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

Theo Chino and Chino LTD, Plaintiffs-Petitioners, -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

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS'-RESPONDENTS' CROSS-MOTION TO DISMISS THE AMENDED VERIFIED COMPLAINT AND ARTICLE 78 PETITION

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Defendants-Respondents the New York State Department of Financial Services and its Superintendent, Maria T. Vullo (collectively, "DFS"), by their attorney, Eric T. Schneiderman, Attorney General of the State of New York, submit this memorandum of law in support of their cross-motion to dismiss the amended verified complaint and Article 78 petition in this hybrid action.[1]

PRELIMINARY STATEMENT

Plaintiffs-Petitioners Theo Chino and Chino LTD bring this hybrid action challenging 23 NYCRR Part 200—a consumer protection regulation that was adopted by the New York State Department of Financial Services in June 2015 to address virtual currency business activity (the "Regulation"). Chino argues that the Regulation is invalid because it: (i) violates the separation of powers doctrine; (ii) is arbitrary and capricious; (iii) is preempted by federal law; and (iv) contains disclosure requirements that violate his commercial speech rights under the First Amendment to the United States Constitution.

These claims fail on both procedural and substantive grounds. Procedurally, Chino has failed to allege any facts demonstrating that he has suffered—or is likely to suffer—a cognizable injury because of the Regulation, and thus lacks standing to bring this litigation.

Substantively, Chino's claims fail as a matter of law. Chino first argues that the Regulation violates the separation of powers doctrine. But in promulgating the Regulation, 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 delegated to it by the New York Financial Services Law to prescribe rules and regulations

[1] This action is being brought as both an Article 78 proceeding—challenging DFS's regulation of virtual currencies as arbitrary, capricious, and beyond its jurisdiction—and an action—seeking a declaratory judgment pursuant to CPLR § 3001. *See* Am. Pet'n ¶ 49.

necessary to protect consumers of financial products and services. N.Y. Fin. Servs. Law (FSL) §§ 301(a), (c)(1); 302 (a)(1). The Regulation fulfills the Governor's and 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). DFS acted legally, constitutionally, and well within its authority in adopting the Regulation.

Chino also asserts a claim under CPLR Article 78 alleging that the Regulation is arbitrary and capricious, but this 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. The Regulation thus has a rational basis, and is not unreasonable, arbitrary, or capricious.

Chino next argues that the Regulation is preempted by the Dodd-Frank Act. That argument fails, however, because the plain language of Dodd-Frank explicitly provides that state governments retain the authority to enact financial consumer protection laws and regulations.

Finally, Chino claims that certain disclosure requirements under the Regulation are impermissible under the First Amendment. But well-established precedent holds that such disclosure mandates in purely commercial contexts need only be reasonable. And the disclosure requirements at issue here easily meet this reasonableness standard since they are rationally related to DFS's interest in protecting the consumers of financial products and services.

STATEMENT OF FACTS

DFS refers the Court to the amended verified complaint and Article 78 petition attached to the affirmation of Jonathan D. Conley as Exhibit A, and the affirmation of Thomas Eckmier, for a full recitation of the facts and circumstances underlying this litigation. For purposes of considering this cross-motion to dismiss, however, the salient facts are repeated here.

A. The New York State Department of Financial Services and its regulation of virtual currencies

The Creation of DFS and its Mission

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

As a complement to the Banking and Insurance Laws, the Legislature enacted the Financial Services Law in 2011, which tasks DFS with regulating and supervising certain

financial products and services and the providers of such products and services. *Id.* ¶ 7. The Legislature declared that the purpose of the Financial Services Law is to "provide for the enforcement of the insurance, banking and financial services laws, under the auspices of a single state agency" that would, among other things, "provide for the regulation of *new* financial services products" and "ensure the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL § 102(f), (i) (emphasis added).

