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Virtual Currencies: Court Rules that Selling Bitcoin Is Not Money Transmitting and Selling Bitcoin to Criminals Is Not a Crime

The ruling is an outlier driven by its unique facts and is unlikely to change the general regulatory landscape for Bitcoin businesses.

In *State of Florida v. Espinoza*, a trial court in Miami recently dismissed all charges against an individual Bitcoin exchanger, who was arrested in a sting operation after agreeing to sell bitcoins to an undercover detective who purported to need them to buy stolen credit cards.[1] The court's decision, which is now being appealed by the prosecution, includes several notable holdings. In dismissing charges that the defendant had operated a money transmitting business without a license, the court held that bitcoins are not "money," that selling bitcoins is not money "transmitting," and that selling bitcoins without charging transaction fees does not involve the operation of a money transmitting "business." Separately, in dismissing money laundering charges against the defendant, the court found that merely selling bitcoins to someone who plans to use them for a criminal purpose — even if that criminal purpose is evident at the time of the sale — is not a sufficient basis for a money laundering charge.

The *Espinoza* decision is the first judicial opinion dismissing charges against a virtual currency exchanger and is worth a careful read. In significant respects, the decision is at odds with prevailing case law from other virtual currency-related prosecutions. In other respects, the trial court's decision addresses issues of first impression and suggests possible limits in how far courts may be willing to go in applying money-transmitting requirements and anti-money laundering (AML) laws to Bitcoin exchange activity. At the end of the day, however, the decision appears to be the product of a unique set of facts, involving an individual engaged in sporadic, small-volume Bitcoin transactions, and does not reflect the overall regulatory trends facing virtual currency businesses.

Factual Background

Michell Espinoza was arrested on February 6, 2014, following an investigation by an undercover detective from the Miami Beach Police Department (the UC).[2] The UC became interested in Espinoza after finding him on LocalBitcoins.com — an online, peer-to-peer Bitcoin exchange, where individual users can post offers to buy or sell bitcoins, including in face-to-face, cash transactions.[3] The UC came across a user on the site with the handle "Michelhack" — later determined to be Espinoza.[4] Espinoza's ad explained that he accepted only cash and that interested buyers would need to meet him in person with either their smartphone wallet or the Bitcoin address where they wanted their bitcoins deposited.[5] The UC did not have any previous reports that Espinoza was engaged in any illicit criminal activity, but Espinoza attracted the UC's interest because of the term "hack" in his username and because he appeared willing to transact business at any time of day and in public places.[6]

On December 4, 2013, the UC contacted Espinoza, claiming to be an interested buyer, and arranged to meet him at a café the next day. At the meeting, Espinoza agreed to sell the UC .40322580 Bitcoin in exchange for US$500 in cash.[7] Espinoza did not charge a fee for the transaction, but he explained to the UC that he would make a 15% profit on the sale by virtue of purchasing the bitcoins at 10% below market value and selling them at 5% above market value.[8] In the course of this first transaction, the UC did not specify what he purportedly wanted the bitcoins for, but he made it clear that he wished to remain anonymous.

Several weeks later, the UC met Espinoza again, at an ice cream store, where he purchased another US$1,000 worth of bitcoins from Espinoza. This time, the UC told Espinoza that he was in the business of buying stolen credit cards from "Russians" and that he would be using the bitcoins for that purpose.[9] Another three weeks later, the UC bought another US$500 worth of bitcoins from Espinoza, this time arranging the transaction entirely through a text message exchange.[10] The UC told Espinoza on this occasion that he wanted to buy US$30,000 in Bitcoin from Espinoza in the future.[11]

On February 6, 2014, the UC met Espinoza in person again, this time at a hotel, with the intent of conducting the US$30,000 transaction.[12] During the meeting, the UC told Espinoza, consistent with the UC's previous representations, that he needed bitcoins in order to acquire wholesale quantities of stolen credit cards, which he intended to resell to others for a higher price.[13] The UC showed Espinoza a "flash roll" of hundred dollar bills purporting to be the purchase money for the bitcoins (which, in fact, was counterfeit).[14] Upon inspection, Espinoza became concerned that the currency was not genuine, but before Espinoza took possession of the counterfeit bills, he was arrested.[15]

Espinoza was charged with one count of unlawfully engaging in business as a money transmitter without a license, in violation of Florida's money services business statute,[16] and two counts of money laundering, in violation of Florida's anti-money laundering statute.[17]

The Court's Decision

On July 22, 2016, Circuit Judge Teresa Pooler granted Espinoza's motion to dismiss all charges, finding that the conduct alleged did not constitute violations of the crimes charged.

Unlicensed Operation of Money Services Business

As to the unlicensed money services business charge, Judge Pooler found that Espinoza's conduct fell short of the relevant statutory requirements in several respects.

First, Judge Pooler found that Espinoza's sale of bitcoins to the UC did not involve the "transmission" of money. According to the court, "transmission" involves sending money from one person or place to another — as in a wire transaction, with the transmitter acting as a middleman between the two parties involved. By contrast, Judge Pooler found Espinoza to be merely a "seller" of Bitcoin, who sold bitcoins to buyers much as a day trader would sell shares of stock.[18] Given that Espinoza was not acting as a middleman between a sender and receiver, Judge Pooler found that he did not qualify as a transmitter.

