

DAO Regulation and Legislation

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Abstract

This article explores the contrast between traditional centralized corporate entities and Decentralized Autonomous Organizations (DAOs) in the U.S. financial regulatory landscape. While traditional entities operate with a centralized structure and clear managerial hierarchies, DAOs disrupt this paradigm with their decentralized, democratic, and digital nature, thanks to blockchain technology. DAOs face significant legal challenges due to their unique structures, including regulatory uncertainty and liability issues. The paper highlights the need for regulatory clarity and adaptation to accommodate the participatory structures of DAOs. It concludes that while existing financial regulations apply to DAOs, they often fall short due to DAOs' unique nature, necessitating an update in regulatory approaches to appreciate the specific virtues of DAOs and Legal Autonomous Organizations (LAOs). The evolving landscape of DAOs demands close observation and involvement from various stakeholders in the blockchain industry to address these regulatory challenges effectively.

Keywords: Wyoming DAO Law, DAO, LAO, DAO Law, decentralized autonomous organization.

A Introduction

For a long time, financial regulatory bodies in the U.S. have been responsible for overseeing corporate entities and their financial assets. A common feature among these corporate entities is that each of them has a centralized structure, with a small group of actors in control of the corporate hierarchy. To comply with the law and regulatory requirements, the management teams of these corporate entities have fiduciary responsibilities towards their entity as well as the shareholders. Therefore, when a corporate entity violates the rules, leading to a reprimand or communication from the government, the message is sent to a readily available, centralized mailing address of a management team member. This also applies when a corporate entity is operating without the proper licensing. In other words, if there is any problem with management, there is a designated managing member responsible for receiving and complying with regulatory correspondence.

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In contrast to traditional centralized corporate entities, Decentralized Autonomous Organizations (DAOs) disrupt the centralized paradigm by placing managerial and long-term development control in the hands of unidentifiable members across an unknown number of jurisdictions. DAOs are decentralized, meaning they don't need any identifiable centralized authority to operate.¹ They use a distributed democratic digital protocol process and have the ability to exist entirely and even exclusively through digital technical operations, thanks to blockchain technology.

DAOs represent their members as standing on an equal footing in terms of the possibility of joining the DAO, the ability to gain access to pertinent information related to the operation of the respective DAO,² and even the possibility of participating in managerial and strategic decisions. Formal hierarchies found in traditional companies are not needed for the DAO to function. In other words, DAOs do not require formal positions of power to operate.

However, DAOs face substantial risks and significant legal challenges, along with their members and development teams that program their creation and deployment.³ Although many DAOs have raised considerable funds successfully, most of them, particularly those not associated with crypto-related objectives, fail to attain their intended missions. Due to the unique distributed structures of DAOs, traditional regulation and the rule of law are unable to account for them, which creates an increasing need for regulatory clarity on DAOs in the U.S. The most significant concerns include ongoing legal ambiguity regarding the potential liability of the different parties involved; regulatory uncertainty encompassing securities, tax, antitrust, insolvency laws, cryptocurrency market volatility, cybersecurity threats; and emerging diverse customs and practices.

The potential of DAOs replacing traditional organizational structures in the U.S. and globally is not yet fully known. However, DAOs are gaining popularity and could bring about a revolutionary business concept based on contemporary ideas of decentralization and fair decision-making among stakeholders. Therefore, it is crucial for lawyers and regulators to observe the development of DAOs as they evolve. Ideally, a diversity of stakeholders in the blockchain industry should be involved in the regulation of DAOs since the industry is still in its infancy and no single person or entity has all the answers to the regulatory challenges.

1 Aaron Wright (2021). The Rise of Decentralized Autonomous Organizations: Opportunities and Challenges. *Stanford Journal of Blockchain Law & Policy*. <https://stanford-jblp.pubpub.org/pub/rise-of-daos/release/1>.

2 *Id.*

3 *See: Commodity Futures Trading Commission v. Ooki DAO* (3:22-cv-05416) where the court found Ooki DAO to be an unincorporated association that falls within the definition of a 'person' under the Commodity Exchange Act, therefore subjecting Ooki DAO and its participants to personal legal liability.

