SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: SUBMISSIONS PART – Rm 130

THEO CHINO	:	
	:	
Plaintiff-Petitioner,	:	**Index No.: 101880/2015**
	:	**Hon. Lucy Billings**
-against-	:	
	:	
THE DEPARTMENT OF FINANCIAL SERVICES; ANTHONY J. ALBANESE, In his Official Capacity as the Acting Superintendent of the Department of Financial Services.	:	
Defendants-Respondents.	:	

MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS' CROSS-MOTION TO DISMISS THE "ARTICLE 78 & DECLARATORY JUDGMENT PETITION"

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page(s)**

State Statutes

State Regulations

State Rules

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PRELIMINARY STATEMENT

In this hybrid[1] action, *pro se* "Plaintiff-Petitioner" Theo Chino ("Petitioner") challenges the "Virtual Currency" regulation promulgated by the New York State Department of Financial Services (the "Department") at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (cited as "NYCRR") (the "Regulation"). Specifically, the "Declaratory Judgment Petition" (the "Petition") asserts that the Department should be enjoined from enforcing the Regulation, or the Regulation declared unconstitutional, because: (i) the Department exceeded its legislative mandate in promulgating the Regulation, making the regulatory scheme arbitrary and capricious (*see* Petition, ¶¶ 53-73); (ii) if the Department's promulgation of the Regulation was consistent with the enabling legislation, such delegation of authority was a violation of "the separation-of-powers doctrine" (*see* Petition, ¶¶ 74-80); and (iii) certain provisions of the

[1] Mr. Chino is bringing this action as both an Article 78 proceeding to challenge the Department's regulation of virtual currencies as arbitrary, capricious, and beyond their jurisdiction, while also styling the matter as an action seeking a declaratory judgment pursuant to CPLR § 3001. *See* Petition, ¶ 49.

Regulation, particularly relating to the definition of regulated activity, are arbitrary and capricious (*see* Petition, ¶¶ 81-112).

The Department and Anthony Albanese,[2] designated as Defendants-Respondents, now move to dismiss this Petition in its entirety, on both procedural and substantive grounds. Procedurally, the Petition is deficient because it fails to allege any facts establishing that Petitioner has standing to challenge the Regulation.

Substantively, the Regulation was promulgated pursuant to a clear legislative mandate to "provide for the regulation of new financial services products," "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision," "protect the public interest" and "protect users of banking, insurance, and financial services products and services." New York Financial Services Law (hereinafter cited as the "FSL") §§ 102(f), (i), (j), and (l). This mandate is clear, unambiguous and wholly consistent with the separation of powers doctrine.

Finally, the Regulation is neither arbitrary nor capricious; it is rationally tailored to ensure that virtual currency services and products, like other financial services and products, are provided in a safe and sound manner which protects New Yorkers from fraud and other wrongdoing.

STATEMENT OF FACTS

The Department refers the Court to the Petition, annexed to the Affirmation of Anthony J. Tomari ("Tomari Aff.") as Exhibit "A," and the Affirmation of Peter C. Dean sworn to April 22, 2016 ("Dean Aff."), for a full recitation of the facts and circumstances underlying this controversy.

[2] Anthony Albanese is sued in his official capacity as Acting Superintendent of the Department. Mr. Albanese resigned that post on December 1, 2015, and the Acting Superintendent of the Department is now Maria T. Vullo. As Mr. Albanese has no further connection to the enforcement of the regulations at issue herein, he should be dismissed from this action.

However, for purposes of considering this cross-motion to dismiss, the salient facts are repeated here.

A. The Petition and the Petitioner

Petitioner is "a New York state citizen ... [and the] 100% owner of Chino, LTD, a Delaware Sub S C-corporation, authorized to do business in New York." *See* Petition, ¶ 45. Petitioner challenges the Regulation, asserting that the Department lacked an "express mandate" from the New York State Legislature to regulate virtual currency business activity. *See* Petition, ¶ 4. As such, Petitioner asserts, the Regulation is arbitrary and capricious in its design and application and must be struck down. *Id.*

Petitioner asserts that he "lives in constant fear that he could inadvertently commit a criminal act and therefore fears the New York State government when it should feel protected by it." *See* Petition, ¶ 15. Petitioner also asserts that he employed one person that he "let go around July 2014 due to the uncertainty of the field." *See* Petition, ¶ 27. He further states that, when he requested a waiver of the fee for a virtual currency license, "he was told that none existed." *See* Petition, ¶ 32. Finally, Petitioner asserts that if he is required to comply with the Regulation, he will be "irreparably harmed since covered business [sic] will be unable to meet the unreasonable and capricious rules set forth by the Department of Financial Services and consumers using the technology will either [sic] patronize businesses that are not covered by the regulation, rather than covered establishments." *See* Petition, ¶ 48. In short, the Petition is drafted in broad and conclusory terms and leaves unclear the exact nature of Petitioner's complaint, the nature of the services he provides, or seeks to provide, and how the Regulation prevents him from doing so. Instead, he merely asserts, without more, that the

Regulation is "arbitrary and truly unscientific"[3] and assumes that it applies to his business. *See* Petition, ¶ 103.

B. The Department and Its Regulation of Virtual Currencies

(1) The creation of the Department and its mission.

