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# BITCOIN CHALLENGES THE REGULATORS:

## Is it a currency, a security, a medium of exchange, or all three? *by Michael Bobelian*

An hour before Benjamin M. Lawsky, superintendent of New York's Department of Financial Services, stepped into a Manhattan hearing room last January, eight camera crews—from CNN, the Associated Press, and other news outlets—were there to jockey for position. Because of overwhelming demand to attend the Bitcoin hearings Lawsky had called, the department rationed seats for the media. A webcast brought the proceedings to another 14,000 viewers in 117 countries.

Every time a doorknob turned, onlookers in the hearing room raised their heads from smartphones in anticipation. Finally, Lawsky—followed by a bevy of advisors—walked into the room, shook hands with the scheduled witnesses, and sat down at a wooden dais.

"It's generally a difficult proposition for financial regulators to forecast technological trends," Lawsky began. "That said, serious people in the technological and investment community are taking virtual currencies seriously. They are putting significant amounts of time, attention, and capital behind them. We, as a regulator, cannot turn a blind eye to something like that. We don't really have a choice."

Christened the hottest technology since the Internet, Bitcoin—the best known of some 80 virtual currencies—had become a darling of the national media. Its potential led Netscape founder and venture capitalist Marc Andreessen to publicly endorse the technology in a *New York Times* essay published the week before. "Bitcoin offers a sweeping vista of opportunity to re-imagine how the financial system can and should work in the Internet era," Andreessen wrote.

Yet outside of techie circles, Bitcoin remains a target of suspicion and ridicule. Its mysterious origins, arcane protocol, anonymous users, and libertarian advocates have spooked governments

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around the world. And its ability to facilitate essentially untraceable transactions in illicit goods means law enforcement views it as little more than a tool for criminals.

On the second day of hearings, Manhattan District Attorney Cyrus R. Vance Jr. turned the conversation to Bitcoin's darker side. "The anonymity offered by these payment systems attracts … criminals who now can easily move, conceal, and launder illicit profits," Vance said. "Without stronger government oversight in this area, we are going to be permitting cybercriminals, identity thieves, even traffickers of child pornography … to operate in what will be a digital Wild West."

Mainstream economists also remain skeptical. Alan Greenspan, former chairman of the Federal Reserve Bank, told Bloomberg TV last year, "You have to really stretch your imagination to infer what the intrinsic value of Bitcoin is. I haven't been able to do it. … If you ask me: 'Is this a bubble in Bitcoin?' Yeah, it's a bubble."

In the face of such widespread suspicion, Bitcoin's backers have struggled to gain the government's trust. Without that sanction, transactions using virtual currency may be relegated to technology enthusiasts operating at the margins of the economy.

But gaining legitimacy involves more than simply convincing regulators of Bitcoin's benefits. Lawsky's hearings exposed a clash of two cultures: On one side were entrepreneurs and venture capitalists eager to embrace innovative technologies. On the other were government agencies prone to deliberation and caution, institutions leery, for the most part, of rapid technological change.

**"Virtual currency is not easily categorized within the divisions in the financial system. … It's neither fish nor fowl."**

—BENJAMIN M. LAWSKY, NEW YORK DEPARTMENT OF FINANCIAL SERVICES

Last August, Lawsky's office had issued 22 subpoenas against Bitcoin-related entities, citing fears that virtual currencies "helped support dangerous criminal activity, such as drug smuggling, money laundering, gun running, and child pornography." The move infuriated Bitcoin's fans, but it produced headlines that made Lawsky the nation's leading virtual currency regulator.

Lawsky was not an obvious candidate for the role. When New York state merged two 19th-century agencies in 2011 to create the Department of Financial Services, it was a minor player in the regulatory world. Practically overnight, Lawsky—a former federal prosecutor with stints as U.S. Senator Charles Schumer's chief counsel and Governor Andrew Cuomo's chief of staff—turned the department into a national force. He did so by collecting a series of legal bounties in banking and insurance enforcement matters, the biggest of which—a $340 million settlement with the United Kingdom's Standard Chartered in 2012—revealed his broader ambitions.

Shifting policy on a national scale, though, would not be easy. "Fashioning appropriate guardrails for virtual currencies presents challenging questions for regulators," Lawsky acknowledged in his opening remarks. "Virtual currency is not easily categorized within the divisions we traditionally think about in the financial system. ... It's neither fish nor fowl."

