

CFTC's Charges Against Ooki DAO Could Have Significant Implications for DAOs

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On September 22, 2022, the Commodity Futures Trading Commission (CFTC) filed a complaint against Ooki DAO, a decentralized autonomous organization (DAO), and its members for (i) offering to enter into and executing leveraged retail commodity transactions outside of a registered futures exchange, (ii) failing to register as a futures commission merchant (FCM), and (iii) failing to implement know-your-customer (KYC) and customer identification program (CIP) procedures as required of FCMs under the Bank Secrecy Act. Concurrent with the complaint, the CFTC published a settlement order against the individual founders of bZeroX, LLC (bZeroX) for the same violations.

According to the CFTC's complaint and settlement order, the bZx protocol was originally developed and maintained by bZeroX and its founders. The bZx protocol allowed any person with an Ethereum wallet to contribute collateral to open leveraged positions whose value was determined by the price difference between two digital assets from the time the position was established to the time it was closed. According to the CFTC, these transactions did not involve the sale of actual digital assets, but rather financial settlement based on the price movements of the two digital assets. As a result, the CFTC believes these activities amount to retail commodity transactions, which were offered and executed off of a registered futures exchange by an unregistered FCM, to ineligible participants and entities.

On approximately August 23, 2021, bZeroX transferred control of the bZx Protocol to the bZx DAO, which was eventually renamed the Ooki DAO. From that point forward, the bZx DAO (and Ooki DAO) could act with respect to the bZx Protocol only through a vote of individuals holding BZRX tokens (the "Token Holders"). The CFTC cited to one public call in which one of the founders allegedly indicated that transitioning to a DAO would insulate the bZx protocol from regulatory oversight and accountability. The CFTC disagreed, and brought an enforcement action against bZeroX, its founders, and the Ooki DAO itself.

The charges imposed by the CFTC in these cases are not new or novel. The CFTC often charges persons or entities who offer leveraged or margined cryptocurrency contracts (or other forms of derivatives) to retail participants with the failures identified in the Ooki DAO complaint and the bZeroX settlement order. However, the Ooki DAO complaint relies on the novel and untested legal theory that all the Ooki DAO's token-holders who voted for the operation of the protocol should be held liable for violations of various federal statutes.

As CFTC Commissioner Summer Mersinger wrote in her dissenting statement, the CFTC is authorized by the Commodity Exchange Act to bring enforcement actions against persons for violations committed by another person or persons, but only under theories of principal-agent liability, aiding-and-abetting liability, and control person liability. In contrast, the CFTC's legal theory for holding the Token Holders liable is based on a State-law doctrine that members of a for-profit unincorporated association are jointly and severally liable for the debts of that association. Specifically, the CFTC cites to three cases holding (generally speaking) that individual members of a for-profit unincorporated association are personally liable for the debts of the association. However, these cases were tried under State law, and were related to contract disputes and torts involving private parties (not a government agency).

If the court agrees with the CFTC, the decision could have significant implications for DAOs. Specifically, it would enable the CFTC (and other regulators like the SEC with authority over other types of cryptocurrencies) to hold individuals personally liable merely for voting in DAO decisions. Additionally, DAOs themselves may be compelled to register with the CFTC (which may not even be possible) and comply with the Bank Secrecy Act requirements. A DAO can be a helpful alternative to traditional institutions because they potentially eliminate certain burdensome issues related to third-party intermediaries and principal-agent problems, but an adverse decision in this case could minimize the appeal of managing a protocol through a DAO.

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