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. Victoria St. George

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF DEFENDANTS'– RESPONDENTS' CROSS-MOTION TO DISMISS THE AMENDED COMPLAINT AND VERIFIED 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" or the "Department"), by their attorney, Eric T. Schneiderman, Attorney General of the State of New York, submit this reply memorandum of law in further support of their cross-motion to dismiss the petition in this hybrid action.

Preliminary Statement

In its moving papers, DFS demonstrated that petitioner Theo Chino's challenge to 23 NYCRR Part 200 (the "Regulation") should be dismissed on both procedural and substantive grounds. *See* Defs.'–Resps.' Mem. of Law in Support of Cross-Motion to Dismiss the Am. Compl. & Ver. Pet'n, dated June 23, 2017 ("DFS Moving Br."). None of Chino's arguments in his opposition papers adequately refutes DFS's arguments. 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. *Id.* at 9–13.

Substantively, Chino's claims fail as a matter of law. In promulgating the Regulation in June 2015, DFS—the state agency charged with regulating New York's financial services industries—properly exercised the authority granted to it by the New York Financial Services Law to prescribe rules and regulations necessary to protect consumers of financial products and services. N.Y. Fin'l Servs. Law (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 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," because he does not, and cannot, show "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). While acknowledging that DFS has the inherent authority to regulate financial products and services, Chino argues that virtual currency is not financial in nature because it is not a government-backed currency. This argument is meritless, and is belied by Chino's own statements, the straightforward text of the Financial Services Law, and common sense.

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 fares no 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 also claims that the Regulation is arbitrary and capricious. This claim likewise fails because, as the text of the Regulation makes clear, it 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 claims that certain disclosure requirements under the Regulation violate his First Amendment rights. 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. Accordingly, the petition should be dismissed.

ARGUMENT

I. Chino lacks standing to challenge the Regulation.

As demonstrated in DFS's moving papers, Chino's allegations are inadequate to establish standing to bring this challenge because nothing in the petition demonstrates that he has suffered—or is likely to suffer—a cognizable injury *because of* the Regulation.

To establish standing, a plaintiff must demonstrate an "injury in fact." *See N.Y. State Ass'n of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 214–15 (2004). The basis of Chino's standing argument is that he has "been irreparably harmed by the Regulation because it effectively forced [him] to close his Bitcoin processing business, Chino LTD." Chino's Memo. of Law in Opp'n to DFS's Cross-Mot. to Dismiss the Am. Ver. Compl. & Article 78 Pet'n, dated July 14, 2017 ("Opp'n Br.") 6 (citing Chino Aff. ¶¶ 15–19). But as detailed in DFS's cross-motion to dismiss, Chino has failed to allege any facts demonstrating that the Regulation caused him to halt Chino LTD's business operations. *See* DFS's Moving Br. 10–12.

In his opposition, Chino maintains that he "did not voluntarily shut down Chino LTD" because it "would have been operating illegally had it continued its Bitcoin processing services without a license …." Opp'n Br. 8; *see also id.* at 9 (alleging that "Chino LTD could no longer offer Bitcoin services" in 2016 "because it did not receive a license." (citing Chino Aff. ¶ 20)).

But this argument is founded on the faulty premise that DFS denied his request for a license to operate Chino LTD under the Regulation. DFS never denied Chino's application. To the contrary, 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.[1]

Chino alleges that the "Regulation is the proximate cause [for] halting his Bitcoin processing business activities," Opp'n Br. 8–9, but the Regulation plainly had nothing to do with Chino's decision to close his business. Chino never ascertained whether Chino LTD needed a license to operate under the Regulation. He simply assumed it would. And DFS never barred Chino from operating his business. Indeed, 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.

In sum, the cause of Chino's halted business operations (and any financial losses that resulted) was Chino—not the Regulation. Chino closed his business on the speculative assumption that its operations *might* be impacted by the Regulation, and now argues that the resulting financial losses constitute an injury in fact.

