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QUICK TAKE

# Venture Catalyst:

Sushi Raise & Decentralized Governance

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## **VENTURE CATALYST:** **SUSHI RAISE AND DECENTRALIZED GOVERNANCE**

### **Cumberland Counterparties,**

Over the past week, we've seen a new level of energy in the decentralized governance space as significant debate has been had over a proposed strategic sale of Sushi. The Sushi governance forum has been lit up this month after Sushi lead developer OxMaki put forward details for a token sale.

This example brings a spotlight to one of the most radical differences between centralized companies and the order of operations in DeFi. Governance tokens have become a best practice for founders in the space, as it provides a mechanism for token holders to have a say in deciding both the direction of the project and how the founders can spend the funds received from the sale of such tokens, which drives engagement in the token and incentivizes liquidity providing. As shown with Sushi, this can put the community at odds with the founders—but that is widely viewed as a feature, not a bug.

In DeFi, it is not uncommon for a project to be fully controlled by a DAO. In these cases, board members are replaced by governance-appointed, multi-sig wallet signers. Decision-making is passed onto the platform's users and stakers. The new dynamics introduced by this structure came into the spotlight this past week with the DEX platform Sushiswap.

### **The Proposal**

The initial proposal called for Sushi to sell 25% of the SUSHI tokens from its treasury at a 25% discount to a broad group, including a who's-who of crypto VCs. While the initial goal was to sell \$20m worth of SUSHI, the proposed sale was significantly oversubscribed and the amount was increased to \$60m.

**The proposal was quickly met with broad pushback from the community. The common themes in critiques were:**

- It wasn't clear why Sushi needed to sell SUSHI tokens.
- It wasn't clear what value Sushi would get in return for selling tokens at a discount.

These critiques address the two reasons protocols sell from treasury holdings: to gain access to capital and to build partnerships through aligned incentives.



## Gaining Access to Capital

Sushi's run rate is notably low, especially when compared with centralized exchanges. Therefore, community members wanted to know: *Why sell anything? How will the \$60m be utilized?* While it's a bit of a fallacy to talk about price predictions when it comes to funding, the fact that SUSHI is down 70% since the high established as recently as March, understandably had many community members arguing it was unwise to sell at these levels (much less to sell at a discount to these levels).

There have been several other proposals put forward as better ways to use Sushi's treasury tokens (and we will discuss a few later), but at the end of the day, if the Sushi team wanted to sell \$60m worth of SUSHI, they could do it with much less slippage than 25%. A good OTC desk could handle this type of order via a TWAP for around 50 basis points. If that's the case, what's the 25% discount paying for?

## Building Partnerships Through Aligned Incentives

A conversation between an investor and a company or protocol team should be a two-way courtship. Obviously, a company or protocol team needs to have a concrete idea they are selling to be successful in asking someone else to write a check. But savvy founders also are sizing up the VC firm in the process, recognizing that the best investors will be able to add value beyond capital via their expertise, connections and passion. This is why Cumberland so often invests in trading venues and infrastructures: that's the area where our expertise would help the most.

In this case, the Sushi community had a lot of unanswered questions about what value the VCs would provide to Sushi.

Some of the more prominent names on the list made strong pitches, including Franklin Bi from Pantera, who laid out some of the ways VCs provide value for projects. In a conversation with Cumberland, he highlighted the value of having VCs with coins locked up, saying, "When the market is ticking up, everything is easy. When we enter a bear market, when talent and capital leave, it helps to have partners that are locked in for the long haul."

## The Structure

At the end of the day, so much comes down to how a deal is structured and that's where a lot of the community pushback comes from. Obviously, the way the current TWAP is structured can lead to misaligned incentives, giving VCs a reason to sell SUSHI in the market ahead of the deal finalizing and then allowing them to buy back 25% lower. Additionally, the concept itself of selling tokens at a discount doesn't seem appropriate in the case of SUSHI, a well-established token with multiple venues for liquidity.

In the last few days, several alternative proposals have been put forward: two from UMA, a DeFi derivatives protocol with proven expertise in bespoke derivatives products designed to align incentives, and another from Arca, a crypto fund that specializes in applying tried-and-true valuation methodologies from traditional markets to crypto markets. Both UMA and Arca are asking the same question: "Is selling a token at a discount with a lock-up really the best we can do?"

## The UMA Solutions

On July 13<sup>th</sup>, on Twitter, Hart Lambur from UMA first put forward a proposal – backed by a smart contract – to sell a “range token.” The range token looks a bit like a convertible bond: if SUSHI is trading between \$4 and \$16 at expiry, the token would settle at \$1. The Sushi team could mint these tokens and sell them below \$1, giving investors an expected yield, plus additional upside if SUSHI traded above the range.

In their feedback, VC’s made it clear they didn’t want yield, they wanted upside. UMA came back with another proposal, a “Success Token.” This token would essentially be SUSHI plus an embedded out-of-the-money call option, which Sushi could sell to VCs at the market price of SUSHI. This structure replaced the price discount with a free call option, incentivizing investors to support the growth of Sushiswap.

Kevin Chan from UMA explains: “In the past, selling tokens at a discount was the traditional, and only way for DAOs to raise funds. However, this isn’t traditional finance and we need to start utilizing better alternatives as an industry. Range tokens, success tokens and KPI options are among the treasury primitives built on UMA to help DAOs raise funds and align incentives with their investors.’ If we are in DeFi, we should use DeFi products.”

## The Arca Proposal

Jeff Dorman, the CIO of Arca Digital Asset Funds, put forward another proposal after arguing that the initial proposal was particularly bad for current SUSHI holders, of which Arca is one, currently holding 7% of circulating xSUSHI. They propose that instead of selling tokens at a discount, the Sushi team uses the new limit order functionality to place resting limit offers on platform above the current spot price, and Arca has pledged to backstop the deal with a minimum of a \$10m purchase at the first price. In a call with Jeff, he said, “I think it’s so striking that even in the bear market we’re in, you’ve got people lining up to put money into SUSHI. It also shows that Sushi is not in a position where they need to accept a discount.”

## What’s Next?

This is an ongoing debate, so there’s no resolution yet, although it does appear the conversation is moving forward and we can expect resolution in the coming days. While the debates that have been occurring on the governance forum are fascinating, perhaps one of the most powerful takeaways is that the debates occurred at all. It’s happening in the public domain, allowing investors from extremely different profiles to not only voice their views but propose novel structures based on the capabilities of smart contracts. The debate is driven by pulling the best ideas from the way things have always been done, without becoming limited by them. And so unfolds the promise of DeFi.

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## Relevant links:

**Initial proposal:** <https://forum.sushi.com/t/sushi-phantom-troupe-strategic-raise/4554>

**UMA Range Tokens:** <https://forum.sushi.com/t/sushi-phantom-troupe-strategic-raise/4554/36>

**UMA Success Tokens:** <https://forum.sushi.com/t/sushi-phantom-troupe-strategic-raise/4554/112>

**Arca Proposal:** <https://forum.sushi.com/t/sushi-phantom-troupe-strategic-raise/4554/182>

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