

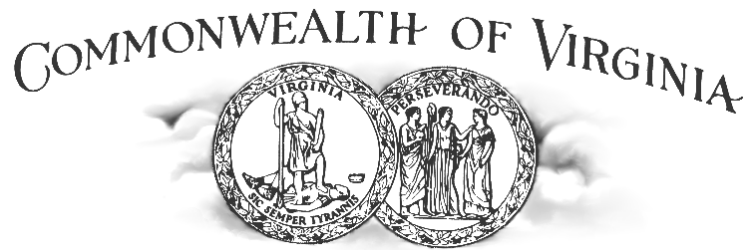
Report Regarding
Decentralized Autonomous Organization (DAO)
Legislation (House Bill 1784 (2023))



State Corporation Commission

November 2023

JEHMAL T. HUDSON
COMMISSIONER



BERNARD LOGAN
CLERK OF THE COMMISSION
P.O. BOX 1197
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STATE CORPORATION COMMISSION

October 30, 2023

The Honorable Richard L. Saslaw
Chair, Senate Commerce and Labor Committee
Senate of Virginia

The Honorable Terry G. Kilgore
Virginia House of Delegates

Dear Senator Saslaw and Delegate Kilgore:

Pursuant to the request of the Senate Commerce and Labor Committee, the State Corporation Commission has prepared this report regarding the subject matter contained in House Bill 1784 (2023), which concerns the recognition of decentralized autonomous organizations (DAOs) under Chapter 13.1 of the Code of Virginia, as well as a securities law exemption related to DAOs.

Please let us know if the Commission may be of further assistance.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Bernard Logan', written in a cursive style.

Bernard Logan, Clerk of the Commission

A handwritten signature in black ink, appearing to read 'Doug Joyce', written in a cursive style.

Doug Joyce, Director
Division of Securities and Retail Franchising

cc: The Honorable Susan Clarke Schaar
Clerk, Senate of Virginia

Table of Contents

<i>Executive Summary</i>	1
<i>Introduction</i>	1
<i>Definition of DAOs</i>	2
<i>Various Approaches to Legal Recognition of DAOs</i>	2
<i>Issues Concerning DAOs</i>	3
<i>Position of Proponents of HB 1784</i>	4
<i>Position of Other Stakeholders Regarding HB 1784</i>	4
<i>Implementation Considerations</i>	5
<i>Securities Law Considerations</i>	5
<i>Conclusion</i>	6
<i>Appendix A</i>	7

Executive Summary

- House Bill 1784 (“HB 1784”)¹ would establish decentralized autonomous organizations (“DAOs”) as a specific type of limited liability company (“LLC”) in Virginia, as well as an exemption under Virginia securities law for DAOs that use “primarily consumptive” tokens as part of their operations.
- A DAO is a novel type of decentralized entity that operates by blockchain with self-executing rules to manage itself following its organization.
- Four states have enacted legislation providing for the legal existence of DAOs, while legislation did not become law in four other states. Two states other than Virginia currently are considering DAO legislation.
- In states that have not passed legislation concerning DAOs, “entity-less” DAOs lack legal recognition and limitation of liability for their members. Even among states that have passed legislation, however, there is no consensus on a “best” entity type for DAOs – with the states following different approaches.
- Proponents of DAOs believe that legal recognition of DAOs in Virginia would provide economic benefit to the Commonwealth and maintain Virginia’s position as a leader in digital technologies.
- Other stakeholders believe that legislation allowing for the legal recognition of DAOs (including HB 1784) raises difficult questions which, if unaddressed, would have unintended consequences both for DAOs and existing LLCs.
- Implementation of HB 1784 and treating DAOs as LLCs is expected to require significant changes to State Corporation Commission (“SCC”) systems to allow for online business entity filings.
- Additionally, other stakeholders have urged that the breadth and effectiveness of the securities law exemption for DAOs in Virginia should be considered if federal securities law does not recognize a similar exemption.

Introduction

By letter dated March 24, 2023, the Senate Committee on Commerce and Labor requested that the SCC study the subject matter contained in HB 1784.² House Bill 1784, as introduced, would establish DAOs as a specific type of LLC under Virginia law. The legislation would create a new chapter in Title 13.1 of the Code of Virginia (“Code”) containing provisions specific to DAO LLCs, while also making them subject to certain provisions of the existing LLC Act found in Chapter 12 of Title 13.1 of the Code. House Bill 1784 also contains provisions exempting certain activities of a DAO from the Virginia Securities Act.³

¹[LIS > Bill Tracking > HB1784 > 2023 session \(virginia.gov\)](#)

² A copy of the letter is attached as Appendix A.

