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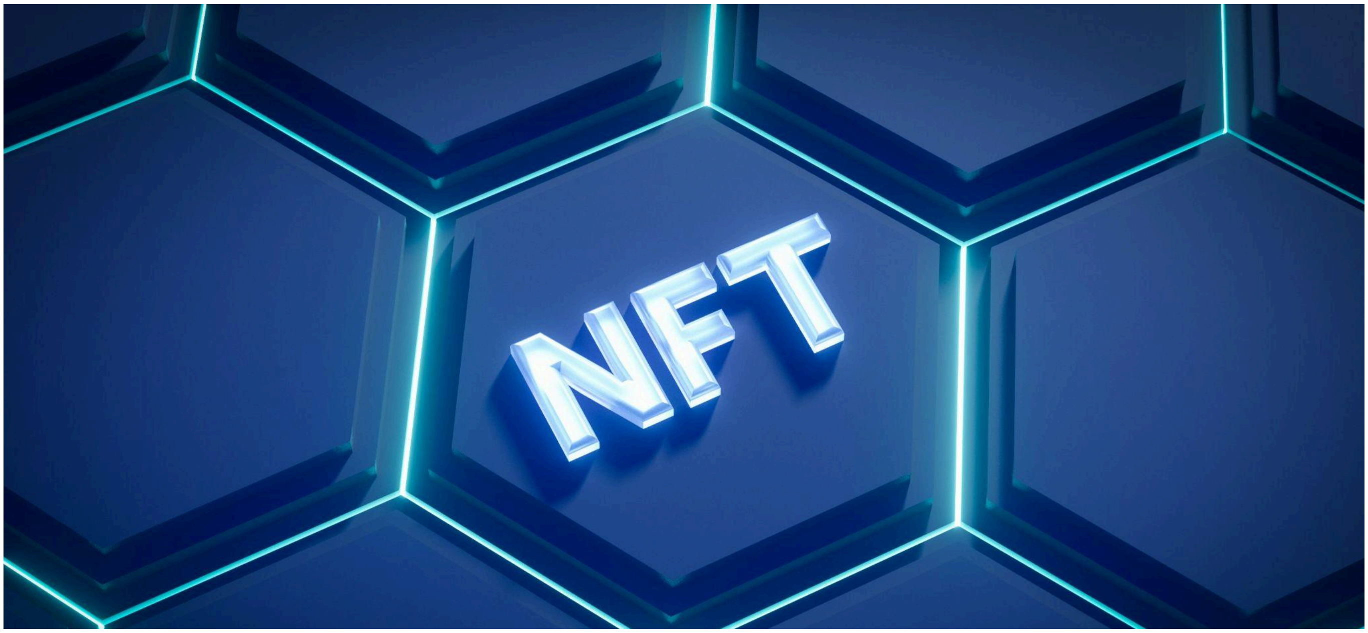

MiCAR: NON-FUNGIBLE TOKENS

by:

Raffaele Battaglini, LL.M.

Santiago Martín Caravaca, LL.M.

Luigi Cantisani, LL.M.

Selen Ekinci, LL.M.

FUTURA Law Firm TECHNOLOGY

1. INTRODUCTION

The regulation of Crypto-assets and related services is becoming standardised across the European Union (EU) through the Markets in Crypto-assets Regulation (Regulation (EU) No 2023/1114 dated 31 May 2023), also known as **MiCAR**.

MiCAR is a comprehensive regulatory framework that governs the issuance, offerings to the public, and admission to trading of Crypto-assets, as well as services related to Crypto-assets within the EU. As such, MiCAR lays down a comprehensive set of requirements for issuers, offerors and Crypto-asset service providers. Within this framework, a Crypto-asset is "*a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology or similar technology*" ("**Crypto-asset**").

MiCAR divides Crypto-assets into the following subcategories:

- Asset-Referenced Tokens ("**ART**"): "*a type of crypto-asset that is not an electronic money token and that purports to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies*";
- Electronic Money Tokens or E-Money Tokens ("**EMT**"): "*a type of crypto-asset that purports to maintain a stable value by referencing the value of one official currency*";
- Crypto-assets other than asset-referenced tokens and e-money tokens.

