From: "Rickard, Jill" <Jill.Rickard@vermont.gov>
Date: Tuesday, April 17, 2018 at 11:22:12 AM
To: "David Hall" <DHall@leg.state.vt.us>
Cc: "Pieciak, Michael" <Michael.Pieciak@vermont.gov>, "Boyles, Gavin" <Gavin.Boyles@vermont.gov>, "Dillon, Molly" <Molly.Dillon@vermont.gov>, "Bill Botzow" <botzow@sover.net>, "Michael Marcotte" <jimkwik@surfglobal.net>
Subject: S.269 - Draft 7.1

David,
DFR has had further discussions around the "personal information trust company" concept. We appreciate the opportunity to provide the following comments on the latest draft of S.269.

In general, it's important to reiterate the existing financial (nondepository or independent) trust company regime does not fit neatly with the "personal information trust company" concept. Trust companies and trust relationships, by definition and based on many years of precedent, involve the care and custody of "property that may be the subject of ownership." Many of the provisions currently in Vermont's law (to say nothing of judge-made law on the topic) simply do not make sense if applied to an entity that holds only information. The term "personal information trust company" and the concept of holding personal information in a "trust relationship" are used throughout Section 2 of the bill. We would respectfully request that these references be changed or removed.

Alternatively, The Vermont Trust Code (14a VSA 102) would need to be amended to expressly exclude personal information trust companies created pursuant to chapter 78 of Title 8 to avoid applying the specific and uniform requirements for financial trusts to this new information fiduciary concept.

However, in either case, we believe it is important to more fully develop and specify the appropriate statutory standards for fiduciary duty (in the context of solely handling personal information), data security, etc. Given that these companies would be receiving and potentially distributing highly sensitive personal identifying information, it may be prudent for the committee to consider further study into these standards before moving forward.

With that in mind, please find DFR's specific requests and comments below.

- Please change "personal information trust company" to "personal information management company" or something similar throughout.
- Please remove all references to "trust," "trustee," and "trust relationship" throughout.
- The definitions of "personal information trust company" and "act as a fiduciary" seem to involve some circularity.
- Instead of defining "personal information management company" as a person who offers services to the public, it may make sense to move the concept of advertising services to Section 2453 (such that a Personal information management company shall not, without first obtaining a certificate of authority, offer to the public by advertising, solicitation, or other means that the person is available to provide personal information management services).
- Section 2455 is missing "and" between (1)(2)(B) and (C).
- Please delete Section 2456(b) in its entirety. The reference to 8 VSA 2410 imports a regime that does not fit neatly with this new concept of personal information management company. Instead, please include language in Section 2457(b) clarifying that DFR has authority to

promulgate rules regarding enforcement. That way, DFR can adopt rules setting forth enforcement procedures specific to these new entities.

- In Section 2457(a), the reference to 8 VSA 2405 also imports a regime that does not fit neatly with this new legal concept. Again, please include language in Section 2457(b) clarifying that DFR has authority to promulgate rules regarding reports and examinations.
- While DFR would be happy to collaborate on the new study (regarding municipal and state authorities' use of blockchain) in Section 3 of the bill, we do not believe DFR has the appropriate expertise to take the lead on such a study.

Please let me know if you have any questions.

Best,
Jill

Jill L. Rickard | Director of Policy | Vermont Department of Financial Regulation

From: David Hall
Sent: Thursday, April 12, 2018 11:49 AM
To: HOUSE_COMMERCE; Oliver Goodenough (OGOODENOUGH@vermontlaw.edu); jhansen3@norwich.edu; Tom Moody; Peter S. Erly; 'michael.pieciak@vermont.gov'
Subject: S.269 - Draft 4.1

Good morning,

Attached is draft 4.1 of the proposed House Commerce amendment to S.269. I reflect changes against the last public draft with yellow highlights.

In order to provide advance opportunity to everyone to reflect on some of the changes, I note the following:

1. **Revised definitions** – Following Committee testimony and discussion concerning a universal definition of "blockchain" and "blockchain technology" this draft includes new definitions for both in 12 VSA 1913, and incorporates that definition by reference throughout the other pieces in the bill.

