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Crypto, DAOs, and the Wyoming Frontier

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On July 1, 2021, Wyoming's Decentralized Autonomous Organization ("DAO") law (Wy. Stat. § 17-31-101 through 17-31-115) became effective. This makes Wyoming the first U.S. state to clarify the legal status of, and legally recognize as a separate entity, a decentralized autonomous organization and its members, and it helps lay the foundation for this growing sector to provide a formal legal entity structure for those participating in unincorporated groups whose governance is generally coded into smart contracts.

DAOs have been around since 2015. One of the most famous DAO projects, called simply "The DAO" launched in 2016 on the Ethereum network and was hacked six weeks later. This hack ultimately resulted in the hard fork of Ethereum from Ethereum Classic. But despite the inauspicious beginnings, DAOs are the infrastructure behind the burgeoning DeFi movement.

What Is a DAO Under Wyoming Law?

Wyoming defines a DAO simply as a Wyoming limited liability company ("LLC") whose articles of organization contain a statement that the company is a DAO. Wy. Stat. § 17-31-104(a). In other words, the DAO Law clarifies that DAOs can use the LLC legal entity form if the DAO meets the other requirements in the DAO Law (e.g., maintaining a registered agent for service of process in Wyoming).

The DAO's articles of organization may define the DAO as either member-managed or algorithmically managed, and, if the articles are silent, the DAO defaults to a member-managed organization. Wy. Stat. § 17-31-104(e). Additionally, the DAO's articles of organization must include a publicly available identifier of any smart contract directly used to "manage, facilitate or operate" the DAO. Wy. Stat. § 17-31-106(b).

Notably, the law requires that, for an algorithmically managed DAO, the underlying smart contracts must be able to be updated, modified, or otherwise upgraded. Wy. Stat. § 17-31-105(d). This means that DAOs that take advantage of Wyoming's LLC law still will maintain some modicum of centralization and human control. Additionally, the DAO's articles of organization must be amended when the DAO's smart contracts have been updated or changed. Wy. Stat. § 17-31-107(a)(iii).

What is the Future of Wyoming's DAO Law?

On May 28, 2021, the Wyoming Select Committee on Blockchain, Financial Technology and Digital Innovation Technology ("Select

Committee”) met in Jackson Hole, Wyoming to discuss amendments to the DAO Law. The primary topics of discussion were:

1. *Member-Managed versus Algorithmically Managed:* As explained above, the DAO Law currently says that the DAO's articles of organization may define whether the DAO is member-managed or algorithmically managed; if the articles are silent, the DAO defaults to a member-managed organization. Wy. Stat. § 17-31-104(e). The proposed revision to the DAO legislation says that the article of organization shall establish how the DAO will be managed by the members, including to what extent the management will be algorithmic. The proposed legislation also eliminates the default to a member-managed organization because the articles of organization can no longer be silent on the question of management. If enacted, this change to the DAO Law would force DAO founders to think more closely about their corporate governance structure at the outset.
2. *Changes to the Smart Contract:* As explained above, the DAO Law currently says that, for an algorithmically managed DAO, the underlying smart contracts must be able to be updated, modified, or otherwise upgraded. Wy. Stat. § 17-31-105(d). The proposed revision to the DAO Law says that if a DAO is entirely algorithmically managed, then the underlying smart contracts must be able to be updated, modified, or otherwise upgraded. This is a clarifying change that would allow immutable smart contracts for DAOs with some degree of member management.
3. *Voting Rights:* The DAO Law currently contains a default rule on voting rights. It says that membership interests in a member-managed DAO are calculated by dividing a member's contribution of digital assets to the DAO by the total amount of digital assets contributed to the DAO at the time of a vote. Wy. Stat. § 17-31-111(a)(i). If members do not contribute digital assets to the DAO as a prerequisite to becoming a member, each member has one membership interest and gets one vote. Wy. Stat. § 17-31-111(a)(ii). The proposed revision to the DAO legislation applies the pro-rata rule to all DAOs, not just to member-managed DAOs. And, the proposed revision clarifies that if all members have not contributed digital assets to the DAO, then the one member-one vote rule applies. This proposed change makes it more likely that every DAO member will have an equal vote on foundational issues like dissolution of the DAO, regardless of whether he or she contributed digital assets.
4. *Dispute Resolution:* The proposed revision to the DAO Law requires that the articles of organization or smart contracts must include provisions dealing with dispute resolution. Thus, founders are urged to consider dispute resolution mechanisms at the inception of their project.
5. *Information Rights:* The DAO Law currently provides that members do not have separate inspection or copying rights and that DAOs do not have a current obligation to furnish any information to members or dissociated members. But the proposed revision to the

DAO Law clarifies that such information and inspection rights are only not available to the extent such information is available on an open blockchain.

Conclusion

As the DAO frontier expands in Wyoming and beyond, the predominant question is: How much human involvement will there be? The forward-thinking legislators and members of the Wyoming Select Committee are not the only ones grappling with this question. Federal and state regulators are contending with these issues, too. As an example, a person only needs to look back to “The DAO” project and 2017. In 2017, the U.S. Securities and Exchange Commission (“SEC”) issued Release No. 81207, which analyzes the application of federal securities laws to tokens issued by The DAO. The SEC says:

Investors' profits were to be derived from the managerial efforts of others—specifically, Slock.it and its co-founders, and The DAO's Curators. The central issue [under federal securities law] is “whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.” SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir. 1973). The DAO's investors relied on the managerial and entrepreneurial efforts of Slock.it and its co-founders, and The DAO's Curators, to manage The DAO and put forth project proposals that could generate profits for The DAO's investors.

Thus, the centralized management of The DAO triggered the application of federal securities laws. Although the SEC did not pursue an enforcement action against The DAO, it issued a stern public warning to all DAOs that “Those who offer and sell securities in the United States must comply with the federal securities laws...” This case is an important reminder that no matter how friendly, accommodating, and applicable the DAO Law is, DAOs are required to comply with federal securities laws as well.

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