³ Code of Virginia § 13.1-501 *et seq.*

Definition of DAOs

A DAO is an organization whose activities are facilitated by blockchain. DAOs, as their name implies (decentralized autonomous organizations), function with a decentralized management structure. Many DAOs use self-executing rules known as smart contracts to manage their activities and for governance purposes. Membership interests are represented by digital assets and members may exercise voting rights through the use of governance tokens.^{4 5}

DAOs exist for a variety of purposes, which are defined by the activities in which they engage. The most prevalent types of DAOs include: (i) Protocol DAOs, which administer a decentralized platform, exchange or application; (ii) Grant/Philanthropy DAOs, which facilitate philanthropic causes and fund projects; (iii) Social DAOs, which may be used to create communities based on specific interests; (iv) Collector DAOs, which invest in valuable assets; and (v) Investment/Venture DAOs, which can provide pooled investments.⁶

A few noted examples from the above list include a Collector DAO that attempted to purchase an original copy of the United States Constitution. Additionally, an Investment DAO was formed to attempt to purchase an NBA franchise. As another example, a Philanthropic DAO has raised significant funds for relief in Ukraine.⁷

Various Approaches to Legal Recognition of DAOs

DAOs are a new type of organization, first emerging in the mid-2010s. Most DAOs operate without a formal, government-recognized entity structure, *i.e.*, they are entity-less. Various websites⁸ estimate that there are more than 19,000 DAOs worldwide. As noted below, a smaller number have chosen to avail themselves of legal recognition as offered by a few United States jurisdictions.⁹

A handful of states have created or are considering legal structures specifically recognizing DAOs. Currently, there is no consensus approach regarding such recognition. Some states have opted for or considered recognizing DAOs as a type of LLC, while others have pursued or enacted legislation establishing DAOs as a distinct legal entity or an unincorporated nonprofit association.

⁴ See HB 1784 for definitions of “smart contract”, “digital asset” and “governance token”.

⁵ For an in-depth discussion of DAOs, see <https://corpgov.law.harvard.edu/2022/09/17/a-primer-on-daos/>.

⁶ <https://www.lifespan.io/news/dao-funding-facts-and-future-2023/#:~:text=As%20of%20April%202023%2C%20the,of%20DAOs%20grew%20by%2066%25.>

⁷ <https://daocentral.com/explore/special-purpose.>

⁸ See, e.g., <https://deepdao.io/organizations, recorded as of October 23, 2023.>

⁹ Of course, DAOs also may be registered in non-U.S. jurisdictions, such as Switzerland, the Cayman Islands, Hong Kong, Panama, Bulgaria, and the Marshall Islands.

Four states (Vermont, Wyoming, Tennessee and Utah) have enacted legislation recognizing DAOs as a legal entity. Vermont added a subchapter to its LLC Act¹⁰ that provided for blockchain-based LLCs (“BLLC”s) in 2018, and has 64 domestic and three foreign active BLLCs as of September 21, 2023, at least some of which are likely to be DAOs.¹¹ Wyoming, as of 2021, allows DAOs to form as LLCs with special provisions.¹² The Wyoming Secretary of State’s office reports 529 DAO LLCs as of September 29, 2023.¹³ Tennessee followed suit in 2022 with its DAO LLC legislation¹⁴ and as of September 26, 2023, has two DAO LLCs per its Secretary of State’s office.¹⁵

Utah’s legislation¹⁶ is the most recent and will allow a DAO to form as a limited liability decentralized autonomous organization (“LLD”) starting January 1, 2024. While an LLD is a distinct legal entity under Utah law, the statute specifies that an LLD is to be treated as the legal equivalent of an LLC.

