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Submitted to Law Commission call for evidence on decentralised autonomous organisations (DAOs)
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Personal response

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Glossary

Question 1: Please provide comments on the glossary entries and provide additional and / or alternative entries where appropriate.

Please share your views below.:

We recognise that some terms within the glossary are contentious such that there is not universal agreement on definitive definitions. To that end, we believe that the definitions provided are sufficient to provide an introduction / guidance to each term.

Chapter 2: What is a DAO?

Question 2: To assist in our understanding of the different crypto-token ecosystem functions performed by various participants, please provide feedback on the high-level descriptions in Chapter 2.

Please share your views below.:

No comment offered.

Question 3: We recognise that there is no singular, authoritative understanding of what a DAO is. However, please explain how you understand each of the individual descriptors of a DAO: (1) decentralised;(2) autonomous; and(3) organisation.

Please share your views below.:

(1) We think that the descriptor for 'decentralised' is sufficiently encompassing - it is difficult to be any more precise than this. Each DAO is capable of having different motivating factors, and a different make up, to that extent it is hard to define how 'decentralised' each DAO will be. We also note the importance of the descriptor identifying that the level of 'decentralisation' can change as the DAO develops.

(2) We believe that the descriptor given to 'autonomous' is a necessity of circumstance, it is clear that what autonomous refers to within a DAO, and what autonomy might entail, means different things to different individuals. As such, the section strikes the right balance in explaining the role 'autonomy' can

play within a DAO.

(3) Your definition of organisation, within this part of the paper, well describes DAOs. Elsewhere in the paper you do mention other types of legal structure.

Some of the organisational structures you define can include a structure that has one human owner and manager, see for example private limited companies (the famous one-man companies of Salomon fame) and the judgement in Re: Neptune Vehicle Washing Ltd [1995] ChD 2 at paragraph 2.4.4. you say a DAO is an association of two or more participants. For definitional purposes, this potential difference should be understood for policy reasons.

Whilst DAOs are close to current legal structures, their qualities mean that similarities cannot always safely be drawn.

Question 4: Are you aware of any DAOs that use the jurisdiction of England and Wales and / or the law of England and Wales as part of their organisational structuring arrangements? If so, please provide details, including the purpose of the DAO and how it utilises the law of this jurisdiction.

Please provide details below::

No view offered.

Chapter 3: The starting point: DAOs as unincorporated associations or general partnerships?

Question 5: In this question we are interested in the legal treatment of a DAO which has not taken any of the additional steps that we discuss in this call for evidence, for example either structuring itself with a variety of incorporated or unincorporated entities or using decentralising elements.

Yes

Please expand on your answer::

Yes, we agree with the statement in so far that DAOs have not incorporated and they are groupings of two or more individuals so can be defined as a partnership and / or an unincorporated association.

With this in mind, and on a more broad point, the issue of how DAOs interact with the insolvency laws has not really been addressed in the consultation. This is a very important point for consideration, if you are proposing to treat them like partnerships or unincorporated associations then the law of personal insolvency (bankruptcy IVAs/DROs) would apply to the partners/participants in the DAO. This is a completely separate system to the corporate insolvency provisions (administration, liquidation, CVA etc).

You may well want to consider whether or not there is a case for a special regime for DAOs, such as railway administration or the Special Manager regimes for various sectors. Either way, as well as the creation of DAOs and their structure, you must closely consider their demise and its management.

It is important to sufficiently define the legal nature of DAOs so as to be able to apply the relevant insolvency laws, this can have large ramifications to human participants in terms of risk and liabilities. As you know, section 9 of the 1890 Partnership Act makes all partners jointly and severally liable. There is no protection of limited liability in this form.

Please share your views below::

(1) Of the DAOs that we are aware of, albeit it a narrow number, they are characterised by the qualities outlined. Indeed, most DAOs that come into existence seem, and seek to, follow these characteristics.

