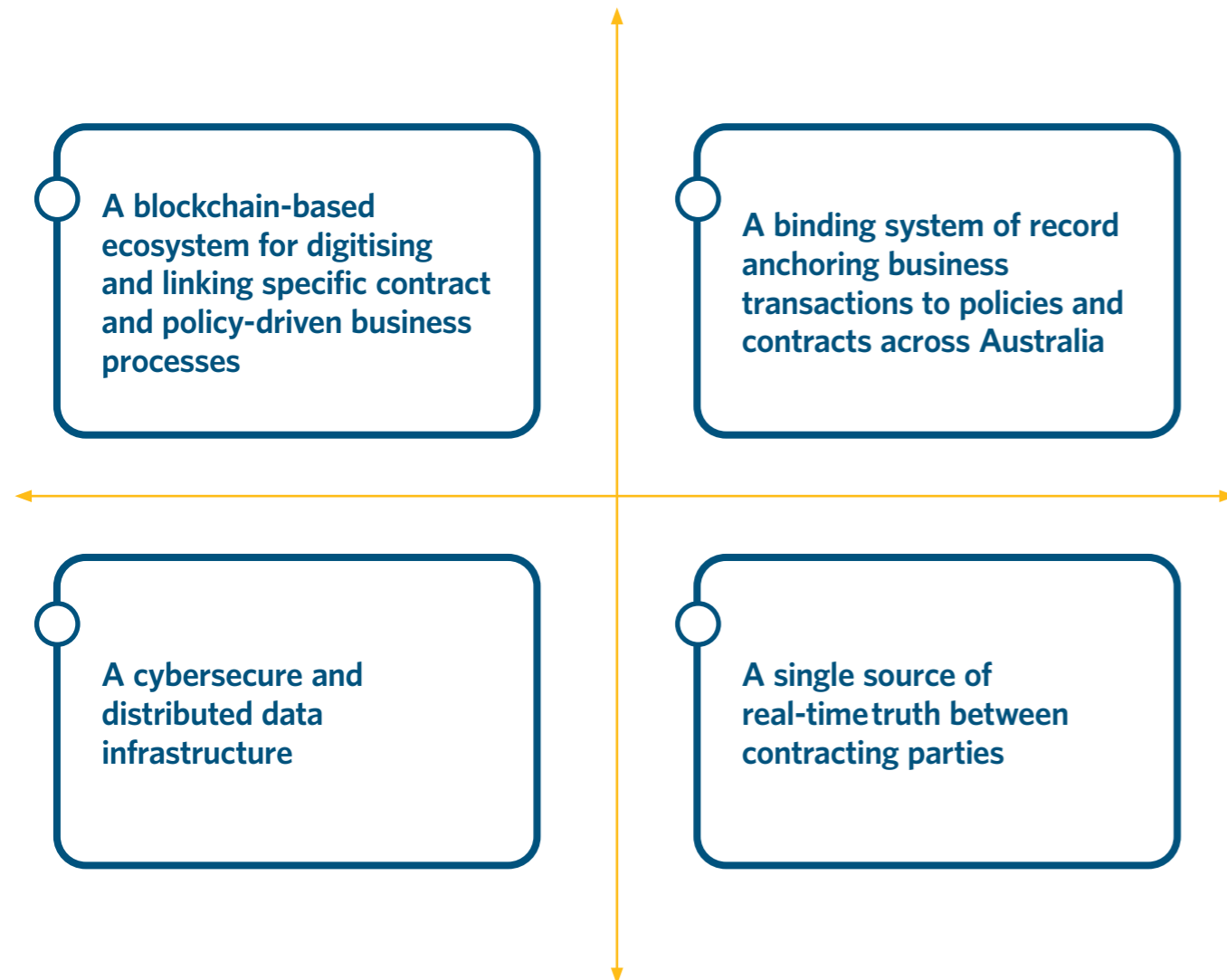
- Parties can agree on a method to automate a contractual obligation, which is then incorporated into contract as machine-readable code, making the contract a smart legal contract (SLC).
- Independent infrastructure hosts the entire SLC and enables execution of its automated (i.e. coded) provisions.

- Independent infrastructure maintains one true live version of the contract and an immutable record of automated contractual events or amendments as between Parties.
- Parties are free to choose extent of automation, coding and data sharing to be incorporated into the contract and enacted on the SLC platform.

Building a secure platform for smart legal contracts

SLCs will require a digital infrastructure or platform on which to run. Close integration of technical and legal infrastructure is necessary to enable companies to adopt SLCs and broader digitisation of their activities, all while ensuring they remain compliant with privacy, security and risk requirements.

Key features of an SLC platform



Next Steps

SLC development timeline



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