



# CUMMINGS PEPPERDINE DE-MYSTIFIES DAOS

## PART 2

In Part I of our two-part series on de-mystifying DAOs we talked about the creation and structure of DAOs.

But what can a DAO actually do? In Part II we look at both this and what the members of a DAO can do.

**Read on. It's interesting, we promise.**

## USE CASES OF DAOS

Perhaps the best way into working out what a DAO can do is to look at some of the ways in which they are currently used, giving some real-life examples.

There are three main use cases for DAOs, and examples of use, are:

**Charitable:** a DAO can be used to accept donations and allow the DAO members the right to vote on which causes to fund.

*Example:* DAOCharity.io was established to create an international community with the common goal of supporting displaced families across Ukraine and equipping the armed forces.

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**Collective Ownership:** the members of a DAO can, together, use the DAO to purchase ... well... literally anything (legal), either physical assets or digital assets. The members can then vote on how to make sure of the assets.

*Example:* ConstitutionDAO was formed in November 2021 with the sole objective of purchasing an original copy of the United States Constitution. This DAO raised \$47 million in Ether, thought sadly in the end it lost its bid to an even higher offer \$43.2 million.

**VC or venture funds:** there are regulations to consider here, in particular those which deal with collective investment schemes and alternative investment funds, but the members of a DAO could create one to pool investment capital and then vote on which projects or investments to make, with the aim of making a profits and returning the profit and capital to members.

*Example:* LinksDAO, which was formed in January 2022 raised £8.58 million and in mid-March 2023 had a bid accepted to buy a golf club for around £900,000, following a member vote that saw an 88.6% vote in favour of putting in an offer.

## WHY USE A DAO?

We've set out above some example of how DAOs can be used and this leads on to the question of why. Why use a DAO instead of another structure, including legal structures which have the ability to enter into contracts with their own legal personality?

One answer to this can be found by looking back as well as forwards and seeing how structures have been created and developed over time to provide societies with they need. A number of scholarly papers have been written on this and delve into sixteenth and seventeenth century examples of trade operations which led to the creation of partnerships and limited liability companies and the first public listing of the Dutch East India Company in 1602 which formed the basis of modern corporate governance.

Some see DAOs as the next stage of development, one which meets the needs of a commercial enterprise in a web3 environment. They cite, among other issues, the ability of DAOs to remove the human "trust" element of being in a collective project or collective investment. Instead the members of a DAO can trust the DAO's code. It is 100% transparent, verifiable by anyone and able to gain global collaboration and coordination. In short, it turns up for you rather than just saying it will.

DAOs also remove what is referred to as the "principal-agent dilemma" by making use of community governance. The principal-agent dilemma is one where there is a conflict in priorities between a person or group (the principal i.e. the stakeholders) and those making decisions and acting on their behalf (the agent i.e. the CEO). The agent (the CEO) may not work in a manner that is in line with the priorities and goals that have been determined by the principal (the stakeholders) and instead act in their own self-interest. For example, an agent might decide to take a risk which the principle would consider excessive, because under certain agency laws it is the principal that bears the burden, not the agent.

## DAO GOVERNANCE

The question that this leads to is what exactly is the governance system for a DAO and how does it work.

In short, a DAO is governed by the voting of its members who vote on proposals which only pass once a quorum of members approve it. The exact detail on how a quorum is determined varies from DAO to DAO and is specified in the smart contracts.

This means that the variations on DAO governance can be endless as each DAO can adapt and nuance rules to those which best serve its purpose. However, most common forms of DAO governance, which often act as the starting place for negotiation on the final rules, are:

**Delegation:** this is the DAO equivalent of representative democracy. Members delegate votes to users, who then nominate themselves and commit to being the guardians of the protocols.

**Automatic transaction governance:** in this instance, transactions will be automatically executed if a quorum of members vote affirmatively.

**Multisig:** this is a system which can work for DAOs which have thousands of voting members. Funds are committed and live in a wallet shared by a small number of trusted, active community members. These trusted members are usually “doxxed” (i.e. the public identities are known to the community) and will act after a vote as the multisig signers of the DAO to execute the will of its members.

**DAO laws:** as with much in the DAO world the US has taken some early steps. Wyoming has pioneered DAO laws which establish legal status for DAOs and these have been followed, with variations, in other jurisdictions. In Part I of Cummings Pepperdine De-mystified DAOs you will find information on potential solutions for corporate wrappers/structures.

## DAO MEMBERSHIP

And so we are led to look at what form DADAO membership can take. Again, this can be very varied with different forms created in response to the needs and wishes of the DAO and its members however they will commonly be, or be based on, one of the following:

**Token-based membership:** where the right to governance tokens is earned through providing liquidity or some other proof of work, and ownership grants voting rights. This is often a permissionless with not authorisation required.

**Share-based membership:** in contrast to token-based, this is often partly permission based. A prospective members can submit a proposal to join the DAO, usually offering tokens or work. The “shares” then represent both direct voting

power and ownership. Members can exit at any time. This is commonly used by charities and investment clubs and can be so close to a company that regulation may be more likely to apply here than with other DAOs.

**Reputation-based membership:** -this represents proof of participation and grants voting power in the DAO. Unlike token or share-based membership, reputation-based DAOs do not transfer ownership to contributors and reputation cannot be bought, transferred or delegated. Instead, DAO members must have earned reputation through participation. A permissionless on-chain voting system may be used, with prospective members can free to submit proposals to join the request reputation tokens in exchange for their contributions.

## RECENT DEVELOPMENTS

In March 2023, members of the European Parliament’s economic affairs and home affairs committees voted in favour of extending European anti-money laundering regulations to DAOs, NFT platforms and DeFi platforms. This may be relevant in the United Kingdom as regulations develop.

## HOW CAN WE HELP?

DAOs are continuing to evolve, and their use cases are clearly visible. But as you can see, they need careful structuring right from the start. At Cummings Pepperdine we can advise and assist you with:

- structuring your DAO;
- negotiating the terms of the smart contracts;
- finding the best wrappers;
- complying with anti-money laundering regulations and other laws;
- the regulatory implications of the issuance of tokens.



## THE TEAM

Cummings Pepperdine is a leading advisor in crypto. We are one of a select few that advises a large and diverse global client base in the crypto space and the only to provide a complete crypto solution building on the three key areas of law, tax and FCA with legal underpinning at every point.

In law, we have a team of qualified and regulated solicitors and a barrister who retains right of audience.

In tax, we have one of the only crypto tax advisors who is both a qualified solicitor and qualified chartered accountant.

In regulation, our team comprises specialists in crypto compliance monitoring structures and governance oversight who are known to the FCA for the quality of their work.

The team is led by Claire Cummings, a leading solicitor specialising in crypto law and the current and evolving regulation. Claire is on the advisory boards of a crypto exchange and an NFT gaming guild and is also a member of the Global Digital Finance working group on



**Claire Cummings**

stablecoins. Claire has also acted as compliance officer, MLRO and director of an FCA regulated fund manager and qualified under SIB to trade derivatives. As a leading expert in crypto, Claire is a sought after speaker and has published multiple articles on the legal and regulatory issues surrounding cryptocurrencies and the crypto eco-system. Claire is named at the Top 10 influencer in London for hedge funds (2&20, 2022) and is included in the CityWealth Crypto Top 100

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The Cummings Pepperdine Online Training Programme, includes sections focussing on Demystifying DAOs , has been designed by a specialist board of compliance consultants, solicitors, chartered accountants, tax advisors and regulatory consultants. We believe that we are the only firm which offers training created by this range of qualified advisors.

[Click here now to make it all work](#)

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