(2) We don't foresee a scenario whereby a DAO is seen as anything other than an unincorporated association, unless it has gone through an incorporation process.

(3) Mistake in question, here - we note this should be the question in the consultation document (not a repeat of the question asked below), and as such we have no view to offer.

Please share your views below::

We would anticipate that most DAOs are capable of meeting this criteria. However, we note that Charitable DAOs are pursuing public benefit objectives as opposed to business objects. They are literally 'not for profits' as opposed to 'for profits'. Not all DAOs will be profit-wealth maximisers, some will be charities.

(1) As above, it is entirely possible for a DAO to be set up as a charity and as such a DAO set up in this manner would not meet the outlined criteria. We anticipate that most DAOs would not be charitable, and thus would meet the criteria.

(2) As we mentioned, in relation to joint and several liability of partners, if the DAO constitution document excluded joint and several liability, this would not be a general partnership. Similar statutory requirements for partnerships under the Partnership Act 1890, if not adhered, to would further dilute the DAOs ability to characterise itself as a partnership.

(3) No view offered.

Question 6: Please identify any problems that the current law in England and Wales presents for the use of trust arrangements as a constituent part of a DAO's overall organisational structuring.

Please share your views below::

If a specific DAO is clothed in aspects of anonymity, then there might be issues around certainty of objects (as you point out, at 3.30). However, that need not be fatal to the characterisation of a DAO as a form of trust. Secret trusts have long been held to be enforceable (Blackwell and Blackwell [1929] AC 318 - half secret trusts; McCormick Grogan [1869] HL 23 Apr - full secret trusts).

The issue of whether crypto is capable of being the subject matter of a trust is an open matter, as discussed in your digital assets consultation paper - it will entirely depend on their classification as property or otherwise.

A charitable trust will have restrictions on investment, and they would have to comply with registration requirements.

Question 7: Do you consider that the current law in England and Wales presents any problems relating to the use of joint ownership arrangements as a constituent part of a DAO's overall organisational structuring? If so, how?

Yes

Please expand on your answer::

In light of the comment in the consultation document around the pooling of funds, it opens up the potential for tracing issues, and subsequently issues on insolvency. The constitutional document of the DAO may well resolve these claims against any common pool.

Chapter 4: The use by DAOs of centralising structural elements

Question 8: Do you consider that the current law in England and Wales relating to the formation of bodies corporate presents problems for those DAOs that choose to use an incorporated entity as part of its organisational structuring?

Yes

Please share your views below::

England and Wales has chosen to have low capitalisation barriers for private limited companies, this leads to easy incorporation sometimes known as the Delaware effect. For some time, England and Wales has been one of the cheapest jurisdictions in which to incorporate. From a DAO perspective this is good, particularly as the companies court is internationally respected for the resolution of disputes. For regulators though, this leads to compliance issues. For international DAOs this may well give rise to future issues of forum shopping, and subsequently compliance issues.

Having a competitive incorporation regime will attract global business to our legal sector.

An ongoing problem for DAOs, is the recurring compliance costs associated with being registered in the UK e.g. for filing and other statutory obligations.

Where the DAO is a charity, incorporation (as a charitable company or a charitable incorporated organisation) carries special regulatory burdens linked to the jurisdiction. So for example, it is necessary to register with the Charity Commission, produce an annual report and file accounts. More significantly, it also impacts on grant-making - i.e., the charity DAO could not fund non-charitable causes.

Question 9: What are the biggest benefits of using incorporation as part of its organisational structuring that might lead a DAO to consider this option?

Please share your views below::

Unlike partnerships or unincorporated associations, incorporation can come with the quality (some say privilege) of limited liability, this protection for shareholders in any incorporated DAO limits their exposure to the amount that they have contributed. Limited liability may also encourage further DAO engagement, where members aggregate their wealth for the DAO object. The dangers of claims against the pool are alleviated by the structure of shareholding. This moves us away from the joint and several liability of partnerships discussed earlier in our response.

