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
Hon. Lucy Billings

ORAL ARGUMENT REQUESTED

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

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INTRODUCTION

Plaintiff-Petitioner Theo Chino ("Petitioner"), by and through his attorney, respectfully submits this memorandum of law in opposition to the cross-motion to dismiss submitted by the Defendants-Respondents 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"). For the reasons set forth below, Respondents' cross-motion to dismiss should be denied. In the alternative, Petitioner respectfully requests leave to amend his pleadings should the Court find any of his pleadings in any way deficient.

STATEMENT OF FACTS

Petitioner challenges the "Virtual Currency" regulation promulgated by the Department at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (cited as "NYCRR") (the "Regulation").

On November 19, 2013, Petitioner incorporated Chino Ltd. in Delaware and on February 24, 2014, Petitioner submitted an application for authority to conduct business in the state of New York under § 1304 of the Business Corporation Law as a foreign business corporation. Affidavit of Theo Chino in Support of Petitioner's Opposition to Respondents' Motion to Dismiss ("Chino Aff.") ¶ 2. The original purpose of Chino Ltd. was to install Bitcoin processing services in the State of New York. Chino Aff. ¶ 2. In March 2014, Petitioner hired an employee to sell Chino Ltd.'s Bitcoin-related services in New York and Bronx County. Chino Aff. ¶ 3. Petitioner's employee distributed surveys to local bodegas and stores to evaluate the Bitcoin landscape and identify potential clients in the Manhattan area. Chino Aff. ¶ 4.

On December 31, 2014, Petitioner co-founded Conglomerate Business Consultants, Inc. (CBC). Chino Aff. ¶ 5. CBC started out by purchasing phone minutes from E-Sigma Online LLC

and later from NobelCom LLC, and then CBC would distribute the phone minutes to bodegas who would in turn sell the phone minutes to customers. Chino Aff. ¶ 6. While CBC distributed phone minutes and provided the Bitcoin processing services directly to bodegas, Chino Ltd. provided technical services to CBC by processing the Bitcoin transactions. Chino Aff. ¶ 7. After business relationships were established with bodegas through selling phone minutes, between December 2014 and May 2015, CBC entered into formal contracts with seven bodegas in New York to offer Bitcoin-processing services. Chino Aff. ¶ 8. Furthermore, the bodegas were given signage to advertise that they accepted bitcoins. Chino Aff. ¶ 8. Every day, CBC would send the bodegas the daily exchange rate that would be used for Bitcoin processing. Chino Aff. ¶ 9.

On August 7, 2015, following the enactment of the Regulation, Petitioner submitted an application for a license to engage in Virtual Currency Business Activity as required under the Regulation. Chino Aff. ¶ 10. While his application was pending, Petitioner commenced this action on October 16, 2015 because he realized the Regulation would require significant costs to run his business. Chino Aff. ¶ 12. After filing suit, on January 4, 2016, Petitioner's application was returned without further processing after the Department performed an initial review. Chino Aff. ¶ 12. In its January 4, 2016 response, the Department stated they were unable to evaluate whether Petitioner's current or planned business activity would be considered Virtual Currency Business Activity that requires licensing under the Regulation. Chino Aff. ¶ 13. Following the January 4, 2016 response, Petitioner was forced to abandon his Bitcoin processing business because his application was not approved. Chino Aff. ¶ 14 Petitioner did not challenge the Department's January 4, 2016 response because he had already commenced this action. Chino Aff. ¶ 14.

The Respondents, moved to dismiss Petitioner's petition in its entirety, on both

procedural and substantive grounds. However, procedurally, the petition is not deficient because Petitioner has standing to challenge the Regulation and he sufficiently demonstrated that he suffered an injury-in-fact.

Substantively, the Department acted beyond the scope of its authority because the Department is only authorized to regulate "financial products and services", but Bitcoin lacks the characteristic of a financial product or service, and, in the absence of an explicit legislative authorization, the Department is not authorized to regulate it. The Department is not entitled to administrative deference because the Regulation governs activities that exceed the scope of the Department's authority. The Regulation is preempted by federal law and the Department does not have the authority to imply additional terms. The Regulation is arbitrary and capricious because: (1) the scope of the Regulation is irrationally broad, (2) the Regulation's recordkeeping requirements are without sound basis in reason, (3) the Regulation irrationally treats virtual currency transmitters differently than fiat currency transmitters, and (4) there is no rational basis underlying a one-size-fits all Regulation that unreasonably prevents startups and small businesses from participating in Virtual Currency Business Activity, and imposes capital requirements on *all* licensees.

ARGUMENT

I. PETITIONER HAS STANDING TO CHALLENGE THE DEPARTMENT'S REGULATION

New York courts have established a two-prong test for evaluating a petitioner's standing to challenge a governmental agency's actions. *See e.g. N.Y. State Ass'n of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211 (2004); *Dairylea Coop., Inc. v. Walkley*, 38 N.Y.2d 6, 9 (1975). In order to challenge the actions of a governmental agency, a petitioner need only show: (1) that there is "injury in fact," meaning that petitioner will actually be harmed by the administrative

action; and (2) that the interest the petitioner asserts falls "within the zone of interests or concerns sought to be promoted or protected by the statutory provision under which the agency has acted." *Novello*, 2 N.Y.3d at 211; *Dairylea*, 38 N.Y.2d at 9. The purpose of a standing analysis is to determine whether a party should have access to the court system. *See Soc'y of Plastics Indus. v. Cty. of Suffolk*, 77 N.Y.2d 761, 769, 794 (1991). Its purpose is not to assess the merits of a party's claim. *See Id.*

Courts have relaxed their standing analyses in light of the increasingly pervasive role that administrative agencies play in impacting the daily lives of citizens. *See Dairylea*, 38 N.Y.2d at 10 (noting that "[t]he increasing pervasiveness of administrative influence on daily life… necessitates a concomitant broadening of the category of persons entitled to judicial determination"); *Sun-Brite Car Wash, Inc. v. Bd. of Zoning & Appeals*, 69 N.Y.2d 406, 413 (1987) (recognizing that standing principles "should not be heavy handed"). "A fundamental tenant of our system of remedies is that when a government agency seeks to act in a manner adversely affecting a party, judicial review of that action may be had." *Dairylea*, 38 N.Y.2d at 10. Petitioner has largely satisfied his burden of establishing that he has standing to challenge the Regulation.

