SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THEO CHINO Plaintiff-Petitioner, -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.	Index No. 101880/2015 AFFIRMATION OF PIERRE CIRIC IN SUPPORT OF PETITIONER'S OPPOSITION TO RESPONDENTS' CROSS-MOTION TO DISMISS

I, Pierre Ciric, an attorney duly admitted to practice law before the courts of the State of New York, and not a party to the above-entitled action, affirm the following to be true to the best of my knowledge and under the penalties of perjury pursuant to New York Civil Practice Law and Rules ("CPLR") § 2106:

1. I am an attorney at the Ciric Law, PLLC and counsel for Plaintiff-Petitioner Theo Chino ("Petitioner") in the above-entitled action.

2. I submit this affirmation in support of the Petitioner's Opposition to Defendants' Cross-Motion to Dismiss the "Article 78 & Declaratory Judgment Petition" filed by the Department of Financial Services (the "Department") and Anthony J. Albanese, in his official capacity as the acting superintendent of the Department (collectively the "Respondents").

3. In my capacity as counsel for Petitioner, I am fully familiar with the facts and circumstances hereinafter contained, the source of such knowledge being the file materials maintained by my office during the course of the action herein.

Background on Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (the "Regulation")

4. According to the Regulation imposed by the Department, anyone "performing exchange services as a customer business" is required to obtain a License.[1]

5. Compliance costs resulting from the Regulation have been reported between $50,000 and $100,000.[2] A copy of this article is annexed as Exhibit I.

6. According to the Regulation, the same requirements apply to all virtual currency transactions, regardless of whether, for example, a Satoshi,[3] worth less than 1 cent, is being transacted, or 100 bitcoins, worth approximately $56,944, are being transacted.[4]

7. The Regulation requires licensees to maintain a capital requirement as determined by the Superintendent.[5] Generally, capital requirements serve either to reduce or to manage risk in the financial sector.[6] In the banking field they provide a cushion to "reduce risk and protect against failure," in the insurance arena they "guard against insolvencies," and in the broker-dealer context they serve to "manage failure."[7]

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[1] *BitLicense Frequently Asked Questions*, N.Y. State Dep't of Fin. Servs., http://www.dfs.ny.gov/legal/regulations/bitlicense_reg_framework_faq.htm.
[2] Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/.
[3] A Satoshi is the smallest fraction of a bitcoin that can be transacted. ALBERT SZMIGIELSKI, BITCOIN ESSENTIALS 33 (2016). One Satoshi is the equivalent of 0.00000001 bitcoin. *Id.*
[4] *See id*; *Bitcoin Calculator*, COINDESK, http://www.coindesk.com/calculator/ (last visited Aug. 2, 2016) (valuing one bitcoin at $565.67 as of August 15, 2016).
[5] 23 NYCRR § 200.8.
[6] *See* Daniel M. Gallagher, *The Philosophies of Capital Requirements*, SEC (Jan. 15, 2014), https://www.sec.gov/News/Speech/Detail/Speech/1370540629644.
[7] *See id*; Robert E. Lewis, *Capital from an Insurance Company Perspective*, 4 ECON. POL'Y REV. 183, 183 (1998).

New York Is An Important Technology Center

8. The technology industry is an increasingly important piece of New York's economy, and digital currency is a prominent emerging technology.[8]

9. Startups are essential to technological innovation and growth, and in 2015, New York City was recognized as being one of the top startup ecosystems in the world.[9] The Regulation has transformed this once welcoming New York landscape into an inhospitable environment for digital currency-related startups.[10]

10. When Superintendent Lawsky announced the final version of the Regulation, he said: "we should not react so harshly that we doom promising new technologies before they get out of the cradle."[11] Yet the Regulation has done just that.[12] The Regulation has effectively forced digital currency-related startups to relocate outside New York and to otherwise severe ties with New York citizens.[13] The Regulation is unjustifiably burdensome on startups and small

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[8] *See The New York City Tech Ecosystem*, HR&A ADVISORS (Mar. 2014), http://www.hraadvisors.com/wp-content/uploads/2014/03/NYC_Tech_Ecosystem_032614_WEB.pdf; Brian Forde, *How to Prevent New York from Becoming the Bitcoin Backwater of the U.S.*, MEDIUM (May 12, 2015), https://medium.com/mit-media-lab-digital-currency-initiative/how-to-prevent-new-york-from-becoming-the-bitcoin-backwater-of-the-u-s-931505a54560#.u05t446p2.

[9] Richard Florida, *The World's Leading Startup Cities*, CITYLAB (July 27, 2015), http://www.citylab.com/tech/2015/07/the-worlds-leading-startup-cities/399623/; Emily Edwards, *Financial Technology Startups Are Bringing Underbanked Into the Economy*, MEDIUM (May 16. 2016), https://medium.com/village-capital/financial-technology-startups-are-bringing-the-underbanked-into-the-economy-24978561b9ea#.635lp86ks.

