# Chino, Ltd


Rep. Roy M. Takumi, Chair
Committee on Consumer Protection & Commerce
State Capitol
415 South Beretania Street
Honolulu, HI 96813

Thursday, February 08, 2018

Hearing on February 9,2018 at 2:30 in conference room 329

**Re: Letter in opposition to HB2257 and its companion bill SB2129**

Honorable Representative Takumi and the members of the committee,

Aloha mai kākou,

My name is Theo Chino. I am the founder and CEO of a small business in New York City serving the north of the island of Manhattan and the Bronx in bitcoin processing services. My business was directly impacted by the illegal introduction of the Bitlicense in New York State.

Because of the uncertainty on the nature of bitcoin, bitcoiners Sal Mansy *(USA v. Mansy et al 2:15-cr-00198)*, Anthony Murgio *(USA v. Murgio et al 1:15-cr-00769)*, Randall Lord *(USA v. Lord 5:15-cr-00240)* were forced to plead guilty to criminal charges. Because of the uncertainty on the nature of bitcoin, misters Costanzo *(USA v. Costanzo et al 2:17-cr-00585)* and Stetkiw *(USA v. Stetkiw 2:17-mj-30566)* are still fighting their criminal charges in Federal court. I decided to sue the state of New York over the constitutionality of the Bitlicense over the nature of bitcoin. Neither the New York nor the ULC Bitlicense definition fix that uncertainty.

I am after all the grandson of a 442nd Regimental Combat Sergeant who served on the European front during World War II. My grand-father was also active in the Congress of Racial Equality and recognized by James Farmer as the individual who coined the organization's name. His cousin, Kamatsu Elizabeth Ohi, the first Japanese-American woman lawyer was arrested by the FBI. So, I will use the law to go for broke against the overreach created by the Bitlicense.

I am an elected member of the Democratic Party County Committee for the 2nd Election District for the 71st Assembly, an active member of the Four Freedom Democratic Club, and the instigator of the

website Outraged Democrats *(https://OutragedDems.nyc.)* The goal is to help any New York City democrat to run for County Committee in order to exterminate once and for all the corrupt influence of our first County Chair; Aaron Burr and his Society of St. Tammany.

Satoshi Nakamoto imbedded into the Genesis Block to the Bitcoin Blockchain the following message: **"'The Times 3 January 2009 Chancellor on brink of second bailout for banks'"** in a way to initiate a discourse about the financial system run from Wall Street in New York City.

At that moment, Satoshi Nakamoto, by solving the ***Byzantine Generals Problem*** created the first **Intangible Commodity** of the Internet.

This is a fact that was presented by professor Mark T. Williams to the Superintended of the New York Department of Financial Services. **"Bitcoin is not a virtual currency but a high risk virtual commodity, in a hyper asset bubble that has begun to pop."** Bejamin Lawsky decided to ignore it when he drafted what is known as the Bitlicense and served as a working base for the Uniform Law Commission bill HB2257/SB2129.

I will not submit the 3781 commentaries that were sent to the NYDFS in 2014. They described back then the fate of the industry in New York State. All the predictions became true. Not only they did not stop any bad guy, but obliterated a burgeoning industry from the State of New York. You will find all the commentaries on the NYDFS web page (*http://www.dfs.ny.gov/legal/vcrf_comments.htm***)**

The point that New York screwed up was clearly made by Senator Carol Blood of Nebraska as she was asking the Nebraska Judiciary Committee to have her bill on including ***Virtual Currencies to the Money Laundering statute*** to be held in committee. She worked for more than a year on that bill but she realized that there was a complete lack of understanding of this blockchain technology. *https://youtu.be/pNc3jM97Meo?t=1h19m38s*

Back in 2014, the Bitcoin Foundation for which I am a Lifetime Member, wrote **"A truly open rulemaking would allow participation far richer than the ability to comment once or twice on draft regulations."** This was true in New York State in 2014, this was true yesterday in Nebraska and it is still true tomorrow in Hawaii. Many of the Nebraskan senators realized that the community had to so much to teach. They came to this realization while they were debating the Uniform Law Commission bill in the Banking, Commerce and Insurance Committee of the Nebraska Legislature. I sincerely hope that you will reach out to the local bitcoiners in your districts.

Coincenter, a Washington D.C. lobbyist organization would have you believe that it is important that there be a **uniform law** across the United States. This is against the essence of what Bitcoin is. Although bitcoin is a **universal intangible commodity**, it is meant to be decided locally on how to regulate it. It is for the local legislators to listen to their local constituent describe how they want to adapt this technology locally to solve their local problems, and then together create the framework that work for them locally.

Two days ago, I was amazed at the number of Nebraskan bitcoiners and blockchain enthusiasts that testified in opposition to the Uniform Law Commission bill by giving real-life examples on how they use and adapt the technology locally to solve local problems and how a uniform legislation would actually impact them.

At the Banking Committee hearing, each of the opposition examples were so unique, that after two hours of testimony a senator let a “oh shit” escape as to say “is there is more?” The legislators came out discovering that there was more to this technology and that ULC bill would be actually very inadequate for Nebraskan. This was echoed at the Nebraska Judiciary Committee when a legislator requested a seminar from all the technical experts present *(https://youtu.be/pNc3jM97Meo?t=2h4m42s.)*

Don’t let Coinbase, a multinational company, whose ideology has been corrupted by Wall Street dictate how Hawaiian should use this technology locally. Coinbase issue as illustrated by Commissioner Ikeda is a real problem that would indeed be solved by the enactment of the ULC bill, but which at the same time would give them a de facto monopoly.

Coinbase problems in Hawaii can be solved by a simple modification to the banking laws to accommodate the unique situation faced by exchanges without stifling the competition necessary for the adaptation of this technology by Hawaiians for Hawaiians. The ULC legislation is not required for their problem to be solved.

Bitcoin is an **intangible commodity** that has been created **to be decentralized** as to not to have one point of failure. The ULC version of the Bitlicense is exceptionally flawed and would create that single point of failure by limiting access to the state to a few extra territorial companies.

The Uniform Law Commission was made aware of many flaws and they that they decided to ignore them during their annual meeting in San Diego. It would be interesting for the member of the committee to inquire as the reasons for the commissioners to ignore the dissent opinion.

If you have any questions, do not hesitate to contact me. In a near future I will be posting tutorials that I have used to train lawyers on what bitcoin is.

Naʻu me ka manaʻo kōkua,

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*Mai poina, na ʻoukou e hāpai i ka ʻōlelo Hawaiʻi i mua. - Elizabeth Kauahipaula*

Testimony of Mark T. Williams[1]
Banking Specialist, Commodities and Risk Management Expert
Boston University Finance Department
To The New York State Department of Financial Services
January 28-29, 2014
Hearing Regarding Virtual Currencies
90 Church Street
New York City, New York

Executive Summary

Since 2009, over seventy-five virtual currencies have been created and are traded globally representing about $11 billion in stated market value. http://coinmarketcap.com/mineable.html. Of these e-currencies, Bitcoin is the leader represents about $10 billion or over 90 percent of total industry market value. Based on its volatile price behavior, **Bitcoin is not a virtual currency but a high-risk virtual commodity, in a hyper-asset bubble that has begun to pop**. Bitcoin the pseudo currency and Bitcoin the low-cost payment system are dependent on each other and inseparable.[2] Over the last year, Bitcoin prices have been artificially inflated through an oligopolistic ownership structure, extreme hoarding practices, unregulated e-exchanges, marketing hype and greater opportunity for market manipulation. The trust and integrity associated with the U.S. Dollar as a transactional currency has been earned over centuries and supported by ongoing monetary and fiscal policy, soundness of central banking systems, regulation and enforcement.[3] There are significant risks and uncertainties associated with virtual currencies that need to be fully measured before they are allowed to proliferate further or be adopted into the financial system. **Bitcoin presents numerous market related risks as it is decentralized, volatile, untraceable, unregulated, and provides no legal protection for consumers.** If Bitcoin, in its embryonic stage, were to replace the U.S. dollar, it would be economically disastrous causing trade to plummet, GDP to fall and unemployment levels and bartering to surge. **Bitcoin is an experiment that needs to remain in the laboratory until it can meet the basic standards required to become a beneficial transactional currency.** As a virtual commodity, Bitcoin remains extremely risky and needs to be closely watched. To transform Bitcoin into a virtual currency would require regulation, centralization, creation of a legal framework and strong regulatory oversight. However, these steps alone would not necessarily guarantee that chronically high price volatility would drop low enough to allow Bitcoin to become a trusted transactional currency.

In conclusion, I hope this testimony will provide additional insight and spur further research and analysis into virtual currencies and the growing risks they pose to U.S. investors, the financial system and to the overall global economy if not properly managed.

[1] Mark T. Williams has no direct or indirect financial interest in either Bitcoin, Bitcoin-related startups or any other
[2] Bitcoin is the equivalent of the locomotive while the payment system is the rails that allow it to move. If the engine does not work no matter how well built the rails, they won't be used.
[3] The Federal Reserve Bank was founded in 1913.

## I. Background

My name is Mark Williams. For the last decade I have taught banking, finance and capital markets at Boston University. My areas of expertise include banking, risk management and commodity trading. Of particular interest is evaluating market bubbles and potential market manipulation schemes. In 2010, through McGraw Hill, I published Uncontrolled Risk, www.uncontrolledrisk.com, a book about the fall of Lehman Brothers and the major factors that caused the real estate bubble.

Prior to Boston University, I was a senior trading floor executive at Citizens Power LLC, a Boston-based commodity-trading firm. Other work experience included stints at the Federal Reserve Bank as a field examiner in Boston and San Francisco. Through my academic and work experiences I have gained a strong understanding of how the capital markets function, the vital role of currency, how financial institutions operate, and how manipulation schemes can be used to distort market prices and harm unsuspecting investors.

For the last year, I have closely followed, evaluated and more recently written on Bitcoin, its market structure and its highly unusual price run-up. During this period it has become increasingly apparent that **structural weaknesses have caused inefficiencies providing greater opportunity for market manipulation**. In this regard, I also bring this matter to your attention for further consideration and review.

## II. Creation of Bitcoin

In 2009, a programmer or group of programmers by the pseudo name Satoushi Nakamoto[4] supposedly designed Bitcoin, a computer generated "virtual currency" produced by solving progressively complex mathematical puzzles.[5] The code-protocol for Bitcoin is open source, allowing it to be easily viewed, commented on and if a majority of programmers agree, changes are adopted. In this regard, Bitcoin is very transparent.[6] The Bitcoin infrastructure that includes a payment system is decentralized and based on a peer-to-peer structure. Individuals in numerous locations, using powerful computers to solve predetermined equations, authenticate e-coins and help keep a general ledger of ongoing transactions. This blockchain ledger provides a visible record of all past, current and all future transactions. For their efforts, puzzle solvers are rewarded with blocks of e-coins. This process is referred to as mining and those that do it are called miners. Interestingly, using such terminology also gives the false impression that something of tangible value is being created such as gold being mined out of the ground. Some enthusiasts have claimed that Bitcoin is gold for geeks. Initially, the barrier to entry to become a miner was low. As time has passed this barrier has risen and those who are already mining have a competitive advantage and

[4] This individual (or group of individuals) has never stepped forward to take credit for his work adding to the mystery and mystique but raises the question does this person actually exist. However, others such as Gavin Andersen have stepped forward serving as the Chief Scientist on the board of the Bitcoin Foundation.

[5] Bitcoin has not been recognized by any of the G20 countries as meeting the definition of currency as it lacks price stability and does not provide a stable store of value. As a result it is a speculative virtual commodity with no tangible value.

[6] The Bitcoin community has argued that this open source approach is a strong control as it allows a large community of computer scientists, software engineers and cryptologists to watch over the system and insure its integrity.

greater market power.[7] To gain a competitive edge, some miners have moved their operations to Iceland to take advantage of the lower cost of geothermal power.

Initially, miners were rewarded with 50 coins per block. More recently, a block is equal to 25 coins. The coin/block ratio will continue to half as time goes on. It takes approximately 10 minutes to mine a block and approximately 4,000 new e-coins are generated globally per day. Presently, over 12.3 million Bitcoins have been minted and by year 2140, the maximum limit of 21 million will be reached. Prescribed quantity limitations create a scarcity that has put upward pressure on prices. This pricing influence works as long as new investors can be recruited to buy newly minted e-coins.

Theoretically, the Bitcoin mining and authenticity process is decentralized, keeping collusion between miners to a minimum. However, in practice, **as prices have skyrocketed, there has been greater economic incentive for miners to ban together in pursuit of greater profits. As a result, this remains a clear weakness in the Bitcoin infrastructure**.[8] As new e-coins are minted they are added to the blockchain and when trades occur, existing e-coins are authenticated against this blockchain. As more Bitcoins are mined, the blockchain grows longer in complexity and the verification time increases.

## III. Why Investors Are Motivated to Buy Bitcoin

What convinces individuals to exchange real money for fake or digital money? **Bitcoin is an unusual investment choice as it has no tangible value and is not backed by anything**.[9] Presently, Bitcoin prices have shot up not because of underlying value but because of misinformation, concentrated market power, hoarding, opaque and unregulated exchanges, insufficient trade reporting, elevated marketing hype and greater opportunities for market manipulation.

In addition to mining or buying Bitcoins on e-exchanges, investors can now buy them from Bitcoin ATMs. Such machines are popping up around the globe in alarming numbers. All that is needed prior to investing is to setup an e-wallet account. **With increased ease and access to buying Bitcoins, also comes greater risk to uninformed and less sophisticated investors.** To minimize investor losses, regulation covering Bitcoin ATM buying also needs to be quickly established.

### a. What is the Value Proposition?

Bitcoin is not a company where investors can own stock. It is not incorporated, has no CEO, management or a board. It is a concept, an experimental idea, its source code is public and its intellectual property is given away for free. Since inception, Bitcoin has been promoted as a disruptive technology, a virtual payment system and a means to take control away from

[7] On a per coin basis, the estimated cost (time and energy usage) of mining Bitcoins has increased to the $10 to $14 range.

[8] Last month a group of miners by the name of Ghash.io demonstrated this system weakness by pooling their computing power to form one supercomputer and showing how to circumvent the decentralized structure and gain 51 percent control.

[9] Unlike conventional currencies that are backed by the full faith and taxing power of the issuing sovereign.

irresponsible central bankers and return the power of currency creation to the people. Some Bitcoiners have even compared the coin's birth to the start of the internet revolution. Others have called this period the Bitcoin Revolution.

Added factors have enticed investors including rapidly rising prices as well as the mystique associated with the programmer or group of programmers using the pseudo name Satoushi Nakamoto. It is puzzling that few investors have questioned why he (or group of programmers) has not publically stepped forward. Could this be an elaborate hoax to hype investor demand or is it a calculated risk management maneuver to shield the creator from legal liability if the invention is used for unlawful purposes?

Regardless of the reason, investor appetite for Bitcoin remains strong. In general, investor rationale has fallen into the following five categories:

1. Virtual currency – It can't be manipulated by central bankers, has finite quantity and when adopted as a world currency it will have immense value.
2. Virtual commodity – Buy Bitcoin and profit from scarcity of supply of a good that will be in great demand.
3. Payment system – Bitcoin is a payment system that will replace Visa, Mastercard and Western Union.
4. Ownership – Buying Bitcoin is like buying into an internet startup venture.
5. Political Statement – Buying Bitcoin is a vote against central bankers and failed policy that has undermined our economy.

## IV. Bitcoin is a Virtual Commodity and **not** a Virtual Currency

**Although Bitcoin was purportedly designed as a virtual currency, it is a highly-speculative virtual commodity**. Since 2013, prices have skyrocketed from $13 to a December market peak of $1,200. Currently, Bitcoin trades for about $850. There is no major currency on the plant that exhibits this sort of price pattern.

a) Why Bitcoin is not a Virtual Currency

Useful transactional currencies are to be saved, lent or spent but not hoarded. Transactional currencies exhibit low price volatility while tradable commodities tend to exhibit high to extreme price volatility. By definition, a currency should have price stability and provide a means of stored value. Faith in and the use of currency for daily activities is a key pump that drives economic prosperity. If a currency has the potential to increase greater than the goods it can buy, owners will natural hoard the currency over ownership of goods. Hard currencies such as the U.S. Dollar, British Pound Sterling and the Euro exhibit low price volatility, providing a dependable means to transact commerce. Gross Domestic Product or GDP is a key economic measurement used to measure goods and services produced. United States, the world's largest economy, has an annual GDP of approximately $15 trillion. If extreme price movements in the U.S. dollar caused its use to fall, commerce would decline, causing GDP and per capita income to also decline. In a contracting economy, unemployment rates rise. In extreme situations, if currency is perceived as having significant appreciation potential, it will be hoarded.

1. Extreme Hoarding

Unlike useful transactional currencies, holders of Bitcoin practice extreme hoarding. Currently, of the approximately 12.3 million e-coins produced, over 90 percent are hoarded and not used (or available) for commerce. The significant daily price fluctuation of Bitcoin including its rapid appreciation, and extreme annual volatility, undermines its ability to serve as a stable, safe and trusted transactional currency.

