



## ARBITRATING DAO DISPUTES A DELECTABLE CAN OF WORMS?

**This article examines some of the relatively novel issues which may arise, when arbitrating (in the traditional sense, rather than on-chain) disputes relating to a Decentralised Autonomous Organisation (DAO).**

Due to the broad range of jurisdiction – and issue-specific variables at play, it is only possible to scratch the surface of the multitude of potential issues which arbitrating DAO disputes may give rise to. It is, however, entirely apparent that there exist many complex and fascinating questions of law in this space, which remain to be resolved across key jurisdictions globally – many of which we shall see play out before tribunals (and, no doubt, courts), over the coming months and years.

## What is a DAO?

A *Decentralised Autonomous Organisation*, more commonly referred to by its acronym, DAO, is a fairly new and novel form of association and is constructed through the use of computer code, and deployed on a blockchain. DAOs may be used to automatically process transactions or functions, through the use of smart contracts. The operations of a DAO are commonly directed through decentralised governance, and without any centralised management function. They are typically managed communally by their members, who hold tokens in a manner similar to members holding shares in a company, which permit them to direct the DAO's governance. Typically, some members in DAOs will exercise their governance rights and vote on proposals as to actions the DAO should take; others may remain largely passive; and another category of core members may hold administration keys, permitting them to effect alterations of the underlying code through which the DAO operates.

Levels of sophistication around DAO governance vary wildly. The DAO structure (or, commonly, the absence thereof) is not infrequently described as being akin to a, "*group chat with a bank account*"<sup>1</sup>, or in similar parlance. More organised DAOs can, however, certainly rival highly professional corporations, with regard to their adoption of structure, management and governance practices.

There are a variety of categories of DAOs in existence, each with a particular nature or purpose, such as DAOs for service provision; DAOs established for social or charitable purposes; and DAO investment vehicles, to name but a few. Service DAOs use automation to fulfil a significant number of common corporate service functions, such as the routine payment of employee wages, or regular supplier invoices; or the automatic generation of

outgoing invoices. As all data relating to a DAO's operations is stored on a blockchain, information relating to payments to employees, contractors or suppliers, or payments received from third parties, can be rapidly collated and categorised, for example, for accounting purposes, or to facilitate the filing of tax returns. The development of reliable recognised on-chain sanctions and compliance checks and "Know Your Client" identity verification services is likely to follow, as the technology in this space continues its rapid development. The automation of functions in this manner has the potential to result in significant cost savings for businesses, who may utilise service DAOs to perform traditionally labour-intensive corporate tasks. Elsewhere, investment DAOs have also been utilised as acquisition vehicles, giving rise to the acronym, "SPAD", as a variation of the special purpose acquisition company, or "SPAC", structure.

Since gaining initial popularity in around 2020, DAOs have grown rapidly in their adoption and there has been a significant increase in the total dollar value of funds locked into DAO contracts<sup>2</sup>. As their utility and technological functionality increases, it is anticipated that we shall see significant continued growth in DAOs going forward, leading to the establishment of a greater number of both independent stand-alone DAOs, created for the fulfilment of specific defined tasks; and the adoption of service DAOs within existing corporate structures, enabling a significant number of existing routine back-office business functions to be automated, at a fraction of the existing operating cost.

## How will disputes relating to DAOs arise?

There exist myriad circumstances in which the operations of DAOs may give rise to disputes. DAOs have become the subject of regulatory enforcement actions – particularly in the U.S., where the Securities and

Exchange Commission (SEC) has concluded that tokens offered and sold by a particular DAO constituted investment contracts, rendering them subject to federal securities laws<sup>3</sup>. Most recently, the SEC has turned its attention to the operator of the SushiSwap decentralised exchange, Sushi DAO, which has confirmed that it is now the subject of an SEC investigation, and issued a proposal to members to, "*Establish a legal defense fund to cover legal costs for core contributors and multisig participants*"<sup>4</sup>. Further, the U.S. Commodity Futures Trading Commission (CFTC), the body charged with regulation of the U.S. derivatives market, has also been active in taking enforcement action against Ooki DAO and its members for (*inter alia*) allegedly failing to ensure the conclusion of transactions on designated contract markets, in accordance with the U.S. Commodity Exchange Act<sup>5</sup>.