The last subcategory mentioned above includes "utility tokens" which are "*a type of crypto-asset that is only intended to provide access to a good or a service supplied by its issuer*" ("**Utility Token**").

MiCAR does not apply to Crypto-assets that are unique and not fungible ("**NFTs**") with other Crypto-assets. Its application is the same regarding Crypto-assets that represent unique and non-fungible services or physical assets. Consequently, marketplaces that facilitate the exchange of NFTs are exempt from MiCAR.

MiCAR entered into force on 29 June 2023 and will be applicable in all EU member states by 30 December 2024. However, rules regarding ARTs and EMTs have already been initiated as of 30 June 2024.

This Monograph is the seventh of a **series** dedicated to MiCAR.

2. THE CONCEPT OF NFTs

2.1 Definition of NFTs

There is no common definition of what constitutes a "unique and non-fungible" Crypto-asset under MiCAR. Although NFTs may be traded on the marketplace and be accumulated speculatively, they are not readily interchangeable and their value cannot be compared to an existing market or equivalent asset. The value of each NFT is linked to its unique features and the utility it provides to the token holder.[1]

Additionally, NFTs that represent legal ownership or rights to physical assets (e.g., real estate, intellectual property) can further complicate their classification, because these tokens bridge digital and traditional legal frameworks.

It is also essential to consider the legal ramifications of interconnected values which could subject NFTs to broader financial regulations. For example, whether the interdependency might create implicit guarantees or securities-like features.

In essence, a Crypto-asset may be considered an NFT if its characteristics and/or the rights it provides distinguish it from the other tokens issued by any issuer.

Attention MiCAR does not apply to Crypto-assets that are unique and not fungible with other Crypto-assets.[2]

Attention Marketplaces, that facilitate the exchange of Crypto-assets that are unique and not fungible with other Crypto-assets, are excluded from the scope of MiCAR, as these assets themselves are also excluded from MiCAR.

2.2 Substance over Form Approach.

MiCAR emphasises a substance-over-form approach, meaning the classification of a Crypto-asset is based on its characteristics rather than the issuer's designation. NFTs that meet the criteria of both (1) uniqueness and (2) non-fungibility are exempt from MiCAR.

It is crucial to separate truly unique Crypto-assets from those that might appear unique due to specific technical identifiers or standards. Thus, the criterion of uniqueness should not rely on the Crypto-asset's technical specificities. Simply assigning a unique identifier to a Crypto-asset does not automatically make it an NFT within the meaning of MiCAR. Instead, uniqueness must be derived from the value represented through the NFT or the tokenised right. In essence, a Crypto-asset that lacks genuine uniqueness due to the presence of comparable and interchangeable attributes fall within MiCAR's regulatory purview.

[1] See Recitals 10 of MiCAR
[2] See Article 2(3) of MiCAR

2.3 Interdependent Value Test

A crucial aspect to consider is the potential value interdependency between NFTs. Such interdependency may determine if the value of one Crypto-asset impacts the value of another; indicating a lack of uniqueness. For instance, 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.

2.4 NFTs in a Large Series or Collection

Crypto-assets that are part of a series or a collection can potentially not qualify as an NFT, assuming they are interchangeable by other Crypto-assets in the series. Interchangeability in this context refers to the sharing of equivalent characteristics, which can happen if the market perceives certain NFTs as similarly valuable despite their unique traits. Therefore, the existence of a series or collection - particularly its size - should be recognised as an indicator of fungibility, but not a definitive criterion.

2.5 Fractionalisation of NFTs

Fractional parts of NFTs should not be considered unique and non-fungible.[3] These fractional parts involve dividing an NFT into several other Crypto-assets. Unlike a collection of NFTs, each fraction of a fractionalised NFT represents partial ownership of the NFT. Hence, it is possible to reassemble the entire NFT by possessing all of its fractional parts. The process of fractionalisation may result in each fraction having identical attributes and thus lacking uniqueness. The "interdependent value test" could assist in classifying such Crypto-assets.