B Advantages of DAOs

I Direct Control in Managerial Decision-making

When compared to traditional companies, DAOs provide individual members with a greater sense of involvement and influence in the organization's activities. By frequently granting managerial participation to members, each member can contribute to decision-making and help shape both short- and long-term strategies for the DAO.⁴ While traditional companies rely on a small group of individuals to dictate decision-making, DAOs share the decision-making process equally among members to create a truly decentralized decision-making system.

On the one hand, a typical U.S. stock investor who doesn't have any voting rights or involvement in the company may feel helpless when stock prices fluctuate due to internal management decisions over which they have no control. On the other hand, the decentralized and participatory nature of DAOs allows members to have more direct influence without relying on a few select executives or intermediaries such as third-party agents, managers or banks.

II Efficiency and Transparency

Forming a DAO in the U.S. is an easier process compared to creating other financial or legal entities.⁵ The registration process is simplified, and there are fewer industry-related hurdles to overcome, which can lead to lower overhead costs.⁶ However, one major drawback is the lack of established regulatory standards for DAOs. Since the sector is relatively new and evolving rapidly, it is crucial for all parties involved to keep up with the ongoing developments and changes in emerging legislation. For instance, it is still unclear how DAOs are treated legally, whether as unincorporated partnerships or some other form of corporate structure.

DAOs often avoid legal formalities and use registration exemptions to address this. Members of DAOs usually agree to govern decision-making through smart contracts, software and code-based rules.⁷ A smart contract is an agreement with terms written into computer code, which is self-executing and runs on a decentralized platform like a blockchain. This ensures that the contract is secure, tamper-proof and transparent. Smart contracts automatically execute and enforce the agreement when predefined conditions are met, without intermediaries like banks, lawyers and courts, reducing the potential for human error or manipulation, as well as the inevitable fees and other costs of the traditional intermediaries.

Trust within DAOs is built upon the transparency of transactional data among its members. This is facilitated by the publicly accessible and unalterable transaction history records on the blockchain.⁸ In contrast to traditional companies, DAOs maintain a publicly viewable ledger. Organizational members can quickly and

4 Gail Weinstein, et al. (2022). *A Primer on DAOs*. Harvard Law School Forum on Corporate Governance.

5 *Id.*

6 *Id.*

7 Wright, *supra*. At 156.

8 Weinstein, *supra*. At 5.

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transparently access transactional data of the organization, which fosters trust within the community.

DAOs use smart contracts and blockchain-based voting protocols to streamline group decision-making.⁹ By relying on blockchain technology for voting, members can authenticate the results of votes cryptographically.¹⁰ The efficient decision-making process and voting measures employed by DAO members have the potential to reduce costs associated with proxy-based voting or other costly voting approaches. Overall, DAOs provide an effective way to make group decisions that are transparent, secure and cost-efficient.

III Elimination of Human Error by Way of Smart Contract Utilization

Smart contracts guarantee that DAO funds are not misused in ways that go against the contract's intended purposes. Since DAOs usually operate on an open-source blockchain network, it becomes almost impossible for any stakeholder or member to conceal any fraudulent or illicit activities within the blockchain.¹¹ Members and interested parties have unrestricted access to examine the blockchain transaction history at any given moment, promoting a culture of trust and transparency that is often absent in many conventional organizational systems.

The use of blockchain-based smart contracts allows DAOs to effectively reduce the chance of self-interested or opportunistic behaviour from its members.¹² The rules of the DAO are governed by the programming language of the smart contract, which prevents individual members from acting in their own interests by enforcing a set of regulations for collaboration among members.¹³ By doing so, DAOs not only maintain a high level of transparency but also prevent potential external risks and liabilities associated with fraudulent activities and human errors.¹⁴

C Disadvantages of DAOs – the Lack of a Legally Recognized Status in the United States

When a DAO is not attached to a legally recognized entity, like an LLC or a foundation, it can be hard to determine which laws and regulations apply to it.¹⁵ This lack of clarity can be confusing for members, creators and regulatory bodies alike. Additionally, because a DAO does not have a traditional management structure, members may worry about being held personally responsible for the debts, liabilities and decisions made by the DAO.¹⁶ Business structures like Limited

9 *Id.*

10 Wright, *supra*. At 161.

11 Weinstein, *supra*. At 5.

12 Wright, *supra*. At 161.

13 *Id.*

14 *Id.*

15 *Id.* At 156.

