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

Theo Chino

Plaintiff-Petitioner,

-against-

The New York State Department of Financial Services and Maria T. Vullo, in her official capacity as Superintendent of the New York State Department of Financial Services.

Defendants-Respondents.

Index No. 101880/2015
Hon. Lucy Billings

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF RESPONDENTS' CROSS-MOTION TO DISMISS THE PETITION

ERIC T. SCHNEIDERMAN
Attorney General of the
State of New York
Attorney for Respondents
120 Broadway, 24th Floor
New York, NY 10271
(212) 416-8108
Jonathan.Conley@ag.ny.gov

JONATHAN CONLEY
Assistant Attorney General
of Counsel

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Preliminary Statement

In their moving papers, the respondents demonstrated that petitioner Theo Chino's challenge to 23 NYCRR Part 200 (the "Regulation"), which addresses virtual currency business activity, is without merit. In promulgating the Regulation in June 2015, the New York State Department of Financial Services ("DFS")—the state agency charged with regulating New York's financial services industries including, among others, the banking and insurance industries—properly exercised the authority granted to it by the New York Financial Services Law ("FSL") to prescribe rules and regulations necessary to protect consumers of financial products and services. FSL §§ 301(a), (c)(1); 302(a)(1). The Regulation fulfills the Governor's and the Legislature's mandate, in the wake of the 2008 financial crisis, that the newly-formed Department "provide for the regulation of new financial services products," "protect the public interest," "protect users of banking, insurance, and financial services products and services," and "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL §§ 102(f), (i), (j), (l).

Chino's response does not meet the heavy burden he bears, in challenging "an agency's exercise of rule-making powers … in the area of its particular expertise," of showing "that the regulation is unreasonable and unsupported by any evidence." *Matter of Spence v. Shah*, 136 A.D.3d 1242, 1246 (3d Dep't 2016) (citations omitted). Chino acknowledges that DFS has the inherent authority to regulate financial products and services, but argues that virtual currency is not a financial product. This argument is meritless, and as detailed below, is belied by Chino's own statements, the straightforward text of the Financial Services Law, and common sense. In

essence, Chino posits the Legislature intended that otherwise identical transactions be treated differently depending on whether they are conducted in dollars or virtual currency. Applying Chino's logic, a company that processes purchases denominated in dollars from an internet retailer can be regulated by DFS as a money transmitter to protect consumers against a risk of loss, but the same consumers are left completely unprotected when a virtual currency service provider is used to purchase those same goods and services. Indeed, virtual currency is arguably more risky to the consumer and can result in clear financial harm. Chino's interpretation of the phrase "financial products and services" to exclude virtual currency is incompatible with both the language and the clear intent of the Financial Services Law to protect consumers of financial products and services, existing or emerging.

Chino's claim that the promulgation of the Regulation violated the separation of powers doctrine fails for the same reason: DFS properly exercised the power delegated to it by the Legislature. And Chino's preemption argument does not fare any better, as it is based on a misreading of the Dodd-Frank Act, which expressly preserves state laws that provide the same or greater protection to consumers. 12 U.S.C. § 5551(a).

Chino expands upon his claim that the Regulation is arbitrary and capricious, but his argument ignores the plain language of the Regulation. As the text makes clear, the Regulation was carefully tailored to only cover uses of virtual currency that are subject to DFS's oversight under the Financial Services Law and to apply existing regulatory concepts that govern the conduct of analogous financial services providers.

Finally, Chino tries to dress up his petition with new factual allegations in an attempt to establish standing. These allegations do not cure this fundamental defect, however, and for this reason, as well, the petition must be dismissed.

ARGUMENT

I. THE REGULATION IS AUTHORIZED BY DFS'S ENABLING LEGISLATION.

A. DFS properly identified virtual currency business activity as a financial product or service subject to its regulatory powers.

Where, as here, an "agency acts in the area of its particular expertise," the "exercise of its rule-making powers is accorded a high degree of judicial deference." *Matter of Spence*, 136 A.D.3d at 1246 (quoting *Matter of Consol. Nursing Home v. Comm'r of N.Y. State Dep't of Health*, 85 N.Y.2d 326, 331 (1995)). Chino's arguments fail to meet his "heavy burden of showing that the regulation is unreasonable and unsupported by any evidence." *Id.*

i. Virtual currency is a financial product or service.

Chino's argument that the phrase "financial products and services" does not encompass virtual currency business activity, (Pet's Opp. Br. 8–9), is based on a contrived and unduly narrow definition of "financial." According to Chino, financial products and services are only those "products and services that involve the use, management, and movement of money," and thus the Legislature intended to limit DFS's authority to regulate "financial products and services" to only those products or services involving "true currency." (*Id*. at 9–10.) As Chino sees it, "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." (*Id.* at 10.) [1]

[1] Chino asserts that virtual currency, as opposed to a "true currency," is "akin to commodity-like mediums of exchange" that should be treated as property, not money. (Pet.'s Opp. Br. 11.) In support of this position, he cites to guidance from the Internal Revenue Service and the Commodity Futures Trading Commission identifying virtual currency as, respectively, property and a commodity. (*Id*.) Chino's reliance on these references is misplaced. The fact that something may be subject to the CFTC's jurisdiction does not mean that it is not financial in nature. Quite the contrary. For example, derivatives—a clear financial product and service—are within the CFTC's jurisdiction. Moreover, the IRS, in establishing regulations to clarify tax treatment for virtual currency's use as payment for wages and other transactions, supports DFS's view that virtual currency is a financial product or service.