Charitable DAOs have a strong incentive to locate the incorporated entity in a jurisdiction where the donors will benefit from tax privileges (e.g., GiftAid). And so, it is rational for a supranational DAO to 'jurisdiction shop' in order to incorporate in a jurisdiction where charities are subject to a beneficial tax regime.

Question 10: Why would a DAO choose not to use incorporation as part of its organisational structuring (in England and Wales, or elsewhere)?

Please share your views below::

Competitor corporate law jurisdictions in Europe e.g. the Netherlands may have more favourable qualities (e.g. restructuring plans) than an incorporate might prefer. Again, this is the Delaware effect, as different jurisdictions have different characteristics and DAO group may want a given set of qualities - hence why the Wyoming DAO entity is so intriguing.

Please share your views below::

As we noted above, annual returns e.g. filing and AML compliance incur ongoing regulatory costs which could prove challenging, particularly for DAO participants located overseas.

One of the problems with 19th century partnerships was that they became too unwieldy. Communication and liabilities became severely problematic for partners. In this we include joint stock companies which were nothing more than large partnerships. If DAOs have widely dispersed ownership models, this modern association of individuals could encounter similar issues including with compliance burdens.

The problem with majority voting in incorporated entities, is the phenomenon of fraud on the minority by wrongdoers in control (see *Foss v Harbottle* (1843) 2 Hare 461). Modern unfair prejudice provisions can help this type of shareholder, but only if it isn't an incorporated entity. It is a known issue, within this sector, that a majority position can lead to abuse against the minority.

Question 11: Can you provide any specific examples of DAOs using an incorporated legal form as part of their organisational structuring in England and Wales?

Please share your views below::

No comment offered.

Please share your views below::

No comment offered.

Question 12: Are there jurisdictions other than England and Wales that provide a legislative approach to legal forms that is more effective or attractive for use by DAOs?

Please share your views below::

As noted above, the Netherlands, Germany and various American states, have very competitive corporate law regimes.

Please share your views below::

No comment offered.

Question 13: Do you consider that England and Wales could or should introduce a new form of entity or recognition specifically tailored to DAOs? If so, please explain why this would be helpful for DAOs and how such an entity could be structured (including the potential trade-offs of formalising such an entity).

Yes

Please expand on your answer::

As we noted with our insolvency responses earlier we are not adverse to the introduction of a Special Manager Insolvency regime for DAOs. It goes without saying then, that for competitive jurisdictional reasons we would also advocate for the introduction of a new form of entity tailored to DAOs.

The introduction of a special charitable wrapper for DAOs should be taken seriously as a policy option. This would address issues such as perpetuity, powers to make charitable investment, and public benefit reporting.

Alternatively, 'off the peg' constitutions could be drawn up and recommended for adoption. This second strategy - perhaps developed in conjunction with the Charity Commission - would be cost effective and relatively straightforward

Chapter 5: The use by DAOs of decentralising structural elements

Question 14: Do you think that the concept of decentralisation (and / or sufficient decentralisation) could usefully be refined, clarified or applied under the law of England and Wales? If so, please explain why and how, and give examples.

No

Please expand on your answer::

As noted elsewhere, and in the consultation document itself, decentralisation means different thing to different individuals and within different technological constructs. To that end, any attempt to define it is limited by understanding of current technological developments, and prevailing societal views at the time. Such definition attempts would be limited by the prospect of tech development, and as we know incorporating a definition in statute would result in a burdensome effort each time it needed to be updated. As such, we don't see any wider benefit to incorporating a definition of decentralisation into law and in fact think that it could inhibit our ability to be responsive and dynamic as the tech develops.

Question 15: To assist in our understanding of the use of crypto-tokens by DAOs, please provide further information on whether software protocol-specified tokens are designed to confer similar rights on holders to the holding of share capital in a business, or equivalent to the holding of a partnership interest in a business.