This is not sufficient to confer standing. Standing requires evidence of a concrete, cognizable injury that was *caused by* the challenged law. *See Novello*, 2 N.Y.3d at 211. Chino makes no such showing here. Instead, Chino presents evidence of a self-inflicted injury that

[1] "Among other issues," DFS noted, "the Application does not contain any description of the Company's current or proposed business activity." Ex. XI to Am. Pet'n. 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.*

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.

Chino has failed to allege any facts showing that the Regulation injured him in a concrete, material way, and therefore lacks standing to bring this litigation. *See Soc'y of Plastics Indus., Inc. v. Cnty. of Suffolk*, 77 N.Y.2d 761, 772 (1991) (to establish an injury in fact, the plaintiff must allege "an actual legal stake in the matter being adjudicated").

II. The Regulation is authorized by DFS's enabling legislation.

In its moving papers, DFS established that Chino's separation-of-powers claim is devoid of merit. *See* DFS's Moving Br. 13–21. In his opposition papers, Chino does not refute any of the arguments raised in DFS's cross-motion to dismiss, and instead simply reasserts the same flawed reasoning already contained in his petition. Consequently, Chino's claims fail as a matter of law for the same reasons set forth in DFS's moving papers.

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

The basis for Chino's separation-of-powers claim is that virtual currency is not a financial product or service, and therefore falls outside of DFS's regulatory authority. Ver. Pet'n ¶¶ 99–102. But as demonstrated in DFS's moving papers, Chino's myopic interpretation of DFS's authority is based on a contrived and unduly narrow definition of "financial," and runs counter to the explicit text of the Financial Services Law. *See* DFS's Moving Br. 13–21. As numerous courts have recognized,[2] virtual currency is a digital form of money—a medium of

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[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."; *United States v.*

exchange that can be substituted for traditional currency.

Virtual currencies 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.[3] 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. Facilitators of online payments, for example, are generally licensed by DFS as money transmitters.[4]

As DFS noted in its moving papers—and which Chino ignored in his opposition—the Financial Crimes Enforcement Network of the U.S. Treasury Department ("FinCEN") has recognized that virtual currency can be used, and sometimes needs to be regulated, as a substitute for fiat currency.[5] *See* DFS's Moving Br. 15. In a 2013 interpretive guidance on virtual

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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….").
Chino does not attempt to distinguish or address this extensive legal authority in his opposition.

[3] *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).

[4] *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).

[5] *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.

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 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.*

FinCEN’s recognition that virtual currency can be used as money, and that certain virtual currency service providers are indistinguishable from money 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.

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.[6] In essence, Chino posits that the Legislature intended that otherwise identical transactions be treated differently depending on whether they are conducted in dollars or virtual currency. By 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. This line of reasoning is specious and defies common sense.

Indeed, virtual currency arguably is 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.

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. Virtual currency business activity represents a

[6] In support of his argument that virtual currency is not a financial product or service, Chino alleges that several states "have taken the position that Bitcoin is not money." Opp'n Br. 13. Chino claims, for example, that "Kansas and Texas have taken the position that Bitcoin is not money and have issued memoranda stating this position." *Id.* But the Kansas and Texas memoranda cited by Chino merely provide that virtual currencies do not fall under those states' respective pre-existing statutes governing money-transmission activities. Neither memorandum takes a position on whether virtual currency is a financial product or service, or whether virtual currency business activity should be regulated. Similarly, Chino alleges that California has twice tried (and failed) "to use the legislative process to pass a bill regulating virtual currency, " that "New Hampshire House of Representatives passed a bill which seeks to exempt virtual currency users from having to register as money service businesses," and that the Texas legislature proposed a constitutional amendment protecting the rights of those who own and use virtual currencies. *Id.* But the legislative efforts of other states have no bearing on whether DFS acted within its statutory authority when it promulgated the Regulation, and thus lend no support to Chino's claims.

new financial product or service with the potential to benefit consumers, while also exposing them to serious harm, as the Mt. Gox fiasco demonstrated.[7] 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 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.