The foundation of Chino's argument—that virtual currency is not a financial product or service—is plainly incorrect. Virtual currency is a digital form of money—a medium of exchange that can be substituted for traditional currency.[2] That virtual currency is a new form of currency created by innovation does not mean it is not covered by the Financial Services Law; under this theory, banking laws enacted before the internet was created would not cover online banking—an untenable argument that no one has made.

Virtual currency was devised as a substitute for fiat currency (such as U.S. dollars and other legal tender whose value is backed by the government that issued it). Bitcoin, for example, was created as an alternative payment system to the systems offered by traditional financial services providers. In his seminal paper, *Bitcoin: A Peer-to-Peer Electronic Cash System*, Satoshi Nakamoto, the pseudonymous creator of Bitcoin, described virtual currency as a "peer-to-peer version of electronic cash" that would eliminate inefficiencies in online payments:

> Commerce on the Internet has come to rely almost exclusively on financial institutions serving as trusted third parties to process electronic payments…. The cost of mediation increases transaction costs, limiting the minimum practical transaction size and cutting off the possibility for small casual transactions, and there is a broader cost in the loss of ability to make non-reversible payments for nonreversible services…. These costs and payment

[2] *See, e.g., United States v. Faiella*, 39 F. Supp. 3d 544, 545 (S.D.N.Y. 2014) (Rakoff, J.) ("Bitcoin clearly qualifies as 'money' or 'funds' .... Bitcoin can be easily purchased in exchange for ordinary currency, acts as a denominator of value, and is used to conduct financial transactions." (citing *Sec. & Exch. Comm'n v. Shavers,* 13 Civ. 416, 2013 WL 4028182, at *2 (E.D.Tex. Aug. 6, 2013)); *United States v. Ulbricht*, 31 F. Supp. 3d 540, 548 (S.D.N.Y. 2014) ("[T]he defendant alleges that he cannot have engaged in money laundering because all transactions occurred through the use of Bitcoin and thus there was therefore no legally cognizable 'financial transaction.' The Court disagrees. Bitcoins carry value—that is their purpose and function—and act as a medium of exchange. Bitcoins may be exchanged for legal tender, be it U.S. dollars, Euros, or some other currency. Accordingly, this argument fails."); *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128, at *3–4 (S.D.N.Y. Sept. 19, 2016) (the Court, noting that "funds" are synonymous with "money", concludes "it is clear that bitcoins are funds within the plain meaning of that term. Bitcoins can be accepted 'as a payment for goods and services' or bought 'directly from an exchange with [a] bank account.'") (citation omitted); *United States v. 50.44 Bitcoins*, No. CV ELH-15-3692, 2016 WL 3049166, at *1 (D. Md. May 31, 2016) ("Bitcoin is an electronic form of currency unbacked by any real asset and without specie, such as coin or precious metal.") (citation and internal quotation marks omitted); *Shavers*, 2013 WL 4028182, at *1 ("It is clear that Bitcoin can be used as money. It can be used to purchase goods or services, and . . . used to pay for individual living expenses. … [I]t can also be exchanged for conventional currencies….").

> uncertainties can be avoided in person by using physical currency, but no mechanism exists to make payments over a communications channel without a trusted party.

Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (2008), at 1, https://bitcoin.org/bitcoin.pdf.

In short, virtual currencies such as Bitcoin were specifically designed to act as substitutes for money, allowing users to make online payments without incurring the costs associated with the traditional intermediaries of financial services. The traditional financial services intermediaries that Nakamoto sought to circumvent are currently regulated by DFS, other state banking regulators, or, in the case of a national bank, by the U.S. Office of the Comptroller of the Currency ("OCC"). Thus, for example, facilitators of online payments are generally licensed by DFS as money transmitters. *See, e.g.,* DFS, *Database of Supervised Financial Institutions*, https://myportal.dfs.ny.gov/web/guest-applications/who-we-supervise (database of financial institutions supervised by DFS organized by name and type of institution); OCC, *Mission*, https://www.occ.treas.gov/about/what-we-do/mission/index-about.html ("The OCC charters, regulates, and supervises all national banks and federal savings associations as well as federal branches and agencies of foreign banks."). Chino offers no reason to conclude that a company providing payment services denominated in virtual currency is, in any way, less engaged in providing a financial product or service than a company that provides payment services denominated in dollars.

The fact that virtual currency can be used, and sometimes needs to be regulated, as a substitute for fiat currency was recognized in 2013 by the Financial Crimes Enforcement

Network of the U.S. Treasury Department ("FinCEN").[3] FinCEN's primary purpose is to safeguard the financial system from evolving national security and money laundering threats.[4] Among other things, FinCEN has issued regulations requiring money services businesses—including money transmitters, check cashers, and currency exchangers—to register with FinCEN, implement anti-money-laundering programs, keep records of their customers, and report suspicious transactions. *See, e.g.*, 31 C.F.R. Chapter X (FinCEN's regulations under the Bank Secrecy Act, 31 U.S.C. 5311 *et seq*.).