In the wake of the financial crisis, the New York State Legislature created the Department to implement a comprehensive approach to the regulation of financial products and services in New York. Dean Aff. ¶ 5. The Superintendent of Financial Services (the "Superintendent") is the head of the Department. FSL § 202(a). By merging the New York State Banking and Insurance Departments, the Legislature created a single agency that could draw on the extensive experience of the staffs of the Department's predecessor agencies in regulating and supervising financial products and services and their providers under the New York Banking Law (cited as the "BL") and Insurance Law. Dean Aff. ¶ 6. Specifically, the Department regulates and supervises a variety of financial services institutions, including all New York state-chartered banking organizations, such as banks, trust companies, savings banks, and credit unions, as well as branches, agencies, and representative offices of foreign banks. *Id.* In addition, the Department regulates and supervises mortgage bankers, brokers, loan originators and servicers, money transmitters, licensed lenders, check cashers, budget planners, sales finance companies, and all insurance companies and insurance producers that do business in New York. *Id.*

As a complement to the Banking Law and the Insurance Law, the Legislature enacted the Financial Services Law, which tasked the Department with the regulation and supervision of certain financial products and services and the providers of such products and services. Dean Aff. ¶ 7. The Legislature declared that the purpose of the Financial Services Law is to "provide for the

[3] As made clear in the Dean Aff., the Regulation imposes requirements that are similar to those imposed upon other financial service products and service providers.

enforcement of the insurance, banking and financial services laws, under the auspices of a single state agency" that would, among other things, "provide for the regulation of *new* financial services products" and "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL §§ 102(f) and (i) (emphasis added); *see id.*

The Financial Services Law's "Declaration of policy" section specifically states that it "is the intent of the legislature that the superintendent shall supervise the business of, and the persons providing, financial products and services...." FSL § 201(a); Dean Aff. ¶ 8. To perform this mandate, the Department is required by the Financial Services Law to "take such actions as the superintendent believes necessary" to "ensure the continued solvency, safety, soundness and prudent conduct of the providers of financial products and services" and to "protect users of financial products and services...." FSL §§ 201(b)(2) and (7); Dean Aff. ¶ 9.

The Financial Services Law defines a "financial product or service" as "any financial product or financial service offered or provided by any person regulated or required to be regulated by the superintendent pursuant to the banking law or the insurance law or any financial product or service offered or sold to consumers," subject to certain exceptions.[4] FSL § 104(a)(2); Dean Aff. ¶ 10.

In addition, the Financial Services Law authorizes the superintendent to promulgate "rules and regulations and issue orders and guidance involving financial products and services, not inconsistent with the provisions of" the Financial Services Law, the Banking Law, the Insurance Law, and "any other law in which the superintendent is given authority." FSL § 302(a); Dean Aff. ¶

[4] For example, a "financial product or service" does not include any financial products or services "regulated under the exclusive jurisdiction of a federal agency or authority"; or "regulated for the purpose of consumer or investor protection by any other state agency, state department or state public authority"; or "where rules or regulations promulgated by the superintendent on such financial product or service would be preempted by federal law." FSL §§ 104(a)(2)(A)(i)–(iii).

11. Such regulations may effectuate "any power given to the superintendent" under the Financial Services Law and other enumerated laws; interpret the Financial Services Law and other enumerated laws; and govern "the procedures to be followed in the practice of the department." FSL §§ 302(a)(1) - (3); Dean Aff. ¶ 12.

(2) The regulation of virtual currencies

Virtual currency is widely acknowledged as "a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction." Dean Aff. ¶ 15. Perhaps the most widely known form of virtual currency, Bitcoin, has been described as a "peer to peer" version of electronic cash that allows "online payments to be sent directly from one party to another without going through" a "trusted third-party." Dean Aff. ¶ 14. In short, virtual currency is a medium of exchange that may be used to buy or sell goods or services and can be used to store value.

Notwithstanding virtual currency's early use as a means of making peer-to-peer payments, a variety of third-party service providers have become an integral part of virtual currency activity and have fundamentally altered the way in which people use virtual currencies. Dean Aff. ¶ 16. For example, third-party service providers facilitate the exchange, between customers, of government-issued fiat currency (such as U.S. dollars or euros) for virtual currency (such as bitcoins), and of virtual currency for government-issued fiat currency. Dean Aff. ¶ 17. In addition, some third-parties provide "wallet" services that hold a customer's virtual currency until the customer wants to draw on the "wallet" to effectuate a payment transaction with the virtual currency. Dean Aff. ¶ 18. Other third-party service providers use virtual currency to transmit funds domestically and internationally outside of the traditional banking system. Dean Aff. ¶ 19.

Such third-party services are directly analogous to established financial services that are regulated under the Banking Law and the Financial Services Law. For example, virtual currency service providers often accept consumer funds – whether in virtual currency, fiat currency, or both – to be sent to another party. Dean Aff. ¶ 20. Similarly, money transmitters accept, for example, U.S. dollars to be sent to another party, and money transmission has been regulated in New York as a licensed financial service since the 1960s. *See* BL § 641; Dean Aff. ¶ 21. Money transmission is regulated to protect consumers against the loss of their funds as a result of fraud or mismanagement by the third-party service provider. Virtual currency service providers pose similar risks. Dean Aff. ¶ 22. For example, Mt. Gox, once the largest Bitcoin exchange service, collapsed in early 2014 and lost more than $450 million worth of bitcoins – nearly 90% of which belonged to Mt. Gox's customers. The CEO of Mt. Gox was subsequently arrested and charged with embezzlement. Dean Aff. ¶ 23.

In addition to the risk of loss to customers, virtual currency business activity has in some cases involved "dark" online marketplaces, including the Silk Road site, where, between 2011 and 2013, illegal drugs and other illicit items and services worth hundreds of millions of dollars were regularly bought and sold using the virtual currency Bitcoin. Dean Aff. ¶ 24. For precisely such reasons, the Regulation is necessary and appropriate to ensure the "prudent conduct of the providers of financial products and services" and "encourage high standards of honesty, transparency, fair business practices and public responsibility." FSL §§ 102(i) and 201(b)(5); Dean Aff. ¶ 24.