Please share your views below::

It entirely depends on the design of software protocol-specified token, and so any DAO engaging with such tokens would need to take particular notice of their nature. For instance, it is entirely possible for a software protocol-specified token to be used to award dividends, to allow owners to show ownership, and to facilitate voting.

In the same way, a shareholder of chose in action (shares) needs to be cautious as different species of share carry different rights. Ordinary shares have no voting rights in AGM. Preference shares take a percentage of distributable profit. It all depends on entitlements to the bundle of rights that the shares amount to.

Please share your views below::

Whether they *should* be liable is an interesting question. The fact they may be liable entirely depends on the particular DeFi protocol and its terms and conditions. Individuals should go into this with their eyes open, and if they do, then we think the approach that any DeFi protocol takes is appropriate.

Question 16: Please describe how you characterise the relationship between (i) DAOs; (ii) developers and / or incorporated companies (or other legal forms or incorporated entities) involved in software development; (ii) software protocols based on open-source code.

Please share your views below::

No comment offered.

Please share your views below::

No comment offered.

Not Answered

Please expand on your answer::

No comment offered.

Please share your views below::

No comment offered.

Not Answered

Please expand on your answer::

No comment offered.

Question 17: Please provide further input on whether, and if so how, DAOs use smart legal contracts.

Please share your views below::

No comment offered.

Please share your views below::

Please share your views below::

No comment offered.

Question 18: How do you consider that the privacy of users and participants could or should be protected where organisational structures and market systems rely on open-source code and publicly accessible transactional data? Please also set out any areas in which you consider that the law of England and Wales could provide greater legal clarity in this respect.

Please share your views below::

Fundamentally we see no issue with the utilisation of open-source data, indeed this is done in other areas e.g. law enforcement investigations. An interesting moral question would be whether the view on this should change where companies / individuals harness open source data and repackage it in a more open and accessible way.

Question 19: Are there any circumstances in which a smart contract (or collection of smart contracts) / a software protocol could (or should) be treated as having legal personality? Please explain your answer and set out any areas in which you consider that the law of England and Wales could provide greater legal clarity in this respect.

Please share your views below::

No comment offered.

Question 20: How does / should the distinction between an incorporated company (or other legal form or incorporated entity) involved in software development and an open-source software protocol (each associated with a particular DAO) operate as a matter of law?

Please share your views below::

No comment offered.

Not Answered

Please expand on your answer::

No comment offered.

Question 21: Do you consider that there is a real risk that a DAO that is structured to ensure that the features described in paragraph 5.72 are not present could be characterised (or re-characterised) as a general partnership under the law of England and Wales? Please explain your reasoning.

Not Answered

Please expand on your answer::

No comment offered.

Not Answered

Please expand on your answer::

No comment offered.

Not Answered

Please expand on your answer::

No comment offered.

Question 22: Please explain any other practical and legal structuring tools that DAOs use in both their blockchain based and non-blockchain based activities. If possible, please explain how you see these techniques interacting with principles of private law (including those discussed in Chapter 5).

Please share your views below::

No comment offered.

Chapter 6: Practicalities of operating a DAO under the law of England and Wales

Question 23: How do DAOs (or the constituent parts thereof) structure their governance and decision-making processes? Please provide examples, including (if possible) where such processes have worked and have not worked.

Please share your views below::

No comment offered.

Not Answered

Please expand on your answer::

No comment offered.

Question 24: How do DAOs (or the constituent parts thereof) assess their tax obligations and (if relevant) residence for tax purposes? Are there any particular areas of uncertainty for DAOs currently operating in the market?