The superintendent also positioned himself as a friend of new technology. During the hearings, Lawsky told Bloomberg TV, "A lot of people I know, when they first hear about Bitcoin, have the same reaction as Mr. Greenspan. We're trying as a regulator to resist that. We're trying to keep an open mind."

What makes Bitcoin so confounding to regulators is its protean nature as a commodity, a currency, and a medium of exchange. Like gold, a Bitcoin is a store of value extracted by "miners." In this case, enterprising tech wizards—working alone or in teams—install free software that enables them to solve a series of complex equations using advanced computers. When miners solve an equation, the network accepts the transaction as valid and awards them new Bitcoins. The equations serve to verify the validity of Bitcoin transactions on the user network by mathematically proving that they occurred only once.

The Bitcoin protocol requires that each new equation is incrementally harder to solve than the preceding one, limiting the rate at which Bitcoins can be added. Currently, there are 12.66 million units in circulation. By the program's design, there can be no more than 21 million Bitcoins—a maximum that's projected to be reached in the year 2140.

Users can also acquire Bitcoins by accepting the virtual currency as payment, or by buying Bitcoins with fiat currency on an exchange. Once users open

an account, the Bitcoin protocol generates a unique address and a public and private encryption "key" to verify transactions.

To exchange Bitcoins, users enter the recipient's coded address and the amount to transfer into an electronic message, and then authorize it with their private key. The Bitcoin protocol does the rest. Every transaction is recorded, time-stamped, and displayed in a public ledger. As Bitcoins move from account to account, the verified transactions form an identifiable chain on this ledger that anyone can view over the Web.

This clever design—what a senior economist at the Federal Reserve Bank of Chicago called "an elegant solution to the problem of creating a digital currency"—catapulted Bitcoin ahead of its virtual competitors.

Patrick A. Murck, general counsel of the Bitcoin Foundation, was among the earliest enthusiasts of Bitcoin. A graduate of the Catholic University of America's Columbus law school in Washington, D.C., he was working at technology venture BigDoor in the Seattle area a few years ago when he first encountered the Bitcoin white paper, published in 2008 by Satoshi Nakamoto. Murck, now 38, recalls thinking, "Wow, they solved all the legal issues facing virtual currencies by not using an issuer or administrator."

Murck also recognized Bitcoin's potential to disrupt the global financial sector, which profits by imposing high transaction fees in a banking system closed to outside innovation. ATMs charge several dollars to extract cash; credit cards, PayPal, and other payment processors assess vendors or users about 3 percent; and money transmitters such as Western Union collect nearly 10 percent—often from low-wage immigrants who have no other way of sending money to their home countries. By comparison, a typical Bitcoin transfer involves a fee of less than 1 percent.

"For the first time in human history, you can send money—or any sort of value—around the world instantly, for almost no fee and with no government or financial institution involved," Murck says. "That's truly revolutionary."

Murck envisioned Bitcoin as a haven for consumers in developing countries as well as in technologically advanced ones. As a decentralized, peer-to-peer network, he believes it could be safe from foreign exchange crises such as those that, in recent years, decimated fiat currencies in Mexico, Argentina, Russia, and Cyprus.

In addition, Murck realized that the anonymity Bitcoin affords users could

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GENERAL COUNSEL, BITCOIN FOUNDATION

give cover to activists around the world. For example, when Visa and MasterCard bowed to political pressure and stopped processing donations to Wikileaks in 2010, supporters of the renegade online publisher could have thrown it a lifeline in Bitcoins. Likewise, dissidents in countries around the globe could receive funds through Bitcoin exchanges, or use virtual currency to transact with vendors beyond the reach of their governments.

Eventually, Murck saw that Bitcoin's potential as a medium of exchange was even greater. Bitcoin's public ledger could provide a chain of title—a means to record or transfer property for all to see, without official oversight, and without the hefty fees for title searches and insurance bound up with the inefficiencies of our current property transfer system. "That's when I had my first 'holy shit' moment," he says.

But for Bitcoin to thrive, its supporters would have to engage with government agencies—and that didn't seem likely. Nakamoto, who released the software that runs the Bitcoin protocol in 2009, remains a mysterious—and elusive—figure. Early adopters include some libertarians who were drawn to Bitcoin for the very reason that they distrust all governments—and doubt that

any would condone circulating nonfiat currency. Within this group, some virtual currency backers were so fervent about their philosophical principles they were willing to forgo the potential riches that might come by obtaining a government imprimatur.