A. Petitioner Sufficiently Demonstrated that He Suffered an Injury-In-Fact

In order to establish standing, a petitioner must demonstrate that he has an "actual legal stake in the matter," in other words, that he has "suffered an injury in fact, distinct from that of the general public." *Novello*, 2 N.Y.3d at 211-12; *Transactive Corp. v. N.Y. State Dep't of Soc. Servs.*, 92 N.Y.2d 579, 587 (1998). A petitioner need not prove actual, present harm. *Police Benevolent Assn. of N.Y. State Troopers, Inc. v. Div. of N.Y. State Police*, 29 A.D.3d 68, 70 (3rd Dep't 2006). Rather, a petitioner need only demonstrate that "it is reasonably certain that the harm will occur if the challenged action is permitted to continue." *Id.* Moreover, a petitioner is

not required to describe his injury "with specific quantification." *N.Y. Propane Gas Ass'n v. N.Y. State Dep't of State*, 17 A.D.3d 915, 916 (3rd Dep't 2005).

Petitioner has sufficiently alleged that he has been irreparably harmed by the Regulation because it effectively forced him to close his Bitcoin processing business. Chino Aff. ¶ 13-14.

i. Before the Regulation was adopted, Petitioner developed and implemented a Bitcoin processing service in New York.

Before the Regulation was implemented, Bitcoin-based business activity was unregulated and, accordingly, its minimal participation costs attracted startup developers like Petitioner. In November 2013, Petitioner incorporated his business, Chino Ltd., with the purpose of installing Bitcoin processing services in the State of New York. Chino Aff. ¶ 2.

In March 2014, Petitioner hired an employee to sell Chino, Ltd. Bitcoin-related services, and began conducting surveys to evaluate the Bitcoin landscape and to identify potential clients in the Manhattan area. Chino Aff. ¶ 3-4. Subsequently, in December 2014, Petitioner co-founded CBC. Chino Aff. ¶ 5. CBC provided the Bitcoin processing services directly to bodegas and Chino Ltd. handled the technical processing of the Bitcoin purchases. Chino Aff. ¶ 7. Between December 2014 and May 2015, CBC entered into formal contracts with seven bodegas in New York to offer Bitcoin-processing services. Chino Aff. ¶ 8. The bodegas were given signage to display that they accepted bitcoins. Chino Aff. ¶ 8. Every day, CBC sent the bodegas the daily exchange rate that would be used for Bitcoin processing. Chino Aff. ¶ 9.

Thus, Petitioner has clearly developed and implemented a Bitcoin processing business in New York.

ii. Petitioner will be required to obtain a license in order to continue his Bitcoin processing business.

Petitioner's Bitcoin processing business certainly falls within the "virtual currency business activity" regulated by 23 NYCRR Part 200. The Regulation requires those engaged in

"virtual currency business activity" that involves New York or New York residents to obtain a license. 23 NYCRR §§ 200.2(q), 200.3(a). Petitioner is a New York resident, who conducts business in New York with New York residents. Furthermore, Petitioner, as a Bitcoin processor performing Bitcoin-based exchange services, is engaged in "virtual currency business activity" as defined in 23 NYCRR § 200.2(q). *See* 23 NYCRR §§ 200.2(p)-(q); Affirmation of Pierre Ciric in Support of Petitioner's Opposition to Respondents' Cross-Motion to Dismiss ("Ciric Aff.") ¶ 4. Thus, the Regulation applies to Petitioner, and in order to continue offering Bitcoin processing services, Petitioner would be required to obtain a license.

iii. The Regulation has halted Petitioner's Bitcoin processing business activities.

Under the Regulation, those wishing to engage in "virtual currency business activity" are forced to assume tens of thousands of dollars in compliance costs, expenses a start-up company cannot realistically be expected to afford. 23 NYCRR § 200.5 (requiring a non-refundable $5,000 application fee); Ciric Aff. ¶ 5.

Despite these financial constraints, Petitioner took affirmative steps to attempt to comply with the Regulation. *See* Affirmation of Dean ("Aff. Dean") ¶ 30. Petitioner researched New York banking law and requested an application fee waiver, which he believed he was entitled to receive. N.Y. Banking Law § 18-a (empowering the superintendent to waive or reduce an application fee); Declaratory Judgment Petition ("Petition") ¶¶ 31-32. Furthermore, in August 2015, Petitioner submitted an application for a license. Aff. Dean ¶ 30; Chino Aff. ¶ 10. While his application was pending, realizing the significant financial impact on his business, Petitioner commenced this action. Aff. Dean ¶ 31; Petition; Chino Aff. ¶ 12.

On January 4, 2016, Petitioner's application was returned without further processing after the Department performed an initial review. Chino Aff. ¶ 13. The Department stated they were

unable to evaluate whether Petitioner's current or planned business activity would be considered Virtual Currency Business Activity that requires licensing under the Regulation. Chino Aff. ¶ 13. Petitioner was forced to abandon his Bitcoin processing business because his application was not approved. Chino Aff. ¶ 14. In order to proceed further, Petitioner would be required to incur expenses beyond his means. Thus, Petitioner has sufficiently alleged that the Regulation is reasonably certain to cause him particularized and imminent economic harm. Therefore, Petitioner has established injury-in-fact to challenge an administrative action.

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

New York courts may grant declaratory relief if a "justiciable controversy" exists. CPLR § 3001. A justiciable controversy exists when there is an actual controversy between adversarial parties who have a stake in the outcome. *Doe v. Coughlin*, 71 N.Y.2d 48, 52 (1987); *Long Is. Light Co. v. Allianz Underwriters Ins. Co.*, 35 A.D.3d 253, 253 (1st Dep't 2006); *United Water New Rochelle, Inc. v. City of N.Y.*, 275 A.D.2d 464, 466 (2nd Dep't 2000). Declaratory relief is appropriate when the challenged regulation proscribes or threatens, or may be interpreted as proscribing or threatening the petitioner's activity. *See Plaza Health Clubs, Inc. v. New York*, 76 A.D.2d 509, 513-14 (1st Dep't 1980). Furthermore, reasonably certain future harm is sufficient to establish standing. *See Police Benevolent Ass'n*, 29 A.D.3d at 70 (finding that petitioners had standing to seek declaratory relief where their harm was not actual or present, but was reasonably certain to occur under the challenged action).

Here, a genuine controversy between adversarial parties who have an interest in the outcome exists. Thus, Petitioner has standing to seek declaratory relief. Petitioner, by taking steps to comply with the Regulation and by filing suit upon realizing that the compliance cost of the regulation would be exorbitant, recognized that the business he engaged in would effectively be proscribed by the Regulation.

