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OBSAH

OBSAH	7
ADAPTING TO THE NEW NORMAL - IMPLICATIONS OF THE PANDEMIC FOR THE FUTURE OF DISPUTE RESOLUTION	12
<i>Lilla Király, Eszter Papp</i>	12
CHINESE APPROACH TO ONLINE DISPUTE RESOLUTION	47
<i>Magdalena Łągiewska</i>	47
CONSTITUTIONALISM AND CONSTITUTIONAL CRISES. PRELIMINARY OBSERVATIONS	63
<i>Egresi Katalin</i>	63
ELECTRONIC EVIDENCE IN CIVIL JUDICIAL PROCEEDINGS IN ALBANIA ...	91
<i>Flutura Kola Tafaj</i>	91
CHALLENGES IN REGULATING DECENTRALISED FINANCE	124
<i>Zsolt Bujtár</i>	124
THE CORRELATIONS BETWEEN SOCIAL MEDIA AND CRIME.....	149
<i>Dávid Tóth</i>	149
THE CURRENT EU AND HUNGARIAN LEGISLATION OF ENERGY COMMUNITIES AND POSSIBLE FUTURE DIRECTIONS	165
<i>Zsófia Biró</i>	165
BLOCKCHAIN AND THE VOTING OF SHAREHOLDERS: SOME PROBLEMATIC ASPECTS	186
<i>Aleksei Volos</i>	186

BLOCKCHAIN AND THE VOTING OF SHAREHOLDERS: SOME PROBLEMATIC ASPECTS

Aleksei Volos¹

Abstract

The purpose of the study is to establish the theoretical and practical aspects of using blockchain technology to vote for shareholders, to provide legal advice to participants in such relationships as well. The object of the research is the relations bound with the use of blockchain for the aims of shareholders voting. It is discussed the voting mechanism and procedure, possible economic and legal advantages, as well as the risks in the area. Among the main results of the work, one should note the fact that an idea has been formed about the main legal risks that may arise when shareholders vote on the blockchain. The scientific novelty of the work is associated with the uniqueness of the purpose of the study, as well as the fact that, based on the existing business practice, a comprehensive view of the legal risks arising from the use of the blockchain for voting by shareholders is proposed.

Keywords:

Shares, shareholders, voting of shareholders, digital law, corporate law, rights of shareholders.

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Introduction

The development of modern technologies follows the path of its introduction into all spheres of public life. Economic relations associated with private law were no exception. The latest technologies are now being applied wherever possible, including more and more actively used in the field of corporate relations. As a result of the coronavirus pandemic, restrictions on the movement of people, the introduction of holidays in a number of countries, the enjoyment of corporate rights and the performance of duties has become difficult. For instance, there are legislative requirements for the procedure for holding the general meeting of shareholders². Different countries have different rules, but usually such a meeting should be held annually. In view of the restrictions imposed, we broached the notion about the procedure for holding such meetings. In practice, this problem has been resolved, but it is difficult to imagine what new difficulties the pandemic will bring and what new global threats will be presented to humanity.

The use of modern technologies can help solve not only this problem, but also seriously simplify the procedure for exercising rights by subjects, reduce the costs that arise in this regard, and improve the efficiency of management and administration. This is especially true in the interaction of entities located in different states, when the

² State Duma of the Russian Federation (1995), About the stock company, The Federal Law, (November, 24, 1995), Moscow, Russia. Retrieved from: <http://pravo.gov.ru/proxy/ips/?docbody=&nd=102038864>. State Duma of the Russian Federation (1994), The Civil Code of the Russian Federation. Part 1, (October, 21, 1994), Moscow, Russia. Retrieved from: <http://pravo.gov.ru/proxy/ips/?docbody=&nd=102033239>.

shareholders participating in the meeting of the company are residents of different countries.

Among the technologies that are increasingly used in order to simplify the voting procedure for participants in a legal entity, we will point out the "blockchain" technology. The legislation of many states of the European Union, as well as the United States and Russia "permits using any information technology, including blockchain, to support the decision-making process - voting, counting voting results, storing information on voting results - during the meeting - along with other services that provide remote participation in the discussion of the issues specified in agenda"³. The admissibility of using blockchain in the aggregate for its apparent legal and economic advantages attracts subjects of corporate relations, who are increasingly using it for voting purposes.

