

DAO FALLACIES

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Common Myths and Uses for Decentralized Autonomous
Organizations

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Abstract

DAO myths are a natural by-product of technological evolution. The paper debunks the top five DAO myths and explores the top five DAO benefits and use cases.

Key Words: Decentralized Autonomous Organization, Digital Assets, Valuation, Blockchain, Myth, Uses, Distributed Ledger Technology, Emerging Technology

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I. Introduction

Decentralized autonomous organizations (DAOs) are not created equal. At their best, DAOs replace large parts of society, business operations across industries, and centralized human decision making with micro-democratic attack resistant decentralized decision making and governance. At their worst, DAOs result in ponzi schemes and rug pulls that undermine the future of web3 and associated upgrades for humanity.

At their best, DAOs replace existing corporate earning mechanisms for humans to earn a living with enhanced workflow, independence, and democratic merit-based feedback in work to earn structures. DAOs can result in an advanced state of automation and human connectivity where smart contracts, algorithms, and code replace human input within an organization to coordinate human collectives efficiently and in an attack resistant way.

DAOs have the potential to substantially upgrade the way humans work. Rather than serving a principal who determines where, what, and when workers have to perform, which often results in a long list of suboptimal outcomes that derive from non-intrinsically motivated work, DAOs allow influence and outcomes of DAO members to be determined by the value a DAO member's contributions to the shared work product. Moreover, if a DAO member adds substantial value to the DAO, other DAO token holders will want to add their skills to the same work product via a policing engagement which focuses all DAO members' joint efforts on the highest possible value proposition. This "value to effort focus of work flows" in the DAO structure has the potential to revolutionize the way society works.

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In their existing format, DAOs can reinvigorated a foundation, donor-advised fund, and crypto foundation. DAOs have the potential to overcome the inefficiencies and principal-agent problems of the modern-day corporation.

In 2022, DAOs are already trusted with billions in assets under management and generate significant APY in DeFi transactions. DAOs handle the day-to-day operations and governance of large funding pools and coordinate payouts across businesses according to democratic rules. If executed properly, they are an effective structure for charity, online community, democracy, business and general governance.

At their worst, DAOs are unorganized, inefficient, slow, exploitable, and deceptive. Several of the identifiable downsides include: siphoned coins, distracted and robo voters, centralization, DAO washing by founders, lack of decentralized governance, and other pitfalls that could end up in mid-term and long-term DAO failure.

In 2021 alone, the total illicit revenue from crypto scams was \$7.7 billion; 37% of that total resulted from “rug pulls,” an increase from the 1% of total illicit revenue in 2020. Although these dollar amounts mirrored a general rise in crypto prices in 2021, the increase in deceptive “rug pulls” illuminates a familiar maxim: more money, more problems.

II. Top 5 DAO Myths

Because the DAO space is still largely in its infancy, misconceptions and myths are prevalent. Below are several of the core myths that need to be proven wrong.

1. Myth #1: Fundraising

Like any new technology and societal development, DAO myths are a natural by-product of technological evolution. Myths and misconceptions about DAOs are natural because the underlying

technology is so new and underdeveloped. Governance experimentation for DAOs is in the very early stages which naturally creates failures and associated misconceptions and myths.

The most common DAO myth in 2022 is probably that the primary function of DAOs is fundraising. Indeed, many DAOs are created for the purpose of fundraising. For example, ConstitutionDAO, Spice DAO, and Dune DAO, are all popular fundraisers.¹ Members of such DAOs receive DAO tokens proportional to their donation value in fungible tokens. Like the first DAO, subsequent fundraiser DAOs are useful to attract the mainstream to the concept of a DAO and its broader sets of uses in business and society.

Fundraiser DAOs are vulnerable in multiple ways. They often lack incentives for meaningful community engagement and tend to dissipate with the hype. Governance through fungible tokens in fundraiser DAOs allows whales to control the DAO, which is antithetical to the idea of DAOs overall and decentralized governance of DAOs specifically. More specifically, selling purchasable voting power via fungible tokens risks hostile takeovers or looting. Although many fundraiser DAOs are popular, they do not represent the greater purpose DAOs have on the future of work and community engagement.