2. **Personal Information Trust Companies**

– Page 3, subsection 2452(d), I have added language for discussion purposes concerning the scope and applicability of regulation. Given the way we currently define "act as fiduciary" in 8 VSA 2401, I think it may be unclear whether a personal information trust company would be subject to regulation as an independent trust company under 8 VSA chapter 77. To avoid this ambiguity, I hoped to clarify that a PI trust business would be subject to regulation under this new chapter to the extent it conducts trust activities concerning PI, and may be subject to regulation under other chapters for other types of trust business.

- Page 3, subsection 2453(c)(1), the Committee wants to clarify that a foreign business may operate as a PI trust company if authorized.

- Page 4, subsection 2453(c)(4), the Committee wants to clarify that someone needs to be physically present in Vermont at least once per year.

- Page 4, subsection 2453(c)(5), the Committee wants to use standard language (from GLB, others) to require an information security program and may include use of blockchain technology.

- Page 6, DFR rules – open question on whether to mandate DFR to adopt rules.

3. Study – expanded: (1) not just e-banking, but all banking; (2) specific to South Burlington pilot project (question whether this second piece is appropriate for DFR?)

4. Fintech Summit – question whether and how ACCD has mandate/permission to do this

5. BBLLC

Though there is little change in this draft, I had a far-ranging discussion with House Ways and Means yesterday and it helped to focus some concerns that this provision may raise, specifically dealing with the addition of "Participants" to the umbrella of statutorily-recognized actors in an LLC who may enjoy limited liability.

In a nutshell, the State and a business organization make a fundamental bargain: the State will recognize the separate legal identity of a business organization and limit the liability exposure of owners/operators/investors if the business organization takes certain procedural steps required by statute (concerning formation, operation, notice, owner/investor/other rights and responsibilities, etc.) and the owners/investors of the business take risk = they risk losing some of their money in a commercial venture, e.g., open a restaurant that might fail, produce a chemical that might be harmful, write a software security program that might be hacked, etc.

The State allows the owner to mitigate that risk by limiting personal liability to the actual investment in the business organization ~ the investor can lose all of the money he or she invests in the business, but not her other personal assets (in contrast to a sole proprietor or partnership). The State (society) makes this trade because it wants individuals to take business risk. It creates minimum statutory safeguards, e.g., a name that includes "LLC" or a minimum vote threshold to change the terms of bylaws, to ensure that people involved with the business have open eyes and are treated fairly.

The concept of "Participants" seems counter to much of this social bargain.
First, the definition of "Participant" gives me pause due to its potential breadth. To be a participant, could you simply:

(1) obtain a partial copy of the decentralized ledger (e.g., download this off the Internet?);

(2) participate in the validation process (e.g., link your computer?);

(3) control any digital asset native to the blockchain technology (what is the scope of these assets?);

(4) make a material contribution to the protocols (e.g., edit open-source code?).

Second—Currently limited liability is a function of statute – we expressly afford it to certain actors provided they comply with the law. However, under this language, the liability of a Participant is a question addressed by the Operating Agreement. Should we convey this authority to the business organization?

Third: Any/every Participant could enjoy the same limited liability as a member. This raises questions:

(1) If the members and investors get the benefit of limited liability because they are taking the risk and "have skin in the game," why should a participant get that same benefit?

(2) Will a participant necessarily even know the terms of the operating agreement, including the extent of his rights or responsibilities? For a private ledger used by an LLC internally, perhaps the LLC would know the participant and entice his or her participation by offering limited liability or other benefits – the LLC may share its operating agreement and market the protections it could offer. But what about large companies, companies using open source code that they invite the public to edit, or public ledgers, e.g., worldwide cryptocurreny mining. Do those miners or other participants really have an understanding of the LLC, or any real nexus to the LLC or Vermont? What is the value for the LLC? The Participants?

(3) Right now under current law the LLC could draft its operating agreement to make a "participant" a member of the LLC to afford liability. Obviously this would require a reasoned calculus by the member and the participant on whether and to what extent the participant would be involved in the business. As the State, wouldn't we prefer this kind of reasoned engagement in exchange for the benefits associated with a limited liability organization?

