How Will Blockchain Impact Your Company?

It will likely affect industries far afield from financial services

This is an exciting time for blockchain, the highly secure, distributed database technology best known as a core component of the digital currency bitcoin. Many people find the subject intimidating and arcane. But ***Stephen Obie****, a* ***Jones Day*** *partner who has immersed himself in it, has a very different view. You can hear it right away when you talk to him: He's excited, energized, enthusiastic. And why not? His firm sees vast potential in blockchain extending well beyond the realm of finance – so much so that it organized an interdisciplinary global working group focused on the area. In remarks that were edited for length and style, he talks about the state of the art and its many potential uses.*

Blockchain technology is proving to be a disruptive force in the capital markets. Where are some of the areas in which you see blockchain technology being used?

Some experts predict that blockchain will change the way a host of industries deal with their supply chains, contracts, records and more.

Stephen Obie: This is an exciting time for the industry because the blockchain is nascent in terms of the applications that people are developing. It was exciting to advise Overstock on the legal issues arising from its public offering utilizing the current regulatory process and adapting blockchain technology as a part of it. It took a lot of education with regulators at the SEC and FINRA to help Overstock get this offering out there.

In terms of other areas where I think you'll see blockchain technology being deployed, certainly those include trading platforms. There are applications being developed for syndicated loans, exchange-like trading and for worldwide platforms to raise money. Given how the technology has developed, even small investors can participate in certain offerings that otherwise were out of their reach, given the cost. This has in some ways been a challenge for regulators, but they've responded by coming up with crowdfunding rules and other mechanisms. This is an exciting and dynamic time because the technology is enabling new ways to raise capital.

One interesting development has been the idea of initial coin offerings in which a coin is offered to raise money, and that coin can be part of a fee that eventually will be used in some sort of application that either exists on the blockchain or otherwise. Some investors think that these coins may have other intrinsic value, which has many people purchasing coins and pushing prices up from their initial offerings. This is also an interesting time for tech companies, because the blockchain enables them to raise money without giving away equity in their organizations.

The applications for blockchain go beyond finance. What other areas of business and government have the potential to gain from blockchain technology?

Obie: We've seen some interesting pilot projects. For instance, a major retailer is going to be using blockchain technology to track the import of pork and other products, right from the raising of pigs in China all the way through the delivery cycle into the U.S. By tracking pork products, that retailer will know – down to the store level – where certain parts of pork have been processed and where they wound up. That information will enable them not only to conduct analyses on general and shipping costs, but also to enhance inventory and cash flow management. The seller benefits too, because as soon as delivery has been accepted, that event can be recorded on a blockchain, and payment can automatically transfer. We're also seeing applications, for instance, in the diamond industry. Diamonds actually have serial numbers that are laser-engraved into them, and you can track the diamond – where it came from, its ownership and history – so you know that, for example, it's not from one of the conflict areas. We're going to see many more such use cases.

In the mortgage and land titling industries, there are many potential efficiencies through the use of blockchain technology to track the purchase of a property all the way through mortgaging and secondary trading. The same is true for car purchases. Even M&A transactions can have certain documents and other information exchanged and recorded quickly on blockchain applications. One area where it potentially could be revolutionary is in the accounting profession. If businesses use blockchains for their finance operations so that records being created are immutable and can't be tampered with, it could help accountants and other auditors as they review company financials.

Finally, the advent of smart contracts will transform how certain industries operate. The insurance industry, for example, could have life insurance or other contracts on a blockchain with electronic data feeding into the contract and payouts occurring based on the data in the feed. I think you'll see that in some other areas as well.

How are regulators responding to these new developments? As you said earlier, it's challenging.

Obie: Regulators have tried to educate themselves and think through how blockchain technology will affect their operations. It's important to note that this is a global event, and regulators in jurisdications around the world have things to think through. In all likelihood, they will take different paths. For example, in the UK and Singapore, the regulators have created technology "hubs" or "centers" that incubate technology and study how current regulatory structures may potentially need to change in light of the new technology. They are also developing what's been called regulatory "sandboxes" designed to give both regulators and developers insight into how a particular application and the technology generally will interact with the legal framework of the country where the sandbox is located.