2. **Myth #2: Scams**

The second most common myth is that DAOs are generally set up by scammers and that DAOs are rife with deception and scams. While it is true that many DAOs and DAO users have fallen victim to the infamous rug-pulls, most of these rug pulls are associated with the lack of decentralized governance in fundraiser DAOs.

Of the top six crypto rug pulls in 2021, two were DAO projects. Anubis DAO, which is reported to have lost nearly \$60 million in

¹ Will Gottsegen, *DAOs and the Next Crowdfunding Gold Rush*, CoinDesk, (Dec. 6, 2021 at 1:58p.m. CST). [DAOs Are the Next Crowdfund Gold Rush](https://www.coindesk.com/dao-gold-rush/) ([coindesk.com](https://www.coindesk.com/))

an alleged rug pull; and Snowdog DAO, reported to have lost \$30 million.

The below examples highlight the abuse potential for DAOs that did not follow proper governance.

a) Insider Abuses

Most DAOs that fall victim to unethical behavior and rug pulls are subject to abuses from insiders. Typically these insider abuses are possible because the insiders are not governed properly and have too much control over the DAO. True decentralized community governance removes the control over keys and code by councils and privileged insiders.

Anubis DAO (a fork of Olympus DAO) launched a token sale on the Copper platform on Oct. 28 2021. The sale attracted substantial interest from investors as the project raised \$60M worth of ETH in under 24 hours. As the sale was about to close, 13597 ETH was removed from the token sale pool and sent to another address. Allegations of a rug pull ensued because the launch platform Copper had not been compromised.

Snowdog DAO (Avalanche protocol) experienced similar abuses. For example, Snowdog DAO suffered an alleged rug-pull when an insider who knew a “challenge key” (a part of the DAOs contract), backran the anticipated buyback and began selling tokens. Many suspect an insider made almost \$10M as the SDOG was converted to other currencies.² As a result, SDOG price quickly lost 90% of its value.³ This project seemed especially suspect because many “mainstream crypto promoters” aggressively promoted Snowdog prior to the incident.⁴ Although examples like this understandably trigger reluctance, there are multiple sustainable DAOs which mechanically prevent such scams.

² *Snowdog Allegedly Falls Victim to Largest Rug-Pull in Avalanche History*, Dreamchain, (Nov. 26, 2021). [Snowdog Allegedly Falls Victim to Largest Rug-Pull in Avalanche History - DreamChain](#)

³ *Id.*

⁴ *Id.*

b) External Takeovers

Anubis DAO and Snowdog DAO provide examples of DAO abuses where the core team failed to maintain integrity from within. But these inside rug pulls are not the only exploitative mechanism within DAOs. DAOs can also be exploited from the outside if the DAO's governance allows fungible voting power.

The lack of proper decentralized governance with non-fungible tokens is a key common denominator among DAO failures and rug pulls. DAOs are controlled by their stakeholders, i.e., "tokenholders." These tokenholders can use their holdings to make proposals, guide the treasury, etc. Other tokenholders within the DAO can vote on whether these proposals should be executed or not. The democratic process and the expected attack resistance are undermined by improper DAO governance. The Build Finance DAO provides a prominent example of a DAO that had a malicious actor who was able to acquire a majority stake in a DAO that is governed with fungible currencies that can be bought on exchanges.

