

---

## MAKING A DAO WORK

---

JULY 2023



## *What's the challenge?*

Blockchain technology allows people to share ideas, ownership, and records like never before. Amongst many exciting applications, these functions permit users to create synergetic, democratic organisations capable of doing much more than any other unincorporated form of association.

Referred to as Decentralised Autonomous Organisations (“DAOs”), as the name suggests, by design a DAO is intended to:

- 1. Avoid any form of centralised establishment, control, or governance; and**
- 2. Empower all members to freely dictate the direction of the DAO by participating in DAO governance.**

The distributed nature of blockchain technology allows for the potential reach of these organisations to be limitless. Moreover, the technology also eliminates the need for any office, central database, directors, or jurisdiction at all.

However, from experience, we have found that, without access to the traditional legal world, most DAOs will struggle to properly function. A DAO will generally need to interact with service providers, contractors, cryptocurrency exchanges and manage a treasury amongst other functions. A DAO will need to work to develop an underlying project/protocol.

Although some DAOs refuse to accept any form of legal vehicle to support their operation, the principles behind many active DAOs are constantly looking for improved ways to interact with the off-chain world.

## *Industry trends when it comes to supporting DAOs*

Short of engaging with the legal world on behalf of the DAO in a personal capacity, it is impossible for key functions to be implemented by members of a DAO. Eventually, key members of many successful DAOs look to establish a legal entity to assist in the running of the DAO.

Several jurisdictions, including the Marshall Islands, Cayman Islands, Wyoming, Switzerland, and Panama, offer options for the creation of legal vehicles to complement the running of a DAO. In some cases, the solutions offered are designed to incorporate the DAO itself.

The key pitch in most cases is the ability to offer legal shelter for members of the DAO and founders. As great as this sounds, the solution is far from optimal for the following reasons:

- 1. It can go against the key principles of decentralisation.**
- 2. The fluidity of membership allowed by the blockchain makes it difficult to manage an incorporated structure intended to embody the DAO.**
- 3. To date, these remain relatively uncharted waters, so the effectiveness of these structures is often unproven.**

Any attempt to ‘incorporate’ or ‘register’ a DAO to establish it as a legal person, commonly referred to as “DAO wrappers”, goes against the fundamental principles of decentralisation. Although each jurisdiction will structure a DAO wrapper differently, in most cases, the process involves creating a legal personality for a DAO which will enable the DAO to directly interact with the traditional legal world. However, a key flaw in this approach, is that this structure, which is intended as a direct legal embodiment of the DAO, will be centrally registered under the laws of a specific jurisdiction, at a specific location and in a specific language. When this happens, in effect, the DAO will have anchored itself to the legal world.

## *The key to decentralisation*

An often-overlooked factor in creating a DAO is the need to have a distributed and plentiful base of active members. A DAO with only a handful of members in one jurisdiction, or a handful of members which exercise majority control, is simply not a DAO. Under some legal systems, this might be treated as an unincorporated partnership. Similarly, a DAO with all, or the majority of its members in one jurisdiction might be considered resident of that jurisdiction, and not a nomad organisation.

Careful planning needs to be curated to ensure that a DAO is properly decentralised. This principle includes not only participants but also intentionally or unintentionally anchoring a DAO to any jurisdiction. Moreover, the activities of a DAO should constantly be reviewed in line with industry developments.

When it comes to tax and other regulatory factors pertaining to members personally, each member should review the position in their respective jurisdiction.

For this reason, instead of attempting to “incorporate” a DAO, we have developed a framework for the establishment of independent support vehicles in Gibraltar. Having embraced blockchain technology early on and being one of the first jurisdictions to create a robust regulatory framework for activities involving blockchain technology, we have carefully followed all developments in the space.

Unlike a DAO wrapper, this kind of support vehicle is designed to be legally independent of the DAO, whilst not being owned by any individual or entity, and mandated by its constitutional documents to carry out key functions for a DAO. This entity can be structured as:

- **A Private Foundation;**
- **A Purpose Trust; or**
- **A Company Limited by Guarantee.**

As self-governing vehicles, each of these can be run to carry out key functions, such as development activities and treasury management, on its own account, and importantly independently of community members whilst ensuring that any activities they carry out are scrutinised from a regulatory perspective and documented.

