DELAWARE PREPARES MAJOR ADVANCE IN USE OF BLOCKCHAIN STOCK LEDGERS

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I. Executive Summary.

As of August 1, 2017, Delaware corporate law will be amended to allow companies incorporated there – which includes two-thirds of the Fortune 500, as well as startups and midsize companies - to rely on a distributed blockchain ledger to issue, store and transfer securities records and communicate with shareholders. The new amendments will allow companies to give shareholders direct ownership and control of their securities, increasing the transparency and efficiency of stock trades, ensuring their accuracy, and potentially putting companies that do not use blockchain ledgers at a competitive disadvantage. Delaware companies taking advantage of the new law will potentially, over time, have an enormous competitive advantage over Delaware companies that do not, and other states' corporate law regimes that prohibit, or at least do not affirmatively make legal, blockchain stock management.

II. What is a Blockchain?

A blockchain, also known as a "distributed ledger," is a distributed (decentralized) database used as a repository of a continuously increasing list of records, each called a "block." The blocks are added by "smart contracts," a piece of software code with an "If/Then" algorithm that executes upon a specific trigger event. Smart contracts are widely used, for example, for online payments that are pre-authorized for a certain date; when the computer's clock indicates that the date has arrived (the "If"), the online payment is automatically triggered (the "Then"). The first blockchain was developed in 2008 to serve as the public ledger for all transactions in bitcoin, the simultaneously released peer-to-peer digital "cryptocurrency" used as a digital payment currency. A blockchain is typically managed by a peer-to-peer network that supports a protocol for validation of new blocks. Once validated and added to the blockchain, a block is timestamped and linked to a prior block in the chain, and cannot be retroactively altered without affecting all other subsequent blocks and signaling the alteration, thereby giving a high degree of certainty in the integrity of each block in the chain, once recorded. The blocks cannot be copied or altered once validated. In other words, an online payment cannot be copied multiple times, or reused. The effect is to create a mutual, shared ledger among multiple parties that contains one immutable copy of the material contained in the blockchain ledger, and which updated in real time.

Blockchain technology, still in its first decade of development, has been hailed as promising transformative potential across a wide range of business and personal domains. It may give individuals far more control over their own information with more privacy and fewer intermediaries, lowering transaction costs and increasing transparency and efficiency. On the other hand, blockchain's promise is completely predicated on its security and integrity. If blockchains, contrary to their proponents' claims, turn out to be susceptible to hacking, viruses, Trojan horses, ransomware, and malware attacks, that promise will not be realized.

III. The Delaware Corporate Law Amendments.

The Delaware General Corporate Law ("DGCL") amendments go into effect on August 1. DGCL section 219(a) and (c) and 224 will be amended to allow the mandatory list of stockholders maintained by a corporation, and which is the conclusive evidence of the corporation's stockholders entitled to vote, to be created and maintained in blockchain form. The amendments will allow shares in corporations to be issued on a blockchain as a type of uncertificated shares. Under the amendments, DGCL section 224 will still require that blockchain-maintained corporate records must be convertible into clearly legible paper form and must allow the corporation to meet other DGCL requirements, such as preparing for stockholder meetings and allowing inspection of books and records. Other sections of the DGCL are being simultaneously amended to make clear that required corporate communications may be made by use of the blockchain.

IV. Impact.

The potential impact of the DGCL amendments is enormous. In general, all stock issued by public reporting companies in the United States, whether certificated or not, must be, according to SEC rules, "depository eligible," and is legally owned by Cede & Co., the nominee of the Depository Trust Company. As a result, what investors own is not a security, but a UCC Article 8 "Security Entitlement" issued by a "Securities Intermediary" - a broker/dealer. Because of the resulting chains of indirect ownership, actual beneficial ownership of securities can often be difficult to determine, and lead to nonsensical results in appraisals, hostile transactions, proxy contests, corporate restructurings, and other circumstances. Blockchain stock ledgers would allow direct ownership of stock. Company issuers, stockholders, and potential investors would be able to communicate directly and in real time. Stock trades would be settled on a same-day basis. The maintenance of capitalization tables would be automated, and they would always be, by definition, accurate, and never at risk of holding up a major corporate transaction while being forensically audited and corrected. Dividend issuance, stock splits, authorization of new shares and other corporate actions would be automated and always accurate. Companies would never be at risk of issuing unauthorized shares. Certificates of good standing and opinion letters would be facilitated. Company issuers, stockholders, and potential investors would be able to see who owns the companies' equity, in real time.

A newly-formed company will find it easier to issue blockchain shares from the outset and maintain its ledger on the blockchain; larger, pre-existing companies will have to convert their stock management processes, but are likely to find doing so worthwhile and necessary as a competitive matter.
The DGCL amendments may also affect paper Uniform Commercial Code filings.

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