Before the Regulation was enacted, Petitioner engaged in Bitcoin processing services in New York. Chino Aff. ¶¶ 3-9. As a result of the Regulation, Petitioner is now effectively barred from continuing his business. Chino Aff. ¶ 14. Therefore, an actual controversy regarding the legal basis of the Regulation exists, and Petitioner has a genuine stake in the outcome. Therefore, Petitioner has standing to seek declaratory relief.

II. THE DEPARTMENT ACTED BEYOND THE SCOPE OF ITS AUTHORITY

The New York Legislature has authorized the Department to regulate financial products and services. Nevertheless, the Department has promulgated a Regulation that monitors and controls non-financial products and services.

A. The Department is Only Authorized to Regulate *Financial* Products and Services

A delegated agency may *only* adopt regulations that are consistent with its enabling legislation and its underlying purposes. *See Greater N.Y. Taxi Assn. v. N.Y.C. Taxi & Limousine Commn.*, 25 N.Y.3d 600, 608 (2015) (emphasis added). The Department cites eight sections of New York Financial Services Law, which it says authorized it to adopt the Regulation. *See* 23 NYCRR § 200 Notes. However, these statutes only authorize the Department to regulate *financial* products and services, and specifically empower the Superintendent to promulgate only those "rules and regulations . . . involving *financial* products and services." N.Y. Fin. Serv. Law (cited as "FSL") §§ 201(a), 302(a); Dean Aff. ¶¶ 6-7, 11, 48 (emphasis added).

If the terms of a statute are clear and unambiguous, "the court should construe [them] so as to give effect to the plain meaning of the words used." *Orens v. Novello*, 99 N.Y.2d 180, 185 (2002) (quoting *Auerbach v. Bd. of Educ.*, 86 N.Y.2d 198, 204 (1995)). Financial Services Law defines "financial product or financial service" circularly to mean, subject to a few exceptions, "any financial product or financial service offered or provided by any person regulated or required to be regulated by the superintendent . . . or any financial product or service offered or

sold to consumers." FSL § 104(a)(2)(A). Thus, because "financial products and services" is not further defined, it is appropriate to give effect to its plain meaning.

A financial product is characterized by its connection with the way in which one manages and uses money. Ciric Aff. ¶ 11. Examples of financial products include mortgage loans and car insurance policies. Ciric Aff. ¶ 11. Financial services are facilities "relating to money and investments." Ciric Aff. ¶ 12. Financial service providers essentially "help channel cash from savers to borrowers and redistribute risk." Ciric Aff. ¶ 12. Banks that administer payments systems, for example, are financial service providers. Ciric Aff. ¶ 12.

Because financial products and services rely on the use and transfer of money, the general purpose of financial regulation is "to protect borrowers and investors that participate in financial markets and mitigate financial instability." Ciric Aff. ¶ 13. It therefore follows that the "financial products and services" the Department is authorized to regulate are those products and services that involve the use, management, and movement of money.

B. Bitcoin Does Not Have the Attributes of Financial Products.

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). Ciric Aff. ¶ 19. 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. Ciric Aff. ¶ 19. Anyone in the bitcoin network may operate as a "miner" by using their computer to verify and record transactions. Ciric Aff. ¶ 19. The bitcoin protocol includes built-in algorithms that regulate this mining function across the network. Ciric Aff. ¶ 19. The protocol limits the total number of bitcoins that will be created. Ciric Aff. ¶ 19. Once bitcoins are created, they are used for bartering transactions using the

blockchain technology. Ciric Aff. ¶ 19. This technology relies on data "blocks," which are "a group of transactions, marked with a timestamp, and a fingerprint of the previous block." Ciric Aff. ¶ 19. A blockchain is "[a] list of validated block, each linking to its predecessor all the way to the genesis block." Ciric Aff. ¶ 19. 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. Ciric Aff. ¶ 19. Therefore, Bitcoin is the result of transparent mathematical formulas, which lack the attributes of traditional financial products or transactions.

Bitcoin is a primary target of the Regulation. *See* Dean Aff. ¶ 60 (noting that the Regulation was proposed to address "firms dealing in virtual currency, including Bitcoin"). A Florida court recently ruled that Bitcoin is not money. *Florida v. Espinoza*, No. F14-2923 at 6 (Fla. 11th Cir. Ct. July 22, 2016) (concluding that "it is very clear, even to someone with limited knowledge in the area, that Bitcoin has a long way to go before it is the equivalent of money" most notably because it is not accepted by all merchants, the value fluctuates significantly, there is a lack of a stabilization mechanism, they have limited ability to act as a store of value, and Bitcoin is a decentralized system.). Kansas and Texas have taken the same position and have issued memoranda stating that Bitcoin is not money. Ciric Aff. ¶ 14.

Accordingly, because Bitcoin is not money, and because currencies are representations of money, Bitcoin is not a true currency, and therefore cannot be analogized to a financial product as Respondents argue. Ciric Aff. ¶ 15; *see In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3 (Sept. 17, 2015). The Code of Federal Regulation defines "currency" as: "[t]he coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance." 31 CFR § 1010.100 (m). 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." *In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3; Ciric Aff. ¶ 15. Accordingly, Bitcoin is not true currency because it is not legal tender in any jurisdiction.

Furthermore, Bitcoin lacks the properties commonly associated with money and true currencies. Unlike true currencies, Bitcoin is neither widely accepted as a medium of exchange nor a stable store of value. *See Espinoza*, No. F14-2923 at 5-6; Ciric Aff. ¶ 16. Additionally, unlike true currencies, Bitcoin is not issued by a government. Ciric Aff. ¶ 16. Because Bitcoin is not issued by a government, no entity is required to accept it as payment. Ciric Aff. ¶ 17. Moreover, while currencies are generally secured by a commodity or a government's ability to tax and defend, Bitcoin is not safeguarded by either. Ciric Aff. ¶ 18; *see Espinoza*, No. F14-2923 at 6. Thus, Bitcoin is not a true currency and therefore lacks the characteristic of financial products. Therefore, it is not subject to regulation by the Department.

Conversely, 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). Ciric Aff. ¶ 18; *In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3. The IRS has concluded that Bitcoin is property, not currency for tax purposes. Ciric Aff. ¶ 18. Likewise, the CFTC treats Bitcoin as commodities, not currencies. *See In re Coinflip, Inc.*, CFTC Docket No. 15-29. at 3.

As with traditional commodities, like crude oil and gold, the value of Bitcoin is highly volatile and dependent upon supply and demand. *See Espinoza*, No. F14-2923 at 5; Ciric Aff. ¶ 20. Furthermore, acquiring Bitcoin is analogous to acquiring other commodities. A person who wishes to obtain a commodity, like gold, for example, can either purchase gold on the market or can mine the gold himself. Similarly, a person who wishes to obtain bitcoins can either purchase

them on the market or "mine" them himself through participation in Bitcoin's transaction verification process. *See* Stephen T. Middlebrook & Sarah Jane Hughes, *Regulating Cryptocurrencies in the United States: Current Issues and Future Directions*, 40 WM. MITCHELL L. REV. 813, 818 (2014). Moreover, like gold, bitcoins are a finite resource. Ciric Aff. ¶ 20.

