



Stephen Palley

Insurance Lawyer for Policyholders | Construction & Technology Focus | Palley Law, PLLC

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How to Sue A DAO

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The term Decentralized Autonomous Organization ("DAO") is often used in the same breath as "Smart Contract" or "Blockchain". They're touted as a new form of legal structure in which ownership, management and control are automated and human involvement is limited or removed, based on a pre-agreed rule set. [1].

To a lawyer, this sounds a lot like a corporation, a legal fiction that grants personhood to a (1) human created organization, which is (2) governed based upon a pre-agreed upon rule set (either contractually agreed upon or imposed by law). Among other things, a corporation can sue or be sued, enter into contracts, and (by virtue of incorporating) offers its human owners and participants some measure of liability protection.

DAOs are often offered as a step past corporations, an evolutionary structure in

which human governance is replaced by code, and the organization acts without human meddling:

*A DAO is an organization that's self-governing and not influenced by outside forces: its software operates on its own, with its by-laws immutably written on the blockchain, not controlled by its creators. DAOs are formed by groups of like-minded individuals with specific projects and goals in mind . . . A DAO purely manages funds: in itself it does not have the capabilities to build a product, write code or develop hardware. **It** requires a Service Provider for this purpose, which **it hires by signing off on a proposal.***

(<https://github.com/slockit/DAO>) (emphasis added). Sounds interesting, and I am not dismissing the utility or potential benefit of automating many elements of a corporate structure by using software, with or without blockchain or smart contract functionality. Still, as I read about DAOs, a couple of questions/concerns arise.

First, the words "general partnership" and "un-incorporated association" keep popping into my mind. Here's the concern: if you don't formalize a legal structure for a human-created entity, courts will impose one for you. As most lawyers will tell you: a general partnership, unless properly formalized or a deliberately created structure, is a **V**ery **B**ad **T**hing. [2]

Among other things, the members of a general partnership can end up jointly and severally liable on a **personal** basis for partnership obligations.[3] The Wikipedia entry on DAOs says that a potential flaw in their structure is that they may not have assets from which to indemnify third parties. This seems wrong to me, or beside the point, and a big concern to a DAO creator or participant regardless. Lacking assets or a legal form, I expect that a Court would see the

entity that isn't really an entity as a fiction and could allow a lawsuit to proceed against the individual members. That's what I might argue if I represented someone who had a quarrel with a DAO.

No human members or participants? A Court would look to see who designed the thing, and keep looking until it found a first mover, or a human hand. Whether or not a judgment is ultimately collectible, you can usually find someone who should be holding the hot potato. As a legal matter, I'm skeptical that it's really possible to abstract human agency, ownership, or control from an entity. As a policy matter, I'm not sure it's a terribly good idea, either.

Second, For a DAO to operate in a world in which legal relationships are formalized by contracts, and enforced by Courts, I don't see how a DAO can act unless it is either a corporation or it has no corporate form and it is simply an extension of its human members. Go to the definition above and re-read this sentence: "It [the DAO] requires a Service Provider for this purpose, **which it hires by signing off on a proposal**." (emphasis added). How can a DAO "sign off" on a proposal if it isn't a corporate entity of some kind? Who will the Service Provider sue if it's unhappy with the DAO's performance?

So . . . how would you sue an unincorporated DAO?^[4] Start with its members. If you can't find members, you sue the DAO's first mover: the person or entity that first created the DAO. And **how do you avoid this?** If you're creating a DAO, consider whether this evolutionary structure might benefit from some basic corporate structure, and whether doing so really limits the DAO's functionality in a meaningful fashion. I'd also ask whether a DAO can actually do anything useful if it does not have some recognized corporate form.

[1]. Photo Credit: <https://pixabay.com/en/courthouse-court-law-justice-legal-1223279/>. License: CCO Public Domain.

[2]. I refer to general legal principles in this post, under U.S. law, and I am painting in very broad strokes. None of this is intended to be legal advice or guidance. Also, I am using the word "corporation" generically to refer to a wide variety of corporate forms recognized by governmental authorities, whether it's a C Corp, an LLC or a Swiss Verein.


