



Liability Gap in Context: The Intersection of DAOs and The Law

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What is the Context?

The use and popularity of Decentralised Autonomous Organisations (DAOs) have been on the rise since 2020 and has since challenged corporate law as we know it today. The “corporate person” is a legal doctrine that allows companies to sign contracts and sue or be sued as a legal entity, but things change when the legal entity is code. The introduction of blockchains, that allow peer-to-peer transactions without the involvement of centralised authorities, have caused a shift. With DAOs, the entities only exist as a code; there is no Head Office, Director or a CEO. Instead they operate solely through “smart contracts” or self executing scripts that are allowed to move money or execute rules as and when conditions are met.

What is Happening?

The central tension of the issues stems from the discrepancy between intangible blockchains and physical legal statutes. In a DAO if over half of the token holders (51% or more) vote to transfer and release funds, the code will do exactly that. In such cases there is no “accounts department” overlooking transactions, which means there is no due diligence being done to potentially stop fraudulent transactions.

Further, participants are frequently using digital wallets without having to disclose their legal identities or locations, essentially making it impossible to trace back to anyone. In the case of breach, you cannot physically serve a lawsuit to a digital wallet. Lastly, DAOs can have several members across several countries, making it difficult to apply laws specific to certain jurisdictions.





What are the Consequences?

The main consequence of this is the liability gap. If there is a bug in the system and there is a breach of any kind, loss of money or if the DAO harms a third party the question becomes who do you sue? In most cases, if the DAO is not a registered company the courts start treating the members or token-holders as General Partners. This poses a big threat for investors because it allows courts to theoretically hold them liable for debt or code mishaps.

Impact on Commercial Law Sphere

These consequences are leading to a shift in commercial dispute resolution. Lawyers now have to adapt and design “hybrid” structures including the DAOs as a part of a company; essentially “wrapping” the DAO to provide members with limited liability. Further there have been changes in methods of arbitration, new age platforms such as *Kleros* are now taking the place of traditional juries in the form of digital decentralised arbitration services. Such platforms allow members to settle disputes instead of a judge, potentially changing the legal landscape for DAO disputes, creating a more just system for the members (and essentially) by the members. Lastly, the question that still stands amidst all this is should software developers owe a fiduciary duty to the users of their code in case of a breach?

Commercial Word of the Article

Decentralised Autonomous Organisations are a new form of internet-based collaboration through an organisation that has its rules set out in code and are a part of the “crypto ecosystem”

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