



Reforming Florida Law So DAOs Are Not DOA

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If you want to build on Bitcoin, there are few better places to be in America than Miami right now. The 2021 Bitcoin Conference took place in this unofficial capital of Latin America to great fanfare. Many attendees, won over by the city's beauty, energy, and freedom, will decide to stick around. It's already happening: one of the oldest Bitcoin companies, Blockchain.com, recently moved its US offices to the southern end of the Sunshine State.¹

We have public leadership to thank for creating the conditions that made our states so attractive to the innovative cryptocurrency industry.² Florida's regulatory sandbox for financial technology firms, a legislative priority of leadership in both the executive and legislative branches, not only affords a legal space for innovation, it serves as a signal that Florida welcomes innovation.³ Locally, Miami Mayor Frances Suarez has made himself something of a celebrity in

the cryptocurrency world for his embrace of Bitcoin's promise to enrich both the city and Miami's citizens and serve as a lifeline for those in developing countries who desperately need it.⁴ State legislators have likewise begun to thoughtfully update our rules to embrace this exciting wave of innovation.⁵

But "few better places" does not mean "no better place." That honor probably goes to a place that most would not expect: Wyoming.⁶

Although Wyoming may not be the first place that comes to mind when one considers financial technology, it has in truth been an innovator in corporate law for some time. Wyoming was the inventor of the limited liability corporation (LLC) back in 1977.⁷ This new way to limit liabilities for businesses while maintaining certain tax advantages proved wildly popular, and the model eventually spread to every state in the country.

Today, Wyoming again leads the nation in its forward-looking menu of cryptocurrency-specific legislation. The Cowboy State has passed over a dozen separate blockchain-related bills into law so far. These range from the necessary and prosaic—things like defining certain terms in law and updating old regulations to be technology-neutral—to the bold and cutting-edge—including laws that outline new banking and organizational models such as the Special Purpose Depository Institution⁸ (SPDI, pronounced "speedy").

Given Wyoming's careful approach in cryptocurrency policy reform, it is likely that many innovations will prove just as influential as the LLC, and other

states have already started drafting and adopting legislation based on the Wyoming template. But as we will see, not every one of Wyoming's laws should be merely copied and pasted. In particular, legislators should think deeply about a new kind of LLC called a DAO LLC or LAO.⁹

What's a DAO?

Wyoming's DAO LLC is a government creation intended to protect those involved with a special kind of technological arrangement known as a DAO, or a "decentralized (or distributed) autonomous organization." DAOs employ cryptocurrency techniques to automate decisions on behalf of users according to predetermined programmatic rule sets.

Although DAOs are quite new to most policymakers, they have been around in some form in the cryptocurrency community since around 2013.¹⁰ Cryptocurrencies allow users to transfer value directly without the need for a trusted third party—like a bank or central bank—to reconcile transactions or manage money supplies. That "value" is represented by data on a publicly viewable ledger called a blockchain, which is maintained by a distributed network of computers that cannot be controlled by any one party.

The structure of many cryptocurrencies thus lends itself to more complex digital arrangements. Users can deploy what is called a "smart contract"—or a self-enforcing digital agreement—to automate decisions based on some preset external criteria.¹¹ For example, several users could send funds to a smart contract that is programmed to buy an asset when it

hits a certain price level and sell the asset when it hits another price level. This is one example of a DAO, and applications of this technology abound in the field of “decentralized finance,” which uses smart contracts to remove intermediaries in complex financial applications.¹²

DAOs are exciting because they can afford individuals more freedom and granularity in their financial lives. Individuals who are confident in their investment acumen and the code of a proposed DAO can directly invest without needing to pay or trust a financial institution which may be expensive or not always have customers’ best interests in mind.

DAOs are a natural choice for seasoned investors in the fast-moving blockchain space. It is a native investment vehicle for the cryptocurrency world. It was literally built for these technologies: a programmable legal structure to channel programmable money.

A central ethos in the smart contracting universe is that “code is law.”¹³ Users agree to the terms bound in their smart contract—indeed, it is technologically enforced to be immutable. *Caveat emptor*: review the code carefully, lest you find yourself burned. Not only is government intervention to roll back a smart contract seen to be undesirable, if smart contracts are good enough, it will be impossible.

But DAOs can be duds. To restate a common computer science adage: “garbage code in, garbage law out.” The name “DAO” is itself synonymous with an infamous industry failure: an entity confusingly called “The DAO” (which will be written in quotations to distinguish from the general

concept) amassed millions in investment and promotion by leaders in the Ethereum community before being hacked and prompting a reorganization of the Ethereum network in order to restore the funds.

