WINSTON & STRAWN LLP

BLOG

DAOs Watch Out: Federal Court in California Decides a DAO Can Be a General Partnership

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On November 18, 2024, in *Samuels v. Lido DAO*,[1] the United States District Court for the Northern District of California denied some defendants' motions to dismiss, finding that the plaintiff sufficiently alleged that a decentralized autonomous organization (DAO) is a partnership under California law, and consequently that these defendants may be liable as general partners. The court relied chiefly on the plaintiff's argument that these defendants "meaningfully participated"[2] in the DAO's governance.

BACKGROUND

A DAO is an organization that utilizes blockchain-based technology tools, including smart contracts, to make decisions and to control property. A DAO usually allows its participants to act by way of "governance tokens" that empower their holders to participate in the governance of the DAO, including voting on decisions that may affect certain property (for more information, see our blog article, DAOs: Understanding the Basics). Since the launch of the first major DAO in 2016 (aptly named "The DAO"), thousands of DAOs have been formed. DAOs vary in purpose and scope; some are formed to engage in projects, to manage software, to invest, to provide services, or for charitable purposes.

The *Samuels v. Lido DAO* case concerns the Lido DAO, a DAO formed to govern aspects of the Lido liquid staking protocol,[3] and certain purchasers of the LDO token. The plaintiff purchased LDO tokens via a digital asset exchange and alleged that he sustained a loss when he later sold those tokens. The plaintiff sued Lido DAO and four holders of a significant amount of LDO tokens. He claimed that Lido DAO, as a partnership, violated federal securities law,[4] and the four significant token holders, alleged to be general partners of that partnership, should be liable for the DAO's violations. The defendants moved for dismissal arguing, among other things, that the DAO is not capable of being sued because it is not a legal entity and that it is not a partnership because, among other things, it observes no formalities normally associated with a partnership.

According to the plaintiff and the Court's judicial notice, Lido DAO is in the business of managing aspects of the Lido Protocol and it maintains certain service fees it collects.[5] It was founded by three individuals whose whereabouts are either unknown or outside the United States. Some legal entities were incorporated to facilitate its creation, but these entities "vigorously repeat in their legal documentation" that they do not control Lido DAO.[6] After Lido DAO was founded, its LDO tokens were sold and later became listed on several major exchanges. Some of its 70-plus

employees, including a business development lead and a chief marketing officer, worked on or promoted the listings.[7]

THE COURT'S REASONING

The Court rejected the argument that Lido DAO is merely software that cannot be sued. This argument was advanced by a limited liability company (LLC) created by a subset of LDO token holders that itself was not sued by the plaintiff, but was formed to make a limited appearance in the lawsuit "to prevent entry of default judgment against Lido."[8] Although the LLC's standing to participate in the lawsuit was questioned by the Court,[9] the plaintiff did not object to the LLC's appearance and the Court considered the LLC's arguments.[10] The Court also noted that the DAO is "a type of organization that seems designed, at least in part, to avoid legal liability for its activities" without elaborating on the reason for such characterization.[11]

The Court accepted the plaintiff's allegations that "Lido DAO is jointly operated by 'large' holders of LDO voting those tokens to cause the DAO to make business decisions," and "Lido DAO's partners are those that have the capacity to meaningfully participate in Lido DAO's business."[12]

Defendants argued that Lido DAO could not be a partnership under California law because California law requires all partners to consent to join a partnership and repurchase of interests by the partnership when a partner leaves a partnership, and because LDO tokens can be freely bought and sold in the open market. However, the Court found that these provisions are only default rules and, based on the facts alleged by the plaintiff, one can reasonably infer that the founding partners of the Lido DAO had opted out of these default rules.[13]

The Court noted that, at the pleadings stage, the plaintiff does not need to identify all general partners of the alleged partnership. The Court also noted that explicit agreement to share profit and loss is not necessary to find the existence of a partnership under California law. In addition, the Court decided that the entities established to facilitate the creation of Lido DAO are not an "affirmative choice of another corporate form [that] weighs against the existence of a partnership," because they do not control Lido DAO; the corporate forms of the holder defendants are also irrelevant, because "California law expressly provides that corporations and other corporate entities can be members of general partnerships."[14]

The Court found that the plaintiff has sufficiently alleged that three of the four large LDO holder defendants meaningfully participated in the Lido DAO partnership:

