

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,

-vs-

RICHARD PETIX,

Defendant.

15-cr-227-A

**DEFENDANT'S SUPPLEMENTAL
SUBMISSION ON MOTION TO
DISMISS COUNT 2 OF
SUPERSEDING INDICTMENT**

The defendant, Richard Petix, by and through his attorneys Matthew R. Lembke and Stephen M. Leonardo, files this supplemental submission: (1) in further support of Petix's motion to dismiss count two of the superseding indictment (operating an unlicensed money transmitting business);¹ (2) in response to the government's opposition to Petix's motion to dismiss count two of the superseding indictment;² and (3) to address issues that arose at oral argument on this aspect of Petix's motion.

Introduction

We do not believe there is any dispute that the conduct that forms the basis of the government's accusation that Richard Petix was "operating an unlicensed money transmitting business" is Petix's sale of Bitcoin to willing buyers in exchange for cash. These were two-party transactions between Petix and the buyers. They

¹ D. 23 (Petix's motion); D.16 (superseding indictment)

² D. 24 (government's opposition to motion to dismiss count two)

were “arm’s length” transactions. The terms of each purchase and sale were negotiated and agreed upon by Petix and each individual purchaser.

There can be no dispute that Petix did not charge a fee in order to complete the purchase and sale.

The Bitcoin Petix sold was transferred directly to the purchaser as the purchaser directed. The cash Petix received in exchange for the Bitcoins he sold was transferred directly to Petix himself personally, or to a bank account owned and controlled by him. Not money was transferred any intermediary. No Bitcoin was transmitted through any intermediary.

In short, every Bitcoin transaction in which Petix engaged was a straight-forward buyer-seller transaction; a common exchange of one thing of value (in this case, Bitcoin) for another thing of value (cash).

The question before the Court is a straight-forward as the transactions themselves: Did Petix’s conduct amount to operating a money transmitting business?

The short answer is no.

There are at least three reasons for this conclusion, none of which are particularly complicated.

First, the sale of Bitcoin to a willing buyer in a two-party transaction does not qualify as “operating in money transmitting business” as defined by law or regulation.

Second, neither Bitcoin itself, nor the activities associated with the buying, selling, and using Bitcoin, constitute a “business” under the law.

And third, even if Bitcoin were a “business” Petix was not an “operator” of that business as defined by law.

We will explain each of these reasons in more detail below.

But before we do that, we believe it is necessary to address certain aspects of the prosecutor’s written opposition to Petix’s motion.

We think this is necessary because, when examined with scrutiny, it is apparent that the prosecutor has addressed a number of things in his opposition papers – none of which address the fatal flaw in his case against Petix on Count Two.

That is to say, the prosecutor has submitted to this Court a sixteen page pleading that ignores controlling law and omits critical facts that prove that Petix was *not* operating a “money transmitting business.”

**The Government's Opposition
to Petix's Motion to Dismiss Count Two**

As we are certain the Court noticed, in his opposition to Petix's motion to dismiss count two, the prosecutor addressed – often in painful detail – a number of subjects that have nothing to do with whether Petix's conduct constituted the operation of a money transmitting business.

We believe that the prosecutor did this for a number of reasons, including: (1) to paint Petix as a reprobate who was previously convicted of an infamous and universally reviled crime; (2) to establish that Petix is a fundamentally dishonest man who lied to his probation officers while on supervised release, and lied again to the law enforcement officers who arrested him on December 4, 2015; (3) to imply that Bitcoin is used almost exclusively for sinister – and usually criminal – purposes; and (4) to divert the Court's attention and obfuscate the specific, narrow issue before the Court; that is, whether Petix's conduct amounted to operating a money transmitting business.

To cite just a few examples:

1. In his opposition to Petix's motion to dismiss, the prosecutor held forth at some length on the background of Bitcoin and the technical aspects and manner in which it is used.³

³ D. 24, pp. 4-6

2. The opening line of the prosecutor's "Preliminary Statement" is about how to catch drug dealers.⁴

3. Throughout his opposition, he makes repeated references to drug trafficking and other nefarious conduct, to which he refers as the "dark net markets."⁵

4. He felt it necessary and important, apparently, in opposing Petix's motion to dismiss count two, to describe for the Court that Petix was on supervised release after having served five years in federal prison for his conviction of transporting child pornography.⁶