> **"The anonymity offered by these payment systems attracts ... criminals who now can easily move, conceal, and launder illicit profits."**
>
> —CYRUS VANCE JR., DISTRICT ATTORNEY, MANHATTAN

Murck was not so rigid. He recognized that Bitcoin needed a policy strategy, a lobbying campaign for recognition, and most of all, a public face to represent the industry. "Financial institutions and government officials are used to seeing a real person walk into their offices," he says. Affable and well spoken, he came to assume the role.

In July 2012, Murck joined six other Bitcoin acolytes to launch the Bitcoin Foundation, a Seattle-based nonprofit organization with offices in Washington, D.C. The foundation chose to educate Bitcoin skeptics rather than advocate for specific regulatory policies. As a measure of his faith, Murck accepted his salary in Bitcoins.

At first, not much happened; government agencies were still struggling to understand Bitcoin. Was it a currency, a security, a commodity, or all three? With little input from the Treasury Department, the Securities and Exchange Commission, the Commodity Futures Trading Commission, or the Federal Reserve Bank, Bitcoin's legal status remained murky—scaring off both would-be users and investors. Without official guidance, commercial banks refused to let Bitcoin businesses open accounts, effectively sending any number of startup companies abroad to operate.

From the outset, Congress fretted about Bitcoin's illegitimate uses. In June 2011, Senators Joe Manchin of West Virginia and Schumer of New York put a bull's-eye on Bitcoin by asking the U.S. Attorney General and the Drug Enforcement Administration to shut down Silk Road, an underground website and booming online marketplace for illegal drugs—all bought and sold using Bitcoins.

Last October, FBI agents arrested Ross Ulbricht—Silk Road's alleged proprietor, known as Dread Pirate Roberts—at a San Francisco library. The agents seized $3.6 million in virtual currency, and later unsealed papers charging the 29-year-

old Ulbricht with narcotics trafficking, money laundering, and an attempted murder-for-hire. (*U.S. v. Ulbricht*, 14-CR-068 (S.D.N.Y. filed Feb. 4, 2014).) Ulbricht has pleaded not guilty.

Months earlier, federal prosecutors had charged Liberty Reserve, a Costa Rica–based virtual currency exchange, with laundering billions of dollars in transactions that involved some 200,000 customers in the United States and more than a million worldwide. For the first time, the Treasury Department invoked against a virtual currency provider section 311 of the USA Patriot Act (31 U.S.C. § 5318A), which permits authorities to designate a foreign financial institution as of "primary money laundering concern." (*United States v. Liberty Reserve, SA*, No. 13-CR-368 (S.D.N.Y. sealed indictment filed May 28, 2013.) Liberty Reserve's co-founder later pleaded guilty to money laundering, unlicensed money transmitting, marriage fraud, and receiving child pornography.

In both cases, the Bitcoin community excused the lapses as the work of either bad apples or unstable companies—and, in the case of Liberty Reserve, an alternative digital system that should be replaced by more trustworthy currencies. Each infraction, however, made it a little tougher for conventional thinkers to accept the potential foibles of virtual currency.

These prosecutions exposed a chasm between Bitcoin entrepreneurs and federal agencies. "A start-up has nothing to lose and everything to gain," Murck observes. "When you're a government official, it's almost the opposite. Why champion something that might get you into trouble?"

Then Bitcoin received an unexpected gift from the Treasury Department.

For the most part, federal and state regulators had remained silent during the FBI's virtual currency prosecutions. For regulators, Bitcoin raised a host of complex problems. It could, for instance, be outlawed at any time by any government hostile to fiat currency alternatives. (In the United States, Article 1 section 10 of the Constitution grants the federal government a monopoly over the creation, production, and issuance of money.) By early last year, rumors were circulating that the Treasury Department might ban all virtual currency.

But in March 2013 the department's Financial Crimes Enforcement Network (FinCEN) surprised everyone by issuing a landmark interpretive guidance, applying existing money transmitter and anti–money laundering rules to entities

using a " 'convertible' virtual currency." The order deftly avoided characterizing Bitcoin: "In contrast to real currency, 'virtual' currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency." (U.S. Dept. Treas., Fin. Crimes Enf. Network, Guidance FIN-2013- G0001 (issued March 18, 2013).)