(a) Promulgation of 23 NYCRR Part 200

On July 23, 2014, pursuant to the State Administrative Procedure Act, the Department published in the New York State Register (the "Register") the proposed virtual currency regulation to be included at 23 NYCRR Part 200. As the Department stated in the Register, the "Purpose" of

the proposed Part was to regulate "virtual currency business activity in order to protect New York consumers and users and ensure the safety and soundness of New York licensed providers of virtual currency products and services." Dean Aff. ¶ 25.

That initial publication in the Register was followed by a 90-day public comment period and Department review of those comments. On February 25, 2015, based upon the public comments received, a substantially revised proposed 23 NYCRR Part 200 was published in the Register. Dean Aff. ¶ 26. After an additional 30-day comment period and Department review of those comments, the final version of 23 NYCRR Part 200 was adopted on June 24, 2015. Dean Aff. ¶ 27.

(b) 23 NYCRR Part 200 Applies Existing Regulatory Concepts to Virtual Currency

The Regulation applies to virtual currency various regulatory concepts that already exist in the Banking Law or the regulations promulgated thereunder. Dean Aff. ¶ 33. As discussed more fully below, these concepts reflect common requirements imposed across a wide variety of financial services and include, for example: the maintenance of certain books and records; reporting requirements; disclosures to consumers; periodic examination by the Department; maintenance of a surety bond or similar security fund to protect consumers; prior Department approval of changes in control of the licensee; and anti-money laundering requirements. Dean Aff. ¶ 34.

LEGAL STANDARDS

On a motion to dismiss under CPLR Rule 3211 or 7804, the complaint must generally be given a liberal construction, facts must be accepted as true, and the court must determine whether the facts alleged fit any cognizable legal theory. *Leon v. Martinez*, 84 N.Y.2d 83, 87-88 (1994). However, "claims consisting of bare legal conclusions with no factual specificity . . . are insufficient to survive a motion to dismiss." *Godfrey v. Spano*, 13 N.Y.3d 358, 373 (2009); *see also Olszewski v.*

Waters of Orchard Park, 303 A.D.2d 995, 995 (4th Dep't 2003); *Biondi v. Beekman Hill House Apt. Corp.*, 257 A.D. 2d 76, 81 (1st Dep't 1999), *aff'd*, 94 N.Y.2d 659 (2000).

ARGUMENT

I. PETITIONER LACKS STANDING TO CHALLENGE THE REGULATION

To challenge a governmental action, a party must first establish that it has standing to sue. *See New York State Ass'n of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211 (2004). "Whether a person seeking relief from a court is a proper party to request an adjudication, 'is an aspect of justiciability which must be considered at the outset of any litigation.'" *Roberts v. Health and Hospitals Corp.*, 87 A.D.3d 311 (1st Dep't 2011) (*quoting Matter of Dairylea Coop. Inc. v. Walkley*, 38 N.Y.2d 6, 9 (1975)). Standing is critical since a court "has no inherent power to right a wrong unless thereby the civil, property or personal right of the plaintiff in the action or the petitioner in the proceeding is affected." *Society of the Plastics Indus., Inc. v. County of Suffolk*, 77 N.Y.2d 761,772 (1991) (*quoting Schieffelin v. Komfort*, 212 N.Y. 520, 530).

The Court of Appeals has set forth a two-part test for determining standing:

> First, a plaintiff must show "injury in fact," meaning that plaintiff will actually be harmed by the administrative action. As the term implies, the injury must be more than conjectural. Second, the injury a plaintiff asserts must fall within the zone of interests or concerns sought to be promoted or protected by the statutory provision under which the agency has acted.

New York State Ass'n of Nurse Anesthetists, 2 N.Y.3d at 211 (*citing Society of Plastics Indus. v. County of Suffolk*, 77 N.Y.2d 761, 763 (1991); *Matter of Colella v. Bd. of Assessors*, 95N.Y.2d 401, 409-10 (2000)). The burden of establishing standing is on the party seeking judicial review. *Soc'y of Plastics Indus., Inc. v. County of Suffolk*, 77 N.Y.2d 761, 769 (1991). Petitioner fails to meet that burden.

A. Petitioner Fails to Allege that He Suffered an Injury-In-Fact

Speculation that a party will likely be injured does not satisfy the "concreteness" required to establish injury in fact. *New York State Ass'n of Nurse Anesthetists*, 2 N.Y.3d at 213. "[S]tanding requires a showing of 'cognizable harm,' meaning that an individual member of plaintiff organizations 'has been or will be injured'; 'tenuous' and 'ephemeral' harm ... is insufficient to trigger judicial intervention." *Id.* at 214 (quoting *Rudder v. Pataki*, 93 N.Y.2d 273, 279 (1999)).

Moreover, a party only has standing to assert claims on his or her own behalf and "not, as a general rule,... on behalf of another." *Caprer*, 36 A.D.3d at 182. Even though "an issue may be one of ... public concern, [that] does not entitle a party to standing." *Id.* at 769; *see also Sun-Brite Car Wash, Inc. v. Bd. of Zoning & Appeals of the Town of N. Hempstead*, 69 N.Y.2d 406, 413 (1987). Without an injury in fact, a petitioner's assertions are "little more than an attempt to legislate through the courts." *Rudder v. Pataki*, 93 N.Y.2d 273, 280 (1999). *Accord Society of Plastics*, 77 N.Y.2d at 769, 773 (explaining that grievances generalized to the degree that they become broad policy complaints are best left to the elected branches; that "an issue may be one of 'vital public concern' does not entitle a party to standing").