The Build Finance DAO labeled itself as a venture builder that was owned and operated by the community. The Build Finance DAO's purpose was to provide services to other DAOs by identifying business ideas, organizing teams, sourcing capital, helping govern product entities, and providing shared service. The Build Finance DAO highlights the potential for abuse in systems without proper decentralized governance. An attacker acquired funding necessary to act opportunistically in the Build Finance DAO. The attacker put forward a proposal that granted themselves control of all key infrastructure of the DAO and the token holders did not control enough counter votes to prevent the takeover.⁵ The attacker minted and sold various tokens by draining liquidity pools.⁶

⁵ Mike Dalton, *Build Finance DAO Suffers Governance Takeover Attack*, CryptoBriefing, (Feb. 15, 2022), [Build Finance DAO Suffers Governance Takeover Attack - Crypto Briefing](#)

⁶ *Id.*

Because the Build Finance DAO allowed token holders to have input on spending decisions of the DAO, the attacker put forward a proposal that granted themselves control. Because of the lack of decentralized power in the Build Finance DAO, the silent majority of token holders did not have enough voting power to prevent the takeover. As a result, the attacker minted and sold various tokens by draining liquidity pools. The attacker also gained control of minting keys, governance contracts, and the treasury. The Build Finance DAO lost complete control over any part of the key infrastructure.

The takeover of the Build Finance DAO highlights the need for sustainable decentralized governance solutions with non-fungible tokens to defend the DAO from attackers/looters and punish self-dealing.

3. **Myth #3: Ungovernable**

The third myth that afflicts the development of DAOs is that DAOs are ungovernable. The word “ungovernable” implies that sufficiently decentralized governance has not been invented to effectively govern DAO concepts. The myth gets perpetuated because many DAOs are still in the early stages of experimentation with DAO designs and decentralized governance. Governance is severely underdeveloped in most DAOs which results typically in a minority of stakeholders that define governance. This, in turn, often result in mediocre and poorly-developed proposals.⁷

While these shortcomings in the DAO ecosystem are real, the experimentation with DAO governance designs is gradually identifying workable decentralized governance solutions for the DAO ecosystem. The key component of that experimentation revolve around the following key metrics:

⁷ Amrit Kumar, *Ownerless Ownership, Trustless Trust - DAOs, the Future of Governance*, beINcrypto, (Sep. 13, 2021). [Ownerless Ownership, Trustless Trust — DAOs, the Future of Governance \(beincrypto.com\)](https://beincrypto.com/ownerless-ownership-trustless-trust-daos-the-future-of-governance/)

1. Non-fungible Tokens or weighted keys, among other electronic accounting methods as accounting for reputation score NOT fungible tokens
2. Two vote model a) loosely coupled vote (no reputation at stake), b) tightly coupled vote (reputation at stake)
3. Reputation generated ONLY for long term valuable work and policing of work NOT for business development work
4. Calculation of reputation voting engine with 50/50 up down
5. Reputation salary in fungible token pro rata to reputation score at point of payment
6. Full voting record transparency

4. **Myth #4:** “Code is Law” Fallacies

The fourth myth is that the Code is Law doctrine creates rigid rules that undermines the dynamic business environment in web3. Smart contracts help implement the code is law doctrine in web3 business solutions. Yet, smart contracts involving fungible currency exchanges are designed to guarantee irreversible, unreviewable, programmed self execution. As such, they create a more rigid structure for business in web3.

In reality, very rarely does any business venture proceed exactly as planned in smart contract code because the reality of business relationships is far more messy and multivalent than can be predicted by a series of smart contracts.⁸ To do business effectively, counterparties need confidence that a fair resolution will occur when transactions do not develop as planned.

Effective human-centric DAO governance solves the issue of rigid smart contract rules that undermine business activities that require more flexibility in web3 and the metaverse. Through effective human-centric DAO governance, the instability generated by the rigidity of the rules is solved by making the rules

⁸ Bob Greenlee, *DAOs as the future? Hard pass, thanks*, TechCrunch, (Dec. 1, 2021). [DAOs as the future? Hard pass, thanks](https://techcrunch.com/2021/12/01/dao-as-the-future-hard-pass-thanks/) | [TechCrunch](https://techcrunch.com/2021/12/01/dao-as-the-future-hard-pass-thanks/)

dynamic which includes both short-term and long-term protocols.⁹

5. **Myth #5: Anonymity leads to Bad Actors**

The fifth myth revolves around the role of anonymity in DAOs. Anonymity is often seen as a way to corrupt human behavior, as in “what do you have to hide”. The notion of “sunlight is the best disinfectant” holds large sway in governance circles. Transparency is seen as the ultimate enforcer of accountability.

