



ARIAS, FABREGA & FABREGA

ARIFA LEGAL FLASH

ARIFA Building, 10th Floor,
Santa María Business District,
PO Box 0816-01098
Panama, Republic of Panama
Tel: +507 205 7000
www.arifa.com

Smart Contracts in Panama: Validity and Legal Issues

Overview

Interest in smart contracts has been on the rise globally in recent years and Panama has been no exception. Between 2021 and 2022, its interest was evidenced by a bill approved by the National Assembly, but which ultimately did not enter into force¹, which intended, among other purposes, to instruct the Panamanian government to include in its agenda the objective of giving “*practical validity*” to smart contracts.

As of September 2023, the validity and perfection of smart contracts is an uncharted area of law in Panama and there is no local court precedent discussing smart contracts. Under this context, this article provides a brief view of the legal issues in Panama surrounding smart contracts.

What are Smart Contracts?

Smart contracts generally refer to computer code that automatically executes all or parts of a transaction stemming from an agreement between certain parties. Said smart contracts are generally agreed upon and executed within a blockchain protocol, making them immutable and decentralized. By encrypting each transaction before storage, smart contracts guarantee all parties involved certain contractual terms without external interference or change. The main difference between smart contracts and traditional contracts is that the latter generally relies on the parties to perform the contract’s obligations, whereas smart contracts self-execute, meaning they automatically carry out the terms of the agreement once certain conditions have been fulfilled².

A simple example may be an agreement whereby a purchaser agrees to pay the seller of a product a purchase price simultaneously with the physical delivery of said product. The smart contract could be programmed so that upon proof of delivery of the product as evidenced in the tracking system of the third-party delivery service provider (which third

¹ Said bill was subsequently vetoed by the executive branch of government and struck down by the Supreme Court of Justice. See Supreme Court of Justice Decision of June 6, 2023.

² For further general discussions and analysis of smart contracts, refer to Levi, Stuart, et al. Skadden, Arps, Slate, Meagher & Flom LLP, “*Legal issues surrounding the use of smart contracts*”, Global Legal Insights, Blockchain & Cryptocurrency Regulation 2020.

party would act as an oracle³ to the smart contract), the smart contract would automatically transfer the purchase price to the seller.

What is the Legal Framework for Smart Contracts in Panama?

As of September 2023, there is no specific legal framework for smart contracts in Panama. Considering the absence of a specific legal framework, in our view the general legal framework that would apply to smart contracts would be the general laws of contracts contemplated in the Civil and Commercial Codes of the Republic of Panama.

From the perspective of the Civil Code, smart contracts would generally be valid under Panamanian law, under the assumption that the smart contracts comply with the three requirements for the validity and effectiveness of contracts set by the Civil Code: (a) consent, (b) object, and (c) cause.

In the example above, two requirements are presumably met: object and cause, which would be the delivery of a product by the seller to the purchaser and the payment by the purchaser to the seller, in connection with such product delivery.

The first requirement, consent, is defined by the Civil Code as the tender offer and acceptance of the object/cause of the contract. Hence, smart contracts are presumed to fulfill the consent requirement. The offer and acceptance, integral components of the underlying agreement, would be encoded within the smart contract. Parties express their consent through the acceptance of the code rather than resorting to traditional methods. Furthermore, Law No. 51 of 2008, which governs electronic documents and signatures, acknowledges the formation of contracts through electronic means and affirms the validity of electronic signatures as legitimate forms of assent.⁴

As an additional note, contracts governed by Panamanian law with a value of more than US\$5,000 are required to be evidenced in writing. The Civil Code and Law 51 of 2008 permits contracts to be evidenced by electronic means. Because the translation from code to natural language is achievable, a compelling case can also be made that any smart contract ingrained in a blockchain protocol will satisfy this formal requirement.

Are Smart Contracts Enforceable in Panama?