In an interview, FinCEN spokesman Steve Hudak acknowledged that the enforcement unit had focused on money-laundering behavior rather than on the nature of virtual currency. "We're interested in activity, and it doesn't matter if it's beads or Bitcoins," he says.

"A whole host of emerging technologies in the financial sector have proven their capacity to empower customers. ... We want these advances to continue."

—JENNIFER SHASKY CALVERY, DIRECTOR, FEDERAL FINANCIAL CRIMES ENFORCEMENT UNIT

Treasury's recognition, however, also presented difficulties for Bitcoin users. FinCEN required Bitcoin administrators and exchangers to register as money services businesses, and to adhere to the requirements of the Bank Secrecy Act (Pub. L. No. 91-508). That meant collecting personally identifying information about users, and reporting that information to FinCEN if the businesses suspect money laundering—undermining any promise of anonymous transactions.

Still, the FinCEN guidelines represented "a watershed moment for the industry," Murck says. "It set a standard that allowed venture capitalists and other investors to feel secure that this is a legitimate currency, and that these are legitimate business opportunities." Indeed, several large venture capital funds—Union Square Ventures, Google Ventures, and Andreessen Horowitz—soon made sizeable investments.

After FinCEN weighed in, Murck ratcheted up his efforts to raise Bitcoin's profile. He and the foundation's chief scientist, Gavin Andresen, agreed to speak at a June 2013 conference in Washington, D.C., sponsored by Thomson Reuters and the International Centre for Missing and Exploited Children (ICMEC). They were invited to discuss

concerns that Bitcoin was being used to facilitate sex trafficking and child pornography transactions.

Some members of the foundation urged Murck to skip the conference, fearing he'd walk into a trap. "My response was, 'So what?' " Murck recalls. "What do we have to lose by participating in this debate when we're on the right side of history?" He saw an opportunity to make a good impression before a hostile audience.

Even so, his co-panelists were ready to provoke. Andrew G. Oosterbaan, head of the Justice Department's Child Exploitation and Obscenity section, asserted, "Child pornography is like Bitcoin in some ways." Usually mild-mannered, Murck angrily fired back, "Bitcoin is nothing like child pornography. If there was one instance of a child being abused because of Bitcoin, that's one too many."

His showing at the ICMEC panel paid off in connections he made with another speaker at the conference: Jennifer Shasky Calvery, FinCEN's director since September 2012.

Before Calvery transferred to Treasury, she served for 15 years in the DOJ as a prosecutor, the last two as chief of the asset forfeiture and money-laundering section. But at FinCEN, Calvery showed a surprising openness to virtual currencies. As she told the ICMEC audience, "A whole host of emerging technologies in the financial sector have proven their capacity to empower customers, encourage the development of innovative financial products, and expand access to financial services. And we want these advances to continue."

Calvery envisioned FinCEN as a bridge between this emerging technology and government watchdogs—a connection that meant encouraging dialogue between the parties. She invited Bitcoin Foundation members to present their views informally at FinCEN's offices before officials from the Federal Deposit Insurance Corporation, the IRS, the Federal Reserve, the Office of the Comptroller of the Currency, the FBI, and others.

Again, Murck saw an opportunity to win over a potentially hostile audience. He had Peter Vessenes, the foundation's board chairman, open the August meeting by describing the Bitcoin protocol. Jim Harper, the foundation's global policy counsel and previously a director at the Cato Institute, addressed the potential of Bitcoin for serving populations in developing countries with limited access to banks. Legal defense chairman Brian E. Klein, a former federal prosecutor now at Baker Marquart in Los Angeles, provided a law enforcement perspective. And Marco A. Santori, a business attorney at

New York's Nesenoff & Miltenberg who spearheads regulatory affairs for the foundation, described the effects of misguided rules that drove abroad many businesses that trade in Bitcoins. "What if Google, IBM, Intel, and Amazon—the nation's crown jewels—were based in Beijing?" Santori asked the officials. (Chinese officials on the mainland later limited the use of Bitcoin, but Hong Kong permits active trading.)

A question-and-answer session followed, and despite some tough inquiries, Murck felt the Bitcoin contingent had swayed a few minds.

