



Wyoming takes a step ahead to clarify the legal status of decentralized autonomous organizations

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On March 17, 2021, Wyoming's state senate passed a bill entitled Decentralized Autonomous Organizations Supplement, sponsored by Wyoming's Select Committee on Blockchain, Financial Technology and Digital Innovation Technology. The bill was then introduced to the Wyoming House of Representatives and referred to its Minerals, Business and Economic Development Committee. If it becomes official law, Wyoming will be the first state in the United States to clarify the legal status of a decentralized autonomous organization.

A decentralized autonomous organization (DAO) is generally believed to be an organization managed by rules encoded as a computer program – including automated smart contracts built on distributed ledgers such as a blockchain – rather than by a hierarchical management structure. Smart contracts used by a DAO help to automate organizational governance and decision-making, ensure compliance with the stipulated conditions, improve the consensus mechanism to involve more participation by minority shareholders, and reduce administrative time and cost for the day-to-day management of an organization. A DAO's financial and transaction records can be maintained on a secure digital ledger to track financial interactions with tamper-proof features to prevent forgery or alterations. Members of a DAO may have the ability to maintain real-time control of their capital contributions.

The legal status of DAOs remains unclear and is subject to debate and discussion. Wyoming's bill aims to apply the Wyoming Limited Liability Company Act to DAOs so they can have legal status as limited liability companies. The bill

makes it clear that it does not repeal or modify any statute or rule of law that applies to a limited liability company (LLC) that is organized under the Wyoming Limited Liability Company Act and that does not elect to become a DAO. Existing Wyoming LLCs may elect to convert to DAOs pursuant to the bill. The registered name for a decentralized autonomous organization shall include wording or an abbreviation to denote its status as a decentralized autonomous organization, specifically DAO, LAO or DAO LLC.

Under the bill, to become a DAO, a company must add a “Notice of Restrictions on Duties and Transfers” statement in its articles of organization or operating agreement. Such a statement must include the following disclosures: (i) the rights of members in a decentralized autonomous organization may differ materially from the rights of members in other limited liability companies and (ii) the Wyoming Decentralized Autonomous Organization Supplement, underlying smart contracts, articles of organization and operating agreement, if applicable, of a decentralized autonomous organization may define, reduce or eliminate fiduciary duties and may restrict transfer of ownership interests, withdrawal or resignation from the decentralized autonomous organization, return of capital contributions and dissolution of the decentralized autonomous organization.

Further, the articles of organization must include a publicly available identifier of any smart contract directly used to manage, facilitate or operate the DAO. If the DAO’s smart contracts have been updated or changed, the articles of organization shall be amended accordingly. Such DAOs may form and operate for any lawful purpose, whether or not for profit.

The bill has provisions specifically applicable to a DAO, but not a traditional LLC. For example, members shall have no right under Wyoming Statute 17-29-410 to separately inspect or copy records of a DAO, and the organization shall have no obligation to furnish any information concerning its activities, financial condition or other circumstances to the extent the information is available on an open blockchain. Further, in addition to other traditional dissolution events, the bill requires that a DAO be dissolved (i) if it has failed to approve any proposals or take any actions for a period of one year or by order of the secretary of state or (ii) if it is deemed to no longer perform a lawful purpose.

The bill also states that unless otherwise provided for in the articles of organization or operating agreement, no member of a DAO shall have any fiduciary duty to the organization or any member, except that the members shall be subject to the implied contractual covenant of good faith and fair dealing.

Notably, to address any conflicting provisions among the articles of organization, the operating agreement, and the underlying smart contracts, the bill provides that where the underlying articles of organization and operating agreement are in conflict, the articles of organization shall preempt any conflicting provisions, and where the underlying articles of organization and smart contracts are in conflict, the smart contracts shall preempt any conflicting provisions, with certain limited exceptions.

For the management of such DAO LLC, the bill provides that the articles of organization may define the decentralized autonomous organization as either a member managed decentralized autonomous organization or an algorithmically managed decentralized autonomous organization. If the type of DAO is not otherwise provided for, then the LLC will be presumed to be a member managed decentralized autonomous organization. An algorithmically managed decentralized autonomous organization may only form if the underlying smart contracts are able to be updated, modified or otherwise upgraded.

The Wyoming Limited Liability Company Act may help to address several legal concerns over DAOs, such as the potential unlimited legal liability for their promoters and participants and the difficulty in enforcing legal liabilities against decentralized autonomous organizations.

For DAOs to achieve mass adoption, technical limitations need to be addressed as well, such as incompetently designed and insecure smart contract systems, security vulnerabilities, and potential adverse consequences resulting from updates to the smart contracts. A well-known example of such limitations is “The DAO,” which was initially designed for venture capital funding purposes. The DAO launched with a \$150 million crowdfunding campaign in 2016, only to be eventually delisted. In addition to legal issues it encountered, The DAO suffered a cyberattack which exploited a combination of coding vulnerabilities, draining it \$11.5 million in cryptocurrency, which was valued at US\$50 million at that time. However, this hack was later reversed, and investors’ funds were recovered via a hard fork of the Ethereum blockchain.

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