

**Reply to ESMA Consultation ESMA75-453128700-52 of
29 January 2024 – NFTs**

Rome, April 29, 2024

The majority of the arguments here presented correspond to the ideas and the arguments contained in the book “Diritto dei non-fungible token” written by Paolo Maria Gangi (in Italian) and published in January 2024 by Giappichelli publishing company.

Q6: Do you agree with the conditions and criteria proposed for NFTs in order to clarify the scope of crypto-assets that may fall under the MiCA regulation? Do you have any additional condition and/or criteria to suggest? Please illustrate, if possible, your response with concrete examples

We don't agree with paragraphs 69, 70 and 71 and we think that those paragraphs will generate two negative consequences: 1) they will offer unclear guidelines to law operators and NCAs decreasing the EU's rule of law in relation to NFTs and crypto assets; 2) they will create an unfriendly regulation environment for the EU creative and digital industry substantially obliging many creators and NFTs creators to build their collection abroad.

We provide a specific commentary below in relation to paragraphs 69, 70 and 71.

1) Paragraph 69

Paragraph 69 states *“for a crypto-asset to be considered unique, its value should be intrinsically connected to its individual attributes and the specific utility it confers to its holder. A key aspect that should be considered is the value interdependency that may exist between NFTs, or which determines if the value of one crypto-asset influences the valuation of another, indicating a lack of uniqueness. For example, an NFT representing a piece of digital artwork may lose its uniqueness if it is part of a larger collection, and its value is*

influenced by other crypto assets in the series. To express it differently, if the valuation of a crypto-asset originates from a comparison between crypto-assets possessing comparable attributes that make them interchangeable, the crypto-asset should not be exempted from MiCA. Therefore, the notions of uniqueness and fungibility within the meaning of MiCA seemed to be detached from that of negotiability on a secondary market”.

The value of numerous goods, both tangible and intangible, derives from a comparison of goods with the same features. Consider, for example, an authentic Warhol painting: clearly, an authentic Warhol painting has a value that is largely comparable to other works by the same artist and different from any painting made by an unknown author, no matter how aesthetically pleasing it may be; in fact, we speak of an artist's quotation (or a Warhol quotation in this example), which then varies slightly from work to work but always within a well-defined range.

Secondly, and in contrast to tangible goods or other types of digital goods not created on a blockchain, the distributed ledger of blockchains always allows for the inspection of an NFT's history (through the explorers): when it was created, with which contract, the various changes of ownership, and the price paid for each sale. This means that the value of each NFT definitely depends not only on the creator and the NFT project to which it belongs (just like a physical Warhol's paintings depends ultimately on the fact that is an authentic Warhol painting and, therefore, that belongs to Warhol or its “trademark”) but also that each NFT has its own history, publicly inspectable by anyone, which primarily contributes to determining its value and is, therefore, ultimately impossible to abstract the value of an NFT from the blockchain market system in which it exists. Consider, for example, an artistic NFT in a single copy that hypothetically belonged to various famous influencers: such an NFT would certainly have a much higher value than another artistic NFT always made in a single copy by the same artist but with a history (publicly inspectable) of unknown buyers.

The guideline at issue, therefore, really makes no sense for two reasons.

First because the criterion according to which *“the valuation of a crypto-asset originates from a comparison between crypto-assets possessing comparable attributes”* can be applied to basic the majority of goods being their digital or physical making therefore this criterion useless and confusing. Also a Warhol painting value (i.e. a physical good) depends on a valuation in relation to other Warhol paintings (date of creation, subjects, various owners of the painting). The same could be said for jewelleries or cars or many other goods

whose value is not only related to its utility but also to the value of their trademarks, designs, aetc.

Second, the same market of the NFTs and its added value depends ultimately on the fact that through the explorers the history and the features of each NFT (prices, various buyers, smart contract with which has been generated) are publicly inspectable by anyone and that those data are written immutable in the blockchain and cannot be altered. If correctly applied the criterion of the valuation originating from a comparison would be applicable to all NFTs and this makes no sense.

