Governor Jack Markell announces Delaware Blockchain Initiative

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On May 2, 2016, at the second annual Consensus Conference in New York, Delaware Governor Jack Markell announced his support for the creation of a new method of representation of corporate share ownership. In addition to traditional certificated and uncertificated shares, all Delaware corporations (including a majority of the Fortune 500) may soon have the ability to issue shares using the same technology that underlies the virtual currency Bitcoin. The announcement is part of the Delaware Blockchain Initiative, a groundbreaking new project seeking to clarify the State's law and welcome the blockchain industry into the state.

Whether they call it "Bitcoin 2.0," "Blockchain," "Distributed Ledger Technology," or simply "DLT," advocates for the technology have praised its potential to clear and settle nearly any transaction imaginable. The most-promised use case may be in the capital markets, where today's clearance and settlement is only possible in reliance on numerous clearinghouses, custodians, exchanges and fiduciaries. Each of these intermediaries add a layer of complexity, cost and delay that this new technology can eliminate, argue Blockchain technology advocates.

Blockchain Technology

A blockchain is a ledger of transactions between parties on a network. The difference between a blockchain and a traditional database is that the ledger is "distributed." That is, each party on the network maintains a complete copy of the same ledger. The parties all participate collectively in the validation and recordation of transactions on the ledger via a computerized consensus protocol. There is no clearinghouse required to clear and settle those transactions.

Thus, a blockchain ledger can efficiently record transactions without costs and delays caused by intermediaries. Though Bitcoin was the first application of blockchain technology, blockchains can also be used to clear, settle, validate and record transactions in any asset that can be digitized, including securities, derivatives, title to real and personal property, health records and legal claims. Blockchain technology has the potential to affect some of the roles currently played by intermediaries in many industries, in the same way that the Internet has changed the roles of intermediaries in many types of transactions.

The Delaware Blockchain Initiative

The Delaware Blockchain Initiative (the "Initiative") is an outreach effort led by the Governor's office and Delaware's Department of State. The immediate elements of the project are:

- the assurance that virtual currency and blockchain businesses will not face new proscriptive regulation in Delaware;
- the Governor's support for the amendment of Delaware law to accommodate distributed ledger shares;
- the appointment of Andrea Tinianow as the state's Blockchain Ombudsman to spearhead the effort, and the state's Legal Ambassadors (the Blockchain Technology Team at Pillsbury Winthrop Shaw Pittman); and
- the launch of a proof-of-concept with Symbiont – a blockchain technology provider – to develop distributed ledger solutions for archival records;

Potential Benefits of Distributed Ledger Shares

Today, financial institutions' databases exist in isolation. Their stored data are not shared with each other. For one database to update its stored data without laborious manual input, it must query the stored data of another database. This process can be time-consuming and unreliable. Today's highly sophisticated clearance-and-settlement networks use interconnected databases that can track ownership of currencies, securities and commodities – sometimes as part of a single trade. Thus, it can take days to settle some transactions.

The key benefits of blockchain shares are that participants share a single database: a distributed ledger. As such, trades can execute instantaneously, without reliance on intermediaries, and settlement is guaranteed. "T+3" settlement delays need no longer exist. Voting and other governance processes can be included in the blockchain processes. Both publicly traded and privately held companies might benefit from the efficiencies of a blockchain ledger.

Technical Barriers

Despite the tremendous potential of blockchain technology, six years after its invention, its only real world financial services applications (beyond, of course, virtual currency) have been behind the doors of innovation labs. Technical challenges persist. For example: Permissionless ledgers like the Bitcoin or Ethereum blockchains are more secure, but are open for any participant to join. Permissioned ledgers like those being developed in-house by many financial institutions have yet to prove their security, but can be more scalable and more culturally acceptable due to the participants' control over new entrants. Still, whether permissioned or permissionless, blockchains are tremendously reliant on network effects to operate efficiently. A few banks on a blockchain probably creates a less secure and less efficient system than a piece of legacy database software on a central server. A few hundred banks, though, creates a much more powerful and much more efficient network than has ever existed. Expectedly, consensus among financial institutions as to new blockchain standards and topologies is difficult to achieve.

Legal Challenges

The greatest impediment to the implementation of this technology remains a legal one. Two, in fact. The first impediment is straightforward: Delaware corporate law does not explicitly permit the authorization of blockchain-based shares. The Delaware Blockchain Initiative is the first step in the process to change this.

The second impediment is more complex: Legally-cognizable settlement finality on a blockchain is an unproven theory. Settlement finality refers to the point in time where the definitive transfer of ownership – not merely custody – occurs between parties to a transaction. Practically, it is the point at which settlement instructions are irrevocable and the transaction becomes irreversible. The Delaware Commercial Code, for example, contemplates that corporations will authorize shares that will be traded and paid for using brokers, banks and other intermediaries. Today, it is an open question whether distributed ledger shares – which can be born directly onto a blockchain, traded directly between participants and paid for with a digital currency – are recognized under the law.

The Delaware Blockchain Initiative seeks to address this challenge as well by setting up a legal foundation for the entire lifecycle of a corporate share, from cradle to grave, within Delaware. This will only be a foundation, though. Subsequent to authorization, various other statutes, regulations and self-regulatory rules far beyond the scope of Delaware law affect corporate shares. For example, SEC and CFTC rules govern certain issuer activities and the behavior of participants in secondary markets.

The Path Forward in Delaware

Delaware's Blockchain Legal Ambassadors are collaborating with the Delaware Corporation Law Council to develop amendments to Delaware law. Since, the legislature convenes in January of every year for six months, it is possible that the new legal framework for distributed ledger shares will exist as early as the summer of 2017. Corporations looking to issue new shares in Delaware – whether via IPO or otherwise – should pay the closest attention. Developing a comprehensive corporate blockchain legal strategy will likely take time, and the hypothetical new laws may quickly become a reality.

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