If the U.S. were to adopt Bitcoin in its current embryonic state as a parallel currency and the same level of hoarding was practiced, it would be economically disastrous, for U.S. trade, the banking system, GDP, standard of living and overall level of employment. Trade would decline as holders of currency would use it as a commodity to speculate and not as a means for transacting business. Given that the U.S. dollar is the world reserve currency with over $1.2 trillion in circulation, it would also have a significantly negative impact on global economy and trade.

2. Tax Implications

Given the high price run-up in Bitcoin, there are significant tax considerations that also influence the level of hoarding versus spending. If an e-coin was purchased for $500 and it now trades for $850, (a $350 taxable profit) the owner is going to be less motivated to use it for transactional purposes, especially if doing so would trigger a tax event. Globally, tax treatment uncertainty persists, as countries are just starting to establish tax rules for virtual currencies. In general the decision will come down to taxing e-currency income either at current income or at capital gains tax rates.

## V. Hyper Price Volatility

In 2013, Bitcoin increased in price by an astonishing 9,000 percent with 150 percent price volatility. In comparison, the U.S. dollar to other hard currencies typically exhibits an annual price movement in the 10 to 12 percent range. To provide perspective, Bitcoin is 7 times more volatile than gold and 8 times more volatile than the S&P 500 Index. In recent months, prices have been on a rollercoaster dropping by 30 percent since the market high. It is not uncommon for daily prices to move by 20 or 30 percent. During the second week of December 2013, in a 48 hour period, prices plummeted by 50 percent only to rise again two weeks later. Since the December low of approximately $535, Bitcoin has gained about $300.

### 1. Well Established Retailers are not Willing to Accept Bitcoin Price Risk

High daily price risk presents a major hurdle for the adoption of Bitcoin as a viable virtual currency. Large retailers work on tight margins sometimes as little as 10 to 15 percent. Given that daily price movements can be two times greater, a sudden price drop could wipe out retailer profits and even generate a significant loss. **Technically, at present levels, if a large retailer were to accept Bitcoin price risk directly, they would no longer be in the retail business but in the high-risk commodity trading business**. If a publically traded company, shareholder could revolt.

### 2. Increased Concentration Risk to Financial Middlemen – Growing Regulatory Concern

Given the high daily price risk associated with Bitcoin, retailers have been hesitant to assume this significant market risk. In response, several Bitcoin startups including BitPay and Coinbase have emerged. These financial middlemen sit between customer and retailer, fixing the Bitcoin exchange rate prior to sale. When using such middlemen, retailers might advertise they take Bitcoin, even posting a sticker on their doors, but technically, they are not taking Bitcoin, they are taking U.S. dollars. **Importantly, these types of financial arrangements do not reduce overall market risk but simply concentrates this risk.** Theoretically, if these hard-currency payments are coming directly from the financial middlemen, retailers should be indifferent. However, BitPay and Coinbase have limited balance sheets that restrict the amount of market-price risk they can (and should) safely warehouse. Using current price history, a single day drop of 20 percent on a large enough position could be financially devastating, even causing bankruptcy for these middlemen if not properly managed. Moreover, a derivatives market that would normally help such firms offset or hedge-out this risk has not yet materialized.

**Given the growing concentration risk to financial middlemen such as BitPay and Coinbase, and the significant market disruption that would occur by even one firm bankruptcy, regulators will need to rapidly establish prudent minimum capital requirements especially if retailer demand for using such thinly capitalized intermediaries grows.**

3. Virtual Commodity Risk

As a virtual commodity, Bitcoin remains an extremely risky investment and needs to be closely watched[10]. Speculative interest has increased as prices have risen. Many of these investors are U.S. Citizens. Rapidly those that previously mined coins as well as new groups of investors have become speculators. In a perverse way, inflated prices have been used to validate the Bitcoin investment thesis instead of reliance on fundamental analysis, data and hard facts to arrive at a fair market value. Lack of analyst coverage has also inhibited the quality and quantity of market research available before making investment decisions[11].

## VI. Could Bitcoin be transformed into a virtual currency?

It is plausible that Bitcoin could be transformed into a virtual currency but it would need to be significantly modified so it encouraged greater transactional use, circulation and less hoarding. Freicoin, a relatively new pseudo currency has attempted to solve this hoarding problem by charging holders a fee, after a set number of days, if the coin has not been used.[12] Present daily, weekly, monthly and annual price swings of Bitcoin have to fall substantially. For example, Bitcoin's annual price volatility would have to drop at least 10 fold, (10 to 15 percent range) from its current stratospheric level of 150 percent. Last, greater regulation, centralization, creation of a legal framework and strong regulatory oversight would also need to be put in place. In this "wild-west" trading atmosphere tighter controls over global e-exchanges and participants would also have to be implemented in an attempt to further discourage market manipulation.

## VII. Bitcoin is in a Hyper Asset Bubble That Has Begun to Pop

In an efficient capital market, capital flows to its highest and best use as investors seek tradeoffs between desired risk and desired return. When investors receive timely, accurate and transparent information, the likelihood of an asset bubble is diminished. However, even in efficient, seasoned and well-developed financial markets it is not uncommon to experience bubbles (e.g., Dotcom 2001, Real Estate 2007/8). Historically, asset bubbles have three phases: growth, maturity and pop. Not all bubbles experience rapid price collapses, sometimes prices deflate over an extended period, allowing investors to experience lower losses when exiting[13].

Bitcoin was created in 2009, hitting its growth stage in 2011 and maturity stage in 2013. The pin that began to pop the Bitcoin bubble was the central bank of China decision in December 2013 to crackdown on e-currency. Prices remain about 30 percent lower since this significant market news.

The recent hyper-price run up, investor expectations of a quick gain, weaknesses in efficient market mechanics and increased opportunities for market manipulation have contributed to the Bitcoin asset bubble. **When the Bitcoin hyper-bubble bursts, prices could drop below $10 as soon as**

[10] The U.S. Commodity Futures Trading Commission would be a logical regulator to oversee the commodity attributes of Bitcoin.

[11] Bank of American/Merrill Lynch began coverage in December 2013 stating Bitcoin could rise to $1,300 while Citigroup indicated it could not substantiate the value of Bitcoin.

[12] This fee is paid to e-coin miners.

[13] Investor/speculators can make money in all three phases of an asset bubble.

**June of 2014.** This bubble burst prediction has been detailed in several articles, one of which published in December 2013 is attached (http://read.bi/1czm9bz). **If such a price collapse did occur, it would further undermine investor trust and immediately jeopardize the chances of Bitcoin being adopted as a virtual currency.**

The final driving force that will burst the Bitcoin bubble is growing investor awareness that what they bought has greater risk and uncertainty than anticipated. Regulation hearings such as the one being held by the New York State Department of Financial Services on January 28 and 29th of 2014 will also assist Bitcoin investors in better understanding what they are or are not buying. Examples of risks that once factored in will push Bitcoin prices down include a growing regulatory climate, greater oversight, decreased opportunities to influence Bitcoin prices, challenges associated with commercialization, reputational risk linked to illicit activities (e.g, Silk Road), competitive pressure from better designed e-currencies, evidence that existing markets are rigged against smaller investors and/or disclosure of market manipulation.

## VIII. Dangerously High Potential for Market Price Manipulation

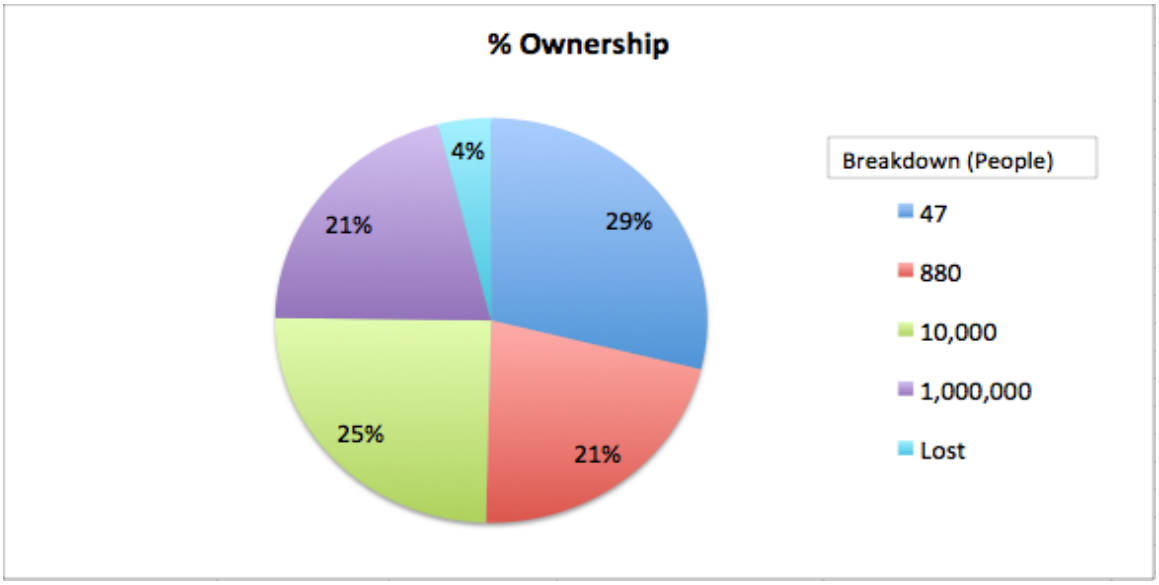
As a rapidly developing decentralized market with no regulation and oversight, and as profit opportunities increase, the motivation to influence prices has also increases. **The Bitcoin marketplace has several inherent weaknesses that make it ripe for market manipulation schemes.**

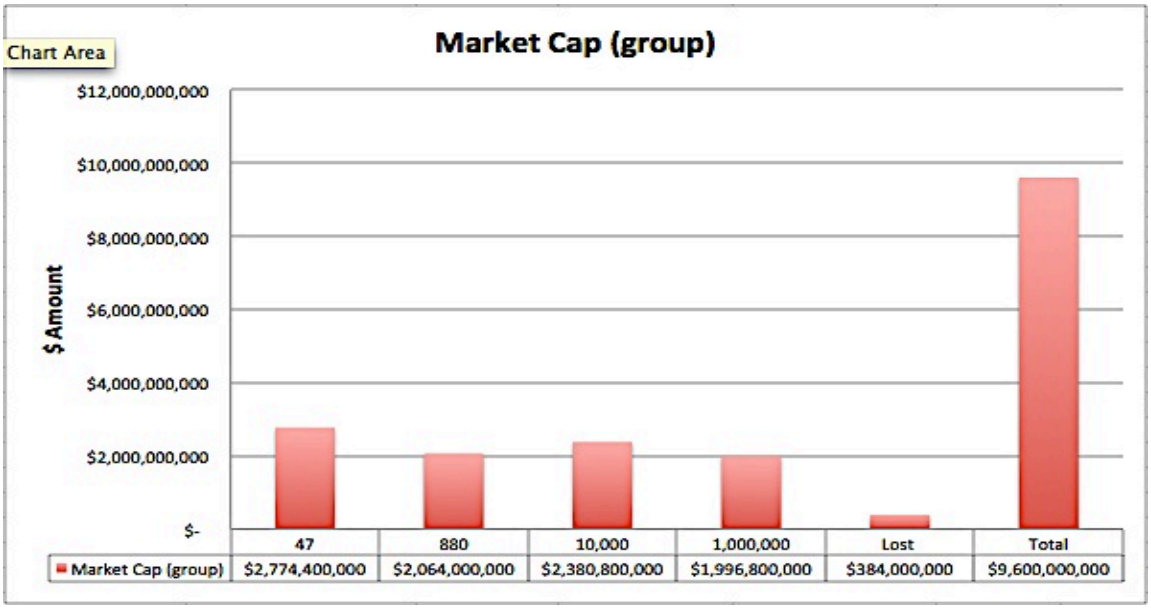
### 1. Pyramid Ownership Structure – Concentrated Market Power

Bitcoin ownership is concentrated in the hands of a small group of individuals providing them with an immense amount of market power. As of December 2013, 47 individuals controlled 29 percent of outstanding coins, each owning an average of about $60 million worth of Bitcoins. Collectively, 930 individuals controlled 50 percent of e-coins, each owning an average of about $2 million-worth of Bitcoins. This oligopoly of investors has much greater influence over price than the rest of investors. This is particularly the case as e-coin miners and early buyers (2009-2012) represent the majority of holders. More broadly, fewer than 11,000 individuals controlled 75 percent of coins while the remaining 1 million investors (many of them late comers) controlled only a sliver (20.8%) of coins. This pyramid structure allows a tiny number of miners/owners to influence how many coins are hoarded and how many new ones are made available on the market. Creating potentially artificial supply/demand imbalance would also help ensure, as long as more investors are clamoring to buy, that Bitcoin prices remain at overinflated prices. Generating an aggressive and ongoing media buzz could also ensure an adequate crop of new investors.

| Breakdown (people) | % Ownership | Total bitcoins | Bitcoins owned(group) | Bitcoins owned (individual) | Market Cap (indiv) | Market Cap (group) |
|---|---|---|---|---|---|---|
| 47 | 28.90% | 12,000,000 | 3,468,000 | 73,787.23 | $ 59,029,787.23 | $ 2,774,400,000 |
| 880 | 21.50% | 12,000,000 | 2,580,000 | 2,931.82 | $ 2,345,454.55 | $ 2,064,000,000 |
| 10,000 | 24.80% | 12,000,000 | 2,976,000 | 297.60 | $ 238,080.00 | $ 2,380,800,000 |
| 1,000,000 | 20.80% | 12,000,000 | 2,496,000 | 2.50 | $ 1,996.80 | $ 1,996,800,000 |
| Lost | 4.00% | 12,000,000 | 480,000 | N/A | N/A | $ 384,000,000 |
| Total | 100.00% | | 12,000,000 | | | $ 9,600,000,000 |
| Value of Bitocoin | $ 800 | | | | | |

Source: http://www.businessinsider.com/927-people-own-half-of-the-bitcoins-2013-12#ixzz2pJLm4MgQ




2. Hoarding Sets an Artificially Inflated Price Floor

Hoarding is expected when an investor anticipates that the value of the asset held will be worth more in the future than what it is today. Investor hoarding is not uncommon for commodities that are in temporary or permanent low supply and are in high demand. The act of hoarding, if an investor controls enough of an asset, can also move prices higher. In 1979, the Hunt Brothers

attempted to corner the market in silver[14]. Unlike in the silver market, no single Bitcoin investor has been able to amass control to the level of the Hunt Brothers.

Theoretical Example – Supply-side Manipulation

If I own 100 cokes at $1 each and I have 100 thirsty customers, the market price will remain at $1. However, if I hoard 90 cokes and only allow 10 for sale, the price will be artificially increased as long as 100 thirsty customers remain.

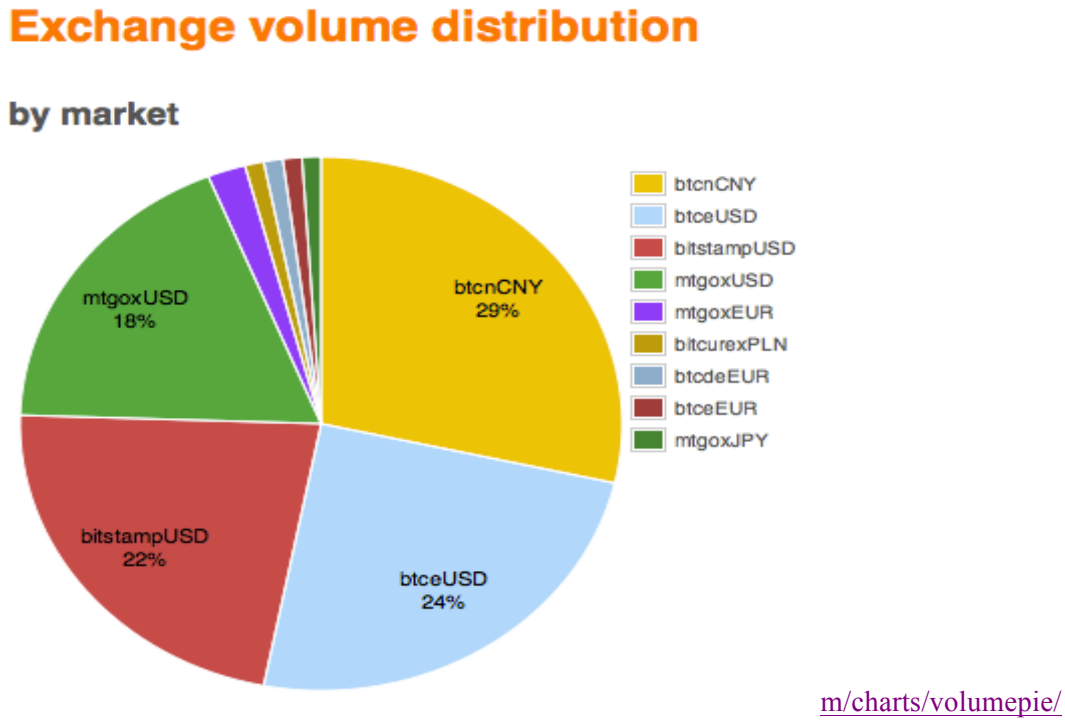
Given the tiny ownership structure of Bitcoin, it is highly probable that this group collectively has used extreme hoarding (intentionally or unintentionally) as a means to set an artificially inflated price floor. Miners of e-coins and holders can help influence the amount of (newly mined and existing) coins that are available for sale. Daily trading volumes on the largest crypto-currency exchanges are only a small percentage (less than 5 percent) of overall Bitcoins minted. As a growing number of buyers enter the market (fueled by marketing hype), this marginal quantity of e-coins for sale, could help set an artificial price floor.

