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Tennessee's DAO Statute: A Trendsetter For Blockchain-Based Corporate Governance

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On April 20, 2022, Tennessee Governor Bill Lee signed into law a bill to allow decentralized autonomous organizations (DAOs), to register as a type of limited liability company. As the second U.S. state to grant legal status to DAOs (following a similar Wyoming law passed in 2021), Tennessee has become a trendsetter for blockchain-based corporate governance. This new DAO Act is expected to attract significant blockchain investment and job growth to the thriving tech sector in Tennessee. As one of the bill's sponsors, House Representative Jason Powell, put it, Tennessee may soon be dubbed the "Delaware of DAOs".

What is a DAO? A DAO is an organization operating on a blockchain platform. Unlike a traditional LLC, which is governed by its operating agreement, a DAO is usually governed by:

- (i) **Smart contracts:** A DAO's operating rules are written in computer code stored on a blockchain ledger, known as the "smart contract." This series of executable code determines the operation of the DAO, and runs automatically when certain predefined triggering events occur; and
- (ii) **Governance tokens:** Similar to certain membership interests in an LLC, each member of a DAO receives tokens as a representation of their interest in the DAO. As could be the case in other LLCs, it is possible to structure a DAO so that different tokens have different rights. The smart contract defines those rights; in a typical DAO, those with governance tokens (which would be similar to a membership interest with voting rights in a traditional LLC) can propose new initiatives and then vote on them.

When a legal entity is a DAO, each step of corporate governance and decision-making is automated through smart contracts and the participation of token holders. As a result, DAOs are self-sustaining and autonomous entities with a self-administering organizational structure and a correspondingly reduced need for manual administration when compared to traditional LLCs or corporations.

2. Why do people set up DAOs? DAOs bring individuals across the world and their resources together for investment, mergers and acquisitions, non-profit goals, or other specific initiatives. For example, in February 2022, a DAO formed by a group of crypto enthusiasts raised \$4 billion to acquire the Denver Broncos. In 2021, another group formed a DAO for the sole purpose of bidding on an original copy of the U.S. constitution being auctioned by Sotheby's. Aside from the frictionless governance structure, another benefit of DAOs is, because they are truly decentralized organizations, most DAOs can issue tokens that do not meet the current definition of a "security" and thus are able to avoid potentially burdensome securities law compliance.

3. Why do we need the DAO Act? Prior to passage of the DAO Act in Wyoming and now Tennessee, a DAO was not formally recognized as a unique governance structure, and therefore there was no easy way to establish a DAO structure that provided the benefits of recognized business entity structures, such as limitations on the liability of the equity owners. Without that protection, a token holder in a DAO that is not organized as another type of entity could theoretically be held liable for the debts of the DAO, even though the

DAO actions were carried out automatically by a computer-run smart contract on autopilot without any human intervention.

4. What does the Tennessee DAO Act provide? The new DAO Act amends the Tennessee Limited Liability Company Act and allows an LLC to make an election to become a DAO. An entity may register in Tennessee as a DAO and carry on operations in other jurisdictions just like any other type of business entity. Forming a DAO in Tennessee requires the following:

- **Statement in the Articles of Organization**
 - The LLC must contain an express statement in its articles of organization that the company is a DAO.
 - An existing LLC may also convert to a DAO by amending its articles of organization with an express statement.
 - The DAO Act sets forth the required statement that must be contained in the articles of organization
- **Name of the Organization:** The registered name for a DAO must include "DO", "DAO", "DO LLC", or "DAO LLC."
- **Governance Structure:** The articles of organization must:
 - Specify whether the DAO is a "smart contract-managed DAO" or a "member-managed DAO." The legislation will treat a DAO as a "member-managed DAO" by default unless otherwise provided in the articles of organization.
 - Include publicly available identifier of a smart contract directly used to manage, facilitate, or operate the DAO.
- **Miscellaneous:**
 - A DAO will be dissolved if it fails to approve proposals or take actions for one year, or fails to perform a lawful purpose as determined by the Tennessee secretary of state.
 - A member of the DAO (i.e., the token holder) does **not** have a fiduciary duty to the DAO except for implied covenant of good faith and fair dealing.

SUMMARY: DAOs are poised to become a fast growing type of business organization, sitting at the dynamic intersection among corporate governance, blockchain, cybersecurity, and investment. According to the World Economic Forum, the value of assets held in smart contracts had grown to \$13 billion by 2020. The Tennessee DAO Act is a significant step towards filling the gap between innovation and legislation.

Baker Donelson will continue to follow this developing area of law and provide updates as they become available. For more information, contact [Chris Sloan](#), [Vivien F. Peaden](#), [CIPP/US](#), [CIPP/E](#), [CIPM](#), [PLS](#), or your Baker Donelson [Information Technology](#) attorney.