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

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

The Financial Services Law also authorizes the superintendent to promulgate "rules and regulations and issue orders and guidance involving financial products and services, not

[2] These exceptions include any financial product or service that is (i) subject to federal preemption, (ii) regulated under the exclusive jurisdiction of a federal agency or (iii) regulated for the purpose of consumer or investor protection by any other state agency. FSL §§ 104(a)(2)(A)(i)–(iii).

inconsistent with the provisions of" the Financial Services Law, the Banking Law, the Insurance Law, and "any other law in which the superintendent is given authority." FSL § 302(a). Such regulations may effectuate "any power given to the superintendent" under the Financial Services Law and other enumerated laws; interpret the Financial Services Law and other enumerated laws; and govern "the procedures to be followed in the practice of the department." *Id.*

The Regulation of Virtual Currencies

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

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

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

In addition to the risk of loss to consumers, virtual currency business activity has in some cases involved "dark" online marketplaces, including the Silk Road site, where, between 2011 and 2013, illegal drugs and other illicit items and services worth hundreds of millions of dollars were regularly bought and sold using the virtual currency Bitcoin. *Id.* ¶ 25. For precisely such reasons, DFS is tasked with enacting regulations to ensure the "prudent conduct of the providers of financial products and services" and "encourage high standards of honesty, transparency, fair business practices and public responsibility." *Id.* (quoting FSL §§ 102(i), 201(b)(5)).

The Promulgation of 23 NYCRR Part 200

On July 23, 2014, pursuant to the State Administrative Procedures Act, DFS published the proposed virtual currency regulation in the New York State Register. As stated in the Register, the purpose of the proposed regulation was to regulate "virtual currency business

activity in order to protect New York consumers and users and ensure the safety and soundness of New York licensed providers of virtual currency products and services." *Id.* ¶ 26.

That initial publication in the Register was followed by a 90-day public comment period and Department review of those comments. *Id.* ¶ 27. On February 25, 2015, based upon the public comments received, a substantially revised regulation was published in the Register. *Id.* ¶ 27. After an additional 30-day comment period and Department review of those comments, the final version of 23 NYCRR Part 200 was adopted on June 24, 2015. *Id.* ¶ 28.

B. Theo Chino, his businesses, and the commencement of this litigation

2013-2014: Chino establishes Chino LTD and Conglomerate Business Consultants, Inc.

Chino founded Chino LTD in 2013 for the purpose of "install[ing] Bitcoin processing services in the State of New York." Am. Pet'n ¶¶ 2, 73. In March 2014, Chino hired an employee to "sell Chino LTD's Bitcoin-related services" and the employee "distributed surveys to local bodegas and stores to evaluate the Bitcoin landscape and identify potential clients in the Manhattan area." *Id.* ¶¶ 74–75. In December 2014, Chino co-founded a second company, Conglomerate Business Consultants, Inc (CBC). *Id.* ¶ 76. CBC started out distributing "phone minutes" to bodegas for resale to the public, and later entered into contracts with "seven bodegas in New York to offer Bitcoin-processing services." *Id.* ¶¶ 77–78. CBC distributed "phone minutes and the Bitcoin processing service directly to bodegas" and "Chino LTD provided the actual processing services." *Id.* ¶ 81.

More specifically, "Chino LTD provided all the research and development for Bitcoin processing, bought all of the computer [sic] to run the backend of processing Bitcoin, rented all of the hosting equipment to run the front end of processing Bitcoin, and developed custom operating systems to run the Bitcoin processing." *Id.* ¶ 82.

2015-2016: Chino submits an incomplete application, preemptively shuts down his businesses, and sues DFS

On June 24, 2015, the Regulation went into effect. *Id.* ¶ 1. Two weeks later, Chino filed an application on behalf of Chino LTD with DFS for a license to engage in Virtual Currency Business Activity. *Id.* ¶¶ 5, 88; Ex. IX to Am. Pet'n (Chino's application). In October 2015, Chino commenced this litigation. Am. Pet'n ¶ 6.

In January 2016, DFS advised Chino by letter that it had performed an initial review of his application, but was unable to determine whether Chino LTD needed a license to operate because of the "exceptionally limited" information he had provided. *See* Ex. XI to Am. Pet'n (Jan. 4, 2016 letter). "Among other issues," DFS noted, "the Application does not contain any description of the Company's current or proposed business activity." *Id.* Consequently, DFS was unable to evaluate whether Chino LTD's "current or intended business activity (if any) would be considered Virtual Currency Business Activity that requires licensing under the New York Financial Services Law and regulations." *Id.* (citing 23 NYCRR Part 200).

Because of this lack of information, DFS explained that it was returning Chino's application "without further processing," but "emphasiz[ed] that the instant letter does not offer any opinion as to whether or not any business activity of the Company requires or would require licensing by New York." *Id.* In the event Chino "[s]hould … have any questions" about the letter, DFS provided him with the contact information of the Supervising Bank Examiner for DFS's Capital Markets Division. *Id.*

Chino never followed up with DFS about his application—he never supplemented his application with more information, never communicated with DFS to ascertain whether he needed a license to operate Chino LTD, and never submitted an application on behalf of his other

company, CBC. Instead, he immediately shut down CBC on the purported grounds that DFS "did not approve" his application for Chino LTD. *Id.* ¶ 94.

