Brussels, 15 June 2023

Open Letter About Concerns and Proposed Refinements Regarding the Regulation of Smart Contracts in the Data Act

Dear EU co-legislators,

In light of the ongoing trialogue negotiations on the Data Act, the undersigned would like to express the Blockchain industry's recognition of your efforts to bring forth the principle of technological neutrality and negotiate an outcome where the use of certain technologies is not obstructed. We share and support the common objective to foster the process of digitalisation in a responsible and transparent way through which data is protected and preserved.

Technological neutrality embodies two fundamental principles: freedom of choice, refraining from mandating the use of any specific technology, and safeguarding regulations from becoming outdated by ensuring their applicability regardless of the technology used. The current text of the Data Act challenges these principles, as it could limit the use of Smart Contracts based on public/permissionless technology and introduces uncertainty for already deployed Smart Contracts. This could have profound implications, particularly for startups and SMEs, who may rely heavily on Smart Contracts for their operations and business models which could potentially fall foul of the new regulations. Rather than ensuring technological neutrality, this would pose substantial challenges, stifling innovation, and dampening the entrepreneurial spirit at the heart of the EU's digital market.

In the pursuit of technological neutrality, it seems that some co-legislators sought to establish a framework that avoids any form of segregation or differentiation among different self-executing Smart Contracts. However, while we acknowledge that the intention of these co-legislators is not to regulate Smart Contracts beyond the scope of the Data Act and its specific use-cases for data-sharing, **we strongly believe that the current language of the text does not help to clarify this intention and leaves the door open for different interpretations with potentially negative consequences.** In fact, such a "one-size-fits-all" approach - as currently foreseen in the proposal - could have (possibly unintended) negative consequences putting EU market participants at a significant disadvantage vis-à-vis others. This would in particular contradict Art. 3 para. 3 TEU, which provides that the Union shall not only create a highly competitive social market economy, but also promote scientific and technological advancements.

In particular, we want to stress the impact of applying Article 2(16) in conjunction with Article 30, as this could lead to a substantial portion of existing Smart Contracts that rely on public electronic data records utilising public blockchains, such as Ethereum, Avalanche, Cardano, Cosmos, IOTA, NEAR, Chromia, and Polkadot being deemed to be in breach of law. The broad interpretation and application of these articles could not only have unintended consequences for the legality and operability of these widely used Smart Contracts, but could also have a significant economic impact on the Single Market, especially given their market cap resembling their economic value.

NETWORK	TOKEN	MKT CAP (USD)	STAKED (USD)	DELEGATORS	VALIDATORS
Ethereum	ETH	$ 210,938,714,633	$ 30,936,542,412	n/a	549949
Binance Chain	BNB	$ 52,909,328,474	$ 8,012,478,271	> 11000	29
Cardano	ADA	$ 12,044,596,086	$ 8,407,356,878	n/a	885
Solana	SOL	$ 7,919,895,672	$ 7,948,402,916	296403	10895
Polkadot	DOT	$ 7,899,419,242	$ 4,134,694,733	> 7399	924
Avalanche	AVAX	$ 5,492,521,113	$ 3,814,288,891	72996	1167
Algorand	ALGO	$ 1,569,989,852	$ 835,187,761	22,558	120
Fantom	FTM	$ 1,300,577,546	$ 641,898,230	n/a	64
Multiversx	EGLD	$ 1,081,652,189	$ 692,257,401	n/a	n/a

Source: Remaining regulatory challenges in digital finance and cryptoassets after MiCA, Study requested by the ECON Committee.

Ensuring the steady and successful growth of public blockchains is both a strategic and economic opportunity for the European Union. However, the broad wording of Article 30 could undermine the growth of decentralised finance in particular, which relies heavily on both public blockchains and smart contracts tailored to a very specific set of services. Consequently, public blockchains could find themselves rendering the immutability guarantee which underpins their commercial viability void by being forced to introduce single points of failure. Moreover, this could call into question the design of blockchain oracles without a clear direction as to how or from where such an undertaking should begin.

For example, while the proposed provisions governing Smart Contracts are primarily about data sharing/processing, we are concerned that the broad interpretation of the definition of "Smart Contracts" used in the context of agreements making data available could be extended to also include those Smart Contracts enabling the exchange of digital assets. Such an outcome would pose significant operational and compliance challenges, also causing the Data Act to conflict with the requirements of the MiCA Regulation.

As previously highlighted (here), we strongly believe that more legal clarity could be achieved rather easily in the following ways (in order of preference):

1. **First Proposal: Substitution of 'Smart Contract' with the term 'Digital Contract':** The term 'Smart Contract' has become a term of art in Web3 and blockchain contexts that has a specific and technical meaning distinct from the types of data sharing arrangements contemplated by the Data Act. Therefore, the Data Act would benefit from shifting its terminology from 'Smart Contracts' to something else, such as 'digital contracts' or 'automated data sharing agreements', which would more accurately reflect the intended regulatory scope. By adopting a term distinct from what is already used in the Web3 industry as 'Smart Contracts', the Act could eliminate ambiguities about the applicability of Article 30's stringent requirements. This change would clarify that these requirements are intended solely for those computer programs used for automated execution of an agreement in the specific context of the Data Act, and not for other DLT-based software that falls outside this purview. Thus, a revised terminology could ensure that the Data Act's provisions target their intended area, without inadvertently stifling innovation in broader DLT applications.