[10] *See* Roberts, *supra* (reporting that in the wake of the Regulation's adoption, scores of bitcoin companies relocated outside the state of New York and severed ties to New York customers).

[11] Ben Lawsky, *The Final NYDFS BitLicense Framework*, MEDIUM (June 3, 2015), https://medium.com/@BenLawsky/the-final-nydfs-bitlicense-framework-d4e333588f04#.akxneegmv.

[12] *See, e.g.*, Roberts, *supra*.

[13] *See id.*; *BitLicense Restrictions for New York Customers*, BITFINEX (Aug. 7, 2015), https://www.bitfinex.com/posts/51.

companies, and has in many instances left businesses with no other option than to flee and otherwise abandon New York.[14]

Characteristics of Financial Products

11. Financial products are characterized by their connection to money management and use.[15] Examples of financial products include mortgage loans and car insurance policies.[16]

12. Financial services are facilities "relating to money and investments."[17] Financial service providers essentially "help channel cash from savers to borrowers and redistribute risk." Banks that administer payments systems, for example, are financial service providers.[18]

13. Because financial products and service involve money, the general purpose of financial regulation is "to protect borrowers and investors that participate in financial markets and mitigate financial instability."[19]

Bitcoin Is Property, Not Money

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[14] *See, e.g. id.*; Joseph Adinolfi, *Some digital-currency startups are fleeing New York,* MARKETWATCH (Aug. 18, 2015), http://www.marketwatch.com/story/some-digital-currency-startups-are-fleeing-new-york-2015-08-18; Everett Rosenfeld, *Company leaves New York, protesting 'BitLicense'*, CNBC (Jun. 11, 2015), http://www.cnbc.com/2015/06/10/company-leaves-new-york-protesting-bitlicense.html; Jamie Redman, *Bitlicense Forces Major Bitcoin Businesses to Leave in Droves*, BITCOIN.COM (Aug. 10, 2015), https://news.bitcoin.com/bitlicense-forces-major-bitcoin-businesses-leave-in-droves/.
[15] *See Financial Product*, CAMBRIDGE BUS. ENG. DICTIONARY, http://dictionary.cambridge.org/us/dictionary/english/financial-product.
[16] Irena Asmundson, *Financial Services: Getting the Goods*, IMF (Mar. 28, 2012), http://www.imf.org/external/pubs/ft/fandd/basics/finserv.htm.
[17] *Financial Services*, CAMBRIDGE ADVANCED LEARNER'S DICTIONARY & THESAURUS, http://dictionary.cambridge.org/us/dictionary/english/financial-services.
[18] Asmundson, *supra*.
[19] Edward V. Murphy, *Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets*, CONGRESSIONAL RESEARCH SERVICE (Jan. 30, 2015), https://www.fas.org/sgp/crs/misc/R43087.pdf.

14. Some states have decided that Bitcoin is not money. Kansas and Texas have taken the same position and issued memoranda stating that Bitcoin is not money. [20]

15. Because Bitcoin is not money, and because currencies are representations of money, Bitcoin is not true a currency.[21] True currencies, unlike Bitcoin, "are designated legal tender, [that] circulate and are customarily used and accepted as a medium of exchange in the country of issuance."[22]

16. Unlike true currencies, Bitcoin is neither widely accepted as mediums of exchange nor a stable store of value,[23] nor issued by a government.[24]

17. Because Bitcoin is not issued by a government, no entity is required to accept it as payment.[25]

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[20] *See* Tex. Dep't of Banking, Supervisory Memorandum 1037, Regulatory Treatment of Virtual Currencies Under the Texas Money Services Act 2-3 (Apr. 3, 2014), http://www.dob.texas.gov/public/uploads/files/consumer-information/sm1037.pdf (stating "[Bitcoin] as currently implemented cannot be considered money or monetary value under the Money Services Act."); Kan. Office of the State Bank Commissioner Guidance Document, MT 2014-01, Regulatory Treatment of Virtual Currencies Under the Kansas Money Transmitter Act 2-3 (June 6, 2014), http://www.osbckansas.org/mt/guidance/mt2014_01_virtual_currency.pdf (stating "[Bitcoin] as currently in existence [is] not considered 'money' or 'monetary value' by the [Office of the State Bank Commissioner], [it is] not covered by the [Kansas Money Transmitter Act].").

[21] *See* Leo Haviland, WORD ON THE STREET: LANGUAGE AND THE AMERICAN DREAM ON WALL STREET 294 (2011); *In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3 (Sept. 17, 2015).

[22] *In re Coinflip, Inc.* at 3; *see also* Notice 2014-21, IRS, https://www.irs.gov/pub/irs-drop/n-14-21.pdf (recognizing that bitcoins "[do] not have legal tender status in any jurisdiction").