3. <u>E-currency Trading Exchanges</u> - Lack of Openness, Regulation or Oversight

The buying and selling of Bitcoin is controlled by a handful of exchanges in places like China, Japan, Slovenia, and Bulgaria. Trading is done primarily at unregulated exchanges such as BTC China, Mt.Gox, Bitstamp[15] and BTCe. These exchanges handle the bulk of e-currency trading and provide important market pricing signals. More recently, Coinbase[16], a privately held U.S. based startup, has begun facilitating Bitcoin transactions. At these exchanges, it is also not uncommon for certain well-connected buyers and sellers to gain preferential treatment in terms of price execution. Front running is not uncommon. In this "wild-west" atmosphere some exchanges have failed. In November 2013, GBL, based in Hong Kong, closed it's doors, costing investors over $4 million. European Banking Authority has also warned of the dangers of others failing and the lack of investor protection laws.

[14] At the peak in 1979, the Hunt brothers controlled about one-third of the world's estimated silver supply. Initially prices climbed 8 times higher once the hoarding strategy was executed.
[15] Bitstamp is located in London but its bank that transfers currency is located in Slovenia.
[16] This thinly capitalized startup also plays a market risk mitigation role by taking on Bitcoin price risk and fixing the hard currency rate received by retailers.

Pie chart link: http://bitcoincharts.co




m/charts/volumepie/

In direct conflict with Bitcoin philosophy of open source code, e-exchanges do not practice transparency or level of openness that is standard at other commodity exchanges. As a general rule, fine-grain trading information is not offered, making full price discovery difficult. Although static end-of-day closing price is available, important historical intraday trading statistics including volume, bid/ask spread and price are intentionally withheld from the market.

On several occasions, attempts have been made to obtain such data but these requests have been rebuffed. Without having to disclose such trading data, manipulators have a greater chance to thrive.

4. Market Price Quotes – Suspiciously Large Pricing Differential at Exchanges Remain

At any given time it is not uncommon for the market quote between e-currency exchanges to vary by 10 percent or more. At current pricing, the trading differential on one exchange (e.g., Mt Gox compared to BTC e) can be $85 to $100 or more. Trading fees and currency conversion costs (US dollars/Yen/Euro to Bitcoin), explains only a small portion of this suspiciously large pricing differential.

**Lack of transparency, withholding of important intraday trading data, and no regulatory oversight has opened the door for the potential of various market manipulation schemes at the e-currency trading exchanges.**

5. High Potential for False and Misleading Trades

The concentrated ownership structure, lack of regulation or independent controls around e-currency exchanges, increases the opportunity for e-coin holders and exchanges to participate in market manipulation schemes that inflate trade volume, trade price or both.

**Given the large ownership concentration and the small amount of minted e-coins that are released to the market, even tiny trades, e.g., 5 coins, on the margin, can have an influence on overall price**. Trades that are completed at above market prices or down to given the appearance of greater traded volume can distort market prices. Especially if the market is thinly traded and other investors are not aware of the manipulation.

Theoretical Example – Paint the Tape

If I own 100 e-coins, and if I sell 1 e-coin at an above market price to a willing accomplice, that would increase the overall economic benefit for both participants. In this scheme both seller and buy benefit. The seller gets an inflated value for all 100 e-coins and the buyer, paying above market, loses on 1 e-coin but gains on the 99 others held.

Moreover, if an aggressive Bitcoin promotion campaign is deployed to entice new buyers to enter the market, such practices would generate significant buying traffic and financial gain for those 47 individuals that own 29 percent of all e-coins. As well as to the 930 others that own 50 percent or $5 billion of outstanding e-coins. Other non-academic research has been completed in this area supporting the theory of price fixing.[17]

**Based on the high potential for price fixing, the major e-exchanges should be required to demonstrate that such anti-market behavior is not occurring and adequate prevention controls are firmly in place.**

## VIII. Bitcoin Marketing Blitz

It is a given that investors that have better information make better and more informed investment decisions. The ongoing Bitcoin marketing Blitz is well orchestrated. The number of websites and blogs promoting e-currency, disseminating misinformation and in recruiting new investors has grown significantly. Much focus is placed on positioning Bitcoin as the "New, New Thing," a disruptive technology that will change the world and allow participants to get-rich quick. The trumpeting of stories about newly minted Bitcoin millionaires is commonplace. Presently, much of investor information also fails to disclose the many inherent risks associated with virtual currency /commodity investing. Some Bitcoin investors mistakenly think an e-coin investment is the equivalent of owning stock in a startup.

As virtual currency prices have inflated, the amount of internet-buzz promoting Bitcoin ownership has proliferated. New investors have been influenced by a barrage of web-driven marketing hype and by online message board postings. Some of which, it appears, have been used in an attempt to

[17] Falkvinge & Co., Bitcoin's Vast Overvaluation appears caused by pricing fixing September 13, 2013.

pump-up prices. Much of this propaganda appears to be linked to some of the largest Bitcoin owners, e-currency exchanges, self-interested venture capital firms and other e-coin dependent businesses. In the stock market it would be the equivalent of the largest investors banning together and aggressively talking-up their book through multiple media channels. However, in the financial markets, there is a combination of transparent financial reporting, regulation, diligent shareholders, stock analysts and financial journalists all acting as important counterbalances. Presently, these market information safeguards and quality controls are lacking. Recently, one of the Winklevoss twins of Facebook fame, who with his brother own an estimated 1 percent of all outstanding Bitcoins or $100 million, prognosticated that Bitcoin would catapult to $40,000. Remarkably, this super-bullish prediction was made when Bitcoin traded at $1,000, yet no creditable rationale was given why this fortyfold increase would happen. Such talking-up-your-book marketing can be particularly dangerous for unsophisticated investors, especially when market information is more one-sided.

More recently, the venture capital community has provided funding upward of $50 million for Bitcoin related companies, growing the involvement of business-savvy groups.[18] As the attempt to commercialize Bitcoin accelerates and the financial stakes get higher, there will be a greater focus on lobbying and industry self-promotion. Organizations such as Bitcoin Foundation, Bitcoin.org, Reddit.com, Coindesk.com, help.org and weusecoins.com remain primarily focused on gaining industry converts. Few Bitcoin websites presently provide investors with detailed, risk-focused and balanced information. **In such an environment, it is understandable how a hyper-asset bubble could have mushroomed so rapidly and why it has been more challenging for investors to make prudent investment decisions.**

In conclusion, I hope this testimony will provide additional insight and spur further research and analysis into virtual currencies and the growing risks they pose to U.S. investors, the financial system and to the overall global economy if not properly managed.

[18] Coinbase receiving the lion's share of this early round of venture capital funding.

Bitcoin Foundation

Benjamin M. Lawsky
Superintendent of Financial Services
New York Department of Financial Services
One State Street
New York, NY 10004-1511

August 5, 2014

Dear Superintendent Lawsky:

The Bitcoin Foundation is pleased to offer this preliminary, procedural comment on DFS-29-14-00015-P, **"**Regulation of the conduct of virtual currency businesses.**"** Given the prospects Bitcoin holds out for global financial inclusion, enhanced liberty and dignity, improved privacy protection, and stable money supplies, the Bitcoin community is very passionate about digital currency and keenly interested in the proposed regulation. Your engagement with the community so far is appreciated, and we are confident that continuing to engage with the community by conducting a fully open, transparent, participatory, and collaborative rulemaking will help produce a credible and workable regulation for digital currency businesses located in New York or serving New York customers.

Below we suggest not only that you extend the comment period by more than a nominal period, but also consider conducting hearings on the proposal and adopting an iterative process, in which you issue drafts, take comment, and re-issue drafts until all issues are fully vetted. The Bitcoin community will be able to comment more cogently if you share the research and analysis that underlies the proposal. The community can help you fit regulatory means to public interest ends if they have access to the risks your study of digital currencies identified. The department should use modern tools to conduct a rulemaking that befits the coming era, the Bitcoin era.

**Extend the Comment Period, Iterate on Drafts, Hold a Hearing**

You have already received a letter signed by over 400 individual Bitcoin enthusiasts, Bitcoin industry executives, members of the Bitcoin Foundation's leadership, and Bitcoin venture investors, all asking for an extension of the comment period. As you know, 45 days is the minimum comment period, and a proposal does not expire until 365 days after being published or after the last public hearing. New York agencies frequently accept comments for periods beyond the minimum 45 days.

The proposed regulation is sweeping, and it must be digested not only by existing New York financial services business, which have the greatest capacity to assess the regulation, but also by U.S.-based businesses outside of New York, international Bitcoin businesses, and fledgling Bitcoin businesses around the world. All of them may have content they can usefully contribute to the process given sufficient time. Language in the proposed regulation that may draw both commercial and non-commercial software providers within its scope requires giving an even broader circle of potentially affected participants in the digital economy ample opportunity to comment.

To put our extension request in context, your office announced that it was inquiring into digital currencies in August, 2013.[1] In late November, you announced your intention to hold a hearing on digital currency and a potential **"**BitLicense**"** proposal,[2] with those hearings coming in late January.[3] With the release of the proposed regulation late last month, almost a year's work had gone into its drafting. Given the complexity of the issues, few would have faulted your office for taking even longer.

The process does not conclude with the issuance of a proposed rule, however. The second, arguably more important phase of your inquiry is to submit your proposal to the public for review. Given the complexities, it would not be inconceivable for the public comment phase of the rulemaking process to take at least as long as the initial research and drafting.

With some important, sophisticated exceptions, the Bitcoin community is not well-versed in New York financial services law or regulation. It takes time to gather the meanings of legal terms of art and to compare them with emerging technologies, processes, and business models in the Bitcoin world. The Bitcoin community will be able to more meaningfully comment with more time to consider the proposal.

Given that the initial research and drafting took New York financial regulatory experts nearly a year to produce, a comment period reaching even six months would be appropriate. Better still, you could adopt an iterative process, in which you issue drafts, take comments for three months, re-draft, and take comments again until the many, many issues raised by the proposed regulation are thoroughly vetted in true collaboration with the community.

You could match your January hearing on the questions around digital currency regulation with a hearing on the proposed solution. While eliciting needed discussion, doing so would signal to the Bitcoin community that you are serious about a collaborative effort.

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[1] New York Department of Financial Services, **"**Notice of Inquiry on Virtual Currencies,**"** August 12, 2013, see: http://www.dfs.ny.gov/about/press2013/memo1308121.pdf.

[2] New York Department of Financial Services, **"**Notice of Intent to Hold Hearing on Virtual Currencies, Including Potential NYDFS Issuance of a BitLicense,**"** http://www.dfs.ny.gov/about/press2013/virtual-currency-131114.pdf.

[2] New York Department of Financial Services, **"**Notice of Intent to Hold Hearing on Virtual Currencies, Including Potential NYDFS Issuance of a 'BitLicense,'**"** http://www.dfs.ny.gov/about/press2013/virtual-currency-131114.pdf.

[3] New York Department of Financial Services, **"**NYDFS Outlines Additional Details on Witnesses and Panels for Virtual Currency Hearing on January 28 and 29 in New York City,**"** http://www.dfs.ny.gov/about/panels_witnesses_virtual_currency_hearing.pdf.

A token deadline extension of 45 days would be welcomed by the Bitcoin community, among whom many expressed consternation at the broad sweep of the regulations and the compressed time frame for comments. But your options are far broader. A longer deadline extension, the commitment to an iterative process, and a hearing on the proposed regulation each would signal your willingness to work with the Bitcoin community on creating a workable, credible regulatory environment in New York.

**Articulate/Release the Public Interest Outcomes the Proposed Regulation Would Produce**
As you know, New York's State Administrative Procedure Act (SAPA) requires a statement of **"**needs and benefits**"** to accompany proposed regulations. Such a statement must set forth:

> the purpose of, necessity for, and benefits derived from the rule, a citation for and summary, not to exceed five hundred words, of each scientific or statistical study, report or analysis that served as the basis for the rule, an explanation of how it was used to determine the necessity for and benefits derived from the rule, and the name of the person that produced each study, report or analysis. N.Y. SAP. LAW **§** 202-a(2)(b).

The statement of needs and benefits published in the proposed regulation's SAPA notice asserts the existence of needs and benefits, but it does not articulate what they are except in gross summary. (We reproduce it here for the benefit of other readers of this comment.)

> Extensive research and analysis by the Department of Financial Services (the **"**Department**"**), including a two-day hearing held in January 2014, has made clear the need for a new and comprehensive set of regulations that address the novel aspects and risks of virtual currency. Existing laws and regulations do not cover proposed or current virtual currency business activity. The proposed regulation is therefore necessary to ensure that: (a) persons or entities engaged in virtual currency business activity operate in a safe and sound manner; (b) New York consumers and other residents are protected from the risks posed by virtual currency business activity; and (c) persons or entities engaged in new virtual currency business activity have a framework within which they can grow.

The Bitcoin community has a lot to offer in comments on the proposed regulation, but it will not be able to comment cogently unless the benefits summarized here are actually articulated in a publicly released document.

We commend to you the methodology (if not the outcome) of a July report issued by the European Banking Authority (EBA).[4] The EBA report assessed some benefits of digital currencies, and it listed and categorized the risks it perceived from digital currencies. We believe the EBA report could be improved, but it has the benefit of using a methodology—risk

[4] European Banking Authority, **"**EBA Opinion on 'Virtual Currencies,'**"** EBA/Op/2014/08 (July 2014) https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf.

management and cost-benefit—that will permit constructive engagement between the Bitcoin community and regulatory authorities in Europe.

The Bitcoin community would like to know—and could comment more helpfully if it did know—what novel aspects of digital currency your research and analysis identified. In the view of your office, what risks exist with digital currencies that don't exist with other currencies? There certainly are risks[5]—the community would benefit from understanding how your office frames them. We recommend that you publish the research and analysis referred to in the statement of needs and benefits as soon as possible, but well before the close of the first round of comments.

If you choose not to do your own public release, please treat this comment as a request under the New York Freedom of Information Law, N.Y. Pub. Off. Law sec. 84 et seq., for the opportunity to inspect or obtain copies of any risk management and cost-benefit analysis (or any other systematic assessment) that is a part of the **"**extensive research and analysis**"** referred to in the statement of needs and benefits for the proposed regulation. If there are any fees for searching or copying these records, please inform us if the cost will exceed one bitcoin. We would also like to request a waiver of all fees in that the disclosure of the requested information is in the public interest and will contribute significantly to the public's understanding of the proposed regulation. This information is not being sought for commercial purposes.

The New York Freedom of Information Law requires a response time of five business days, but we will happily toll this deadline until 15 days ahead of the current/original comment deadline. We will happily toll it further in the event of an extension of the comment deadline. Our goal is not to be burdensome, but to get for the Bitcoin community the most information we can about the proposed regulation, allowing the community to better inform you about the effects of your proposal.

If access to the records we are requesting will take longer than the amounts of time we propose above, please contact us with information about when we might expect copies or the ability to inspect the requested records. If you deny any or all of this request, please cite each specific exemption you feel justifies the refusal to release the information and notify us of the appeal procedures available to us under the law.

**Engage Creatively with the Community**

The Bitcoin Foundation can't speak for all in the Bitcoin community, of course, and views range widely, but the bulk of the community appreciates your willingness to engage with it, such as by participating in community discussion on Reddit. Given this willingness to use modern tools, the department should resist the constraints of administrative procedures

[5] Many can be inferred from our systematic assessment of risks to Bitcoin. *See* Bitcoin Foundation, **"**Removing Impediments to Bitcoin's Success: A Risk Management Study**"** (Spring 2014) https://uranus.bitcoinfoundation.org/static/2014/04/Bitcoin-Risk-Management-Study-Spring-2014.pdf.

developed in the era of postage stamps. Notice-and-comment rulemaking arose during an era when communication was cumbersome and crowdsourcing was impossible.

A truly open rulemaking would allow participation far richer than the ability to comment once or twice on draft regulations. The department could take comments and amendments, and interact with commenters, in a better organized and more interactive fashion. Shortly after the release of the proposed **"**BitLicense**"** regulation, a copy of it was placed on the News Genius web site,[6] which permits annotations of the text. There are copies of the **"**BitLicense**"** proposal on Github.[7] These tools provide decentralized administrative procedures that are appropriate for public comment, information-gathering, and language selection for any Bitcoin regulation. We are confident that the community will meet you wherever you announce you will be engaging with them.

The Bitcoin community is eager to have full participation in the department's proceeding. That participation should befit Bitcoin and digital currencies. It should be open, transparent, participatory, and collaborative. Notice-and-comment, and a 45-day comment period, are the minimum requirements of New York law. While extending the comment period to a generous, appropriate length, the Department of Financial Services should plan to iterate on the drafting of the regulation, it should make its research and analysis available to the public, and it should use modern tools to collect comments and amendments and to interact with the Bitcoin community.

Thank you very much for considering these views. We intend to file thorough and constructive comments on the substance of the proposed regulation in the near future.