- One holder defendant was alleged to have "helped 'influence[]' and 'guide[]' the development of Lido and the DAO's website heralded [the defendant's] ability to 'lend its expertise to LidoDAO [sic] governance.'"[15]
- Another holder defendant was alleged to have "announced itself that it would contribute to Lido DAO as a 'governance participant,' and in at least one instance did express a view on DAO governance"; the plaintiff also alleged that this holder defendant purchased tokens worth US$70M.[16]
- A third holder defendant presents "a closer call." The plaintiff alleged that "[a]fter an initial purchase of US$25M worth of LDO, [the defendant] purchased even more tokens, noting that it was 'looking forward to being more active in governance' and that it was 'uniquely positioned to lend its expertise to LidoDAO [sic] governance.' And it was able to purchase these tokens because it voted for them to be sold to it."[17]

However, the Court dismissed one defendant, finding that the plaintiff failed to allege specific facts:

- "[The complaint noted] only that one of [the defendant's] partners praised Lido DAO, that [the defendant] was chosen to get involved with the DAO because it could add its 'expertise in the successful development of distributed protocols' to the DAO, and that it participated in a sale in which it, along with other entities, purchased 30 million LDO. It [did] not allege that [the defendant] participated in Lido DAO governance or made any statements about doing so."[18]

IMPLICATIONS

Other courts have previously held that a DAO can be a general partnership or unincorporated association. In *CFTC v. Ooki DAO*, also decided in the Northern District of California, the Court held that a DAO can be an unincorporated association that can be served—through its chat box and online forum—and can be liable under the Commodity Exchange Act.[19] In a 2023 decision in *Sarcuni v. bZx DAO*, the United States District Court for the Southern District of California held that all token holders of a DAO can be partners in a partnership.[20] This view, however, is not unanimously held.[21]

There are still many uncertainties surrounding the nature of DAOs and the status of participants in those DAOs. While the *Samuels* Court's reasoning was mostly based on the scope of the partnership alleged by the plaintiff, which includes only those large holders with "the capacity to meaningfully participate in Lido DAO's business,"[22] the Court left open the possibility of a broader group, including all DAO token holders or everyone who has voted on a proposal in the DAO, or a narrower group, including only the founders of the DAO.[23] If this "meaningful participation" approach is applied, courts will grapple with complex legal and factual questions to establish which token holders are meaningfully participating in the DAO's affairs. Similarly, the Court's decision relied on California law to determine whether the plaintiff sufficiently alleged the existence of a general partnership; it is possible that Courts in other states may reach different conclusions based upon differing state laws. That may result in a single DAO having different legal status across different states.

The Court's general characterization of the DAO being an organization type used to avoid legal liability is also alarming to the digital assets industry sector. While the Court did not elaborate on the specific reason for such characterization, the founders, participants, and promoters of DAOs may need to more clearly demonstrate the legitimate business and social benefits of DAOs—such as facilitating decentralized collaboration—when interacting with courts, regulators, and the public.

Holders of DAO tokens should consider the potential exposure to partnership liability and be especially careful when purchasing DAO tokens in large quantities, participating in the governance of a DAO, or making representations about participation in a DAO. Deployers of DAOs may elect to "wrap" their DAO by forming a legal entity to conduct some or all the DAO's activities. Many DAOs elect to "wrap" themselves by delegating some actions to an ownerless Cayman "foundation company" that is limited by shares, and that employs professional directors who are entrusted with keys to DAO treasuries and are empowered to engage in legally significant activities where certainty as to legal status is required, such as hiring vendors and signing legal agreements. A DAO may also be formed as a legal entity. Some states have created bespoke legal entity types expressly for DAOs.[24] Wyoming recently approved a new type of entity known as the "decentralized unincorporated non-profit association" (DUNA), which makes the DAO itself a legal entity, provides liability protection for DAO token holders, and clarifies tax treatment for any value that flows to token holders from the DAO.[25] As entrepreneurs continue to experiment with the use of digital assets, new technologies built with blockchains and smart contracts, and to innovate in their governance approaches, we expect to see states continue to experiment with new approaches to protecting those who interact with DAOs.

Law Clerk Douye Xu also contributed to this blog post.

If you have any questions or need any assistance related to the content of this article, please contact the authors listed below or your relationship partner.

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[1] *Samuels v. Lido DAO*, Order re Motion to Dismiss, No. 23-cv-06492 (N.D. Cal. Nov. 18, 2024).

[2] *Id.* slip op. at 15.

[3] *See* Lido DAO, https://docs.lido.fi/lido-dao/.

