Valitas Insights: Blockchain and M&A
Five Potential Use-Cases for Blockchain Technology in M&A: Part 1 – Fortifying Trust

Over the past few months, "Bitcoin" has become a global buzzword, often associated with either incredible wealth creation, or scandal and dismissiveness. The concept of a decentralized currency is both a fascinating and polarizing subject. It has received public endorsements from the likes of Peter Thiel, Goldman Sachs, and even Paris Hilton and Floyd Mayweather. It has also received polarizing disapproval from Jamie Dimon, CEO of J.P. Morgan and Chinese government regulators. The concept of Bitcoin is such a profound and fascinating topic that the search term "Bitcoin" has surpassed the total "Justin Bieber" searches on Google since August 2017.

In this three-part series, we will stay away from 'Bitcoin Mania' and focus on the underlying technology behind Bitcoin: Blockchain. More specifically, we will outline five potential use-cases for blockchain technology in M&A, with an emphasis on how blockchain can *improve* rather than compete with the current infrastructure. In Part 1, we consider the role of blockchain technology in creating a higher degree of certainty in contractual agreements between the parties to an M&A transaction. In subsequent installments, we will discuss the following use-cases: Due diligence and Compliance, Cross border payments, Confidentiality, and "The Delaware Initiative."

If, after reading the preceding paragraph, you are scratching your head and thinking: "What the heck is blockchain?", we suggest you get a primer on the term before reading further. Here are five links that we found helpful:

1) An eight-minute video by HBR explaining how blockchain works
2) An inforgraphic by IBM explaining blockchain and some of its use cases
3) An interactive webpage by Goldman Sachs on blockchain
4) A video by IBM explaining the difference between Bitcoin and blockchain
5) Once you have a basic understanding, check out this beginners guide to Ethereum by Blockgeeks. Ethereum is essentially a platform used to develop applications on blockchain

Now that everyone is on a similar playing field, let's dive into the first of five potential use-cases for blockchain technology in the world of M&A and raising capital…

1. Establishing Certainty: Fortifying Trust with a Smart Contract
The Problem Today: All things being equal, establishing and earning trust is among the most essential elements of any M&A deal. Trust, however, is difficult to establish and virtually impossible to guarantee. As a result, countless hours are spent creating and negotiating contracts. While a contract is enforceable by law, provisions are subject to interpretation, and there is no absolute guarantee that a litigated outcome will represent either side's intention. Legal battles are costly from a time, money, and emotional perspective.

Jurisdictional issues can add further complications. Ultimately, trust that the counterparty will hold up his/her end of the deal is the foundation of any contract.

The Blockchain Solution: Smart Contracts. A foundational element of a 'smart contract' on the blockchain is that contractual outcomes become systematic rather than trust-based. There is no room for a "he said/she said" argument, because once the contract has been established on the blockchain, the outcome is guaranteed. Seth Godin described this as follows: "Creating 'I will if you will' contingent agreements is significantly easier once we use the blockchain and the real-time coordinating power of the net."

In an M&A transaction, replacing an earnout with a smart contract represents a simple example of how blockchain could improve current infrastructure[1]. When agreeing to earnouts, both sides accept a tremendous amount of counterparty risk. Earnouts are essentially a series of 'if then' contingencies, which at their core, assume that the counterparty will uphold his/her end of the bargain. Smart contracts built on a blockchain could reduce this risk significantly. For instance, the intervals over which earnout conditions are paid could be automated. While earnouts are typically paid out at the end of an agreed term i.e. two years, a smart contract could automate payments to be quarterly, monthly, weekly, or even immediately, as a condition is met.

As a rudimentary example, consider an earnout structured as a 1% royalty of sales during the year after a transaction closes. A smart contract could be built on a foundation of "if then" contingencies on the following basis: if a transaction clears from a Point of Sales system, referred to as an Oracle[2], then 1% of that transaction amount is withdrawn from the acquirer's bank account and deposited to the target's bank account.

This smart contract could become increasingly complex if more detailed earnout conditions are established or if payments are made using the buyer's shares. However, the underlying concept remains the same: enforcement of the underlying agreement is systematic.

More to come in Part 2 and Part 3... Stay tuned...

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[1] For more on earnouts, we recommend this Wildeboer Dellelce LLP article, which can be found here.
[2] An Oracle, in the context of blockchains and smart contracts, is an agent that finds and verifies real-world occurrences and submits this information to a blockchain to be used by smart contracts (https://blockchainhub.net/blockchain-oracles/)