In rejecting the same argument urged by Chino here, FinCEN has recognized virtual currency's use as a substitute for money. In a 2013 interpretive guidance on virtual currencies, FinCEN observed that virtual currencies are "a medium of exchange that operates like a currency in some environments." *FinCEN Guidance* at 1. Because virtual currency is a stand-in for money, FinCEN clarified that "[t]he definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies," and that "[a]ccepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the [Bank Secrecy Act]." *Id*. at 3.

FinCEN therefore determined that a virtual currency "administrator" (a person who issues a virtual currency) and an "exchanger" (a person who exchanges a "virtual currency for real currency, funds, or other virtual currency") are engaged in a "money service business" and must register with the U.S. Treasury Department. *Id.* at 1–2. In reaching this conclusion, FinCEN explicitly noted that an administrator or exchanger who "(1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason ***is*** a money

[3] *See Guidance on the Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FinCEN, FIN-2013-G001 (Mar. 18, 2013) ("FinCEN Guidance"), at 1, http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf.

[4] U.S. Dep't of the Treasury, FinCEN, *Mission*, https://www.fincen.gov/about/mission (last visited Jan. 14, 2017).

transmitter under FinCEN's regulations." *Id*. at 3. FinCEN has thus determined that anyone providing certain services involving virtual currency is subject to the same Bank Secrecy Act compliance requirements as money transmitters. *Id.*

ii. The regulation of virtual currency business activity is properly within DFS's mandate.

FinCEN's recognition that virtual currency can be used as money, and that certain virtual currency service providers are indistinguishable from transmitters, check cashers and other, more traditional money services businesses, underscores that DFS properly determined within its broad mandate that virtual currency business activity is subject to regulation under the Financial Services Law. "Where an agency has been endowed with broad power to regulate in the public interest, courts generally will uphold reasonable acts that further the regulatory scheme." *Agencies for Children's Therapy Servs. v. N.Y. State Dep't of Health*, 136 A.D.3d 122 at 128 (2d Dep't 2015) (citations omitted). Here, following the 2008 financial crisis, the Governor and the Legislature expressly created an "innovative" regulatory agency that would protect consumers and "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL § 102 (i). Explaining the impetus for creating the Department of Financial Services, Governor Andrew Cuomo noted that "Albany was nowhere to be found when the Great Recession hit and our citizens were jolted by the fallout from collected debt obligations, derivatives and other financial products that were allowed to grow out of control with no meaningful government intervention."[5] The solution, the Governor urged, was "a newly formed department … capable of regulating modern financial services organizations." *Id*.

[5] Governor Andrew Cuomo, State of the State Address, (Jan. 5, 2011), http://www.governor.ny.gov/assets/documents/SOS2011.pdf.

New York State Senator James Seward (R-Oneonta) echoed that same sentiment in explaining his vote in favor of the legislation creating DFS:

> I'm pleased that the Legislature includes some specific legislative intent recognizing the fact that it is necessary for our regulatory system to be responsive, effective, and innovative in order to compete in this global marketplace. And I see this legislation as being a first step, a big step toward our ultimate goal of transforming and modernizing the regulation of insurance, banking and other financial products in New York State.

N.Y. State Senate, Transcript of Regular Session, (Mar. 29, 2011), http://open.nysenate.gov/transcripts/floor-transcript-032911v1txt.

The regulation of virtual currency business activity is precisely the type of regulation envisioned by the Governor and the Legislature when they empowered DFS to regulate banks, insurance companies, *and other financial services industries*—including financial products and services—in the modern, post-financial-crisis era. Before DFS's creation in 2011, some argued that derivatives or other risky financial products could not be regulated, and the Financial Services Law made plain that those arguments no longer can prevail with respect to other new, complex financial products yet to be used or named. *See, e.g.,* Sewell Chan, *Financial Crisis Was Avoidable, Inquiry Finds*, N.Y. Times (Jan. 25, 2011), http://www.nytimes.com/2011/01/26/business/economy/26inquiry.html.

Virtual currency business activity represents a new financial product or service with the potential to benefit consumers, while also exposing them to serious harm, as the Mt. Gox fiasco demonstrated.[6] Left unregulated, the virtual currency market can also become a haven for black-market transactions, tax evasion, money laundering, and terrorist financing. This is precisely the

[6] As referenced in DFS's moving papers (Resps.'Cross-Mot. Br. 7), Mt. Gox, once the largest Bitcoin exchange service, collapsed in early 2014 after a purported security breach led to the loss of more than $450 million worth of bitcoins. *See, e.g.,* Carter Dougherty and Grace Wang, *Mt. Gox Seeks Bankruptcy After $480 Million Bitcoin Loss*, Bloomberg, Feb. 28, 2014, http://www.bloomberg.com/news/articles/2014-02-28/mt-gox-exchange-files-for-bankruptcy.

type of situation where DFS has a compelling policy interest to act, in accord with its mandate, in order to protect consumers and the market. Accordingly, DFS appropriately promulgated its Regulation of virtual currency business activity to safeguard against the abuse and misuse of a new financial product.

In arguing to the contrary, Chino fails to cite to the text or legislative history of the Financial Services Law, instead relying on various outside sources. But even using his proffered definitions of financial products and services, the fallacy of Chino's argument is evident. Chino suggests the following definitions, drawn from the Cambridge English Dictionary, of the phrase "financial products and services":

> Financial Product: a product that is ***connected with*** the way in which you manage and use your money, such as a bank account, a credit card, insurance, etc.
>
> Financial Services: business services ***relating to*** money and investments, for example those offered by banks.