Legislation is pending in California and New Jersey as of the date of this report. The California legislation would permit DAOs to organize as unincorporated nonprofit associations.¹⁷ The New Jersey legislature is considering an LLC approach as part of a broader “Virtual Currency and Blockchain Regulation Act”.¹⁸

In addition to Virginia’s HB 1784, proposed legislation did not pass in Texas (2023, unincorporated nonprofit association),¹⁹ New Hampshire (2023, separate legal entity)²⁰ or Ohio (2022, LLC).²¹

Issues Concerning DAOs

Most DAOs operating in the United States lack legal status and carry the potential for unlimited liability for their members. DAOs’ management and governance structures generally could have difficulty fitting within statutes designed for corporations, LLCs, and partnerships. A DAO may face barriers on its ability to contract and otherwise engage in what are routine governance and business tasks for traditional business entities. It is unclear to what jurisdiction or jurisdictions an “entity-less” DAO may be subject due to its fundamental nature of decentralization. DAOs exist in a gray area as to securities and tax laws, and the federal landscape in this area is evolving.²²

¹⁰ <https://legislature.vermont.gov/statutes/chapter/11/025> (Includes, but is not specific to DAOs).

¹¹ <https://bizfilings.vermont.gov/online/BusinessInquire> (search by registration type).

¹² <https://www.wyoleg.gov/Legislation/2021/SF0038>.

¹³ Information provided by the Wyoming Secretary of State’s office on September 29, 2023.

¹⁴ <https://www.capitol.tn.gov/Bills/112/Amend/HA0748.pdf>. House Bill 1784 appears to be similar to Tennessee’s legislation.

¹⁵ Information provided by the Tennessee Secretary of State’s office on September 26, 2023.

¹⁶ <https://le.utah.gov/~2023/bills/static/HB0357.html>.

¹⁷ https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240AB1229.

¹⁸ <https://www.njleg.state.nj.us/bill-search/2022/A1975>.

¹⁹ <https://capitol.texas.gov/BillLookup/History.aspx?LegSess=88R&Bill=HB3768>.

²⁰ https://www.gencourt.state.nh.us/bill_status/billinfo.aspx?id=566&inflect=2.

²¹ <https://ohiohouse.gov/legislation/134/hb585>.

²² See <https://corpgov.law.harvard.edu/2022/09/17/a-primer-on-daos/>.

Position of Proponents of HB 1784²³

The proponents of HB 1784 point to legal issues faced by DAOs and the economic benefits to Virginia as bases for recognizing DAOs. DAOs are neither expressly permitted nor prohibited by statute in Virginia, as is the case in the majority of United States jurisdictions without legislation specific to DAOs, and these “entity-less” DAOs face several legal perils. First and foremost, without legislation, members face potential personal liability for the actions of their associated DAO, as members are not afforded statutory liability protections such as those offered to beneficial owners of corporations and LLCs. Additionally, the ability of a DAO to validly contract could be questioned, as could its tax status. It is not clear how a Virginia court would classify a DAO in the event of litigation. In a recent case, a federal court in California held that DAOs could be deemed to be general partnerships, with members potentially jointly and severally liable for the activities of the DAO.²⁴

The proponents point to economic benefits through the enactment of laws that will help Virginia keep pace with the use of technology to maintain and increase development of digital technologies in the Commonwealth. According to proponents, Virginia may retain and attract businesses that use secure digital ledgers such as blockchain. Proponents caution that expertise in Virginia may go elsewhere if a legal framework for DAOs does not exist, with a resultant economic loss to the Commonwealth. Proponents also point out that such a legal framework would provide protection to consumers.

Position of Other Stakeholders Regarding HB 1784²⁵

Other stakeholders note that DAOs are relatively new types of entities, and that their status and the laws concerning them continue to rapidly evolve. These stakeholders state that establishing DAOs as a type of LLC is a significant change to make without considering alternative approaches, such as whether a new type of business entity should be created, and that the complexity of issues requires deliberation before placing DAOs within existing business entity statutes. They further assert that the legislation leaves unanswered questions regarding corporate governance, compliance and tax matters. These stakeholders also assert that the proposed legislation does not place fiduciary duties on a Virginia DAO LLC, and a typical Virginia consumer would not understand this lack of protection.

These stakeholders outline technical drafting issues that they assert should be addressed,²⁶ including that the bill would require a DAO to be an LLC in Virginia and that language in the DAO legislation could be read as invalidating existing LLC operating agreements for non-DAO LLCs. They also suggest that clarity is needed around the definition of

²³ The SCC acknowledges the assistance of Benjamin Knotts, Legislative Director, Americans for Prosperity Virginia and Greg Leffel, Executive Director, Virginia Blockchain Council, in providing information for this report.

²⁴ Order, *Sarcuni v. bZx DAO, et al.*, ___ F. Supp. 3d ___, 2023 WL 2657633, 115 Fed. R. Serv. 3d 935 (S.D. Cal. March 27, 2023).