Blockchain is a peculiar technology, a specific database. It consists of a continuous sequential chain of blocks, each of which contains specific information. The uniqueness of this technology is that the data cannot be modified, but at the same time the anonymity of users and the transparency of the data itself are guaranteed. Blockchain can be used for a variety of purposes, including those aimed at the emergence, change, termination of rights and obligations (conclusion and fulfillment of contracts, voting in elections, maintaining registers, etc.). For example, there are prospects for using blockchain in maintaining corporate registers and recording rights to shares in electronic form. According to the point of view of a lawyer, blockchain can act as a

³ Novoselova, L. & Medvedeva, T. (2017). Blockchain for shareholders. *Economy and law*, № 10, pp. 10-21.

method and / or a special additional tool for the exercise and implementation of subjective rights.

It was determined that in different countries of the world a business practice of using blockchain technology has been formed for the purpose of voting by corporation members. Technical development and a complex epidemiological situation in the world only speed up these processes. It's quite another matter that law and legislation are not fully prepared for this. This could potentially lead to legal problems in the future, in particular if the case on the legality of voting on the blockchain is brought into court.

1. Materials and Methods

As a part of the proposed study, the purpose was to find out the prospects for using blockchain technology for the purposes of holding a shareholders' meeting, to establish directions for improving the legislation of the countries of the world and business practice in this direction.

The complex of interrelated tasks should be resolved in order to achieve this purpose. First, we should study the business practice of using blockchain technology for the purposes of shareholder voting and systematize it, taking into account the legal aspects. Secondly, it is necessary to assess some of the legal risks that may arise in connection with this. Thirdly, we should outline the prospects for the development of legislation on the establishment of legal norms in connection with the use of blockchain in corporate relations. The object of the research is the relations bound with the use of blockchain for the aims of shareholders voting. The author describes the essence of blockchain, its legal significance.

Considering the purpose of this article, the author has chosen the appropriate subject and research methodology. The following sources were selected as materials to be studied (subject of research). At first, these are materials of business practice, which contain information on the use of blockchain technology for the purposes of voting by corporation members. There are a lot of such sources today. Basically, they are freely available on the Internet, as well as in advertising materials of firms providing technical services related to the blockchain. Secondly, these are the norms of the legislation of various states concerning the issue of regulating the voting process of shareholders. Most countries in the world have not formed a special legislative approach to voting by shareholders on the blockchain, but the laws and practice of its application generally do not disallow its use. Thirdly, the author studied the scientific literature on the research topic, the opinions of scientists from different countries about the legal and economic aspects of using blockchain technology for corporate purposes.

The complex of various methods of cognition was used in order to achieve the objective of the study. First of all, these are traditional general scientific (analysis, synthesis, deduction, induction, analogy, comparison) and special methods (formal analysis, dogmatic method, comparative legal). Among the special approach, the method of legal modeling was used, by which the author proposed a model for the use of blockchain technology for the purposes of voting by corporation members. This model unveils the procedure for voting by shareholders using blockchain technology and can be used to improve the legislation of various countries, as well as in business practice. The economic analysis of law was also used, which made it possible to formulate the main economic and legal risks from using the blockchain for voting by shareholders.

Methodological limitations that may affect the integrity of the results obtained are associated with the limited empirical base of the study. The results of the work and the main conclusions of the author are based on the existing business practice. However, this practice is not spacious today. In addition, in different countries of the world there is no judicial practice that could confirm or refute the conclusions of the author. Thus, the author's scientific approach can be further adjusted sometime after the formation of a stable business and judicial practice regarding the use of blockchain for voting by shareholders.

2. Results

The author has reviewed the procedure for voting by shareholders using the blockchain technology. Ongoing and refining the scientific achievements of other authors, it is necessary to point out four stages of such a vote. The first stage includes an initialization phase. The second stage is preparatory. The third stage is directly voting, according to the rules of the central system. Stage four is counting of votes.

Today, it should be emphasized that there are serious legal risks associated with the use of blockchain for corporate law purposes. Its minimization is possible by improving legislation, international acts, as well as carrying out scientifically based recommendations to lawyers practicing in this area.

