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 11 UNITED STATES OF AMERICA

12 UNITED STATES DISTRICT COURT
 13 FOR THE CENTRAL DISTRICT OF CALIFORNIA
 14 EASTERN DIVISION

15 UNITED STATES OF AMERICA,
 16 Plaintiff,
 17 v.
 18 \$15,000.00 IN U.S. CURRENCY,
 19 Defendant.

No. EDCV 16-01166-DSF (KKx)

**REPLY MEMORANDUM IN SUPPORT OF
 RENEWED MOTION FOR SUMMARY
 JUDGMENT; SUPPLEMENTAL DECLARATION
 OF FRANK D. KORTUM**

**DATE: February 13, 2017
 TIME: 1:30 p.m.
 CTRM: D (First Street Courthouse)**

22 DAVID SCOTESE,
 23 Claimant.

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1 **I. SCOTESE IS A MONEY TRANSMITTER BECAUSE HE TRANSFERRED**
2 **BITCOIN TO ANOTHER LOCATION.**

3 In its Renewed Motion for Summary Judgment ("RMSJ" (Dkt. 39))
4 the government argued that Scotese engaged in money transmission
5 because he transferred bitcoin to "another location or person" within
6 the meaning of 31 C.F.R. § 1010.100(ff)(5)(i). RMSJ at p. 12:1-6.

7 The government also pointed out that

8 when an exchanger or administrator of virtual currency accepts
9 real currency from an individual and in exchange sends "value
10 that substitutes for currency" (i.e., bitcoin) to the electronic
11 account of that individual, "transmission [has occurred] to
12 another location." Virtual Currency Guidance at 4.

13 RMSJ at 12:6-12.¹ Finally, the government made it clear that the
14 language from the Virtual Currency Guidance quoted above appeared in
15 a subsection entitled "Centralized Virtual Currencies." Id. at
16 12:21-22.²

17 In opposing the RMSJ, Scotese argues that the language from the
18 Virtual Currency Guidance quoted above is inapplicable because it
19 refers to an "administrator" of centralized virtual currency, while
20 the bitcoin that he exchanged is a decentralized virtual currency
21 (meaning that no administrator is involved). Claimant's Renewed
22 Statement ("RS" (Dkt. 43)) at p. 4. Scotese's argument is without

23
24 ¹ The Virtual Currency Guidance does not specifically refer to
25 bitcoin but instead refers to "virtual currency." Virtual Currency
26 Guidance at p. 1. Bitcoin in turn is a form of virtual currency.
United States v. 50.44 Bitcoins, No. ELH-15-3692, 2016 WL 3049166 at
*1 (D. Md. May 31, 2016).

27 ² There is accordingly no basis for Scotese's assertion (RS at
28 4:21-22) that the government's argument on this point is
"misleading."

1 merit because it depends on an isolated reading of both the Virtual
2 Currency Guidance and the regulation that it interprets.³
3 Specifically, when the Virtual Currency Guidance is read in the
4 context of the entirety of the relevant portion of 31 C.F.R. §
5 1010.100(ff)(5)(i)(A), it is clear that money transmission can occur
6 to "another location"--in the form of an electronic account--within
7 the meaning of that section of the regulations.⁴ A transmission to
8 another location that takes the form of an account can occur whether
9 or not an administrator is involved,⁵ and whether or not the virtual

11 ³ See generally Charles Schwab & Co. v. Debickero, 593 F.3d
12 916, 921 (9th Cir. 2010)(regulation construed "as a whole, rather
13 than in isolation . . ."); see also Fitzgerald v. Fairfax County
School Board, 556 F.Supp.2d 543, 554 (E.D. Va. 2008)(reading statute
14 "together with the related [agency] regulations and guidance . . .
15 .").

16 ⁴ In an introductory section that preceded the discussion of
17 how money transmission can occur to "another location," the Virtual
18 Currency Guidance stated that "[t]he term 'money transmission
19 services' means 'the acceptance of currency, funds, or other value
20 that substitutes for currency from one person and the transmission of
21 currency, funds, or other value that substitutes for currency to
22 another location or person by any means.'" Virtual Currency Guidance
23 at p. 3 (quoting 31 C.F.R. 1010.100(ff)(5)(i)(A))(emphasis altered).
The Virtual Currency Guidance also states, in the same introductory
24 section, that "[t]he definition of a money transmitter does not
25 differentiate between real currencies and convertible virtual
26 currencies." Id. There is accordingly no significance here to the
27 Virtual Currency Guidance's discussion of "another location" in the
28 "Centralized Virtual Currencies" section as opposed to the "De-
Centralized Virtual Currencies" section. Furthermore, the identical
treatment of real currencies and convertible currencies for the
purposes of defining money transmission means that there is no basis
for differentiating between "Centralized Virtual Currencies" and "De-
Centralized Virtual Currencies" for the purposes of this motion.