²⁵ The SCC acknowledges the assistance of the Business Law Section Council, Virginia Bar Association, in providing information for this report.

²⁶ The SCC understands that the stakeholders have met to discuss drafting issues.

“membership interest” and provisions related to a DAO’s management, membership, voting rights, amendment and dissolution. Finally, these stakeholders have noted the difficulty of siting a decentralized organization in any particular state, as well as potential problems with required reporting of beneficial ownership information under the federal Corporate Transparency Act, which becomes effective on January 1, 2024.²⁷

Implementation Considerations

As previously noted, states have taken several different approaches in deciding whether and how to establish an entity type for DAOs. No consensus exists on a single model for entity type across jurisdictions. DAOs operate without regard to jurisdictional lines. Until consensus across states is reached on a preferred form of a DAO as an entity, a patchwork of differing entities will exist and questions may arise on how these differing entities could be recognized in states with different models for DAO entity types.²⁸

Including DAOs under the Virginia LLC Act would require the SCC to implement changes to its Clerk’s Information System (“CIS”) to allow online registration of DAOs. From a practical standpoint and from prior experience, the SCC anticipates the need for a delayed effective date to ensure sufficient time to complete implementation of system changes. The preliminary estimate of the cost to implement HB 1784 was, at the time of its introduction, \$650,000.²⁹

Securities Law Considerations

As noted above, the proposed legislation anticipates that DAOs organized in Virginia could use tokens as part of their operations, including allowing members to vote on a DAO’s actions. The legislation provides that these tokens would be exempt from registration under the Virginia Securities Act³⁰ so long as the tokens are “primarily” consumptive. Although exemption from securities registration in Virginia may be appropriate, other stakeholders have expressed concern over how that standard might be applied. While the exemption would apply to registration under the Virginia Securities Act; federal securities regulators may take a different approach without being bound by Virginia law.

²⁷ DAOs, if they become “reporting entities,” would be required to comply with the Corporate Transparency Act ([Corporate Transparency Act Compliance for DAOs \(natlawreview.com\)](#)).

²⁸ Similar to most other states, Virginia’s business entity statutes require foreign (non-Virginia) entities to register prior to conducting business in the Commonwealth (*see* Code §§ 13.1-757 (stock corporations), 13.1-919 (nonstock corporations), 13.1-1051 (limited liability companies), 13.1-1241 (business trusts), and 50-73.53 (limited partnerships)).

²⁹ *See* 2023 Session Fiscal Impact Statement for HB 1784 at [Model FIS \(virginia.gov\)](#). The SCC is contracted with a third-party vendor for the development and maintenance of CIS, and must negotiate price and resource time with that vendor. The preliminary estimate is consistent with the cost incurred by the SCC to implement other recent, similar changes (*i.e.*, adding protected series LLCs as part of the LLC Act).

³⁰ Code § 13.1-501 *et seq.*

Conclusion

This report summarizes issues regarding state-level recognition of DAOs and related securities considerations. For additional information, please contact the following:

For questions concerning legal recognition and registration of DAOs:

Bernard Logan, Clerk of the Commission

(804) 371-9733

sccefile@scc.virginia.gov

For questions concerning securities law considerations and exemptions:

Doug Joyce, Director

Division of Securities and Retail Franchising

(804) 371-9911

SRF_General@scc.virginia.gov

COMMONWEALTH OF VIRGINIA

SUSAN CLARKE SCHAAR
CLERK OF THE SENATE
POST OFFICE BOX 396
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SENATE

March 24, 2023

The Honorable Jehmal T. Hudson
Chair, State Corporation Commission
P.O. Box 1197
Richmond, Virginia 23218

Dear Commissioner Hudson:

This is to inform you that, pursuant to Rule 20 (o) of the Rules of the Senate of Virginia, the Senate Committee on Commerce and Labor has referred the subject matter contained in House Bill 1784 to the State Corporation Commission for study. It is requested that the appropriate committee chair and bill patron receive a written report, with a copy to this office, by November 1, 2023.

With kind regards, I am

Sincerely yours,

A handwritten signature in black ink that reads "Susan Clarke Schaar".

Susan Clarke Schaar

SCS:lgs

cc: Sen. Richard L. Saslaw, Chair, Senate Committee on Commerce and Labor
Del. Terry G. Kilgore, Patron of HB 1784
Amigo Wade, Director, Division of Legislative Services
Margaret D. Sacks, Legislative Engagement, State Corporation Commission