The parties signed smart contract.

Why does the court recognize
contract not concluded

The article provides advice to counterparties planning to start working with smart contracts. You will learn why courts refuse to protect the rights of parties if the transaction is made using a smart contract.

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IN During the process automation period, the parties began to use smart contracts. For example, Sber issued a bank guarantee using a smart contract on a blockchain platform, and the Central Bank allowed the use of the digital ruble in smart contracts.

Smart contracts are executed automatically, which reduces the time and financial costs of the parties to the transaction. The smart contract code is resistant to external interference, all conditions and actions defined by such a contract are publicly available, and all network participants can verify the execution.

At the same time, legislation and judicial practice are adapting to new realities with a delay, as a result of which the use of smart contracts is associated with regulatory risks. How to predict and avoid them is discussed in the article.

What is a smart contract

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A smart contract is an agreement that is executed by a computer algorithm, without the participation of the parties. There are two main approaches to defining a smart contract:
— a computer algorithm is only a means of executing a transaction;
— is an independent form of agreement.

Provisions on smart contracts are contained in Article 309 of the Civil Code, which recognizes a smart contract as an alternative way of fulfilling an obligation that does not require additional expression of will by the parties.

According to civil law, a smart contract in itself, without a contract concluded in a traditional form, has no legal force. The parties must provide for such a method of fulfilling the obligation in a traditional contract as concluding a smart contract. The way the legislator formulated the provisions on smart contracts significantly limits the possibilities of the parties.

Features of concluding and executing smart contracts

A smart contract is concluded by creating a computer program that contains the main provisions of the contract. For example, when a certain event occurs, the algorithm will automatically write off a specified amount from the buyer's account and transfer it to the seller.

Once created, the program is executed automatically, without requiring confirmation or expression of will of the parties. At the same time, if a smart contract is concluded using blockchain technology, its terms cannot be changed after conclusion, and execution cannot be stopped.

In addition to automatic execution, the smart contract software code can autonomously perform other actions, which provides the parties with greater opportunities to clarify the terms of the contract and protect their rights.

For example, when concluding a car rental agreement by drawing up a smart contract, the algorithm can provide for automatic ignition blocking in the event of late payment or violation of other conditions. Similarly, the program can independently calculate interest for late payment and write it off from the debtor's account.

Currently, smart contracts are widely used in digital financial markets and exchanges, in transactions with cryptocurrency, where automation of execution significantly simplifies activities taking into account the number of transactions.

At the same time, it is theoretically possible to link software code with material objects, such as remotely controlled vehicles and automated production lines.

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Courts ignore the main criterion of a smart contract - autonomy of execution in the absence of the will of the parties

Risks when concluding smart contracts

The key risk is that the courts do not understand smart contract technology due to the novelty of the institution and insufficient legal regulation. In judicial practice, one can often find cases in which the courts apply the term "smart contract" to any agreement concluded using information technology, ignoring the main criterion - the autonomy of execution in the absence of the will of the parties.

Also, current legislation does not recognize smart contracts as independent agreements. It should be noted that concluding an agreement only in the form of a program code may entail recognizing the entire agreement as not concluded.

As in a regular contract, a smart contract must specify the essential terms and the persons acting as parties to the contract. If the parties to the agreement are not specified, the court may reject the claim.

Example from practice. The plaintiff entered into an agreement with the defendant to purchase a car using a smart contract and transferred 1.78 million rubles in pursuance of the agreement. However, the defendant returned the transferred amount and refused to fulfill his obligations. The plaintiff filed a claim with the court to compel the execution of the agreement, presenting screenshots as evidence. The court rejected the claim, since it was impossible to determine the other party to the agreement based on the evidence presented. The court also noted that the payment order did not contain a specific indication of the seller and the buyer, the name of the goods sold, their identification features, quantity and cost, as well as a reference to the relevant civil law contract[1].

[1] resolution AS of the Volga District from 18.05.2023 in case No. A55-7445/2022
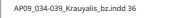
In this case, the courts incorrectly applied the term "smart contract" to a contract concluded using electronic means. The plaintiff was forced to file a claim for enforcement, and payment was made by bank transfer. Thus, both elements of performance were made dependent on the will of the parties.

There are also a number of doctrinal problems in domestic legislation and judicial practice:
— there is no clear relationship between the two forms of the contract — written and "programmatic". In other words, the doctrine has not yet developed the necessary rules for the latter form to be considered observed;

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The legislation does not recognize smart contracts as independent agreements

— issues related to the legal status of a thing controlled by a software algorithm, for example, in the event of its accidental destruction with damage to third parties, are not regulated. At the moment, the concept of the "Internet of Things" is actively developing, in which software code remotely controls objects;

— it is necessary to determine the limits of civil liability of the algorithm developer, since the execution of the contract directly depends on the program code. The developer may make a mistake in the code or interfere with the terms of the smart contract in bad faith, which may result in losses. Options for solving these problems can be found in foreign legislation and judicial practice. For example, the legislation of the Republic of Singapore expressly states that an offer and acceptance of a contract may be expressed by means of electronic communication (Electronic Transactions Act 2010, Art. 11). At the same time, as follows from judicial practice, the same grounds for invalidity may be applied to smart contracts as to ordinary contracts.

Example from practice. The court declared the smart contract invalid due to a technical error that resulted in the parties entering into a contract for the purchase and sale of cryptocurrency at an extremely low price (B2C2 Ltd v. Quoine Pte Ltd [2020]).

The application of basic rules of contract law to smart contracts indicates that foreign legal order has determined the nature of this phenomenon.

On the contrary, in the domestic legal system, the institution of smart contracts exists practically in a legal vacuum, in which the position of the courts and the prospects of disputes are impossible to predict.

At the same time, there are examples in practice where courts have considered disputes arising from smart contracts, ensuring the protection of rights under such agreements.

Example from practice. The court granted the claim for recovery debt under a supply agreement concluded in the "blockchain contract" format in electronic form, consent

for the use of which the parties signed a simple electronic signature. In this case, the parties entered into a supply agreement and an additional agreement to it on the procedure for concluding appendices to the supply agreement in electronic form[2].

It is not entirely clear from the text of the decision whether the parties actually entered into a smart contract or simply signed an agreement in electronic form, but this case demonstrates the recognition of the institution of smart contracts in the Russian legal order.

How to Reduce Risks When Concluding a Smart Contract

Taking into account the peculiarities of legislative regulation of smart contracts in the Russian Federation, it is better to use program code as a method of execution. The parties must first conclude an agreement in writing and provide for autonomous execution through the use of information technology.

This solution limits the flexibility of using smart contracts, but increases the likelihood of successfully defending your rights in court, since the court will be able to rely on the terms of the contract in written form when resolving a dispute.

If the parties need to conclude the main contract exclusively in electronic form, a preliminary contract may be written. In this case, the preliminary contract should reflect the condition for concluding the main contract in the form of a smart contract.

It is also possible to enter into an agreement that will subject the relations arising from the smart contract to the law of another jurisdiction. However, given that there are no specific rules on this issue, it is difficult to convince the court that the contract should be considered in another country or in an arbitration institution.

The legislative regulation of this institution also contains many gaps, as a result of which the conclusion of smart contracts is associated with a large number of risks for the parties to the agreement. But it is worth considering that at the moment the level of technical development does not allow to fully reveal the potential of smart contracts. In particular, the subject of such agreements is significantly limited.

But even now, automation of execution can allow parties to build their contractual relations more simply and efficiently, carefully using existing legal mechanisms and technological solutions.

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[2] decision of the Arbitration Court of Omsk Region dated 05/27/2019 on the case No. A46-4990/2019

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