Part I: With New DAO Law on the Books, Utah Joins Race with Wyoming and Tennessee to Become U.S. “Crypto Capital”

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Little-known legal trivia: In 1977 Wyoming was the first state to pioneer the LLC, which is now a commonly applied legal innovation. Fast forward more than forty years…in July 2021, Wyoming again tried to be at the vanguard of new corporate formations and passed legislation that recognized decentralized autonomous organizations, or DAOs, as legally distinct business entities, with protections for token holders similar to those offered to corporation stockholders or limited liability company members. Wyoming may have jumped off the blocks first, but Tennessee and Utah are not far behind. Recently, on March 1, 2023, the Utah Legislature passed HB 357 (codified at Utah Code Ann. §48-5-101-406), the “Utah Decentralized Autonomous Organizations Act” (the “Utah Law”).

This article is **Part I** of a two-part article on developments in state DAO LLC laws. In this part, we will briefly outline the basics of a DAO and the latest state enactments in the area, as well as explain why real-world corporate formations may be attractive for some DAO members. In **Part II**, we will do a deep dive into the more notable aspects of the new crop of state DAO LLC laws and offer some final thoughts.

DAO Basics

DAOs are the organizational primitive of Web3, allowing individuals to organize and coordinate at arms-length, and relying on code (a “protocol”) to govern and execute functions traditionally determined by organizational governing documents like operating agreements and articles of formation and executed by fiduciaries like managers and executives. A DAO’s protocol is committed to a public ledger on a blockchain, whereas a limited liability company (LLC) or corporation would file its formation documents with the Secretary of State of its state of formation. The use of a blockchain guarantees accessibility and transparency. Each member is granted governance rights – the ability to propose and approve initiatives, called proposals – through a governance token. Contributions to the DAO are typically rewarded through tokens funded by the DAO’s treasury assets, which can be additional governance tokens, stablecoins, or any other digital asset.

One of the main aspects of a DAO is that the protocol is governed by smart contracts, which form the backbone of DAOs, defining the rules of the organization and housing the treasury. Rules are encoded as smart contracts onto the blockchain to automate the purpose of the organization and are enforced via an on-chain consensus mechanism (i.e., by voting on a proposal). If certain parameters are met, smart contracts can autonomously execute functions, and send and receive funds. Theoretically, a DAO is entirely automated (think of a vending machine that runs on code and can order new inventory on its own). However, most of today’s DAOs are not wholly run or managed through smart contracts and have value-adding humans at the edges, who may require the ability to act off-chain.

New DAO Laws

In passing its DAO law, Wyoming established what it called “baseline requirements” for member managed or algorithmically managed DAOs and provided regulations for DAO formation and other traditional corporate actions and functions, thereby giving DAOs the ability to operate as a limited liability entity without losing its Web3 structure and dynamic. Wyoming’s DAO law (SF0038, codified at W.S. §17-31-101 through §17-31-116) is a supplement to the state’s LLC statute, such that the provisions of the Wyoming LLC Act apply to DAOs, absent certain exceptions under the DAO law. As described in the bill summary, the law covers DAO formation, articles of organization, operating agreements, smart contracts, management, standards of conduct, membership interests, voting rights, the withdrawal of members and dissolution.

The DAO law and its amendments, the "Wyoming Decentralized Autonomous Organization Supplement," are together just one part of the state's ongoing push to attract blockchain businesses and generally establish itself as a new, crypto-friendly technology hub. Notably, in March 2022, Wyoming Governor Mark Gordon signed an amendment to the DAO Supplement into law (SF0068) (the DAO Supplement and its 2022 amendments, collectively, the "WY Law") tweaking some of the language to better reflect how members join, leave, and participate in DAOs.

In the wake of the WY Law amendments, on April 20, 2022, Tennessee's governor signed Tennessee's own DAO law (HB2645/SB2854, to be codified at Tenn. Code Ann. §48-250-101 through 48-250-115) (the "TN Law"), which largely tracks the original WY Law in providing that the Tennessee Revised LLC Act applies to DAOs to the extent not inconsistent with the bill. The bipartisan law out of Tennessee's capitol, Nashville – a burgeoning tech hub in its own right – hopes to make Tennessee a "beacon for blockchain investment, new jobs and investment" as Nashville is "becoming a hotbed for Web3 companies," according to proponents of the law.

Why are these state DAO laws an important development for DAOs? While DAOs are emerging as a viable structure in the DeFi space, recent court rulings show that DAO's non-traditional makeup may not necessarily be a shield from real-world liability. For example, in a recent California district court decision, the court ruled that various defendants allegedly holding governance tokens to a particular DAO could be deemed to be members of a "general partnership" under California law under the facts outlined in Plaintiffs' complaint, and thus potentially joint and severally liable for negligence related to a phishing attack that resulted in the loss of users' cryptocurrency. In another ongoing CFTC enforcement against a DAO operating as unregistered futures commission merchants, the specter of joint and several liability has also been raised in court by interested parties. Thus, though DAOs may be an emerging Web3 formation that presents a decentralized alternate structure for business and investment, given the nascent and uncertain legal landscape it often makes prudential sense for such an entity to create a separate legal entity or "wrapper" (one option being under state DAO LLC laws) to represent the DAO in off-chain activities and legal contracting and offer a liability shield for individual DAO members.

As illustrated above, state DAO LLC laws are one potential option for DAOs to explore, particularly given the current litigation and enforcement environment. In Part II, we will explore the main provisions of the latest Utah DAO Law as well as the other recent state DAO LLC laws. Stay tuned!

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