LEGAL STANDARDS

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

ARGUMENT

I. Chino's factual allegations are insufficient to establish standing.

To challenge a governmental action, a party must first establish that it has standing to sue. *See N.Y. State Ass'n of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211 (2004). The burden of establishing standing is on the party seeking judicial review. *Soc'y of the Plastics Indus., Inc. v. Cnty. of Suffolk*, 77 N.Y.2d 761,769 (1991). Chino has failed to meet that burden here.

Whether an individual "seeking relief from a court is a proper party to request an adjudication is an aspect of justiciability which must be considered at the outset of any litigation." *Roberts v. Health & Hospitals Corp.*, 87 A.D.3d 311 (1st Dep't 2011) (citation and internal quotation marks omitted). Standing is critical since a court "'has no inherent power to right a wrong unless thereby the civil, property or personal right of the plaintiff in the action or the petitioner in the proceeding is affected.'" *Soc'y of the Plastics Indus., Inc.*, 77 N.Y.2d at 772 (*quoting Schieffelin v. Komfort*, 212 N.Y. 520, 530 (1914)).

To establish standing, a plaintiff must demonstrate an "injury in fact." *N.Y. State Assoc. of Nurse Anesthetists*, 2 N.Y.3d at 211, 214-15. As the term implies, an injury in fact means that

"the plaintiff will actually be harmed by the administrative action." *Id.* The alleged "injury must be more than conjectural." *Id.* Speculation that a party will likely be injured does not satisfy the "concreteness" required to establish injury in fact. *Id.* "[S]tanding requires a showing of 'cognizable harm,' meaning that an individual member of plaintiff organizations 'has been or will be injured'; 'tenuous' and 'ephemeral' harm … is insufficient to trigger judicial intervention." *Id*. at 214 (quoting *Rudder v. Pataki*, 93 N.Y.2d 273, 279 (1999)). Even though "an issue may be one of … public concern, [that] does not entitle a party to standing." *Soc'y of Plastics Indus., Inc.*, 77 N.Y.2d at 769. Without an injury in fact, a plaintiff's assertions are "little more than an attempt to legislate through the courts." *Rudder*, 93 N.Y.2d at 280.

A. Chino has failed to allege that he suffered an injury-in-fact.

Here, Chino's allegations are inadequate to establish standing for one simple reason: nothing in the petition demonstrates that Chino has suffered—or is likely to suffer—a cognizable injury *because of* the Regulation. This deficiency is fatal to Chino's claims.

Chino's standing argument rests solely on the fact that he voluntarily shut down his businesses after submitting an incomplete application to DFS for a license to engage in virtual currency business activity. Chino commenced this litigation while his application was pending. In January 2015, DFS advised Chino that it had performed an initial review of his application, but was unable to determine whether Chino LTD needed a license to operate because of the "exceptionally limited" information he had provided. *See* Ex. XI to Am. Pet'n. In response to this news about his incomplete application, Chino shut down both of his businesses, which allegedly resulted in financial losses.

In an attempt to establish standing, Chino points to Chino LTD's tax returns from 2013 to 2016, alleging that they demonstrate the financial losses he incurred because of the Regulation.

Id. ¶¶ 85–87, 91, 94. Specifically, Chino alleges that Chino LTD suffered the following losses:

2013 tax year	Chino LTD suffered losses of $4,367 "due to the cost of purchasing computer equipment to test how to protect Bitcoin and figure out how to monetize it." Am. Pet'n ¶ 85.
2014 tax year	Chino LTD suffered losses of $59,667 "due to the cost of computer hardware required to run Bitcoin warehousing, the cost of renting computer time on the cloud, and marketing the service to bodegas." *Id.*
June 2015	*Regulation promulgated as 23 NYCRR Part 200. Id.* ¶ 1.
August 2015	Chino submitted an application on behalf of Chino LTD for a license to engage in Virtual Currency Business Activity. *Id.* ¶¶ 5, 87.
2015 tax year	Chino LTD suffered losses of $30,588. *Id.* ¶ 87. "These losses were due to the cost of utilities to process Bitcoin (computer time on the internet cloud), the interest on the borrowed capital required to purchase the equipment the previous year, the cost associated with supporting CBC (who entered into the agreements with bodegas), and the cost of litigation." *Id.*
2016 tax year	Chino LTD "no longer offer[ed] Bitcoin services," but "remained an active S-Corporation and suffered losses of $53,053." *Id.* ¶ 94. These "losses were due to the utilities for keeping the equipment to process Bitcoin in the event of successful litigation, the interest on the borrowed capital from the previous three years, and the cost of litigation." *Id.*

