

Delaware First to Allow Corporate Recordkeeping Using Blockchain Technology

IN SHORT

The Situation: Delaware is the first U.S. state to allow the use of blockchain technology for corporate recordkeeping.

The Result: Utilizing blockchain technology can potentially improve a company's recordkeeping for proxy voting, and for stock ownership and transfers.

Looking Ahead: Believing that the benefits of blockchain are substantial, some companies are already investigating the introduction of the technology to their recordkeeping functions.

On August 1, 2017, Delaware became the first state to allow corporations to use blockchain technology to maintain corporate records. This development comes almost a year after Vice Chancellor J. Travis Laster of the Delaware Court of Chancery issued a clarion call to corporations, investors, and financial intermediaries to use the technology to "fix the plumbing" of the voting and stockholding infrastructure of the U.S. securities markets.

In his speech to the Council of Institutional Investors in September 2016, Vice Chancellor Laster lamented the complexities created by the nominee system for registering ownership of stock. Under the current system, depositories such as the Depository Trust Company hold stock certificates as owners of record and track transfers using an electronic book-entry system. He noted the problems the nominee system can create for voting, including the many opportunities for errors arising from the multiple parties and transactions required for beneficial owners to vote on matters submitted to stockholders.

Vice Chancellor Laster urged industry participants to explore the use of blockchain-based distributed ledger technology to address these problems and reduce overall transaction costs. Blockchain technology enables direct transactions that are cryptographically secure and eliminates the need for intermediaries to verify and process transactions.



Under the new law, stock ownership can be registered, transfers can be recorded, and proxy votes can be tracked and verified using a blockchain.



The new Delaware law addresses the problems identified by Vice Chancellor Laster by amending Title 8 of the Delaware General Corporation Law to allow corporations to use electronic databases such as blockchain-based distributed ledgers to create and maintain corporate records, including a corporation's stock ledger. Under the new law, stock ownership can be registered, transfers can be recorded, and proxy votes can be tracked and verified using a blockchain.

The potential benefits of allowing corporations to use a blockchain in this manner are substantial, and include the following:

- Corporations could establish a more reliable record of authorized shares and track ownership in shares on a real-time basis. This could reduce or even eliminate inconsistencies in corporate records regarding share counts and ownership interests.
- Blockchain technology could also resolve complexities and confusion created by the nominee system, by eliminating the distinction between record holder and beneficial owner.
- It could allow transactions to settle instantaneously rather than in a matter of days, while also reducing transaction costs.

Even as Delaware adopts these changes, risks and questions associated with blockchain technology remain, including the following:

- How will data on the blockchain be secured from hackers and viruses?
- How transparent will the data be, and who will have access to it?
- How can the data be audited?
- What method will be used to validate transactions?
- Who will have organizational control of the ledger?
- Who will cover the cost of any fraud that occurs?
- Can a blockchain system without a transfer agent comply with federal securities laws and broker-dealer requirements without additional SEC/FINRA guidance?

These issues and more, no doubt, will be discussed and addressed as Delaware moves forward with this initiative. However, some corporations have already concluded that the potential benefits of blockchain technology are too great to ignore, and these entities have begun investigating the use of this technology to maintain their corporate records.

As the home jurisdiction for over 60 percent of the companies on the Fortune 500 list, Delaware is blazing the trail for corporations to leverage the power of blockchain technology to manage corporate records and answer Vice Chancellor Laster's call to unclog the pipes of the voting and stockholding infrastructure of the U.S. securities markets.

TWO KEY TAKEAWAYS

1. The benefits of blockchain technology for corporate recordkeeping include a more reliable record of authorized shares and the tracking of share ownership on a real-time basis. Transactions could also settle instantaneously, and their associated costs could be reduced.
2. Still, some risks and questions associated with blockchain technology remain, particularly pertaining to security issues, transparency, data auditing, and methodology for validating transactions.

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