Because Bitcoin is not a true currency, it therefore follows that not all Bitcoin-based businesses provide financial services. For example, a business that exchanges bitcoins for another type of cryptocurrency cannot be said to provide a financial service because the service does not involve a transmission of true currency. As would be the case if the business exchanged used books for other used books, such a service is analogous to a barter exchange service, not a financial service.

Bitcoin does not qualify as money or true currencies; therefore Bitcoin products are not financial products and Bitcoin services are not financial services. As a result, Bitcoin does not fall within the scope of the Department's regulatory authority. Thus, in promulgating the Regulation to regulate virtual currency business activity, the Department exceeded the scope of its enabling legislation.

C. The Department Does Not Have the Authority to Add Additional Terms.

"[A]n ambiguous term may be given more precise content by the neighboring words with which it is associated." *Bilski v. Kappos*, 130 S. Ct. 3218, 3226 (2010) (quoting *United States v. Stevens,* 130 S.Ct. 1577, 1587 (2010)). When a statute includes an explicit definition, then "[i]t is axiomatic that the statutory definition of the term excludes unstated meanings of the term." *Meese v. Keene*, 481 U.S. 465, 484-485 (1987); *see Burgess v. United States,* 553 U.S. 124, 130 (2008) ("When a statute includes an explicit definition, we must follow that definition" (internal quotation marks omitted)).

Further, "[i]t is well established that in exercising its rule-making authority an administrative agency cannot extend the meaning of the statutory language to apply to situations not intended to be embraced within the statute." *Trump-Equit. Fifth Ave. Co. v Gliedman*, 57 N.Y.2d 588, 595 (1982) (citing *Jones v Berman*, 37 N.Y.2d 42 (1975)). "Nor may an agency promulgate a rule out of harmony with or inconsistent with the plain meaning of the statutory language." *Id.* (citing *Finger Lakes Racing Ass'n. v N.Y. State Racing & Wagering Bd.*, 45 N.Y.2d 471 (1978); *Harbolic v Berger*, 43 N.Y.2d 102 (1977)).

Furthermore, under the "expressio unius est exclusio alterius" rule, "the failure of the Legislature to include a matter within a particular statute is an indication that its exclusion was intended" *Matter of Brown v. N.Y. State Racing & Wagering Bd.,* 2009 NY Slip Op 204, ¶ 6, 60 A.D.3d 107, 116-17, 871 N.Y.S.2d 623, 630 (App. Div.); *Jewish Home & Infirmary v. Comm'r of N.Y. State Dep't of Health*, 84 N.Y.2d 252, 262, 616 N.Y.S.2d 458, 462, 640 N.E.2d 125, 129 (1994); *N.Y. City Council v. City of N.Y.*, 4 A.D.3d 85, 96, 770 N.Y.S.2d 346, 354 (App. Div. 2004) (citing McKinney's Cons Laws of NY, Book 1, Statutes §240, at 411-412, citing *Doyle v. Gordon*, 158 N.Y.S.2d 248 (Sup. Ct. 1954)). If the New York Legislature wanted specific terms to be included in the definition of "financial product or service," it would have expressly referred to them in the FSL§ 104(a)(2)(A) definition. The terms "virtual currency" or "Bitcoin" are omitted from the definition of "financial product or service." *See* FSL§ 104(a)(2)(A). Therefore, under the "expressio unius est exclusio alterius" rule, the Legislature indicated that the exclusion was intended.

Furthermore, a "rule of construction is that the expression of one thing implies the exclusion of another." *Biggs v. Zoning Bd. of Appeals of the Town of Pierrepont, N.Y.*, 2016 NY Slip Op 26139, ¶ 2, 52 Misc. 3d 694, 698, 30 N.Y.S.3d 797, 800 (Sup. Ct.). We can infer that the

expression of exemptions in a statute indicates an exclusion of other exemptions. *Morales v. Cty. of Nassau*, 94 N.Y.2d 218, 224, 703 N.Y.S.2d 61, 64, 724 N.E.2d 756, 759 (1999). The definition of "financial product or service" makes reference to exclusions. *See* FSL §§ 104(a)(2)(B), 104(a)(2-a)(B). It was the intent of the New York Legislature to limit the scope of the definition of "financial product and service" because it created specific exceptions. Therefore, FSL § 104(a)(2) was not intended to be a catch-all provision. In fact, FSL § 104(a)(2)(B)'s exclusions infer that other "financial product or service" would be excluded from the definition as well. Therefore the New York Legislatures did not intend for Bitcoin to be specifically included in the scope of FSL § 104(a)(2).

Although New York Legislature has authorized the Department to regulate financial products and services, it did not offer any definition which included the concept of virtual currency. *See* FSL § 104(a)(2). Although there is split authority as to whether cryptocurrencies may have characteristics or attributes of money in a criminal context (*United States v. Murgio*, No. 15-cr-769 (AJN), 2016 U.S. Dist. LEXIS 131745 (S.D.N.Y. Sep. 19, 2016)), the absence of any precise definition of "financial product or service" in the present case does not allow the Department to extend the scope of the definition, and include Bitcoin as a "financial product or service" in its Regulation. Therefore, FSL § 104(a)(2) excludes "virtual currency" from the definition of "financial product or service". If the New York Legislature wanted to include "virtual currency" in the definition, it could have explicitly made reference to it in the definition. It is beyond the scope of the Department's authority to add the new term "virtual currency." Further, these statutes specifically empower the Superintendent to promulgate only those "rules and regulations… involving financial products and services." FSL §§ 201(a), 302(a); Dean Aff. ¶¶ 6-7, 11, 48. The Department cannot extend the meaning of "financial product and service" to

Bitcoin. It is up to the New York Legislature to make the determination whether Bitcoin qualifies as a "financial product or service." The New York Legislature's silence does not give the Department the authority to define virtual currencies and regulate Bitcoin. The definition of Bitcoin is not clear because there are significant differences in the interpretation. *See* Ciric Aff. ¶ 21; *In re Coinflip, Inc.*, CFTC Docket No. 15-29 at 3. The Department does not have the authority to make its own assessment beyond the definition. *See Trump-Equit. Fifth Ave. Co.* 57 N.Y.2d at 595.