Sincerely,

Jim Harper
Global Policy Counsel
The Bitcoin Foundation

[redacted]

[6] *See* **"**Proposed BitLicense Regulations,**"** News.Genius.com http://news.genius.com/New-york-department-of-financial-services-proposed-bitlicense-regulations-annotated.
[7] *See* **"**BitLicense,**"** GitHub.com https://github.com/pmlaw/BitLicense; **"**Proposed BitLicense Regulations for the State of New York,**"** Github.com https://github.com/onenameio/proposed-bitlicense-regulations; **"**BitLicense,**"** Github.com https://github.com/walne/BitLicense.

# Uniform Law Commission

**NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS**

111 N. Wabash Ave.
Suite 1010
Chicago, IL 60602
(312) 450-6600 tel
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www.uniformlaws.org




*Via Email to:*
*llew@bitcoinfoundation.org*

July 31, 2017

Mr. Llew Claasen
Executive Director
The Bitcoin Foundation, Inc.
One Ferry Building, Suite 255
San Francisco, CA 94111

Re: July 14, 2017 Letter to The National Conference of Commissioners on Uniform State Laws regarding the Uniform Regulation of Virtual Currency Business Act

Dear Mr. Claasen,

Thank you again for your comments on the Uniform Regulation of Virtual Currency Businesses Act. I write to let you know that your letter and its enclosures were made available in hard copy and electronically to all members of the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws) during consideration of the act. Your letter also is posted on our website along with other comments and letters in support of the act received before the Conference voted to approve the act. The act was approved by the Conference on Wednesday, July 19, 2017.

The act will go through a few more steps internal to the Uniform Law Commission before it is ready for enactment by the states. We expect to release the final act for enactment later this year.

As the oldest law reform organization in the United States, the ULC improves the law by providing states with non-partisan, carefully considered, and well-drafted uniform acts and model laws that bring clarity and stability to critical areas of the law. Throughout the drafting process, the ULC receives input from knowledgeable observers and experts in relevant fields of law.

We appreciate your interest in our work.

Sincerely,

Liza I. Karsai
Executive Director
Uniform Law Commission

The Ciric Law Firm, PLLC 17A Stuyvesant Oval, New York, NY 10009

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July 7, 2017

Liza Karsai
Executive Director
The National Conference of Commissioners on Uniform State Laws
111 N. Wabash Avenue
Suite 1010
Chicago, Illinois 60602
Email: lkarsai@uniformlaws.org
Phone: (312) 450-6604

Dear Ms. Karsai:

The National Conference of Commissioners on Uniform State Laws, its leadership, as well as its Executive Committee ("you") are hereby notified that the Ciric Law Firm, PLLC represents Theo Chino, a New York resident, in connection with the case *Chino vs. NY Dept. Financial Services* ("NYDFS") (Index No. 0101880-2015) challenging the controversial "Virtual Currency" regulation (Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations), also known as BitLicense, promulgated by NYDFS in August 2015. A copy of a recently filed Amended Complaint dated May 29, 2017 is attached to this letter as Exhibit A for your review.

On behalf of our client, this letter is submitted to the National Conference of Commissioners on Uniform State Laws (hereinafter "ULC") regarding the proposed uniform statute titled "Uniform Regulation of Virtual Currency Businesses Act" (available at http://www.uniformlaws.org/shared/docs/regulation%20of%20virtual%20currencies/2017AM_VirtualCurrencyBus_Draft.pdf) (hereinafter "Proposed Statute").

Because this Proposed Statute raises a number of significant legal and policy concerns, which are described below, we ask, on behalf of our client, that you seek from the Drafting Committee on Uniform Regulation of Virtual Currency Business Act that the Proposed Statute be withdrawn from further consideration and from any further vote or adoption at the July 14-July 20, 2017 San Diego meeting.

1. **It is neither desirable nor practicable for ULC to propose a model act when many states have drastically different legal views on the topic at hand, here "virtual currency."**

The process designed by ULC has been highly successful and beneficial to the law when the legal issues involved are sufficiently stable and generate sufficient consensus amongst the legal community, allowing ULC, in these circumstances, "to promote uniformity in the law among the several States on subjects as to which uniformity is desirable and practicable" (Constitution of the National Conference of Commissioners on Uniform State Laws, § 1.2).

However, based on the reasons below, it is clear that it would be neither desirable, nor practicable for the Drafting Committee on Uniform Regulation of Virtual Currency Business Act to move forward with the Proposed Statute.

Because a number of states have already taken conflicting positions on both the economic nature of "virtual currencies" such as Bitcoin, as well as on the legal approach to regulate such a new technology, continuing any work on the Model Statute would be ill advised.

First, states have already taken very different legislative approaches regarding "virtual currencies." California has already attempted to introduce legislation twice before withdrawing such attempts due to concerns about potential impacts on new technology start-ups. Additionally, Washington already enacted the Uniform Money Services Act regulating virtual currency as a money transmission. Other states, such as Georgia, New Jersey, North Carolina and Pennsylvania have already passed legislation that correct ambiguities in money transmission law in order to create certainty for innovators. Finally, on June 2, 2017, New Hampshire enacted a statute exempting digital currency traders from the state's money transmission regulations.

Second, it can hardly be said that an agreed-upon definition of "virtual currency" exists, let alone a clear definition of its economic nature. States, as indicated above, have indeed taken opposing views as to the economic nature of Bitcoin in their legislative approaches. Furthermore, widespread conflicts regarding the economic nature of Bitcoin exist across a number of state and federal courts. See *Florida v. Espinoza*, No. F14-2923 at 6 (Fla. 11th Cir. Ct. July 22, 2016) (concluding that "it is very clear, even to someone with limited knowledge in the area, that Bitcoin has a long way to go before it is the equivalent of money" most notably because it is not accepted by all merchants, the value fluctuates significantly, there is a lack of a stabilization mechanism, they have limited ability to act as a store of value, and Bitcoin is a decentralized system.). See also *United States v. Petix*, No. 15-CR-227A 2016 U.S. Dist. LEXIS 165955 (W.D.N.Y., Dec. 1, 2016).

Finally, significant disagreement exists amongst various federal agencies, such as the CFTC or the IRS as to the economic nature of Bitcoin. *See In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3 (Sept. 17, 2015). *See also* Notice 2014-21, IRS, https://www.irs.gov/pub/irs-drop/n-14- 21.pdf (recognizing that bitcoins "[do] not have legal tender status in any jurisdiction").

Therefore, any further push of the Proposed Statute by ULC would necessarily result in unnecessary conflicts or push-backs for states that have already adopted a position as to a certain

legislative approach and an economic definition of "virtual currencies" which may differ with the assumptions of the Proposed Statute. In states where no definite position would have been adopted, the Proposed Statute will trigger significant lobbying from various constituents, including those with views opposing the Proposed Statute.

2. **Further consideration of the Proposed Statute would inject significant legal uncertainty because its initial framework is subject to a legal challenge in the foreseeable future**

The Proposed Statute's initial framework is based upon the controversial "Virtual Currency" regulation (Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations), also known as BitLicense, promulgated by NYDFS in August 2015.

The court challenge against the Bitlicense, known as an Article 78 proceeding in New York State courts, presents arguments which create significant legal uncertainties and concerns for any state interested in adopting the Proposed Statute.

As explained in the attached Amended Complaint, elevating the Bitlicense as a model statute would raise significant concerns as to the true economic nature of "virtual currencies" such as Bitcoin. Furthermore, such a model statute, if adopted by a legislature, would raise federal law preemption and first amendment concerns similar to those raised by client in New York, even if certain aspects of the Bitlicense have been amended in the Proposed Statute.

Because Article 78 proceedings typically get reviewed by multiple appellate jurisdictions, such a legal uncertainty is unlikely to be resolved in the near future. Such legal uncertainty would be a major concern for any state considering the Proposed Statute.

Because of the reasons stated above, we respectfully request, on behalf of our client, that you seek from the Drafting Committee on Uniform Regulation of Virtual Currency Business Act that the Proposed Statute be withdrawn from further consideration and from any further vote or adoption at the July 14-July 20, 2017 San Diego meeting.

If you have any questions please let me know.

Sincerely yours,

Pierre Ciric
Member of the Firm

Cc: Richard T. Cassidy
Rich Cassidy Law, P.C.
Suite D5
(Pierson House)
1233 Shelbourne Road
South Burlington, VT 05403
Phone: 802-864-8144
Email: matt@richcassidylaw.com

# EXHIBIT “A”

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

| | |
|---|---|
| THEO CHINO and CHINO LTD,<br><br>Plaintiffs-Petitioners,<br><br>-against-<br><br>THE NEW YORK DEPARTMENT OF FINANCIAL SERVICES and MARIA T. VULLO, in her official capacity as the Superintendent of the New York Department of Financial Services,<br><br>Defendants-Respondents. | Index No. 101880/2015<br>Hon. Lucy Billings<br><br>**AMENDED VERIFIED COMPLAINT AND ARTICLE 78 PETITION**<br><br>**ORAL ARGUMENT REQUESTED** |

Plaintiffs-Petitioners Theo Chino and Chino LTD, by and through their attorney, Pierre Ciric, with the Ciric Law Firm, PLLC, upon information and belief, alleges the following against the New York Department of Financial Services ("NYDFS") and Maria T. Vullo, in her official capacity as the Superintendent of NYDFS:

## PRELIMINARY STATEMENT

1. This case is about the "Virtual Currency" regulation promulgated by NYDFS at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (cited as "NYCRR") (the "Regulation"). The effective date of the regulation was June 24, 2015.

2. On November 19, 2013, Theo Chino incorporated Chino LTD. The original purpose of Chino LTD was to install Bitcoin processing services in the State of New York.

3. On December 31, 2014, Theo Chino co-founded Conglomerate Business Consultants, Inc. ("CBC"). CBC entered into formal contracts with seven bodegas in New York to offer Bitcoin processing services provided by Chino, LTD through the resale of calling cards by the bodegas to their customers. Theo Chino's goal was to secure long-term and stable

commercial relationships with the bodegas using CBC's calling cards. Once those relationships were established, bodegas would be able to offer the use of Bitcoin as a settlement method for regular items sold by bodegas (milk, food, etc.). At all times, Chino LTD was providing Bitcoin processing services to CBC and to the bodegas for transactions involving both calling card and regular items.

4. While CBC was a distributor of the Bitcoin processing service directly to bodegas, Chino LTD provided the actual processing services.

5. As required under NYCRR § 200.21, Theo Chino, on behalf of Chino LTD, submitted an application for license on August 7, 2015 to engage in Virtual Currency Business Activity, as defined in 23 NYCRR § 200.2(q).

6. While the application was pending, Theo Chino filed pro se his first complaint/petition on October 16, 2015 because he realized that the Regulation would impose significant costs to run his business and because the deadline to challenge the Regulation, 4 months after the effective date, October 24, 2015, was nearing.

7. On January 4, 2016, NYDFS returned Chino LTD's application without further processing after they performed an initial review. The stated reason for returning the application was that NYDFS was unable to evaluate whether the company's current or planned business activity would be considered Virtual Currency Business Activity that requires licensing under the New York Financial Services Law and regulations.

8. On January 4, 2016, CBC stopped offering Bitcoin processing services when NYDFS did not approve Chino LTD's application.

9. NYDFS acted beyond the scope of its authority when it promulgated the Regulation because NYDFS is only authorized to regulate "financial products and services", but

Bitcoin lacks the characteristic of a financial product or service, and, in the absence of an explicit legislative authorization, NYDFS is not authorized to regulate it.

10. During hearings held by NYDFS on the topic of virtual currency on January 28 and January 29, 2014 in New York City, Mark T. Williams, member of the Finance & Economics Faculty at Boston University, was the only witness present at the hearings who introduced in the written record direct testimony as to the economic nature of Bitcoin. His testimony establishes that Bitcoin is not a currency, but instead should be treated as a commodity. New York State Department of Financial Services Hearings on the Regulation of Virtual Currency (2014)(statement of Mark T. Williams, Member of the Finance & Economics Faculty, Boston University), http://www.dfs.ny.gov/about/hearings/vc_01282014/williams.pdf.

11. NYDFS does not have the authority to imply additional terms to a statute. If the legislature wanted NYDFS to regulate Bitcoin or other so-called "cryptocurrencies," it would have included it in the definition of "financial product or service".

12. The Regulation is preempted by federal law because under the Dodd-Frank Act, State consumer financial laws are preempted if the State law "is preempted by a provision of Federal law other than title 62 of the Revised Statutes." 12 U.S.C. § 25b(b)(1)(C).

13. The Regulation is arbitrary and capricious because: (1) the scope of the Regulation is irrationally broad, (2) the Regulation's recordkeeping requirements are without sound basis in reason, (3) the Regulation irrationally treats virtual currency transmitters differently than fiat currency transmitters, and (4) there is no rational basis underlying a one-size-fits all Regulation that unreasonably prevents startups and small businesses from participating in Virtual Currency Business Activity, and imposes capital requirements on *all* licensees.

14. The Regulation violated the First Amendment of the U.S. Constitution and the New York Constitution under the compelled commercial speech and the restricted commercial speech doctrines because some of the required disclosures under the Regulation are forcing Plaintiffs-Petitioners to make false assertions to customers, or overly broad or unduly burdensome statements to their customers.

## PARTIES

15. Plaintiff-Petitioner Chino LTD is a Delaware Sub S-corporation, authorized to do business in New York. Chino LTD's principal place of business is located at 640 Riverside Drive, Apt 10B, New York, NY 10031, in New York County.

16. Plaintiff-Petitioner Theo Chino is a New York State resident, residing at 640 Riverside Drive, Apt 10B, New York, NY 10031, in New York County. He is the owner of Chino LTD.

17. Defendant-Respondent the New York Department of Financial Services is an agency of the State of New York charged with the enforcement of banking, insurance, and financial services law. N.Y. Fin. Serv. Law (cited as "FSL") § 102. NYDFS's principal place of business is located at 1 State St, New York, NY 10004, in New York County.

18. Defendant-Respondent Maria T. Vullo is the Superintendent of NYDFS. The Superintendent is head of NYDFS. FSL § 202. Maria T. Vullo's principal place of business is located at 1 State St, New York, NY 10004, in New York County.

## JURISDICTION AND VENUE

19. This Court has subject matter jurisdiction to decide this Petition pursuant to CPLR § 7803 because the body or officer, here Defendant-Respondents, proceeded in excess of jurisdiction, because the Regulation promulgated by Defendants-Respondents is a final

determination made in violation of lawful procedure, affected by an error of law, and is arbitrary and capricious.

20. This Court has subject matter jurisdiction to render a declaratory judgment pursuant to CPLR § 3001.

21. This Court has personal jurisdiction over Defendants-Respondents pursuant to CPLR § 301.

22. Venue properly lies in the County of New York pursuant to CPLR §§ 503(a), 505(a), 506(a), 506(b), and 7804(b), as the parties reside in the County of New York, as Defendants-Respondents' principal office is located in the County of New York, as Defendants-Respondents made the determination at issue in the County of New York, as material events took place in the County of New York, and as claims are asserted against officers whose principal offices are in New York County.

## FACTUAL BACKGROUND

### Bitcoin

23. Bitcoin was collaboratively developed by an independent community of Internet programmers without any financial backing from any government.

24. Bitcoin is the result of transparent mathematical formulas, which lack the attributes of traditional financial products or transactions.

25. Bitcoin consists of four different components: (1) a decentralized peer-to peer network (the bitcoin protocol), (2) a public transaction ledger (the blockchain), (3) a decentralized mathematical algorithm, and (4) a decentralized verification system (transaction script). Andreas M. Antonopoulos, MASTERING BITCOIN: UNLOCKING DIGITAL CRYPTOCURRENCIES (2014).

26. Bitcoins are created through the computation of a mathematical algorithm through a process called "mining," which involves competing to find solutions to a mathematical problem while processing bitcoin transactions. *Id.* Anyone in the Bitcoin network may operate as a "miner" by using their computer to verify and record transactions. *Id.* The bitcoin protocol includes built-in algorithms that regulate this mining function across the network. *Id.* The protocol limits the total number of bitcoins that will be created. *Id.* Once bitcoins are created, they are used for bartering transactions using the blockchain technology. *Id.* This technology relies on data "blocks," which are "a group of transactions, marked with a timestamp, and a fingerprint of the previous block." *Id.* A blockchain is "[a] list of validated block, each linking to its predecessor all the way to the genesis block." *Id.* The genesis block is "[t]he first block in the blockchain, used to initialize the cryptocurrency, and the universe of bitcoin transactions in capped at 21 million. *Id.*

27. As with traditional commodities, like crude oil and gold, the value of Bitcoin is highly volatile and dependent upon supply and demand. Like gold, bitcoins are a finite resource. "[O]nly 21 million bitcoins will ever be created." *Frequently Asked Questions*, BITCOIN, https://bitcoin.org/en/faq#is-bitcoin-a-bubble (last visited Aug. 16, 2016).

28. Furthermore, acquiring Bitcoin is analogous to acquiring other commodities. A person who wishes to obtain a commodity, like gold, for example, can either purchase gold on the market or can mine the gold himself. Similarly, a person who wishes to obtain bitcoins can either purchase them on the market or "mine" them himself through participation in Bitcoin's transaction verification process. *See* Stephen T. Middlebrook & Sarah Jane Hughes, *Regulating Cryptocurrencies in the United States: Current Issues and Future Directions*, 40 WM. MITCHELL L. REV. 813, 818 (2014).