⁵ Claimant asserts that he "relies on . . . administrators to
perform the 'transmission' to which plaintiff refers" RS at
p. 6:9-10. Even if this is true, such reliance does not change the
character of Scotese's activities as a money transmitter because his
assertion constitutes an admission that he (A) is responsible for
causing the transmissions to occur as part of his business; and (B)
uses the services of administrators to complete the transmissions on
his behalf.

1 currency is centralized or decentralized.⁶ Here, Ochle sent currency
2 from his physical address to Scotese, and in return Scotese sent
3 Bitcoin to an account that Ochle could access electronically. See
4 generally Motion at p. 12 n.16 (describing bitcoin transmission
5 process). This exchange constitutes transmission to another
6 location, thus satisfying the transmission requirement of 31 U.S.C. §
7 5330. See RMSJ at p. 11-12.⁷

8 Scotese next argues that he was not a money transmitter because
9 the "De-Centralized Virtual Currencies" section of the Virtual
10 Currency Guidance contains a statement that "a person . . . is an
11 exchanger and a money transmitter if the person accepts such de-
12 centralized convertible virtual currency from one person and
13 transmits it to another person as part of the acceptance and transfer
14 of currency, funds, or other value that substitutes for currency."
15 RS at p. 4-5 (quoting Virtual Currency Guidance at p.5)(added

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19 ⁶ The regulatory definition of money transmitting applies both
20 to persons transmitting funds to "another location or person" (31
21 C.F.R. § 1010.100(ff)(5)(i)(A)) and "any other person engaged in the
22 transfer of funds." Id. § 1010.100(ff)(5)(i)(B). Scotese denies
23 that he is a money transmitter under Section 1010.100(ff)(5)(i)(B)
(RS at p. 10-11) but that section is in fact consistent with the
24 statutory inclusion within the term "financial institution" of "any .
25 . . person who engages as a business in the transmission of funds . .
26 . ." 31 U.S.C. § 5312(a)(2)(R). See text accompanying Note 19,
27 infra.

28 ⁷ Scotese asserts that "he sent bitcoin only to the person
purchasing it from him." RS at p. 10:4-5. The text accompanying
this footnote makes it clear that this assertion is irrelevant
because Scotese, by sending money to Ochle's bitcoin account, was
sending money to another location within the meaning of 31 C.F.R. §
1010.100(ff)(5)(i)(A).

1 Emphasis omitted).⁸ As Scotese interprets the Virtual Currency
2 Guidance, he is not a money transmitter because he sent the bitcoin
3 to Ochle instead of some third party. Scotese's argument, like his
4 previous argument regarding what constitutes transmission to "another
5 location," is without merit because it depends on an isolated reading
6 of both the regulation and the Virtual Currency Guidance.⁹ The
7 controlling regulation applies where an exchanger has transferred
8 bitcoin to "another location or person." 31 C.F.R. §
9 1010.100(ff)(5)(i) (emphasis added).¹⁰ Here, a money transmission
10 occurred that involved two people (Ochle and Scotese) but, as
11 explained above, after Ochle sent currency from his physical address
12 to Scotese, Scotese transmitted Bitcoin to Ochle's electronic
13 account, which constituted a transmission to another location. See

14
15
16 ⁸ Scotese points out that a person who "creates" bitcoin "may
17 or may not be a money transmitter." RS at p. 4:25-27. The parties
18 agree that at this time there is no evidence that Scotese created
19 bitcoin. That fact ultimately does not help Scotese because he was
20 required to register with FinCEN as an "exchanger" of bitcoin,
21 regardless of whether he created it.

19 ⁹ See Notes 3-4, supra and accompanying text.