Around the same time, Murck and chief scientist Andresen started meeting with staff at the Senate's Homeland Security and Governmental Affairs Committee, with the goal of holding hearings in November. In a series of exhausting sessions, Murck says, he opened some eyes about the potential of virtual currencies—and also came to trust FinCEN's Calvery.

"I've met the director. I've looked her in the eyes. And her reputation stands, in my opinion," he reassured a Bitcoin panel discussion in London before the Senate hearings. "She's a straight shooter, but she's also a tenacious bulldog if you're in her sights."

Still, as the hearings approached many of Murck's peers remained wary of the committee's chairman, Senator Tom Carper of Delaware, who also chairs the Senate's Homeland Security Committee. The list of witnesses he'd scheduled included potential Bitcoin critics—including ICMEC's president, law enforcement representatives from the DOJ and the Secret Service, and Calvery.

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**—PATRICK A. MURCK**

As for the FinCEN chief, they needn't have feared. The first to testify, Calvery told the committee, "So often when there's a new type of financial service, the first reaction ... is to think about the gaps and the vulnerabilities that it creates in the financial system. ... But it's also important that we step back and recognize that innovation is a very important part of our economy."

In his own presentation, Murck was cautious. "In the short term," he acknowledged, "consumers should be aware that this is a high-risk environment and that potentially it's not quite ready for mass

consumer adoption today. That time is coming, but it's not here yet."

But Murck also made it clear that America needed Bitcoin as much as Bitcoin needed government approval. "Bitcoin is a global protocol that will thrive with or without U.S. government support, and with or without U.S. banks," he testified. "Thoughtful policy makers and business people should work to integrate Bitcoin and banking ... [to] bring the benefits of Bitcoin to the United States as quickly as they reach the rest of the world."

Senator Carper sounded a hopeful note. "I'm encouraged that maybe it is possible to have the benefits of the virtual currency ... and to actually ... hold down the criminal activity that we talked about here today." He announced that the committee had no plans to initiate legislation.

A few days later, hearings before the Senate's banking committee played out in a similar fashion.

Just when Bitcoin appeared to be coming under the aegis of currency regulators, a second legal front opened in federal court. Last summer, the SEC brought an enforcement action in Texas against the founder and operator of the Bitcoin Savings and Trust for allegedly running a Ponzi scheme that defrauded at least 66 investors of more than $4.5 million. (*SEC v. Shavers*, 13-CV-0416 (N.D. Tex. filed July 23, 2013).)

The defendant, Trendon T. Shavers, challenged the SEC's standing, arguing that Bitcoin investments "are not securities because Bitcoin is not money." The SEC contended that the investments were both investment contracts and

**12.66 million**

**Bitcoin units are currently in circulation**

Rows of Bitcoin-mining USB devices.

Anna P Habich/Shutterstock

notes—and thus securities under the Securities Act of 1933 (15 U.S.C. §§ 77t, 77v) and the Exchange Act of 1934 (15 U.S.C. §§ 78u, 78aa).

In August, U.S. Magistrate Judge Amos L. Mazzant held that "Bitcoin is a currency or form of money, and investors wishing to invest in [Bitcoin Savings and Trust] provided an investment of money." He found that because the transactions met the definition of an investment contract, they were indeed securities, and the case was properly before the court. (*SEC v. Shavers*, 2013 WL 4028182 at *2 (E.D. Tex.).)

Regulation at the state level posed yet another complication for the Bitcoin Foundation. "I refer to the U.S. as a payment technology backwater," Murck declared at the London panel discussion last year. "It's mainly because … when you deal with the U.S., you're not dealing with one country."

In nearly every state where Bitcoin entrepreneurs have customers, they must obtain a separate money transmission license. The process can take 18 months and cost more than $1 million, when legal fees are factored in. It is so onerous, in fact, that only a few dozen businesses such as Western Union, MoneyGram, eBay, and Google have bothered to go through it. For Bitcoin start-ups operating on shoestring budgets, that barrier is nearly insurmountable.

Last spring, Illinois became the first state to target a virtual currency business for failing to obtain a transmission license when it sent a cease-and-desist letter to Square Inc., a mobile payments processor based in San Francisco. Then in May the California Department of Financial Institutions sent a similar letter to the Bitcoin Foundation.