We haven't had a sandbox in the U.S. yet, although the Commodity Futures Trading Commission has shown a great interest in understanding and fostering blockchain technology. Acting Chairman Chris Giancarlo has given a number of speeches in which he has talked about the benefits of this technology, and the CFTC, as a result, put out a new tech hub release just recently. Another regulator, the Office of the Comptroller of the Currency, has come out with a concept release about having a fintech charter. There has been some pushback on the state level, but I think all regulators are interested in knowing where this technology is today and where it's going. We all know that disruption moves fast. It's moving exponentially faster now, and no one wants to be left behind.

Regulators also see benefits to this technology. For instance, going back to Overstock, all trading activity occurring on Overstock's preferred stock is available by looking at a particular website and seeing the blockchain explore data available in the public realm. For regulators with extensive reporting requirements, there's the potential that blockchain applications could vastly decrease the resources required to maintain the huge computer systems where centralized data is housed.

Given that the uses for blockchain are global, what are the jurisdictional issues likely to be?

Obie: We're seeing several jurisdictional issues right now. First, we have the issue of where a transaction is actually occurring. If the blockchain exists basically anywhere, and anybody can pull off a "golden copy" (the latest authentic reference copy of the original database that contains pertinent information about the transaction), when there are transactional disputes that have been recorded using blockchain technology, which jurisdiction is actually being impacted, and where can legal disputes be brought? That will be an interesting development that we'll see in the next couple of years. The legality of smart contracts and how courts and juries will understand them and how they will operate given the current legal frameworks in various nations is another area where the law will be developing … and where the technology will ultimately force changes in some nations' laws.

Even areas that we haven't touched on – for instance, tokens and coins – will see issues. Some nations don't even regard those as securities. Others take a different view.

Just think about bitcoin and how revolutionary it has been. In many ways it has brought great transparency and great value, not only from the technology but also from the way the coins are utilized. But we've also seen instances where bitcoin has

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parties should state all items of costs or potential expenses meant to be included.

Don't forget, though, that a company located in Maryland or New York may not be attempting to enforce its indemnity rights under the laws of or in the courts of those states. Obviously, choice of law and venue provisions may be included and may control; but in their absence, depending on where the goods, services, parties and loss are located, it may be unclear which law applies.

Crafting Language That Fits a Contract

Instead of broad form, intermediate or narrow indemnification provisions may be more appropriate. Intermediate indemnification agreements are slightly less protective and predictable than broad form, but are more widely enforced. The indemnitor generally indemnifies against loss from its sole negligence and from joint negligence. In other words, unless the indemnitee's sole negligence caused the loss, the indemnitor must pay. Some predictability is lost because the indemnitee (in most states) need only prove that the indemnitor was partially liable (e.g., 3 percent) to require the indemnitor to pay for the entire loss.

Simple or narrow indemnification provisions require the indemnitor to pay for loss it solely caused. Derivations of this include mutual indemnification provisions. The split of mutuality can be tied to negligence, property ownership or employees (i.e., you are responsible for your property and employees, and I am responsible for mine, regardless of fault).

Financial resources and regulatory requirements may provide important additional requirements. Counsel should be creative and clear in drafting an indemnification provision to reflect the parties' intent.

Policy Terms Should Be Reviewed

Often companies that assume some form of indemnification would like to have insurance pay for that liability. A starting point is to check the company's policies for exclusions of liability assumed by contract, and related carve-outs and savings clauses, such as "Insured Contracts." Most liability policies include language about contractual liability – whether covered, excluded or something between.

Risks completely out of your control or exclusively in the control of someone else generally are good candidates for risk transfer.

The risks identified in the indemnification agreement are important as well. Ideally these should be similar to those covered in a responding policy's provisions, and not similar to specifically excluded risks.

An indemnitee may seek assurance that the indemnitor will be able to pay indemnification amounts. Some parties put language directly into indemnification provisions to require certain insurance limits. But the language in those policies may be the key to coverage. If possible, specify the coverage terms needed.

Additional insured status is another method of risk transfer that often goes hand-in-hand with indemnification provisions. Whether being an additional insured means that the indemnitor may rely 100 percent on its insurance coverage depends largely on the scope of the indemnification provision, the risk and the policy language. Misalignment of these items should be avoided.

