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Blockchain Law

What is it we're talking about when we talk about crypto?

Robert A. Schwinger, *New York Law Journal – May 28, 2019*

In his Blockchain Law column, Robert A. Schwinger addresses the question of where crypto fits in among all the terms the law uses to describe concepts that relate, however closely or loosely, to money. As cryptocurrency use becomes increasingly common in commercial activity, courts have found themselves having to grapple with how to characterize this new form of asset.

For all the discussions had about cryptocurrency, a very basic question often gets ignored: Just what is it that we're talking about when we talk about crypto? Where does crypto fit in among all the terms the law uses to describe concepts that relate, however closely or loosely, to money? As cryptocurrency use becomes increasingly common in commercial activity, courts have found themselves having to grapple with how to characterize this new form of asset.

Is It 'Money' or 'Funds'?

Since early on in governmental civil and criminal enforcement cases, courts have been comfortable equating crypto with "money" or "funds." In *SEC v. Shavers*, 2013 WL 4028182 (E.D. Tex. Aug. 6, 2013), for example, the defendant received Bitcoin for return for shares in his investment venture. He argued that the court lacked subject-matter jurisdiction over the securities claims against him, asserting that what he sold could not have been "securities" because, since he received only Bitcoin from the investors, there had been no "investment of money" as is required for "securities" under the test of *SEC v. W.J. Howey & Co.*, 328 US 293 (1946). The court disagreed and upheld subject-matter jurisdiction, stating: "It is clear that Bitcoin can be used as money. It can be used to purchase goods or services, and ... used to pay for individual living expenses ... . [I]t can also be exchanged for conventional currencies, ... Therefore, Bitcoin is a currency or form of money ... ."

US v. Ulbricht, 31 F. Supp. 3d 540 (S.D.N.Y. 2014), involved the prosecution of Ross William Ulbricht who, under the moniker "Dread Pirate Roberts," ran the "Silk Road" website where illicit goods and services were bought and sold, often through use of Bitcoin. Ulbricht sought to dismiss his 18 U.S.C. §1956(h) indictment for money laundering conspiracy, arguing that he was not involved in "financial transactions" involving the movement of "funds" or "monetary instruments," as the statute requires. The court disagreed and upheld the indictment. It held that the statutory term "funds" should be given its ordinary dictionary meaning, which refers to "money" and that "'[m]oney' is an object used to buy things." Accordingly, "'funds' can be used to pay for things in the colloquial sense."

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The court held that Bitcoins were "funds" because they "can be either used directly to pay for certain things or can act as a medium of exchange and be converted into a currency which can pay for things." "Indeed," it noted, "the only value for Bitcoin lies in its ability to pay for things." Moreover, Bitcoins "constitute something of value. And they may be bought and sold using legal tender." Particularly given the ills that Congress was seeking to prevent through the money laundering statute, the court concluded that the statute "is broad enough to encompass use of Bitcoins in financial transactions," and that "[a]ny other reading would—in light of Bitcoins' sole raison d'etre—be nonsensical."

A similar ruling was made in another Silk Road prosecution, *US v. Faiella*, 39 F. Supp. 3d 544 (S.D.N.Y. 2014), where the defendant challenged his indictment for operating an unlicensed money transmitting business in violation of 18 U.S.C. §1960 by arguing that his Bitcoin transactions did not involve transmitting "money." Here too, the court rejected this argument and upheld the indictment.

According to the court, "'money' in ordinary parlance means 'something generally accepted as a medium of exchange, a measure of value, or a means of payment,'" and dictionary examples for "money" were not limited to coins and paper money. Moreover, the money transmitting statute in §1960 (like the money laundering statute in §1956(h) discussed in *Ulbricht*) referred to "funds" as well as "money." The court cited a dictionary definition of "funds" as meaning "'available money' or 'an amount of something that is available for use: a supply of something.'" Citing *Shavers*, the court concluded "Bitcoin clearly qualifies as 'money' or 'funds' under these plain meaning definitions. Bitcoin can be easily purchased in exchange for ordinary currency, acts as a denominator of value, and is used to conduct financial transactions." Similar to *Ulbricht*, *Faiella* held that giving §1960 this "broad reading" was consistent with effectuating the legislative purposes behind its enactment.

More recent cases have continued to follow this approach. *US v. Stetkiw*, 2019 WL 417404 (E.D. Mich. Feb. 1, 2019), involved a defendant who ran a service exchanging ordinary currency for Bitcoin and was charged with running an illicit money transmission business under 18 U.S.C. §1960. Citing *Faiella* and other cases, the court held that Bitcoin constitutes "money" and "funds" within the meaning of the statute.

