# THE MORAL LIBERAL

## A Victory for Bitcoin Users

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On July 25, Miami-Dade Florida circuit judge Teresa Pooler dismissed money-laundering charges against Michell Espinoza, a local bitcoin seller. The decision is a welcome pause on the road to financial serfdom. It is a small setback for authorities who want to fight crime (victimless or otherwise) by criminalizing and tracking the "laundering" of the proceeds, and who unreasonably want to do the tracking by eliminating citizens' financial privacy, that is, by unrestricted tracking of their subjects' financial accounts and activities. The US Treasury's Financial Crimes Enforcement Network (FinCEN) is today the headquarters of such efforts.

As an Atlanta Fed primer reminds us, the authorities' efforts are built upon the Banking Secrecy Act (BSA) of 1970. (A franker label would be the Banking Anti-Secrecy Act). The Act has been supplemented and amended many times by Congress, particularly by Title III of the USA PATRIOT Act of 2001, and expanded by diktats of the Federal Reserve and FinCEN. The laws and regulations on the books today have "established requirements for recordkeeping and reporting of specific transactions, including the identity of an individual engaged in the transaction by banks and other FIs [financial institutions]." These requirements are collectively known as Anti-Money-Laundering (AML) rules.

In particular, banks and other financial institutions are required to obey "Customer Identification Program" (CIP) protocols (aka "know your customer"), which require them to verify and record identity documents for all customers, and to "flag suspicious customers' accounts." Banks and financial institutions must submit "Currency Transaction Reports" (CTRs) on any customers' deposits, withdrawals, or transfers of $10,000 or more. To foreclose the possibility of people using unmonitored non-banks to make transfers, FinCEN today requires non-depository "money service businesses" (MSBs) – which FinCEN defines to include "money transmitters" like Western Union and issuers of prepaid cards like Visa – also to know their customers. Banks and MSBs must file "Suspicious Activity Reports (SARs)" on transactions above $5000 that *may* be associated with money-laundering or other criminal activity. Individuals must also file reports. Carrying $10,000 or more into or out of the US triggers a "Currency or Monetary Instrument Report" (CMIR)." Any US citizen who has $10,000 or more in foreign financial accounts, even if it never moves, must annually file "Foreign Bank and Financial Accounts Reports (FBARs)."

In addition, state governments license money transmitters and impose various rules on their licensees.

When most of these rules were enacted, before 2009, there were basically only three convenient (non-barter) conduits for making a large-value payment. If Smith wanted to transfer $10,000 to Jones, he could do so in person using cash, which would typically involve a large withdrawal followed by a large deposit, triggering CTRs. He could make the transfer remotely using deposit transfer through the banking system, triggering CTRs or SARs if suspicious. Or he could use a service like Western Union or Moneygram, again potentially triggering SARs. For the time being, the authorities had the field pretty well covered.

Now come Bitcoin and other cryptocurrencies. Cash is of course still a face-to-face option. But today if Smith wants to transfer $10,000 remotely to Jones, he need not go to a bank or Western Union office. He can accomplish the task by (a) purchasing $10,000 in Bitcoin, (b) transferring the BTC online to Jones, and (c) letting Jones sell them for dollars (or not). The authorities would of course like to plug this "loophole." But the internet, unlike the interbank clearing system, is not a limited-access conduit whose users can be commandeered to track and report on its traffic. No financial institution is involved in a peer-to-peer bitcoin transfer. Granted, Smith will have a hard time purchasing $10,000 worth of Bitcoins without using a bank deposit transfer to pay for them, which pings the authorities, but in principle he could quietly buy them in person with cash.

In the recent legal case, it appears that this possibility for unmonitored transfers was noticed by Detective Ricardo Arias of the Miami Beach Police Department, who "became intrigued" and presumably alarmed upon learning about Bitcoin at a meeting with the US Secret Service's Miami Electronic Crimes Task Force. Detective Arias and Special Agent Gregory Ponzi decided to investigate cash-for-Bitcoin sales in South Florida. (I take details about the case from Judge Pooler's decision in *State of Florida v. Michell Abner Espinoza* (2016).) Arias and Ponzi went to localbitcoins.com to find a seller willing to make a cash sale face-to-face. Acting undercover, Arias contacted one Michell Espinoza, apparently chosen because his hours were flexible. Arias purchased $500 worth of Bitcoin at their first meeting in a Miami Beach coffee shop, and later purchased $1000 worth at a meeting in a Haagen-Daaz ice cream shop in Miami. Arias tried to make a third purchase for $30,000 in a hotel room where surveillance cameras had been set up, but Espinoza rightly suspected that the currency offered was counterfeit, and refused it. At that meeting, immediately after the failed purchase, Espinoza was arrested. He was charged with one count of unlawfully operating a money services business without a State of Florida license, and two counts of money laundering under Florida law.

Judge Pooler threw out all three charges. Evaluating her arguments as a monetary economist, I find that some are insightful, while others are beside the point or confused. On the charge that Espinoza illegally operated an unlicensed money services business, she correctly noted that Bitcoin is not widely accepted in exchange for goods and thus "has a long way to go before it is the equivalent of money." Accordingly, "attempting to fit the sale of Bitcoin into a statutory scheme regulating money services businesses is like fitting a square peg in a round hole." However she also offered less compelling reasons for concluding that Bitcoin is not money, namely that it is not "backed by anything" and is "certainly not tangible wealth and cannot be hidden under a mattress like cash and gold bars." Federal Reserve notes are money without being backed by anything, and bank deposits are money despite being intangible. Gold bars are today not money (commonly accepted as a medium of exchange).

Judge Pooler further correctly noted that Espinoza did not receive currency for the purpose of transmitting it (or its value) to any third party on his customer's behalf, as Western Union does. He received cash only as a seller of Bitcoin. Nor, she held, does Bitcoin fall into any of the categories under Florida's statutory definition of a "payment instrument," so Espinoza was not operating a money services business as defined by the statute. Bitcoin is indeed not a payment instrument as defined by the statue because it is not a fixed sum of "monetary value" in dollars like the categories of instruments that are listed by the statute. It is an asset with a floating dollar price, like a share of stock.

Here Judge Pooler accepted a key defense argument (basically, "the defendant was not transmitting money, but only selling a good for money") that was rejected by Judge Collyer in *U.S. v. E-Gold* (2008). In the e-gold system, Smith could purchase and readily transfer to Jones claims to units of gold held at e-gold's warehouse. Federal officials successfully busted e-gold for "transmitting money" without the proper licenses. Judge Collyer accepted the prosecution's argument that selling gold to Smith, providing a vehicle for him to transfer it to Jones, and buying it back from Jones is tantamount to transmitting money from Smith to Jones. Of course the Espinoza case is different in that Espinoza did not provide a vehicle for transmitting Bitcoin to a third party, nor did he buy Bitcoin from any third party.

On the charge of money laundering, Judge Pooler found that there was no evidence that Espinoza acted with the intent to promote illicit activity or disguise its proceeds. Further, Florida law is too vague to know whether it applies to Bitcoin transactions. Thus: "This court is unwilling to punish a man for selling his property to another, when his actions fall under a statute that is so vaguely written that even legal professionals have difficulty finding a singular meaning."

I expect that FinCEN will now want to work with the State of Florida, and other states, to rewrite their statutory definitions of money services businesses and money laundering to reinforce their 2013 directive according to which Bitcoin exchanges must register as MSBs and so submit to "know your customer" and "file reports on your customer" rules. If even casual individual Bitcoin sellers like Espinoza must also register as MSBs, that will spell the end to legal local Bitcoin-for-cash trades.

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