D. The Regulation is Preempted by Federal Law

The federal preemption doctrine provides, when federal law and state law conflict, federal law prevails. *See McCulloch v. Maryland*, 17 U.S. 316, 330 (1819); *N.Y. Bankers Ass'n v. City of N.Y.*, 119 F. Supp. 3d 158, 182 (S.D.N.Y. 2015). There is a strong presumption against federal preemption of state legislation. *Id*. However, this presumption is abandoned in areas of regulation that have been substantially occupied by federal authority for a long period of time. *Id.* National banking is an area that has been substantially occupied by federal authority for a long period of time. *Id.* The National Banking Act of 1864, ch 106, 113 Stat. 99 (codified as amended in scattered section of 12 U.S.C.), gives national banks "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. § 24. Therefore, the presumption against federal preemption does not apply.

Federal law may preempt state law in three ways, express preemption, implied or field preemption, and conflict preemption. *New York v. W. Side Corp.*, 790 F. Supp. 2d 13, 19 (E.D.N.Y. 2011). "… [I]mplied or field preemption exists where 'federal law is sufficiently comprehensive to make reasonable the inference that Congress left no room for supplementary state regulation'" *Id.* (citing *Bedford Affiliates v. Sills*, 156 F.3d 416, 426 (2d Cir. 1998)).

i. Implied preemption exists in the present case because the federal law is sufficiently

comprehensive to make a reasonable inference that Congress left no room for supplementary state regulation.

In the absence of any pronouncement by the New York Legislature, implied preemption exists here because the federal law defining "financial service or product" is sufficiently comprehensive to reasonably infer that Congress left no room for supplementary state regulation.

Federal law defines "financial service or product" in eleven carefully constructed subparagraphs. 12 U.S.C. §5481(15). This provision includes in the "financial service or product" definition "such other financial product or service as may be *defined by the Bureau [of Consumer Financial Protection]*, by regulation, for purposes of this title, *if the Bureau finds that* such financial product or service is – (I) entered into… with a purpose to evade any Federal consumer financial law; or (II) permissible for a bank or for a financial holding company to offer or to provide under any provision of a Federal law or regulation applicable to a bank or a financial holding company, and has, or likely will have, a material impact on consumers." 12 U.S.C. § 5481(15)(A)(xi) (emphasis added). Therefore, this catchall provision expressly grants the Bureau of Consumer Financial Protection the exclusive authority to determine if a financial product or service falls into its regulating authority.

ii. Under the Dodd-Frank Act, preemption is appropriate.

The Dodd-Frank Act states that a "statute, regulation, order, or interpretation . . . in any State is not inconsistent with… this title if the protection that [it] affords to consumers is greater than the protection provided under this title." 12 U.S.C. § 5551. However, under the Dodd-Frank Act, State consumer financial laws are preempted if the State law "is preempted by a provision of Federal law other than title 62 of the Revised Statutes." 12 U.S.C. § 25b(b)(1)(C). Title 62 of the Revised Statutes contains 12 U.S.C. §§ 5133 through 5243, therefore excluding 12 U.S.C. §5481, making preemption appropriate.

iii. It was not Congress' intent for state regulators to freely regulate financial products and services.

Congress' intent is the cornerstone of every determination of preemption. *Hughes v. Talen Energy Mktg., LLC*, 136 S. Ct. 1288, 1297 (2016); *Altria Grp., Inc. v. Good*, 555 U.S. 70, 76 (2008). Congress' intent may be determined through the scope, structure, and purpose of the federal statute. *N.Y. SMSA Ltd. P'ship v. Town of Clarkstown*, 612 F.3d 97, 104 (2d Cir. 2010).

Congress' objectives in enacting Title 12 of the United States Code was to implement and enforce Federal consumer financial law consistently to ensure that *all consumers* have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive. 12 U.S.C. § 5511(a) (emphasis added). The term "all consumers" establishes a purpose of uniformity in markets for consumer financial products and services. New York does not have the authority to define for themselves a term with the history of substantial federal regulation. *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000).

Further, the New York Legislature recognized that there may be times when regulations promulgated by the New York superintendent on financial products or services would be preempted by federal law. *See* FSL § 104(a)(2)(A)(iii). This is one such time when federal law preempts a New York regulation.

III. THE DEPARTMENT IS NOT ENTITLED TO ADMINISTRATIVE DEFERENCE

Though administrative agencies are given some degree of deference in adopting regulations, such deference is not absolute. *See N.Y. State Ass'n of Counties v. Axelrod*, 78 N.Y.2d 158, 166-67 (1991). Regulations must be "scrutinized for genuine reasonableness and rationality in [their] specific context[s]…" *Id.* at 166.

A. The Regulation Governs Activities That Exceed the Scope of the Department's Area of Expertise

Administrative deference is premised on the notion that the agency has acted within its area of expertise. *See Flacke v. Onondaga Landfill Sys., Inc.*, 69 N.Y.2d 355, 363 (1987). Thus, administrative deference is inappropriate when an agency has acted beyond its area of expertise. *See Bd. of Educ. of City Sch. Dist. v. N.Y. State Pub. Emp't Relations Bd.*, 75 N.Y.2d 660, 666 (1990) (recognizing that an agency "is accorded deference in matters falling within its area of expertise"); *Indus. Liaison Comm. v. Williams*, 72 N.Y.2d 137, 144 (1988) (noting that "the principle of deference should be applied only where such expertise is relevant").

The Department has expertise "in regulating and supervising *financial* products and services and their providers." Dean Aff. ¶¶ 6, 47 (emphasis added). The Regulation, however, only exempts non-financial Virtual Currency Business Activity in one category of regulated activity. *See* 23 NYCRR § 200.2(q)(1) (only exempting non-financial receipt for transmission or transmission of Virtual Currency activity). Thus, the Regulation, extensively governs activities related to Virtual Currency, regardless of whether such activities are related to financial products or services. Accordingly, the Department should not be afforded administrative deference.

B. The Department Promulgated an Arbitrary and Capricious Regulation

Administrative deference is inappropriate where an agency has acted arbitrarily and capriciously. *See Pell v. Bd. of Educ.*, 34 N.Y.2d 222, 231 (1974) (recognizing that court interference is appropriate where "the action complained of is arbitrary and capricious") (citation omitted).

As demonstrated below, the Department acted arbitrarily and capriciously when it promulgated a blanket Regulation that governs a wide variety of non-financial activities, effectively allows only well-funded companies to engage in Virtual Currency-related business

activity, and subjects Virtual Currency businesses to requirements that are inconsistent with the Department's fiat currency regulations. Thus, the Department is not entitled to administrative deference.