29. Bitcoin is not money, and because currencies are representations of money, Bitcoin is not a true currency. *See* Leo Haviland, WORD ON THE STREET: LANGUAGE AND THE AMERICAN DREAM ON WALL STREET 294 (2011); *In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3 (Sept. 17, 2015).

30. True currencies, unlike Bitcoin, "are designated legal tender, [that] circulate and are customarily used and accepted as a medium of exchange in the country of issuance." *In re Coinflip, Inc.* at 3; s*ee also* Notice 2014-21, IRS, https://www.irs.gov/pub/irs-drop/n-14- 21.pdf (recognizing that bitcoins "[do] not have legal tender status in any jurisdiction").

31. Unlike true currencies, Bitcoin is neither widely accepted as mediums of exchange nor a stable store of value, nor issued by a government. Dominic Wilson & Jose Ursua, *Is Bitcoin a Currency?,* 21 GOLDMAN SACHS: TOP OF MIND 6, 6 (2014), http://www.paymentlawadvisor.com/files/2014/01/GoldmanSachs-Bit-Coin.pdf; *See Model State Consumer and Investor Guidance on Virtual Currency*, CONFERENCE OF STATE BANK SUPERVISORS (Apr. 23, 2014), http://www.ncsl.org/documents/summit/summit2014/onlineresources/ModelConsumerGuidance--VirtualCurrencies.pdf; *Virtual Currency: Risks and Regulation*, THE CLEARING HOUSE at 17 (June 23, 2014), https://www.theclearinghouse.org/issues/articles/2014/06/20140623-tch-icba-virtual-currency-paper.

32. In the case *US v. Petix*, Case No. 15-CR-227, currently in the United States District Court, Western District of New York, Magistrate Judge Scott, in his Report and Recommendation dated December 1, 2016, gave a detailed analysis concluding that Bitcoin is not money or funds under 18 U.S.C. § 1960, a federal statute prohibiting unlicensed money transmitting businesses. Magistrate Judge Scott noted that money and funds must involve a

sovereign: "'[m]oney,' in its common use, is some kind of financial instrument or medium of exchange that is assessed value, made uniform, regulated, and protected by *sovereign power.*" (Citation omitted). "Bitcoin is not 'money' as people ordinary understand the term." "Like marbles, Beanie Babies™, or Pokémon™ trading cards, bitcoins have value exclusively to the extent that people at any given time choose privately to assign them value. No governmental mechanisms assist with valuation or price stabilization, which likely explains why Bitcoin value fluctuates much more than that of the typical government-backed fiat currency." *United States v. Petix*, 2016 U.S. Dist. LEXIS 165955 (W.D.N.Y., Dec. 1, 2016, No. 15-CR-227A).

33. Similarly, because Bitcoin is not issued by a government, no entity is required to accept it as payment. Karl Whelan, *How is Bitcoin Different from the Dollar?*, FORBES (Nov. 19, 2013), http://www.forbes.com/sites/karlwhelan/2013/11/19/how-is-bitcoin-different-from-the-dollar/#68c676c86d34.

34. Moreover, while currencies are generally secured by a commodity or a government's ability to tax and defend, Bitcoin is not safeguarded by either. Jonathon Shieber, *Goldman Sachs: Bitcoin Is Not A Currency,* TECHCRUNCH (Mar. 12, 2014), https://techcrunch.com/2014/03/12/goldman-sachs-bitcoin-is-not-a-currency/.

35. Bitcoin lacks the characteristics of a true currency and therefore lacks the characteristics associated with a financial product.

**Regulation**

36. The New York Legislature has authorized NYDFS to regulate *financial* products and services. However, NYDFS promulgated a Regulation that monitors and controls non-financial products and services.

37. Bitcoin is considered a "virtual currency" for purpose of the Regulation.

38. The Regulation requires those engaged in "virtual currency business activity" that involves New York or New York residents to obtain a license. 23 NYCRR §§ 200.2(q), 200.3(a).

39. Applying for the license under the Regulation requires a non-refundable $5,000 application fee. 23 NYCRR § 200.5.

40. It has been reported that companies spent between $50,000 and $100,000 applying for a license under the Regulation. Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/. These companies are then required to shell out even more money every year to continue complying with the Regulation.

41. According to the Regulation, the same requirements apply to all virtual currency transactions, regardless of whether 1-cent worth or thousands of dollars' worth is being transacted.

42. The Regulation requires licensees to maintain a capital requirement as determined by the Superintendent. 23 NYCRR § 200.8.

43. Further, the fundamental protocol used to conduct most Internet activity falls within the Regulation's definition of "Virtual Currency".

44. Subject to three narrow exceptions, "Virtual Currency" means "*any* type of digital unit that is used as a medium of exchange or a form of digitally stored value." 23 NYCRR § 200.2(p) (emphasis added). Furthermore, 23 NYCRR § 200.2(p) mandates that this definition be "broadly construed." *Id.* Given this instruction and the Regulation's failure to define "digital unit" or "medium of exchange," nearly all Internet activity could be interpreted under the Regulation to involve virtual currency.

45. Transmission Control Protocol/Internet Protocol (TCP/IP) allows computers to

communicate over the Internet. Lawrence B. Solum & Minn Chung, *The Layers Principle: Internet Architecture and the Law*, 79 NOTRE DAME L. REV. 815, 821 (2004). People engage the TCP/IP protocol to send emails, visit websites, or download music. John Gallaugher, *12.3, Get Where You're Going*, A MANAGER'S GUIDE TO THE INTERNET AND TELECOMMUNICATIONS (2012), http://2012books.lardbucket.org/books/getting-the-most-out-of- information-systems-v1.3/s16-a-manager-s-guide-to-the-inter.html; Nick Parlante, *How Email Works*, STANFORD UNIV., https://web.stanford.edu/class/cs101/network-4-email.html (last visited Oct. 25, 2016). The TCP/IP system takes data, divides it into packets, and then bounces those packets from the starting point to the final destination. LAWRENCE LESSIG, CODE 43 (2nd ed. 2006). A TCP/IP packet is "the smallest unit of transmitted information over the Internet," and is thus a "digital unit." *See* Roberto Sanchez, *What is TCP/IP and How Does It Make the Internet Work?*, HOSTINGADVICE.COM (Nov. 17, 2015), http://www.hostingadvice.com/blog/tcpip-make-internet-work/; *Digital*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/digital (last accessed Oct. 25, 2016) (defining "digital" as "using or characterized by computer technology"). TCP/IP packets are also "the exchange medium used by processes to send and receive data through Internet networks." *TCP/IP Terminology*, IBM KNOWLEDGE CENTER, https://www.ibm.com/support/knowledgecenter/ssw_aix_71/com.ibm.aix.networkcomm/tcpip_terms.htm (last visited Oct. 25, 2016). Accordingly, a TCP/IP packet, which is a "digital unit," is used "as a medium of exchange," and thus falls within the Regulation's definition of "virtual currency". *See* 23 NYCRR § 200.2(p). This means that when people engage in Internet activity, they almost always use "virtual currency", as it is defined in the Regulation, to do so, rendering such activity potentially subject to the Regulation.

46. NYDFS intended to regulate financial intermediaries in so-called

"cryptocurrencies." Nermin Hajdarbegovic, *Lawsky: Bitcoin Developers and Miners Exempt from BitLicense*, COINDESK (Oct. 15, 2014), http://www.coindesk.com/lawsky-bitcoin-developers-miners-exempt-bitlicense/ (noting that the Superintendent clarified, "[w]e are regulating financial intermediaries . . . we do not intend to regulate software or software development"). Many cryptocurrencies, like Bitcoin, are blockchain technologies. *E.g.* Steven Norton, *CIO Explainer: What is Blockchain?*, WALL ST. J. (Feb. 2, 2016), http://blogs.wsj.com/cio/2016/02/02/cio-explainer-what-is-blockchain/. Blockchains are essentially public ledgers that record users' entries. *Id.* For example, when a person exchanges a bitcoin, or a fraction thereof, the transaction is recorded on the Bitcoin blockchain. *See How Does Bitcoin Work?*, BITCOIN, https://bitcoin.org/en/how-it-works (last visited Oct. 25, 2016). Blockchain technologies fall within the Virtual Currency definition because they can be used as a medium or exchange or a form of digitally stored value. *See* 23 NYCRR § 200.2(p). Even non-financial uses of blockchain technology fall within the Regulation's definition of "virtual currency" because, to participate in blockchain technology, a user engages "digital unit[s]," that [are] "used as medium[s] of exchange." It is digital units, like bitcoins, that carry value, and "even non-financial uses require a de minimis amount of currency," a "medium of exchange." *See* 23 NYCRR § 200.2(p); Trevor I. Kiviat, Note, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 DUKE L.J. 569, 591, 597 (2016); Jeffrey A. Tucker, *What Gave Bitcoin Its Value?*, FOUND. FOR ECON. EDUC. (Aug. 27, 2014), https://fee.org/articles/what-gave-bitcoin-its- value/. Because blockchain technologies fall within the Regulation's definition of "virtual currency", they are potentially subject to the Regulation. *See* 23 NYCRR §§ 200.2(p)(q)-200.3. Blockchain technologies, however, are not inherently financial. *See* Luke Parker, *Ten Companies Using the Blockchain for Non-Financial Innovation*, BRAVE NEW COIN (Dec. 20,

2015), http://bravenewcoin.com/news/ten-companies-using-the-blockchain- for-non-financial-innovation/. People can, and do use blockchain technologies to engage in a slew of non-financially related activities. *See*, *e.g. id.* Artists use blockchain technology to assert ownership over their works, insurers use blockchain technology to track diamonds, and people use blockchain technology to timestamp documents and photos. *See id.* Additionally, people can use blockchain technology to cast votes, send messages, or enter into contracts. *See Blockchain Technology in Online Voting*, FOLLOW MY VOTE, https://followmyvote.com/online-voting-technology/blockchain-technology/; Naomi O'Leary, *British Traders Have Discovered Bitcoin*, BUS. INSIDER (Apr. 2, 2012), http://www.businessinsider.com/british-traders-have-discovered-bitcoin-2012-4 (noting that the first Bitcoin transaction was used to send a political message); Nik Custodio, *Explain Bitcoin Like I'm Five*, MEDIUM (Dec. 12, 2013), https://medium.com/@nik5ter/explain-bitcoin-like-im- five-73b4257ac833#.ri7s32qfb. Yet, the definition of "virtual currency" does not exclude or otherwise exempt these non- financial uses of blockchain technology, rendering such uses potentially subject to the Regulation. *See* 23 NYCRR § 200.2(p).

47. Five categories of activities qualify as Virtual Currency Business Activities. *See* 23 NYCRR §§ 200.2(q), 200.3. Each category is defined by terms that have a broad range of meanings, and that encompass numerous activities that are entirely unrelated to financial exchanges, services, or products. Furthermore, only one category of activities exempts non-financial uses. *See* 23 NYCRR § 200.2(q).

48. The Regulation requires anyone engaged in "storing, holding or maintaining custody or control of Virtual Currency on behalf of others" to obtain a License and comply with the Regulation. 23 NYCRR § 200.2(q)(2). However, the Regulation fails to clarify what

activities qualify as "storing," "holding," or "maintaining custody or control" of Virtual Currency. *See* 23 NYCRR §§ 200.1-200.22. Thus, if a New York citizen established a trust, designated himself as trustee, and funded the trust with his own bitcoins, he would arguably be required to obtain a license, because, as a trustee, he could be interpreted as "holding... Virtual Currency on behalf of others," in this case, the beneficiaries of the trust. Likewise, a bitcoin owner's fiancée would not legally be allowed to hold her fiancé's Bitcoin wallet for safekeeping unless she first obtained a license, because in safekeeping his Bitcoin wallet, she would arguably be "holding...Virtual Currency on behalf of others."

49. The Regulation also requires anyone "controlling... a Virtual Currency" to obtain a license. The Department did not define "controlling," leaving room for expansive interpretation. *See* 23 NYCRR §§ 200.1-200.22. Arguably, any Bitcoin owner with a tenuous relationship to New York is subject to the Regulation. A Bitcoin owner "controls" a Virtual Currency, regardless of whether that Bitcoin owner uses bitcoins as financial instruments. This means that someone wishing to cast a vote using bitcoins, exercise his freedom of speech using bitcoins, or create digital art using bitcoins would arguably be required to obtain a license and comply with the Regulation in order to do so.

50. The Regulation requires most actors engaged in "controlling, administering, or issuing a Virtual Currency" to obtain a license and abide by minimum capital requirements, even if such "controlling, administering, or issuing" has no tie to the financial sector. *See* 23 NYCRR §§ 200.2(p), 200.2(q)(4), 200.3, 200.8. Furthermore, the blanket Regulation subjects those engaged in "[t]ransmitting Virtual Currency" to minimum capital requirements unless "the transaction is undertaken for non-financial purposes *and* does not involve the transfer of more than a nominal amount of Virtual Currency." 23 NYCRR §§ 200.2(q)(1), 200.3, 200.8 (emphasis

added). Therefore, a father who wishes to give his daughter one bitcoin for her birthday would be transmitting a non-nominal amount of Virtual Currency, and would thus be required to obtain a license and abide by minimum capital requirements in order to do so.

51. The Regulation requires Licensees to: (1) record "each transaction, the amount, date, and precise time of the transaction... the names, account numbers, and physical addresses of (i) the party or parties to the transaction that are customers or accountholders of the Licensee; and (ii) to the extent practicable, any other parties to the transaction," and (2) maintain those records "for at least seven years." 23 NYCRR § 200.12(a). These extensive and onerous requirements apply to *all* virtual currency transactions, regardless of whether, for example, a Satoshi, worth less than 1 cent, is being transacted, or 100 bitcoins, worth approximately $56,944, are being transacted. *See id*. A Licensee could foreseeably be forced to spend more money to make and retain records than the transaction itself is worth.

52. The Regulation's anti-money laundering provisions are inconsistent with NYDFS's preexisting anti-money laundering regulations. NYDFS has imposed stringent anti-money laundering requirements upon Virtual Currency businesses that it has not imposed on fiat currency transmitters. *See* 23 NYCRR § 200.15; 3 NYCRR § 416.1.

53. NYDFS requires money transmitters to comply with federal anti-money laundering laws. 3 NYCRR § 416.1. The Regulation, however, requires virtual currency transmitters to comply with anti-money laundering requirements that go beyond those required under federal law. *See* 23 NYCRR § 200.15.

54. The Regulation requires Licensees to file Suspicious Activity Reports ("SAR") even if they would not be required to do so under federal law. 23 NYCRR § 200.15(e)(3)(ii). Furthermore, this provision subjects such firms to potential liability for submitting SARs because

though the federal SAR requirements include a safe harbor provision that extends immunity to disclosing institutions, the Regulation does not contain a comparable provision. 31 U.S.C. § 5318(g)(3); 23 NYCRR § 200.15. Thus, under NYDFS's regulatory scheme, a money transmitter dealing in fiat currency that is not required to file SARs would be required to file SARs if that transmitter wished to engage in Virtual Currency transmission. *See* 23 NYCRR § 200.15(e)(3)(ii).

55. Additionally, the Regulation requires Licensees to retain all records related to their anti- money laundering programs for at least seven years. 23 NYCRR § 200.12(a). By contrast, fiat currency transmitters are only required to retain such records for five years. 3 NYCRR § 416.1(b)(2)(i) (requiring licensees to retain records in accordance with 31 CFR § 103); 31 CFR § 1010.430(d) (formerly at 31 CFR § 103.38(d); requiring licensees to retain records for five years).

56. A number of other requirements imposed on Virtual Currency business are not imposed on other money transmitters, such as keeping records on all transactions, including the identity and physical address of the parties, 23 NYCRR § 200.15(e)(1)(i); reporting and notifying transactions exceeding $10,000 in an aggregate amount, 23 NYCRR § 200.15(e)(2); or complying with a Cyber Security Program, including staffing and reporting requirements, 23 NYCRR § 200.16.

57. Superintendent Benjamin Lawsky publically admitted that the rationale for these different rules not imposed on other institutions was to test them as "models for our regulated banks and insurance companies," and not as a genuine response to a pressing regulatory need. Superintendent Benjamin M. Lawsky, Address at Benjamin N. Cardozo School of Law (Oct. 14, 2014), at page 2 (transcript available at

http://web.archive.org/web/20150702103620/http://www.dfs.ny.gov/about/speeches_testimony/sp141014.htm).

58. The Regulation is an untailored blanket regulation that fails to consider that not all virtual currency businesses are equally situated, and it irrationally imposes capital requirements on all Licensees.

59. The Regulation has a severe disparate impact on startups and small businesses, which do not have access to the funds and resources the Regulation requires. The cost of applying for a License is exorbitant. *See* 23 NYCRR § 200.5 (requiring a non-refundable $5,000 application fee); Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/. Furthermore, the costs of staying in compliance with the Regulation, if granted a License, are unwarranted and potentially excessive. Licensees are required to "maintain at all times such capital in an amount and form as the superintendent determines is sufficient." 23 NYCRR § 200.8(a). This vague, open-ended requirement is likely to unreasonably impede cash-strapped startups and small businesses from being able to engage in Virtual Currency Business Activity. The Regulation's requirement that Licensees "maintain a surety bond or trust account... in such a form and amount as is acceptable to the superintendent" is similarly prone to effectively prohibit underfunded startups and small businesses from engaging in Virtual Currency related business. *See* 23 NYCRR § 200.9(a).