Contracts serve as a foundational tool for nurturing trust among the parties involved, ensuring that commitments and agreements are honored. This trust is derived from the

³ Oracles are defined as trusted third parties that retrieve mutually agreed off-chain information and then push that information to the smart contract at predetermined times.

⁴ Under Panamanian law, electronic signature is defined as a technical means to identify a person who gives their consent to an electronic document or data message. Electronic signatures are given the same validity as written signatures provided that each of the following conditions are met: (i) a method has been used to identify the originator of the data message and to indicate that the signatory has approved its content; and (ii) the method is reliable and appropriate for the purpose for which the message was generated or communicated.

assurance that in the event of a breach, the aggrieved party has recourse to either seek judicial enforcement of the contract or claim damages as compensation for the breach.

In the realm of smart contracts, the performance of obligations is inherently guaranteed through their self-executing nature. These digital agreements are designed to automatically execute and enforce themselves upon meeting predefined conditions, eliminating the necessity for traditional judicial interventions to ensure enforcement.

During the contractual relationship, parties to a smart contract may attempt to request a Panamanian court to grant ex-post enforceability or review. Ex-post review or enforcement of smart contracts in local Panamanian courts may present practical challenges, in particular, because of the decentralized nature of smart contracts; the lack of familiarity by courts with smart contracts; and the difficulty local courts may encounter in comprehending the coding language used in smart contracts.

Smart contracts, typically integrated into decentralized blockchain protocols, lack clear central authority or jurisdiction. If jurisdiction and governing law are not explicitly specified in the contract, the inherent decentralized complexity can pose challenges for courts when addressing disputes arising from smart contracts, especially in cross-border transactions. The recognition and enforcement of smart contract agreements are still evolving, and it is our understanding that, generally, legal systems lack sufficient case law or statutes to delineate the extent of judicial oversight. Consequently, interpreting and enforcing these types of contracts implies inherent uncertainty and risk in the context of litigation or dispute resolution.

Considering said challenges, we would recommend any party to a smart contract to consider: (a) executing a natural language “off-chain” master agreement governing the overall legal relationship, including governing law and dispute resolution mechanisms, which off-chain agreement would make reference to the smart contracts that would be entered and self-executing, as an *ancillary agreement* to said off-chain agreement, (b) limiting smart contracts to its practical purpose: the self-execution of the relevant aspects of the transactions that may be self-executing, thereby limiting the scope and related uncertainty of enforceability risks, and (c) structuring the smart contracts as Ricardian contracts. “Ricardian” contracts consist of smart contracts linked to a traditional natural language contract, which would presumably permit the local courts to easily understand, interpret, and enforce the content thereof.

In any case, under freedom of contract principles, the relevant parties may also wish to explore the possibility of governing the relevant agreements under foreign law and submit disputes to a foreign court that may provide more legal certainty to the parties with respect to smart contracts. Provided that the provisions of the chosen governing law do not violate the public policy of the Republic of Panama, the courts in Panama will allow for any choice of law as the governing law of such agreements.

Are Smart Contracts Valid in Panama?

At present, if the parties enter into an off-chain agreement, as described above, including (a) facilitating the execution and delivery of smart contracts that would be self-executing and (b) complying with the electronic signature and documentation requirements of Law 51 of 2008, our view is that such smart contracts would be valid and enforceable under the laws of the Republic of Panama. Nevertheless, ex-post review or enforcement of smart contracts in local Panamanian courts may present practical challenges.

The view that smart contracts would be valid is consistent with the aforementioned bill which sought to instruct the Panamanian government to give “*practical validity*” to smart contracts. The phrase “*practical validity*”, in our view, means that, from the perspective of the National Assembly, smart contracts are currently valid, but may face certain *practical* challenges to their widespread adoption that could be addressed by the authorities⁵.

Author

[Javier Yap Endara](#), Partner
Arias, Fábrega & Fábrega
iyapendara@arifa.com

Acknowledgments

The author wishes to acknowledge the contribution of associate [Nicolás Ramos](#) in the writing of this article.

⁵ However, as mentioned, such bill did not enter into force.