IV. THE REGULATION IS ARBITRARY AND CAPRICIOUS

Even if the Court finds that Bitcoin is controlled by FSL §104(a)(2)(A), the Court may still find that the Regulation is arbitrary and capricious.

A regulation may only be upheld "if it has a rational basis, and is not unreasonable, arbitrary or capricious." *Axelrod* 78 N.Y.2d at 166. The Court must scrutinize administrative regulations "for genuine reasonableness." *Id.*

A. The Scope of the Regulation is Irrationally Broad

A regulation that is irrational is arbitrary and capricious. *See Axelrod* 78 N.Y.2d at 167-68; *c.f. Bernstein v. Toia*, 43 N.Y.2d 437, 448 (1977) (noting that a regulation should be upheld "if not irrational or unreasonable"). Furthermore, a regulation is irrational, and therefore arbitrary and capricious, if it is excessively broad in scope. *See id.* at 165, 169 (reinstated the Supreme Court's declaration that the challenged regulation was null and void because there was no "rational basis for the promulgation of a rule so broad in scope").

i. <u>The fundamental protocol used to conduct most Internet activity falls within the Regulation's definition of "virtual currency".</u>

Subject to three narrow exceptions, "Virtual Currency" means "*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) (emphasis added). Furthermore, 23 NYCRR § 200.2(p) mandates that this definition be "broadly construed." *Id.* Given this instruction and the Regulation's failure to define "digital unit" or "medium of exchange," nearly all Internet activity could be interpreted under the Regulation to involve Virtual Currency. Thus, the definition of Virtual Currency is grossly overinclusive and

irrational.

Transmission Control Protocol/Internet Protocol (TCP/IP) allows computers to communicate over the Internet. Lawrence B. Solum & Minn Chung, *The Layers Principle: Internet Architecture and the Law*, 79 NOTRE DAME L. REV. 815, 821 (2004). People engage the TCP/IP protocol to send emails, visit websites, or download music. Ciric Aff. ¶ 22.

The TCP/IP system takes data, divides it into packets, and then bounces those packets from the starting point to the final destination. Ciric Aff. ¶ 23. A TCP/IP packet is "the smallest unit of transmitted information over the Internet," and is thus a "digital unit." Ciric Aff. ¶ 23. TCP/IP packets are also "the exchange medium used by processes to send and receive data through Internet networks." Ciric Aff. ¶ 23. Accordingly, a TCP/IP packet, which is a "digital unit," is used "as a medium of exchange," and thus falls within the Regulation's definition of Virtual Currency. *See* 23 NYCRR § 200.2(p). This means that when people engage in Internet activity, they almost always use Virtual Currency, as it is defined in the Regulation, to do so, rendering such activity potentially subject to the Regulation. Therefore, the Regulation's definition of Virtual Currency is irrationally overinclusive, and is thus arbitrary and capricious.

ii. The definition of "virtual currency," even as it applies to the intended targets of the Regulation largely does not distinguish between financial and non-financial uses, and is thus irrationally overinclusive.

The Department intended to regulate cryptocurrency financial intermediaries. Ciric Aff. ¶ 24. Many cryptocurrencies, like Bitcoin, are blockchain technologies. Ciric Aff. ¶ 25. Blockchains are essentially public ledgers that record users' entries. Ciric Aff. ¶ 25. For example, when a person exchanges a bitcoin,[1] or a fraction thereof, the transaction is recorded on the

[1] When "bitcoin" is not capitalized it "describe[s] units of account." Ciric Aff. ¶ 25. When capitalized, Bitcoin "describe[s] the concept of Bitcoin, or the entire network itself." Ciric Aff. ¶ 25.

Bitcoin blockchain. Ciric Aff. ¶ 25.

Blockchain technologies fall within the Virtual Currency definition because they can be used as a medium or exchange or a form of digitally stored value. *See* 23 NYCRR § 200.2(p). Even 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 of exchange." *See* 23 NYCRR § 200.2(p); Trevor I. Kiviat, Note, *Beyond Bitcoin: Issues in Regulating Blockchain Transactions*, 65 DUKE L.J. 569, 591, 597 (2016); Ciric Aff. ¶ 26. Because blockchain technologies fall within the Regulation's definition of Virtual Currency, they are potentially subject to the Regulation. *See* 23 NYCRR §§ 200.2(p)(q)-200.3.

Blockchain technologies, however, are not inherently financial. Ciric Aff. ¶ 27. People can, and do use blockchain technologies to engage in a slew of non-financially related activities. Ciric Aff. ¶ 27. 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. Ciric Aff. ¶ 27. Additionally, people can use blockchain technology to cast votes, send messages, or enter into contracts. Ciric Aff. ¶ 27.

Yet, the definition of Virtual Currency does not exclude or otherwise exempt these non-financial uses of blockchain technology, rendering such uses potentially subject to the Regulation. *See* 23 NYCRR § 200.2(p). Therefore the definition is irrationally overinclusive, rendering it arbitrary and capricious. Because the Regulation is entirely premised upon an arbitrary and capricious definition of "virtual currency," the entire framework should be nullified.

iii. The Regulation governs Virtual Currency Business Activity, as defined by five irrationally overinclusive, undefined categories of activities including activities that have no rational link to financial products or services.

Five categories of activities qualify as Virtual Currency Business Activities. *See* 23 NYCRR §§ 200.2(q), 200.3. Each category is defined by terms that have a broad range of meanings that encompass numerous activities that are entirely unrelated to financial exchanges, services, or products. Furthermore, only one category of activities exempts non-financial uses. *See* 23 NYCRR § 200.2(q).

The Regulation requires anyone engaged in "storing, holding or maintaining custody or control of Virtual Currency on behalf of others" to obtain a License and comply with the Regulation. 23 NYCRR § 200.2(q)(2). However, the Regulation fails to clarify what activities qualify as "storing," "holding," or "maintaining custody or control" of Virtual Currency. *See* 23 NYCRR §§ 200.1-200.22. Thus, if a New York citizen established a trust, designated himself as trustee, and funded the trust with his own bitcoins, he would arguably be required to obtain a license, because as a trustee, he could be interpreted as "holding… Virtual Currency on behalf of others," in this case, the beneficiaries of the trust. Likewise, a bitcoin owner's fiancée would not legally be allowed to hold her fiancé's Bitcoin wallet for safekeeping unless she first obtained a license, because in safekeeping his Bitcoin wallet, she would arguably be "holding…Virtual Currency on behalf of others."