60. The tech industry is an increasingly important piece of New York's economy, and digital currency is a prominent emerging technology. *See The New York City Tech Ecosystem*, HR&A ADVISORS (Mar. 2014), http://www.hraadvisors.com/wp-content/uploads/2014/03/NYC_Tech_Ecosystem_032614_WEB.pdf; Brian Forde, *How to*

*Prevent New York from Becoming the Bitcoin Backwater of the U.S.*, MEDIUM (May 12, 2015), https://medium.com/mit-media-lab-digital-currency-initiative/how-to-prevent-new-york-from-becoming-the-bitcoin-backwater-of-the-u-s-931505a54560#.u05t446p2. Startups are essential to technological innovation and growth, and in 2015, New York City was recognized as being one of the top startup ecosystems in the world. Richard Florida, *The World's Leading Startup Cities*, CITYLAB (July 27, 2015), http://www.citylab.com/tech/2015/07/the-worlds-leading-startup-cities/399623/; Emily Edwards, *Financial Technology Startups Are Bringing Underbanked Into the Economy*, MEDIUM (May 16. 2016), https://medium.com/village-capital/financial-technology-startups-are-bringing-the- underbanked-into-the-economy-24978561b9ea#.635lp86ks. However, the Regulation has transformed this once welcoming New York landscape into an inhospitable environment for digital currency-related startups. Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/.

61. When Superintendent Lawsky announced the final version of the Regulation, he said: "we should not react so harshly that we doom promising new technologies before they get out of the cradle." Ben Lawsky, *The Final NYDFS BitLicense Framework*, MEDIUM (June 3, 2015), https://medium.com/@BenLawsky/the-final-nydfs-bitlicense-framework-d4e333588f04#.akxneegmv. Yet the Regulation has done just that. The Regulation has effectively forced digital currency-related startups to relocate outside New York and to otherwise severe ties with New York citizens. *See, e.g.*, Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/. The Regulation is unjustifiably burdensome on startups and small companies, and has in many instances left businesses with no other option than to flee and

otherwise abandon New York. *See id.*; *BitLicense Restrictions for New York Customers*, BITFINEX (Aug. 7, 2015), https://www.bitfinex.com/posts/51.

62. Between November 2014 and June 2015, Theo Chino filed five Freedom of Information Law ("FOIL") requests to understand NYDFS's process for framing the Regulation. Indeed, as required under New York State's Administrative Procedure Act, Defendant-Respondent referred to, in the statement of "needs and benefits" published with the proposed regulation, an "extensive research and analysis" performed to prepare the Regulation.

63. Theo Chino did not receive any of the requested information. Instead, NYDFS said they did not have any of the records requested or that NYDFS is in possession of some of the records requests but the records have not been provided because they are exempt from disclosure.

64. A similar FOIL was submitted by Jim Harper, then Global Policy Counsel at the Bitcoin Foundation, a not-for-profit organization dedicated to the advancement of Bitcoin, to Defendants-Respondents on August 5, 2014, to which he never received any response.

**Other States, Agencies, and Jurisdictions**

65. Bitcoin is akin to commodity-like mediums of exchange. This view is consistent with the positions taken by the IRS and the Commodity Future Trading Commission (CFTC).

66. The IRS has concluded that bitcoins are property, not currency for tax purposes. Notice 2014-21, IRS, https://www.irs.gov/pub/irs-drop/n-14-21.pdf.

67. Texas and Kansas have taken the position that Bitcoin is not money and issued memorandum stating this. Tex. Dep't of Banking, Supervisory Memorandum 1037, Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act 2-3 (Apr. 3, 2014), http://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf; Kan. Office

of the State Bank Commissioner Guidance Document, MT 2014-01, Regulatory Treatment of Virtual Currencies Under the Kansas Money Transmitter Act 2-3 (June 6, 2014), http://www.osbckansas.org/mt/guidance/mt2014_01_virtual_currency.pdf.

68. California has tried twice to use the legislative process to pass a bill regulating virtual currency. California introduced AB-1326 to regulate virtual currency business on February 27, 2015. A.B. 1326, 2015-2016 Reg. Sess. (Cal. 2015), History, https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=201520160AB1326. The bill was ordered to become an inactive file on September 11, 2015 at the request of Senator Mitchell. *Id.* The bill was reintroduced on August 8, 2016. *Id.* On August 15, 2016, Assembly member Matt Dababneh withdrew the bill from consideration. Aaron Mackey, *California Lawmaker Pulls Digital Currency Bill After EFF Opposition,* ELEC. FRONTIER FOUND. (Aug. 18, 2016), https://www.eff.org/deeplinks/2016/08/california- lawmaker-pulls-digital-currency-bill-after-eff-opposition.

69. New Hampshire's House of Representatives passed HB 436, which seeks to exempt virtual currency users from having to register as money service businesses. Rebecca Campbell, *New Hampshire's Bill to Deregulate Bitcoin Passes House,* CryptoCoinsNews (Mar. 11, 2017), https://www.cryptocoinsnews.com/new-hampshires-bill-deregulate-bitcoin-passes-house/.

70. In Texas, a constitutional amendment was proposed, Texas House Joint Resolution 89, which would protect the right to own and use digital currencies like Bitcoin in Texas. Stan Higgins, *Texas Lawmaker Proposes Constitutional Right to Own Bitcoin,* COINDESK (Mar. 3, 2017), http://www.coindesk.com/texas-lawmaker-proposes-constitutional-right-bitcoin/. The constitutional amendment would prevent any government effort to interfere with that use or

ownership of digital currencies like Bitcoin. *Id.*

71. A Florida court recently ruled that Bitcoin is not money. *Florida v. Espinoza*, No. F14-2923 at 6 (Fla. 11th Cir. Ct. July 22, 2016) (concluding that "it is very clear, even to someone with limited knowledge in the area, that Bitcoin has a long way to go before it is the equivalent of money" most notably because it is not accepted by all merchants, the value fluctuates significantly, there is a lack of a stabilization mechanism, they have limited ability to act as a store of value, and Bitcoin is a decentralized system.)

**Chino LTD**

72. On November 19, 2013, Theo Chino incorporated Chino LTD in Delaware. A copy of the Delaware Certificate of Incorporation is attached as Exhibit I.

73. On February 24, 2014, I submitted an application for authority to conduct business in the state of New York under § 1304 of the Business Corporation Law as a foreign business corporation. The original purpose of Chino LTD was to install Bitcoin processing services in the State of New York. A copy of the New York filing receipt is attached as Exhibit II.

74. In March 2014, Theo Chino hired an employee to sell Chino LTD's Bitcoin-related services in New York County and Bronx County.

75. Chino LTD's employee distributed surveys to local bodegas and stores to evaluate the Bitcoin landscape and identify potential clients in the Manhattan area. A copy of one of the translated surveys is attached as Exhibit III.

76. On December 31, 2014, Theo Chino co-founded Conglomerate Business Consultants, Inc. ("CBC"). A copy of the New York Certificate of incorporation is attached as Exhibit IV.

77. CBC started out by purchasing phone minutes from E-Sigma Online LLC, and later from NobelCom LLC. CBC would distribute the phone minutes to bodegas who would in turn sell the phone minutes to customers. A copy of a receipt of transactions between CBC and Multiservice And Innovations Inc. involving NobelCom LLC phone minutes is attached as Exhibit V.

78. After business relationships were established with bodegas through selling phone minutes, between December 2014 and May 2015, CBC entered into formal contracts with seven bodegas in New York to offer Bitcoin processing services provided by Chino LTD. A copy of one of the contracts between CBC and a bodega is attached as Exhibit VI. Theo Chino's goal was to secure long-term and stable commercial relationships with the bodegas using CBC's calling cards. Once those relationships were established, bodegas would be able to offer the use of Bitcoin as a payment method for regular items sold by bodegas (milk, food, etc.). At all times, Chino LTD was providing Bitcoin processing services to CBC and to the bodegas for transactions involving both calling card and regular items.

79. The bodegas were given signage to display that they accepted Bitcoins. A photo of the signage is attached as Exhibit VII.

80. Every day, Chino LTD would provide the bodegas the daily exchange rate that would be used for the Bitcoin processing services.

81. While CBC was a distributor of phone minutes and the Bitcoin processing services directly to bodegas, Chino LTD provided the actual processing services.

82. Chino LTD provided all the research and development for Bitcoin processing, bought all of the computer to run the backend of processing Bitcoin, rented all of the hosting equipment to run the front end of processing Bitcoin, and developed custom operating systems to

run the Bitcoin processing.

83. Chino LTD's Bitcoin processing business fell within the "Virtual Currency Business Activity" under the Regulation. The Regulation requires those engaged in "Virtual Currency Business Activity" that involves New York or New York residents to obtain a license. 23 NYCRR §§ 200.2(q), 200.3(a).

84. Theo Chino is a New York resident who conducted business in New York with New York residents thus the Regulation applied to Theo Chino and Chino LTD.

85. In 2013, the year Chino LTD was incorporated, it suffered losses of only $4,367. The losses were due to the cost of purchasing computer equipment to test how to protect Bitcoin and figure out how to monetize it. A copy of Chino LTD's 2013 U.S. Income Tax Return for an S-Corporation is attached as Exhibit XII.

86. In 2014, Chino LTD suffered losses of $59,667. The losses were mainly due to the cost of computer hardware required to run the Bitcoin warehousing, the cost of renting computer time on the cloud, and marketing the service to bodegas. A copy of Chino LTD's 2014 U.S. Income Tax Return for an S-Corporation is attached as Exhibit XIII.

87. In 2015, the year Chino LTD submitted an application for a license to engage in Virtual Currency Business Activity, Chino LTD suffered losses of $30,588. The losses were due to the cost of the utilities to process Bitcoin (computer time on the internet cloud), the interest on the borrowed capital required to purchase the equipment the previous year, the cost associated with supporting CBC (who entered into the agreements with bodegas), and the cost of litigation. A copy of Chino LTD's 2015 U.S. Income Tax Return for an S Corporation is attached as Exhibit XIV.

88. As required under NYCRR § 200.21, Theo Chino, on behalf of Chino LTD,

submitted an application for a license on August 7, 2015 to engage in "Virtual Currency Business Activity," as defined in 23 NYCRR § 200.2(q). A copy of the application is attached as Exhibit IX.

89. Theo Chino took other affirmative steps and researched New York banking law and requested an application fee waiver, which he believed he was entitled to receive under N.Y. Banking Law § 18-a, which allows the superintendent to waive or reduce an application fee.

90. August 16, 2015, Theo Chino submitted an application under the New York State Minority Owned/Women Owned Business Enterprise Program for Chino LTD, which is still pending with New York State. A copy of the application and of its status information is attached as Exhibit VIII.

91. Realizing he would be required to incur expenses beyond his means to comply with the burdensome compliance costs under the Regulation, Theo Chino initiated this lawsuit on October 16, 2015, one week before the expiration of the deadline to challenge the Regulation.

92. In January 2016, one customer at a bodega named Rehana's Wholesale made a purchase using Bitcoin which was processed by Chino LTD. A copy of the bill indicating the purchase is attached as Exhibit X.

93. On January 4, 2016, NYDFS returned Chino LTD's application without further processing after they performed an initial review. The stated reason for returning the application was that NYDFS was unable to evaluate whether the company's current or planned business activity would be considered Virtual Currency Business Activity that requires licensing under the New York Financial Services Law and regulations. A copy of the January 4, 2016 letter is attached as Exhibit XI.

94. On January 4, 2016, CBC stopped offering Bitcoin processing services when

NYDFS did not approve Chino LTD's application. In 2016, even though Chino LTD could no longer offer Bitcoin services because it did not receive a license, Chino LTD remained an active S-Corporation and suffered losses of $53,053. The losses were due to the utilities for keeping the equipment to process Bitcoin in the event of a successful litigation, the interest on the borrowed capital from the previous three years, and the cost of the litigation. A copy of Chino LTD's 2016 U.S. Income Tax Return for an S Corporation is attached as Exhibit XV.

## FIRST CAUSE OF ACTION
### Violation of the Separation of Powers Doctrine and Ultra Vires Conduct

95. Plaintiffs-Petitioners incorporate by reference all of the preceding paragraphs.

96. Under the New York State Constitution Art. III, § 1, "[t]he legislative power of this state shall be vested in the senate and assembly."

97. A delegated agency may only adopt regulations that are consistent with its enabling legislation and its underlying purposes.

98. When an administrative agency moves beyond enforcing policies enacted by the legislative branch and implements policy on its own accord, it is acting outside the scope of its authorized power.

99. On, October 3, 2011 the New York State Banking Department and the New York State Insurance Department were abolished and the functions and authority of both former agencies transferred to NYDFS. The New York Legislature has authorized NYDFS to regulate *financial* products and services. FSL §§ 201(a) and 302(a). It did not offer any definition which included the concept of virtual currency. *See* FSL § 104(a)(2).

100. As explained above, Bitcoin is not a financial product or service.

101. Therefore, NYDFS has promulgated a Regulation that monitors and controls non-financial products and services.

102. The Regulation promulgated by Defendants-Respondents is in violation of the separation of powers established by the New York Constitution, is *ultra vires*, without lawful authority, and in violation of law. Therefore, Defendant-Respondents proceeded in excess of jurisdiction.

## SECOND CAUSE OF ACTION
### Arbitrary and Capricious Regulation

103. Plaintiffs-Petitioners incorporate by reference all of the preceding paragraphs.

104. An administrative regulation will be upheld only if it has a rational basis, and is not unreasonable, arbitrary or capricious.

105. A regulation is irrational, and therefore arbitrary and capricious, if it is excessively broad in scope.

106. The Regulation is arbitrary and capricious because it does not have a rational basis and it is excessively board in scope.

107. Subject to three narrow exceptions, "Virtual Currency" means "*any* type of digital unit that is used as a medium of exchange or a form of digitally stored value." 23 NYCRR § 200.2(p) (emphasis added). Furthermore, 23 NYCRR § 200.2(p) mandates that this definition be "broadly construed." *Id.* Given this instruction and the Regulation's failure to define "digital unit" or "medium of exchange," nearly all Internet activity could be interpreted under the Regulation to involve Virtual Currency. Thus, the definition of Virtual Currency is grossly overinclusive and irrational.

108. Even non-financial uses of blockchain technology fall within the Regulation's definition of Virtual Currency because, to participate in blockchain technology, a user engages

"digital unit[s]," that [are] "used as medium[s] of exchange." the definition of Virtual Currency does not exclude or otherwise exempt these non- financial uses of blockchain technology, rendering such uses potentially subject to the Regulation. *See* 23 NYCRR § 200.2(p).

109. The Regulation requires anyone engaged in "storing, holding or maintaining custody or control of Virtual Currency on behalf of others" to obtain a License and comply with the Regulation. 23 NYCRR § 200.2(q)(2). However, the Regulation fails to clarify what activities qualify as "storing," "holding," or "maintaining custody or control" of Virtual Currency. *See* 23 NYCRR §§ 200.1-200.22.

110. The Regulation also requires anyone "controlling... a Virtual Currency" to obtain a license. NYDFS did not define "controlling," leaving room for expansive interpretation. *See* 23 NYCRR §§ 200.1-200.22. Arguably any Bitcoin owner with a tenuous relationship to New York is subject to the Regulation

111. The Regulation requires Licensees to: (1) record "each transaction, the amount, date, and precise time of the transaction... the names, account numbers, and physical addresses of (i) the party or parties to the transaction that are customers or accountholders of the Licensee; and (ii) to the extent practicable, any other parties to the transaction," and (2) maintain those records "for at least seven years." 23 NYCRR § 200.12(a). These extensive and onerous requirements apply to *all* virtual currency transactions, regardless of whether 1-cent worth or thousands of dollars' worth are being transacted. It is unreasonable to require Licensees to create and maintain records of microtransactions

112. The Regulation's anti-money laundering provisions are inconsistent with NYDFS's preexisting anti-money laundering regulations. NYDFS has imposed stringent anti-money laundering requirements upon Virtual Currency businesses that it has not imposed on fiat

currency transmitters. NYDFS requires money transmitters to comply with federal anti-money laundering laws. 3 NYCRR § 416.1. The Regulation, however, requires virtual currency transmitters to comply with anti-money laundering requirements that go beyond those required under federal law. *See* 23 NYCRR § 200.15. There is no rational basis or objective reason provided by NYDFS for subjecting fiat money transmitters and Virtual Currency transmitters to different anti-money laundering requirements.

113. The Regulation requires Licensees to file Suspicious Activity Reports ("SAR") even if they would not be required to do so under federal law. 23 NYCRR § 200.15(e)(3)(ii). This requirement imposes an unreasonable burden on virtual currency firms who would not otherwise be subject to federal SAR provisions. Furthermore, this provision subjects such firms to potential liability for submitting SARs because though the federal SAR requirements include a safe harbor provision that extends immunity to disclosing institutions, the Regulation does not contain a comparable provision. 31 U.S.C. § 5318(g)(3); 23 NYCRR § 200.15. Thus, under NYDFS's regulatory scheme, a money transmitter dealing in fiat currency that is not required to file SARs would be required to file SARs if that transmitter wished to engage in Virtual Currency transmission. *See* 23 NYCRR § 200.15(e)(3)(ii). There is no rational basis to support NYDFS's inconsistent treatment of money transmitters.