Ciric Aff. at ¶¶ 11–12 (emphasis added). These definitions actually support DFS's position, however, because they do not, as Chino urges, limit financial products and services to the use of fiat currency. Rather, financial products and services are those products and services that relate to, or are connected with, the use and management of money. Accordingly, the proper inquiry here is not whether virtual currency is or is not fiat currency, but rather whether the uses of virtual currency addressed in the Regulation relate to, or are connected with, the use of money. And they clearly do.

Furthermore, services and products can be financial in nature even if they do not involve fiat currency. For example, insurance is a financial product,[7] as Chino acknowledges, but

[7] Chino refers to mortgage loans and car insurance policies—both also regulated by DFS—as examples of recognized financial services. (Ciric Aff. ¶ 11.)

insurance transactions are not necessarily conducted in fiat currency. Insurance companies can and do accept premium payments in virtual currency,[8] and also insure virtual currency.[9] Another financial service regulated by DFS, safety deposit box providers, is not regulated because of the involvement of fiat currency; rather, safety deposit box providers are regulated to ensure that consumers are protected against a risk of loss when they store items of value with a third party. *See* N.Y. Banking L. Arts. VIII, VIII-A.

Puzzlingly, while Chino maintains that virtual currency is not a financial product or service, he repeatedly acknowledges in his opposition brief that it is. For example, Chino admits that virtual currency is a "medium of exchange," (Pet.'s Opp. Br. 11), and recognizes that some virtual currency businesses provide financial services, (*Id*. at 12). Moreover, in Chino's preemption argument (addressed more fully below), he argues that the Regulation impermissibly addresses issues involving "[n]ational banking [...] an area that has been substantially occupied by federal authority for a long period of time." (*Id*. at 15.) In short, at the same time that Chino is arguing that virtual currency has no financial uses, he is arguing that the Regulation is preempted because virtual currency is a banking service covered by the National Bank Act. Chino cannot have it both ways.

For all of these reasons, DFS's application of the Financial Services Law to virtual currency business activity is fully consistent with its authority to regulate the financial services industries and all financial products and services in New York. The petition should therefore be dismissed.

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[8] *See, e.g.,* Parker Beauchamp, *Heads, Tails or Bitcoin? Why Our Business Took a Chance on Tech*, InGuard (Apr. 13, 2015) (detailing the reasons InGuard began accepting Bitcoin as a payment option), http://www.inguard.com/blog/heads-tails-or-bitcoin-why-our-business-took-a-chance-on-tech.

[9] *See, e.g.,* Daniel Cawrey, *$5 Billion Insurance Company Offers Bitcoin Coverage to Businesses*, Coindesk (June 2, 2014), http://www.coindesk.com/great-american-insurance-bitcoin-coverage-businesses/.

B. The Legislature's empowerment of DFS to regulate financial products and services does not violate the separation of powers doctrine.

For similar reasons, there is no merit to Chino's argument that DFS's mandate to regulate financial products and services violates the separation of powers doctrine. As stated more fully in its moving papers, DFS made no "difficult choices between public policy ends" in promulgating the Regulation. *Matter of N.Y. Statewide Coal. of Hispanic Chambers of Comm. v. N.Y.C. Dep't of Health*, 23 N.Y.3d 681, 700–01 (2014) (holding that under the factors set forth in *Boreali v. Axelrod*, 71 N.Y.2d 1 (1987), "an administrative agency exceeds its authority when it makes difficult choices between public policy ends, rather than finds means to an end chosen by the legislature"). Nor did DFS exercise "value judgments entailing difficult and complex choices between broad policy goals to resolve social problems," or create "its own comprehensive set of rules without benefit of legislative guidance." *Greater N.Y. Taxi Assoc. v. N.Y.C. Taxi & Limousine Comm'n*, 25 N.Y.3d 600, 610–11 ("The Second *Boreali* factor is whether the agency merely filled in details of a broad policy or if it 'wrote on a clean slate, creating its own comprehensive set of rules without benefit of legislative guidance." (quoting *Boreali*, 71 N.Y.2d at 13)).

Rather, the Regulation dovetails with the stated purpose of the Financial Services Law, to respond in a timely and effective way to an innovative and risky financial product or service, ensuring that consumers and financial markets are protected from harm. Consistent with the mandate imposed by the Financial Services Law, DFS's Regulation only applies to "financial" uses of virtual currency and requires that persons engaged in such activities comply with well-established safeguards that apply to a broad range of financial services industries. Accordingly, there is no separation of powers issue here, as DFS is acting fully within its authority under the Financial Services Law to "provide for the regulation of new financial services products" and

"ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL §§ 102(f), (i).

Chino's opposition fails to refute DFS's argument and his separation-of-powers challenge to the Regulation should therefore be rejected.

II. THE REGULATION IS NOT PREEMPTED.

Chino's argument that the Regulation is preempted by federal law, (Pet.'s Opp. Br. 15), rests on a misreading of certain provisions of the Dodd-Frank Act ("Dodd-Frank"). Specifically, Chino begins by citing the authority given to the Consumer Financial Protection Bureau ("CFPB") under Dodd-Frank to define the financial products and services that are subject to its regulation. (Pet.'s Opp. Br. 16 (citing 12 U.S.C. § 5481(15)(A)(xi).) Chino then cites another section of Dodd-Frank, 12 U.S.C. § 25b(b)(1)(C), which provides that 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," which does not include § 5481, to argue that the Regulation is preempted because the CFPB's power to define exists outside of "title 62 of the Revised Statutes." *Id*.