[23] Dominic Wilson & Jose Ursua, *Is Bitcoin a Currency?,* 21 GOLDMAN SACHS: TOP OF MIND 6, 6 (2014), http://www.paymentlawadvisor.com/files/2014/01/GoldmanSachs-Bit-Coin.pdf.

[24] *See Model State Consumer and Investor Guidance on Virtual Currency*, CONFERENCE OF STATE BANK SUPERVISORS (Apr. 23, 2014), http://www.ncsl.org/documents/summit/summit2014/onlineresources/ModelConsumerGuidance--VirtualCurrencies.pdf; *Virtual Currency: Risks and Regulation*, THE CLEARING HOUSE at 17 (June 23, 2014), https://www.theclearinghouse.org/issues/articles/2014/06/20140623-tch-icba-virtual-currency-paper.

[25] Karl Whelan, *How is Bitcoin Different from the Dollar?*, FORBES (Nov. 19, 2013), http://www.forbes.com/sites/karlwhelan/2013/11/19/how-is-bitcoin-different-from-the-dollar/#68c676c86d34.

18. While currencies are generally secured by a commodity or a government's ability to tax and defend, Bitcoin is not safeguarded by either.[26]

19. Bitcoin is akin to commodity-like mediums of exchange. This view is consistent with the positions taken by the IRS and the Commodity Future Trading Commission (CFTC). The IRS has concluded that bitcoins are property, not currency for tax purposes.[27] In fact, Bitcoin is the result of transparent mathematical formulas, which lack the attributes of traditional financial products or transactions. Bitcoin consists of four different components: (1) a decentralized peer-to peer network (the bitcoin protocol), (2) a public transaction ledger (the blockchain), (3) a decentralized mathematical algorithm, and (4) a decentralized verification system (transaction script).[28] Bitcoins are created through the computation of a mathematical algorithm through a process called "mining," which involves competing to find solutions to a mathematical problem while processing bitcoin transactions.[29] Anyone in the Bitcoin network may operate as a "miner" by using their computer to verify and record transactions.[30] The bitcoin protocol includes built-in algorithms that regulate this mining function across the network.[31] The protocol limits the total number of bitcoins that will be created.[32] Once bitcoins are created, they are used for bartering transactions using the blockchain technology.[33] This technology relies on data "blocks," which are "a group of transactions, marked with a timestamp, and a fingerprint of

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[26] Jonathon Shieber, *Goldman Sachs: Bitcoin Is Not A Currency,* TECHCRUNCH (Mar. 12, 2014), https://techcrunch.com/2014/03/12/goldman-sachs-bitcoin-is-not-a-currency/.
[27] Notice 2014-21, IRS, https://www.irs.gov/pub/irs-drop/n-14-21.pdf.
[28] ANDREAS M. ANTONOPOULOS, MASTERING BITCOIN: UNLOCKING DIGITAL CRYPTOCURRENCIES (2014).
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*

the previous block."[34] A blockchain is "[a] list of validated block, each linking to its predecessor all the way to the genesis block."[35] The genesis block is "[t]he first block in the blockchain, used to initialize the cryptocurrency, and the universe of bitcoin transactions in capped at 21 million.[36]

20. As with traditional commodities, like crude oil and gold, the value of Bitcoin is highly volatile and dependent upon supply and demand. Like gold, bitcoins are a finite resource. "[O]nly 21 million bitcoins will ever be created."[37]

21. Even the definition of Bitcoin is not clear because there are significant differences in the interpretation.[38]

The Fundamental Protocol used to Conduct Most Internet Activity Falls within the Regulation's Definition of "Virtual Currency"

22. Transmission Control Protocol/Internet Protocol (TCP/IP) allows computers to communicate over the Internet.[39] People engage the TCP/IP protocol to send emails, visit websites, or download music.[40]

23. The TCP/IP system takes data, divides it into packets, and then bounces those packets from the starting point to the final destination.[41] A TCP/IP packet is "the smallest unit of

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[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Frequently Asked Questions*, BITCOIN, https://bitcoin.org/en/faq#is-bitcoin-a-bubble (last visited Aug. 16, 2016).
[38] *See* Notice 2014-21, IRS, https://www.irs.gov/pub/irs-drop/n-14-21.pdf.
[39] Lawrence B. Solum & Minn Chung, *The Layers Principle: Internet Architecture and the Law*, 79 NOTRE DAME L. REV. 815, 821 (2004).
[40] John Gallaugher, *12.3, Get Where You're Going*, A MANAGER'S GUIDE TO THE INTERNET AND TELECOMMUNICATIONS (2012), http://2012books.lardbucket.org/books/getting-the-most-out-of-information-systems-v1.3/s16-a-manager-s-guide-to-the-inter.html; Nick Parlante, *How Email Works*, STANFORD UNIV., https://web.stanford.edu/class/cs101/network-4-email.html (last visited Oct. 25, 2016).
[41] LAWRENCE LESSIG, CODE 43 (2nd ed. 2006).