Even taking this chronological narrative as true, Chino has failed to establish a connection between the Regulation and his purported "injury in fact"—Chino LTD's financial losses. Indeed, as this chronology shows, most of Chino's financial losses—those arising in 2013, 2014, and the first half of 2015—were incurred before the Regulation was promulgated. This alone belies any claim that they were caused by the Regulation.

But the other alleged financial losses are equally unhelpful to Chino because they are entirely unrelated to the Regulation. As noted above, Chino never ascertained whether his businesses needed a license to operate under the Regulation. He simply assumed they would. And DFS never barred Chino from operating his businesses. To the contrary, DFS told Chino in the clearest possible terms that it would need more information before it could determine whether Chino LTD's business activities fell under the Regulation's purview. *See* Ex. XI to Am.

Pet'n. And as Chino himself acknowledges, he never provided DFS with enough information to process his application. Am. Pet'n ¶ 94. Instead, he charted a decidedly different course by preemptively halting the operations of CBC and Chino LTD and commencing this litigation.

Chino ascribes the losses he incurred in 2015 and 2016 to the costs of this litigation, utility fees, and the interest paid on borrowed capital. *Id.* But these losses plainly arise from Chino's decision to challenge the legality of the Regulation before determining whether it even applied to his businesses, and cannot be plausibly attributed to the Regulation going into effect. In short, the cause of Chino's seized business operations (and any financial losses that resulted) was Chino—not the Regulation.

Chino shuttered his businesses on the speculative assumption that their operations *might* be impacted by the Regulation, and now argues that the resulting financial losses constitute an injury in fact. This is not enough to confer standing. Standing requires evidence of a concrete, cognizable injury that was *caused by* the challenged law. *See N.Y. State Ass'n of Nurse Anesthetists,* 2 N.Y.3d at 211. Chino makes no such showing here. Instead, Chino presents evidence of a self-inflicted injury that resulted—not from the challenged Regulation—but from his own assumptions about how that Regulation might affect his businesses down the road. Such broad, non-descript allegations of anticipatory harm are far too attenuated to establish standing; the fact that a law or regulation may be enforced does not, on its own, establish an injury in fact.

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

II. The Regulation is well within DFS's enabling legislation and does not violate the separation of powers doctrine.

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 Consol. Nursing Home v. Comm'r of N.Y. State Dep't of Health*, 85 N.Y.2d 326 (1995). Chino's arguments fail to meet his "heavy burden of showing that the regulation is unreasonable and unsupported by any evidence." *Id.*

1. 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, Am. Pet'n ¶¶ 9–11, 29, 36, 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 have the "characteristics of a true currency," and thus the Legislature intended to limit DFS's authority to regulate only those products or services involving "true currency." *Id.* 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.* ¶¶ 29, 35.[3]

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

[3] 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. Am. Pet'n ¶¶ 65–66. In support of this position, he cites 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.

exchange that can be substituted for traditional currency.[4] 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—a dubious (and legally unfounded) proposition.

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.[5]

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. These traditional intermediaries have long been regulated by DFS, other state banking regulators, and (in the case of national banks) the U.S. Office of the Comptroller of the Currency ("OCC"). Facilitators of online payments, for

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[4] *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."; *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."), *aff'd* 2017 WL 2346566, at * 1 (2d Cir. May 31, 2017); *United States v. Murgio*, No. 15-CR-769 (AJN), 2016 WL 5107128, at *3–4 (S.D.N.Y. Sept. 19, 2016) (recognizing that Bitcoin is synonymous with money, as it "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); *Sec. & Exch. Comm'n v. Shavers,* 13 Civ. 416, 2013 WL 4028182, at *2 (E.D.Tex. Aug. 6, 2013), 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….").

