I have been doing some pondering around the DAICO concept to understand how to shovel it to the real life business challenges. I really love the idea of having more investor protection when raising significant amounts of funds from the public investors, as the reputation, if there where any begin with, so called ICO industry is very tarnished.

DAICO brings its own share of issues. I feel we cannot solve all the problems today, but we can discuss different scenarios. As always, things will be robust if everything go well, but there might be unforeseen consequences of applying smart contracts in the existing legal framework.

Assumptions

To narrow down the discussion, let's do some assumptions

1. Let's assume funds are raised by selling a utility token as an unregulated sales event, albeit later I refer to some particular aspects of DAICO that could make the offering more securities-like. Here the unregulated refers to not-regulated-under-securities-regulation, but is still covered under FINMA token sale regulation.

2. Funds raised to be spent by a for-profit Swiss company based in Zug, also known as a cryptovalley, a popular destination for ICO hustlers. The point of a utility token is to develop a (semi-) decentralized platform business (in gaming/travel/payments/ai/bots) where the token acts as an in-game currency, reward or membership mechanism.

3. Let's assume we raise an amount of ~USD 15,000,000 worth of ether through Ethereum token sales, so we have some mutual ground to understand what kind of amounts we are talking about it if it bears any significance.

4. The applied DAICO model: Token sale funds are collected in an tap wallet. Oracles, 4-5 publicly known reputable person appointed for a duty, can initiate token solver dissolve vote of the funds. In the case of such a vote, the token holders vote for the dissolving event, choosing whether to keep the funds in the wallet or triggering a refund of the remaining funds. Token holders can also vote to increase or decrease the tap that describes the speed the company is receiving the funds.

Potential issues

Asymmetric first year tap

The first year involves one off expenses that need to be paid in order to establish a functional company and token ecosystem. Thus, I propose having one off post sale tap event to kick off the project with§ USD 3M - 4M worth of expenses.

Taxing

If funds are raised for for-profit company it needs to pay taxes (disclaimer: I do not have facts if non-profits need to pay any taxes in Switzerland). A token sale, by the name of it, is a sale event. Potential taxes include corporate tax and possible sales tax. I assume this need to be paid after one fiscal year. Thus, the first tap should include the future tax liabilities from the sale event itself.

One off gatekeeper payments

There are various other crypto ecosystem gate keeper payments that need to be addressed during the first year. Premium wallets charge ~USD 100k for a listing the token. The listing fees for crypto exchanges varies from 1-3M USD (top volume) to 100k - 200k for less well known trading platform.

Oracles legal protection

Oracles can initiate the dissolvent vote of the funds. Thus, Oracles exert some degree of controls of the funds, but I would see their role as more of the summoners of a general assembly meeting style voting event instead of being responsible parties.

Depending on the direction where the vote goes and the conflicting interest of community members, token holders from aggressive litigation regimes might want to sue the oracles. They might be unhappy because they are not given the refund. Or the Company might be unhappy when the refund becomes effective and they feel oracles voted incorrectly.

In the case of the Company, the terms of sale may state that the Company will accept any decision Oracles do. However in the case of token holders, after changing owner on the secondary markets, token holders are not bound to any contract. Thus, wealthy token holders, when feeling their interest threatened, may go after Oracles to get some funds out because Oracles are easy targets.

Token holding and voting rights

Token holders exercise control, through voting, over the funds as they can decide tap going up and ultimate refund decision. By being able to enforce control might be a sign of a securities like nature, akin to equity. Thus this would push the DAICO offerings towards regulated offerings meaning they need more comprehensive prospectus and disclose statements than utility tokens.

Custodian and bankrupt issues

When the funds are in the tap wallet the Company does not have access to them. The funds might still go to the Company balance sheet through the token sale event. In the case the Company needs to be closed down, due to refund voting or the token holders decide not to have the tap open enough to perform legally required payments (taxes), the Company defaults and its creditors are not treated according to the local law.

1. On a paper, company has balance, as tap wallet funds are accounted for the company
2. Token holders vote to close the the tap
3. Company bankrupts because it cannot pay its ongoing expenses
4. Creditors go after token holders who embezzled the company money by ordering a refund, as the company clearly could have settled it bills with the money there was

Potential dual legal entity solution

Some of the issues could be addresses as the following

1. Set up two separate legal entities. One for profit company working on the product and a non-profit foundation that holds the token sale funds.
2. The non-profit foundation exists solely for the interest of token holders. The non-profit bylaws govern the usage of the token sale funds by dictating that the funds can be only transferred to the for-profit Company through the tap event, or refunded. Non-profit bylaws are often flexible. This opens the door for having the token holder voting for tap and dissolving as a legacy legal recognised event. Because non-profits cannot do profit, the likelihood of triggering securities regulation is low.
3. The for-profit Company receives the money through the tap event only. This is in the form of a grant from the non-profit. Thus, the company does not need to account for the money it doesn’t have 100% control over.

Even though dual legal entity model would map to the DAICO model to real world more cleanly, such dual legal entity increase the legal fees and legal complexity of DAICO operation considerably. For example, non-profit would need to pay its own governmental fees (Swiss government registration fees and things like accounting). In this case, I would feel Oracles could have a special right to cover this from the tap wallet, for the fees that are needed to “cover the tap wallet itself.”