transmitted information over the Internet," and is thus a "digital unit."[42] TCP/IP packets are also "the exchange medium used by processes to send and receive data through Internet networks."[43]

Blockchain Technologies Are Not Inherently Financial

24. The Department intended to regulate cryptocurrency financial intermediaries.[44]

25. Many cryptocurrencies, like Bitcoin, are blockchain technologies. [45] Blockchains are essentially public ledgers that record users' entries. [46] For example, when a person exchanges a bitcoin,[47] or a fraction thereof, the transaction is recorded on the Bitcoin blockchain.[48]

26. Non-financial uses of blockchain technology fall within the Regulation's definition of Virtual Currency because to participate in blockchain technology, a user engages "digital unit[s]," that [are] "used as medium[s] of exchange." It is digital units, like bitcoins, that carry value, and "even non-financial uses require a de minimis amount of currency," a "medium

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[42] *See* Roberto Sanchez, *What is TCP/IP and How Does It Make the Internet Work?*, HOSTINGADVICE.COM (Nov. 17, 2015), http://www.hostingadvice.com/blog/tcpip-make-internet-work/; *Digital*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/digital (last accessed Oct. 25, 2016) (defining "digital" as "using or characterized by computer technology").
[43] *TCP/IP Terminology*, IBM KNOWLEDGE CENTER, https://www.ibm.com/support/knowledgecenter/ssw_aix_71/com.ibm.aix.networkcomm/tcpip_terms.htm (last visited Oct. 25, 2016).
[44] *See* Sarah Jane Hughes & Stephen T. Middlebrook, *Advancing a Framework for Regulating Cryptocurrency Payments Intermediaries*, 32 YALE J. ON REG. 495, 536-37 (2015); Nermin Hajdarbegovic, *Lawsky: Bitcoin Developers and Miners Exempt from BitLicense*, COINDESK (Oct. 15, 2014), http://www.coindesk.com/lawsky-bitcoin-developers-miners-exempt-bitlicense/ (noting that the Superintendent clarified, "[w]e are regulating financial intermediaries . . . we do not intend to regulate software or software development").
[45] *E.g.* Steven Norton, *CIO Explainer: What is Blockchain?*, WALL ST. J. (Feb. 2, 2016), http://blogs.wsj.com/cio/2016/02/02/cio-explainer-what-is-blockchain/.
[46] *See, e.g.*, *id.*
[47] When "bitcoin" is not capitalized it "describe[s] units of account." *Some Bitcoin Words You Might Hear*, BITCOIN, https://bitcoin.org/en/vocabulary#block (last visited Oct. 25, 2016). When capitalized, Bitcoin "describe[s] the concept of Bitcoin, or the entire network itself." *Id.*
[48] *See How Does Bitcoin Work?*, BITCOIN, https://bitcoin.org/en/how-it-works (last visited Oct. 25, 2016).

of exchange."[49]

27. Blockchain technologies are not inherently financial.[50] People can, and do use blockchain technologies to engage in a slew of non-financially related activities.[51] Artists use blockchain technology to assert ownership over their works, insurers use blockchain technology to track diamonds, and people use blockchain technology to timestamp documents and photos.[52]Additionally, people can use blockchain technology to cast votes, send messages, or enter into contracts.[53]

California Has Declined To Regulate Bitcoin

28. California has tried twice to use the legislative process to pass a bill regulating virtual currency. California introduced AB-1326 to regulate virtual currency business on February 27, 2015.[54] The bill was ordered to become an inactive file on September 11, 2015 at the request of Senator Mitchell.[55]

29. The bill was reintroduced on August 8, 2016. Id. On August 15, 2016,

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[49] *See* § 200.2(p); Trevor I. Kiviat, Note, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 DUKE L.J. 569, 591, 597 (2016); Jeffrey A. Tucker, *What Gave Bitcoin Its Value?*, FOUND. FOR ECON. EDUC. (Aug. 27, 2014), https://fee.org/articles/what-gave-bitcoin-its-value/.
[50] *See* Luke Parker, *Ten Companies Using the Blockchain for Non-Financial Innovation*, BRAVE NEW COIN (Dec. 20, 2015), http://bravenewcoin.com/news/ten-companies-using-the-blockchain-for-non-financial-innovation/.
[51] *See, e.g. id.*
[52] *See id.*
[53] *See Blockchain Technology in Online Voting*, FOLLOW MY VOTE, https://followmyvote.com/online-voting-technology/blockchain-technology/; Naomi O'Leary, *British Traders Have Discovered Bitcoin*, BUS. INSIDER (Apr. 2, 2012), http://www.businessinsider.com/british-traders-have-discovered-bitcoin-2012-4 (noting that the first Bitcoin transaction was used to send a political message); Nik Custodio, *Explain Bitcoin Like I'm Five*, MEDIUM (Dec. 12, 2013), https://medium.com/@nik5ter/explain-bitcoin-like-im-five-73b4257ac833#.ri7s32qfb.
[54] A.B. 1326, 2015-2016 Reg. Sess. (Cal. 2015), History, https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=201520160AB1326.
[55] *Id.*