[3]. Why is this bad? A quick anecdote may help illustrate. While waiting for a

hearing to start a few years ago in D.C. Superior Court, I heard a Judge explain to a not very happy defendant that even though he (1) hadn't signed a contract or (2) even known anything about it, he was (3) personally liable to the plaintiff because his "partner" had signed it using the name of their jointly owned and never-incorporated business. Corporate form isn't perfect protection, particularly if you ignore the corporate form. Still, this poor fellow was on the hook for a contract he claimed he knew nothing about, because a Court found that in the absence of any corporate form he was part of a general partnership. You don't want to be that guy.

[4]. To anyone who thinks this is some kind of a roadmap for lawyers to sue DAOs: not really, and that wasn't my point. This post could just as easily have been titled "How to participate in a DAO and avoid personal liability" or "Don't Be The Guy in Footnote 3."

 Dao, Contract Law, Legal Technology

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Stephen Palley

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Pamela Morgan

Attorney, Educator, Entrepreneur

Good article, thanks for bringing up these issues.

I'm not sure the narrow definition of a DAO by slockit is the same as what many others in the space consider DAO.

From git:
"Would-be participants in the DAO can for a period of time acquire DAO tokens by sending Ether to the DAO. These tokens will give them the right to vote on business decisions (proportional to the number of tokens acquired) as well the opportunity to receive the rewards generated by the products and services built on the DAO's behalf by the Service Provider."

From that description, the A (autonomous) part seems to be missing. Business decisions + profit usually = liability. As you rightly pointed out, it seems here owning a token represents a partnership interest - depending on the jurisdiction of course. If the DAO was non-profit, things become grayer.

From a technology perspective, a DAO could easily contract and sign any

proposal with it's own public/private key pair that automatically "signs" based upon policy controls. It could do so based upon code without human interaction of any kind. If it actually did this autonomously, then at least in states like California that have adopted some form of the Uniform Unincorporated Non-Profit Association Act, the token holders might be protected from individual liability even without formal entity registration (like formal incorporation).

But it seems that's not how slockit is designing the DAO (for now). With this design, the relationship between the signature of the DAO and voting by token holders is clear and therefore it seems even in CA, the individuals who voted with their tokens could be held responsible individually for exercising managerial control. Maybe I'm missing something in the design?

Caveat: The real underlying issue here is tying "real-world" identity to token holders, which is not a matter of law but is a matter of enforcement. "Piercing the veil" now has a technological counterpart.

(I'm not licensed to practice law in CA, the comment above is meant to illustrate possible outcomes, none of this is legal advice)

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 [Paul Boldra](#), [Michael Milnes](#), and [Stephen Palley](#)



Pamela Morgan 2nd

Attorney, Educator, Entrepreneur

Re: Making someone a token holder w/o their consent - if the holder exercised no control then, legally it's unlikely they would be held responsible (assuming their identity is known). Yes, this technique could be used to dilute ownership, however then the "voting" mechanism proposed wouldn't work very well.

Re: DAO's owned by DAO's. Yes, of course you could obscure ownership in a similar way that corporations do today - LLC owning LLC owning LLC etc. If the DAO aren't controlled by someone with a 'real world' identity it would be extremely difficult to attach liability.

Re: " 'Piercing the veil' could be a mathematical impossibility or it could lead to an innocent bystander." Yes, I agree. People used to seek a liability veil from the government, by way of registration of a formal entity. However those typically require a registered agent, a person within the local jurisdiction, to accept notice of lawsuits. This is a policy issue. Now, there is another option by separating identity from the DAO and other token uses. It's important to note, however, that many are trying to require our new world to comply with traditional identity. The attacks on encryption are just one part of these goals. There are many working against this as well. You bring up an important point regarding innocent bystanders.

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 [Paul Boldra](#) and [Stephen Palley](#)



Paul Boldra

Senior Consultant at SAP AG

> The real underlying issue here is tying "real-world" identity to token holders, which is not a matter of law but is a matter of enforcement. "Piercing the veil" now has a technological counterpart

Do you understand that these "tokens" are simply secrets? I could send you a private key to a DAO crowdsale right now, and thus make you a "token holder," completely without your consent. Furthermore, I could automatically create DAOs which are owned by DAOs ad infinitum. "Piercing the veil" could be a mathematical impossibility or it could lead to an innocent bystander.

