Proskauer

CFTC Ooki DAO Enforcement Action Update: The Commission Responds

Blockchain and the Law Blog on **November 18, 2022**

On September 22, 2022, the CFTC announced an order simultaneously filing and settling charges against bZeroX, LLC ("bZeroX") and its creators for illegally offering leveraged and margined retail commodity transactions in digital assets, operating as an unregistered futures commission merchant and failing to conduct KYC on its customers. According to the CFTC, a month prior to this settlement announcement, bZeroX transferred control of the bZx Protocol to the bZx DAO, a decentralized autonomous organization ("DAO"), which later renamed itself as the Ooki DAO. On the same day as the bZeroX settlement was announced, the CFTC filed an enforcement action against the Ooki DAO (successor to bZeroX) for violating those same regulations. The CFTC stated that bZeroX and its creators engaged in this unlawful activity in connection with their decentralized blockchain-based software protocol that functioned in a manner similar to a trading platform. The transactions executed on bZeroX, and subsequently on the Ooki DAO, were required to take place on a registered designated contract market. Additionally, the complaint asserted that bZeroX and Ooki DAO were operating as unregistered futures commission merchants by soliciting and accepting orders from customers, accepting money or property as margin and extending credit.

The structure of Ooki DAO, and the CFTC's enforcement action against the DAO itself, has garnered a lot of media attention (and industry reaction) and raised novel legal issues.

A DAO is a decentralized autonomous organization where token holders, here the Ooki "governance" token holders, have the ability to vote on governance decisions of the DAO. Specifically, the CFTC alleged that the Ooki DAO is an "unincorporated association" comprised of "Ooki Token holders who have voted those tokens to govern the Ooki Protocol." The CFTC brought the action against the Ooki DAO, implicitly arguing that because token holders participated in the DAO's governance they could be personally liable for its actions. In response to the CFTC's actions, several interested parties have either filed amicus briefs or petitioned the CFTC to promulgate rules to clarify the obligations of individuals participating in a DAO and avoid chilling innovations in software development.

For example, on October 31, 2022, Haun Ventures, a venture capital firm, petitioned the CFTC to promulgate a rule limiting the scope of DAO-participant liability. The petition called for more "clarity and certainty" from the Commission on the obligations and liabilities of individual DAO participants. Haun Ventures claimed that the CFTC's action against Ooki DAO has had a chilling effect on DAOs in general and disincentivizes participation by good actors. Furthermore, Haun Ventures contended that the CFTC's action against Ooki DAO goes beyond the Commission's mandate by creating liability even for DAO participants who do not "actively engage in or facilitate unlawful activity." Other interested parties have also objected to the CFTC's "expansive" theory of liability, which would "ensnare" token holders who took no part in the decisions that contributed to the DAO's alleged violations.

In the petition, Haun Ventures recommended a new rule limiting liability to DAO token holders who actively engage in or facilitate a violation of the Commodity Exchange Act and the CFTC's regulations. Liability would require actively voting in favor of, or otherwise supporting, the underlying proposal or action that results in a violation. Haun Ventures' petition states that such a rule would have a positive impact on DAO governance by clarifying that token holders may vote on proposals without rendering themselves liable for all future actions of the DAO.

The amicus briefs have also objected to the unconventional and novel method by which the CFTC served the summons and complaint on Ooki DAO. As the Ooki DAO is made up of anonymous users (who may or may not reside in the U.S.), the CFTC noted that there are "significant obstacles to traditional service of process" and requested that the court allow the Commission to serve the summons and complaint to the Ooki DAO via what the CFTC identified to be the "method the Ooki DAO itself holds out to communicate with it." On October 3, 2022, a California district court granted the CFTC's motion to effectuate alternative service against Ooki DAO and approved of the CFTC serving the summons and complaint through the Ooki DAO website's "Help Chat Box" and also posting notice of the summons and complaint on the "Ooki DAO Online Forum." (*CFTC v. Ooki DAO*, No. 22-5416 (N.D. Cal. Oct. 3, 2022)). Because the CFTC provided the documents in this manner on September 22, 2022, the court held that the Commission had effectively served the Ooki DAO on that date.

Following the ruling on alternative service, the court received a request to file an amicus brief expressing concern about the order granting alternative service, which it granted, along with other requests from amici; subsequently, a scan of the docket shows that the court set a December 7, 2022 date for a hearing on the reconsideration of the alternative service order. Generally speaking, the amicus briefs argue that a DAO is not like a traditional business entity where providing notice to the central organization is sufficient for due process and that there is no statutory basis for declaring that a DAO is a "person" under the Commodity Exchange Act (which includes "associations" under such definition). The briefs further claim that DAO token holders are not required to participate in the Ooki DAO Online Forum and that a DAO by definition is decentralized and posting to an online forum and help chat associated with the DAO is not necessarily going to provide "actual notice" to all potential defendants as required by law. The amici argue that if the CFTC wishes to hold individuals responsible for violations of the CFTC's regulations, it should identify those individuals who violated the regulations and provide proper service of process.

In response, on November 14, 2022, the CFTC filed a consolidated opposition to the amicus briefs on this issue, arguing that the court should not reconsider its order upholding service, as the CFTC's service method followed applicable law and resulted in actual notice. On this issue, the CFTC argues that the law does not require it to serve all members of an unincorporated association, which is what it considers the Ooki DAO to be, to effectuate service of process. Overall, the CFTC contends that the Ooki DAO fits the 'well-established definition of an unincorporated association," and strongly disagrees with the amici's characterization of this action:

> "The CFTC is not suing technology…the CFTC's action is not against the blockchain-based Ooki Protocol, but against the Ooki DAO—an association that acts and makes collective decisions regarding the Ooki Protocol through voting by its governance token holders."

In its opposition papers, the CFTC clarified its intentions and commented on the uproar over the hypothetical possibility for joint liability for Ooki DAO members. It reiterated that it did not sue any individual Ooki DAO members (listing only the Ooki DAO unincorporated association, not any individual Ooki DAO members, as a defendant), nor did the complaint request that the court enter judgment against any individual Ooki DAO member on the basis of that member's joint and several liability for a judgment against the Ooki DAO. As the CFTC explained in its opposition papers, in the hypothetical event the CFTC requests and obtains a money judgment against the Ooki DAO, the CFTC could enforce that judgment only against the Ooki DAO's assets.

With a lot of potential legal issues wrapped up in a motion to reconsider alternative service of process on the Ooki DAO, we will be watching closely to see how the court rules.

View original.

Related Professionals

- **Elanit Snow**
  Senior Counsel