[5] *See* Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (2008), at 1, available at https://bitcoin.org/bitcoin.pdf (last visited Jun. 21, 2017).

example, are generally licensed by DFS as money transmitters.[6] 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 acknowledged in 2013 by the Financial Crimes Enforcement Network of the U.S. Treasury Department ("FinCEN").[7] FinCEN's primary purpose is to safeguard the financial system from evolving national security and money laundering threats.[8] 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.

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.

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[6] *See* 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).

[7] *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.

[8] U.S. Dep't of the Treasury, FinCEN, *Mission*, https://www.fincen.gov/about/mission (last visited June 22, 2017).

FinCEN therefore concluded 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 decision, 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 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.*

2. 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 DFS, Governor 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."[9] The solution, the Governor urged, was "a newly formed department … capable of regulating modern financial services organizations." *Id.*

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.

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. *See supra* p. 6. Left unregulated, the virtual currency market can also become a haven for black-market transactions, money laundering, and terrorist financing. This is exactly the type of situation where DFS has a compelling policy interest to act, in accord with its mandate, to protect consumers and the market. And that is precisely what DFS did here in adopting a rational, carefully crafted regulatory framework designed to safeguard the public against the potential abuse and misuse of a new financial product and service.

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 the financial products and services in New York.

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

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 claim that the Regulation violates the separation of powers doctrine.

Boreali v. Axelrod, 71 N.Y.2d 1 (1987) is the seminal case "for determining whether agency rulemaking has exceeded legislative fiat." *Matter of NYC C.L.A.S.H., Inc. v. N.Y. State Off. of Parks, Recreation & Historic Preserv.*, 27 N.Y.3d 174, 178 (2016). In that case, the Court of Appeals set forth four "intertwined factors for courts to consider when determining whether an agency has crossed the hazy 'line between administrative rule-making and legislative policy-making.'" *Greater N.Y. Taxi Assoc. v. Taxi & Limo. Comm'n*, 25 N.Y.3d 600, 610 (2015).[10]

The **first** *Boreali* factor is whether the agency did more than balance costs and benefits according to preexisting guidelines, but instead made "value judgments entailing difficult and complex choices between broad policy goals to resolve social problems." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 610. There are no broad policy judgments at issue here; virtual currency business activity is not banned or even discouraged under the Regulation. Rather, DFS extended well-established safeguards that apply to a broad range of financial services to new financial services involving virtual currency. And in doing so, DFS fulfilled the legislative intent expressed in the Financial Services Law by (i) "provid[ing] for the regulation of new financial services products;" (ii) "ensur[ing] 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

[10] The Court of Appeals has counseled against treating the *Boreali* factors "as discrete, necessary conditions that define improper policy making by an agency." *Matter of Statewide Coalition of Hispanic Chambers of Comm. v. N.Y.C. Dep't of Health*, 23 N.Y.3d 681, 696–97 (2014). Nor are they criteria to be "rigidly applied in every case in which an agency is accused of crossing the line into legislative territory." *Id.* To the contrary, courts are directed to view them as "overlapping, closely related factors" that may shed light on whether "an agency has crossed that line" between rule making and policy making. *Id.*

financial products and services, through responsible regulation and supervision;" and (iii) "protect[ing] users of financial products and services…." FSL §§ 102(f), (i); 201(b)(7).

The **second** *Boreali* factor is "whether the agency merely filled in details of a broad policy or if it wrote on a clean slate, creating its own comprehensive set of rules without benefit of legislative guidance." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 611. Far from being written on a clean slate, the Regulation applies well-accepted regulatory concepts to virtual currency that already exist in the Banking Law (or the regulations promulgated thereunder). Eckmier Aff. ¶ 34. These concepts reflect common requirements imposed across a wide variety of financial services, including:

- the maintenance of certain books and records;
- reporting requirements;
- disclosures to consumers;
- periodic examination by DFS;
- maintenance of a surety bond or similar security fund to protect consumers;
- prior Department approval of changes in control of the licensee; and
- anti-money laundering requirements.

See id. ¶¶ 35–40. The application of existing regulatory concepts comports with DFS's mandate to ensure "the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." FSL § 102(i); Eckmier Aff. ¶ 41.

The **third** *Boreali* factor is "whether the legislature has unsuccessfully tried to reach agreement on the issue, which would indicate that the matter is a policy consideration for the elected body to resolve." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 611–12. Here, the Legislature has not made any attempt to pass legislation governing virtual currency activity or taken any action that would suggest any inconsistency between the promulgation of the Regulation and the Legislature's intent as expressed in the Financial Services Law. Eckmier Aff. ¶ 58.