Here, Petitioner's allegations are inadequate to establish standing to bring this challenge. The alleged "harm to plaintiff-petitioner," appearing at page 12 of the Petition, is entirely speculative. Specifically, Petitioner asserts, that "***If*** required to comply with the Regulation, [Petitioner], will be irreparably harmed since covered business will be unable to meet the unreasonable and capricious rules set forth by the Department of Financial Services and consumers using the technology will either patronize businesses that are not covered by the regulation, rather [sic] than covered establishments."[5] *See* Petition, ¶ 48 (emphasis added). There is, however, no allegation that Petitioner is actually engaged in activity that would be covered by the Regulation.

[5] Petitioner does not identify the part of the Regulation to which this allegation refers.

Indeed, although Petitioner submitted an application to be licensed under the Regulation, his application was returned because it did not possess sufficient information to allow the Department to discern whether Petitioner was engaged in virtual currency business subject to the Regulation. Dean Aff. ¶ 31.

Even assuming that Petitioner is engaged in regulated virtual currency business activity, the alleged injuries he would suffer from being licensed – that he will be "unable to meet the unreasonable and capricious rules" and that "consumers … will […] patronize businesses that are not covered by the regulation" – are conclusory, tenuous and speculative at best. *See* Petition, ¶ 48. Moreover, as set forth in the Dean Aff., the Regulation incorporates regulatory concepts that are widely applied to small and large financial service providers alike. Dean Aff. ¶¶ 33-45. The Petition lacks any specific allegation explaining why Petitioner cannot comply with requirements that other financial service providers, including other small businesses, currently comply with.

Petitioner's other alleged injuries are too attenuated to establish standing. Petitioner's assertion that he "lives in constant fear that he could inadvertently commit a criminal act and therefore fears the New York State government when it [sic] should feel protected by it" is entirely speculative. *See* Petition, ¶ 15. This criticism could just as easily be aimed at any other law or regulation – the fact that a law or regulation may be enforced does not, on its own, establish an injury-in-fact. Moreover, this argument ignores the fact that there is no provision in the Regulation for criminal penalties. The criminal conviction relating to virtual currency cited by Petitioner arises out of violations of wholly unrelated laws. *See* Petition, ¶ 17.

Finally, Petitioner alleges he "employed one person that he let go around July 2014 due to the uncertainty of the field, a fact that [Petitioner] told DFS superintendent in person and has been illustrated in hundreds of the thousand public comment[s] received by DFS." *See* Petition, ¶ 27.

Such broad, non-descript and anticipatory allegations of harm are insufficient to establish standing. Moreover, Petitioner allegedly fired his sole employee around the time that the first draft of the Regulation was published in the Register – nearly a year before the final version of the Regulation became effective.

In short, Petitioner fails to show how the Regulation has impacted him in any concrete, material way. As such, Petitioner has not alleged "an actual legal stake in the matter being adjudicated," and thus lacks standing. *Soc'y of Plastics Indus.*, 77 N.Y.2d at 772.

B. Petitioner Lacks Individual Standing to Obtain the Declaratory Relief He Seeks

Petitioner lacks individual standing to seek the declaratory relief requested in the Complaint because he has not shown that the relief sought will "directly and specifically affect" him. CPLR 3001 provides that the Supreme Court may render a declaratory judgment "as to the rights and other legal relations of the parties to a *justiciable controversy*." CPLR 3001 (emphasis added). Accordingly, to have standing to seek declaratory relief, Petitioner must show that the declaratory relief will "have some practical effect," *i.e.*, that he will be "directly and specifically affected" by the resolution of the matter. *Lumbermens Mut. Cas. Co. v. Progressive Cas. Ins. Co.*, 168 A.D.2d 708, 709 (1st Dep't 1990). The allegations in the pleading "must demonstrate the existences of a bona fide justiciable controversy, defined as a real dispute between adverse parties, involving substantial legal interests for which a declaration of rights will have some practical effect." *Palm v. Tuckahoe Union Free Sch. Dist.*, 95 A.D.3d 1087, 1089 (2d Dep't 2012) (internal quotations and citations omitted); *see also Long Island Lighting Co. v. Allianz Underwriters Ins. Co.*, 35 A.D.3d 253 (1st Dep't 2006) ("A declaratory judgment action thus requires an actual controversy between genuine disputants with a stake in the outcome, and may not be used as a vehicle for an advisory opinion.") (internal quotations omitted).

In the instant case, Petitioner seeks a declaratory judgment from this Court that "to the extent this Court finds that Title 23, Chapter 1, Part 200 of the ... [NYCRR] authorized Defendants to promulgate the Regulation, the Court should issue a declaratory judgment pursuant to CPLR 3001 finding these delegations to be unconstitutional as in violation of the separation-of-powers doctrine, and further that the Defendants' actions taken pursuant to them are invalid." *See* Petition, ¶ 80. But the Petition-Complaint contains no allegations as to how Petitioner will either "directly" or "specifically" be affected by a declaratory judgment in this matter. *N.Y.S. Assn. of Nurse Anesthetists v. Novello*, 2 N.Y.2d 207, 211, 214-15 (2004) (dismissing claim based upon potential future injury due to lack of standing and stating "[t]hat in the future the hypothesized harm might befall [plaintiff] does not at this time entitle plaintiff to maintain this action").