[4] The plaintiff alleged that because Lido DAO sold unregistered securities, he is entitled to recission under Section 12(a)(1) of the Securities Act of 1933. The Court rejected the defendants' argument that the plaintiff is not eligible under Section 12(a)(1) because he bought the tokens on the secondary market instead of buying directly from Lido DAO. The Court stated, among other things, "[L]iability for losses incurred from the purchase of unregistered securities only attaches to someone who 'offers or sells' those securities" (quoting Section 12(a)(1)), but the "offers or

sells" requirement can be satisfied by successful solicitation motivated in part by the solicitor's or the security owner's financial interest. *Id.* slip op. at 2, 19. The Court found that the plaintiff has properly alleged solicitation, and such solicitation can be motivated by Lido DAO's financial interest because increased secondary market liquidity of LDO benefits Lido DAO. *Id.* slip op. at 20–21. The court also held that liability under Section 12(a)(1) is not limited to public offerings. *Id.* slip op. at 2, 23–27.

[5] *Samuels v. Lido DAO*, Order re Motion to Dismiss, slip op. at 3–4.

[6] *Id.* slip op. at 3.

[7] *Id.* slip op. at 4–7.

[8] *Id.* slip op. at 7; *Samuels v. Lido DAO*, Dolphin CL, LLC's Motion to Dismiss Plaintiff Andrew Samuels's Amended Complaint as to "Lido DAO," at 1 n.2 (N.D. Cal. July 11, 2024).

[9] *Samuels v. Lido DAO*, Order re Motion to Dismiss, slip op. at 7–9.

[10] *Id.* slip op. at 8. According to the court, the plaintiff was suing the "entity that operates the particular Lido deployment" and he has alleged that Lido DAO engaged in "the actions of an entity run by people," including "mak[ing] decisions through tokenholder votes, maintain[ing] a treasury where it keeps its retained percentage of staking rewards, and ha[ving] hired over 70 employees." (internal quotation marks omitted).

[11] *Id.* slip op. at 1.

[12] *Id.* slip op. at 10 (internal quotation mark omitted).

[13] *Id.* slip op. at 12–13.

[14] *Id.* slip op. at 13–14.

[15] *Id.* slip op. at 15 (internal citation omitted).

[16] *Id.* (internal citation omitted).

[17] *Id.* (internal citation omitted).

[18] *Id.* slip op. at 15–16 (internal citation omitted).

[19] *CFTC v. Ooki DAO*, Order Concluding That Service Has Been Achieved, No. 3:22-cv-05416 (N.D. Cal. Dec. 20, 2022) (Before this Order, the court ordered the CFTC to serve the founders of Ooki DAO who were also token holders, and the CFTC complied, but the court ultimately concluded that service to the founder-holders was not required by law.); *CFTC v. Ooki DAO*, No. 3:22-cv-05416 (N.D. Cal. June 8, 2023) (default judgment).

[20] *Sarcuni v. bZx DAO*, 664 F. Supp. 3d 1100, 1117–18 (S.D. Cal. 2023).

[21] *See* SEC, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (Release No. 81207, July 25, 2017), https://www.sec.gov/files/litigation/investreport/34-81207.pdf (discussing how token holders in The DAO were dispersed and pseudonymous, which "made it difficult for them to join together to effect change or to exercise meaningful control," with "thousands of individuals and/or entities that traded DAO Tokens in the secondary market—an arrangement that bears little resemblance to that of a genuine general partnership.")

[22] *Samuels v. Lido DAO*, Order re Motion to Dismiss, slip op. at 10.

[23] *See id.* slip op. at 11.

[24] *See* Wyoming Decentralized Autonomous Organization Supplement, Wyo. Stat. Ann. §§ 17-31-101–17-31-116 (2021); Vermont's Blockchain-Based Limited Liability Companies, Vt. Stat. Ann. tit. 11, §§ 4171–4176 (2018); Utah's

Decentralized Autonomous Organization Act, Utah Code Ann. §§ 48-5-101–48-5-406 (2024); New Hampshire Decentralized Autonomous Organization Act, N.H. Rev. Stat. Ann. §§ 301-B:1–301-B:31 (effective July 1, 2025); Tennessee's Decentralized Organization, Tenn. Code Ann. §§ 48-250-101–48-250-115 (2022).

[25] *See* Wyoming Decentralized Unincorporated Nonprofit Association Act, Wyo. Stat. Ann. §§ 17-32-101–17-32-129 (2024). Read

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