

# CLIENT ALERT

## Top 6 Tips for Blockchain Start-Ups

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### 1. Know your Market.

Blockchain is still unknown to many industries and across many jurisdictions, many of which have not been exposed to the technology it harnesses and are unaware – and sometimes apprehensive - about how it works. This collective fear of the unknown has the potential to impede investment, understanding and exploration of ideas and opportunities.

#### What to consider:

- Blockchain implementations involving distributed ledgers entail putting trust and authority in a decentralised network rather than a central institution – is your sector ready for this control shift?
- How can blockchain or distributed ledger technology be used to achieve objectives in your industry (such as reducing costs or creating new business opportunities)?
- Who is most susceptible to blockchain implementations in your industry? Are they on board with the use-cases you have in mind, and are these easy to explain?
- What are the knock-on effects on your sector when it comes to governance, organisational structure, talent and legacy systems and business processes?

### 2. Outreach to Regulators.

The fast-moving nature of blockchain, coupled with it being a completely new application, has meant that regulators are scrambling to keep up. Blockchain is changing the status quo, and therefore faces barriers to widespread adoption by entrenched financial institutions if its regulatory status remains unsettled. It is key to establish dialogue among blockchain solution providers, industry users and regulators so that blockchain applications are optimised to work within coherent regulatory frameworks.

#### What to consider:

- How do current regulations impact your application of blockchain for both yourself and your customers? Is there a way your solution can simplify compliance with those regulations?
- Is your application of blockchain multi-jurisdictional? Are the regulations consistent between jurisdictions? Do inconsistencies between jurisdictions create hurdles or open opportunities?
- Who are the primary regulators in the industry you will target? Do those regulators need teach-ins or other types of help to understand blockchain technology?
- How robust are these regulations – do they interfere with or help facilitate your proposed application?
- Is there scope for you to interact with the regulator and turn to it for guidance on bringing your application to market?

### 3. Seek Ecosystem Harmony.

An inherent benefit of blockchain is ecosystem simplification: with all transactions being added to a single ledger, the complexity and clutter of multiple ledgers is reduced. However, currently we see that in certain sectors, organisations are developing their own blockchains and applications specific to them alone. Different chains --> different standards --> different network effects. The result is inefficiency and a move away from the fundamental intended benefit.

#### What to consider:

- Are there other players in your sector with whom you share opportunities and/or threats?
- Do any bottlenecks exist that prevent you from working together?
- How do you propose to share data with other players in your sector?
- Do any competition restrictions exist that will cause concern for customers using distributed ledger technology?

### 4. Keep your friends close... and your potential security risks closer.

Even taking into account the strength of encryption and private or permissioned blockchains, cybersecurity will always be a fundamental concern raised by the wider population. This must be addressed before your blockchain application can be embraced. The level of proactive acknowledgment and engagement of privacy concerns, modeled around core issues of security, trust and value, will drive the level of public approval of blockchain applications.

#### What to consider:

- How is the security of your intended blockchain application perceived by potential customers? Is the confidence in your sector particularly skewed one way or the other?
- How can you engage with customers and convey that privacy and security are priorities for your application?
- Who has access to the ledger and how is access controlled?
- What information will be stored on your blockchain? Is that information subject to controls?
- How are error transactions handled? How are bad actors handled?
- Who owns data that is stored on the blockchain?
- What oracles will you need, and how will you ensure that those oracles continue to provide correct information?
- How will future software updates be implemented and will these raise fresh security concerns?

### 5. Node Money Node Problems.

Although a key benefit of blockchain is the elimination of third-party intermediaries and overhead costs for exchanging assets, thereby greatly reducing transaction fees, the peer-to-peer transactions involved give rise to potentially high aggregate costs. If your blockchain implementation will utilise nodes, a critical mass of nodes - each performing the same tasks as all others on its own copy of the data to try to be the first to find a solution - is required. Inefficiencies arise from those nodes working extremely hard yet not contributing significantly to the network overall. A blockchain application must harness network effects to give value to its customers and/or the sector it operates in itself.

#### What to consider:

- Is your proposed blockchain application affordable and more efficient than the existing processes available?
- What are the main drivers of cost in your implementation of the blockchain?
- Will the initial capital costs prove to be high enough to be seen as a deterrent?
- Are there ways to share costs and the processing load with other blockchain applications / third-parties?

#### 6. Go Big (Picture): Consider issues faced by all new companies.

It is key for any start-up to make sure it has a grasp not only of the fundamentals in the area in which it operates, but of the broader issues applicable to it as a new company.

#### What to consider:

- Who owns the intellectual property in your blockchain solution? How will that IP be assigned to your company? What measures should you take to protect that IP (trade secret, copyright, patent)?
- Will open source software be used? If so, how will you ensure that your solution does not become subject to open source licensing? Alternatively, do you plan to open source your solution?
- How will you brand your solution?
- Who makes key decisions for your company? Can one founder make decisions without consulting others?
- If potential investors want to see restrictions on when founders can sell their equity or compete with your company, what restrictions are you willing to agree to?
- Is insurance coverage obtainable? If so, what coverage will you need?

#### Where we can help...

Each startup business is unique. At Crowell & Moring, we understand that entrepreneurs not only need sound business advice, but also practical, real legal solutions from experienced practitioners across different jurisdictions as they navigate formation, capital needs, cross-border concerns, commercial growth, and eventual partnerships or acquisitions. Our professionals have extensive experience in growing companies across a wide range of geographies and industries, and we follow our clients hand-in-hand through the enthusiasm and trials that come with launching new businesses.

For early-stage companies, timing, speed, and resources are of critical importance. Our seamless integration across offices and jurisdictions allows us to balance careful consideration of each company's circumstances with a highly efficient process to get companies up and running quickly and affordably. And when it comes to raising capital, we are well-versed in market standards and players either side of the Atlantic, have streamlined our processes to help businesses secure the funding they need when they need it, and work hard to protect our clients' interests down the road. We have advised on everything from "friends and family" investment rounds, to sophisticated multi-million dollar debt and equity financings, giving each type of financing and client the same high quality and affordable service.

Being in the early-stage company space provides us with the opportunity to not only interact with many early-stage companies, but also to interact with and represent prominent investors. The value we can provide in capital-raising extends to evaluating

investor presentations and business plans, information on the market and investors, and business strategies to best position a company for success. Our experience representing both emerging companies and investors allows us to provide our clients with unique insight into issues that come to bear in financing transactions.

The first few steps a business takes are crucial, and we appreciate and admire entrepreneurs for their courage and ingenuity in taking those steps. We take great joy in being true counselors and partners to our clients in the beginning and each step of the way forward.

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