While Petitioner vigorously asserts the Regulation will impact his business, there is no assertion as to what loss of business, if any, he has suffered. The absence of a showing of actual injury due to the Regulation is fatal to Petitioner's claim for a declaratory judgment.

II. THE REGULATION IS WELL WITHIN THE DEPARTMENT'S ENABLING LEGISLATION AND DOES NOT VIOLATE THE SEPARATION OF POWERS DOCTRINE

A. The State Legislature Expressly Conferred Upon the Department the Ability to Regulate Financial Services Offered to New Yorkers

It is well established that the Legislature may enact a general statutory provision and delegate power to an agency to fill in the details, as long as reasonable safeguards and guidelines are provided to the agency. *Greater N.Y. Taxi Assoc. v. Taxi and Limo. Comm'n*, 25 N.Y.3d 600, 637 (2015); *Matter of General Electric Corp. v. N.Y. Div. of Tax.*, 2 N.Y.3d 249, 254 (2004) ("The cornerstone of administrative law is derived from the principle that the Legislature may declare its will, and after

fixing a primary standard, endow administrative agencies with the power to fill in the interstices in the legislative product by prescribing rules and regulations consistent with the enabling legislation").

In addition, an administrative agency "is clothed with those powers expressly conferred by its authorizing statute, as well as those required by necessary implication." *Matter of City of New York v. State of N.Y. Comm'n on Cable Tel.*, 47 N.Y.2d 89, 92 (1979). As such, "an agency can adopt regulations that go beyond the text of its enabling legislation, provided they are not inconsistent with the statutory language or its underlying purposes." *Children's Therapy Services v. New York Dep't of Health*, __A.D.3d __, 22 N.Y.S.3d 524, 530 (2d Dep't 2015). Where, as is the case here, an agency has been endowed with broad power to regulate in the public interest, courts generally will uphold reasonable acts that further the regulatory scheme. *Matter of New York State Ass'n of Crim. Def. Lawyers v. Kaye*, 96 N.Y.2d 512, 518 (2001). The propriety of an agency's action often depends upon the nature of the subject matter and the breadth of legislatively conferred authority. *City of New York v. N.Y. Comm'n on Cable, supra, 47 N.Y.2d* at 96. An agency may not act or promulgate rules that contravene its enabling legislation. *Finger Lakes Racing Ass'n v. N.Y.S. Racing and Wagering Bd.*, 45 N.Y.2d 471, 480 (1978); *Greater N.Y. Taxi Assoc. v. Taxi and Limo. Comm'n, supra.* 121 A.D.3d at 28. The pertinent inquiry then becomes, whether the authority granted to the agency by the Legislature included the power to enact the rules and regulations at issue, or whether the agency exceeded its authority and acted in a manner not contemplated by the Legislature. *Greater N.Y. Taxi Assoc. v. Taxi and Limo. Comm'n*, 25 N.Y.2d at 608.

Here, the enabling legislation clearly authorized the Department to enact rules and regulations pertaining to financial products, services and the providers of such products and services. Dean Aff. ¶¶ 5, 7. The Legislature declared that the purpose of the Financial Services Law is to "provide for the enforcement of the insurance, banking and financial services laws, under the

auspices of a single state agency" that would "provide for the regulation of *new* financial services products" and "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL §§ 102(f) and (i) (emphasis added); *see id.* Furthermore, the Financial Services Law's "Declaration of policy" section states that it "is the intent of the legislature that the superintendent shall supervise the business of, and the persons providing, financial products and services...." FSL § 201(a); Dean Aff. ¶ 8. To perform this mandate, the Department is required to "take such actions as the superintendent believes necessary" to "ensure the continued solvency, safety, soundness and prudent conduct of the providers of financial products and services" and to "protect users of financial products and services...." FSL §§ 201(b)(2) and (7); Dean Aff. ¶ 9.

In addition, the Financial Services Law authorizes the Superintendent to promulgate "rules and regulations and issue orders and guidance involving financial products and services, not inconsistent with the provisions of" the Financial Services Law, the Banking Law, the Insurance Law, and "any other law in which the superintendent is given authority." FSL § 302(a); Dean Aff. ¶ 11.

In short, the Legislature created the Department with the express intention that it regulate, among other things, new financial products and services, such as virtual currency products and services, and the Department's enactment of 23 NYCRR Part 200 falls comfortably within the Department's legislative mandate to "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL § 102(i).

B. The Legislature's Empowerment of the Department to Regulate Financial Services Offered to New Yorkers Does Not Violate the Separation of Powers Doctrine

The concept of the separation of powers of the three coequal branches of government "is the bedrock of the system of government" adopted by New York. *In the Matter of C.L.A.S.H. v. N.Y.S. Office of Parks*, 2016 N.Y. LEXIS 703 at *4 (March 31, 2016). Legislative delegations to agencies of the authority to administer, by rule or regulation, are often subject to "separation of powers" arguments, and the pertinent inquiry is whether the challenged rule "exceeds the parameters of the power granted by the legislature." *Id.* at *5. Accordingly, the issues of delegation of power and separation of powers are often considered together. *Id.*; *Greater N.Y. Taxi Assoc.*, 25 N.Y.2d at 608. As recently observed by the Court of Appeals, "[t]he constitutional principle of separation of powers . . . requires that the [l]egislature make the critical policy decisions, while the executive branch's responsibility is to implement those policies." *Greater N.Y. Taxi Assoc.*, 25 N.Y.2d at 609, *quoting Bourquin v. Cuomo*, 85 N.Y.2d 781, 784 (1995); *Children's Therapy Services v. New York Dep't of Health*, __A.D.3d __, 22 N.Y.S.3d 524, 529 (2d Dep't 2015).