In fact, DFS's ability to regulate financial products and services is subject to regular legislative review. Specifically, the Financial Services Law requires that DFS "submit a report annually to the governor and to the legislature" containing, among other things, "a general review of the insurance business, banking business, and financial product or service business," as well as details regarding regulations promulgated under the Financial Services Law. FSL § 207(a)(1), (14); Eckmier Aff. ¶ 57. Consistent with this requirement, DFS has advised the Governor and Legislature annually since 2014 on the events leading up to the Regulation's promulgation and its status since going into effect. *See id.* ¶¶ 59–63. Yet since its promulgation in 2015, no legislation has been introduced seeking to regulate virtual currency business activity or invalidate the framework established by the Regulation.

The **fourth** *Boreali* factor is "whether the agency used special expertise or competence in the field to develop the challenged regulations." *Greater N.Y. Taxi Assoc.*, 25 N.Y.3d at 612. As noted previously, DFS was formed through the consolidation of its long-standing predecessor agencies, the Departments of Banking and Insurance, and is New York's primary financial services regulator. Unquestionably, DFS has extensive expertise in the field of financial services regulation. And given that the Regulation pertains to virtual currency products and services, which are financial products and services, DFS plainly relied on its special expertise in developing the Regulation; thus, the fourth *Boreali* factor is easily satisfied.

In light of the above, *Boreali* fully supports DFS's actions. Courts have consistently refused to hold that *Boreali* prohibits an agency's regulations where, as here, the regulations track the agency's statutory mandate.[11] In precisely the same way, the Regulation implements the

[11] *E.g.*, *NYC C.L.A.S.H., Inc.*, 27 N.Y.3d at 178 (distinguishing *Boreali* and holding that the Office of Parks and Recreation acted within its statutory mandate in passing regulations limiting smoking in outdoor areas); *Matter of Nat'l Restaurant Ass'n v. N.Y.C. Dep't. of Health*, 148 A.D. 3d 169 at 173–78 (1st Dep't 2017) (holding under

statutory authority given to DFS by the Legislature to ensure the safety and soundness of financial services and products offered to New Yorkers and that the providers of these products and services institute adequate consumer protections. Accordingly, Chino's separation of powers challenge to the Regulation fails as a matter of law.

III. The Regulation is neither arbitrary nor capricious and has a rational basis.

In exercising its rule-making powers, an administrative agency "is accorded a high degree of judicial deference, especially when the agency acts in the area of its particular expertise." *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." *Id.* In evaluating whether an agency rule or regulation is arbitrary and capricious under Section 7803 of the CPLR, a court must determine whether there is "a rational basis to support the findings upon which the agency's determination is predicated." *Nat'l Restaurant Assoc.*, 2016 WL 751881, at *3.

Moreover, agencies are presumed to have developed an expertise and judgment that requires the courts to accept the agency judgment if not unreasonable. *Lynbrook v. N.Y. State Pub. Employment Relations Bd.*, 48 N.Y.2d 398, 404 (1979). And when matters of specialized knowledge or judgment are entrusted to an agency, the court may not substitute its own judgment. *In the Matter of Graves v. City of New York*, 53 Misc.3d 895, 38 N.Y.S.3d 741, 746 (Sup. Ct. N.Y. Cnty. 2016) (citing *City Servs., Inc. v. Neiman*, 77 A.D.3d 505 (1st Dep't 2010)). *"*It has been established as a fundamental rule of administrative law that a reviewing court, in dealing with a determination an administrative agency alone is authorized to make, 'must judge the propriety of such action solely by the grounds invoked by the agency.'" *In the Matter of the*

Boreali analysis that the New York City Department of Health did not act outside the bounds of its authority in the area of public health by passing a rule requiring chain restaurants to post sodium warning labels).

Brennan Ctr. v. N.Y. State Bd. of Elections, 29 N.Y.S.3d 758, 773–74 (Sup. Ct. Albany Cnty. Mar. 16, 2016) (quoting *Matter of Barry v. O'Connell*, 303 N.Y. 46, 50–51 (1951)).

