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DAOs and challenges for the settlement of disputes

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The organizational regime of DAOs, free from hierarchies and leaderships, operates via smart contracts, in which are inserted its functioning rules, or terms of use. A DAO, therefore, is not controlled by an individual or a group of people, but rather by a code that is executed automatically, as if it were pre-programmed software. Its members make proposals that are submitted to polls according to the terms of use. The decentralization and autonomy of this sort of organization, on the one hand, decrease individual efforts and turn the decision-making process faster and more transparent. On the other hand, however, it entails doubts and uncertainty especially related to legal personality, legal representation, competent courts, applicable law, and liability limits, both towards its members and third parties.

This lack of definition, usual in new technologies operating on blockchain, is truly challenging. What to do when one of these organizations, executing a particular proposal, violates the law or causes damage to a third party? After all, DAOs are not to be confused with their personal members, nor have their own legal personality enabling them to engage in litigations promoted by potentially injured parties. They are also not subject, beforehand, to any specific legal regime.

The solution adopted by the State of Vermont, in the United States, to address some of the legal challenges, was to create, in July 2018, a new kind of corporate organization named as Blockchain-Based Limited Liability Company, permitting the creation of legal persons whose organizational and governance structures are suitable to the particular circumstances of DAOs. The State of Wyoming, in turn, allows DAOs to fit as Limited Liability Companies, facilitating the allocation – and limitation – of liabilities.

In general, the legal provisions are scarce. In the absence of legal regulation, there are two possibilities able to mitigate these uncertainties. The first one is an “organic” solution: as situations are faced by the group, proposals of resolution can be submitted to a voting process. Nonetheless, when adopting this option, there is the possibility (and likelihood) that the members will not reach the minimum quorum for the decision-making.

The second possibility is foreseeing some of the scenarios in the DAO’s terms of use, similarly to adhesion contracts. The uses are countless. For instance, the following clauses can be included: (i) choice of court or arbitration clauses; (ii) clauses containing the applicable law; (iii) clauses regarding who will be the representative of the group in a possible lawsuit and the terms of his/her choice; and (iv) clauses limiting or allocating the liability among members.

Certainly, even if the parties regulate such provisions within the DAO’s terms of use, they will be subject to the limits imposed by law. For example, in Brazil, a clause that limits the liability among the members will hardly be considered a valid one in case of intent or serious fault.

Regarding the relations of DAOs with third parties, it is also important for them to conclude an agreement governing which will be the applicable law and the competent jurisdiction, as well as the agent that will act as the representative of the DAO, in order to mitigate uncertainties in the resolution of possible disputes with third parties. Otherwise, parties will likely face difficulties in effectively resolving their disputes.

DAOs are one more example of the opportunities (and doubts) emerging with new technologies. The lack of regulation strengthens the importance for the user to foresee the possible implications resulting from it.

>>> This content belongs to our e-book "DAOs: Legal Challenges for Decentralized Autonomous Organizations". Click here to read more articles.

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