"The California state DFI said this was an invitation to talk," Murck told *CoinDesk*, an online news service that tracks digital currencies. "I've received nicer invitations, but we took it ... as an opportunity to engage in a discussion about what we think the issues are, and how we think the law agrees."

He tapped Perkins Coie attorney J. Dax Hansen to draft a detailed response. Hansen emphasized that the Bitcoin Foundation does not operate a Bitcoin exchange, does not sell Bitcoins to consumers, and has no business operations in California. "Bitcoins are not written or signed notes or drafts, and therefore, are not payment instruments regulated by the California Money Transmitter Act," he asserted. That distinction, Murck told *CoinDesk*, is important because a lot of businesses have been sitting on the sidelines of virtual commerce "scared

Steve Jurvetson

"Eventually, Bitcoin will be made to follow the same standards as all these other payment systems. That will probably **BE THE END OF THEM.**"

—**JAMIE DIMON,** CHAIRMAN, JPMORGAN CHASE

that just by selling Bitcoins, they would become money transferors."

Even though Hansen asked for a formal opinion, the DFI—which last year merged with the Department of Corporations to become the Department of Business Oversight—took no further action.

In October the California Legislature passed AB 786, introduced by Assembly Member Roger Dickinson (D-Sacramento), amending the Money Transmission Act (Cal. Fin. Code §§ 2000–2175) to ease licensing requirements for Bitcoin businesses. This year Dickinson introduced AB 129 to formally recognize a broad range of alternative currencies.

In New York, meanwhile, Lawsky was still making headlines with his hard-hitting tactics against Bitcoin entrepreneurs. Had he instead followed the lead of California's DFI, Murck says, "New York could have had the same exact dialogue without the subpoenas."

Tactics aside, Lawsky had legitimate reasons to be concerned. Another bombshell—this time in the Bitcoin Foundation's own boardroom—exploded the day before his January hearings opened. Federal prosecutors in Manhattan charged Charles Shrem—vice-chairman of the foundation and co-founder and CEO of the BitInstant exchange—and a co-defendant with participating in a scheme to use Bitcoins to launder money for Silk Road customers. (*United States v. Faiella*, No. 14-MAG-0164 (S.D.N.Y. sealed complaint filed Jan. 24, 2014).)

Shrem pleaded not guilty to the charges and stepped down from the board, but his arrest was deeply embarrassing to the foundation. "To Charlie's credit, he always puts Bitcoin first," Murck said a few days later. "He did here

as well, and he resigned almost immediately."

For some, excising Shrem from the organization wasn't enough. Bitcoin's supporters had presented themselves as law-abiding innovators who needed a hands-off approach from the government to thrive. The arrest of one of their own undermined that claim, and cast a shadow over Lawsky's regulatory hearings.

> **"We think Bitcoin is the most disruptive thing to money since the move away from the gold standard."**
>
> —**NICK SHALEK,** RIBBIT CAPITAL

During two days of testimony, however, Lawsky's new posture as an up-and-comer was on full display. "Ultimately," he declared, "it's our expectation … to put forward during the course of 2014 … a proposed regulatory framework for virtual currency firms operating in New York." Unlike other regulators, he promised that his department was prepared to create distinct rules for virtual currencies. And he went a step further, announcing that his agency was evaluating whether to issue a "BitLicense" specifically tailored to virtual currencies.

Testimony at the hearings echoed this new attitude of cooperation, with hardly any disputes among the interlocutors. Lawsky frequently sided with Bitcoin enthusiasts in their criticism of the financial sector, and he acknowledged their plight in trying to meet burdensome regulations.

In the private sector, Bitcoin was also making inroads. By the end of 2013, more than 1,000 brick-and-mortar merchants and 10,000 online businesses—including Overstock.com—accepted Bitcoin. In December, Bank of America added Bitcoin to the list of currencies it tracks for investors. Wells Fargo and other banks began warming up to Bitcoin businesses, a key step for the currency's proliferation.

But deep-seated misgivings re-mained, particularly among industry titans. At the Davos Conference in Switzerland last winter, JPMorgan Chase chairman Jamie Dimon told CNBC, "The question isn't whether we accept it. The question is: Do we even participate with people who facilitate Bitcoin? It's a terrible store of value. It can be replicated over and over. It doesn't have the standing of the government. … A lot of it is being used for illicit purposes ... so eventually it will be made … to follow the same standards as all these other payment systems. That will probably be the end of them."