20 ¹⁰ The language from Virtual Currency Guidance upon which
21 Scotese relies does not specifically refer to "another location," but
22 as discussed above the term "another location" appears in both an
23 introductory section of the Virtual Currency Guidance (Virtual
24 Currency Guidance at p.3) as well as in the "Centralized Virtual
25 Currencies" section." Id. at p.4. 31 C.F.R. § 1010.100(ff)(5)(i)(A)
26 applies to transmissions to other "location[s] or person[s]"
27 regardless of whether the Virtual Currency Guidance reproduces the
28 entirety of that phrase in every section in which it is mentioned.
See generally United States v. Budovsky, No. 13cr368 (DLC), 2015 WL
5602853 at *10 (S.D. N.Y. Sept. 23, 2015)(Virtual Currency Guidance
was "interpretive guidance" that "did not create new law."). In
other words, the absence of the term "other location" from the
section of the Virtual Currency Guidance that Scotese quotes does not
affect either the meaning of 31 C.F.R. § 1010.100(ff)(5)(i)(A) or its
application here.

1 text accompanying Notes 3-4, supra.¹¹ Scotese was therefore required
 2 to register his money transmitting business with the Financial Crimes
 3 Enforcement Network ("FinCEN"), and his admitted failure to do so
 4 subjects the defendant currency to forfeiture.¹²

5 **II. SCOTESE'S EXCHANGE BUSINESS IS A "FINANCIAL INSTITUTION" WITHIN**
 6 **THE MEANING OF THE REPORTING REQUIREMENT.**

7 Scotese next argues that he is not a "financial institution"
 8 subject to the reporting requirements of 31 C.F.R. 1010.311. RS at
 9 p. 7:25-27.¹³ The premise of Scotese's argument is that although a
 10 "currency exchange" is a financial institution under 31 U.S.C. §
 11

12 ¹¹ As discussed above, Scotese's assertion that "he sent bitcoin
 13 only to the person purchasing it from him" (RS at p. 10:4-5 (emphasis
 14 added)) is irrelevant because by sending money to Ochle's bitcoin
 15 account, Scotese was sending money to "another location" within the
 meaning of 31 C.F.R. § 1010.100(ff)(5)(i) (emphasis added). See Note
 7, supra and accompanying text.

16 ¹² Scotese has presented no evidence that he registered his
 money transmitting business with FinCEN. RMSJ at p. 6:5-10.
 17 FinCEN's website (<https://www.fincen.gov/msb-state-selector>) confirms
 18 that Scotese has not registered. See Supplemental Declaration of
 Frank D. Kortum ¶ 2 & Exhs "A" (results of Scotese name search) & "B"
 (results of Murrieta city search).

19 ¹³ 31 C.F.R. § 1010.311 implements the reporting requirement of
 20 31 U.S.C. § 5313. Section 5313 is in effect incorporated by
 reference into 18 U.S.C. § 1960, which is the basis for forfeiture
 21 here. Specifically, as explained in the RMSJ, Section 1960 prohibits
 22 the operation of an unlicensed money transmitting business, which is
 defined as a money transmitting business that "fails to comply with
 23 the money transmitting business registration requirements under
 section 5330 of [T]itle 31, United States Code, or regulations
 24 prescribed under such section." 18 U.S.C. § 1960(b)(1)(B). RMSJ at
 p. 9-10. 31 U.S.C. § 5330(d)(1) in turn defines a "money
 25 transmitting business" in part as one that provides a "currency
 exchange" or "engages as a business in the transmission of funds,"
 26 and "is required to file reports under 31 U.S.C. § 5313"
 Section 1960 also defines "money transmitting" to include
 27 "transferring funds." Budovsky, supra, 2015 WL 5602853 at *14.
 28 Bitcoins are "funds" within the meaning of Section 1960. Id.

1 5312(a)(2)(J), the definition of "currency" found in 21 C.F.R.
2 1010.100(m) does not include virtual currency.¹⁴ RS at p. 8:5-11.
3 The courts have consistently rejected similar arguments. For
4 example, in United States v. Budovsky, No. 13cr368 (DLC), 2015 WL
5 5602853 at *14 (S.D. N.Y. Sept. 23, 2015), the court specifically
6 rejected the defendant's argument that bitcoin was not currency under
7 the definition set forth in 31 C.F.R. 1010.100(m). 2015 WL 5602853
8 at *9. The Budovsky court cited the Virtual Currency Guidance for
9 the proposition that the applicable regulations "do[] not
10 differentiate between real currencies and convertible virtual
11 currencies." Id. at *10 (quoting Virtual Currency Guidance at p.
12 3).¹⁵ Similarly, other courts have been consistent in their adoption
13 of FinCEN's position that the essential characteristics of virtual
14 currency justify its regulation as real currency. See, e.g., United
15 States v. 50.44 Bitcoins, No. ELH-15-3692, 2016 WL 3049166 at *1 (D.
16 Md. May 31, 2016)(citing Virtual Currency Guidance);¹⁶ see also S.E.C.
17