However, "[t]he branches of government cannot always be neatly divided ... and common sense must be applied when reviewing a separation of powers challenge. As long as the legislature makes the basic policy choices, the legislation need not be detailed or precise as to the agency's role." *Greater N.Y. Taxi Assoc.*, 25 N.Y.2d at 609; *see also C.L.A.S.H.*, 2016 N.Y. LEXIS 703 at *7-8. "[W]here an agency has been endowed with broad power to regulate in the public interest, courts generally will uphold reasonable acts that further the regulatory scheme." *Children's Therapy Services*, __A.D.3d __, 22 N.Y.S.3d 524, 529.

In adopting the Regulation, the Department applied to virtual currency business activities regulatory concepts that already exist in the Banking Law and the regulations promulgated thereunder. Dean Aff. ¶ 33. These concepts reflect common requirements imposed across a wide

variety of financial services and include, for example: the maintenance of certain books and records; reporting requirements; disclosures to consumers; periodic examination by the Department; maintenance of a surety bond or similar security fund to protect consumers; prior Department approval of changes in control of the licensee; and anti-money laundering requirements. Dean Aff. ¶ 34. The application of existing regulatory concepts comports with the Department's mandate to ensure "the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL § 102(i); Dean Aff. ¶ 41.

Petitioner's reliance upon *Boreali v. Axelrod,* 71 N.Y.2d 1 (1987), is misplaced. In *Boreali*, "the seminal case addressing the proper delegation of power, [the Court of Appeals] ... set out four 'coalescing circumstances' that are non-mandatory, somewhat intertwined factors for courts to consider when determining whether an agency has crossed the hazy 'line between administrative rule-making and legislative policy-making.'" *Greater N.Y. Taxi Assoc. v. Taxi and Limo. Comm'n*, 25 N.Y.3d 600, 610 (2015); *Children's Therapy Services v. New York Dep't of Health*, __A.D.3d __, 22 N.Y.S.3d 524, 529 (2d Dep't 2015). As noted by the Court of Appeals:

> As the term "coalescing circumstances" suggests, we do not regard the four circumstances as discrete, necessary conditions that define improper policymaking by an agency, nor as criteria that should be rigidly applied in every case in which an agency is accused of crossing the line into legislative territory. Rather, we treat the circumstances as overlapping, closely related factors that, taken together, support the conclusion that an agency has crossed that line. . . .

Matter of Statewide Coalition of Hispanic Chambers of Comm. v. N.Y.C. Dep't of Health, 23 N.Y.3d 681, 696-97 (2014).

The "central theme" of a *Boreali* analysis is that "an administrative agency exceeds its authority when it makes difficult choices between public policy ends, rather than find[ing] means to an end chosen by the legislature." *Id.* at 700 (2014). In the present matter, the end chosen by the Legislature is clear – the regulation of financial products, services, and their providers in

order to ensure safety and soundness and protect consumers. The Regulation is a reasonable means to that end.

The **first** *Boreali* factor is whether the agency did more than balance costs and benefits according to preexisting guidelines, but instead made "value judgments entailing difficult and complex choices between broad policy goals to resolve social problems." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 610-611; *Children's Therapy Services*, __A.D.3d at __, 22 N.Y.S.3d at 529. There are no broad policy judgments at issue here; virtual currency business is not banned or even discouraged under the Regulation. Rather, the Department extended well-established safeguards that apply to a broad range of financial services to new financial services involving virtual currency. In doing so, the Department fulfilled the legislative intent expressed in the Financial Services Law: to "provide for the regulation of new financial services products"; to "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision;" and to "protect users of financial products and services...." FSL §§ 102(f) and (i); FSL § 201(b)(7).

The **second** *Boreali* factor is "whether the agency merely filled in details of a broad policy or if it wrote on a clean slate, creating its own comprehensive set of rules without benefit of legislative guidance." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 611; *Children's Therapy Services*, __A.D.3d at __, 22 N.Y.S.3d at 529. Far from writing on a clean slate, in promulgating the Regulation, the Department applied well-accepted regulatory concepts that already exist in the Banking Law or the regulations promulgated thereunder to virtual currency business activity. Dean Aff. ¶ 33.

For example, the requirement that entities engaging in regulated virtual currency business activity maintain books and records sufficient to allow the Superintendent to determine whether the licensee is complying with applicable laws, rules, and regulations (23 NYCRR 200.12) mirrors

existing requirements that broadly apply to entities providing financial services in New York, including banks and trust companies (BL § 128), money transmitters (BL § 651-b), check cashers (BL § 372), and budget planners (BL § 586). Dean Aff. ¶ 35. A requirement to maintain a surety bond or similar security fund for the protection of customer funds (23 NYCRR 200.9) equally applies to money transmitters (BL § 643), mortgage bankers and brokers (BL §§ 591 and 591-a), check cashers (3 NYCRR 400.12), and budget planners (BL § 580). Dean Aff. ¶ 36.

The requirement that a licensee maintain an anti-money laundering (or "AML") program (23 NYCRR 200.15) emulates requirements that apply to money transmitters and check cashers (3 NYCRR Parts 416, 417), as well as to, for example, New York banks and trust companies and the New York branches of foreign banks (3 NYCRR Parts 115 and 116). Dean Aff. ¶ 37.

Requirements to submit certain reports, including reports of financial condition, and to be periodically examined apply not only to virtual currency licensees (23 NYCRR 200.13 and 200.14) but also to, for example, money transmitters (3 NYCRR 406.7 and 406.10), check cashers (3 NYCRR 400.3, BL § 372-a), and banking organizations (BL §§ 36, 37, 125, 255, *et al.*). Dean Aff. ¶ 38.

