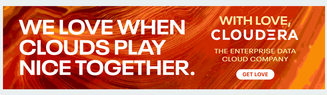

Technology

How AI Is Changing Contracts

by Beverly Rich

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Summary. Many companies struggle to develop and maintain contracts in an effective, efficient manner. But the rising popularity of AI contracting software has the potential to improve how all firms contract in three important ways: First, it can change the tools firms use to... more

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Contracting is a common activity, but it is one that few companies do efficiently or effectively. In fact, it has been estimated that inefficient contracting causes firms to lose between 5% to 40% of value on a given deal, depending on circumstances. But recent technological developments like artificial intelligence (AI) are now helping companies overcome many of the challenges to contracting.

The main challenge firms face in contracting arises from the sheer number of contracts they must keep track of; these often lack uniformity and are difficult to organize, manage, and update. Most firms don't have a database of all the information in their contracts – let alone an efficient way to extract all that data – so there's no orderly and fast way to, for example, view complex outsourcing agreements or see how a certain clause is worded across different divisions. It requires a lot of manpower to draft, execute, and improve not only the contracts themselves, but also the contracting processes and the transactions these contracts govern.

If, for example, a large tech company finds itself with a huge volume of procurement contracts that all have varying renewal dates and renegotiation terms, it would require hundreds of hours and a team of contract managers to review and track of all this information to ensure that no renewal or opportunity is missed.

AI software, however, can easily extract data and clarify the content of contracts. (It could quickly pull and organize the renewal dates and renegotiation terms from any number of contracts.) It can let companies review contracts more rapidly, organize and locate large amounts of contract data more easily, decrease the potential for contract disputes (and antagonistic contract negotiations), and increase the volume of contracts it is able to negotiate and execute.

In my research, I have seen that many companies use contract management software, and a smaller number of firms – mostly those with a high volume of routinized contracts – use more advanced software with AI capabilities. These firms have generally seen an increase in productivity and efficiency in their contracting.

The use of AI contracting software has the potential to improve how all firms contract – and it will do so in three ways: by changing the tools firms use to contract, influencing the content of contracts, and affecting the processes by which firms contract.

Improved Tools for Managing Contracts

While software for legal document review has existed for years, it typically only helps companies store and organize their contracts. Contracting software that uses AI raises the bar for what these tools can accomplish. AI contracting software can, for example, identify contract types (even in multiple languages) based on pattern recognition in how the document is drafted. Because AI contracting software trains its algorithm on a set of data (contracts) to recognize patterns and extract key variables (clauses, dates, parties, etc.), it allows a firm to manage its contracts more effectively because it knows – and can easily access – what is in each of them. AI software also offers simple prediction, which has implications for due diligence: AI contracting software can quickly sort through a large volume of contracts and flag individual contracts based on firm-specified criteria.

Current AI software can also read contracts accurately in any format, provide analytics about the data extracted from the contracts, and extract contract data much faster than would be possible with a team of lawyers. This may sound like bad news for lawyers, but this is not necessarily the case: having additional contract data could allow firms to update their contracts more regularly, and lawyers could focus more on their role as counsel instead of contract reviewer.

Keeping Contracts Consistent

AI contracting software helps firms keep terms and usage consistent in all of their contracts. For example, if a company wants to define the term "confidential information" in a specific way in its non-disclosure agreements (NDAs), it must make sure that all of its divisions are on board with this definition, and that changes to the definition get incorporated quickly and accurately, because variation could prove damaging to the company. AI contracting software can easily keep this term consistent across the firm's templates, and it can spot other terms that signal "confidential information" in NDAs from business partners.

Being able to identify and extract key data points helps firms organize and execute contracts as well. For example, a company with a large number of vendor contracts must ensure that they are keeping track of variations in termination provisions and penalty and damage provisions – both in their own contracts and in vendor contracts. Managing variations is a huge undertaking that requires proactive organization. But AI contracting software can record and standardize these provisions in the company's contracts and in those that vendors send, making it far easier to identify instances of noncompliance and ensure that unfavorable provisions are dealt with promptly.

Additionally, AI contracting software can quickly assess risk in contracts (performing the risk analysis much faster than a team of lawyers) by identifying terms and clauses that are suboptimal. And it can reduce the risk of human error in contract drafting and review.

New Processes Require New Skills

As new AI contracting tools change the actual content of contracts, this in turn affects the contracting processes that firms use. Previously, successful contracting required skills in drafting and negotiating contracts, as well as in managing and reviewing them. Specialized high-value transactions were dependent on groups of attorneys devoting hours to comprehensive due diligence. Contracting professionals were expected to find clever ways to draft contracts to include clauses that favored their client. And even more routine transactions required employees to pay close attention to details.

But when most due diligence and contract organization – and even contract drafting – is done using AI contracting software, the resources required to produce a large volume of contracts, both simple and complex, will change. This doesn't necessarily mean companies will need fewer lawyers, but rather their roles may transform. For example, lawyers will spend more time in assessing risk and providing counsel, rather than in document review. And instead of having a large team of associates conduct due diligence before a deal, companies will have a smaller, more agile team review the documents that the software flags and then offer advice. Indeed, Professor Gillian K. Hadfield, a law professor at the University of Southern California who specializes in contract law, believes that AI in contracting will lead to a better use of legal talent: "lawyers will shift their focus from routine activities to much more high value work involved in shaping strategies and navigating complex legal problems."

Similarly, the role of contract management professionals will shift. Whereas contract compliance was previously done by an entire team, AI tools enable a well-designed software platform – coupled with a few employees – to do the job. Rather than organizational skills being key to the role, contract managers will need more technical and process flow expertise to work with the software.

These improvements to tools, content, and processes will mean that contracting becomes faster, better, and easier once this technology is more widespread. But it is important to recognize that, while AI promises to do a lot, it won't do everything.

Contracting technology is currently at a midpoint: One stream of development will be in industries with highly routinized, template-based contracts. Here, AI contracting technology will be used in a blockchain model, allowing contracts to evolve and essentially re-write themselves according to the parties' needs. The other main use will be to help develop contracting standards, such as how to debate and structure certain clauses. When companies negotiating a contract can easily access every similar contract from the past twenty years, prioritized by industry, and see what wording is most commonly used, we should see less onerous negotiating over clauses, leading to an easier contracting process.

Understanding what AI contracting tools can and cannot do is key to their successful implementation and use. Right now, they may offer the highest value add to companies with large volumes of contracts – cutting time spent in contract review and drafting – and companies that conduct more routinized transactions. But as this technology develops, it is all but certain that it will one day be useful to all firms.

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