18 ¹⁴ 31 C.F.R. 1010.100(m) defines currency as

19 The coin and paper money of the United States or of any other
20 country that is designated as legal tender and that circulates
21 and is customarily used and accepted as a medium of exchange in
22 the country of issuance. Currency includes U.S. silver
certificates, U.S. notes and Federal Reserve notes. Currency
also includes official foreign bank notes that are customarily
used and accepted as a medium of exchange in a foreign country.

23 ¹⁵ The Virtual Currency Guidance recognizes that virtual
24 currency is not "legal tender" and "does not have all the attributes
of real currency." Virtual Currency Guidance at p. 1 & n.3 (citing
25 31 C.F.R. 1010.100(m)). Virtual currency is nevertheless subject to
regulation as currency because it is a "substitute for real
currency." Id. at p. 1.

26 ¹⁶ The government cited 50.44 Bitcoins at page 12 of its Renewed
27 Motion for Summary Judgment, but Scotese makes no meaningful attempt
to address either that case or the other cases cited by the
28 government for the proposition that bitcoins are currency.

1 v. Shavers, No. 4:13-CV-416, 2014 WL 12622292 at *7 (E.D. Texas
 2 August 26, 2014)(Virtual Currency Guidance "demonstrates that virtual
 3 currencies, like Bitcoin, are being treated like money for purpose of
 4 federal regulation.").¹⁷ The Court should therefore reject Scotese's
 5 argument that "currency" does not include virtual currency, and that
 6 he did not operate a "currency exchange."¹⁸

7 Scotese's argument also overlooks the fact that he engaged in
 8 other activities that triggered for his obligation to report
 9 financial transactions and register with FinCEN. For example, "any .
 10 . . person who engages as a business in the transmission of funds . .
 11

12 ¹⁷ Limiting the definition of "currency" under 31 C.F.R.
 13 1010.100(m) to traditional currency, as Scotese suggests, would be
 14 inconsistent with the intent of Congress in enacting Section 1960 "to
 15 prevent innovative ways of transmitting money illicitly." See United
 16 States v. Murgio, ___ F.Supp.3d ___, 2016 WL 5107128 at *4 (S.D. N.Y.
 17 Sept. 19, 2016). Such a limitation of the currency definition also
 18 ignores the fact that harm from the free movement of the monetary
 19 proceeds of crime occurs whether the money takes the form of
 20 traditional currency, virtual currency, or counterfeit currency.
 21 Here, the money that Ochle sent to Scotese constituted the proceeds
 22 of one or more narcotics transactions, but criminals also often
 23 launder counterfeit money. See, e.g., Chowdhury v. I.N.S., 249 F.3d
 24 970, 974 (9th Cir. 2001); see also Nathan K. Cummings, The
 25 Counterfeit Buck Stops Here, 8 S.Cal. Inderdisc. L.J. 539, 545 (1999)
 26 ("many counterfeiters sell their bogus bills for real cash . . . as a
 27 way to 'launder' counterfeit bills . . ."). Under the regulatory
 28 interpretation Scotese advocates, someone prosecuted for transmitting
 counterfeit money as part of a money laundering scheme could claim
 that the registration requirement did not apply to him because the
 counterfeit bills are not legal tender. The government respectfully
 suggests that such a result would be absurd. See generally Campbell
v. Hampton Roads Bankshares, Inc., 925 F.Supp.2d 800, 810 (E.D. Va.
 2013)(rejecting "literal reading" of statute where such a reading
 would lead to an "absurd" result); accord Buche v. Liventa
Bioscience, Inc., 112 F.Supp.3d 883, 885 (D. Minn. 2015); Valle v.
RJM Acquisitions, LLC, No. 3:12-cv-00957, 2015 WL 739855 at *3 (D.
 Conn. Feb. 19, 2015). The Court should accordingly reject Scotese's
 attempt at a restrictive definition of the term "currency."