Consumer disclosures (which may include, for example, disclosures of risks and of the terms of transactions, as well as disclosures on receipts) (23 NYCRR 200.19) also apply, for example, to budget planners (BL § 584-a), money transmitters (3 NYCRR 406.3 and 406.4), and banks and trust companies (3 NYCRR 6.3, 6.8, 9.5, 13.4, *et al.*). Dean Aff. ¶ 39.

In addition, Department approval for a change of control is required not only for virtual currency licensees (23 NYCRR 200.11) but also for money transmitters (BL § 652-a), budget planners (BL § 583-a), check cashers (BL § 370-a), and banks and trust companies (BL § 143-b), among others. Dean Aff. ¶ 40.

The **third** *Boreali* factor is "whether the [L]egislature has unsuccessfully tried to reach agreement on the issue, which would indicate that the matter is a policy consideration for the elected body to resolve." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 611-12; *Children's Therapy Services*, __A.D.3d at __, 22 N.Y.S.3d at 529. Here, the Legislature has not made any such attempt to pass legislation governing virtual currency activity or taken any action that would suggest any inconsistency between the promulgation of the Regulation and the Legislature's intent as expressed in the Financial Services Law. Dean Aff. ¶ 56.

In fact, the Department's ability to regulate financial products and services is subject to regular legislative review. Specifically, the Financial Services Law requires that the Department "submit a report annually to the governor and to the legislature" containing, among other things, "a general review of the insurance business, banking business, and financial product or service business," as well as details regarding regulations promulgated under the Financial Services Law. FSL § 207(a)(1) and (14); Dean Aff. ¶ 57. In its 2013 "Annual Report," submitted in June 2014, the Department reported that it had "launched a fact-finding inquiry concerning virtual currency, considering whether further regulations, in addition to current money transmission regulations, are necessary." Dean Aff. ¶ 58. The 2013 Annual Report further stated: "In August [2013], the Department requested information from over 20 virtual currency participants, ranging from service providers to investors. In November [2013], the Department announced notice of its intent to hold public hearings on virtual currencies and the potential issuance of a 'BitLicense' [*i.e.*, a virtual currency license]. The Department is continuing its fact finding and exploring potential regulatory frameworks." Dean Aff. ¶ 59.

In its 2014 Annual Report, submitted in May 2015, the Department again reported to the Governor and Legislature about virtual currency regulation. Specifically, the Department stated that,

following "public hearings that the Department held in January 2014," the Department proposed a "comprehensive regulatory framework for firms dealing in virtual currency, including Bitcoin. The regulatory framework contains key consumer protection, anti-money laundering compliance, and cyber security rules tailored for virtual currency firms." Dean Aff. ¶ 60. Presently, with the legislative session winding down, no legislation has been introduced seeking to regulate virtual currency business activity or invalidate the framework established by the Regulation. Thus, not only has the Legislature not attempted to regulate in this area, but it is on actual notice that the Department promulgated the Regulation almost a year ago.

The **fourth** *Boreali* factor is "whether the agency used special expertise or competence in the field to develop the challenged regulations." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 612; *Children's Therapy Services*, __A.D.3d at __, 22 N.Y.S.3d at 529. As noted previously, the Department was formed through the consolidation of its long-standing predecessor agencies, the Departments of Banking and Insurance, and is New York's primary financial services regulator. Unquestionably, the Department has extensive expertise in the field of financial services regulation, and it used this expertise in developing the Regulation. As the Regulation pertains to virtual currency products and services, which are financial products and services, the Department's special expertise in all financial products and services in New York is required; thus, the fourth *Boreali* factor is easily satisfied.

In light of the above, *Boreali* fully supports the Department's actions. Courts have consistently refused to hold that *Boreali* prohibits an agency's regulations where, as here, the regulations track the agency's statutory mandate. *E.g.*, *C.L.A.S.H. v. N.Y.S. Office of Parks*, 2016 N.Y. LEXIS 703 (N.Y. March 31, 2016) (distinguishing *Boreali* and holding that the Office of Parks and Recreation acted within its statutory mandate in passing regulations limiting smoking in outdoor

areas); *Matter of National Restaurant Association v. N.Y.C. Dep't. of Health*, 2016 N.Y.Misc. LEXIS 603 at *9 (S.Ct. N.Y. Cty. February 26, 2016) (After applying the *Boreali* factors, Court held that the New York City Department of Health did not act outside the bounds of its authority in the area of public health by passing a rule requiring chain restaurants to post sodium warning labels). In precisely the same way, the Regulation implements the statutory authority given to the Department by the Legislature to ensure the safety and soundness of financial services and products offered to New Yorkers and that the providers of these products and services institute adequate consumer protections. Accordingly, Plaintiff's separation-of-powers challenge to the regulations fails as a matter of law.

III. THE REGULATION IS NEITHER ARBITRARY NOR CAPRICIOUS

"An administrative agency's exercise of its rule-making powers is accorded a high degree of judicial deference, especially when the agency acts in the area of its particular expertise." *In the Matter of Spence v. Shah*, 136 A.D.3d 1242, 1246 (3d Dep't 2016) *citing Matter of Consolation Nursing Home v. N.Y.S. Dep't of Health*, 85 N.Y.2d 326, 331 (1995). In such circumstances, as is the case here, "the party seeking to nullify such a regulation has the heavy burden of showing that the regulation is unreasonable and unsupported by any evidence." *Spence, supra* at 1246; *Matter of N.Y. Correction Officers v. State office of Mental Health*, 2016 N.Y.App.Div. LEXIS 2571 at *4 (3d Dep't April 7, 2016). In determining whether an agency rule or regulation is arbitrary and capricious under Section 7803 of the CPLR, a court must look to the record to determine whether there is "a rational basis to support the findings upon which the agency's determination is predicated." *National Restaurant Assoc. v. N.Y.C. Dep't of Health*, 2016 N.Y.Misc. LEXIS 603 at *9 (S.Ct. N.Y.Cty February 26, 2016).