Aside from the regulatory landscape and matters of public law, which will vary wildly across jurisdictions, disputes pertaining to DAOs may also arise in other ways, such as with regard to their operations vis-à-vis consumers, and the terms and conditions they impose on any users of their services; disputes as between members of the DAO, relating to (for example) the exercise of rights of governance, or multi-signature participation in the disbursement of treasury funds, for example; or disputes as between the DAO and other third parties, such as business partners, in relation to the performance (or the absence thereof) of contractual obligations. Disputes of this nature often arise under bilateral or multilateral private contracts which, given the inherently international and decentralised nature of Web3, commonly refer disputes to arbitration.

For a variety of reasons which we have previously considered in a broader Web3 context<sup>6</sup>, arbitration may well be an excellent choice for the resolution of private disputes

1 The New York Times, "*The Latecomer's Guide to Crypto*", Kevin Roose, 18 March 2022

2 <https://cointelegraph.com/news/dao-treasuries-top-25-billion-for-the-first-time-deepdao>

3 Securities and Exchange Commission Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, 25 July 2017 (<https://www.sec.gov/litigation/investreport/34-81207.pdf>);

4 <https://forum.sushi.com/t/establish-sushi-legal-defense-fund/11813>

5 <https://www.cftc.gov/media/7681/enfookicomplaint092222/download>

6 <https://www.hfw.com/The-arbitrability-of-Web3-disputes-An-effective-court-of-First-World-problems-March-2023>

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relating to DAOs. However, whether this is in fact the case in each particular circumstance will require careful consideration, in order to ensure the best prospects of avoiding any unintended consequences, or thorny legal problems.

#### **Can a DAO be a proper party to arbitration proceedings?**

An significant initial consideration, at the outset of any potential arbitration involving a DAO, is the question of whether DAOs can themselves validly be the subject of arbitration proceedings. This will require careful analysis, in particular to determine whether the DAO in question has its own legal capacity and persona (to permit it to enter into an arbitration agreement), or whether it is ultimately merely an unorganised association of its individual members.

The answer to this question may very well differ from jurisdiction to jurisdiction. The law in many countries is languishing well behind the speed of technological development, and many have not yet reached the stage of having formally acknowledged the existence of DAOs, let alone considered their legal status. In the United Kingdom, the Law Commission is currently seeking evidence in

advance of a public consultation in relation to the future legal status and characterisation of DAOs in England and Wales<sup>7</sup>; the Registration Authority of the Abu Dhabi Global Market (ADGM) free trade zone is also presently seeking feedback on its proposed legislative regime for distributed ledger technology and DAOs; in Singapore, DAOs are not automatically recognised as legal entities under existing legislation and, as in many other jurisdictions, they may therefore require a legal “wrapper” in order to obtain their own distinct legal persona, and to be capable of entry into contracts and arbitration agreements. In other jurisdictions, the legal status of DAOs is uncertain. As things stand, they may be treated very differently across different jurisdictions.

It is of interest to note that both the SEC and the CFTC considered it appropriate (albeit in the context of the exercise of their regulatory powers) to take steps against unwrapped DAOs<sup>8</sup> with no place or address of incorporation, and whose legal status is, perhaps, unclear. In a similar manner, could an unincorporated DAO which, for example, publishes terms of service incorporating an arbitration agreement on its public website,

by which users of its services may be bound (which has validly been found to be the case previously<sup>9</sup>), open the door to arbitration against unincorporated associations? Or, by taking such actions, would individual members of the DAO be deemed to be entering into arbitration agreements in their personal capacities? Many questions of this nature are yet to be fully tested in the courts of major jurisdictions globally.