16 Rachael Browndorf & Andrew Lom (2021). *Wyoming to Recognize Daos as LLCs*. Regulation Tomorrow. www.regulationtomorrow.com/us/wyoming-to-recognize-daos-as-llcs/#:~:text=On%20April%2021%2C%202021%2C%20Wyoming%20Governor%20Mark%20Gordon,Innovation%20Technology%20and%20takes%20effect%20July%201%2C%202021.

Liability Companies (LLCs) and Corporations help to reduce the personal liability of their members and owners. However, the liability risks for members of DAOs are still unclear in most U.S. jurisdictions.¹⁷

D Applicable Legal Standards and Necessary Registrations

The U.S. Securities and Exchange Commission (SEC) warned in 2017 that it would typically consider tokens issued by DAOs as securities, comparable to stocks.¹⁸ This classification would require DAOs to follow federal securities laws, which include registration and ongoing public reporting requirements.¹⁹

I Tokens as Securities in 2017 SEC Release and the Howey Test

Gary Gensler, the Chairman of SEC, has stated that regulating the cryptocurrency and blockchain industry is one of the top priorities for the agency.²⁰ If DAO tokens are considered securities under the Securities Act of 1933, they will come under the reporting obligations of the Securities Exchange Act of 1934. This will make it difficult for many DAOs to comply with the reporting standards, as certain registration and reporting requirements mandate filing audited financial documents and disclosing the names of an organization's directors.²¹ These regulatory requirements are in direct conflict with the decentralized nature of a DAO that prides itself on having no centralized authority or board of directors.

Determining whether a token issued by a DAO is a security or not involves applying the 'Howey Test' as the appropriate legal standard.²² The U.S. Supreme Court introduced this test in 1946, in a case involving the Howey Company, a Florida-based citrus grove that sold half of its acreage to the public. Howey claimed that the sale of these citrus acreages would help in the financial development of the citrus farm.²³ The company would maintain and operate the citrus grove, while the buyers of these acres would receive a warranty deed as proof of purchase.²⁴ Buyers believed that they would receive a share of the profits generated by the citrus acreage. Most of these buyers came from outside Florida and had little or no knowledge about citrus groves.²⁵

The Howey Company was sued by the SEC for allegedly offering investment contracts that were similar to an initial public offering (IPO) of company stocks.

17 Wright, *supra*. At 156.

18 Securities and Exchange Commission (25 July 2017). *SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities*. <https://www.sec.gov/news/press-release/2017-131>.

19 *Id.*

20 See SEC Speech from Chair Gary Gensler (2021). *Remarks before the Aspen Security Forum*. <https://www.sec.gov/news/speech/gensler-aspen-security-forum-2021-08-03>.

21 Securities and Exchange Commission, *supra*.

22 *Id.*

23 *S.E.C. v. W.J. Howey Co.*, 328 U.S. 299 S.Ct. 1100, 1103, 90 L.Ed. 1244 (1946).

24 *Id.*

25 *S.E.C. v. W.J. Howey Co.*, *supra*. At 297.

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The company was selling citrus grove deeds without the necessary registrations, which violated the Securities Act.²⁶

Section 2(1) of the Act, at that time, defined ‘security’ as including common documents that were traded for speculation or investment. The definition also stated that securities were ‘a certificate of interest or participation in any profit-sharing agreement, investment contract, ... and in general, any interest or instrument commonly known as a “security”’.²⁷ The issue before the Supreme Court was whether the land sales contract, the warranty deed and the service contract, when considered together, constituted an ‘investment contract’ under Section 2(1) of the Act. At the time, the term ‘investment contract’ in Section 2(1) had not yet been defined.²⁸