However, the court may not substitute its own judgment for that of the administrative agency. *Id.* "It has been established as a fundamental rule of administrative law that a reviewing court, in dealing with a determination an administrative agency alone is authorized to make, 'must judge the propriety of such action solely by the grounds invoked by the agency.'" *In the Matter of the Brennan Center v. N.Y.S. Bd. of Elections*, 2016 N.Y.Misc. LEXIS 793 at *31 (S.Ct. Albany Cty. March 16, 2016).

Petitioner asserts that the Regulation is arbitrary and capricious because the definition of regulated virtual currency business activity, and the exceptions thereto, are arbitrary and capricious. However, the definition of covered virtual currency business activity reflects the Department's careful crafting of the Regulation to ensure that it did not exceed the authority granted by the Financial Services Law. The Regulation specifically defines "Virtual Currency" as "any type of digital unit that is used as a medium of exchange or a form of digitally stored value." 23 NYCRR 200.2(p); Dean Aff. ¶ 47.

Consistent with the Department's mandate to regulate only "*financial* products and services" (FSL § 201(a)) (emphasis added), the definition of "Virtual Currency" excludes "digital units" that, among other things, "are used solely within online gaming platforms" and "have no market or application outside of those gaming platforms." 23 NYCRR 200.2(p)(1). Such digital units, which are wholly confined to the game's environment, are not part of a *financial* product or service as defined by state law. Dean Aff. ¶ 48.

Also excluded from the definition of "Virtual Currency" are digital units used in a "customer affinity or rewards program," such as, for example, a frequent flyer program. 23 NYCRR 200.2(p)(2). As with digital units used solely within online gaming platforms, digital units in such customer affinity or rewards programs "cannot be converted into, or redeemed for," fiat currency or

Virtual Currency. 23 NYCRR 200.2(p)(2). Thus, they are not part of a *financial* product or service. They are simply a form of benefit conferred on a customer as part of a merchant transaction. Dean Aff. ¶ 49.

The third and final exclusion from the definition of "Virtual Currency" is for digital units used in "Prepaid Cards," which are narrowly defined as being issued and redeemable *solely* in fiat currency (*e.g.*, a gift card issued in U.S. dollars). *See* 23 NYCRR 200.2(p)(3) and 23 NYCRR 200.2(j). "Prepaid Cards" therefore do not involve virtual currency. Dean Aff. ¶ 50.

The Regulation defines licensable "Virtual Currency Business Activity" as the conduct of any of the following activities involving New York or a New York Resident:[6]

a. "receiving Virtual Currency for Transmission or Transmitting Virtual Currency, except where the transaction is undertaken for non-financial purposes and does not involve the transfer of more than a nominal amount of Virtual Currency";

b. "storing, holding, or maintaining custody or control of Virtual Currency on behalf of others";

c. "buying and selling Virtual Currency as a customer business";

d. "performing Exchange Services as a customer business"; or

e. "controlling, administering, or issuing a Virtual Currency."

23 NYCRR 200.2(q); Dean Aff. ¶ 51.

To narrow the Regulation to ensure that it is consistent with the Financial Services Law, 23 NYCRR 200.2(q)(1) excludes from the definition of Virtual Currency Business Activity a transaction that "is undertaken for *non-financial* purposes and does not involve the transfer of more than a nominal amount of Virtual Currency" (emphasis added). To further ensure that non-financial activity is *not* regulated, the Regulation also provides that the "development and dissemination of

[6] 23 NYCRR 200.2(h) defines "New York Resident" as "any Person that resides, is located, has a place of business, or is conducting business in New York."

software in and of itself does not constitute Virtual Currency Business Activity." 23 NYCRR 200.2(q); Dean Aff. ¶ 52.

Other exclusions and exemptions contained in the Regulation are consistent with the Legislature's intent as expressed in the Financial Services Law and with existing regulatory approaches enacted in the Banking Law. Dean Aff. ¶ 53. For example, the exclusion of persons chartered under the Banking Law from the requirements of the Regulation – which Petitioner seems to assert is arbitrary and capricious – emulates the provisions of Banking Law § 641(1), which excludes banks, trust companies, and other entities from the obligation to be licensed as a money transmitter. (Nonetheless, chartered entities must still be "approved by the superintendent to engage in Virtual Currency Business Activity." 23 NYCRR 200.3(c)(1); Dean Aff. ¶ 54.) Similarly, "merchants and consumers that utilize Virtual Currency solely for the purchase or sale of goods or services or for investment purposes" are also exempt from the Regulation. 23 NYCRR 200.3(c)(2). Dean Aff. ¶ 55.

Accordingly, the Regulation challenged in this Petition is eminently reasonable, appropriately focused and well-crafted to attain the Department's legislatively mandated purpose: the safety and soundness of the financial services and products offered to New Yorkers. Petitioner's arguments to the contrary are without merit and his Petition must be dismissed.

CONCLUSION

For the reasons stated herein, it is respectfully submitted that the Petition must be denied and the Respondent's cross-motion to dismiss the Petition as a matter of law must be granted, along with such other and further relief as the Court deems just, proper and appropriate.

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Respectfully submitted,

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