5. Likewise, the prosecutor decided that, in dealing with a motion directed at one specific count of the indictment, he was obligated to regale the Court on the details of how and why Petix is alleged to have violated his supervised release, the allegedly false statements he made on his probation questionnaires,

⁴ D. 24, p. 2

⁵ D. 24, p. 2 ("To catch a small time drug dealer..."; ... "funds in connection with drug dealing..."; "... among other unlawful activity, drug trafficking..."; "...that drug trade has taken to the Internet..."; "...it has paved the way for customers to access a world's array of contraband with the click of a button..."; "Vendors on a succession of dark net markets ...") D. 24, p. 3 ("... sometimes the sole method of payment accepted on leading dark net markets..."); D. 24, p. 13 (...Dark net markets are not known to use a silver dollar ...; "...Ransomware refers to malicious software (malware) that a victim ...")

⁶ D. 24, p. 6

and the allegedly false statements he made the arresting officers at the scene of his December 4, 2015 arrest.

In our view, none of this information is helpful to the Court in resolving the question of whether Petix is properly charged with operating a money transmitting business.

In any event, after the prosecutor had completed eight pages of what was, in large part, extraneous, unnecessary, and unfairly prejudicial information, he turned to his discussion of the law relating to the unlicensed operation of a money transmitting business.⁷

**The Government's Analysis of the Law Concerning Operating an
Unlicensed Money Transmitting Business**

Not surprisingly, the prosecutor's discussion of the law applicable to money transmitting businesses, and interplay between Bitcoin and money transmitting businesses, is not only incomplete and inaccurate, but it is misleading.

In his legal discussion, the prosecutor "cherry picked" various excerpts of 18 U.S.C. § 1960, as well as selected portions of related federal regulations, and an "interpretive guidance" memorandum prepared by the United States Treasury

⁷ D. 24, pp. 8-11

Department's Financial Crimes Enforcement Network (FinCEN) to support the government's case.⁸

The upshot of all this is that, providing extraneous, unnecessary, and inflammatory background information, and combining it with an incomplete and misleading discussion of the law, the prosecutor has laid before this Court a pleading that could lead a reasonable person to conclude that – not only was the charge in Count Two against Petix valid – any transaction involving the sale or transfer of Bitcoin – to whomever it may have been made, and under whatever circumstances the transfer may have occurred – is illegal if the person engaging in it failed to comply with the registration requirements of 31 U.S.C. § 5330 or the related regulations.

In fact, reading the entirety of the prosecutor's opposition to Petix's motion to dismiss count two, a reasonable person could conclude that the use of Bitcoin in any way, shape, or form, is illegal.

But that's simply not the case.

The government *knows* that Bitcoin is not, in and of itself, illegal. In his affidavit in support of the criminal complaint filed in this case, HSI Special Agent Brechler (no doubt assisted in his preparation of the affidavit by the lead prosecutor

⁸ D. 8-11

in our case) stated that “Bitcoin is not inherently illegal and has known legitimate uses, much like cash[.]”⁹

Yet, remarkably, nowhere in the government’s opposition to Petix motion does the prosecutor mention the undisputed fact that Bitcoin is not, in and of itself, illegal.

Below, we will set out our reasons why we believe the prosecutor resorted to that tactics described above.

Petix’s Conduct Does Not Constitute Operation of a Money Transmitting Business and, Therefore, Registration With the Treasury Department is Not Required

Not to put too fine a point on it, the critical questions in regard to Count Two are: (1) What is a “money transmitting business”?; and (2) Was Petix operating one?

In light of this very straight-forward, narrow question, perhaps the most egregious omission by the government in its opposition to Petix’s motion is its failure to provide the Court with the Second Circuit’s definition of a money transmitting business.

⁹ D. 1, p.3, note 1

We suspect that the reason the prosecutor did not give the Court the Second Circuit’s definition of a “money transmitting business” is that it completely pulverizes the government’s claim that Petix was operating one.