Please share your views below::

Yes. Individuals acting in the crypto-asset area have engaged in taxation in 'good faith', in the manner that we would usually expect i.e. that individuals make a payment to the IRS / HMRC on yearly profits. However, recently where crypto-assets have gone insolvent courts have found that individuals are not secured creditors as they do not retain a right over pooled-assets in 'earn accounts' such that they are amongst ordinary creditors in seeking return of their funds (see Re: Celsius Network LLC et al Case No. Number: 22-10964 (MG)). This has led to suggestions of the law picking arguments that suit its purpose i.e. the coins belong to you and you owe money on profits for tax purposes, but they don't belong to you and your an ordinary creditor for insolvency purposes. This is an issue that requires further attention.

Please share your views below::

No comment.

Question 25: Do you consider that anti-money laundering regulations apply to DAOs (or one or more of their constituent elements)?

Yes

Please expand on your answer::

(1) Again, we make no claims as to how wide spread this practice may be, but it is entirely possible that a DAO might (a) be a cryptoasset provider or (b) be carrying out a business in the UK. In terms of (a) it is unlikely that many would be seeking explicitly to be an open cryptoasset provider. However, given the definitional difficulties surrounding 'making arrangements with a view to' it is entirely possible that a wider class of DAOs could inadvertently fall foul of the regulations in their current 'vague' guise. It would be prudent, if as suggested elsewhere in this response, the UK wants to make its self a jurisdiction that is friendly to DAOs for it to write specific AML guidance in relation to DAOs - most notably in relation to 'making arrangements...'. In relation to (b) most DAOs will be carrying out a business in the UK.

(2) Again, this entirely depends on the approach the UK wants to take in relation to whether it wants to be a jurisdiction that is perceived as friendly towards DAOs or not. If it wants to be friendly, then the approach under RAO is too broad, such that the MLR would be triggered if it advice etc under the DAO led to the exchange of crypto (not the DAO actively facilitating the exchange). However, if it wants to adopt a stricter approach then perhaps it would consider it. That said, we believe that a more lenient (open) approach would be the best to adopt.

(3) if it was interpreted the same way as under the RAO, it may have the potential to discourage individuals / DAO from operating in the UK.

(4) It is likely that the obscure structures of DAOs that often lack transparency would increase their risk profile such that any institution dealing with them would consider them to have a 'high money laundering risk' and in this scenario the AML provisions would be triggered. Further, in general it is likely that government would. / should want to ensure that ownership structures underpinning DAOs are more transparent, in light of their international AML obligations.

General knowledge.

Please share your views below::

(1) It may be particularly difficult for a DAO to be able to list all participants, particularly if it is a large scale DAO. Record keeping and due diligence may be tricky because of the make up of the DAO. Finally, AML training could prove difficult for those engaging in the DAO given it doesn't necessarily have the same organisational structures, knowledge base and command line as traditional businesses.

(2) The blockchain could certainly be utilised in terms of record keeping and perhaps greater training / emphasis needs to be placed on how this can be utilised.

(3) Yes.

General knowledge.

Question 26: Please describe any particular areas of regulatory uncertainty for DAOs currently operating in the market.

Please share your views below::

No comment offered.

Please share your views below::

No comment offered.

Please share your views below::

No comment offered other than countries should try where possible to make their rules as favourable as possible, taking into account risk factors, otherwise DAOs and other cryptoasset businesses simply jurisdiction shop. A tight regulatory regime does not necessarily avoid existing problems i.e. can still expose UK consumers to risk, DAOs are not confined by traditional regulator borders.

Please share your views below::

It is our view that DAOs tend to decide to utilise the regulatory rules in the primary country of operation. However, the potential is there like in other cryptoasset areas for a DAO to jurisdiction shop in terms of rules and obligations where it thinks that the rules it is currently abiding by are not favourable.

Question 27: We welcome suggestions from stakeholders as to other issues which should be included in our scoping study. For each issue, we would be grateful for the following information:(1) a summary of the issue / problem;(2) an explanation of why the issue needs to be considered. For example, problems that it causes / could potentially cause to DAOs in practice; and(3) suggestions as to what could be done to address the issue, and any evidence of the costs and benefits of the solution.

Please share your views below::

No comment offered.