Assemblymember Matt Dababneh withdrew the bill from consideration.[56] He stated, "Unfortunately, the current bill in print does not meet the objectives to create a lasting regulatory framework that protects consumers and allows this industry to thrive in our state. More time is needed and these conversations must continue in order for California to be at the forefront of this effort."[57]

30. The Electronic Frontier Foundation opposed the bill because it would have hurt consumers and certain businesses.[58]

Virtual Currency Transmitters are Treated Differently Than Money Transmitters

31. A number of requirements imposed on Virtual Currency businesses are not imposed on other money transmitters (keeping records on all transactions, including the identity and physical address of the parties;[59] reporting and notifying transactions exceeding $10,000 in an aggregate amount;[60] complying with a Cyber Security Program, including staffing and reporting requirements[61]).

32. During a speech at Benjamin N. Cardozo School of Law, the Superintendent of the Financial Services for the State of New York at the time, Benjamin M. Lawsky, stated: "Moreover, to the extent that there are some specific areas of the regulation that are somewhat stronger or more robust for virtual currency firms than those for other financial institutions – such as our cyber security rules – that is primarily because we are actually considering using

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[56] Aaron Mackey, *California Lawmaker Pulls Digital Currency Bill After EFF Opposition,* ELEC. FRONTIER FOUND. (Aug. 18, 2016), https://www.eff.org/deeplinks/2016/08/california-lawmaker-pulls-digital-currency-bill-after-eff-opposition.
[57] *Id.*
[58] *Id.*
[59] 23 NYCRR 200.15(e)(1)(i)
[60] 23 NYCRR 200.15(e)(2)
[61] 23 NYCRR 200.16

them as models for our regulated banks and insurance companies." Superintendent Benjamin M. Lawsky, Address at Benjamin N. Cardozo School of Law (Oct. 14, 2014), at page 2 (transcript available at https://web.archive.org/web/20150702103620/http://www.dfs.ny.gov/about/speeches_testimony/sp141014.htm). A copy of this transcript is annexed as Exhibit II.

WHEREFORE, for the reasons stated in the Petitioner's opposition to Respondents' cross-motion to dismiss, Petitioner respectfully request Respondents' cross-motion to dismiss be denied.

Dated: October 27, 2016
New York, New York

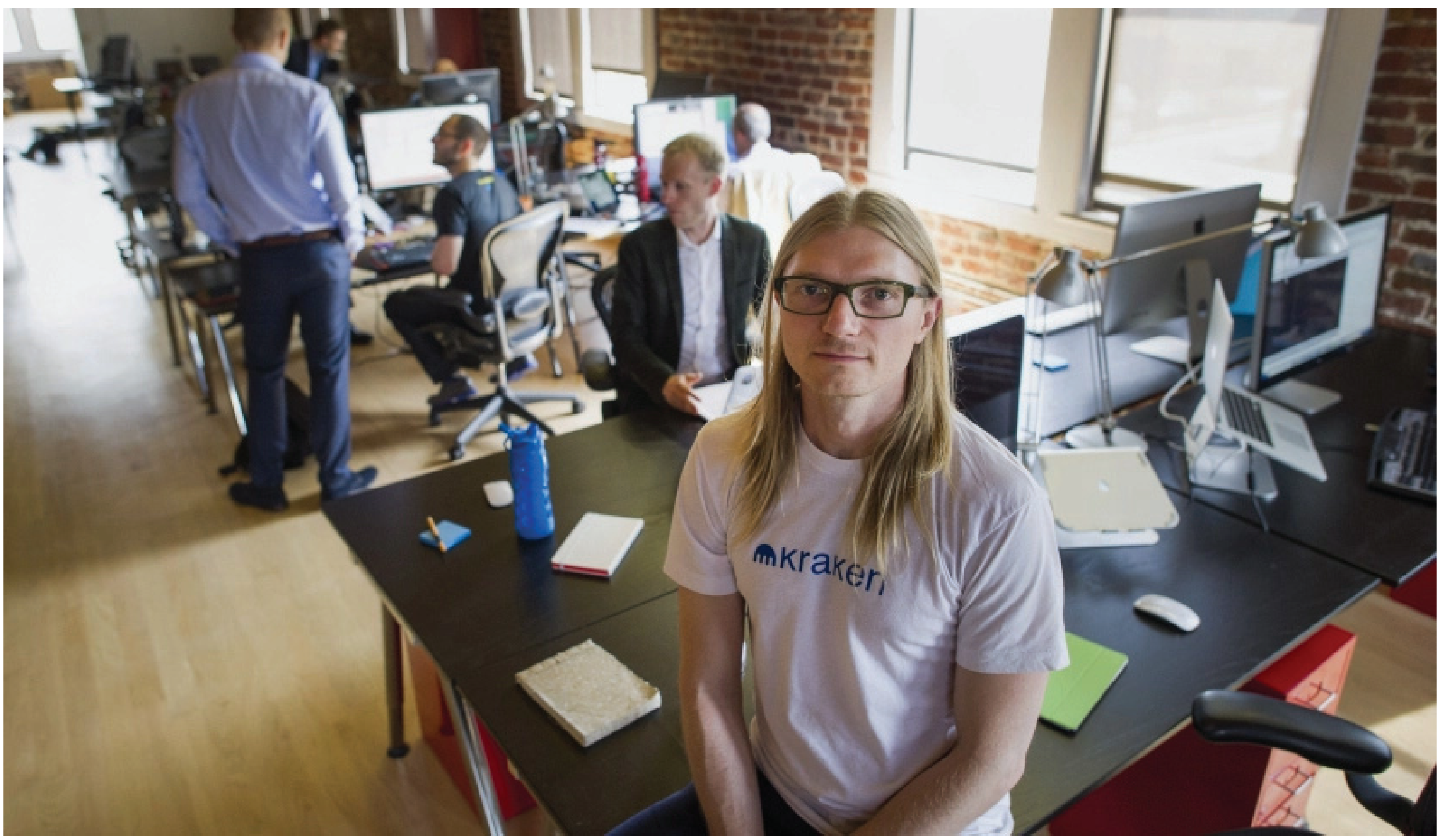
Pierre Ciric
THE CIRIC LAW FIRM, PLLC
17A Stuyvesant Oval
New York, NY 10009
Email: pciric@ciriclawfirm.com
Tel: (212) 260-6090
Attorney for Petitioner