In order to address some of these issues of legal uncertainty, many DAOs have chosen to operate – and to contract – through a recognised legal entity, such as a Cayman Islands foundation; a British Virgin Islands limited company; a Swiss Association; a Singapore Public Company Limited By Guarantee; or a Wyoming “DAO LLC”, or elsewhere. A number of jurisdictions globally have existing corporate structures which are considered suitable for the needs of a DAO, whereas others have adopted specific legislation that supports the legal incorporation and recognition of DAOs, and which aims to attract DAOs to incorporate there. We understand that other jurisdictions are considering enacting such legislation, or creating new corporate structures which would be particularly suitable for DAOs.

<sup>7</sup> <https://www.lawcom.gov.uk/project/decentralised-autonomous-organisations-daos/>

<sup>8</sup> Sushi DAO and Ooki Dao respectively, see 3, 4 and 5 above

<sup>9</sup> *Johnson v. Maker Ecosystem Growth Holdings, Inc. et al*, United States District Court Northern District of California, 9th Circuit, Case No. 20-cv-02569-MMC

Incorporation of a legal entity with which to wrap the activities of a DAO and its assets, liabilities and contractual obligations also may bring with it other benefits, some of which are touched upon below.

In contrast, the risk of not legally wrapping a DAO in a disputes context arises as a result of the fact that the legal status of an unwrapped DAO is, in many jurisdictions, unclear. As has previously been argued, “...if you don’t formalize a legal structure for a human-created entity, courts will impose one for you...”<sup>10</sup>. This statement is equally valid in relation to the potential arbitrability of DAO disputes. Certain jurisdictions may determine, through court judgments or new legislation, that unincorporated DAOs do nonetheless exhibit sufficient characteristics of an existing recognised legal structure, so as to have their own legal persona, and to validly enter into contracts and be a participant in arbitral proceedings. There already exist proforma best practice governance standards for DAOs, including those set out within the Model Law for Decentralised Autonomous Organisations published by the Coalition of Automated Legal Applications (COALA)<sup>11</sup> which, if adopted by states, may result in unwrapped DAOs being granted independent legal personality.

### **How can a DAO be notified of the commencement of proceedings?**

If it is considered, for whatever reasons, that a DAO - whether legally wrapped or not – is a valid party to an arbitration agreement and proceedings arising under it, another potentially thorny issue concerns how best to validly serve the DAO with a notice of arbitration, and to ensure ongoing compliance with recognised standards of arbitral due process throughout the proceedings. To offer but one example of a prevalent issue in the world of Web3, locating information relating to the applicable registered address or physical, or even email, address of a range of market participants, is often

something of a challenge. Identifying individual members of a DAO, at least beyond adopted pseudonyms, may be an incredibly difficult task.

Effecting service so as to comply with national laws or institutional arbitration rules may be considerably simpler in the context of legally wrapped DAOs, which will have a registered office address somewhere in the world. Similarly so, perhaps, when the DAO or its members are publicly being actively represented by legal counsel of record. A careful case-by-case analysis of how service can be effected should be considered, prior to the attempted commencement of any arbitration proceedings.

Outside of the sphere of arbitration, it is of interest that the CFTC opted to serve its recent Complaint against the unincorporated Ooki DAO through a “Help Chat Box” and “an online discussion forum” on the Ooki Dao public website. The CFTC claimed these to be the channels which Ooki DAO itself held out as means through which it may be contacted. The receipt of the Complaint was in fact confirmed by Ooki Dao via its official Twitter account, which assisted a California court to uphold these non-traditional methods of service as valid<sup>12</sup>.

This potential complexities around this, ordinarily, relatively simple procedural task are reflective of the broader challenges with ensuring that DAO, and possibly also its members, are afforded what must amount to fairness and due process, in all aspects of the arbitration proceedings. A failure to do so may result in any award eventually being challenged at the time of enforcement. Achieving this standard may however, in certain cases, prove incredibly complex. Similarly, from a DAO’s perspective, ordinarily simple tasks, such as obtaining legal advice, may require careful planning and consideration, and possibly even the establishment of a legal engagement and response entity, in order to avoid inadvertently waiving

privilege over advice disseminated to all members globally. In all, a plethora of interesting legal issues for consideration.

