

# What Legal Personhood For DAOs Means For Crypto Industry

By **Jeffry Henderson and Douglas Arend** (August 21, 2023)

In what appears to be a case of first impression, a federal district court recently held, in *U.S. Commodity Futures Trading Commission v. Ooki DAO*, that a decentralized autonomous organization is a person subject to the provisions of the Commodity Exchange Act, as amended, and the rules and regulations of the CFTC.

DAOs are certain computerized technologies applied in decentralized finance. The Kraken trading platform describes DAOs as "software running on a blockchain that offer users a built-in model for the collective management of its code."<sup>[1]</sup>

On June 8, Judge William Orrick of the U.S. District Court for the Northern District of California entered an order granting CFTC's motion for default judgment against a DAO called Ooki, for allegedly violating the CEA in connection with operating an online protocol called the bZx Protocol, for buying and selling certain cryptocurrency derivatives.<sup>[2]</sup>

By way of background, the CFTC settled an action in September 2022 against bZeroX LLC, a Delaware limited liability company, which previously operated the bZx protocol, and bZeroX's principals. In the bZeroX action, the CFTC had alleged that bZeroX offered leveraged off-exchange transactions in cryptocurrencies on the bZx protocol deemed to be commodities, without the protocol being registered as required under the CEA.

In the consent order settling the action against bZeroX and its two founders, the CFTC alleged that bZeroX transferred control of the protocol from bZeroX to a DAO called bZx DAO, which subsequently renamed itself and began doing business as Ooki DAO.

Separately from the bZeroX Action, bZeroX applied for and was issued a trademark for "Ooki," in which bZeroX's business was described as:

Commercial lending services; Commodity exchange; Commodity trading for others; Cryptocurrency exchange services; Cryptocurrency trading services; On-line real-time currency trading; On-line trading of financial instruments, shares, options and other derivative products.<sup>[3]</sup>

DAOs differ from traditional organizations managed by boards, committees and executives. Rather than being governed by a limited group, DAOs use a set of rules written down in code and enforced by the network of computers running shared software.

To become a member of a DAO, users need to first join the DAO by buying its cryptocurrency. Holding the asset then generally gives users the power to vote on proposals and updates, proportional to the amount they hold. The voting element was particularly important in the CFTC's jurisdictional assertion in the bZeroX action.

The bZx protocol was used for tokenized margin trading and lending in various



Jeffrey Henderson



Douglas Arend

cryptocurrencies, rather than using fiat currencies in such transactions. In the protocol, users could select an available blockchain network to connect a wallet to deposit or withdraw cryptocurrencies. The protocol described itself as being "non-custodial," in that users maintained control over their own passwords and digital assets.

Prior cases initiated by either the CFTC or, in the case of cryptocurrencies regulated as securities, the U.S. Securities and Exchange Commission, alleged that certain online trading platforms were engaged in offering products or conducting transactions requiring registration under the CEA, or applicable securities laws, respectively.

These other cases focused the legal analysis primarily on the trading platforms themselves, and the kinds of products or types of transactions they offered.[4] The persons who operated or maintained the platforms were typically entities such as corporations or limited liability companies. As such, they were clearly within applicable statutory definitions of "person."

Issues of control or corporate governance were examined by applying traditional legal principles regarding business enterprise and structure. The focus was on whether entities operating the platforms were required to be registered, not whether the platforms were functioning with no cognizable persons operating the subject platforms.

What distinguishes Ooki DAO is that the court concluded that a technology that allows unrelated parties to use software code on a blockchain without the need for a centralized coordinating authority could nevertheless be regulated as a "person" under the CEA.

Section 4(a) of the CEA makes it unlawful:

for any person to offer to enter into, enter into, execute, confirm the execution of, or conduct an office or business in the United States for the purpose of soliciting or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity future delivery ... unless (1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission [CFTC] as a contract market or derivatives transaction execution facility for such commodity.

In the order, Judge Orrick concluded that Ooki DAO was an unincorporated association, under both California and U.S. law, and that as an unincorporated association, Ooki DAO could be sued under the CEA, notwithstanding opposing arguments contained in amicus briefs filed in this case.

The amicus briefs argued that Ooki DAO was not a proper party defendant because it was: (1) a technology and not an entity; (2) not an unincorporated association; and (3) not a person subject to the CEA. Judge Orrick rejected each of these arguments.

