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Authors:

[Monisha Coelho](#)

Blockchain Smart Contracts: Changing the Way Business is Done Today

Your vendor wants to use A Blockchain “Smart Contract” for the transaction. Now what?

At a glance:

- Smart contracts are digital agreements that automatically execute transactions between parties, increasing speed, accuracy, and integrity in payment and performance.
- Smart contracts are legally enforceable if they comply with contract law.
- Many industries are using smart contracts to cut costs and increase efficiencies.

Companies are now using blockchain “smart contracts” to handle the purchase and sale of their goods and services to ensure quicker payments and seamless transactions. The Covid-19 pandemic has required more digitized transactions, including those which execute autonomously, unhindered by lockdowns and delays in the supply chain systems. Various platforms (IBM, Microsoft, H.P.) offer parties the ability to use smart contracts for their transactions, making their use more accessible and widespread than before.

What is a Smart Contract?

A “blockchain” is a computer-coded system of chain-linking transactions (information, records) such that they cannot be altered or tampered with, ensuring authenticity and efficiency.

According to IBM:

“As each transaction occurs, it is recorded as a “block” of data. Each block is connected to the ones before and after it. Transactions are blocked together in an irreversible chain: a blockchain.

To speed transactions, a set of rules – called a smart contract – is stored on the blockchain and executed

automatically. A smart contract can define conditions for corporate bond transfers, include terms for travel insurance to be paid and much more.”

Thus, a smart contract is an agreement between parties, entirely in computer code, and executed on a blockchain or distributed ledger platform. A smart contract is brief, with terms focused on payments for goods and services. A smart contract can be combined with a “paper” legal agreement that incorporates standard (or specific) legal terms.

Essentially, a smart contract works on an if-this-then-that protocol, e.g., if goods are received in the buyer’s warehouse by 5 pm, then release payment of \$10,000 to the seller. Thus, once the buyer confirms receipt of the goods in the warehouse, the smart contract will automatically release payment to the seller – without any further action by either party. Since it’s written in computer code, the smart contract self-executes once certain objective criteria (e.g., receipt of goods) are met.

Payment between the parties is made via a digital or cryptocurrency, which moves automatically from the buyer’s electronic wallet to the seller’s wallet. Today, platforms offering blockchain smart contracts also offer their own or other cryptocurrencies to make and receive payment, which amounts could then be converted into local currency.

Smart contracts are simpler now, but as they are more widely used and accepted, they will be able to handle more complex transactions. They will also promote greater contract standardization.

Are Smart Contracts Legally Enforceable?

To be legally enforceable, smart contracts must comply with basic contract law requirements, i.e., there must be an offer, acceptance, and consideration. By joining a “paper” legal contract to the digital smart contract, it is possible to add numerous legal provisions to the transaction. A business can have the best of both worlds, faster electronic payment with standard legal agreements, for a binding contract.

California law already recognizes the use of electronic records in legal proceedings. Digital and electronic signatures and records now have the same legal weight and effect as paper versions.

California permits parties to form and sign contracts by electronic means if the transaction complies with the state's version of the Uniform Electronic Transactions Act (CUETA) (Civ. Code § 1633.1 *et seq.*) A legally enforceable contract can be formed purely electronically if the requirements of CUETA are satisfied, i.e., prior consent of parties to conduct the transaction electronically, the signature must be clearly linked to the document, documents must be capable of electronic retention, etc. The federal equivalent statute is called the Electronic Signatures Recording Act ("E-Sign Act.")

Is There Recognition of Blockchain and Smart Contracts in California?

While California does not have a law addressing blockchain smart contracts directly, it has started legal efforts to do so. On September 28, 2018, the Governor of California signed SB-838 into law. It permits some privately held companies and social purpose organizations to use blockchain technology for certain corporate records, including issuing and transferring stock and the number of shares registered in the name of each stockholder.

In October 2018, the Governor of California also approved, through legislation, creating a "Blockchain Working Group." The working group submitted its report to the Legislature in September 2020 recommending the use of blockchain technology in numerous aspects of commercial and everyday life. Some recommendations include using blockchain technology to create a digital identification driver license (DID) and storing it in a digital wallet; identifying the source of various food products in the supply chain to detect the origins of food contamination instantly; and carry out property registration, land title searches, and sale of properties.

Other states in the country are doing likewise. Arizona and Nevada have each amended their state's version of the UETA to include blockchain smart contracts as electronic records.

Currently, the California Secretary of State has approved the use of various technology vendors for generating digital and electronic signatures and records, such as DocuSign, DigiCert, Entrust Datacard, GMO GlobalSign, Notarius, etc. according to the CUETA. If the state approves vendors for smart contracts, their use will become much more accessible and standardized.

Which Businesses Are Using Smart Contracts?

Walmart requires its lettuce and spinach suppliers to use blockchain to ensure food safety. Albertsons, Dole Food Company, Kroger, Nestlé, Tyson Foods, and Unilever are doing the same.

Many global banks (Bank of America, CitiBank, JP Morgan, HSBC), and 12 of the 26 banks in China, have already adopted blockchain technology for various use cases and financial transactions (e.g., standardizing export-import documentation for global trade, verifying cross border interbank payments.)

The use of smart contracts is being examined and tried by insurance companies to quickly process claims' payouts. Remittances could be automatic instead of manual, escrow may no longer be necessary, there could be costs savings, and a virtual signature could negate the need for a physical presence. Peer-to-peer networks could be established via smart contracts to self-insure, without the need for an intermediary or administrator.

When a vehicle is sold, the dealer would share the customer data with the DMV so the DMV could check the vehicle's history, verify the owner's details, and confirm registration. Smart contracts could automatically assign license plates and the creation of new records such as title and registration.

Why Should I Care?

Blockchain smart contracts have significant benefits in terms of increasing financial liquidity through quicker payment methods. For automated systems that electronically register receipt of goods and services, smart contracts will permit the release of payments almost instantaneously rather than waiting for days/weeks for manual entries. If combined with paper legal contracts, smart contracts will provide the same legal security to parties on all sides

of the transaction. Additional transaction costs can be significantly reduced since smart contracts eliminate the need for fund transfer fees, commissions, agent fees, escrow fees.

The risks associated with smart contracts are being addressed. The biggest one is immutability, or the inability to modify the contract once it is set in motion. Errors in coding can also impact the effectiveness of the transaction. However, both these aspects can be addressed through the paper legal contract similar to other transaction contingencies. Transaction security and privacy concerns can be addressed by using private blockchain platforms. One thing is sure, technology is revolutionizing business globally. Understanding and adopting technologies helpful to a business open up new opportunities and markets and promote efficiency and cost savings.

Monisha Coelho represents clients – from startups to multinational corporations – in commercial and corporate matters and litigation before state and federal courts. Monisha is a data security and privacy attorney advising companies on CCPA and CPRA compliance, enforcement, risk mitigation, and litigation. She is licensed to practice law in India and advises clients on cross-border US-India business transactions, litigation, and data privacy matters.

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