Chino argues that the Regulation is invalid because it is over-inclusive. *See* Am. Pet'n ¶¶ 43, 45, 105–08. But in making this argument, Chino blatantly misconstrues the Regulation's scope. Chino contends, for example, that the Regulation covers all non-financial uses of blockchain technology—including an artist's use of "blockchain technology to assert ownership over [his or her] works," an insurer's use of "blockchain technology to track diamonds," or a person's use of "blockchain technology to timestamp documents and photos." *Id.* ¶¶ 45–46. Expanding on this general theme, Chino goes so far as to suggest that the Regulation covers the basic exchange of *all* information over the internet. *Id.* ¶ 43. This is patently false.

The definition of "Virtual Currency" under the Regulation 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); Eckmier Aff. ¶ 47. These terms—"medium of exchange" and "form of digitally stored value"—are commonly used to describe financial products and services.[12]

"Medium of exchange" is defined as "something that is used to pay for goods or services, for example a particular currency."[13] 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

[12] *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").

[13] Cambridge Business English Dictionary, http://dictionary.cambridge.org/dictionary/english/medium-of-exchange (last visited Jun. 22, 2017).

of the card. Many such stored value cards are already regulated by DFS as money transmission.[14] 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 also challenges the provisions of the Regulation setting forth recordkeeping requirements, anti-money-laundering requirements, and capital requirements. *See* Am. Pet'n ¶¶ 50–56, 111–21. But each of these provisions was properly crafted with a rational basis.

The record-keeping requirements are not "onerous." *Id.* ¶ 111. Similar record-keeping requirements apply to other licensees or chartered entities including, for example, check cashers,

[14] *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*, http://www.dfs.ny.gov/banking/ialfmta.pdf.

money transmitters and banks. *See* 3 NYCRR § 400.1; N.Y. Banking Law §§ 128, 651-b. Keeping records of transactions 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, Am. Pet'n ¶ 52, but this is mistaken. The suspicious activity report ("SAR") requirement referenced by Chino, *id.* ¶¶ 54, 113, 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 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 requires. 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. 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. *Id.* § 401.1(b)(1), (3). Similarly, 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." *Id.* § 406.13; *see also id.* § 400.1(c)(6)(iv), (v) (check cashers must have a $100,000 line of credit and $10,000 in cash at each location). These are commonly applied, basic consumer protection requirements.

Chino also misconstrues the minimum capital requirements under Section 200.8, alleging the Regulation arbitrarily "impose[s] blanket capital requirements on *all* actors subject to the Regulation." Am. Pet'n ¶ 118. 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 id.* § 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. 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." *Id.* § 200.4(c)(7)(i), (ii), (iv), (vii). This provision of the Regulation, like the other provisions discussed above, shows the lengths to which DFS went to adopt a set of rational, narrowly tailored 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. And here, DFS acted fully in keeping with the authority delegated to it under the Financial Services Law in adopting the Regulation.

In sum, the Regulation is reasonable, appropriately focused, and rationally based to attain DFS's legislatively mandated purpose of ensuring the safety and soundness of the financial services and products offered to New Yorkers. Chino's arguments to the contrary are meritless.

IV. The Regulation is Not Preempted by Federal Law.

Chino argues that the Regulation is preempted by the Dodd-Frank Act on three grounds. *See* Am. Pet'n ¶¶ 122–28. First, Chino argues that Dodd-Frank "defines 'financial service or product' in eleven carefully constructed subparagraphs," so it is "sufficiently comprehensive to reasonably infer that Congress left no room for supplementary state regulation." *Id.* ¶¶ 124–25. Second, Chino points to a federal preemption provision of Dodd-Frank, which provides that a state consumer financial law is preempted if that law is otherwise "preempted by a provision of Federal law," to argue that the Regulation is preempted here. *Id.* ¶ 126. And third, Chino asserts that Congress' objectives in enacting Dodd-Frank "was to implement and enforce Federal

consumer financial law consistent 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." *Id.* ¶ 127 (citing 12 U.S.C. § 5511(a)). Because "the term 'all consumers' establishes a purpose of uniformity in markets for consumer financial products and services," Chino reasons, "New York does not have the authority to define for themselves a term with the history of substantial federal regulation." *Id.*

But this faulty line of reasoning relies on a misreading of 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. *See* 12 U.S.C. § 5551(a). Moreover, laws are considered consistent with Dodd-Frank, and thus are not preempted, if they afford consumers greater protection than otherwise provided under Dodd-Frank. *Id.* For this reason, Congress expressly provided that no part of Dodd-Frank "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); *In re Grand Theft Auto Video Game Consumer Litigation*, 251 F.R.D. 139, 150 (S.D.N.Y. 2008).