Chino's argument, however, completely misreads Dodd-Frank, which was enacted to *preserve* consumer protection laws, not preempt them. And Dodd-Frank does so explicitly, providing that nothing in its provisions shall exempt a person from complying with state law:

> This title [Title 12] … may not be construed as annulling, altering, or affecting, or exempting any person subject to the provisions of this title from complying with, the statutes, regulations, orders, or interpretations in effect in any State, except to the extent that any such provision of law is inconsistent with the provisions of this title, and then only to the extent of the inconsistency.

12 U.S.C. § 5551(a). Moreover, laws are not considered inconsistent, and therefore are not preempted, if they afford consumers greater protection than provided under Title 12. *Id.* In a similar vein, Congress expressly provided that no part of Title 12 "shall be construed as modifying, limiting, or superseding the operation of any provision of an enumerated consumer law that relates to the application of a law in effect in any State with respect to such Federal law." 12 U.S.C. § 5551(b).

It is true that a federal statute may "implicitly override[]state law either when the scope of a statute indicates that Congress intended federal law to occupy a field exclusively … or when state law is in actual conflict with federal law." *Freightliner Corp. v. Myrick*, 514 U.S. 280, 287 (1995) (citing *English v. General Elec. Co.,* 496 U.S. 72, 78–79 (1990)). And "implied conflict pre-emption" does exist "where it is 'impossible for a private party to comply with both state and federal requirements,'" *id.* (quoting *English*, 496 U.S. at 79), or "where state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,'" *id*. (quoting *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941)). But there is a strong presumption against preemption in areas where states have historically exercised their police powers, such as here in the area of consumer protection. *N.Y. SMSA Ltd. P'Ship v. Town of Clarkstown*, 612 F.3d 97, 104 (2d Cir. 2010) (The "'historic police powers of the State []' is not to be superseded by a federal statute unless it was 'the clear and manifest purpose of Congress' to do so.") (quoting *Wyeth v. Levine*, 555 U.S. 555, 563 (2009)).

Nothing in the Dodd-Frank provisions cited by Chino evinces a Congressional intent to preempt state consumer protection laws; indeed, such a claim is antithetical to the sponsors of the CFPB, including U.S. Senator Elizabeth Warren. Thus, the CFPB itself has recognized that Dodd-Frank "did not supplant the states' historic role in protecting consumers in the financial

marketplace." Brief for the CFPB as Amici Curiae Supporting Defendants-Appellees, *The Otoe-Missouria Tribe of Indians v. N.Y. State Dep't of Financial Servs.*, 769 F.3d 105 (2d Cir. 2014) (No. 13-3769-CV) [hereinafter *CFPB Amicus Brief*]; *see also The Otoe-Missouria Tribe of Indians*, 769 F.3d 105 (upholding the DFS's authority to regulate payday lending by certain Indian tribes to New York residents). In supporting continued state interest and authority in protecting consumers, the CFPB rejected the notion Chino advances here, that Congress intended the CFPB to be the sole voice in consumer protection. Rather, as the CFPB itself has urged, Congress "expressly preserved states' authority to enact and enforce laws that provide consumers greater protections." *CFPB Amicus Brief* at 4 (citing 12 U.S.C. § 5551(a)). Dodd-Frank therefore does not reflect a general interest in "uniform regulation." *Id.* at 8.

Section 5481(15)(A)(xi), cited by Chino, merely sets forth the CFPB's authority to identify financial products and services that it may regulate. It does not, as Chino claims, make the CFPB the sole arbiter of the definition of financial products and services for all purposes, including all state regulations of such products and services. There is simply no way to read § 5481(15)(A)(xi) as a federal preemption provision within the meaning of 12 U.S.C. § 25b(b)(1)(C).[10] Moreover, Chino conveniently omits the fact that 12 U.S.C. § 25b(b)(1)(C), titled "State law preemption standards for national banks and subsidiaries clarified," only clarified the existing preemption standards that apply to national banks and their affiliates and subsidiaries.[11] As neither of Chino's entities is a national bank or affiliated with any national

[10] Furthermore, the CFPB has partnered with states, including with DFS, to protect consumers by investigating wrongdoing and bringing enforcement actions to halt harmful conduct that violates both state and federal law. *See, e.g.,* Complaint at 2–3, *Consumer Fin. Prot. Bureau v. Pension Funding, LLC,* No. 8:15-cv-1329 (C.D. Cal. Aug. 20, 2015); CFPB Amicus Brief at 4.

[11] Notably, §§ 1044(a) and 1045 of the Dodd-Frank Act (codified at 15 U.S.C. § 25b) was enacted in response to the Supreme Court's decision in *Watters v. Wachovia*, 550 U.S. 1 (2007), which upheld a broad interpretation of the OCC's authority to preempt state law. Finding that the courts and the OCC had taken preemption too far, Congress imposed certain restrictions in Dodd-Frank, including a provision that state consumer financial protection laws are only preempted as applied to a national bank if they are discriminatory against a national bank, significantly

bank in any way, this provision has no bearing on this case at all. Indeed, were Chino's reading correct, a new administration could remove funding from the CFPB and preempt states from protecting consumers altogether. Such a result is directly contrary to the sponsors of the Dodd-Frank Act, and to the actions of the CFPB since its creation in 2011.