EXHIBIT “I”

TECH BITCOIN REGULATION

Behind the "exodus" of bitcoin startups from New York

by Daniel Roberts @readDanwrite AUGUST 14, 2015, 11:19 AM EDT



Jesse Powell, CEO of Kraken, one of the bitcoin companies that chose to exit New York.
Photograph by David Paul Morris — Bloomberg via Getty Images

The exits were a strong reaction to the application requirements for a BitLicense.

Last weekend the deadline to apply for a BitLicense came and went, and a slew of bitcoin startups went too—right out of New York State.

The BitLicense is New York's regulatory badge of approval, required of all digital-currency businesses that are deemed "money transmitters" (companies that hold customer funds, most of them exchanges). And it has been highly controversial in bitcoin circles since it was first unveiled over year ago, after multiple revisions.

Bitcoin executives—even those who chose to apply for a license for their company—have gripes about the final set of rules, and are still hoping to see it change. This weekend, many of them decided to make a statement: rather than apply for the license, they left New York. For some with physical headquarters in the state, that meant literal moving trucks. For others it meant cutting off service to New York-based customers.

To leave New York entirely may seem like a drastic step, but much of the most fevered activity around trading of the digital currency is happening outside the U.S. anyway. The new defectors are all following ShapeShift, a startup led by outspoken bitcoin entrepreneur Erik Voorhees, which was the first to go, cutting off service to New York just days after the BitLicense came out.

Why are they upset?

Critics of the BitLicense see limitations in the specific rules, such as the requirement of new licenses for every new service offered. But the application process, too, has left some companies wringing their hands.

The application costs $5,000, which alone does not necessarily seem excessive. But executives say that the paperwork was extensive and required legal help, which carries additional fees. Jaron Lukasiewicz, CEO of Coinsetter, tells *Fortune* his company spent nearly $50,000 to apply for the BitLicense. George Frost, chief legal officer at Bitstamp, told Coindesk it was more like $100,000 for his company. If either of those figures is remotely accurate, that cost would certainly be prohibitive for smaller companies.

"You'd hope that the costs are outweighed by the value, but for some, maybe not," says Lukasiewicz. He says that Coinsetter seriously considered not applying, but, "I definitely don't need the legal risk."

Lukasiewicz is not a fan of the BitLicense, or of regulation in general for the space, but he says, "I don't want to have to hide in New York. And I viewed it as something that could have marketing upside in terms of helping people feel safer using us."

Those who leave and those who stay

This is not a comprehensive list, but here are some of the companies that packed up and left New York: Bitfinex, BitQuick, BTCGuild, Eobot, Genesis Mining, GoCoin, Kraken, LocalBitcoins, Paxful, and Poloniex.

Almost all of them published statements about their reasons for refusing to apply, and most of them read

license, "comes at a price that exceeds the market opportunity of servicing New York residents. Therefore, we have no option but to withdraw our service from the state."