It gives the impression that the European legislator of the MiCA believes that tokens, due to the very nature of blockchains, entail an increase in risk so that if a fungible material good can circulate freely in the market, the sale of the same good incorporated into a token entails a greater risk and, therefore, must be surrounded by special precautions which, specifically, consist in being subject to the obligations imposed by Title II of the MiCA. In addition to being an inconsistent position from a regulatory standpoint, it is a short-sighted choice of legislative policy because tokenomics will undoubtedly constitute a very important line of development of the global economy, and it is not appropriate for the European Union to strangle it with the imposition of excessive authorization burdens compared to the low risk that NFTs can pose to European consumers.

We suggest that paragraph 69 and the criterion of *“the valuation of a crypto-asset originates from a comparison between crypto-assets possessing comparable attributes”* be outright deleted.

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2) Paragraphs 70 and 71

Paragraph 70 states as follows: *“NFTs that are part of a series, or a collection can be qualified as crypto-assets in the meaning of MiCA if they are interchangeable. Such crypto-assets could be considered as interchangeable in practice if they share equivalent characteristics. This can occur in scenarios where the market views certain NFTs as having similar value despite unique attributes. The existence of a series or a collection - and more precisely its size – should thus be considered as an indicator of fungibility without being an overriding criterion”*.

Paragraph 71 states as follows: *“for instance, in the case of a collection of NFTs where the uniqueness of each cryptoasset can be questioned (e.g. several NFTs representing the same image with minor modifications) this collection should fall under MiCA. On the other hand, in the case of a series of NFTs in the manner of a series of numbered serigraphs or pictures, the numbering of which would have an impact on the value and uniqueness of the NFTs, these cryptoassets could be seen as a series of crypto-assets that are non-fungible”*.

This guideline is highly questionable as, upon closer examination, a project like CryptoPunks is essentially a collection of digital collectibles. Therefore, under such a guideline, CryptoPunks, as tokenized collectibles, would be at a disadvantage (i.e., they would be subject to the rules that Title II of MiCA sets for fungible tokens) compared to physical collectibles such as, for example, Pokemon cards. The unreasonableness of such a conclusion is apparent, even in light of a mere application of the principle of equality which dictates that like cases should be treated alike and different cases differently.

Moreover, this will oblige EU businesses to not make use of NFTs but rather to issue collectibles in the form of physical cards (like Pokemon cards) or digital data but not based on blockchains or DLT.

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We suggest to amend paragraphs 70 and 71 in way that will be clear that collections of NFTs like the BAYC (comprised of 10,000 NFTs) or the Penguins (comprised of 8,888 NFTs), or similar, do not fall within MiCA. Under the current wording of paragraphs 70 and 71 a collection of 10,000 NFTs like the BAYC would fall under title II of MiCA exactly like a collection of several billions of fungible tokens (as usually fungible tokens projects issues billions or more of tokens). This is a non-sense. Therefore we suggest that clear indications

should be given for the size of a collection to fall under MiCA (or to be considered as fungible tokens under MiCA).

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3) Paragrah 72

Paragraph 72 states as follows: *“in addition, the utility function of NFTs can also play a role. In some cases, NFTs might confer similar utility or access rights. Owning an NFT might grant access to exclusive events or benefits. Here, the specific attributes of the NFT become less relevant compared to the utility it provides, making different NFTs functionally interchangeable for practical purposes”*.

Based on that guideline, an NFT that incorporates the utility of receiving one of the thousands of tickets that grant access to a particular event should be considered "fungible" for regulatory purposes because it incorporates a fungible good. The inconsistency of this guideline is clear: it is not understood why the sale of a series of fungible physical goods does not entail any regulatory obligation under MiCA, while the sale of the same as a right incorporated in a token would make them utility tokens subject to the regulations of Title II of MiCA. The consequence of this guideline would be to the practical impossibility of using NFTs for incorporating to tokenizing services in the EU.

We suggest that paragraph 71 be outright deleted.

Paolo Maria Gangi

