

DAOs: Understanding the Basics

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Decentralized Autonomous Organizations (DAOs) are one of many white-hot blockchain topics promising to bring a blockchain-based method for managing any organization in a decentralized automated way. Adding to the intrigue, DAOs are often associated with the creation of a proprietary blockchain token. This is a first in a series of articles exploring the business and legal ramifications of these intriguing new organizations.

WHAT ARE DAOs?

Decentralized Autonomous Organizations, also known as DAOs, are being used as an alternative way to organize and manage an organization or even a company. In short, the organization is effectively “programmed” into a series of smart contracts that are stored on a blockchain. These smart contracts dictate the basis of the organization’s management and decision-making. Essentially, a DAO is “an internet community with a shared bank account”—the organization is run by code on the blockchain rather than a hierarchical leadership system.^[1] This implies that the organization’s members directly serve as managers and owners without a need for extra bureaucracy.

HOW DOES A DAO WORK?

The DAO relies on smart contracts that automatically execute when conditions are fulfilled. The smart contract outlines the organization’s rules, which can only be changed via vote. It can also send and receive funds without relying on a human-driven intermediary.^[2]

Upon purchasing DAO tokens, commonly with Ethereum, members can vote on rules and directly spearhead company changes which would subsequently trigger the smart contracts. The tokens serve a critical role in voting—any member should theoretically be able to participate.^[3] This promotes a more horizontal, transparent organizational structure.^[4]

Consider Friends With Benefits (FWB), a DAO founded in September 2020 that requires community members to review and vote on membership applications, which uses \$FWB tokens to hold ownership, and now encompasses almost 2,000 members.^[5] FWB is based on an exclusive, private membership system in which members must purchase a minimum share of \$FWB tokens for ownership in order to participate in FWB decision-making.

How does this work? When potential members buy the minimum share of \$FWB tokens (with Ether or other cryptocurrencies) and their written applications are approved and voted on by existing members, they will gain access to the FWB communication channels on the Discord platform. With more than 100 channels on the FWB Discord server, members facilitate and promote discussions and exchanges. Subsequently, members with at least 75 \$FWB tokens may propose resolutions in elections, with one token serving as one vote. Tokens incentivize members to participate, vote, and even trade.^[6]

With such a mechanism in place, FWB has proceeded to secure a \$10 million total investment from the likes of Andreessen Horowitz, Pace Capital, and Li Jin. This investment was voted on by the FWB members with their tokens, with 98.07% in favor.^[7] Since its foundation, FWB members have launched projects such as an NFT gallery, virtual music studio, as well as real-life global parties. The latest project, FWB Cities, aims to incentive FWB membership via real-world benefits which further builds on the metaverse and expands accessibility to new members.^[8]

In the videogame industry, the **MetaClan** DAO incorporates a play-to-earn gaming model while bringing together a community of gaming enthusiasts—gamers, developers, studios, etc.—to build a “next-generation video game guild” based on an NFT-based gaming space.^[9] MetaClan members can collaborate, build, and play together to complete in-game quests, which subsequently reward them with cryptocurrency or NFTs. Like FWB, the MetaClan membership process requires purchasing shares with the DAI digital currency to join the community.^[10]

SO WHY DAOS?

Blockchain’s transparency allows easy, public verification—this promotes trust within the DAO and in the voting process. Services are decentralized and automated, bypassing the need for any unnecessary human manipulation.^[11] This DAO structure can be helpful, especially for charities and contractors.

On the flip side, smart contracts may lack legal enforceability. The DAO itself may not own assets as there is no specific individual or entity to do so. However, meticulous smart contract structuring may appease concerns associated with traditional contracts.^[12]

Furthermore, DAOs pose great implications for blockchain-based gaming and eSports. Gamers and developers can now collaborate as the DAO facilitates communication and community gathering via rewards in NFTs and cryptocurrency payouts.

Stay tuned as we continue to explore the intricacies of creating a DAO, case studies of successful DAOs, securities issues implicated by DAOs (especially those with their own tokens), and implications for how we may do business in the future, from clubs, for-profit organizations, the metaverse, and beyond.

[1] What are DAOs? Here’s what to know about the ‘next big trend’ in crypto, CNBC, <https://www.cnbc.com/2021/10/25/what-are-daos-what-to-know-about-the-next-big-trend-in-crypto.html>, (last visited Nov 5, 2021).

[2] Decentralized autonomous organizations (DAOs), Ethereum.org, <https://ethereum.org/en/dao/>, (last visited Nov 5, 2021).

[3] What Do DAOs Actually Do?, Coindesk, <https://www.coindesk.com/business/2021/09/27/what-do-daos-actually-do/>, (last visited Nov 4, 2021).

[4] What is a DAO?, Coindesk, <https://www.coindesk.com/learn/what-is-a-dao/>, (last visited Nov 4, 2021).

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[6] Why Your Group Chat Could Be Worth Millions, New York Magazine, <https://nymag.com/intelligencer/2021/10/whats-a-dao-why-your-group-chat-could-be-worth-millions.html>, (last visited Nov 8, 2021).

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[8] Investing in Friends With Benefits (a DAO), Andreessen Horowitz, <https://a16z.com/2021/10/27/investing-in-friends-with-benefits-a-dao/>, (last visited Nov 8, 2021).

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[10] MetaClan Combines Esports and the Decentralized Organization, Gamma Law, <https://gammalaw.com/metaclan-combines-esports-and-the-decentralized-organization/>, (last visited Nov 9, 2021).

[11] Decentralized autonomous organizations (DAOs), Ethereum.org, <https://ethereum.org/en/dao/>, (last visited Nov 4, 2021).

[12] Get to Know This Acronym for a Crypto Regulatory Alternative: DAOs, Bloomberg Law, <https://news.bloomberglaw.com/business-and-practice/get-to-know-this-acronym-for-a-crypto-regulatory-alternative-daos>, (last visited Nov 5, 2021).

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