Even some digital currency companies that are not money-transmitters, and thus do not need to obtain a BitLicense, voiced their criticism of the regulations and support for companies that exited. Paul Puey, CEO of Airbitz, wrote, "Luckily at Airbitz, we aren't affected… With all the companies announcing these restrictions today, it should remind the community of the importance to be, and to support, decentralization. Bitcoin was intended to give people true control and access to their money and every time we use a centralized service, we aren't truly using Bitcoin."

Bitcoin blogs like CoinFox and Coin Telegraph are calling this a "mass exodus" while *New York Business Journal* christens it "The Great Bitcoin Exodus." But before the weight of these exits gets overstated, it is important to note that most of the hottest, best-funded bitcoin companies—for example, Coinbase, Circle, 21 Inc., and itBit—are staying. Of the companies that left New York this week, Bitfinex was the most significant and surprising.

Bitreserve, which is headquartered in South Carolina but has New York clients, is staying. CEO Anthony Watson, a former Nike CIO and alum of *Fortune*'s 40 Under 40 list, tells *Fortune* that being regulated is a priority: "Bitreserve has an extensive and comprehensive licensing strategy for all 50 states in the U.S., including New York." Coinsetter, which does much of its business in Canada thanks to acquiring Cavirtex last year, is staying. Gemini, a planned exchange from Cameron and Tyler Winklevoss, who already run a bitcoin pricing index and have invested in a slew of bitcoin companies, is staying; the twins have made it clear they are in no hurry to launch their exchange until it is fully licensed. (Coinbase, a leading exchange that has investment from the NYSE, launched without a BitLicense.)

In total, 22 companies have applied for a BitLicense thus far. As for the blowback from the companies that refused, a spokesperson for the NYDFS told *Fortune*, "There are always going to be those who argue for little-to-no regulation, but we think that ultimately the BitLicense is going to a be a positive for the long-term health of this industry. If digital currency is going to gain wider adoption, strong consumer protections and oversight (to help ensure that customer money doesn't fall into a black hole) will be critical."

What to expect next

For now, no one knows quite what level of action—how quickly or how severe—the NY Department of Financial Services will take against companies that continue to operate in New York without a BitLicense.

Having a BitLicense may even end up being seen as a "nice to have," but not crucial. Think of it as a building being LEED-certified, bearing the seal that shows it is eco-friendly. Lukasiewicz likes that analogy. But he believes that any company with customers in New York that didn't apply is taking a big risk. After all, the industry watched closely the prosecution, in Manhattan, of Silk Road mastermind Ross Ulbricht.

"I do think the biggest story in bitcoin in the next year," Lukasiewicz says, "will be watching the NYDFS and seeing what develops next."

This story was updated to include a comment from the NY Department of Financial Services; it also originally stated, in error, that Xapo was one of the companies leaving New York.

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EXHIBIT “II”

EXCERPTS FROM SUPERINTENDENT LAWSKY'S REMARKS ON VIRTUAL CURRENCY AND BITCOIN REGULATION IN NEW YORK CITY

Benjamin M. Lawsky, Superintendent of Financial Services for the State of New York, is delivering remarks today at the Benjamin N. Cardozo School of Law in New York City. The following are excerpts from Superintendent Lawsky's remarks on virtual currency and Bitcoin regulation as prepared for delivery.

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Excerpts from Superintendent Lawsky's Remarks at the Benjamin N. Cardozo School of Law
New York, NY
October 14, 2014

As Prepared for Delivery

Ultimately, after the Mt. Gox collapse, we redoubled our efforts and put forward our proposal for public comment six months ahead of schedule in July 2014.

That regulatory framework included a number of key provisions to safeguard customer assets; protect consumers from fraud and abuse; root out money laundering and other illicit activity; and put up strong defenses against would-be hackers by emphasizing the need for robust cyber security.

To be clear, our proposal was meant as a beginning – not an end – to a healthy, vigorous public discussion about what the final regulation should look like.

We want to move quickly to put in place rules of the road for virtual currency firms to provide greater clarity and certainty about the regulatory environment. But not move so quickly that we risk mistakes.

To that end, while we put forward our proposal for public discussion ahead of schedule – after some members of the virtual currency community asked for additional time to formulate their feedback, we listened and doubled the length of the initial comment period. Indeed, I think there may have been some who mistakenly assumed our initial regulation was a take-it-or-leave-it, all-or-nothing proposal that would take effect in a matter of days or weeks.

Truth be told, public comment periods generally take a good deal of time in government.

Moreover,we will likely make certain changes to our initial proposal – and clarify other provisions.

And state law provides for an additional comment period when an agency makes material changes to a proposed regulation, which should provide a further opportunity for public feedback.

Suffice it to say, there is and will be a significant amount of time for stakeholders to provide input on the Department's regulatory framework.

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Now, while we will be making substantive changes to the regulation, and we very much appreciate the time so many people took to formulate and submit comments – I've read many of them myself – we do think that many of the original proposals make sense, are good for consumers, and good for the long-term health of the virtual currency industry.