114. The Regulation requires Licensees to retain all records related to their anti-money laundering programs for at least seven years. 23 NYCRR § 200.12(a). By contrast, fiat currency transmitters are only required to retain such records for five years. 3 NYCRR § 416.1(b)(2)(i) (requiring licensees to retain records in accordance with 31 CFR § 103); 31 CFR § 1010.430(d) (formerly at 31 CFR § 103.38(d); requiring licensees to retain records for five years). There is no rational reason or objective rationale to require virtual currency transmitters to retain their

records two years longer than non-technology based financial transmitters are required to retain their records.

115. The Regulation has a severe disparate impact on startups and small businesses, which do not have access to the funds and resources the Regulation requires. The cost of applying for a License is exorbitant. *See* 23 NYCRR § 200.5 (requiring a non-refundable $5,000 application fee).

116. The costs of staying in compliance with the Regulation, if granted a License, are unwarranted and potentially excessive. Licensees are required to "maintain at all times such capital in an amount and form as the superintendent determines is sufficient." 23 NYCRR § 200.8(a). This vague, open-ended requirement is likely to unreasonably impede cash-strapped startups and small businesses from being able to engage in Virtual Currency Business Activity. The Regulation's requirement that Licensees "maintain a surety bond or trust account... in such a form and amount as is acceptable to the superintendent" is similarly prone to effectively prohibit underfunded startups and small businesses from engaging in Virtual Currency related business. *See* 23 NYCRR § 200.9(a).

117. At that point the Regulation was promulgated, both the application fee and the compliance costs were overly burdensome to Plaintiffs-Petitioners. Chino LTD does not run a high volume business, rather offering small processing services for small purchases in retail stores. The capital requirements imposed by the Regulation are disproportionate compared to the profit Chino LTD would make on each transaction or each retail relationship. Having the same standards apply to Chino LTD that apply to large financial institutions is unreasonable.

118. While it may be appropriate to impose minimum capital requirements on select Virtual Currency businesses, it is irrational, arbitrary, and capricious, to impose blanket capital

requirements on *all* actors subject to the Regulation. The Regulation, however, applies to a wide range of virtual currency businesses that do not pose the same risks banks, insurance companies, and broker-dealers do. Applying capital requirements to such businesses is inappropriate and irrational

119. Chino LTD would be forced to maintain a minimum capital requirement even though it is operating at a very low risk.

120. Defendants-Respondents have never provided an objective rationale for these burdensome and arbitrary requirements.

121. Therefore, the Regulation promulgated by Defendants-Respondents is arbitrary and capricious.

## THIRD CAUSE OF ACTION
**Federal Preemption**

122. Plaintiffs-Petitioners incorporate by reference all of the preceding paragraphs.

123. Implied preemption exists where federal law is sufficiently comprehensive to make a reasonable inference that Congress left no room for supplementary state regulation.

124. Federal law defines “financial service or product’ in eleven carefully constructed subparagraphs of 12 U.S.C. § 5481(15).

125. The federal law is sufficiently comprehensive to reasonably infer that Congress left no room for supplementary state regulation.

126. The Dodd-Frank Act states that a "statute, regulation, order, or interpretation . . . in any State is not inconsistent with... this title if the protection that [it] affords to consumers is greater than the protection provided under this title." 12 U.S.C. § 5551. However, under the Dodd-Frank Act, State consumer financial laws are preempted if the State law “is preempted by a provision of Federal law other than title 62 of the Revised Statutes.” 12 U.S.C. § 25b(b)(1)(C).

Title 62 of the Revised Statutes contains 12 U.S.C. §§ 5133 through 5243, therefore excluding 12 U.S.C. §5481, making preemption appropriate.

127. Congress' objectives in enacting Title 12 of the United States Code was to implement and enforce Federal consumer financial law consistently to ensure that *all consumers* have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive. 12 U.S.C. § 5511(a) (emphasis added). The term "all consumers" establishes a purpose of uniformity in markets for consumer financial products and services. New York does not have the authority to define for themselves a term with the history of substantial federal regulation.

128. Therefore, the Regulation is preempted by federal law.

## FOURTH CAUSE OF ACTION
**Violation of the First Amendment of the U.S. Constitution and the New York Constitution**

129. Plaintiffs-Petitioners incorporate by reference all of the preceding paragraphs.

130. The Regulation violated the First Amendment of the U.S. Constitution, as applied to the states through the Fourteenth Amendment, under the compelled commercial speech doctrine and/or the restricted commercial speech doctrine.

131. The First Amendment protection under the New York Constitution is stronger than the one provided in the U.S. Constitution, therefore, the First Amendment claims sought by Plaintiffs-Petitioners under the U.S. constitution are also asserted under the New York Constitution.

132. The following section of the Regulation violate either the compelled commercial speech or the restricted commercial speech doctrine under the U.S. Constitution and violate the First Amendment of the New York Constitution: 23 NYCRR §§ 200.19, 200.19(a)(6), 200.19(a)(7), 200.19(a)(8), 200.19(a)(9), 200.19(b)(1), 200.19(b)(2), 200.19(c)(3), 200.19(c)(4),

and 200.19(g).

133. The disclosures are not purely factual and uncontroversial.

134. One of the required disclosures is that "the nature of Virtual Currency may lead to an increased risk of fraud or cyber attack." FSL § 200.19(a)(8). However, this is blatantly false. Using virtual currencies puts you at no greater risk of fraud or cyber-attack than using a credit card or online shopping. The compelled disclosures are not reasonably related to the State's interest in preventing deception of consumers.

135. The compelled disclosures do not directly advance—and are far more extensive than is necessary to serve—any interest the state might have.

136. 23 NYCRR § 200.19(a)(6) requires Plaintiffs-Petitioners to make a specific disclosure about the lack of business continuity. This compelled disclosure is speculative, because using Bitcoin does not trigger a business continuity risk higher or lower than using other forms of payments. This disclosure is both unjustified and unduly burdensome because Plaintiffs-Petitioners contracted with each bodega customer to provide Bitcoin processing services for each transaction, which is no more or less riskier than any other service used by Plaintiffs-Petitioners' customers, especially if Defendants-Respondents do not have the jurisdictional basis to regulate Bitcoin.

137. 23 NYCRR § 200.19(a)(7) requires Plaintiffs-Petitioners to make a specific disclosure about the volatility of Bitcoin's value. This compelled disclosure is irrelevant, since Plaintiffs-Petitioners guarantees an exchange rate to the bodega's customer, and has agreed to take the exchange rate risk away from the bodega's customer. This disclosure is both unjustified and unduly burdensome because Plaintiffs-Petitioners contracted with each bodega customer to eliminate the exchange rate risk from the bodega customer.

138. 23 NYCRR § 200.19(a)(9) requires Plaintiffs-Petitioners to make a specific disclosure about the technological difficulties which Plaintiffs-Petitioners may encounter in delivering their Bitcoin processing services. This compelled disclosure is inaccurate, as the Bitcoin technology is no more or less reliable than other technological devices, such as credit card payment machines, and because technological difficulties relate to the equipment used by the customer and are not intrinsically related to the nature of Bitcoin. Furthermore, this requirement restricts Plaintiffs-Petitioners' commercial speech rights, because they can no longer make any statements as to the reliability of a payment using Bitcoin. This disclosure is both untrue, and is also unjustified and unduly burdensome because Plaintiffs-Petitioners' speech is severely restricted AND his ability to market Bitcoin processing services is severely restricted.

139. 23 NYCRR § 200.19(b)(1) requires Plaintiffs-Petitioners to make a specific disclosure about the customer's liability for unauthorized Bitcoin transactions. This compelled disclosure is overly broad, because Plaintiffs-Petitioners would be unable to identify specifically a given customer liability when the bodega customer uses Bitcoin as compared to using other forms of payments. This disclosure is unjustified and unduly burdensome because Plaintiffs-Petitioners' ability to market Bitcoin processing services is hampered by the lack of specific instructions from the government in articulating the customer's liability when he uses Bitcoin as compared to using other forms of payments.

140. 23 NYCRR § 200.19(b)(2) requires Plaintiffs-Petitioners to make a specific disclosure about the customer's right to stop a pre-authorized Bitcoin transaction. This compelled disclosure is both irrelevant and overly broad, since Plaintiffs-Petitioners guarantee a return policy at least equivalent to the return policy of the bodega to the bodega's customer. Therefore, this disclosure is overly broad, because Plaintiffs-Petitioners cannot guarantee more

than what the bodega provides to its current customer under existing New York law. This disclosure is unjustified and unduly burdensome because Plaintiffs-Petitioners cannot guarantee more than what the bodega provides to its current customer under existing New York law.

141. 23 NYCRR § 200.19(c)(3) requires Plaintiffs-Petitioners to make a specific disclosure about the type and nature of the Bitcoin transaction. This compelled disclosure is overly broad, since Plaintiffs-Petitioners would be unable to identify specifically the extent to which this information should be provided when the bodega customer uses Bitcoin as compared to using other forms of payments. This disclosure is unjustified and unduly burdensome because Plaintiffs-Petitioners cannot guarantee more than what the bodega provides to its current customer under existing New York law.

142. 23 NYCRR § 200.19(c)(4) requires Plaintiffs-Petitioners to make a specific disclosure about the ability to undo the Bitcoin transaction. This compelled disclosure is both irrelevant and overly broad, since Plaintiffs-Petitioners guarantees a return policy at least equivalent to the return policy of the bodega to the bodega's customer, therefore eviscerating the need for this required disclosure. This disclosure is both irrelevant and unduly burdensome because Plaintiffs-Petitioners cannot guarantee more than what the bodega provides to its current customer under existing New York law.

143. Similarly, 23 NYCRR § 200.19(g) requires Plaintiffs-Petitioners to make a specific disclosure about fraud prevention. This compelled disclosure is both irrelevant and overly broad, since Plaintiffs-Petitioners are already required to engage in fraudulent activity prevention under New York law, and because this requirement would trigger enormous administrative burdens well in excess of the Plaintiffs-Petitioners' ability to generate income from Bitcoin processing services. This disclosure is both irrelevant and unduly burdensome

because Plaintiffs-Petitioners would be subject to an enormous administrative burden well in excess of his ability to generate income from Bitcoin processing services.

144. Therefore, the Regulation violates both the First Amendment of the U.S. Constitution and of the New York Constitution.

## REQUEST FOR RELIEF

WHEREFORE, Plaintiffs-Petitioners respectfully request judgment as follows:

(a) Enjoining and permanently restraining Defendants-Respondents and any of their agents, officers, and employees from implementing or enforcing the Regulation on the basis that it is unlawfully *ultra vires*, and declaring the Regulation invalid;

(b) Declaring the Regulation unconstitutional because it violates the separation-of-powers doctrine to the extent they are found to have delegated and/or authorized Defendants-Respondents to promulgate the Regulation;

(c) Enjoining and permanently restraining Defendants-Respondents and any of their agents, officers and employees from implementing or enforcing the Regulation on the basis that it is arbitrary and capricious;

(d) Enjoining and permanently restraining Defendants-Respondents and any of their agents, officers and employees from implementing or enforcing the Regulation on the basis that it is preempted by federal law;

(e) Enjoining and permanently restraining Defendants-Respondents and any of their agents, officers and employees from implementing or enforcing the Regulation on the basis that it violates both the First Amendment of the U.S. Constitution and of the New York Constitution;

(h) Declaring that the Regulation is preempted by federal law;

(i) Declaring that the Regulation violates both the First Amendment of the U.S. Constitution and of the New York Constitution;

(j) Awarding Plaintiffs-Petitioners incidental monetary relief as well as its reasonable attorneys' fees, costs and interest, including without limitation attorney's fees permitted under CPLR Article 86, and;

(k) Granting such other and further relief as the Court deems just and proper.

Dated: May 25, 2017
New York, New York

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*Attorney for Plaintiffs-Petitioners*

**VERIFICATION**

STATE OF NEW YORK )

) ss:

COUNTY OF NEW YORK )

Theo Chino, being duly sworn, deposes and says:

I am a plaintiff-petitioner in the above-entitled action. I have a read the foregoing complaint and know the content thereof. The same are true to my knowledge, except as to matters therein stated to be alleged on the information and belief and as to those matters I believe them to be true.

THEO CHINO

SWORN to before me, this 24 day May, 2017

NOTARY PUBLIC

SHAKIRA LATEEFAH SPENCE
Notary Public - State of New York
NO. 01SP6295206
Qualified in Bronx County
My Commission Expires Dec 30, 2017

**VERIFICATION**

STATE OF NEW YORK )

) ss:

COUNTY OF NEW YORK )

Theo Chino, being duly sworn, deposes and says:

I am the owner of Chino LTD, a plaintiff-petitioner in the above-entitled action. I have a read the foregoing complaint and know the content thereof. The same are true to my knowledge, except as to matters therein stated to be alleged on the information and belief and as to those matters I believe them to be true. The reason this verification is not made by plaintiff-petition is that plaintiff-petitioner is a corporation and Theo Chino is its duly authorized representative. The sources on which I rely in verifying the truth of the allegations in the complaint are the documents contained in the accompanying exhibits to the complaint and other books and records maintained by Chino LTD.

THEO CHINO
On behalf of Chino LTD

SWORN to before me, this 24 day May, 2017

NOTARY PUBLIC

SHAKIRA LATEEFAH SPENCE
Notary Public - State of New York
NO. 01SP6259206
Qualified in Bronx County
My Commission Expires Dec 30, 2017

JON M. SANDS
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IN THE UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

| | |
|---|---|
| United States of America,<br>Plaintiff,<br>vs.<br>Thomas Mario Costanzo, et al.,<br>Defendant | No. CR-17-0585-01-PHX-JJT<br>**MOTION TO DISMISS COUNTS 1 & 2 OF THE INDICTMENT**<br>**(Oral Argument Requested)** |

Defendant Thomas Mario Costanzo submits the attached memorandum of law in support of his First Motion to Dismiss Counts 1 & 2 of the Indictment, which charge him with operating an unlicensed money transmitting business in violation 18 U.S.C. § 1960 and Conspiracy to do the same in violation of 18 U.S.C. § 371. Counts 1 & 2 of the Indictment should be dismissed because the alleged substantive conduct does not constitute "money transmitting" as contemplated by 18 U.S.C. § 1960.

First, Congress has not defined Bitcoin as money or currency. The Government's attempt to use a dated statute to create a crime that Congress has not defined violates Due Process and Fundamental Fairness. Second, Counts 1 & 2 of the Indictment fail to state a claim because person-to-person exchanges of Bitcoin that do not involve a third party cannot constitute "transmitting" under § 1960.

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Excludable delay under 18 U.S.C. § 3161(h)(1)(D) may result from this motion or from an order based thereon.

Respectfully submitted: October 30, 2017.

JON M. SANDS
Federal Public Defender

*s/Maria Teresa Weidner*
MARIA TERESA WEIDNER
Asst. Federal Public Defender

**ME M O R A N D U M**

## I. BACKGROUND

As to the facts set forth in the Indictment in support of Counts 1 & 2, it is simply alleged that Mr. Costanzo and co-defendant Dr. Steinmetz operated a money transmitting business, that said business was not licensed or registered in the State of Arizona, and that the business model for said business was no more than to enable "customers to exchange cash for 'virtual currencies,' charging a fee for the[ ] service." *See* Doc. 18, First Superseding Indictment, at ¶¶ 1-3.

## II. STANDARD OF REVIEW

Rule 12 of the Federal Rules of Criminal Procedure provides that a defendant make seek dismissal of an indictment that fails to state an offense. Fed. R. Crim. P. (12)(b)(2) ("Any defense, objection, or request which is capable of determination without the trial of the general issue may be raised before trial by motion") and 12(b)(3)(B) ("[A]t any time while the case is pending, the court may hear a claim that the indictment or information fails to…state an offense."). "In ruling on a pre-trial motion to dismiss an indictment for failure to state an offense, the district court is bound by the four corners of the indictment." *United States v. Boren*, 278 F.3d 911, 914 (9th Cir.2002).

## III. DISCUSSION

The Indictment in this matter is defective because it fails in two ways to allege conduct that meets the definition of "money transmitting" set forth in 18 U.S.C. § 1960: 1) Bitcoin is not "money" under the statute; and 2) operating a Bitcoin exchange is not "transmitting" under the statute. The Indictment's assertion that Mr. Costanzo "operated a money transmitting business" by "enabling…customers to exchange cash for 'virtual currencies,' charging a fee for the[ ] service" is conclusory and does not survive analysis. *See* Doc. 18, at ¶¶ 1 & 3. A person-to-person exchange of cash for a privately created commodity that is not money is simply outside the regulatory sphere of "money transmitting businesses."

**Bitcoin Is Not "Money."**

Under 18 U.S.C. § 1960, a defendant is guilty of an offense when he "knowingly conducts, controls, manages, supervises, directs, or owns all or part of an unlicensed money transmitting business." The statute defines "money transmitting" to include "transferring funds on behalf of the public by any and all means including but not limited to transfers within this country or to locations abroad by wire, check, draft, facsimile, or courier." 18 U.S.C. § 1960(b)(2). Accordingly, a defendant can be guilty of an offense under the statute only where the object he transmits is "money" or "funds." The statute, however does not define the critical terms "money" or "funds." *See* 18 U.S.C. § 1960. For its part, the State of Arizona defines the term "money" as "a medium of exchange that is *authorized and adopted by a domestic or foreign government* as a part of its currency and that is *customarily used and accepted as a medium of exchange in the country of issuance*." A.R.S. § 6-1201(9) (emphasis added). A definition of the term "funds" was not identified by undersigned counsel in the Arizona Revised Statutes.