2.1. Case-study

Global practice already knows a large number of examples of blockchain use for the purposes of voting by participants in a legal entity. This mainly applies to joint stock companies.

We should consider an example from the US practice in 2019. The blockchain is successfully used for voting in corporations, including those with more than 8 million shareholders holding a total of almost 4

trillion shares. Immediately after the vote, there is an opportunity to get an instant result of how it was conducted. This speed allows shareholders to make decisions about where to spend the remaining funds and to conduct the business of a legal entity as efficiently as possible⁴.

The authors from the United States suggest that any corporate action will require an appropriate "Smart Resolution", in other words, they propose to introduce this term to reveal the "smart" nature of these resolutions of the director or shareholder, which will automatically trigger a "resolved" action when passed. For example, when a «smart» permission of shareholder is created for a capital increase and the permit is successfully passed by a 75% majority, the smart permit will cause a corresponding increase in an existing asset class or even issue a new asset class⁵.

Company «Mazars» can be considered as an example of European experience. It is a French organization specializing in audit, accounting, taxation and business consulting (headquartered in Paris). It has been operating on the market since the middle of the 20th century. The company began to actively use blockchain technologies since about 2016 to achieve its purposes, including for organizing voting for its clients, whose shareholders are located in different states⁶. This use of

⁴ Cooper, T. (2019). The problem with proxy voting – and how Blockchain can help. Retrieved from: <https://www.ibm.com/blogs/client-voices/blockchain-makes-shareholder-votes-count/>.

⁵ Otonomos (web-site). (2016). Future of Corporate Law: The Company Smart Contract. Retrieved from: <https://otonomos.medium.com/future-of-corporate-law-the-company-smart-contract-6308c86c6a78>.

⁶ Hmani, I., Pape, M.M., Restes, E., Akakpo, A. (2017). Utilisation de la technologie Blockchain pour le vote électronique. Retrieved from:

technology allows shareholders to significantly save time and money, and also solves the problem of holding voting in the context of restrictions caused by the coronavirus pandemic.

In Russia, the most famous experience in using blockchain technology is the work of the National Settlement Depository, which offers its customers the E-voting service⁷. It is noted that “the most elaborated and well-grounded proposals on the market for services providing corporate procedures are related to the e-proxy voting system using blockchain technology, which is being implemented by Russian specialists. As part of the e-proxy voting, participants in the voting procedure exchange a large amount of data, which is distributed in a cascade way along the chain of nominal holders”⁸. Thus, the technical capabilities have been created for holding various votes by shareholders using blockchain technology in Russia.

Besides, now all over the world special applications are already being created that can be effectively used for the purposes we are considering. So, the Japanese company BitFlyer in the summer of 2020 presented a new blockchain-based application that allows fair voting at virtual meetings of shareholders. The coronavirus pandemic, according

<https://www.esilv.fr/portfolios/utilisation-de-technologie-blockchain-vote-electronique/>.

⁷ National Settlement Depository (official web-site). (2020). E-voting – electronic voting of shareholders. Retrieved from: <https://www.nsd.ru/services/depozitariy/uslugi-dlya-emitentov/e-voting-elektronnoe-golosovanie-aktsionerov/>.

⁸ Novoselova, L. & Medvedeva, T. (2017). Blockchain for shareholders. *Economy and law*, № 10, pp. 10-21.

to representatives of the company, hastened the process of creating this application⁹.

In theory, the blockchain can be used when holding a meeting of any corporate legal entity. But the significance of the blockchain is most clearly seen in situations where a large number of participants vote and when there is a need to reduce costs and expenses. These factors are more clearly appeared in relation to joint stock companies. But all of the above may be relevant for other corporations (in particular, limited liability companies, partnerships, associations, unions).

As one can propose, in different countries of the world a business practice of using blockchain technology has been formed for the purpose of voting by corporation members. A large number of firms offer technical services in this field, many joint stock companies are ready to use them. Technical development and a complex epidemiological situation in the world only accelerate these processes. Another thing is that law and legislation are not fully prepared for this. This could potentially lead to legal problems in the future, in particular if the case of the legality of voting on the blockchain comes into court.