Sometimes a liability or property policy is not the best fit for a risk. Directors & Officers, Errors & Omissions or professional malpractice policies may provide the better coverage and should not be overlooked.

Lastly, if defense costs are important, the indemnitor should consider its insurance coverage and whether it pays defense and investigation costs for other parties (in the event of a litigation or an investigation). It should also evaluate whether the defense costs erode coverage limits. Eroding limits could leave insufficient coverage for the actual liability.

In sum, where indemnification provisions are needed, counsel should be clear, seek predictability to the greatest extent feasible and remember to utilize insurance policies to maximize the protection for all parties. Doing so will make management happier and the transaction more financially secure.

Blockchain

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been used by criminals for nefarious purposes. Regulators have struggled to figure out how they can regulate technology that transcends international borders and yet is easy to access using your home computer and the internet. I think regulators are interested in getting their arms around what's happening with this technology.

What areas of the law are most likely to be affected?

Obie: In the first instance, there's great interest in figuring out how blockchain technology can be utilized in financial services. As a result, we've seen consortiums being formed. We've seen financial services companies thinking about how their processes can be updated to take advantage of this technology as it evolves, and strategizing as to what legal changes might be needed to fully implement such technology. That's one area.

As I mentioned earlier, the changes to supply chains will be profound. The efficiencies and incentives made possible are very exciting. Contracting is going to be another area where blockchain technology will impact how business is done. That includes how we give disclaimers, how we provide warranties, even the language of the contracts. If it's now going to be electronic and stored on a blockchain, just about every industry will see changes.

There's also the operation of smart contracts themselves. There are times when the full provisions are built into a contract. How do you utilize the full provision for a smart contract? It will be an issue that lawyers and others will grapple with as more people become astute in using the technology and as the technology becomes pervasive throughout the economy.

Finally, health care is another area where blockchain technology will have a substantial impact, in part because it will enable people to have access to their health records in a secure manner anywhere in the world. That's one of the areas of great promise for blockchain technology.

How is Jones Day working with its clients on blockchain matters?

Obie: As a multipractice, multijurisdictional law firm that collaboratively serves clients as one firm worldwide, we have the ability to provide seamless service across the entire spectrum of new opportunities created by blockchain, and do so all around the world. We have an interdisciplinary team that brings together leading lawyers from all relevant disciplines, including intellectual property, banking and finance, financial regulation, disputes and litigation, and, of course, capital markets and transactions, from our London, Sydney, Munich, Singapore and New York offices, just to name a few. We're advising our extensive base of multinational corporate clients on topics ranging from investing in cryptocurrencies and, if so, how to do it, to the legal issues related to cybersecurity, contracts, originations, dispute resolution and fiduciary obligations. We take tremendous pride in our ability to serve clients and take seriously their protection as challenging and interesting legal issues emerge from disruptive trends.

What else are clients asking you about bitcoins and blockchain?

Obie: Cybersecurity matters are at the top of everyone's minds, and they want to know how to prepare for cybersecurity incidents. Most know about the recent ransomware attacks where the ransom required was to be paid in bitcoin. Companies everywhere are thinking about how to prepare for such an event, particularly given the last one, which seemed to really impact Europe and Asia. Given that the value of cryptocurrencies has increased as an asset class, clients have also asked if they should invest in them, and how they might do so, and what legal issues are involved. They want to know how liquid the market is, and where coins can be traded. The third area that clients have asked us to counsel them on is how these applications can make it to the market in the current legal environment in which they're being sold.

What makes all of this especially interesting from a legal standpoint is that because of blockchain's worldwide presence and multidimensional aspects, no one is asking us to take a look at the technology and legal issues from any *one* nation's view, or any *single* aspect of the law. Clients are coming to us for a multijurisdictional, multipractice view because the applications that are being developed, regardless of where they are developed, will be cross-border applications going forward, and they will touch many areas of the law.

There has never been a more exciting time to be a lawyer than right now.

Note: The views expressed are the personal views of the lawyer and do not necessarily reflect those of the law firm with which he is associated.