The Court ruled that the Howey Company met the criteria of a profit-sharing business venture.²⁹ The investors had provided capital with the expectation of sharing in the earnings and profits while the promoters or managers ran the citrus grove.³⁰ Regardless of the label given to the contracts, they were deemed to be investment contracts.³¹ The Court clarified that for the Securities Act an investment contract refers to a transaction or scheme where an individual invests money in a common enterprise and expects profits solely from the efforts of the promoter or third party.³² The SEC can consider various factors that can classify securities, including the ability to be pledged, voting rights proportionate to the number of shares owned, and the potential to appreciate in value.³³

II *Applicability of the Investment Company Act*

It is also possible for DAOs that invest in ‘securities’ to be considered ‘investment companies’ under the Investment Company Act of 1940 (ICA). In order to publicly offer securities, investment companies so defined by the ICA must register with the SEC. Even if a DAO does not offer securities in a public market, it must still register with the SEC if it has over a 100 holders unless all holders qualify for a 3(c)(7) exemption under the ICA.³⁴ While it may be tempting for a DAO to avoid the costs and challenges of registration, doing so would severely limit the transfer of interests within the DAO because it would not be recognized as an investment company.³⁵

26 *Id.* At 294.

27 U.S. Congress (1934). *United States Code: Securities Act*. 15 U.S.C. §§ 77a-77mm 1934.

28 *Id.*

29 *S.E.C. v. W.J. Howey Co.*, *supra*. At 300.

30 *Id.*

31 *Id.*

32 *Id.*

33 *Wright*, *supra*. At 1103.

34 3(c)(7) exemptions under the Investment Company Act allow private investment companies to become exempt from some SEC regulations if they sell securities exclusively to ‘qualified purchasers’ rather than the general public. Among other criteria, a qualified purchaser must already own ‘not less than \$5,000,000 in investments’ as per 15 USC § 80a-2(a)(51). See, Roger Ragor (2021). *What Is a 3C7?* International Business Times 29 March 2021, <https://www.ibtimes.com/terms/123/3c7>.

35 *Weinstein*, *supra*. At 8.

III Lack of Antitrust Guidance

To date, U.S. antitrust agencies have not provided any substantial guidance on the regulation of DAOs.³⁶ The possibility of antitrust intervention arises when a DAO is perceived to function as a collaborative assembly of members participating in a joint process – basically colluding in a cartel – rather than the DAO operating as a single entity.³⁷ Even though a DAO operates transparently and efficiently, potential competitors might try to disrupt the process by raising antitrust concerns.³⁸ If the authorities should launch antitrust investigations in the DAO sector, DAO members might be personally accused of antitrust violations and even face criminal liability.³⁹

E Wyoming: Independent DAOs and LLC Status

Wyoming is the first state in the U.S. to classify DAOs as LLCs, thanks to the enactment of Wy. Stat. § 17-31-101-115 ('Bill 38') on 21 April 2021.⁴⁰ According to Bill 38, a DAO is recognized as an LLC if its articles of organization specifically state that it is a decentralized autonomous organization.⁴¹ The Bill was sponsored by Wyoming's Select Committee on Blockchain, Financial Technology, and Digital Innovation Technology, and it became effective on 1 July 2021.⁴²

The statute recognizes DAOs as a type of LLC. On the same day it took effect, American CryptoFED DAO became the first DAO to be legally recognized in Wyoming after completing the required registrations.⁴³ On 9 March 2022, Wyoming amended Bill 38, creating the current version of the statute.⁴⁴

Under Wy. Stat. § 17-31-101-115, or Bill 38, 'the traditional legal protections afforded a Wyoming LLC are extended to algorithmic and member-managed DAOs incorporated under the law, with a few exceptions.'⁴⁵ The following are the key features of a Wyoming DAO LLC:⁴⁶

- a There must be a registered agent in Wyoming.
- b The legal name must include 'DAO' or 'LAO'⁴⁷ or 'DAO LLC'.
- c There is a presumption that the DAO LLC is member-managed unless its articles say it is algorithmically managed.

36 *Id.*

37 *Id.*

38 *Id.*

39 *Id.*

40 Andrew Lom & Rachael Browndorf (2021). *Wyoming to Recognize DAOs as LLCs*. Regulation Tomorrow, www.regulationtomorrow.com/us/wyoming-to-recognize-daos-as-llcs/#:~:text=On%20April%2021%2C%202021%2C%20Wyoming%20Governor%20Mark%20Gordon,Innovation%20Technology%20and%20takes%20effect%20July%201%2C%202021.