2.2. The procedure for voting shareholders using blockchain technology

⁹ Oki, H. (2020). BitFlyer Blockchain revela aplicación de votación para reuniones virtuales de accionistas. Retrieved from: <https://es.cointelegraph.com/news/bitflyer-blockchain-reveals-voting-app-for-virtual-shareholders-meetings>

We suggest to consider the process of voting by participants in a legal entity using blockchain technology¹⁰. In the scientific literature, above researchers point out the stages of voting. Among them, we emphasize the following. The first step includes an initialization phase, which includes defining the rules governing voting, the central system and all other protocol systems.

The legal entity (its executive bodies) will have to upload the list of owners of shares (shares) before the voting date on a special electronic platform.

The second step is preparatory. The central system, based on the data obtained at the first stage, will check whether a particular participant has the right to vote, whether he can enter the system.

The third step is directly voting, taking into account the rules of the central system. Each participant constructs and transmits their vote to the network. Voting participants will be given a certain number of voting tokens and access to the network via private keys. Shareholders will send their "vote coins" to public addresses that match their voting preferences in accordance with the blockchain transaction protocol. The number of such "coins" per shareholder will be equal to the number of shares that one owns. For example, for a member of a limited liability company, the number of "coins" will be distributed in proportion to their share in the corporation.

¹⁰ Hardwick, F.S., Gioulis, A., Akram, R.N, Markantonakis, K. (2018). E-Voting With Blockchain: An E-Voting Protocol with Decentralisation and Voter Privacy. 2018 IEEE International Conference on Internet of Things (iThings) and IEEE Green Computing and Communications (GreenCom) and IEEE Cyber, Physical and Social Computing (CPSCom) and IEEE Smart Data (SmartData), Halifax, NS, Canada, 2018, pp. 1561-1567.

Before the voting process begins, shareholders can appoint a proxy to vote in their place. This will be achieved, for example, by providing a private key. This procedure will allow the shareholder to determine exactly how the voting on their shares went.

The four step is counting of votes.

Each shareholder and their proxies can check exactly how their votes were cast and included in the vote count, as well as independently verify the voting results. Also, this procedure has advantages for regulators (for instance, government bodies, notaries, other persons, if by virtue of law they must check the voting process). They will be sure that no unfair (as well as illegal) actions have interfered with the voting process. Both shareholders and management will have access to real-time vote counting, giving both parties an equal chance to intervene at the last minute of campaigning¹¹.

3. Discussion

The results of the study indicate that in different countries of the world, including Russia, there is no special legal regulation for the situation of holding shareholders' voting using the blockchain. Consequently, legal risks arise that could potentially lead to the invalidation of a vote in certain cases. This aspect of the problem has been partially raised in various scientific studies, primarily from the standpoint of the positive and negative features of the blockchain technology, as well as the risks associated with its use.

¹¹ Nord, S.J. (2019). Blockchain pluming: a potential solution for shareholder voting? *University of Pennsylvania Journal of Business law*. Vol. 21:3, pp. 706-756.

3.1. The pluses and minuses of using blockchain technology for the purpose of shareholder voting

The economic and legal significance of the blockchain has been considered in the studies of scientists from around the world, including for the purposes of exercising corporate rights. As a whole, the main advantages of blockchain technology for the purposes of voting by participants in a legal entity are usually referred to as high speed, as well as transparency and accuracy of the procedure itself. Furthermore, when using the blockchain, there is a decrease in errors and costs, there is a greater accuracy of voting and the legitimacy of decisions, an increase in the transparency of a level playing field for competition between corporate stakeholders¹².

Technical tools today allow business to use the accuracy, speed and security of blockchain technology in order to simplify administration processes and get rid of inefficiencies. It also provide confidence in all documents, as they are encrypted in the ledger and therefore cannot be lost or damaged. This means that companies do not need to worry about long-standing documents that they may need someday, as they will always be recorded and stored online¹³. There are other advantages of smart contracts and blockchain technology for corporate governance, many of which are detailed in the economics and management literature.

¹² Panisi, F., Buckley, R.P., Arner, D. (2019). Blockchain and public companies: f revolution in share ownership transparency, proxy voting and corporate governance? *Stanford Journal of blockchain law & policy*, Vol. 2.2, pp. 189-220.

