

**MODEL LAW FOR DECENTRALIZED
AUTONOMOUS ORGANIZATIONS
(DAOS)**



**Essentials: Model Law of Decentralized
Autonomous Organizations
[DAO Model Law]**

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Link to the Model Law can be found at:

<https://coala.global/wp-content/uploads/2021/06/DAO-Model-Law.pdf>

1. Background

Decentralized Autonomous Organizations (DAOs) can be classified into two distinctive categories: registered DAOs, i.e. DAOs that are organized according to the laws of a State and that are registered in a corporate registry, and unregistered DAOs, i.e., DAOs that are created outside of the legal frameworks defined by national laws and are not registered in a corporate registry. The vast majority of existing DAOs are unregistered DAOs and their legal status is currently uncertain: they are *alegal*. The result is a great deal of legal uncertainty, which can be detrimental to the development and utilization of this new model of social and business organization.

The DAO Model Law is a multistakeholder effort led by COALA (Coalition of Legal Automated Applications) to provide legal certainty for DAOs and their participants, and unlike other regulatory frameworks, accommodate flexibility for their unique features and further innovation. Since DAOs are inherently transnational in nature, the drafters and contributors to the DAO Model Law (“Model Law”) believe that it would be desirable to adopt a uniform, model set of rules that could be implemented internationally to provide legal certainty for DAOs and their members and participants.

The Model Law is therefore designed as a best practice guide for DAOs and States are encouraged to adopt or transpose its provisions into their domestic law.

2. Key Considerations

The Model Law Task Force studied the provisions of corporate law, aiming for a light-touch approach to regulation based on the principles of functional and regulatory equivalence.

Functional equivalences work as a pathway to establish the equivalence of an object that is already contemplated by legal rule and another that is not. Such equivalences broaden the means by which a regulated activity can be considered legally compliant. A well-known precedent is the UNCITRAL Model Law for Electronic Commerce, which establishes functional equivalence between a paper-based document and an electronic document. For the regulation of DAOs, the Model Law aims to establish functional equivalence between the transfer of corporate shares on the official company share registers and the use of blockchain-based infrastructure to achieve the same function.

Regulatory equivalences work with a similar logic, identifying the policy objective behind any given regulation and how this same goal can be achieved through different means, in this case through the affordances of blockchain technology. To establish regulatory equivalence the Model Law holds that the publication of certain information on a publicly-accessible blockchain meets the publicity objective of corporate registration.

Using these conceptual frameworks, the Model Law addresses the following points:

- Identification of legal corporate rules that can be fulfilled through technological guarantees in the blockchain space (e.g. smart-contract-based separation of funds, blockchain-enforced “corporate veil”, real-time audits and reporting, agency problem, etc.)
- Discussions on the specificities of blockchain-based organisations that must be accounted for from a legal perspective(e.g. forking, protocol changes, etc.) and elaboration of techno-legal solutions to address these specificities.
- Identification of legal corporate rules that do not have a technical equivalent solution (e.g., KYC identification of all participants) and elaboration of techno-legal alternatives that better account for the technical guarantees of blockchain technology.
- Establishing the legal foundations of ‘regulatory equivalence’ – collecting previous examples of “functional equivalence” (e.g. the UNCITRAL electronic contracts) and “regulatory equivalence” (e.g. EU ‘principle-based’ regulatory approaches).

The DAO Model Law draws on lessons from model laws for flexible business organizations (e.g., OAS Model Law for the Simplified Stock Corporation) to pursue specific objectives like the uniform treatment of DAOs across States—particularly with respect to recognizing the legal personality and/or limited liability of its members. It also considers a series of new scenarios that are not encountered during the ordinary operations of more traditional organisations, by setting out procedures for hard forking decisions and remedying technical bugs or exploits that would otherwise render the DAO unoperational. It stipulates a series of governance rules for handling exceptional events such as TheDAO attack and other contentious forks, thereby mitigating both public policy concerns regarding unaccountability and participant concerns about potential joint and several liability.