(4) Under current law, in the event of a lawsuit, a court might "pierce the corporate veil" and disregard the organization—and the limited liability it affords—if the finds that there isn't sufficient basis to recognize the organization as a legal entity distinct from its owners. This may happen where the owner doesn't actually take risk ~ doesn't actually invest enough money into the business for it to be viable. It may also happen if the owner doesn't treat the business as separate entity ~ doesn't observe the formalities of keeping records, holding annual meetings, having separate accounts, etc. And, if the business otherwise fails to observe the statutory requirements for that business, e.g., file an annual registration, it is no longer recognized by the State. These legal requirements are fundamental to recognizing business organizations and their practices as legitimate. By way of example, the necessity of a true transfer of risk underpins the concept of captive insurance companies. If the parent company doesn't transfer risk to its captive subsidiary, it loses the benefits that would otherwise accrue, e.g., the ability to deduct insurance premiums from taxable income. To hold up the bargain, the State requires these type of distinctions between owners/investors and entities. In the context of a BBLLC, however, the Participant doesn't necessarily have any of this – they may get the benefits of the limited liability organization without any of the costs. As a matter of public policy, what is the off-setting benefit here?

(5) In the event of a lawsuit, how difficult will it be for a court to identify who each Participant is, the capacity of each Participant when taking certain actions, what his or her liability is, and whether to recognize a legal distinction between the Participant and the LLC. What precedent does the Court have to rely on? This may all be philosophical, but on the other hand, could there be real-world consequences? I haven' had time to think all the way through these, but some possible examples:

(A) An invididual software engineer in Vermont is a Participant who writes a substantial part of the code for a Vermont BBLLC that is a cybersecurity company. The code is faulty, and millions of user accounts are hacked. Consumers sue the LLC. Under the operating agreement, the Participant has the same limited liability as the members, who are at risk of losing their entire investment in the LLC. However, the Participant has not made any financial investment in the LLC. Therefore, the extent of the Participant's exposure *through the LLC* is zero. Under current law, one theory consumers could advance is that the Participant/coder is in a partnership with the LLC, and is therefore personally liability for damages. However, under the BBLLC arrangement, he can argue he is not in partnership – he is a Participant and has no liability.

(B) An individual in New York mines a cryptocurrency for a Vermont BBLLC that created the currency. Under the Operating Agreement, the Participant has the same limited liability as a member. A

Vermont investment firm has invested several million dollars in the cryptocurrency. Due to an infirmity in the way the cryptocurrency "wallets" interface with the system, a large amount of the cryptocurrency is stolen from the wallets by Russian hackers. Users must decide whether to re-write the chain to address the situation and try to restore the currency back to the rightful owners, potentially creating a "hard fork" ~ two conflicting chains. However, a majority of operators and miners refuse to do this fearing the integrity of the code, and the investment firm loses its investment entirely. It sues the miners and everyone involved for damages. Under current law, the New York miner may be personally liable for damages. However, as a Participant, he essentially has no liability.

(C) A Vermont business is organized as a Vermont BBLLC. It uses a public ledger and open source code to manage its records, and it affords limited liability to all Participants who work on the code (protocols) and validate its processes to encourage their participation and benefit from their work. An individual who writes code (intentionally)(unintentionally) causes trade secrets, nonpublic personal information, damaging documents, etc., to be exposed to the Internet. The BBLLC is sued, or faces regulatory action. The coder claims limited liability as a Participant.

What are the costs and benefits to be balanced in these scenarios for society, for Vermont businesses, for Participants, and for plaintiffs who suffer harm?

6. Blockchain in Municipal Records – open questions as to whether Committee will pursue these provisions in light of concerns from municipal organizations.

Sorry for the lengthy and late email. I'm sure it will all benefit from discussion with people who are far more knowledgeable about these issues than I am.

Best,

David

David P. Hall, Esq.
Legislative Counsel
Vermont Legislative Council
115 State Street
Montpelier, VT 05633
(802) 828-2231
dhall@leg.state.vt.us