Nothing in the provisions of Dodd-Frank evinces a Congressional intent to preempt state consumer protection laws. 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 Fin. Servs.*, 769 F.3d 105 (2d Cir. 2014) (No. 13-3769-CV) [hereinafter *CFPB Amicus Brief*]; *see also The Otoe-Missouria Tribe of Indians v. N.Y. State Dep't of Fin. Servs.*, 769 F.3d 105 (2d Cir. 2014) (upholding DFS's authority to regulate payday lending by certain Indian tribes to New York residents). In supporting continued state authority in protecting consumers, the CFPB explicitly rejected the notion 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" and does not preempt the Regulation. *Id.* at 8.

Relying on Section 5481(15) of the Dodd-Frank Act, Chino claims that the CFPB is the sole arbiter of what constitutes a financial product or service. So, as Chino reads it, the CFPB's definition of a financial product or service is controlling in all contexts—and thus preempts any state law aimed at regulating a financial product or service. But Chino's reliance on Section

5841(15) is misplaced. The provision merely sets forth the CFPB's authority to identify the financial products and services that it—*the CFPB*—may regulate.[15]

Chino nevertheless maintains that Dodd-Frank preempts *all* state consumer financial laws (barring a few exceptions not relevant here). *See* Am. Pet'n ¶ 126. But nothing in Dodd-Frank's text or legislative history supports this view. Indeed, the only way to draw such a mistaken impression of Dodd-Frank's federal preemption standards is to ignore the plain, unambiguous language of the statute. Because under Dodd Frank's federal preemption clause (12 U.S.C. § 25b(b)(1)(c))—expressly titled "State law preemption standards for national banks and subsidiaries clarified"—the only state laws that are subject to preemption are those that apply to national banks and their subsidiaries.[16] As neither of Chino's entities is a national bank or affiliated with any national bank in any way, this provision has no bearing on this case at all.

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

V. The Regulation's disclosure requirements do not violate Chino's First Amendment rights.[17]

Chino argues that the Regulation violates the First Amendment by requiring licensees to

[15] In fact, the CFPB has partnered with states, including with DFS, to protect consumers by 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.

[16] Notably, Sections 1044(a) and 1045 of the Dodd-Frank Act were 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 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).

[17] Chino also brings his commercial-speech claims under the New York Constitution on the grounds that it affords "stronger" protection than the U.S. Constitution. Am. Pet'n ¶ 131. This is mistaken. New York courts have, at times, interpreted the protections afforded under the New York Constitution's free speech clause more expansively than those afforded under the First Amendment, but "the New York Court of Appeals has not articulated a stricter standard for regulation of commercial speech than that imposed by the federal Constitution." *Clear Channel Outdoor, Inc. v. City of New York*, 594 F.3d 94, 112 (2d Cir. 2010). Consequently, Chino's commercial speech claims fail under the New York Constitution for the same reasons they fail under the First Amendment.

disclose certain information to its customers. *See* Am. Pet'n ¶ 14. These challenged disclosure requirements are governed by Section 200.19 of the Regulation, which sets forth a non-exhaustive list of disclosures a licensee must make to its customers. Chino claims that some of these disclosure requirements are unconstitutional. *See id.* ¶ 132. But the government may require a commercial speaker to disclose factual information about its product or service so long as the mandated disclosure is reasonably related to the government's interests. *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 651 (1985). And every disclosure required under the Regulation is factual, accurate, and objectively verifiable. Because these disclosures serve New York's significant interest in educating and protecting consumers of financial products and services, Chino has no First Amendment right not to disclose this information to his customers. *See, e.g.*, *Zauderer*, 471 U.S. at 651 (observing that the plaintiff's "constitutionally protected interest in *not* providing any particular factual information in his advertising is minimal"); *Nat'l Elec. Mfrs. Ass'n v. Sorrell*, 272 F.3d 104, 113–14 (2d Cir. 2001) ("Protection of the robust and free flow of accurate information is the principal First Amendment justification for protecting commercial speech, and requiring disclosure of truthful information promotes that goal."). The Court should therefore dismiss his First Amendment claim.

CONCLUSION

For the reasons set forth in this memorandum, DFS respectfully submits that the petition should be denied and that the cross-motion to dismiss the petition should be granted in its entirety, along with any other relief the Court deems just and proper.

Dated: New York, New York
June 23, 2017

Respectfully submitted,

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