For all of these reasons, Chino's preemption argument is without merit and should be rejected.

III. THE REGULATION IS NEITHER ARBITRARY NOR CAPRICIOUS.

As the respondents established in their moving papers, DFS did not act arbitrarily or capriciously in promulgating the Regulation to address virtual currency businesses. In his opposition papers, Chino argues that certain provisions of the Regulation are arbitrary and capricious, including the definition of virtual currency business activity, the recordkeeping requirements, the anti-money-laundering requirements, and the capital requirements. Each of these provisions, however, was carefully and properly crafted with a sound, rational basis.

An "agency's exercise of its rule-making powers is accorded a high degree of judicial deference, especially when the agency acts in the area of its particular expertise." *Matter of Spence*, 136 A.D.3d at 1246 (quoting *Matter of Consol. Nursing Home*, 85 N.Y.2d at 331). In such circumstances, as is the case here, the "party seeking to nullify such a regulation has the heavy burden of showing that the regulation is unreasonable and unsupported by any evidence." *Spence,* 136 A.D. at 1246; *accord Matter of Puerto v. Doar*, 142 A.D.3d 34, 46 (1st Dep't 2016). Chino has failed to meet that burden here.

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interfere with the national bank's exercise of a permitted power, or are expressly preempted by federal law. *See Gordon v. Kohl's Dep't Stores*, 172 F.Supp.3d 840, 863, n.10 (E.D. Pa. 2016); *see also* John Walsh, OCC Interpretive Letter No. 1132, 2011 WL 2110224 (May 12, 2011) (noting that the Dodd-Frank Act "eliminates preemption of state law for national bank subsidiaries, agents and affiliates").

As a threshold matter, the Regulation does not, as Chino contends, cover the basic exchange of *information* over the internet, (Pet.'s Opp. Br. 20–21), or artists' use of "blockchain technology to assert ownership over their works" (*Id.* at 21). Rather, the definition of "Virtual Currency" is limited to "any type of digital unit that is used as a medium of exchange or a form of digitally stored *value.*" 23 NYCRR 200.2(p); Dean Aff. ¶ 47 (emphasis added). These terms—"medium of exchange" and "form of digitally stored value"—are commonly used to describe financial products and services. *See, e.g.*, *United States v. Faiella*, 39 F. Supp. 3d 544, 545 (S.D.N.Y. 2014) (observing that "money" in ordinary parlance means "something generally accepted as a medium of exchange, a measure of value, or a means of payment"); Paul Krugman, *The Int'l Role of the Dollar: Theory and Prospect in Exchange Rate Theory & Practice* 8.2 (John F. Bilson & Richard C. Marston eds., 1984) (noting that money generally "serves three functions: it is a medium of exchange, a unit of account, and a store of value"); *see also United States v. E-Gold, Ltd.*, 550 F. Supp. 2d 82, 94 (D.D.C. 2008) (holding that "a 'money transmitting service' includes not only a transmission of actual currency, but also a transmission of the *value* of that currency through some other medium of exchange") (emphasis added).

"Medium of exchange" is defined as "something that is used to pay for goods or services, for example a particular currency."[12] A "form of digitally stored value" includes certain uses of virtual currency that are analogous to stored value cards denominated in fiat currency, such as debit card-like products that are loaded with a set amount of money for use by the holder of the card. Many such stored value cards are already regulated by DFS as money transmission. *See, e.g,* DFS, *Application for a License to Engage in the Business of Issuing Travelers Checks, Money Orders, Prepaid/Stored Value Cards, and/or Transmitting Money*,

[12] Cambridge Business English Dictionary, http://dictionary.cambridge.org/dictionary/english/medium-of-exchange (last visited Jan. 16, 2017).

http://www.dfs.ny.gov/banking/ialfmta.pdf; DFS, *Credit Cards, Debit Cards, Gift Cards and What You Need to Know About Using Them*, http://www.dfs.ny.gov/consumer/brcard.htm. Moreover, the definition of "virtual currency" explicitly excludes non-financial uses of virtual currency, such as digital units used solely within online gaming platforms or customer rewards programs, neither of which can be converted into, or redeemed for, fiat currency or virtual currency. *See* 23 NYCRR 202.2(p).

In the same way, the definition of "virtual currency business activity," on its face, is intended to capture "financial product[s] or services[s] offered or sold to consumers" while excluding other, non-financial activity. FSL § 104(a)(2). Thus, "virtual currency business activity" is limited to receiving for transmission and transmitting virtual currency (except for non-financial purposes in nominal amounts); storing, holding or maintaining custody of virtual currency on behalf of others; buying and selling virtual currency as a customer business; performing exchange services; and issuing a virtual currency. 23 NYCRR § 200.2(q). Taken together, the definitions of virtual currency and covered business activity tailor the application of the Regulation to any person who provides financial services—exchange, storage, transmission, and the like—involving virtual currencies that have a financial use as a medium of exchange or as a means of storing value. Accordingly, the Regulation is reasonably crafted to ensure consistency with DFS's legislatively mandated purpose.