Second, Judge Pooler considered and rejected an alternative argument made by the prosecution that Espinoza was a seller of "payment instruments" — another type of money services business subject to the same licensing requirements as a money transmitting business. The applicable statutory definition of "payment instrument" includes any "check, draft, warrant, money order, travelers' check, electronic instrument, or other instrument, payment of money, or monetary value whether or not negotiable." Notwithstanding the inclusion of "monetary value" in the list, Judge Pooler concluded that Bitcoin does not fit into any of these categories.[19] Instead, Judge Pooler found that Bitcoin is a form of "property," adding

that it "has a long way to go before it is the equivalent of money."[20] Judge Pooler offered several observations about Bitcoin in this regard, finding that Bitcoin is not widely accepted by merchants as a form of payment, that its value fluctuates greatly, limiting its utility as a store of value, and that it consists of a decentralized system that is not "backed by anything."[21] Based on these views, Judge Pooler found that regulating a Bitcoin seller as a money services business would be "like fitting a square peg into a round hole."[22]

Third, Judge Pooler found that, in any event, Espinoza had not engaged in money transmitting or selling payment instruments *as a business* — another element of the offense. In order to qualify as a money services business, Judge Pooler reasoned, an individual must charge a "fee" for his services. Instead, Espinoza made a profit simply by selling bitcoins for a higher price than he had paid for them.[23] The court found the situation to be no different from an individual making a profit from "selling his personal property."[24]

In light of all these considerations, Judge Pooler dismissed the money transmitting charge against the defendant. While Judge Pooler noted that the Florida legislature may choose to adopt statutes specifically regulating virtual currency in the future, she held that, under current Florida law, the court lacked a sufficient basis to find that Espinoza's sale of Bitcoin to the UC amounted to the operation of an unlicensed money services business.[25]

Money Laundering

As to the money laundering charge against Espinoza, Judge Pooler found that the alleged conduct did not involve the requisite criminal intent. The applicable money laundering statute, in relevant part, prohibits a person from conducting a financial transaction involving "sting money" — *i.e.*, property that a law enforcement officer represents will be used to conduct or facilitate criminal activity — if the person intends to "promote" the carrying on of the criminal activity through his action.[26] Judge Pooler found that Espinoza had engaged in a financial transaction by accepting money in exchange for bitcoins, and that the UC had represented the bitcoins would be used to conduct or facilitate criminal activity, namely, the purchase of stolen credit cards.[27] However, she found that the defendant's alleged conduct did not involve an "intent to promote" that criminal activity. Finding the term "promote" to be "troublingly vague," Judge Pooler asked rhetorically, "Is it criminal activity for a person merely to sell their property to another, when the buyer describes a nefarious reason for wanting the property?"[28] In the absence of clearer statutory guidance, Judge Pooler answered this question in the negative, concluding that Espinoza should not be considered to have intended to "promote" the purchase of stolen credit cards merely by selling bitcoins to someone claiming to want them for that purpose.[29] Judge Pooler added, dismissively, that there was "unquestionably no evidence that the Defendant did anything wrong, other than sell his Bitcoin to an investigator who wanted to make a case."[30]

Commentary

Insofar as the *Espinoza* decision holds that Bitcoin is not tantamount to "money" for purposes of money transmitting business regulations, the opinion is an outlier. The Florida statute at issue in *Espinoza* specifically applies not just to fiat currency or traditional modes of payment but to any form of "monetary value." The analogous federal statute — Title 18, United States Code, Section 1960 — contains comparably broad language, which the courts have repeatedly interpreted to encompass virtual currency, on the theory that it is a liquid form of value that can be used, like money, to pay for goods and services.[31] Perhaps more importantly, the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) has made clear that federal licensing requirements for money transmitters do not "differentiate between real currencies and convertible virtual currencies," but rather apply to anyone involved in accepting and transmitting "anything of value that substitutes for currency" — including virtual currencies

such as Bitcoin.[32] Thus, notwithstanding the *Espinoza* court's comment that Bitcoin "has a long way to go" before it is equivalent to money, in the eyes of FinCEN and other courts that have considered the question, Bitcoin is sufficiently equivalent to money to fall within the scope of money transmitting laws.

In other respects, however, the *Espinoza* decision explores less settled territory. In particular, in holding that the defendant did not engage in money "transmitting" because he was not the middleman in a two-party transaction, the decision raises the question whether merely selling bitcoins in exchange for fiat currency is sufficient to constitute money transmission. In such a transaction, there is only one party involved, who is both buying and receiving the bitcoins; the bitcoins are not sent to a separate recipient. FinCEN takes the view that selling virtual currency as part of an exchange operation nonetheless constitutes money transmitting, in that it involves transmission of money from one *location* to another — that is, transmission from the location where the money is held prior to the transaction (*e.g.*, in the buyer's bank account) to the virtual location where it is sent as a result of the transaction (*e.g.*, the user's address on the Bitcoin network).[33] However, this theory of money transmitting has not been squarely tested in litigation, and Judge Pooler does not appear to have considered it in her ruling.

