

A Little Laissez-Faire Fiduciary-ness Could be Okay

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In January of 2022, Tennessee introduced a new piece of legislation allowing a Decentralized Autonomous Organization (“DAO”) to qualify as a Limited Liability Company (“LLC”) under the Tennessee Revised Limited Liability Company Act (“TRLLCA”).² Under the new legislation, an existing LLC can convert to a Decentralized Autonomous Organization Limited Liability Company (“DAO LLC”)³ or a new company can organize initially as a DAO LLC by stating so in the articles of organization signed and filed with the secretary of state.⁴ Notably, the legislation affords significant rights to DAO participants as members of member-managed limited liability companies, without certain core corresponding obligations—including fiduciary duties—that have been a hallmark of Tennessee business entity law (including the TRLLCA).⁵

Notwithstanding the glaring problems in the statutory drafting, including the requirement that immutable smart contracts be amendable

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² TENN. CODE ANN. §§ 48-250-101 – 48-250-118 (2022).

³ *Id.* § 48-250-103(b).

⁴ *Id.* § 104(a).

⁵ *Id.* § 103(c).

or subject to modification,⁶ specific criticisms concerning the elimination of fiduciary duties⁷ are potentially premature. Sometimes, too many restrictions on innovation, especially without concrete knowledge of full capabilities of DAOs, can do more harm than good. Allowing DAOs to ‘play in a regulatory sandbox’ would give the owner and regulators time to figure out necessary regulations. Arguments against the elimination of default fiduciary duties declare that there is great, impending, potential harm that would stem from this and that actors cannot be trusted. But this depiction overlooks the very nature of a DAO and what the industry hopes to accomplish with a blockchain platform. Though I am not discounting that there will be bad actors—as there always are—I do not necessarily believe that the potential harm from inaction, not imposing fiduciary duties and other regulation off the bat, is greater than the cost of acting too soon and not allowing the industry to develop and adapt. I agree with the words of Wulf Kaal, that if innovators are deprived “in developing decentralized infrastructure solutions, society at large suffers.”⁸

⁶ Teague, *supra* note 6 (“The Wyoming and Tennessee statutes both require that any smart contracts utilized by the DAO be capable of upgrade or amendment. By their very nature, smart contracts are immutable, so to ‘amend’ a smart contract must mean to abandon it in favor of a new smart contract, or to have storage variables capable of modification.”).

⁷ Joan MacLeod Heminway, *The Fiduciary-ness of Business Associations*, TRANSACTIONS: TENN. J. BUS. L. (forthcoming 2023).

⁸ Wulf A. Kaal, *A Decentralized Autonomous Organization (DAO) of DAOs*, (March 6, 2021). Available at SSRN: <https://ssrn.com/abstract=3799320> or <http://dx.doi.org/10.2139/ssrn.3799320>. Though, Kaal also argues that “[t]ying the legal existence of a DAO to any forms of existing legal and jurisdictional frameworks typically results in the need for a representative in the chosen legal framework and

At least by waiting, regulators will later be able to better see the clear path forward and act in accordance with what has been learned versus having to step back and undo actions previously taken.

The option to eliminate fiduciary duties and the inclusion of broad, general language in the statute is good for the development of the LLC law into a new domain. For one, DAOs, in and of themselves, are still very new—as of 2016 with the Ethereum Blockchain and “The DAO” — and because of the range of industries and practices that could be affected and the unknown ways in which DAOs will develop—I support the flexibility allowed by the statute to let DOA LLCs choose whether to impose fiduciary duties.

Second, I trust the blockchain platform concept. One of the big appeals of DAOs is that they are more secure from third-party interference because the organization exists on an immutable blockchain, meaning it lacks the ability to be changed retroactively. “Blockchain technology removes fraudulent transactions.”⁹ Thus, because the majority

jurisdiction, which, in turn, centralizes the DAO and results in the failure of the DAO concept.” Simply put, the DAO shouldn’t really be tied to any existing laws and should be an endeavor all its own.

⁹ Mark Fenwick et al., *Legal Education in the Blockchain Revolution*, 20 VAND. J. ENT. & TECH. L. 351, 366 (2017). “Blockchain’s security measures make blockchain validation technologies more transparent and less prone to error and corruption. While blockchain’s use of digital signatures helps establish the identity and authenticity of the

of DAO processes can be determined through event-enacted smart contracts, thereby limiting the interaction with third parties, there should be less need for fiduciary duties. Additionally, “because of the value-to-effort focus of workflows in the DAO structure, supervision and imposition of legal duties are less clearly applicable”¹⁰ Kaal still notes, however, that issues do arise with regard to third-party liability and the availability of legal recourse.¹¹ But, again, this will likely develop with the technology and as issues arise. Also, I recognize that trusting the smart contract or code actually means trusting the coder and developer and the network you are a part of.¹² But I am not sure that requiring fiduciary duties really solves this problem because the coder or developer may not be a member of the LLC and the fiduciary duties are imposed after formation, meaning after the coding has already been done.

Finally, I found comfort in the important fact that the legislation does not prohibit the use of fiduciary duties in DAO LLCs. It merely

parties involved in the transaction, it is the Internet's completely decentralized network connectivity that allows the most protection against fraud.”

¹⁰ Kaal, *supra* note 8, at 8.

¹¹ *Id.* at 9.

¹² Patrick Murck, *Who Controls the Blockchain?*, HARV. BUSI. REV., (Apr. 19, 2017), <https://hbr.org/2017/04/who-controls-the-blockchain> (Accessed: March 15, 2023) (“In a blockchain transaction, you don’t have to trust your counterpart to perform their obligations or properly record transactional data, since these processes are standardized and automated, but you do have to trust that the code and the network will function as you expect.”).

leaves the choice up to the founders and promoters of the DAO.¹³ From a “survival-of-the-fittest” approach: if fiduciary duties are such a big, essential item, then smart owners or founders of DAOs would—in theory—know to include fiduciary duties and, if they don’t, they are taking a larger risk, especially in the as DAOs, continue to develop and grow. Additionally, other members would learn to only join or support DAOs with fiduciary duties imposed. Accordingly, I would lean on the adaptability or private ordering and the idea that any given DAO LLC can elect to protect itself and its equity owners via contracting from the get-go. Additionally, as DAOs that don’t include fiduciary duties get the rug pulled out from under them or run into other fiduciary-related problems, if they fail often enough, and in a notable way, we may later amend the statute to provide a default of fiduciary duties later, once we have seen how the current law fails and exactly what issues we run into. Then the appropriate authorities can draft new law, even better than could be drafted if they chose to amend it today.

In conclusion, while I agree with Professor Heminway’s point that the elimination of the default rule in favor of fiduciary duties represents a

¹³ TENN. CODE ANN. §§ 48-250-103(c) (“if applicable, of a decentralized organization *may* define, reduce, or eliminate fiduciary duties. . .”) (emphasis added).

stark departure from the traditional approaches to business entities and associations, I am not completely impassioned that it is a seriously detrimental flaw that needs immediate attention and revision.