¹³ Thompson, E. & Coin, R. (2019). How smart contracts are used in administration. *Yahoo finance*. Retrieved from: <https://finance.yahoo.com/news/smart-contracts-used-administration-070027540.html>.

As an additional plus, we note the possibility of transparent voting by proxy. It is usually difficult or almost impossible to verify how a proxy was voted. Blockchain makes it easy. Due to the speed and convenience, voting using blockchain could motivate shareholders to more regular direct participation in governance and require more frequent voting on more issues.

It is significant that certain aspects of the problem of the ratio of positive and negative aspects of the blockchain have not been unanimously recognized by specialists. For example, while discussing with American and European colleagues, the Russian author L.V. Sannikova notes that "the blockchain does not simplify voting, except for the possibility of remote access, does not eliminate intermediaries, and the benefits of using it are not trivial¹⁴". The quoted statement is not indisputable and cannot be attributed to all possible circumstances, because it does not take into account all permissible economic factors. Blockchain can significantly simplify the voting procedure, help reduce costs, and then the advantages from its use can be more clear. At the same time, it should be noted that it is really difficult to assess the positive and negative factors from using the blockchain in each specific case.

An clear exaggeration is the opinion expressed by an Italian scientist that the main advantage of blockchain and smart contracts is the almost complete elimination of the risks of default on contractual obligations¹⁵. It stands to reason, the risks will remain, however, the risks

¹⁴ Sannikova, L.V. (2019) Blockchain in corporate governance: problems and prospects. *Law and Economics*, № 4, pp. 27 - 36.

¹⁵ Pasquino, V. (2017). Smart contracts: caratteristiche, vantaggi e problematiche. *Diritto e Processo* derecho y proceso - right & remedies, pp. 239-247.

associated with improper performance of the obligation directly by the debtor will significantly decrease. However, we cannot exclude the risks of a technical plan, for example, in terms of a computer error.

It should be recognized that some of the positive features of blockchain may have the opposite effect. For example, quick voting is not always effective. It is believed that managers can use the blockchain to speed up voting by manipulating shareholders and abusing their rational use. Indeed, there are such risks¹⁶. However, it should be borne in mind that the very activity of shareholders to participate in voting implies their professionalism and independent assessment of risks. The question of whether to vote quickly or take time to think should remain with the member of the corporation, regardless of the voting method.

Needless to say, the risks from using blockchain are not limited to what has been said. Here we can point out the possibility of cyber threats and hacker attacks (for example, data falsification), operational risks (including insufficient or erroneous coding); risks associated with increased transparency¹⁷. Significantly, continental European researchers point out that economic expectations from blockchain use are often exaggerated¹⁸.

¹⁶ Nord, S.J. (2019). Blockchain plumbing: a potential solution for shareholder voting? *University of Pennsylvania Journal of Business law*. Vol. 21:3, pp. 706-756.

¹⁷ Panisi, F., Buckley, R.P., Arner, D. (2019). Blockchain and public companies: a revolution in share ownership transparency, proxy voting and corporate governance? *Stanford Journal of blockchain law & policy*, Vol. 2.2, pp. 189-220.

¹⁸ Syda, L. (2018). Blockchain: quel impact pour les smart contracts sur le Droit? Retrieved from: <https://www.carrieres-juridiques.com/actualites-et-conseils->

To what extent these risks are higher or lower than those risks that are usually assumed by shareholders participating in “traditional” types of voting, can be determined only taking into account specific factors and characteristics of the activities of individual corporations. The legislation should only allow shareholders to make their own choice about the form and mechanism of voting.

3.2. Opportunities to mitigate legal risks from using blockchain technology for the purpose of shareholder voting

Many potential participants are repelled by the legal risks associated with the ambiguous interpretation of the legislation in relation to situations of using the blockchain. The authors from the United States, taking into account the experience of various states, noted that in jurisdictions where full dematerialization processes have not yet been carried out, although this is allowed by law, the conversion of shares from certified securities to uncertified securities usually requires a decision of the board of directors, which cannot be fully implemented in action until all share certificates have been transferred to the corporation¹⁹. The legal framework could mitigate some of the risks of blockchain use and provide voting platforms with the right level of security and privacy, which will be of particular importance for its widespread trust among shareholders.

