



Legal Insights

BVI law: Treatment of DAOs in insolvency situations

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The British Virgin Islands (“**BVI**”) has been proactive in addressing the legal implications of decentralised autonomous organisations (“**DAOs**”), particularly concerning their assets and liabilities in the context of insolvency. While the BVI does not have specific legislation exclusively addressing DAOs, existing laws and legal principles can be applied to assess the treatment of DAO assets and liabilities.

- Legal Structure:** BVI law does not have legislation or case law which defines what is a DAO. In the United States, courts have considered the issue of whether or not members of a DAO may be considered as forming a partnership in certain circumstances. However, to date, this issue has not arisen before the BVI courts. DAOs can be completely decentralised in the sense of being an unincorporated association of persons operating under the framework of certain governance protocols or rules for a common purpose. Further, many DAOs operating in the BVI are often set up as companies or limited partnerships or more often they are organised so that the actions or collective decisions of DAO members are undertaken through a corporate vehicle governed by token holders (such as via a company limited by guarantee) so as to mitigate this risk. The legal structure affects the treatment of assets and liabilities in case of insolvency. If a DAO is incorporated as a company, it will generally follow the BVI Business Companies Act (as amended) which provides the framework for solvent liquidation or the BVI Insolvency Act (as amended) which governs insolvent liquidations.
- Assets and Liabilities:** In insolvency proceedings, the assets and liabilities of the DAO (if the DAO is structured as a BVI business company or limited partnership) will be treated like those of any other BVI legal entity. In this case the DAO assumes its own liabilities. In the event of insolvency, the DAO itself is responsible for its debts, and creditors can pursue the DAO’s assets for satisfaction of those debts. The precise treatment would depend on the governance rules established by the DAO and the specific agreements among members and stakeholders. Virtual assets are treated as property under BVI law and this has a number of implications, including (i) these types of assets will form part of the DAO’s liquidation estate under BVI law, and (ii) the usual tools that can be employed by insolvency professionals in insolvency proceedings under BVI law (e.g. interim proprietary injunctions to freeze virtual assets or crypto wallets, disclosure orders in support of interim injunctions) are also available in the context of the insolvency of a DAO.
- Insolvency Procedures:** If a DAO is deemed insolvent, it may be subjected to the usual insolvency processes, such as court-appointed liquidation. The BVI has robust legal frameworks for insolvency, including under the BVI Insolvency Act (as amended), which outlines the processes for dealing with insolvent entities (if the DAO is structured as a BVI business company or limited partnership).

4. **Recognition of Smart Contracts:** While BVI law does not explicitly address smart contracts, they may be recognised as valid under existing contractual principles. This means that smart contracts governing DAO operations could play a crucial role in defining the rights and obligations of members, especially in insolvency scenarios.
5. **Member Liability:** The liability of members and operators of the DAO may depend on the legal structure and the specific provisions in the DAO's governing documents. If structured appropriately, member liability may be limited, mitigating personal financial exposure in the event of the DAO's insolvency. Generally, members of a BVI business company (or similarly structured DAO) are not personally liable for the debts of the company beyond their unpaid contributions, provided that the company is properly maintained and corporate formalities are followed. This limited liability is a fundamental principle of modern corporate law meant to protect individual members from the organisation's liabilities.
6. **Exceptions to Limited Liability:** In certain situations, such as where there is evidence of fraud, improper conduct, or disregard for the separate legal personality of the entity, the BVI courts may hold individuals liable (known as "piercing the corporate veil"). This means that if members of a DAO were found to have acted in a manner that effectively pierced the corporate veil of the DAO and undermined the legal entity's status, they could be held responsible for the DAO's losses or debts.
7. **Jurisdictional Considerations:** Given the BVI's status as an offshore financial centre, the legal treatment of DAOs engaging in cross-border operations may involve additional complexities.

This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific advice on the matters covered above, please contact your usual Loeb Smith attorney or any of the following:

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