The court also held that because the defendant transferred the Bitcoins to another location, this constituted "money transmitting" under §1960(b)(2) because he was accepting currency and transmitting its value to that other location, citing an interpretive "Guidance" issued by the Department of Treasury Financial Crimes Enforcement Network (FinCEN), "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies," FinCEN Guidance FIN-2013-G001 (March 18, 2013). The court noted that while this would not apply to persons who purchase virtual currency for their own accounts as an investment, the defendant here was plainly running a business in which he charged fees for a transmission service and thus was engaged in money transmitting.

Likewise, *Temurian v. Piccolo*, 2019 WL 1763022 (S.D. Fla. April 22, 2019), involved various claims for conversion against software developers who were alleged, among other things, to have fraudulently transferred various of plaintiffs' bitcoin and ether tokens to themselves through unauthorized access to the plaintiffs' digital cryptocurrency wallet. While defendants moved to dismiss, they did not attempt to contest the sufficiency of the claim for conversion of cryptocurrency. The court noted: "Although the Eleventh Circuit has yet to decide whether cryptocurrencies are considered 'money' for the purposes of a claim of conversion, other district courts have held that they do for the purposes of federal money laundering statutes" (citing *Faiella* and *Shavers*).

Is It a 'Payment Instrument', 'Monetary Instrument' or 'Instrument' Having 'Monetary Value'?

In *State v. Espinoza*, 264 So. 3d 1055 (Fla. Dist. Ct. App. 3d Dist. Jan. 30, 2019), the defendant "operat[ed] an unlicensed cash-for-bitcoins business." He was charged with violating Fla. Stat. §560.125 (2013), which prohibits engaging in a "money services business" without a license. The statute defines a "money services business" to include those who act "as a payment instrument seller, … or money transmitter." Id. §560.103(22). The defendant moved to dismiss, asserting that he did not fall within the statute because Bitcoin was not "money" or "monetary value" and his sale of Bitcoins did not constitute selling "payment instruments." The trial court had agreed and dismissed the information but the appellate court reversed.

The appellate court in *Espinoza* held that while Bitcoin was not "currency," it represented "monetary value," which under the statute existed "whether or not redeemable in currency," and therefore constituted a "payment instrument." Moreover, "bitcoins function as a 'medium of exchange,'" noting testimony showing that various persons accepted it as a form of payment. For this reason, "it necessarily qualifies as 'monetary value'" under the statute. The appellate court thus reinstated the charge of operating an unlicensed money services business. It also reversed the dismissal of Florida money laundering charges, likewise refusing to accept defendants' argument that his activity did not involve "financial transactions" or "monetary instruments" as required under that statute, Fla. Stat. §896.101 (2014).

The ruling in *Espinoza* had been presaged in *US v. Murgio*, 209 F. Supp. 3d 698 (S.D.N.Y. 2016), where the court upheld defendants' indictment for operating a website that functioned as an unlawful and unlicensed Bitcoin exchange, in violation of 18 U.S.C. §1960. First, relying on the reasoning of *Ulbricht* and *Faiella* which relied upon common dictionary definitions, the court held that Bitcoins were "money" and "funds" within the meaning of §1960, rejecting the defendants' arguments that the court should construe §1960 by looking at narrower definitions of "money" and funds" found in *Black's Law Dictionary* and UCC §1-201(b)(24).

Murgio also upheld defendants' indictment under §1960(b)(1)(A), the prong of §1960 that criminalizes operating a money transmitting business without a license in a state that requires such a license, which in *Murgio* was Florida. Noting that Florida defines "monetary value" as "a medium of exchange, whether or not redeemable in currency" (citing Fla. Stat. §560.103(21)), the court concluded that because "Bitcoins, as explained previously, function as a 'medium of exchange[,]' [t]hey therefore fall within Chapter 560's express definition of 'monetary value.'" The court also held that Bitcoins fall within the statutory definition of "payment instruments," which includes any "instrument" or "monetary value," Fla. Stat. §560.103(29), and thus since "bitcoins function as a medium of exchange, and they are therefore both monetary value and payment instruments, as Florida defines those terms." *Murgio* also correctly predicted that the original lower court ruling in *Espinoza*, which at that time had not been reversed, would not be followed by Florida courts of higher authority.

Is It 'Currency'?