41 *Id.*

42 *Id.*

43 For more information, see <https://www.americancryptofed.org/>.

44 Updated: Wyoming Passes DAO Supplement Recognizing Decentralized Autonomous Organizations (DAOs) as LLCs, Practical Law Legal Update w-032-5565.

45 Decentralized Autonomous Organizations (DAOs): Overview, Practical Law Practice Note w-036-6149.

46 *Id.*

47 'Limited Autonomous Organization', https://sos.wyo.gov/Forms/WyoBiz/DAO_Supplement.pdf.

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- d The articles of organization must include the DAO's smart contract and be amended whenever the smart contract changes.
- e In case of conflict between the articles of organization and the smart contract, the smart contract prevails.
- f The lack of approval of any proposal, or any non-taking any action, for one year automatically dissolves the DAO LLC.
- g Unless expressed otherwise, the laws governing regular Wyoming LLCs apply to DAO LLCs.
- h Members do not owe fiduciary duties to the DAO LLC or any other member unless otherwise provided for in the articles of organization.

Four main sections of the Statute govern the formation of a Wyoming DAO LLC: (1) § 17-31-104 regarding the definition and election of the DAO status; (2) § 17-31-105 regarding the formation of the DAO LCC; (3) § 17-31-106 regarding the articles of organization; and (4) § 17-31-108 regarding the operating agreement.

I § 17-31-104. Definition and Election of Decentralized Autonomous Organization Status

This section describes a decentralized autonomous organization as 'a limited liability company whose articles of organization contain a statement that the company is a decentralized autonomous organization'.⁴⁸ An LLC already registered in Wyoming may convert to a DAO LLC by amending its articles of organization.⁴⁹

For a DAO LLC to exist, the articles of organization must contain the following statement:

NOTICE OF RESTRICTIONS ON DUTIES AND TRANSFERS

The rights of members in a decentralized autonomous organization may differ materially from the rights of members in other limited liability companies. The Wyoming Decentralized Autonomous Organization Supplement, underlying smart contracts, articles of organization and operating agreement, if applicable, of a decentralized autonomous organization may define, reduce or eliminate fiduciary duties and may restrict transfer of ownership interests, withdrawal or resignation from the decentralized autonomous organization, return of capital contributions and dissolution of the decentralized autonomous organization.⁵⁰

II § 17-31-105. Formation

In order for a DAO to be formed as an LLC pursuant to Wyoming statute:⁵¹

- a One or more members must sign the articles of organization, and someone must deliver an original or an exact and confirmed copy to the Secretary of State.
- b The DAO LLC must have and maintain a Wyoming registered agent.

⁴⁸ § 17-31-104(a).

⁴⁹ *Id.* at (b).

⁵⁰ *Id.* at (c).

⁵¹ § 17-31-105.

- c The DAO LLC may form or operate for any legal purpose, regardless of whether it is for profit.
- d A publicly available identifier must be provided to the Secretary of State.

III § 17-31-106. *Articles of Organization*

In addition to the DAO statement of section § 17-31-104(c), ‘the articles of organization shall include a publicly available identifier of any smart contract directly used to manage, facilitate or operate the decentralized autonomous organization.’⁵² DAO LLC articles of incorporation must govern the following⁵³:

- i Relations among the members and between the members and the decentralized autonomous organization;
- ii Rights and duties under this chapter of a person in their capacity as a member;
- iii Activities of the decentralized autonomous organization and the conduct of those activities;
- iv Means and conditions for amending the operating agreement;
- v Rights and voting rights of members;
- vi Transferability of membership interests;
- vii Withdrawal of membership;
- viii Distributions to members prior to dissolution;
- ix Amendment of the articles of organization;
- x Procedures for updating, modifying or otherwise revising the organization’s smart contracts;
- xi Dispute resolution; and
- xii All other aspects of the decentralized autonomous organization.