Chino's other arguments concerning the purported arbitrary and capricious nature of the Regulation likewise fail. The record-keeping requirements are not "onerous." (Pet.'s Opp. Br. 23.) Similar record-keeping requirements apply to other licensees or chartered entities including, for example, check cashers, money transmitters and banks. *See* 3 NYCRR § 400.1; N.Y. Banking L. §§ 128, 651-b. Keeping records of each transaction is a necessary and sound business practice,

and there is nothing arbitrary or capricious about requiring a business that transacts with the public to keep records.

Chino also asserts that virtual currency service providers are subject to different anti-money laundering requirements than money transmitters, (Pet.'s Opp. Br. 23–25), but this is simply incorrect. The suspicious activity report ("SAR") requirement referenced by Chino, (Pet's Opp. Br. p. 24), requires any person engaged in virtual currency business activity to file a SAR with DFS if that person is not required to file a report under federal law, 23 NYCRR § 200.15(e)(3)(ii). This provision, however, does not subject virtual currency service providers to different requirements from those that apply to money transmitters. To the contrary, it ensures that virtual currency service providers, money transmitters, and other similar financial services companies are subject to the same requirements in order to protect against illegal activity in the markets. While there is substantial overlap between the virtual currency business activity subject to the Regulation and FinCEN's registration requirements, there are some entities that could be subject to the Regulation but not required to register with FinCEN. By virtue of this provision, those entities must file the same types of SARs that FinCEN would require. It is neither arbitrary nor capricious to require such reporting, because any entity involved in the global transmission of funds—whether denominated in dollars or virtual currency—risks facilitating illegal transactions.

Nor is there anything arbitrary or capricious about the Regulation's minimum capital requirements. *See* 23 NYCRR § 200.8. These requirements do not, as Chino asserts, unreasonably inhibit the ability of businesses to obtain a license and operate. (Pet.'s Opp. Br. 25–30.) First, financial services companies regulated by DFS generally have to meet minimum standards to obtain a license. For example, licensed lenders need liquid assets of $50,000 and a

line of credit of at least $100,000. 3 NYCRR § 401.1(b)(1), (3). Money transmitters are required to maintain a surety bond of at least $500,000, which can be increased to "such principal amount as the superintendent shall have determined." 3 NYCRR § 406.13. And check cashers must have a $100,000 line of credit and $10,000 in cash at each location that they apply to operate. 3 NYCRR § 400.1(c)(6)(iv), (v). These are commonly applied, basic consumer protection requirements.

Chino also mischaracterizes the minimum capital requirements under 23 NYCRR § 200.8, alleging the Regulation arbitrarily "impose[s] blanket capital requirements on *all* actors subject to the Regulation." (Pet.'s Opp'n Br. 28.) Contrary to Chino's argument, rather than imposing a uniform, "one-size-fits-all" capital requirement, the Regulation takes a flexible approach by requiring the licensee to maintain "capital in an amount and form as the superintendent determines is sufficient to ensure the financial integrity of the Licensee and its ongoing operations *based on an assessment of the specific risks applicable to each Licensee.*" 3 NYCRR § 200.8(a) (emphasis added). In determining the amount and form of sufficient capital for each licensee, the Regulation provides a non-exhaustive list of nine factors for DFS's Superintendent to consider, including the composition of the licensee's total assets, the anticipated volume of the licensee's virtual currency business activity, the types of entities to be serviced, and the products or services to be offered by the licensee. *See* 3 NYCRR § 200.8(a)(1), (3), (8), (9). The Regulation is plainly designed to ensure that the minimum capital requirement is rationally based on and calibrated to reflect the virtual currency business activity in which a particular licensee engages, as DFS determines in each case when it processes a license application.

In his efforts to brand the Regulation as arbitrary and capricious, Chino also ignores DFS's authority under Section 200.4(c) to issue conditional licenses to entities that do not meet the full requirements of the Regulation. 3 NYCRR § 200.4(c). Similar to the factors provided under Section 200.8 for evaluating a licensee's capital requirements, the Superintendent's discretion to grant a conditional license is informed by eight factors, including "the nature and scope of the applicant's or Licensee's business," "the anticipated volume of business to be transacted by the applicant or Licensee," "the measures which the applicant or Licensee has taken to limit or mitigate the risks its business presents," and "the applicant's or Licensee's financial services or other business experience." 3 NYCRR § 200.4(c)(7)(i), (ii), (iv), (vii). This provision of the Regulation, like the other provisions discussed above, demonstrates the lengths to which DFS went to promulgate a rationally based, narrowly tailored set of rules to govern virtual currency business activity.

Consistent with the mandate imposed under the Financial Services Law, DFS applied existing regulatory concepts to virtual currency business activity to ensure that consumers and the financial system are protected. In the field of financial services, new products are routinely developed and DFS was created precisely to keep pace with new developments, whether they be mortgage-backed securities, collateralized loan obligations, derivatives or virtual currency. And here, the Regulation is fully in keeping with the powers given to DFS under the Financial Services Law.

IV. CHINO LACKS STANDING TO CHALLENGE THE REGULATION.

In his petition, Chino's standing was premised on the speculative allegation that if he were required to comply with the Regulation, he would be irreparably harmed because his business would be "unable to meet the unreasonable and capricious rules set forth by the

Department of Financial Services," and Bitcoin consumers would "patronize businesses that are not covered by the [R]egulation." (Pet'n ¶ 48.) But as the respondents noted in their moving papers, this is not sufficient to establish standing, because the petition contains no allegation that Chino actually engaged in activity that would be covered by the Regulation.