[emploi-juridique/blockchain-quel-impact-pour-les-smart-contracts-sur-le-droit/1609](https://doi.org/10.1007/978-94-007-1609-1_1609).

¹⁹ Panisi, F., Buckley, R.P., Arner, D. (2019). Blockchain and public companies: f revolution in share ownership transparency, proxy voting and corporate governance? *Stanford Journal of blockchain law & policy*, Vol. 2.2, pp. 189-220.

Admittedly, blockchain-based corporate governance will also raise fundamental and purely practical legal questions. For example, how indispensable is the classic "physical" management of a legal entity and how it relates to governance using the blockchain. Is it possible in this case to completely move away from the management of a legal entity with the obligatory presence of a head or manager? Recent data indicate that even the majority of institutional investors are not yet in favor of full virtuality, offering room for a step-by-step transition to it²⁰.

Even more legal issues and difficulties will arise when using blockchain technology when voting by shareholders located in different countries. In this case, conflicts in law may arise, because the participants of a legal entity, being residents of different countries and having different personal laws, can interpret the arisen legal incidents in different ways. In a number of states, blockchain is directly allowed for corporate governance purposes, somewhere - theory and practice have not given an unambiguous answer to the question posed.

It is possible to subordinate the voting process to the law of one state (it is most logical to subordinate it to the law of the organization in which the vote is held). However, this will not solve all the problems. At first, a sovereign state can also act as a shareholder, which can have immunity both under international law and under its own legislation. Secondly, a number of legal systems establish the so-called super-imperative rules in private international law, which restrict the application of conflict of laws rules. It is entirely possible to assume that the practice of individual states will follow the path of limiting the use of

²⁰ La farre, A. & Van der Elst, C. (2018). Blockchain Technology for Corporate Governance and Shareholder Activism. SSRN Electronic Journal. January, 34 pp.

the blockchain precisely because it is too independent of state influence and control.

Thus, the certain legal framework is required at both the international and national levels, which would be aimed at reducing the legal risks from using the blockchain when voting by shareholders.

First, work is needed to systematize legislation on the use of modern technologies at the regional level. This will simplify the work of lawyers and shareholders themselves. For example, at the level of the European Union, it would be promising to work on the generalization of legislative acts of all EU countries related to corporate governance using digital technologies. Based on the results of such work, scientifically based recommendations could be issued on how to reduce legal risks from using blockchain for voting by shareholders.

Secondly, the possibility of using the blockchain for voting by shareholders should be explicitly provided for by the constituent documents of the legal entity.

Thirdly, participants in a legal entity must determine in advance a list of the most significant issues, the decision of which cannot be made remotely. A specific list must be established by law. Some issues require real discussion and the presence of members of the organization and cannot be addressed online. These are questions concerning the very existence of the organization (reorganization, termination, change of the field of activity, etc.).

Conclusion

Thus, the blockchain technology can be effectively used when voting by shareholders, as well as during other meetings in a corporation. This will greatly simplify the procedure for exercising rights by subjects,

reduce the costs that arise in connection with this, and increase the efficiency of management and administration. The relevance of the blockchain is most clearly seen in the interaction of entities located in different states. In particular, when the shareholders participating in the meeting of the company are residents of different countries.

Today, it should be emphasized that there are serious legal risks associated with the use of blockchain for corporate law purposes. Its minimization is possible by improving legislation, international acts, as well as providing scientifically based recommendations to lawyers working in this area.

However, one should not overestimate the capabilities of blockchain technology in general and for corporate law in particular. Blockchain is a special technology, a specific database. It can act as a method and / or a special additional tool for the exercise and implementation of subjective rights. In particular, the blockchain can be used for the purposes of voting by corporation members. Its application in a specific case should be decided by the participants of the legal entity independently, taking into account all the positive factors and risks. At the same time, the legislation of the countries of the world can be clarified in order to reduce legal risks, for example, by establishing a rule that voting using technologies is fully equivalent to face-to-face voting, unless otherwise decided by the corporation's members.

It is also necessary to establish at the level of the law that some issues require real discussion and the presence of members of the organization and cannot be considered online. These are questions concerning the very existence of the organization (reorganization, termination, change of the field of activity, etc.).

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