For instance, in the case of a collection of NFTs where the uniqueness of each Crypto-asset can be questioned (e.g. several NFTs representing the same image with minor modifications), such collection should fall under MiCAR. 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 Crypto-assets could be seen as a series of Crypto-assets that are non-fungible.

2.6 Utility Function of NFTs

Owning an NFT could provide access to exclusive events or benefits. In this scenario, the specific attributes of the NFT become less significant than the utility it offers; rendering different NFTs functionally interchangeable for practical use. Thus, these Crypto-assets could be seen as non-fungible. As an example, a music artist might issue NFTs that grant holders access to exclusive concerts. The specific attributes of each NFT (such as different album cover art) are secondary to the utility they provide. Thus, owning any NFT

[3] See Recitals 11 of MiCAR

from this collection serves the same function, making them interchangeable for the purpose of gaining concert entry.

Furthermore, when NFTs provide access to physical assets or exclusive memberships, the legal obligations and consumer protection regulations associated with these utilities must be evaluated to ensure compliance with existing laws.

3. CONCLUSIONS

The world of NFTs presents a unique and complex dimension within the broader Crypto-asset landscape. Due to NFTs distinguishable characteristics of uniqueness and non-fungibility, they set them apart from other types of Crypto-assets, subsequently, making them not subject to MiCAR. The intricacy of NFTs becomes particularly evident when considering factors such as the substance-over-form approach, the potential value interdependency of NFTs within a series or collection, and the process of fractionalisation. Each of these aspects contributes to the complexity of the NFT landscape and highlights the need for careful consideration when dealing with these Crypto-assets.

Legal professionals must also be vigilant about evolving jurisprudence and regulatory interpretations, as courts and regulators begin to address disputes and compliance issues related to NFTs.

In conclusion, while NFTs present exciting opportunities, their unique characteristics and potential complexities require a nuanced understanding and careful navigation; particularly in light of the evolving regulatory environment epitomised by MiCAR. Future developments in this space will undoubtedly continue to challenge and shape our understanding of NFTs. Ensuring that NFTs are structured and marketed in a manner that aligns with legal standards will be crucial for their sustainable integration into the broader Crypto-asset ecosystem.

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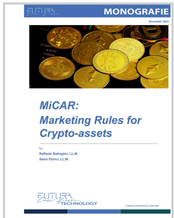
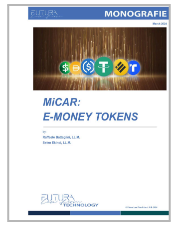
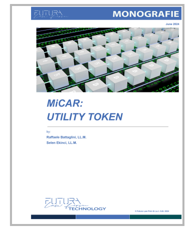
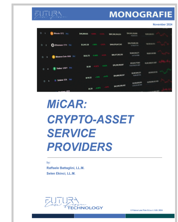
Previous monographs in the MiCAR series

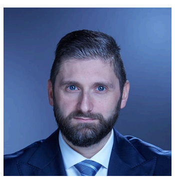








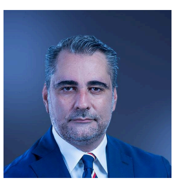
Authors



Raffaele Battaglini

CEO

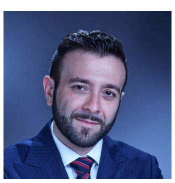
Legal advisor to tech companies for M&A deals and adoption of new technologies with a particular focus on blockchain and tokenisation.



Santiago Martin Caravaca

Tech Lawyer

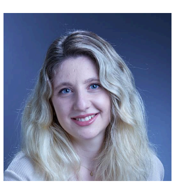
He deals with new technology law with a focus on the digital transformation of the arts and sports sectors with AI and blockchain.



Luigi Cantisani

Tech Lawyer

Legal advisor in digital technology law, with a particular focus on the compliance of online platforms and crypto-related projects. R Doctoral researcher engaged in Apps at the University of Warwick.



Selen Ekinci

Next Law Lawyer

Focused on private international law and contract law, she deals with contract drafting in the technological field.

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Futura Law Firm S.t.a.r.l. S.B.
Via Davide Bertolotti n. 7
10121 **Torino** | +39 011 08 66 155
info@futura.legal | **futura.legal**