In his opposition brief, Chino tries to correct this defect by introducing some new details about his purported business activities involving Conglomerate Business Consultants, Inc. ("CBC") and Chino Ltd. (Pet.'s Opp'n Aff. ¶¶ 5–14.) Specifically, Chino alleges that he founded Chino Ltd. in 2013 for the purpose of installing "Bitcoin processing services." (Pet.'s Opp. Br. 1.) In March 2014, Chino allegedly hired an employee to "sell Chino Ltd.'s Bitcoin-related services" and the employee began to survey the interest of "local bodegas" in Bitcoin. (*Id*.) In December 2014, Chino co-founded a second company, CBC. (*Id.*) CBC allegedly started out distributing "phone minutes" to bodegas for resale to the public. (*Id*. at 1–2.) At some point, CBC entered into agreements with "seven bodegas in New York to offer Bitcoin-processing services" and, "[e]very day, CBC would send the bodegas the daily exchange rate that would be used for Bitcoin processing." (*Id.* at 2.) Chino Ltd. "provided technical services to CBC by processing the Bitcoin transactions." (*Id*.) Based on these purported activities, Chino asserts that his "Bitcoin processing business certainly falls within the 'virtual currency business activity' regulated by 23 NYCRR Part 200." (*Id.* at 5.)

These additional allegations are not enough to establish standing, however, because Chino has not demonstrated that he or any of his businesses were ever engaged in activity requiring a license from DFS. A license is required under the Regulation if a person engages in any of the following activities in New York or with a New York Resident:

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

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

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

d. performing Exchange Services as a customer business; or

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

23 NYCRR 200.2(q).

The newly raised allegations in Chino's opposition papers establish, at most, that CBC and Chino Ltd. provided some unspecified "processing" services. There is no allegation that these processing services ever involved the receipt of virtual currency for transmission, the storage of virtual currency on behalf of others, the buying and selling of virtual currency as a customer business, or any other licensable activity. Chino alleges that CBC provided bodegas with a daily exchange rate, but this, at best, suggests CBC was performing exchange services as a customer business, which is defined as "the conversion or exchange of Fiat Currency or other value into Virtual Currency, the conversion or exchange of Virtual Currency into Fiat Currency or other value, or the conversion or exchange of one form of Virtual Currency into another form of Virtual Currency." 23 NYCRR 200.2(d). But there is no allegation in Chino's petition or opposition papers that CBC actually provided exchange services. Chino merely alleges that CBC sent seven local bodegas daily exchange rate information. (Pet.'s Opp. Br. 2.) Moreover, Chino's alleged harm—that DFS "forced" him to abandon his Bitcoin processing business when it returned his license application—relates to the license application submitted by Chino Ltd. (*Id.*) CBC never even applied for a license.

The burden of establishing standing is on the party seeking judicial review. *Soc'y of Plastics Indus., Inc. v. Cnty. of Suffolk*, 77 N.Y.2d 761, 769 (1991). Here, Chino maintains that he has "largely" established standing, (Pet.'s Opp. Br. 4), but his vague descriptions of his business activities are simply insufficient to meet his burden, "largely" or otherwise, *see N.Y. State Assoc. of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211, 214–15 (2004). There is simply no basis to conclude that Chino has suffered an injury in fact, or that he is "reasonably certain" to suffer an injury by operation of the Regulation in the future. *See Patrolmen's Benevolent Assoc. v. N.Y. State Troopers*, 29 A.D.3d 68, 70 (3d Dep't 2006) (holding that a future injury may suffice to establish standing "as long as it is reasonably certain that the harm will occur if the challenged action is permitted to continue"); *N.Y. State Assoc. of Nurse Anesthetists*, 2 N.Y.3d at 211, 214-15 ("speculation about the future … cannot, under our precedents, supply the missing ingredient of in-fact injury").

Chino argues that he has standing because he would have been required to obtain a license from DFS in order to continue operating CBC. This argument, however, is based on speculation and pure conjecture. Chino has not applied for a license to operate CBC, and DFS has not taken any action to impact Chino's ability to seek such a license. Moreover, there are no factual allegations demonstrating that CBC would be covered by the Regulation if Chino were to actually apply for a license. And even if CBC's business activities were covered by the Regulation, the alleged injuries Chino would suffer from being licensed—that he would be "unable to meet the unreasonable and capricious rules" and that "consumers … will … patronize businesses that are not covered by the [R]egulation" (Pet'n ¶ 48)—are conclusory and tenuous. In sum, Chino has not alleged "an actual legal stake in the matter being adjudicated," *Soc'y of Plastics Indus.*, 77 N.Y.2d at 772, and therefore lacks standing.

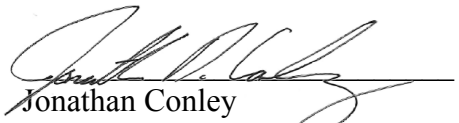
CONCLUSION

The respondents respectfully submit that the petition must be denied and that the cross-motion to dismiss the petition must be granted in its entirety, along with any other relief the Court deems just and proper.

Dated: New York, New York
January 20, 2017

Respectfully submitted,

ERIC T. SCHNEIDERMAN
Attorney General of the
State of New York
Attorney for Respondents
By:



Jonathan Conley
Assistant Attorney General
120 Broadway, 24th Floor
New York, NY 10271
(212) 416-8108
Jonathan.Conley@ag.ny.gov