Anonymous decentralized networks may encourage troll behavior. That is, people in anonymous networks may behave in ways they would not engage in had they been identified. In other words, anonymous participants might feel safe to attack others without retribution. Most anonymous interactions/comments in Web 2.0 are worthless without communicating any lasting connections that can improve society. In the DAO context, trolling behavior destabilizes the organization and causes friction between members and the DAO.

By contrast, if implemented correctly, anonymity significantly upgrades DAO governance. The friction that arises from anonymous trolling can be mitigated through the implementation of incentivized reputational architecture governed by protocols decided upon by the community.¹⁰ If properly implemented, anonymity strengthens decentralized governance by taking out parts of the human nature that hold business and society back. First and foremost, anonymity allows individuals to relate to each other without the inherited biases of generations of predecessors and a lifetime of existing in centralized power structures and associated societal expectations on individuals. This in turn,

⁹ Craig Calcaterra & Wulf Kaal, *Decentralization: Technology's Impact on Organizational and Societal Structure*, 153 (2021).

¹⁰ *Id.*, at 68.

allows information to flow from the edges of the system with individuals who would have no agency in centralized structures but can add invaluable input into the system. Such inputs will not materialize, or are much less likely to materialize, if DAO participants know each other. In this sense, while it is eternally difficult with existing technology to attain true anonymity in web3 systems, anonymity in DAO governance is the wholly grail of decentralized web3 business and society.

III. Top 5 DAO Benefits

Despite the myths, DAOs can have many positive impacts on business and society through the future of work, micro-democracy, and community engagement. DAOs can create a world where value exchange is based on outcomes rather than tasks. They are a tool to overcome the inefficiencies and burdens of modern centralized institutions.

1. *Use #1: Community Development*

DAOs provide an efficient and low-cost way of community development and participation. DAOs can be seen as a programmable organization of people that form around a shared mission and foster emergent online communities.¹¹ DAO members have intrinsic and extrinsic incentives to collaborate with other DAO communities to bolster each other's capabilities.¹²

A meaningful reputation governance and accounting mechanism for motivating business and governance participation encourages mutually beneficial contributions to the community. Proper reputation accounting switches the incentives from short-term

¹¹ Michael O'Rourke, *DAOs will be the future of online communities in five years*, CoinTelegraph, (Oct. 23, 2021), [DAOs will be the future of online communities in five years \(cointelegraph.com\)](https://cointelegraph.com/news/dao-will-be-the-future-of-online-communities-in-five-years)

¹² *Id.*

zero-sum thinking to long-term positive-sum motivation.¹³ Members who actively contribute positively within a DAO can be continually rewarded (and thereby incentivized) to maintain their behavior. Fundamentally, users will **want** to maintain the community as they are directly incentivized to do.

2. *Use #2: Future of Work - Work to Earn*

The traditional work environment in centralized structures is prone to extrinsically motivated work engagement which intensifies principal agent problems. Rather than serving a principal who determines where, what, and when workers have to perform, which often results in a long list of suboptimal outcomes that derive from non-intrinsically motivated work.

DAOs have the potential to substantially upgrade the way humans work. DAOs free individuals from anyone except themselves, their own actions, and the projects they share values and skillsets with and focus energy on. DAOs allow influence and outcomes of DAO members to be determined by the value a DAO member's contributions to the shared work product. Moreover, if a DAO member adds substantial value to the DAO, other DAO token holders will want to add their skills to the same work product via a policing engagement which focuses all DAO members' joint efforts on the highest possible value proposition. This "value to effort focus of work flows" in the DAO structure has the potential to revolutionize the way society works.

Braintrust, for example, is a decentralized talent network with algorithmically controlled marketplace governed by network participants.¹⁴ The Braintrust network has tens of thousands of talent participants and hundreds of Fortune 1000 companies,

¹³ Calcaterra & Kaal, *supra* note 10, at 127.