Saying this, creating a support vehicle in parallel to the creation of a DAO allows developers to ensure optimal synergies between the DAO and its support vehicle. Furthermore, early establishment will help the DAO get off the ground with assistance from the support vehicle.

### Private Foundation

#### **General:**

The Private Foundations Act 2017 allows for the establishment of foundations in Gibraltar. A foundation is an entity with separate legal personality which can hold and deal with property in its own name as absolute legal and beneficial owner, for the specific purposes that are detailed in the Foundation Charter. The purposes can be very wide, need not be charitable, and indeed can be “anything capable of fulfilment” as long as they are not illegal, immoral or contrary to public policy. Foundations can set up subsidiaries, invest in other companies or carry out commercial or trading activity if this is in pursuit of its purposes.

#### **Foundation Charter:**

This is the main constituting document of the Foundation and will set out the specific purposes for which the Foundation is being set up. The Foundation Charter can be drafted to allow for amendments to be made to the purposes of the Foundation, providing flexibility in the event of future changes of circumstances.

#### **Foundation Rules:**

These are the by-laws which describe the rules for the ongoing operation of the Foundation.

#### **Working with the DAO:**

The constitutional documents of the Foundation can be drafted to ensure effective lines of communication between the DAO and Foundation. For example, the Foundation might be mandated to consider proposals made by the DAO when following its predetermined purposes (see below).

This ensures synergies between the DAO and Foundation, whilst maintaining the independence of both. The Foundation is responsible for its own actions and will be able to review and verify any deliverable before implementing it.

Both the Foundation Rules and Charter can be as prescriptive as required.

#### **The Founder:**

An entity or individual will need to be identified as the Founder of the Foundation. The Founder would provide the initial assets to the Foundation as an irrevocable endowment. Usually, the Founder endows a sum of cash such as £1,000 to ensure that the initial endowment is under the control of the Council at the point of establishment.

### ***The Foundation Council:***

The Gibraltar Private Foundations Act 2017 requires at least one Councillor to be a corporate body holding a licence to act as a professional trustee. The Foundation Council manages and administers the Foundation, approves spending, and works to achieve the purposes of the Foundation.

### ***The Guardian:***

In most cases, a Guardian must also be appointed to further safeguard the purposes and/or interests of beneficiaries (if any are identified).

### ***Beneficiaries:***

Foundations do not need to have designated beneficiaries. The Foundation can be set up simply to pursue its “purposes” as set out below. Generally, there are no designated beneficiaries for this type of foundation.

### ***Establishment:***

As soon as the Foundation Charter, Foundation Rules and supporting documents have been executed and the parties to the Foundation (Founder, Council, Guardian & Beneficiaries) have been identified, the Founder makes the irrevocable endowment to the Foundation. An application to register the Foundation is filed and, upon completion of the registration process, a Certificate of Establishment is issued which serves as conclusive evidence of the registration of the Foundation.

### ***Example “Purposes” for the Foundation\*:***

- Support the maintenance, upgrading and development of the protocol’s infrastructure and oracles;
- Support the promotion and development of the project/protocol;
- Contract advisors and employees, and create incentive plans to develop the project/protocol;
- Support and finance, by way of grants or otherwise, appropriate research and development in the field of decentralised ledger technology and blockchains;
- Promote and educate the public on decentralised ledger technology and blockchains;
- Receive and distribute contributions and participate strategically in other entities or projects with a view to benefitting the project/protocol directly or indirectly;
- Acquire, hold or grant trademarks and other intellectual property rights or licences;
- Organise conferences and other events that support and promote the project/protocol;
- Promote and support, by way of grants or otherwise, all projects that use or feature in the protocol; and
- Build an active community for the project/protocol.

\*These would need to be tailored to each project.

### ***Benefits of a Foundation:***

- Unlike a trust, a foundation has legal personality and can hold assets as legal and beneficial owner. The concept of the trust is often met with confusion or difficulty in civil law-based jurisdictions, which may not recognise it. Conversely, the use of foundations is common in civil law jurisdictions, and this understanding can often facilitate transactions and planning.