But Dimon's remarks didn't phase Murck. "It just shows that he doesn't understand Bitcoin, and that's OK," he told Bloomberg TV. "A lot people don't. It's still early … and I'm sure he'll come to terms with it."

Far from sharing big bankers' reluctance, venture capital firms are swarming to Bitcoin. "The financial sector is large, complacent, slow-moving, and relies on its market size and the regulatory process to win the day without focusing on consumers," says Nick Shalek, a partner at Ribbit Capital in Palo Alto. "Banks and other financial institutions have forgotten how to innovate."

But this new medium of exchange still has bugs. The Bitcoin protocol is prone to glitches, and virtual currency exchanges have proved to be unstable. Tokyo-based Mt. Gox—once Bitcoin's largest exchange—filed for bankruptcy in Japan in February and in Texas a month later under Chapter 15. (*In re MtGox Co., Ltd.*, No. 14-BK-31229 (Bankr. N.D. Tex. filed March 9, 2014).)

Earlier, Mt. Gox indicated that 850,000 Bitcoins—worth some $400 million—had been lost or stolen. A week later, it claimed to have found some of the missing currency in a "forgotten" account. A class action against the exchange was filed in Chicago. (*Greene v. MtGox, Inc.*, No. 14-CV-1437 (N.D. Ill. filed Feb. 27, 2014).)

Like any other data stored on a computer, Bitcoins can also be hacked or lost. These structural deficiencies, combined with rampant speculation in Bitcoin as a commodity, contribute to wild price fluctuations that have deterred its widespread circulation. The grandiose claims of its advocates notwithstanding, Bitcoin is still a negligible player in the financial world: Total Bitcoin transactions averaged $68 million per day, Fitch Ratings reported in February. In comparison, Visa and MasterCard together averaged $30 billion in credit card transactions per day.

In late March, the Treasury Department muddied the regulatory waters further. The Internal Revenue Service issued a notice that for tax purposes, virtual currency should be treated as property. (See IRS Notice 2014-21 issued Mar. 25, 2014.) The notice meant that taxpayers must, for every transaction, determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt, and report any taxable gains or losses.

So as of 2014, a federal court had found that Bitcoin is a security, and separate units of the Treasury Department had defined it as currency (FinCEN) and as property (the IRS). But Perkins Coie's Hansen, who represents the Bitcoin

Foundation, sees no major regulatory conflict. "Bitcoin can be property under one regime, currency in another regime, and a commodity in another regime," he says. "It doesn't bleed out from one silo into another silo."

The IRS notice, however, could have dire consequences for Bitcoin users. In a blog post, the foundation stated that it "appreciates the IRS's hard work in providing much-needed clarity," but that the designation as property "may make compliance with tax laws unnecessarily cumbersome and imposes untenable recording and reporting requirements on its users."

In a recent televised interview, investor Warren Buffett described virtual currencies as "a mirage." But at this stage it would be unwise to dismiss Bitcoin. One day it may threaten the primacy of both credit cards and banks. It might even drive a wedge between the banking and retail sectors over the issue of transaction fees.

"The exciting thing about Bitcoin is that anyone with an Internet connection can participate in the financial network without much cost or friction," says Ribbit's Shalek. "We think Bitcoin is the most disruptive thing to money since the move away from the gold standard."

> **"Bitcoin can be property under one regime, currency in another regime, and a commodity in another."**
>
> —**J. DAX HANSEN,** PERKINS COIE

Ever the optimist, Murck explains that the Bitcoin protocol—a foundational technology in the way that TCP/IP, HTML, and SMTP set the standards for the Internet and email—continues to evolve. "We're moving to version 0.9, which is commonly referred to as the payment protocol," he says. "People can append rich data to every transaction that happens across the network. And that data could be a smart contract, a conditional payment, an identity service. ... Who knows what people could come up with?"

In their respective camps, Lawsky and Murck serve as unofficial spokesmen. But they've both softened their rhetoric since Lawsky issued the infamous 22 subpoenas last August.

On the second day of testimony in January, Lawsky told a TV interviewer, "Down the road, there could be an alternative currency. ... It has a lot of potential for the future."

A few hours later Murck chimed in on the same network, "I commend New York for having hearings to understand how their existing rules apply to this space. That's an important step."