¹⁴ Braintrust Whitepaper, *Braintrust: The Decentralized Talent Network*, The Braintrust Technology Foundation, (Sep. 2021). [Braintrust: The Decentralized Talent Network \(usebraintrust.com\)](https://usebraintrust.com)

processing millions of dollars in transactions each month. Braintrust users earn native token BTRST by introducing/onboarding clients (demand) and talent (supply). Clients use BTRST to enhance job postings. Talent use BTRST to enhance their proposals or take courses to level up their skills. Despite its advances in innovation for redefining work outcomes, Braintrust uses a suboptimal governance model with a one token, one vote system for proportional control over how the network is governed.

a) Play-To-Earn

The future of work offered by DAOs is not limited to traditional employment either. Some projects incentivize users through a different business model, *play-to-earn*.¹⁵ Play-to-earn games are based on a business model where users play a game and earn some reward for their engagement and time. Projects that leverage play-to-earn business models often do so by using either NFT items with variable scarcity (e.g. weapons, skins, monsters), which can be purchased or sold on the open market or by using a certain type of cryptocurrency or play-to-earn token, which is generally created by game developers.

b) Learn-To-Earn

Similar to the play-to-earn business model, some projects are offering *learn-to-earn* programs.¹⁶ In this model, users watch videos or read articles, take quizzes, and can earn a specified amount of crypto assets as rewards.

¹⁵ David Vidal-Tomas, *The new crypto niche: NFTs, play-to-earn, and metaverse tokens*, Munich Personal RePEc Archive, (Jan. 2, 2022).

[*MPRA_paper_111351.pdf \(uni-muenchen.de\)](https://www.mpr.de/paper/111351.pdf)

¹⁶ Ehsan Yazdanparast, *All You Need to Know About “Learn and Earn” Crypto Programs*, Medium, (Nov. 28, 2021). [All You Need to Know About “Learn and Earn” Crypto Programs | by Ehsan Yazdanparast | Coinmonks | Medium](https://medium.com/@ehsan.yazdanparast/all-you-need-to-know-about-learn-and-earn-crypto-programs-b4e1e1e1e1e1)

Two recognized types of learn-to-earn programs exist. Learn-to-earn programs are either offered by centralized exchanges where users complete tasks through the exchanges and receive rewards directly on the exchange. Or, learn-to-earn programs are offered by projects or partners of the projects where users are required to provide their wallet addresses to projects. Once the task is completed, the project transfers the rewards to the user.

c) Work-To-Earn

Work-to-earn structures are intended to free participants from the strictures of traditional corporate structures.¹⁷ Work-to-earn DAOs allows anyone, anywhere, at any time to work for a digital community. Work-to-Earn has been analogized to a party bike or a group paddle boat where individual participants can choose to contribute to the group effort as much as the individual desires to move the organization forward, or not contribute at all.¹⁸ In this work structure, it is entirely up to the individual how much they want to contribute.

DAOs need human labor, whether it's for a protocol DAO looking to create new FinTech, or a Social DAO looking to propagate culture. In order to attract long-term talent, it needs to be always up to each individual DAO member how much time they put in. DAOs that create quota and participation requirements may not be sustainable long-term in a work-to-earn value-to-efforts workflow environment.

Reputation accounting allows more opportunities to arise to individuals who build their reputation within the DAO - it may

¹⁷ Lucas Campbell, *How to Get Paid by DAOs*, Bankless, (Oct. 20, 2021) [How to get paid by DAOs - Bankless \(bankless.com\)](https://bankless.com/how-to-get-paid-by-daos)

¹⁸ *Id.*

start as a one-off bounty, then part-time, then potentially a full time gig.