### **Enforcement of arbitral awards against DAOs**

Assuming one is able to obtain an arbitral award against a DAO, how would enforcement against the DAO take place, in light of its decentralised nature, and taking account of the fact that it may not even be capable of legally owning assets directly? Once again, this will require very careful consideration on a case-by-case basis. Much may depend on whether the DAO is legally wrapped, and the jurisdiction of incorporation of the legal entity through which it operates – and, of course, the location of any assets which may be enforced against. In circumstances where the DAO has a legal wrapper, more ‘traditional’ considerations relating to the enforcement of arbitral awards are likely to apply. Nonetheless, issues such as public policy of the jurisdiction of enforcement – and its attitude towards, and the legality of, participation in Web3 projects - should also be carefully considered.

If a DAO is not legally incorporated, or otherwise cannot legally own assets, it is certainly possible that there exists the potential to attack the assets of the members of the DAO, who have caused it to act in the manner complained of. Without a legal wrapper, members may, in particular jurisdictions, be treated as general partners or similar, and bear unlimited joint and several liability – and there will not exist any corporate veil to be pierced, in order to protect them.

However, in order to seek enforcement against DAO members’ assets, it may be considered necessary to have an arbitral award against such members directly, in their personal capacities. If their identity is known or discoverable (once again, not always a simple task), it may be argued that they are valid parties to the arbitration agreement.

<sup>10</sup> “How to Sue A Decentralized Autonomous Organization”, Stephen D Palley, <https://www.coindesk.com/markets/2016/03/20/how-to-sue-a-decentralized-autonomous-organization/>

<sup>11</sup> Coalition of Automated Legal Applications, Model Law for Decentralised Autonomous Organisations (DAOs), 2021: <https://coala.global/wp-content/uploads/2021/06/DAO-Model-Law.pdf>

<sup>12</sup> Commodity Futures Trading Commission v Ooki Dao, United States District Court, Northern District of California, Case No. 3:22-cv-05416-WHO, Order concluding that service has been achieved: <https://storage.courtlistener.com/recap/gov.uscourts.cand.400807/gov.uscourts.cand.400807.63.0.pdf>



They may, perhaps, be the only valid parties to an arbitration agreement, from the side of the DAO, if the DAO is unincorporated.

As such, prior to the commencement of any arbitration proceedings against a DAO, early consideration should be given to the question of whether: (a) a DAO; (b) some or all of its members; or (c) any combination of such parties, may validly be Respondent(s) in arbitration proceedings. This determination may be critical to a Claimant's prospects of eventual recovery. Similar considerations of legal persona and standing are, of course, equally valid and relevant in the context of considering the commencement of claims at arbitration by, or on behalf of, a DAO or its members, or any class thereof.

#### **The future of DAO disputes**

As jurisdictions slowly develop their own settled positions relating to the extent of their recognition of DAOs, and their corresponding legal status and persona, many of the issues

considered in this article will become clearer. However, that is unlikely to occur in short order and there will, for many years, remain a very significant disparity between jurisdictions globally, as to their treatment of both incorporated and unincorporated DAOs, and a great deal of legal uncertainty attaching to their status and capacity.

Considering the (once again now, growing) value of funds flowing through the crypto markets, and the tremendous range of potential uses of DAOs and the continuing increase in their adoption, it is clear that disputes will arise, and will need to be fought over. The manner in which DAOs are formed and structured, and any legal wrappers which they may adopt, should be carefully considered from the very outset, in order to address some of the complexities set out herein. How these issues will be resolved by courts and arbitral tribunals over the coming years is, presently, something of a delectable can of worms, waiting to be opened.

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