While *Shavers*, a 2013 securities case, held that "Bitcoin is a currency ... ," others have not agreed. In 2014, the IRS took the position that "[f]or federal tax purposes, virtual currency is treated as property" and "is not treated as currency." IRS Notice 2014-21 (March 23, 2018). In *US v. Zaslavskiy*, 2018 WL 4346339 (S.D.N.Y. Sept. 11, 2018), where the court held that the virtual currencies at issue were "securities" under the *Howey* test, it noted that the statutory definition of a "security" excludes "currency," and so rejected the defendant's attempt to circumvent the *Howey* test by arguing that because cryptocurrencies were "currencies" they therefore could not be "securities." *Espinoza* also held that "Bitcoin does not expressly fall under the definition of 'currency'" found in Florida's money services businesses statute. A very recent FinCEN Guidance concerning money transmission services took the approach of using the phrase "value that substitutes for currency" to refer to cryptocurrencies. "Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies," FinCEN Guidance FIN-2019-G001 (May 9, 2019).

Is It 'Cash', 'Quasi-Cash' or 'Cash-Like'?

How to characterize cryptocurrency has also become an issue under credit card agreements, which often charge higher interest rates for cash advances than for ordinary purchases of goods or services. Into which category should cryptocurrency purchases fall? The court in *Eckhardt v. State Farm Bank FSB*, 2019 WL 1177954 (C.D. Ill. March 13, 2019), faced this issue.

In *Eckhardt*, the plaintiff's credit card agreement set a higher rate for "quasi-cash transactions" which were defined as "items that are convertible to cash or similar cash-like transactions ... including wire transfer money orders, other money orders, travelers checks, or foreign currency or tax payments" but excluding "casino chips, bets or wagers, gaming transactions (including Internet gambling), lottery tickets or the like." The plaintiff alleged that the bank initially treated his purchases of cryptocurrency as ordinary purchases but later began reclassifying them as "quasi-cash transactions" subject to a higher interest rate. Plaintiff alleged that this change violated various provisions of the Truth in Lending Act (TILA), 15 U.S.C. §1601 *et seq*., and Regulation Z, 12 C.F.R. §1026 *et seq*., and the bank moved to dismiss.

The court dismissed plaintiff's claim that the bank's change of how it characterized cryptocurrency purchases under the agreement violated TILA or Regulation Z requirements of providing adequate notice of a significant change in account terms. It held that a mere change in the *application* of the unchanged cardholder agreement did not fall within the prohibitions of the statute and regulations.

The court nevertheless found that other TILA and Regulation Z provisions were implicated under plaintiff's allegations, namely those requiring that account disclosures "be presented clearly and conspicuously." The bank had sought to dismiss this claim, arguing that cryptocurrency by its nature was "cash-like." The court held that the bank's argument "presents an issue of fact" that precluded dismissing this claim on a preliminary motion in which plaintiff's allegations must be taken as true. The court cited a dictionary definition of "cash" as "money in the form of coins or bank-notes, esp[ecially] that issued by a government," and held that "[p]laintiff has plausibly alleged facts indicating cryptocurrency is unlike this definition of 'cash' and is instead more akin to a good, such as software." The court also noted plaintiff's argument that this uncertainty "is exacerbated because cryptocurrency is dissimilar to the examples of quasi-cash set forth in the [agreement's] definition." The clear and conspicuous disclosure claim was thus upheld at the pleading stage.

Based on this same issue of fact, the court also upheld as presenting a fact question plaintiff's claim for breach of contract in the bank's applying the "quasi-cash" provision to his cryptocurrency purchases, and plaintiff's claim for declaratory relief on the issue of whether cryptocurrency was "cash-like." However, the court rejected plaintiff's claim for breach of the covenant of good faith and fair dealing and his TILA claim for failure to provide accurate periodic statements.

Conclusion

Courts largely have been unwilling to hold as a matter of law (such as on motions to dismiss a claim or an indictment) that cryptocurrency falls outside broad terms like "money," "funds," "payment instrument" or "cash-like." But they also may be reluctant to conclude as a matter of law that cryptocurrency must always fall within such terms, and so far have been leaving this as a fact question that can legitimately be presented by allegations and may need to be resolved based on the evidence.

Cases presenting these questions can thus be expected to continue for some time. Indeed, *Eckhardt* noted that in the credit card-TILA context, there is a pending Southern District of New York case, *Tucker v. Chase Bank USA N.A.*, No. 1:18-cv-03155 (KPF), that presents "a virtually identical complaint" under TILA and a dismissal motion "presenting th[e] exact question" under TILA as in *Eckhardt*. A California federal court recently issued a minute order summarily denying a bank's motion to dismiss TILA, breach of contract and declaratory claims brought by a cryptocurrency purchaser under similar circumstances, although expressing interest in returning to the issue at the summary judgment stage. *Galavis v. Bank of America, N.A.*, No. 2:18-cv-09490-SVW-PJW, Order Denying Motion to Dismiss (C.D. Cal. March 26, 2019). The debate over just what is it we're talking about when we talk about crypto apparently will continue for some time to come.

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