2. **Second Proposal: Clarification of the scope of Article 30:** Should the aforementioned suggestion of changing the term 'Smart Contracts' to 'digital contracts' within the Data Act prove unsuitable for regulators, there is a viable alternative that aligns the regulatory intent with the practicality of the industry: the first paragraph of Article 30 could be revised to better delineate its intended scope. If legislators prefer to retain the broader definition of 'Smart Contracts' within the Data Act, it would be paramount to include additional clarification within the text, explaining that Article 30's requirements are tailored for specific situations and use cases. More precisely, the applicability of Article 30 should be narrowed down to 'Smart Contracts' deployed on private and permissioned electronic data records in the context of executing a data sharing agreement. Finally, the provisions of Article 30 should only apply to 'the offering party' as suggested by the EP Mandate, so as to prevent the perpetual and limitless responsibility of other persons in the 'absence of a vendor'.

3. **Third Proposal: Limitation of Article 2(16) to Privately Operated and Permissioned electronic data Records:** Although it is the least favourable option, altering the definition of 'Smart Contracts' as proposed in Article 2(16) can still mitigate some of the potential negative impacts.

This change would mean that 'Smart Contracts' only include those computer programs that execute agreements automatically via a series of **privately operated and permissioned** electronic data records. While this modification would alleviate immediate concerns regarding the Data Act, by clearly delineating that the Regulation is explicitly intended for privately operated smart contracts, it is not without drawbacks. Namely, it introduces a definition of 'smart contract' into EU law for the first time, **which fails to accurately capture the existing understanding of 'smart contracts' as a term of art** in blockchain and Web3 applications. This is a short term solution in which the legislator addresses the current discrepancy while potentially leading to confusion and complications in the future.

The three options outlined above hold immense significance in realising the principle of technological neutrality. Only by delineating these crucial details and clarifying the real scope of this Regulation, we can ensure that Europe truly adheres to this principle and fosters an environment where equal treatment is granted to all technological solutions.

Achieving the objective of the first proposal relies on the willingness and desire to adapt and change the terminology. We respectfully understand there might not be enough willingness at this late stage of the legislative discussions and are thus proposing an alternative solution (see Second Proposal), which could still bring an acceptable degree of clarity, even if the definition of a 'Smart Contract' under Article 2 remains unchanged. However, we would insist on shifting the terminology from 'smart contracts' to 'digital contracts' within the Data Act as this could accurately mirror the intended regulatory scope, eliminating ambiguities regarding the applicability of Article 30's stringent requirements. This solution ensures that the Data Act's provisions are targeted correctly, thereby avoiding unintentional constraints on broader DLT applications. The advantage of this approach lies in its clarity and precision, ensuring that the Data Act's requirements only apply to specific software used in the context of the Data Act.

The second proposal could also bring an acceptable degree of clarity. It suggests revising the first paragraph of Article 30 to explicitly outline its targeted scope. This option serves as an effective compromise if regulators are inclined to retain a broader definition of 'Smart Contracts'. It strikes a balance between the regulatory intention and the practical realities of the industry. By specifying that the requirements of Article 30 are specifically designed for particular situations and use cases, this approach offers a nuanced resolution that could cater to both the regulators' objectives and the industry's operational nuances.

Finally, the third option, while serving as a contingency if one of the previous two do not materialise, could present both short-term relief and long-term uncertainty. While it could immediately mitigate some concerns surrounding the Data Act by explicitly excluding smart contracts deployed on public DLT, it risks creating future confusion as the Data Act's interpretation of 'smart contracts' would then significantly deviate from the understanding prevalent in the Web3 industry. Therefore, while this option offers an immediate solution, it may spawn future discord and complexities due to its failure to accurately reflect industry norms.

Each of the preceding proposals, in their unique manner, aligns with the regulatory aspirations while acknowledging the significance of technological neutrality. Crucially, these suggestions prevent the Data Act from rendering widely used existing Smart Contracts unlawful under the provisions of Article 30. This recognition reflects the diverse nature of Smart Contracts that may in some cases be deployed on public distributed ledger technologies, whereby the users agree to a different set of essential requirements and where no single entity remains in control of the network or is able to unilaterally interrupt or alter the underlying Smart Contract.

We respectfully request your consideration of this proposed refinement to not undermine the regulatory clarity for the blockchain sector the EU is hoping to achieve with the MiCA Regulation. The finalisation of MiCA has propelled Europe as a significant international player in the blockchain industry. We hope this Open Letter contributes to a constructive discussion and are open to discussing this further should you require any further clarifications.

We appreciate your attention to this matter and we remain available to provide further information, clarification, or assistance in refining the regulatory language.

Affirmed by the undersigned,