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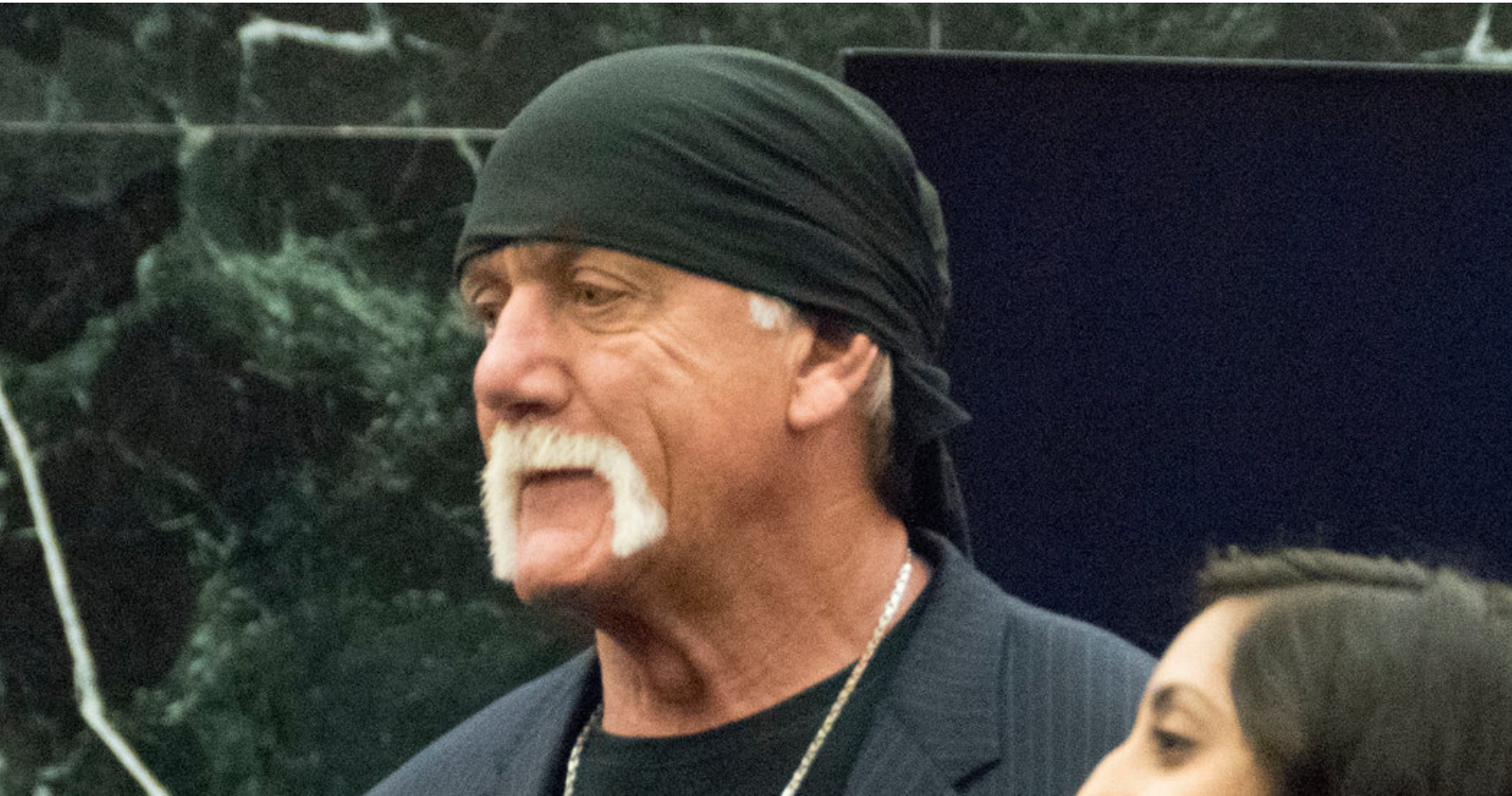
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