The Regulation also requires anyone "controlling… a Virtual Currency" to obtain a license. The Department did not define "controlling," leaving room for expansive interpretation. *See* 23 NYCRR §§ 200.1-200.22. Arguably any Bitcoin owner with a tenuous relationship to New York is subject to the Regulation. A Bitcoin owner "controls" a Virtual Currency, regardless of whether that Bitcoin owner uses bitcoins as financial instruments. This means that someone wishing to cast a vote using bitcoins, exercise his freedom of speech using bitcoins, or

create digital art using bitcoins would arguably be required to obtain a license and comply with the Regulation in order to do so.

As these scenarios demonstrate, the scope of activities subject to the Regulation is irrationally overinclusive, rendering the Regulation arbitrary and capricious.

B. The Regulation's Recordkeeping Requirements are without Sound Basis in Reason.

A regulation is arbitrary if it is "without sound basis in reason." *See Heintz v. Brown*, 80 N.Y.2d 1998, 1001 (1992) (quoting *Pell v. Bd. of Educ.* 34 N.Y.2d at 231).

The Regulation requires Licensees to: (1) record "each transaction, the amount, date, and precise time of the transaction… the names, account numbers, and physical addresses of (i) the party or parties to the transaction that are customers or accountholders of the Licensee; and (ii) to the extent practicable, any other parties to the transaction," and (2) maintain those records "for at least seven years." 23 NYCRR § 200.12(a). These extensive and onerous requirements apply to *all* virtual currency transactions, regardless of whether, for example, a Satoshi,[2] worth less than 1 cent, is being transacted, or 100 bitcoins, worth approximately $56,944, are being transacted. *See id*; Ciric Aff. ¶ 6. It is unreasonable to require Licensees to create and maintain records of microtransactions. A Licensee could foreseeably be forced to spend more money to make and retain records than the transaction itself is worth. Thus, the Regulation's recordkeeping requirements are so irrationally untailored that they cannot be said to have any sound basis in reason, rendering them arbitrary and capricious.

C. The Regulation Irrationally Treats Virtual Currency Transmitters Differently Than Fiat Currency Transmitters.

A regulation that is inconsistent with an agency's preexisting regulations is arbitrary and

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[2] A Satoshi is the smallest fraction of a bitcoin that can be transacted. Ciric Aff. ¶ 6. One Satoshi is the equivalent of 0.00000001 bitcoin. Ciric Aff. ¶ 6.

capricious. *See Law Enforcement Officers Union, Dist. Council 82 v. State*, 229 A.D.2d 286, 293, 655 N.Y.S.2d 770, 775 (App. Div. 1997). In that case, the challenged regulation allowed for the double celling of inmates. *Id.* at 289. A preexisting regulation set forth minimum square footage requirements for single and multiple occupancy inmate housing units. *Id.* at 290-91. The challenged regulation did not set a minimum square footage requirement or explain its reason for omitting such a requirement. *Id.* at 291. The court affirmed the lower court's finding that there was "no rational basis for establishing a minimum square footage requirement for single and multiple occupancy housing units while having no such requirement for double occupancy housing units," rendering the regulation arbitrary and capricious. *Id.* at 292.

Here, the Regulation's anti-money laundering provisions are inconsistent with the Department's preexisting anti-money laundering regulations. The Department has imposed stringent anti-money laundering requirements upon Virtual Currency businesses that it has not imposed on fiat currency transmitters. *See* 23 NYCRR § 200.15; 3 NYCRR § 416.1. There is no rational basis or objective reason provided by Respondents for subjecting fiat money transmitters and Virtual Currency transmitters to different anti-money laundering requirements.

The Department requires money transmitters to comply with federal anti-money laundering laws. 3 NYCRR § 416.1.[3] The Regulation, however, requires virtual currency transmitters to comply with anti-money laundering requirements that go beyond those required under federal law. *See* 23 NYCRR § 200.15.

The Regulation requires Licensees to file Suspicious Activity Reports ("SAR") even if they would not be required to do so under federal law. 23 NYCRR § 200.15(e)(3)(ii). This

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[3] These regulations were adopted by the Banking Department, which was subsequently assumed by the Department. *See* Dean Aff. ¶¶ 5-6.

requirement imposes an unreasonable burden on virtual currency firms who would not otherwise be subject to federal SAR provisions. Furthermore, this provision subjects such firms to potential liability for submitting SARs because though the federal SAR requirements include a safe harbor provision that extends immunity to disclosing institutions, the Regulation does not contain a comparable provision. 31 U.S.C. § 5318(g)(3); 23 NYCRR § 200.15. Thus, under the Department's regulatory scheme, a money transmitter dealing in fiat currency that is not required to file SARs would be required to file SARs if that transmitter wished to engage in Virtual Currency transmission. *See* 23 NYCRR § 200.15(e)(3)(ii). There is no rational basis to support the Department's inconsistent treatment of money transmitters.

Additionally, the Regulation requires Licensees to retain all records related to their anti-money laundering programs for at least seven years. 23 NYCRR § 200.12(a). By contrast, fiat currency transmitters are only required to retain such records for five years. 3 NYCRR § 416.1(b)(2)(i) (requiring licensees to retain records in accordance with 31 CFR § 103); 31 CFR § 1010.430(d) (formerly at 31 CFR § 103.38(d); requiring licensees to retain records for five years). There is no rational reason or objective rationale to require virtual currency transmitters to retain their records two years longer than non-technology based financial transmitters are required to retain their records.

Accordingly, the Regulation is inconsistent with the Department's preexisting anti-money laundering regulation, and there is no rational basis to support the additional requirements included in the Regulation. Thus, the Regulation's anti-money laundering requirements are irrational, arbitrary and capricious to the extent that they require action not otherwise required under federal law.

D. There is no Rational Basis Underlying a One-size-fits All Regulation that: (1) Unreasonably Prevents Startups and Small Businesses from Participating in Virtual

Currency Business Activity, and (2) Imposes Capital Requirements on *All* Licensees.

A regulation that lacks a rational basis is arbitrary and capricious. *See Axelrod* 78 N.Y.2d at 167-69. In *Axelrod*, the court nullified a blanket, one-size-fits-all reimbursement reduction rate, finding that the rate was "not based on a rational, documented, empirical determination" that those subject to the blanket reduction were similarly situated; accordingly, the court deemed the regulation arbitrary and capricious. *See id.* The court further noted that the Regulation's disparate impact contributed to its irrationality. *Id.* at 168.