3. Features of the Model Law

The Model Law consists of the following Chapters:-

Chapter 1 sets out the broad range of economic and social activities that DAOs can engage in, the rights and obligations that DAOs can enjoy as a separate legal person, and also provides important definitions used in the Model Law.

Chapter 2 sets out the eleven (11) technical and governance requirements that a DAO needs to meet to benefit from legal personality, and for its Members to receive limited liability protection.

Chapter 3 sets out the potential actions that may lead to Members forfeiting limited liability protection, namely fraud and failure to comply with binding arbitral awards or court orders. This is intended to limit the grounds on which a Member may be held jointly liable with a DAO, while not precluding the possibility that a Member may be personally liable (e.g., under tort law principles).

The chapter also clarifies that minimum capital requirements are not mandatory for DAOs, as is increasingly the case with traditional corporate entities, while still acknowledging that

some DAOs may wish to voluntarily introduce reserve funds and insurance schemes to enhance public confidence in their ability to meet their debts to third party creditors. The remainder of the chapter is devoted to governance rights, providing considerable leeway to DAOs to create multiple classes of participation and diverse voting rights structures, as well as the possibility to protect minorities and appoint proxies.

Chapter 4 builds on the question of how a DAO under the Model Law is to be governed. It seeks to allow individual DAOs to have considerable flexibility in how their internal organization and procedures take place, without being bound by the same constraints that a number of corporate entities are subject to (e.g., in-person, physical meetings). The Model Law enables management by consensus as well as the appointment of Administrator(s). It recognizes that, irrespective of how the DAO is managed, the DAO may need to have representation off-chain for certain purposes and activities. This chapter therefore provides a procedure for appointing a Legal Representative with narrowly-defined powers that can interact with territorially bound national jurisdictions. In the spirit of contractual freedom, DAOs are permitted to appoint fiduciaries if they wish, but the Model Law makes clear that merely holding a position with a particular title and having certain potentially discretionary decision-making power (e.g., core Developer, Administrator, Member) should not be in itself sufficient to imply fiduciary status.

The provisions of Chapters 1-4 are akin to most corporate law statutes and address the aspects of DAOs that are similar to other business organizations.

Chapter 5, in contrast, recognizes that DAOs have technical features that raise new questions that merit specific treatment. This Chapter, therefore, includes specific articles that concern the consequences of Contentious Forks, modifications, upgrades and migrations on the legal personality of a DAO (as well as its claims and assets), and the limited liability of its Members. Moreover, there may be Failure Events that are specific to DAOs, which under this Chapter may lead to the liability of Persons who are grossly negligent or acting in manifest bad faith in making a decision, but will not attach to those not involved in the decision.

Chapter 6 is the final part of the Model Law and includes two (2) important miscellaneous provisions that are necessary in creating a coherently complete legal framework for DAOs. Firstly, it specifies when general business organization law should be applied to DAOs by a jurisdiction that adopts the Model Law. Only lacunae in the by-laws and the Model Law should be filled by domestic general business organization law, and if there is any ambiguity arising from this gap-filling function, it should be resolved in a manner that upholds the objectives and letter of the Model Law.

Secondly, it establishes the recognition of DAOs as pass-through entities for tax purposes, so as to simplify the process of taxation for DAOs which are non-territorial and transnational by their nature, and instead make Members and Participants responsible for tax compliance.

Next Steps

In the coming months the Model Law Task Force hopes to engage a broad audience of people and diverse stakeholders in order to raise awareness on the topics addressed, foster discussions and collaborate on the model's continuous evolution. With this first iteration, the goal was to convene legal scholars in blockchain to bridge the gap between a variety of existing and potential activities of DAOs and the various regulatory frameworks currently or yet to be implemented in different jurisdictions. But this is only the beginning of a much longer journey: the DAO Model Law will depend on ongoing exchanges between lawyers, technologists and eventually policy makers to thoughtfully address the fast-moving landscape of blockchain-based systems and achieve broad and participatory adoption.