Policymakers’ ears will no doubt be ringing if they are learning of this incident for the first time. “The DAO” invited scrutiny on the grounds of fraudulent and misleading activity, possible securities law violations, and even issues with the Ethereum network that ultimately changed to roll back the hack, thereby undermining the “code is law” spirit.¹⁴

The Good and the Bad of Wyoming Law

It is against this backdrop that the state of Wyoming attempted to address legal uncertainties surrounding DAOs by passing a first-in-the-nation bill integrating this novel technological corporate form into law in 2021.

As a risk-taking first mover, Wyoming has benefitted greatly by attracting investment and talent to its state. It is fantastic that the Cowboy State has decided to lead on cryptocurrency. Hopefully, states like Florida will be motivated to follow its lead and share in the innovation. Yet risks sometimes pan out poorly. This may end up being the case with Wyoming’s DAO law, and other states should take note.

The “Wyoming Decentralized Autonomous Organization Supplement” aims to provide a legal structure in which DAOs can operate.¹⁵ The problem the bill intends to address is the purported lack of a welcoming liability structure for DAOs.¹⁶ By default, DAO participants may be treated as

a general partnership, which exposes actors to high financial liability should the venture turn south.

The new law creates a custom-built legal entity, a DAO LLC or LAO, that applies LLC-like liability protections to DAOs that register as such. But the LAO structure does not create any new protections that are not available in existing LLC structures while imposing new obligations that may prove unattractive to actors in the fast-moving DAO space.

First, DAOs can and have already registered as a traditional LLC.¹⁷ This would grant them the liability benefits that the bill intends to provide without any of the downsides that we will soon discuss. In the best-case scenario, this bill may merely end up being irrelevant. But as we'll see, some of the legal precedents established by this bill could legally complicate smart contracting, as it would introduce government involvement in ways inappropriate for the intentions of the technology.

Second, the LAO structure introduces obligations on DAOs that are unattractive and unnecessary, as crypto lawyers have pointed out.¹⁸ For instance, the LAO form does not allow "algorithmically-managed" DAOs to operate as a manager-management structure, which necessarily limits LAO activities. LAOs would also be required to publish smart contract addresses and update the contracts at least once a year, which could create unnecessary security problems.

More fundamental, however, is the philosophical mismatch between the problems that DAOs aim to solve and the level of government involvement

proposed. Requiring that smart contracts be amendable at government request, for instance, deeply contradicts the "code is law" ethos of smart contracting.

To use a metaphor more lawmakers are by now familiar with, it would be a bit like requiring that all cryptocurrencies be reversible upon government request. Yet one of the core reasons that cryptocurrency was developed was to prevent this kind of central transaction control.

Wyoming's law is still new, so it is hard to see whether or not worst-case scenarios may come to pass, or if early critiques will prove overblown. Fortunately, Wyoming's legislature has proven to be a champion for cryptocurrency innovation, so if the bill does prove problematic, it will surely be eager to fix any flaws. In the meantime, other states can avoid the risks that this approach may pose by passing simpler legislation on which they can build.

How Florida Can Avoid DAOsaster

Despite some of the concerns with the Wyoming law, there is still good reason for states to consider passing their own DAO legislation. Regulatory uncertainty can be its own kind of innovation-killer. The fact that individuals may fear that DAOs are automatically illegal in the state of Florida will often prevent them from moving to and building in our state.

In fact, Florida has much lower hanging fruit to harvest.¹⁹ Recently, the Office of Financial Regulation stated that most cryptocurrency businesses will have to obtain a costly money transmission license to operate legally in the state, even if they do

not hold customer funds.²⁰ The reason for this unintuitive ruling is that Florida has yet to update its definition of “money” in law, which means that an unfortunate precedent set in *State vs. Espinoza* is the prevailing rule.²¹ Legislators should first consider clearing up this very easy problem, as was under consideration in the 2021 session.²²

Next, legislators should consider simple defining legislation that defines what smart contracts and DAOs are in law and states that they are not illegal as such. The reforms could even clarify that DAOs can apply to become LLCs in the state if they meet the same criteria as any other potential LLC. Furthermore, in the interest of consumer protection, legislators could consider a kind of sandbox-like arrangement where potential users are educated about the experimental nature of these arrangements before getting involved.

DAOs are an exciting kind of experimental financial arrangement that could generate great benefits and new opportunities for Floridians. But with reward comes risk, and DAOs could just as easily fail. Legislators should think of themselves as innovators here, too. They can recognize the exciting benefits that DAOs can generate and weigh that against consumer protection and education obligations that they shepherd as public leaders. A hybrid reform that both defines these technologies in law and creates a space for experimentation can provide the kind of protection to which the public is accustomed along with the innovation that is necessary for our state to grow and thrive.

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