IV § 17-31-108. *Operating Agreement*

An operating agreement may provide for aspects regarding the obligations, rights and duties of the members and the operation of the decentralized autonomous organization. Additionally, a smart contract may function as an operating agreement.⁵⁴

F Analysing the Wyoming DAO Law

I *Positives*

Protecting Assets: In Wyoming, DAOs structured as LLCs enjoy the same rights and protections as traditional LLCs. This provides limited liability for its members, effectively safeguarding their personal assets from the organization’s debts and liabilities.⁵⁵

Ease of Establishment: Wyoming DAO LLCs follow the same formation process as traditional LLCs, making them relatively easy to establish. The registration

52 § 17-31-106(b)

53 *Id.* at (c)

54 § 17-31-108.

55 *Chapter 31: Decentralized Autonomous Organization Supplement.* Wyoming Senate, General Session. WS-17-31-101 through 17-31-116. <https://www.wyoleg.gov/2021/Introduced/SF0038.pdf>.

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process involves filing with the Wyoming Secretary of State and completing the required documentation, such as the Articles of Organization.⁵⁶

Simplified Document Drafting: Similar to traditional LLCs, Wyoming DAO LLCs are based on the typical LLC business model, requiring only standard documents such as the Articles of Organization. This makes drafting legal documents for DAO LLCs straightforward for those familiar with LLC formation.

Avoid Double Taxation: LLCs avoid double taxation, as the owners and company are not taxed separately. Instead, like traditional LLCs, DAO LLCs are ‘pass-through’ organizations. The organization’s profits are taxed only once, namely through each member’s individual tax return.⁵⁷ Additionally, the Tax Cuts and Jobs Act of 2017 enables members to potentially qualify for up to a 20% deduction of their business income.⁵⁸

Transparency: Unlike traditional LLCs, which may keep their business model and operations private, DAO LLCs provide transparency to their members. The smart contract code behind a DAO enables trustworthiness, transparency and verifiability by mitigating human error risks and implementing smart code.⁵⁹

Increased Member Involvement and Equitable Decision-Making: DAOs empower their members with voting rights, ensuring that decisions are made collectively and equitably. This is in contrast to traditional corporations, which often centralize decision-making power within a board of directors. DAO LLCs ensure that every member has a voice and a vote in the organization’s operations.⁶⁰

II Negatives

Public Smart Contract: Although transparency is generally seen as a positive aspect, Wyoming law requires DAO LLCs to disclose their smart contract address in the Articles of Organization filed with the Wyoming Secretary of State. This makes the smart contract publicly accessible, potentially raising privacy concerns.⁶¹

Instability and Threats during Inactivity: Wyoming DAO LLCs are subject to automatic dissolution if they remain inactive for one year. Members must be vigilant about maintaining the organization’s operations to avoid dissolution.⁶²

No Manager-Managed DAO LLCs: While traditional LLCs can choose between manager-managed or member-managed structures, Wyoming DAO LLCs are restricted to member-managed structures only.⁶³

Government and Agency Confusion: Regulatory standards for decentralized organizations are relatively new and often subject to varying interpretations from

56 *Id.*

57 *Id.*

58 *Tax Reform: Deductions, Depreciation, and Expensing.* (2017). IRS. *Tax Cuts and Jobs Act of 2017.* <https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-a-comparison-for-businesses> (Accessed 3 April 2023).

59 Wyoming Senate, General Session, *supra*.

60 *Id.*

61 G. Shapiro (10 April 2021). *Wyoming’s Legal Dao-SASTER.* by Gabriel Shapiro. Found at <https://lexnode.substack.com/p/wyomings-legal-dao-saster>.