Like in *Axelrod*, the Regulation is an untailored blanket regulation that fails to consider that virtual currency businesses are not all equally situated, and irrational imposes capital requirements on all Licensees.

i. <u>There is no rational basis to support a Regulation that effectively inhibits startups and small businesses from engaging in Virtual Currency Business Activity.</u>

Like the regulation in *Axelrod*, the Regulation has a severe disparate impact on startups and small businesses, which do not have access to the funds and resources the Regulation requires. The cost of applying for a License is exorbitant. *See* 23 NYCRR § 200.5 (requiring a non-refundable $5,000 application fee); Ciric Aff. ¶ 5. Furthermore, the costs of staying in compliance with the Regulation if granted a License are unwarranted and potentially excessive. Licensees are required to "maintain at all times such capital in an amount and form as the superintendent determines is sufficient." 23 NYCRR § 200.8(a). This vague, open-ended requirement is likely to unreasonably impede cash-strapped startups and small businesses from being able to engage in Virtual Currency Business Activity. The Regulation's requirement that Licensees "maintain a surety bond or trust account… in such a form and amount as is acceptable to the superintendent" is similarly prone to effectively prohibit underfunded startups and small businesses from engaging in Virtual Currency related business. *See* 23 NYCRR § 200.9(a).

The tech industry is an increasingly important piece of New York's economy, and digital currency is a prominent emerging technology. Ciric Aff. ¶ 8. 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. Ciric Aff. ¶ 9. However, the Regulation has transformed this once welcoming New York landscape into an inhospitable environment for digital currency-related startups. Ciric Aff. ¶ 9.

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." Ciric Aff. ¶ 10. Yet the Regulation has done just that. Ciric Aff. ¶ 10. The Regulation has effectively forced digital currency-related startups to relocate outside New York and to otherwise severe ties with New York citizens. Ciric Aff. ¶ 10. The Regulation is unjustifiably burdensome on startups and small companies, and has in many instances left businesses with no other option than to flee and otherwise abandon New York. Ciric Aff. ¶ 10.

Petitioner was able to afford to operate his business until the Regulation was promulgated. At that point, both the application fee and the compliance costs were overly burdensome. Petitioner does not run a high volume business, rather offering small processing services for small purchases in retail stores. The capital requirements imposed by the Regulation are disproportionate compared to the profit Petitioner would make on each transaction or each retail relationship. Having the same standards apply to Petitioner that apply to large financial institutions is unreasonable, and prevented Petitioner from maintaining the operation of his business in New York.

Contrary to Respondents' approach, the State of California has tried twice to use the legislative process to pass a bill regulating virtual currency, AB-1326. Ciric Aff. ¶ 28. The bill

was first withdrawn on September 11, 2015. Ciric Aff. ¶ 28. The bill was reintroduced on August 8, 2016. Ciric Aff. ¶ 29. On August 15, 2016, Assemblymember Matt Dababneh withdrew the bill from consideration. Ciric Aff. ¶ 29. 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." Ciric Aff. ¶ 29.

ii. The Regulation irrationally imposes capital requirements on all Licensees.

While it may be appropriate to impose minimum capital requirements on select Virtual Currency businesses, it is irrational, arbitrary, and capricious, to impose blanket capital requirements on *all* actors subject to the Regulation. For example, it may be rational to impose minimum capital requirements on cryptocurrency broker-dealers because fiat currency broker-dealers are subject to minimum capital requirements. *See* 23 NYCRR § 200.8 (subjecting all Licensees to capital requirements); N.Y. Gen. Bus. Law § 352-k (imposing minimum capital requirements on broker-dealers). However, there is no rational basis for imposing minimum capital requirements on providers of non-financial services, because such actors do not pose the kinds of risks that minimum capital requirements are employed to mitigate.

Generally, capital requirements serve either to reduce or to manage risk in the financial sector. Ciric Aff. ¶ 7. 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." Ciric Aff. ¶ 7.

The Regulation, however, applies to a wide range of virtual currency businesses that do not pose the same risks banks, insurance companies, and broker-dealers do. Applying capital requirements to such businesses is inappropriate and irrational.

The Regulation requires most actors engaged in "controlling, administering, or issuing a Virtual Currency" to obtain a license and abide by minimum capital requirements, even if such "controlling, administering, or issuing" has no tie to the financial sector. *See* 23 NYCRR §§ 200.2(p), 200.2(q)(4), 200.3, 200.8. Furthermore, the blanket Regulation subjects those engaged in "[t]ransmitting Virtual Currency" to minimum capital requirements unless "the transaction is undertaken for non-financial purposes *and* does not involve the transfer of more than a nominal amount of Virtual Currency." 23 NYCRR §§ 200.2(q)(1), 200.3, 200.8 (emphasis added). Therefore, a father who wishes to give his daughter one bitcoin[4] for her birthday would be transmitting a non-nominal amount of Virtual Currency, and would thus be required to obtain a license and abide by minimum capital requirements in order to do so. Such an absurd scenario highlights the irrationality of the one-size-fits all minimum capital requirements in the one-size-fits all Regulation.

Petitioner would be forced to maintain a minimum capital requirement even though he is operating at a very low risk. The minimum capital requirement would not protect consumers since Petitioner is processing small purchases made with bitcoins in small retail stores. Therefore, the minimum capital requirement is disproportionate to risks associated with the activities Petitioner is conducting. There is no rational basis for imposing minimum capital requirements on every actor engaged in Virtual Currency Business Activity. Accordingly, the Regulation's blanket capital requirements provision is irrational, and thus arbitrary and capricious.

iii. Respondents admitted that the requirements imposed on Licensees, which do not apply to other money transmitters, were only a test ground for traditional financial

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[4] One bitcoin is worth more than a nominal amount. *See Nominal*, BLACK'S LAW DICTIONARY (10th ed. 2014) (defining "nominal" as "trifling" in price or amount); Ciric Aff. ¶ 6.

institutions.

A number of other 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, 23 NYCRR § 200.15(e)(1)(i); reporting and notifying transactions exceeding $10,000 in an aggregate amount, 23 NYCRR § 200.15(e)(2); complying with a Cyber Security Program, including staffing and reporting requirements, 23 NYCRR § 200.16).

Respondents have never provided an objective rationale for these burdensome and arbitrary requirements. In fact, Respondents publicly admitted that the rationale for these different rules not imposed on other institutions was to test them as "models for our regulated banks and insurance companies," and not as a genuine response to a pressing regulatory need. Ciric Aff. ¶ 32. Respondents are not entitled to use a burgeoning industry as a testing ground of unauthorized regulatory power, and the Court should step in to set aside this arbitrary Regulation.

CONCLUSION

For all the reasons set forth herein, Respondents' cross-motion to dismiss should be denied in its entirety. In the alternative, Petitioner respectfully requests leave to amend his pleadings should the Court find any of his pleadings in any way deficient.

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