3. *Use #3: Micro-Democracy*

Through smart contracting, DAOs enable forms of micro-democratic structures. Micro-democracies in modern information technology can help every member of an open society to participate directly in the decision-making of every community affair.¹⁹

Several DAO projects seek to harness the benefits of blockchain to facilitate micro-democracy. Projects like *Proof of Humanity* and *UBI DAO* offer democratic solutions through on-chain verified human beings.²⁰ Users can “vouch” for each other with financial stake, while false vouchers are punished. Verified users can accrue tokens that get streamed directly to their address. Of course, these attempts are all falling victim to web-of-trust theory that has been proven to not work long-term because the sockpuppet attacks that are inevitable in this design.²¹

Microdemocracy and proper incentive design can reverse decreasing voter participation that undermines representative democracies.²² Microdemocratic voting would provide a more immediate feedback system between voters and their representatives. Because decentralized technology enables the *transparent and incorruptible* tallying of votes, nearly instantaneously, voting can be more dynamic and incremental - political will can be exercised more directly.

¹⁹ Aaron Ran, *Micro Democracy: The Democracy Revolution of the Information Era*, (2020).

²⁰ Divya Siddarth et al, *Who Watches the Watchmen? A Review of Subjective Approaches for Sybil-resistance in Proof of Personhood Protocols*, Proof of Personhood: A Review, 13 (2020). [2008.05300.pdf \(arxiv.org\)](https://arxiv.org/abs/2008.05300)

²¹ <https://wulfkaal.com/2020/05/25/self-sovereign-identity/>

²² Calcaterra & Kaal, *supra* note 10, at 165.

Quadratic voting, for example, allows a first glimpse of the innovations that are possible with micro democratic systems.²³ Each voter may be given a limited number of VOTE tokens which may be spent on any issue the voter is concerned with during a set period. Users who allocate more VOTE tokens, have a bigger influence in the outcome than users who allocates less.

4. **Use #4: Efficiency**

DAOs improve economic efficiency. One of the problems with centralized structures is that power accumulates which is bad for market efficiency and liquidity.²⁴ Markets are the most efficient mechanism for price discovery. The market determines how many members a DAO can support in its network, and how much work they should do. Markets help determine the equilibrium between all the industries and companies to determine how much of each work and good is required to keep an organization running efficiently.

Decentralization improves the market in its efficiency at price discovery and liquidity.²⁵ The liquidity of a market is its momentum. Liquidity is measured by its velocity (dynamism, motion, rate of transactions), but also by its mass (how valuable are the total goods or assets). When there is too much mass and not enough velocity, it can gunk up the engine - when there is too little mass in the market, it can be cleared too quickly. Centralization and monopolies are a threat to market liquidity as they can have too much mass or too much velocity. Decentralized structures are better because mass and velocity are uncorrelated

²³ Steven Lalley & Glen Weyl, *Quadratic Voting: How Mechanism Design Can Radicalize Democracy*, American Economic Association Papers and Proceedings, 1(1), 2018.

²⁴ Calcaterra & Kaal, *supra* note 10, at 123.

²⁵ Calcaterra & Kaal, *supra* note 10, at 124.

meaning more stable and predictable liquidity and therefore, more market efficiency.

5. **Use#5: Diversity**

DAOs encourage diversity of thought, background, and skillset. Diversity of viewpoints is severely diminished when power is centralized. Information technology allows a global network of people to form, open to members of diverse values and backgrounds.²⁶

For example, market decentralization via Initial Coin Offerings (ICOs) provide lower barriers to entry for a more diverse body of investors and thus increase the diversity and the heterogeneity of start-up funding. Borderless ICOs are directly marketed to a worldwide potential pool of investors. Flatter markets with more diverse interests and talents are more effective and efficient at achieving truth discovery, like price discovery and the identification of ideal solutions to arbitrary new problems that arise.²⁷ Decentralization and DAOs promote that diversity by improving its members autonomy and freedom, nurturing their natural development.

IV. **Conclusion**

This paper has evaluated common DAO myths. Counteracting the DAO myths, the author has shown that the opportunities for business and society that are presented by well-functioning DAOs are unparalleled.

²⁶ Calcaterra & Kaal, *supra* note 10, at 35.

²⁷ Calcaterra & Kaal, *supra* note 10, at 235.

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