Judge Orrick determined that through deployment of crypto tokens, users of the bZx protocol could engage in transactions subject to CFTC regulation, and therefore, Ooki DAO was not merely a technology. He also reviewed reference sources cited by CFTC and in the amicus briefs, and determined that Ooki DAO constituted an unincorporated association under both California and federal law.

Finally, he found that Ooki DAO was a person under the CEA because the CEA includes "associations" in the definition of "person." Interestingly, Judge Orrick declined to adopt detailed findings of fact proposed by CFTC.

Although this case was not decided on the merits, and Ooki DAO did not answer or otherwise plead or appear at a hearing held in this matter, Judge Orrick's procedural decision that DAOs are persons under the CEA nevertheless has several potentially significant implications for decentralized finance.

First, Judge Orrick allowed CFTC to serve Ooki DAO by posting copies of the summons and complaint in Ooki DAO's website online discussion forum and help chat box. In this way, Judge Orrick embraced other courts' willingness to permit unique service of process in decentralized finance or cryptocurrency cases, including online posting, and in other cases, airdropped nonfungible tokens.

Second, persons and companies engaged in decentralized finance risk enforcement action, notwithstanding the underlying architecture enabling DAOs to operate through consensus mechanisms. Such mechanisms allow a potentially large number of participants to act collectively, without any single person being separately responsible for management or having decision-making authority.

On this point, the CFTC charged the principals of bZeroX in the bZeroX action with control person liability under the CEA.<sup>[5]</sup> CFTC rules applicable to off-exchange transactions define "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

With respect to bZeroX, the CFTC claimed that members of a DAO who have the power or authority to vote on governance matters concerning the DAO, and who exercise such power by voting, control the DAO, and therefore are liable for actions of the DAO.

As CFTC Commissioner Summer Mersinger noted in her dissent to the settlement in the bZeroX action, in a hypothetical situation involving a DAO that submits for a vote by its members a governance proposal having nothing to do with the CEA or CFTC rules, a member voting on the proposal "has now become a member of the unincorporated association and [possibly unknowingly] assumed personal liability and is subject to CFTC sanctions for any violations of the CEA by the DAO."

Cryptocurrencies have seen dramatic growth and expansion within just a few years. Related legal requirements and standards have similarly expanded, and digital smart contracts functioning as trading platforms or exchanges take this expansion even further.

Such rapid developments have resulted in questions such as whether consensus mechanisms, which ostensibly function with no centralized control or governance hierarchy, are within the jurisdiction and regulatory reach of existing laws.

As the legal environment in decentralized finance continues to evolve and change, cases such as Ooki DAO may help to provide some clarity and reduce uncertainty, both for those who operate in this area and for lawyers who represent them.

---

*Jeffrey M. Henderson is a shareholder and Douglas E. Arend is of counsel at Greenberg Taurig LLP.*

*The opinions expressed are those of the author(s) and do not necessarily reflect the views*

*of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

[1] <https://www.kraken.com/learn/what-is-decentralized-autonomous-organization-dao>.

[2] <https://www.cftc.gov/media/8736/enfookidaoorder060923/download>.

[3] <https://trademarks.justia.com/903/12/ooki-90312366.html>.

[4] The CFTC's enforcement actions in this regard typically allege that certain cryptocurrency trading platforms offering leveraged derivative products are operating as unregistered designated contracts markets. See *CFTC v. Binance Holdings Limited et al.*, No. 1:23-cv-01887 (N.D. Illinois, filed March 27, 2023); *CFTC v. HDR Global Trading Limited et al.*, No. 1:20-cv-08132-LTS-JLC (S.D. New York, filed May 5, 2022); *In the Matter of: Payward Ventures Inc. (d/b/a Kraken)*, CFTC Docket No. 21-21 (Sept. 28, 2021). The SEC's corresponding actions commonly allege that platforms offering securities are unregistered exchanges or unregistered alternative trading systems. See *SEC v. Bittrex Inc. et al.*, No. 2:23-cv-00580 (W.D. Washington, filed April 17, 2023); *SEC v. Beaxy Digital Ltd. et al.*, No. 1:23-cv-1962 (N.D. Illinois, filed March 29, 2023).

[5] <https://www.ecfr.gov/current/title-17/chapter-I/part-49/section-49.2>.