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Delaware Encourages Use of “Blockchain” Technology for Corporate Recordkeeping

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Amendments to the Delaware General Corporation Law (“DGCL”) allowing for the use of “distributed ledgers”, or “Blockchain” technology, for corporate recordkeeping, including stock ledgers, became effective on August 1, 2017. These amendments reflect the Delaware bar’s continued efforts to stay at the forefront of corporation law developments. These innovative changes were promoted by the Delaware Blockchain Initiative, led by a former Delaware governor. Vice Chancellor J. Travis Laster of the Delaware Court of Chancery has also been actively promoting the use this new technology to “fix the plumbing” of the voting and stockholding infrastructure of the U.S. securities markets.

What is Blockchain technology?

According to Don & Alex Tapscott, authors of *Blockchain Revolution (2016)*, “The blockchain is an incorruptible digital ledger of economic transactions that can be programmed to record not just financial transactions but virtually everything of value.” Information held on a blockchain is a shared and continually reconciled database. The blockchain database isn’t stored in any single location. Instead, it consists of a distributed system of registers which are accessible to anyone on the internet and are all connected through a secure validation mechanism.

The first and still most popular application of Blockchain technology was the Bitcoin payment network, and its usage has now spread to many other new cryptocurrencies. The same Blockchain technology can be applied to corporate recordkeeping. It would theoretically allow for the issuances and transfers of shares without a third-party intermediary, thereby increasing the accuracy of recording such issuances and transfers and minimizing the potential for clerical mistakes.

The Amendments

The specific amendments to Sections 219 and 224 of the DGCL permit (but do not require) the use of “distributed electronic networks or databases”, allowing a corporation’s shares to be recorded and transferred on a decentralized electronic network rather than on a centrally located stock ledger. This new distributed ledgers technology is by definition only applicable to corporations with uncertificated shares. Section 224 still requires that records be capable of being converted into a clearly legible paper form within a reasonable time period.

The amendment to Section 224 of the DGCL further requires the blockchain stock ledger to perform three main functions: (i) to enable the corporation to prepare a list of shareholders, (ii) to record various voting information as required by the DGCL, and (iii) to transfer stock as governed by Article 8 of the Uniform Commercial Code.

The overall effect of these amendments is to validate blockchain technology as a means of complying with all share recordkeeping requirements of the DGCL.

Potential Benefits

Potential benefits from using a blockchain stock registry could be extraordinarily significant.

First and foremost, it has the potential to eliminate the current nominee system for registering ownership of stock, where depositories such as the Depository Trust Company hold stock certificates as owners of record and track transfers using their own electronic book-entry system. This separation of record ownership by the depository from beneficial ownership by the client was implemented in the 1970s by the SEC. It was in response to dramatically increased trading volumes during the 1960s and 1970s, which had overwhelmed the traditional system of presenting share certificates for transfer to the issuer or its transfer agent. The solution was to take the burden of tracking record ownership off of the issuer by allowing most market transactions to be effected in the electronic system of the depository. DTC was charged with running a centralized electronic book-entry system covering all the shares it owned of record (which today is substantially all shares of most public companies).

In its time the electronic book-entry system was an innovative technology that allowed the markets to continue to function. Forty plus years later, however, it still causes many opportunities for errors and inefficiencies arising from the multiple parties and transactions required for beneficial owners to vote on matters and to transfer shares. Blockchain technology is thought to have the potential to entirely eliminate the need for such intermediaries and the distinction between record holder and beneficial owner. It is viewed in effect as the new and improved form of electronic tracking system, replacing the DTC system of record and beneficial owners with a system that operates with only one type of owner, the record owner.

Another potential benefit is that Blockchain technology enables direct transactions without the need for intermediary verification and processing, meaning that settlements could occur immediately rather than in a matter of days or longer, which would also reduce transaction costs. Plus, comprehensive real-time share ownership information would be continuously available to any participant in the system, *i.e.*, complete transparency.

Finally, because a Blockchain system is an “incorruptible digital ledger”, inconsistencies in corporate records regarding share counts and ownership interests could be reduced or even eliminated.

The Long Path Ahead

Despite these substantial potential benefits, the Delaware amendments are really nothing more than a means of encouraging consideration of Blockchain technology for use in maintaining corporate records. The amendments make clear that these technologies are consistent with Delaware corporation law, but they do not attempt to address any of the mechanics of how such a system actually would work. Many practical issues are yet to be addressed and resolved, including:

- Who will be able to input and access data on the distributed ledgers?
- How will data be secured?
- How will the transaction validation process work?
- Who/what will have organizational control of the distributed ledgers?
- How can the data be audited?

But all these issues have been addressed and adequately resolved in the Bitcoin application, so there is reason to believe that they can be worked out in the context of corporate recordkeeping as well.

These amendments are just the opening salvo in the effort to apply a very innovative technology to the very traditional world of corporate recordkeeping, which will no doubt be a long and difficult path. But they are a promising beginning which should encourage issuers, investors and financial market professionals to begin the process of investigating the use of Blockchain technology to maintain stock ledgers.