The *Espinoza* decision also raises the question whether a person or entity must profit in a particular way or with a certain degree of formality in order to be considered a money transmitting "business." Judge Pooler found that the defendant had not engaged in money transmitting as a business because he had not charged a "fee" for his services. Other cases applying money transmitting laws have held that the issue turns simply on whether the defendant acted for profit, and have pointed to the charging of a fee merely as evidence of a for-profit operation, rather than a legal requirement in and of itself.[34] Judge Pooler's contrary view that profit alone is not enough seems to have been influenced by the fact that Espinoza appeared to be selling bitcoins in one-off transactions, arranged individually through LocalBitcoins.com. His activity was thus arguably more akin to the sale of personal property through a classified ad, as opposed to the operation of a continuous business enterprise.

Lastly, the dismissal of the money laundering charge in *Espinoza* raises the issue of what criminal liability a Bitcoin exchange business may bear from processing transactions for customers whom it knows are engaged in illegal activity. Judge Pooler's ruling accords with prevailing case law holding that one cannot be held liable for money laundering simply by virtue of engaging in transactions with money that one knows will be used in criminal activity. Typically, money laundering laws require an intent to "promote" the criminal activity, which has been held to require more than mere knowledge of the criminal activity. However, virtual currency businesses should be aware that such knowledge does provide a sufficient basis for other criminal charges. For example, the federal money transmitting statute, Section 1960, prohibits one from operating a money transmitting business involving funds "known to the defendant" to be intended for use in supporting unlawful activity.[35] Moreover, under the Bank Secrecy Act (BSA), a money transmitting business is subject to criminal penalties for wilfully failing to file suspicious activity reports, which should be filed upon learning that a customer's financial transactions are connected to criminal activity.[36] Indeed, Section 1960 and BSA charges have successfully been brought against Bitcoin exchangers under just such circumstances.[37]

Conclusion

In rebuffing the prosecution of a Bitcoin exchanger, the *Espinoza* decision underscores the uncertainty that still surrounds the legal treatment of virtual currency and the hesitation courts may have toward applying money transmitting laws and AML laws to this novel context. However, the decision does not reflect general legal trends so much as the unique factual background of the case. Indeed, what seemed to concern Judge Pooler the most was the targeting of Espinoza, a small-time, casual seller of bitcoins, for a sting operation, despite there being no prior indication that he was involved in criminal activity.

Whether the *Espinoza* ruling stands as a legal precedent will be decided in the pending appeal of the case. But regardless, the case may serve as an admonition to law enforcement, in its efforts to patrol the virtual currency space, to be more discriminating in its choice of investigative targets.

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Endnotes

[1] *State of Florida vs. Espinoza*, Order Granting Defendant's Motion to Dismiss the Information (Fla. 11th Cir. Ct. Jul. 22, 2016) [hereinafter Espinoza Order]. Per convention, the term "Bitcoin" is capitalized in this commentary when referring to the currency generally but referred to in lower case when referring to units of the currency.

[2] *Id.* at 1.

[3] *Id.*

[4] *Id.* at 1-2.

[5] *Id.* at 2.

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id.* at 2-3.

[11] *Id.* at 3.

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] Fla. Stat. § 560.125(5)(a).

[17] Fla. Stat. § 896.101(5)(a)&(b).

[18] Espinoza Order at 4.

[19] Espinoza Order at 5.

[20] Espinoza Order at 6.

[21] *Id.* at 5-6.

[22] *Id.* at 6.

[23] *Id.* at 5.

[24] *Id.*

[25] *Id.* at 6.

[26] *Id.*

[27] *Id.* at 6-7.

[28] *Id.* at 7.

[29] *Id.*

[30] *Id.*

[31] *See, e.g.*, *United States v. Budovsky*, 2015 WL 5602853 at *13 (S.D.N.Y. Sep. 23, 2015); *United States v. Faiella*, 39 F. Supp. 3d 544, 545 (S.D.N.Y. 2014); *United States v. E-Gold, Ltd.,* 550 F. Supp. 2d 82, 84-85 (D.D.C. 2008).

[32] FinCEN, *Application of FinCEN's REgulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FIN-2013-5001 (Mar. 18, 2013) [hereafter FinCEN March 2013 Guidance], at 3.

[33] *Id.* at 3-4. The FinCEN March 2013 Guidance also takes the position that a person is a money transmitter if the person accepts Bitcoin from one person and transmits it to another person — even if the acceptance and transfer are not part of the same transaction — if the conduct is part of an exchange operation as opposed to selling other goods or services.

[34] *See, e.g., U.S. v. Mazza-Alaluf*, 607 F. Supp. 2d 484, 490-91 (S.D.N.Y. 2009).

[35] 18 U.S.C. § 1960(b)(1)(C).

[36] 31 U.S.C. §§ 5318(g) & 5322(a).

[37] *See U.S. v. Faiella*, Complaint, 14 Mag. 164 (S.D.N.Y. Jan. 24, 2013).