In this matter, the object at issue—Bitcoin—is neither "money" nor "funds" under the federal statute. A logical, textual reading of the statute limits its application to "currency," which does not include Bitcoin. To expand interpretation of the undefined terms "money" or "funds" beyond currency so as to shoehorn in recent developments such as Bitcoin would cause the statute to lose all rational limitations. Where Congress has not established legislative parameters to address recent developments such as Bitcoin and so-called "virtual currencies," it is agency overreach for the Department of Justice to pursue prosecution under statutes that simply do not apply. It is the place of the judiciary to halt such trespasses upon the separation of powers whenever such may appear before it.

1. <u>"Money" and "Funds" Under the Statute Mean Currency.</u>

According to Black's Law Dictionary, the terms "money" and "funds" are nearly coextensive. Indeed, Black's defines "funds" to mean"[a] sum of money or other

liquid assets established for a specific purpose." Black's Law Dictionary (9th ed. 2009). Money is a somewhat less elusive term. Black's Law Dictionary defines it in two primary ways: broadly, as "[a]ssets that can be easily converted to cash," and narrowly, as "[t]he medium of exchange authorized or adopted by a government as part of its currency; esp. domestic currency." *Id.*

The broad definition of money—convertible assets—cannot be applied to § 1960 without rendering the statute utterly meaningless. Indeed, if § 1960 were applicable to any asset with liquidity, it could encompass the business of moving almost any item (e.g., houses, cars, boats, stamp collections) and could make the transfer of such items a felony offense in certain circumstances. It is a well-established canon of construction that statutes are to be interpreted to avoid illogical or absurd results. Interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available. *See, e.g., Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982) (citing *United States v. American Trucking Assns., Inc.*, 310 U.S. 534, 542-543 (1940); *Haggar Co. v. Helvering*, 308 U.S. 389, 394 (1940)); *see also id.,* (citing *Crooks v. Harrelson*, 282 U.S. 55, 60, (1930) ("[l]aws enacted with good intention, when put to the test, frequently, and to the surprise of the law maker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law making authority, and not with the courts.")). Accordingly, the broad definition of money advocated by the government by virtue of Counts 1 & 2 of the Indictment simply cannot apply to § 1960.

The narrow definition of money—currency—applies a more natural and appropriate limitation on the application of § 1960. Although the legislative history of § 1960 is not instructive, it is obvious that in 1992, when the statute was first enacted, Congress could not have contemplated its application to so-called "virtual currencies," and the term "money" as used in the statute would likely have been synonymous with

the term "currency." Indeed, the purpose of the statute—to ensure that those who transmit money for a business register with the federal government, obtain state licenses, and submit to applicable regulations—seems much more appropriately directed to those in the actual business of transmitting currency. *See* 18 U.S.C. § 1960(b)(1). The federal government has an obvious and substantial interest in currency: currency is issued by the federal government; it is printed by the federal government; and its value is regulated by federal monetary policy. *See, generally* U.S. CONST. art. 1, § 8, cl. 5 (bestowing on the legislature the power "[t]o coin Money, [and] regulate the Value thereof"). The logical and textual interpretation of § 1960 as a statute that seeks to punish those who transmit currency for others for profit but fail to properly register or obtain applicable licenses is appropriate and makes sense. On the other hand, the government's attempt to contort § 1960 so as to punish those who do not register or obtain licenses to transmit a virtual, internet-based commodity that is a completely de-centralized, private creation is far from apparent.

Bitcoin is not directly regulated by the federal government or any foreign government; it is not subject to domestic or international monetary policy. While Congress has not addressed Bitcoin or other virtual internet-based commodities as of yet, the executive branch, specifically, the Department of Treasury's Financial Crimes Enforcement Network ("FinCEN") issued interpretative guidance in March of 2013. *See* Exhibit A, FIN-2013-6001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, Mar. 18, 2013. Notably, interpretative guidance is exempt from notice and comment requirements of the Administrative Procedure Act ("APA"). *Id.; see also* Exhibit B, Internal Revenue Manual, Part 32.1.1.2.6 (noting that interpretative rules are exempt from the APA's notice and comment requirements). The Internal Revenue Manual explains that interpretative guidance does not require notice to or comment from the public as would otherwise be required by law for a substantive rulemaking because "the underlying

statute implemented by the regulation contains the necessary legal authority for the action taken and any effect of the regulation flows directly from that statute." *Id.* For the reasons set forth above, such is not the case with the Treasury Department's attempt at extra-legislative guidance regarding virtual internet-based commodities. *See, e.g., F.C.C. v. Fox Television Stations, Inc.,* 556 U.S. 502, 536-37(2009) (citing *Mistretta v. United States,* 488 U.S. 361, 372-374 (1989) ("If agencies were permitted unbridled discretion, their actions might violate important constitutional principles of separation of powers and checks and balances. To that end the Constitution requires that Congress' delegation of lawmaking power to an agency must be 'specific and detailed…' Congress must 'clearly delineat[e] the general policy' an agency is to achieve and must specify the 'boundaries of [the] delegated authority….' Congress must 'lay down by legislative act an intelligible principle,' and the agency must follow it.")(internal quotations omitted).

Finally, had Congress intended the term "money" to be defined so expansively it would have explicitly and expressly done so; as much is abundantly clear via comparison to the federal money laundering statute, 18 U.S.C. § 1956. Section 1956 does not rely on an expansive definition of "money" but instead expressly and broadly applies to, among other things, certain "financial transactions involving property represented to be the proceeds of specified unlawful activity, or property used to conduct or facilitate specified unlawful activity." 18 U.S.C. § 1956(c)(2).

2. Bitcoin Is Not Currency.

The U.S. Government recognizes significant differences between "currency" and Bitcoin. FinCEN defines "currency as:

> [t]he coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance. Currency includes U.S. silver certificates, U.S. notes, and Federal Reserve

> notes. Currency also includes official foreign bank notes that are customarily used and accepted as a medium of exchange in a foreign country.

31 C.F.R. § 1010.100(m) (2014). Bitcoin clearly does not meet this definition and therefore is not "currency."

FinCEN further distinguishes "currency (also referred to as 'real currency')" from so-called "virtual currency" which includes Bitcoin and is defined as "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency." Exhibit A. FinCEN notes in particular that "virtual currency does not have legal tender status in any jurisdiction. *Id.* The significant differences between "currency" and "virtual currency" are further recognized by the Internal Revenue Service ("IRS"), which does not treat "virtual currency" as "currency" for purposes of determining whether a transaction results in foreign currency gain or loss under U.S. federal tax laws. *See* Exhibit C, Internal Revenue Service, Notice 2014-21.

3. Defining Bitcoin as "Money" Under § 1960 Raises Constitutional Problems.

In addition to the separation of powers issues referenced above, interpreting the terms "money" or "funds" under the statute to include a commodity such as Bitcoin raises concerns that § 1960 fails to "provide the kind of notice that will enable ordinary people to understand what conduct it prohibits." *City of Chicago v. Morales*, 527 U.S. 41, 56 (1999). "[T]he legislative purpose is expressed by the ordinary meaning of words used." *Richards v. United States*, 369 U.S. 1, 9 (1962). The ordinary understanding of "money" and "funds" is consistent with the definition offered above: currency, whether reflected in cash, coin, check, bank wire, or account balance. It does not include cars, real estate, baseball cards, Beanie Babies, Bitcoin, or other assets that, although valuable and potentially even a medium of exchange under certain circumstances, do not fall within the ordinary understanding of "money" or "funds."

The Supreme Court has instructed courts, when confronted with a statute of ambiguous and potentially infinite reach, to interpret it in a manner consistent with the rule of lenity. That is, courts should "exercise[ ] restraint in assessing the reach of a federal criminal statute, both out of deference to the prerogatives of Congress, and out of concern that a fair warning should be given to the world in language that the common world will understand, or what the law intends to do if a certain line is passed." *Arthur Andersen, LLP v. United States*, 544 U.S. 696, 703 (2005) (citations omitted). Here, the statutory terms "money" and "funds" can either be given the ordinary meaning of "currency" or they can be given a meaning so broad as to have no meaning at all. The District Court should show the concern for plain meaning and fair warning that the Supreme Court has instructed, and find that the Indictment fails to allege a transaction in "money" or "funds" and therefore fails to state an offense under either § 1960 or an alleged conspiracy to violate § 1960.

**A. The Indictment Fails to Allege that Costanzo Operated a "Money Transmitting Business" or Engaged in "Money Transmitting."**

Counts One and Two of the Indictment should also be dismissed because the Indictment fails to allege that Costanzo operated a "money transmitting business" or engaged in "money transmitting" as contemplated by the statute.

1. Costanzo Did Not Operate a Money Transmitting Business.

Section 1960 prohibits the unlicensed operation of a "money transmitting business." The use of the term "business" in the statute clearly requires that a defendant sell money transmitting services to others for a profit. Here, the Indictment fails to allege that Costanzo sold such services. Rather, he is alleged to have sold Bitcoin to customers who engaged him as a source of Bitcoin. To the extent Costanzo is alleged to have participated in other activities to secure Bitcoin to sell, such activities were purely incidental to the sale of Bitcoin and do not convert his small business into a money transmitting business. There is no allegation in the Indictment that customers asked for Costanzo to transmit Bitcoin to other locations or persons on their behalf. Rather it is simply alleged that customers paid Costanzo to provide them with Bitcoin.

A Seller of Bitcoin Does Not Meet the Definition of Money Transmitter Under the Applicable Regulations.

The Indictment alleges Costanzo acted as a money transmitter by operating a Bitcoin exchange. A seller of Bitcoin, however, is not included in FinCEN's definition of "money transmitter" and indeed such conduct is expressly excluded from the definition. The regulations provide, in pertinent part:

> (5) *Money transmitter—(i) In general.* (A) A person that provides money transmission services. The term 'money transmission services' means the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency , funds, or other value that substitutes for currency *to another location or person* by any means. . . .
>
> (ii) Facts and circumstances; Limitations. Whether a person is a money transmitter as described in this section is a matter of facts and circumstances. The term "money transmitter" shall not include a person that only: . . . .
>
> (F) Accepts and transmits funds *only integral to the sale of goods or the provision of services*, other than money transmission services, by the person who is accepting and transmitting the funds.

31 C.F.R. § 1010.100(ff)(5)(ii)(F) (2014) (emphasis added). Here, the Indictment alleges only that Costanzo sold Bitcoin to his customers. There is no allegation that Costanzo transmitted Bitcoin to another location or person for his customers. Moreover, since Bitcoins are "goods," Costanzo's alleged conduct is excluded from the definition of the term "money transmitter."

**B. Operation of a Money Transmitting Business Requires the Transmission of Money to a Third Party or Location.**

Mr. Costanzo did not operate a money transmitting business because he did not, nor was he instructed by his customers to, transfer money to a third party or

location. This is an issue of first impression in the Ninth Circuit. However, there is persuasive authority in the Second Circuit—where the majority of litigation involving 18 U.S.C. § 1960 has occurred since at least 1999—for the proposition that transmission of monies or funds to third parties or locations on the customer's behalf for a fee is an essential element of operating a money transmitting business. *See e.g., United States v. Banki*, 685 F.3d 88, 113 n.9 (2d Cir. 2012), as amended (Feb. 22, 2012) ("the business must transmit money to a recipient in a place the customer designates, for a fee paid by the customer" and holding that said description is "legally correct"); *United States v. Mazza-Alaluf*, 621 F.3d 205, 208 (2d Cir. 2010) (citing *United States v. Mazza-Alaluf*, 607 F. Supp.2d 484, 489-90 (S.D.N.Y. 2009), which cites to a 1999 Second Circuit holding: "[a] money transmitting business receives money from a customer and then, for a fee paid by the customer, transmits that money to a recipient in a place that the customer designates..."); *United States v. Bah*, 574 F.3d 106, 110 (2d Cir. 2009) (describing government's evidence that "certain customers came to Bah's restaurant in the Bronx, delivered U.S. currency, and instructed Bah to deliver the equivalent value of local currency to recipients in West Africa"); *United States v. Elfgeeh*, 515 F.3d 100,108 (2d Cir. 2008) (quoting testimony of an FBI agent who testified that a traditional money transmitting business "operates in a similar fashion to Western Union"); *United States v. Velastegui*, 199 F.3d 590, 592 (2d Cir. 1999), ("[a] money transmitting business receives money from a customer and then, for a fee paid by the customer, transmits that money to a recipient in a place that the customer designates...")

The Fourth Circuit has expressed agreement with the Second Circuit's analysis. *See United States v. Talebnejad*, 460 F.3d 563, 565 (4th Cir. 2006) (citing *Velastegui*, 199 F.3d at 592.).

The Seventh and Eighth Circuits, while not directly addressing the definition of a money transmitting business or the essential elements of a violation of § 1960, strongly suggest agreement with the Second Circuit in this regard. *See United*

*States v. Dimitrov*, 460 F.3d 409, 411 (7th Cir. 2008)(noting evidence that defendant operated a money transmitting business through an institution known as the Bulgarian Cultural Center, which offered a number of services to include the transmission of monies from the United States to Bulgaria on behalf of customers who paid a fee); *United States v. Abdullahi*, 520 F.3d 890, 892 (8th Cir. 2008) (recounting that defendant accepted monies from Somalis living in the United States and sent the funds on their behalf to Somalia and other African countries).

In a forfeiture matter, the District of Oregon observed that a defendant "was operating an unlicensed money transmitting business by buying and selling metals to and from customers, storing the customer's metals on site, keeping the customer's cash on deposit and writing checks or wiring money on behalf of his customers directly to third parties." *United States v. $166,450.48 In United States Currency, et al.*, 2014 WL 3891748 at *1.

By contrast with the cases referenced above, Mr. Costanzo is only alleged to have sold his customers a valuable item—Bitcoin. His customers did not direct him to store their money for them or send it to third parties and he is not alleged to have offered such services. Mr. Costanzo was merely a retailer of Bitcoin who acquired it wholesale and then sold it to the public for a fee, much in the manner of sales of goods such as clothing, vehicles, and so forth.

On this point, it is useful to contrast the operation of Mr. Costanzo's alleged Bitcoin exchange with the businesses at issue in both *United States v. Faiella et al*,39 F. Supp.3d 544 (S.D.N.Y. 2014) and *United States v. E-Gold, Ltd.*, 550 F. Supp. 2d 82 (D.D.C. 2008).

1. The instant case as distinguished from *Faiella.*

In denying defendant's motion to dismiss the § 1960 charge set forth in the indictment filed against him, the court in *Faiella* disagreed with defendant's claim that he had "merely sold Bitcoin as a product in and of itself." 39 F. Supp.3d at 546. The

court elaborated that the Indictment in fact alleged that "Faiella received cash deposits from his customers and then, after exchanging them for Bitcoins, transferred those funds [sic] to the customers' accounts on Silk Road[1]," *Id.* The court concluded that "…[t]hese were, in essence, transfer[s] to a third-party agent[, Silk Road.]" *Id.* In so finding, the court further noted that the charging document further alleged the "Silk Road users did not have full control over the Bitcoins transferred to their accounts…Silk Road administrators could block or seize user funds [sic]." *Id.* The indictment here does not allege any such third party transfer—this is a circumstance where the conduct at issue is simply a person-to-person exchange of cash for Bitcoin.

2. The instant case as distinguished from *E-Gold Ltd.*

*E-Gold Ltd.* involves another case where the trial court, here the District Court for the District of Columbia, denied a motion to dismiss § 1960 charges filed against an issuer of online virtual currency known as "e-gold." Unlike the decentralized system responsible for Bitcoin, e-gold was created and operated by a single company. 550 F. Supp. 2d at 85. The company's business model was that "[f]or every transfer of e-gold from one e-gold account to another, e-gold collects a transaction fee." Id. Critically, these transfers were conducted by the defendant, E-Gold, Ltd., at the direction of "the account holder [, who] can then use the e-gold to buy a good or pay for a service, or to transfer funds to someone else." *Id.* The conduct Mr. Costanzo is alleged to have engaged in, by contrast, does not include the transmittal of funds from one party to another at the direction of a client. Mr. Costanzo is simply alleged to have bought and sold Bitcoin. To the extent he made any "transfer," it was only the sort of transfer inherent and incidental to any purchase or sale, not the directed transmittal required by § 1960 's definition of "money transmitting."

[1] For a brief explanation of the online criminal marketplace Silk Road, *see* Exhibit D, USAO, Southern District of New York, Press Release (May 29, 2015).

## CONCLUSION

Based on all of the arguments above, this Court should conclude that the Indictment fails to allege an offense under § 1960. Specifically, the facts and the law militate for this Court to conclude that: 1) Bitcoin is not money or currency, and 2) that a simple person-to-person Bitcoin exchange does not qualify as "money transmitting." Should this Court so find for the defense on either or both of these two grounds, Counts 1 & 2 must be dismissed.

Excludable delay under 18 U.S.C. § 3161(h)(1)(D) may result from this motion or from an order based thereon.

Respectfully submitted: October 30, 2017.

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