The rules also generally mirror the types of requirements that other banks, financial institutions, and money transmitters have to live by – with some alterations owing to the unique nature of virtual currencies.

This is a point that is not well understood. In part, perhaps, because virtual currency sits at the crossroads of a more lightly regulated technology sector and more heavily regulated financial sector.

And most of what Bitcoin firms are being asked to do – whether it is examinations, anti-money laundering compliance, accounting, or recordkeeping – is similar to what other financial firms must do.

Additionally, we agree with the sentiment that financial regulation should be – to the extent practical – technologically neutral. But we cannot stick our heads in the sand about the fact that – when it comes to consumer disclosures, capital accounting, and other issues – there are real differences between fiat currency and virtual currency.

We should simply endeavor to make sure that where there are technologically specific regulations – they are appropriately tailored, reasonable, and warranted.

Moreover, to the extent that there are some specific areas of the regulation that are somewhat stronger or more robust for virtual currency firms than those for other financial institutions – such as our cyber security rules – that is primarily because we are actually considering using them as models for our regulated banks and insurance companies.

As evidenced by the recent JPMorgan hack, cyber security is one of the most important issues the Department of Financial Services (DFS) will face as a regulator in the months and years ahead across the entire financial system. And you will be hearing a lot more from our agency about this in the near future.

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As I said, there are some important changes I think we will make to the proposed regulations, many of which I expect will be clarifying in nature. While I cannot address every category of feedback today because our team is still going through all the comments we've received – I can say we are reviewing all of them closely – I would like to go through a few of these areas today.

First, there is some confusion about who will be required to obtain a BitLicense. For example, some believe that our proposed regulation requires all software developers and individual users of virtual currency to obtain licenses.

To clarify, we do not intend to regulate software as software or software development. For example, a software developer who creates and provides wallet software to customers for their own use will not need a license. Those who are innovating and developing the latest platforms for virtual currency will not need a license. We are regulating financial intermediaries. We are not regulating software development.

Individual users are similarly exempt from the license requirement. People who want to use virtual currency to make purchases or want to hold virtual currency solely for investment purposes will not be required to obtain a license.

Second, there appears to be some concern that virtual currency businesses will need to get several different types of licenses, resulting in a cumbersome and duplicative application process.

To the extent an applicant requires both money transmitter and virtual currency licenses, for example – which is possible – the process will be streamlined. Applicants will be able to cross-satisfy the requirements of each license.

Third, we have also received comments claiming banks are completely exempt from complying with the virtual currency regulations and that is not fair.

That, of course, would not be fair. However, it also isn't true.

The banks we regulate cannot start providing virtual currency services without prior approval from DFS, and they will be have to comply with any requirements that are otherwise imposed on virtual currency businesses.

Fourth, there is much speculation about whether we intend to regulate mining. Mining per se will not be regulated. To the extent a miner engages in other virtual currency services, however – for example, hosting wallets or exchanging virtual currency – a license may be required for those activities.

Finally, I know that there is some concern about the compliance costs of regulation on new or fledgling virtual currency enterprises. This is a difficult issue. We certainly get it and are wrestling with it. There has to be a way for start ups to start up and play by the rules without getting crushed by huge compliance costs. This goes back to that original collision between traditional banking and tech innovation. It requires a creative solution and we are working on that issue.

In part, this concern is also why we want to make the revised regulation quite clear that software companies do not need a BitLicense in order to develop new software and innovate. We are not seeking to stifle technological innovation.

But if a software company is also taking on the responsibility of actually safeguarding customer money – it is a much more difficult calculation.

Again, that is the basic bargain of financial services regulation. We do not, for instance, let someone run a bank out of their garage. And licensure and regulation often helps foster greater trust among consumers.

Companies can, of course, try and run from regulation in a race to the bottom.

To set up shop in dark corners of the globe with little to no oversight.

Or play one regulator off one another to try and water down the rules – a process known as regulatory arbitrage or regulator shopping. We saw this phenomenon a lot during the lead up to the financial crisis.

But our hope is that companies recognize that effective, appropriate regulation will help create a race to the top.

At a basic level, our guiding principle for virtual currency regulation is similar to our guiding principle for regulation at all financial companies.

We have never been an agency that supports regulation for regulation's sake.

We simply want to make sure that there are appropriate guardrails so that consumers are protected and we help prevent illicit activity.

When it comes to safeguarding customer money at a financial company – an unregulated world of caveat emptor has never been a sufficient answer.

Right now, I think, the virtual currency industry is at a bit of a crossroads regarding whether it will become an important part of the future financial system.

At DFS, we're committed to proceeding thoughtfully since virtual currency could ultimately have a number of benefits for our financial system.

Events and discussions like this one really help as we strive to rightsize and modernize our regulation of new financial technologies like virtual currencies.

So thank you for the opportunity to speak with you today and I look forward to your questions.