62 *Id.*

63 *Id.*

different government and regulatory agencies. This may create confusion or volatility in the regulatory landscape, which could lead to Wyoming courts or governmental institutions rejecting or invalidating DAOs not formed as DAO LLCs.⁶⁴

Lack of Universally Defined Terminology: Wyoming legislation defines a subgenre of DAOs to be ‘algorithmically managed DAOs’,⁶⁵ but Bill 38 does not define an algorithmically managed DAO. Although DAOs rely on operational algorithms, these algorithms are generally used in response to human decision-making. The lack of universally accepted definitions creates ambiguity, potentially subjecting DAO members to additional requirements or misunderstandings regarding applicable regulations for their DAO LLCs.⁶⁶

G Additional Financial Standard Regulations: Virtual Currencies, Including Governance Tokens, as Commodities

The Commodity Exchange Act of 1936 defines a ‘commodity’ to include agricultural products and ‘all other goods and articles [...] and all services, rights, and interests [...] in which contracts for future delivery are presently or in the future dealt in’.⁶⁷ It provides expansive regulatory authority and broad enforcement powers to the Commodity Futures Trading Commission (CFTC). The CFTC has ruled that virtual currencies are commodities. Therefore, futures transactions in crypto affecting interstate commerce fall under the regulatory and supervisory powers of the CFTC.⁶⁸

Retail commodity futures transactions are transactions that are entered into ‘on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis’ and which do not result in actual delivery within 28 days.⁶⁹ Retail commodity futures transactions are subject to 7 U.S.C. 6(a) ‘as if’ they are a contract of sale of a commodity for future delivery and therefore must be executed on a regulated exchange.⁷⁰

Any agreement, contract or transaction in any commodity that is entered into with or offered to (even if not entered into) with non-eligible contract participants on a leveraged or margined basis or financed by the offeror, counterparty or a person acting in concert with the offeror or counterparty⁷¹ is, subject to certain exceptions, subject to Section 4(a) of the Act, ‘as if the agreement, contract, or transaction was a contract of sale of a commodity for future delivery’.⁷²

64 *Id.*

65 *Id.*

66 *Id.*

67 7 U.S.C. 1(a)(9) (2018).

68 *Commodity Futures Trading Comm’n v. McDonnell*, 287 F. Supp. 3d 213 (E.D.N.Y. 2018); See Title 17 C.F.R. 180.1.

69 7 U.S.C. 2(c)(2)(D)(i), 2(c)(2)(D)(ii)(III)(aa) (2018).

70 7 U.S.C. 2(c)(2)(D)(iii) (2018).

71 7 U.S.C. 2(c)(2)(D)(i) (2018).

72 7 U.S.C. 2(c)(2)(D)(iii) (2018).

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Section 6(a) of the Act makes it unlawful for any person to offer to, enter into, execute, confirm, the execution of, or conduct an office or business in the U.S. for the purpose of soliciting, or accepting any order for, or otherwise dealing in any transaction in, or in connection with, a commodity futures contract, unless such transaction is made on or subject to rules of a board of trade that has been designated or registered by the CFTC as a contract market for the specific commodity.⁷³

An Eligible Contract Participant⁷⁴ (ECP) includes corporations or organizations with assets exceeding \$10,000,000; a broker or dealer subject to the Securities Exchange Act of 1934 regulations; floor traders; and individuals with extraordinarily high liquefiable assets. All of these participants have common qualities of exceptional knowledge and/or the financial ability to survive an extreme loss of profit or value. The average investor in the U.S. does not have this expertise or knowledge or holds large enough amounts of easily liquefiable funds. In case of a major and unpredicted drop in Ethereum blockchain-based assets, non-ECPs are left with large exposure and may end up congesting the blockchain with mass default rates.

H Conclusion

While DAOs are a new type of entity, regulations and legislative acts applicable to the corporate and financial sectors are largely applicable. Not all of those regulations and legislative acts are well-suited for DAOs because of their participatory structures and processes, which are unique and present new challenges for the development of rules that go beyond outdated reporting and registration standards. Unfortunately, current leaders at the CFTC and SEC are looking to regulate the virtual currency industry restrictively.⁷⁵ These restrictions do not appreciate the specific virtues of DAOs and LAOs. Therefore, it is important to stay up-to-date with the changes in the sector, and the challenges that DAOs face, as they are trying to establish themselves while being pursued by regulatory agencies.

73 7 U.S.C. 6(a) (2018).

74 7 U.S.C. 1a(18) (2018).

75 See, Securities and Exchange Commission (2023). *Crypto Assets and Crypto Enforcement Actions*. Crypto Assets. (<https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>).