¹⁸ Under the Virtual Currency Guidance, "exchanger[s]" of
 virtual currency are subject to regulation. Virtual Currency
 Guidance at p. 5.

1 ." is also a financial institution. 31 U.S.C. § 5312(a)(2)(R);
2 Budovsky, supra, 2015 WL 5602853 at *9.¹⁹ This Court should therefore
3 reject Scotese's argument that he is not a "financial institution."

4 **III. SCOTESE WAS NOT INVESTING IN BITCOIN FOR HIS "OWN ACCOUNT."**

5 Relying on guidance that FinCEN issued in 2014 to an entity
6 considering an investment in bitcoin, Scotese argues that he was not
7 required to register with FinCEN because he was "investing in virtual
8 currency for his own account." RS at p. 11-12. This argument is
9 without merit, for at least two reasons.

10 First, Scotese failed to support his conclusory argument with
11 any specific facts or documentation regarding the nature of his
12 purported investment. A "conclusory statement" unsupported by
13 "specific facts" and documentary evidence is insufficient to defeat
14 summary judgment. Arpin v. Santa Clara Valley Transportation Agency,
15 261 F.3d 912, 922 (9th Cir. 2001). In City of Moses Lake v. United
16 States, 458 F.Supp.2d 1198 (E.D. Wash. 2006), a party opposing
17 summary judgment presented "conclusory" testimony that was
18 unsupported by documentation and that was directly at odds with other
19 documentary evidence. Id. at 1220. The court ruled that the
20 testimony was insufficient to defeat summary judgment. Id.

21 Second, the FinCEN guidance upon which Scotese relies considers
22 "transfers to third parties" to be inconsistent with investing on
23 one's "own account." See Application of FinCEN's Regulations to
24 Virtual Currency Software Development and Certain Investment
25 Activity, FinCEN Guidance No. FIN-2014-R002 at p. 3 (January 30,

26
27 ¹⁹ As discussed above, the courts recognize that bitcoins are
28 funds. Budovsky, supra, 2015 WL 5602853 at *14.

1 2014)(copy attached as Exhibit "C")("Investment Activity Guidance").²⁰
2 The Investment Activity Guidance warns that such transfers "may
3 constitute money transmission" (id.), and emphasizes the point by
4 stating separately that "engag[ing] as a business in the exchange of
5 virtual currency against currency of legal tender . . ." would
6 constitute "money transmit[ing] under FinCEN's regulations." Id.
7 FinCEN's interpretation is consistent with how the courts have viewed
8 the issue. For example, the Court in Securities Industry Association
9 v. Comptroller of the Currency, 577 F.Supp. 252 (D. D.C. 1983),
10 aff'd, 758 F.2d 739 (D.C. Cir. 1985), rev'd on other grounds sub
11 nom., Clarke v. Securities Industry Association, 479 U.S. 388 (1987),
12 distinguished between "investment banks buy[ing] for their own
13 account" and "brokerage activities," which involve active buying and
14 selling. 577 F.Supp. at 256; accord United States v. Diamond, 788
15 F.2d 1025, 1028-29 (4th Cir. 1986). The documentary evidence here
16 demonstrates conclusively that Scotese is a money transmitter rather
17 than someone investing on his own account.²¹

18
19 ²⁰ Guidance No. FIN-2014-R002 is available at
20 <https://www.fincen.gov/sites/default/files/shared/FIN-2014-R002.pdf>.
21 The online version was not paginated, so for the convenience of the
Court the government has added page numbers to the Investment
Activity Guidance attached hereto as Exhibit "C".

22 ²¹ The evidence that Scotese was a money transmitter includes
23 the exchange rates posted on Scotese's website (RMSJ Exh. "G"), the
24 volume of confirmed trades posted on that website (id.), and
25 Scotese's statement that he "sell[s] a lot of bitcoin for cash . . .
26 ." Id. Exh. "I". In the face of this evidence, Scotese offers only
27 a conclusory assertion that he was trading for his "own account." RS
28 at p. 11-12. Scotese's assertion, like the evidence that the court
found to be insufficient in Moses Lake, supra, is "not supported by
any documentation" and "at odds with the . . . documentation . . ."
the government has introduced. See 458 F.Supp.2d at 1220. The Court
should therefore conclude that Scotese's assertion he was investing
for his own account is insufficient to defeat summary judgment. See
id.