- The requirement to have a licenced trustee as a councillor ensures robust anti-abuse protections for the Foundation. Without adequate oversight, it is easy for some vehicles to be used by those running them to their advantage. A Gibraltar Foundation provides regulatory certainty but also mitigates the chances of abuse by requiring the oversight of a licenced trustee that will examine each action point and carefully record every decision.

## Purpose Trust

Purpose trusts are governed by the Purpose Trusts Act 2015 (the “Act”). Trustees may hold property on trust to carry out a specific purpose which is not of a strictly charitable nature. For a DAO, the purpose might involve the support the DAO in various ways. This can be clearly defined in the trust document and might include wording like the suggested purposes listed above for a foundation.

The trust would be established by executing a trust document declaring that the Act applies and having the objects of the trust that purpose. Here an existing vehicle (or other settlor of choice) would settle a portion of their earnings on trust for that purpose.

- **The enforcer:** Purpose trusts must appoint an enforcer whose role is to ensure that the purposes of the trust are carried out. The trust instrument must also provide for the appointment of another enforcer on any occasion in which there is no enforcer.
- **Licensed trustee:** At least one of the trustees must also be a Gibraltar-licenced trustee. This requirement is more lenient than in the case of a foundation, allowing for a wider category of licence holders to fulfil the role.
- **Duration:** The Act provides for the disapplication of the rule against perpetuities. Purpose trusts in Gibraltar may therefore last indefinitely. The trust instrument may, however, specify a date or event on which the trust will cease to be a purpose trust and set out how the assets of the trust will be distributed upon its termination.

## Company Limited by Guarantee

Unlike a regular company limited by shares, a company limited by guarantee is incorporated with no shareholders.

Instead, the company is incorporated with the use of ‘members’ who commit a fixed amount towards the company (this is usually nominal, e.g. £100 per member – this does not need to be paid upfront). These members can have their rights as limited as necessary. A company limited by guarantee can be established as a not-for-profit entity. When structuring a DAO support vehicle, the articles of association of the company can be tailored to ensure that members have no ownership, right to distributions and very limited decision-making powers. With regards to the day to day running of the company, its articles of association would prescribe a list of objectives or purposes which the company must adhere to. This results in an independent entity bound to serve the DAO.

A company limited by guarantee can be run by its board of directors, which would each owe a fiduciary duty to follow the purposes of the company.

### Pre-dominant differences

Private Foundations and Purpose Trusts are very similar in nature and can be used interchangeably for most situations. However, the main differences between the two are:

- **A foundation is able to hold assets and deal with property in its own name as an absolute legal and equitable owner, whereas in the case of a Purpose Trust, the legal title would be held by the trustees (not the Trust itself) for the particular purpose.**
- **A foundation requires a professional trust company licensed by the Gibraltar Financial Services Commission, whereas the comparable requirement for a Purpose Trust allows a local lawyer (amongst others) to act as the professional trustee.**

The key difference in relation to a company limited by guarantee is that there is no requirement to appoint a professional trustee. Although more costly, this requirement often gives comfort to stakeholders and can add a lot of security to the project in terms of regulatory compliance and administrative needs.

As the industry develops further over the coming years, we will no doubt find new guidance on how best to treat a DAO. Part of the beauty of having an independent support vehicle is that a DAO remains flexible and is free to alter the way in which it interacts with this vehicle (if at all) at any stage.



**Jeremy Requena**

Lawyer

[jeremy.requena@hassans.gi](mailto:jeremy.requena@hassans.gi)

+350 20079000



Hassans, Madison Building, Midtown, Queensway, Gibraltar, GX11 1AA.

T: +350 20079000 E: [business@hassans.gi](mailto:business@hassans.gi) [www.gibraltarlaw.com](http://www.gibraltarlaw.com)

This document does not constitute legal advice and is intended only to highlight general issues which may be of interest to our clients. The views expressed are the author's own and do not necessarily represent the views of the firm. Specialist legal advice should always be sought in relation to any particular circumstances.

Hassans International Law Firm Limited trades as 'Hassans'. 'Partner' as used in this document is a job title and does not infer personal liability.

Hassans International Law Firm Limited. Registered in Gibraltar. Registration No. 115509



Hassans 2023. All rights reserved