The Second Circuit has given us, in clear and unequivocal language, a precise and detailed definition of what a “money transmitting business” is and does. That definition is, as follows:

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, usually a foreign country. After the customer gives the money transmitter an amount to send to the designee, the transmitter notifies the “payer” with whom it has a contractual arrangement in the recipient country. The payer then notifies the designated recipient of the money, and pays the money to the designee at the payer’s office. The transmitter then remits to the payer the amount paid to the designee, plus the payer’s commission.¹⁰

In short, a “money transmitting business” is a business that, for a fee, facilitates the transfer of money between two or more entities – other than itself – outside the usual financial system and is not a depository institution.¹¹

We know there was no proof submitted to the grand jury in this case that Richard Petix ever facilitated the transfer of money in this fashion, or that he ever charged, demanded, or collected a fee for doing so. And to be clear, our conclusion

¹⁰ *United States v. Velastegui*, 199 F.3d 590, 592 (2d Cir. 1999) (italics added)

¹¹ See, 31 U.S.C. § 5330 (d)(1); 31 C.F.R. § 1010.100(ff)(5)(i)(A)

about what evidence was or was not submitted to the grand jury is not based, as the prosecutor claims, on “pure, unfounded conjecture,” or on “speculation.” Our conclusion is based on our own investigation of the facts of this case. We know that evidence does not exist, because it never happened.

As a result, if there was evidence before the grand jury that Petix facilitated the transmission of money between other parties for a fee, that evidence is false evidence and we believe the prosecutor knows it is false evidence. Knowingly offering false evidence before a grand jury is misconduct, and a basis for the Court to dismiss not only Count Two, but the entire indictment.

There are additional reasons why Petix was not operating a money transmitting business. Each of these reasons, independently, are grounds for dismissal of Count Two.

One reason is that Bitcoin is not a “business.”

Bitcoin was started in 2009 by an individual (Satoshi Nakamoto) who, by all accounts, vanished in 2011.¹² Yet, the system continues to run on its own. There is no person or entity that continues to run Bitcoin. As a result, “there is no Bitcoin company to raid, subpoena or shut down.”¹³ A “business” as we understand it, is an

¹² Kaplanov, Nikolei M., *Nerdy Money: Bitcoin, The Private Digital Currency, And The Case Against Regulation*, 25 Loy. Consumer L. Rev. 111, 114 (2012)

¹³ *Id. at 128; quoting*, Jerry Brito, *Online Cash Bitcoin Could Challenge Governments, Banks*, Time Techland (Apr. 16, 2011)

entity that has centralized authority and control of its activities, a hierarchy of leadership, and generally consists of one or people engaged in the activities of the entity on the entity's behalf.

Bitcoin, on the on the other hand, is a de-centralized network that relies on transactions conducted over a peer-to-peer network to gain value through demand. It is not run on or through a centralized computer, but rather on each individual member's personal machine.

If Bitcoin, therefore, is not a business, then Petix can have been operating a money transmitting business, and the charge against him in Court Two is fatally flawed and must be dismissed.

The second reason why Petix was not engaged in a money transmitting business is that – even if Bitcoin were a “business” (which, as stated above, it is not) – Petix wasn't “operating” that business.

The government failed to mention in its opposition to Petix's motion that – at least according to the Fourth Circuit Court of Appeals – the prohibitions of 18 U.S.C. § 1960 “appl[y] only to one who ‘conducts, controls, manages, supervises, directs, or owns’ a money transmitting business, knowing that it is not licensed.”¹⁴

<http://techland.time.com/2011/04/16/online-cash-bitcoin-could-challenge-governments/>

¹⁴ *United States v. Talebnejad*, 460 F.3d 563, 568 (4th Cir. 2006)

We think there can be no dispute that Richard Petix did not conduct, control, manage, supervise, direct, or own Bitcoin.

Count Two Must Be Dismissed

In summary, there has been no case, of which we are aware, which has found that the purchase and sale of Bitcoin for cash between two willing parties in an arms-length, negotiated transaction, constitutes operating a money transmitting business.

What seems apparent in this case, is that the government believes that Bitcoin transactions, by their very nature, are indicative of malevolent – and likely criminal – conduct. And as a result of this belief (which we have no doubt is earnest), the government is searching for a way to “crack down,” if you will, on the use of Bitcoin. The problem is, they are trying to do it in a case where there is no federal law prohibiting the conduct in which Petix is alleged to have engaged.

As a result of all the foregoing, it is respectfully requested that the Court dismiss Count Two of the indictment charging Richard Petix with operating an unlicensed money transmitting business on the grounds that this charge of the indictment is defective on its face; or in the alternative, that the Court dismiss this count of the indictment on the grounds that it was the result of improper conduct in the grand jury; and that the Court grant such other relief as may be just and proper.

Dated: November 2, 2016

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