B. Application of the *Boreali* factors compels the conclusion that DFS did not violate 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 explained that the confluence of four circumstances led it to conclude that the challenged administrative rules violated the separation-of-powers doctrine: (1) the agency carved out exceptions that reflected the weighing of stated goals with competing social concerns, (2) the agency did not merely fill in the gaps of broad legislation, but enacted what amounted to a detailed code on an entirely clean slate with no legislative guidance, (3) the agency acted in an area in which the Legislature had tried and failed to reach agreement in the face of public debate and vigorous lobbying, and (4) the agency had no special expertise or technical competence in the area it purported to regulate. *Boreali*, 71 N.Y.2d at 12–14. These "factors are not mandatory, need not be weighed evenly, and are essentially guidelines for conducting an analysis of an

[7] As referenced in DFS's moving papers (DFS's 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.

agency's exercise of power." *Greater N.Y. Taxi Assoc. v. Taxi & Limo. Comm'n*, 25 N.Y.3d 600, 610 (2015). None of the *Boreali* factors supports Chino's challenge. *See* DFS's Moving Br. 18–21.

As addressed more fully in its moving papers, *id.*, DFS made no "difficult choices between public policy ends" in promulgating the Regulation. *Greater N.Y. Taxi Assoc.*, 25 N.Y. at 610; *see also 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*, "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).

In sum, application of the *Boreali* factors compels the conclusion that DFS did not violate the separation-of-powers doctrine in promulgating the Regulation. DFS's Regulation is faithful to the guiding principles the Legislature established in the Financial Services Law. Accordingly, this Court should reject Chino's separation-of-powers challenge to the Regulation and declare that DFS acted within its statutory authority in promulgating 23 NYCRR Part 200.

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

As explained in its cross-motion to dismiss, Chino's claim that the Regulation is arbitrary and capricious is meritless. *See* DFS's Moving Br. 21–26. The Regulation is reasonable, rationally based, and carefully crafted in accordance with DFS's legislatively mandated purpose of ensuring the safety and soundness of the financial products and services offered to New Yorkers. Lacking any legal basis for his claims, Chino opposes DFS's cross-motion papers by simply repeating the same arguments he made in his petition. But for the same reasons provided in DFS's cross-motion to dismiss, these arguments are devoid of merit, and should be rejected. *See* DFS's Moving Br. 21–26.

Chino maintains that the scope of the Regulation is irrationally broad, *see* Opp'n Br. 23–27, but in making this argument, he blatantly misrepresents the Regulation's reach. Chino claims, 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.* at 25; *see also* Am. Pet'n

¶¶ 45–46. Chino goes so far as to suggest that the Regulation covers the basic exchange of *all* information over the internet. *Id.* at 24–25; Am. Pet'n ¶ 43. This is 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). These terms—"medium of exchange" and "form of digitally stored value"—are commonly used to describe financial services and products.[8] 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 a similar vein, 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 Regulation's definitions of virtual currency and covered business activity tailor its application 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

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[8] *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").

exchange or as a means of storing value. *See, e.g.*, 23 NYCRR 200.2(p), (q). As the text of these provisions show, the Regulation is reasonably crafted to ensure consistency with DFS's legislatively mandated purpose. *See* DFS's Moving Br. 21–26.

Chino also challenges the Regulation's recordkeeping requirements, anti-money-laundering requirements, and capital requirements. *See* Opp'n Br. 27–35; *see also* Am. Pet'n ¶¶ 50–56, 111–21. But each of these requirements was properly crafted with a rational basis.

The record-keeping requirements are not "onerous" or "irrationally untailored." Opp'n Br. 27–28. Comparable 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 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.

Nor is there anything arbitrary and capricious about the Regulation's anti-money-laundering requirements. Chino claims that the Regulation requires licensees "to file Suspicious Activity Reports ("SAR") even if they would not be required to do so under federal law." Opp'n Br. 29–30. According to Chino, this "requirement imposes an unreasonable burden on 'virtual currency' firms who would not otherwise be subject to federal SAR provisions." *Id.* at 29. But as explained in DFS's moving papers, the Regulation 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. Although there is substantial overlap between the virtual currency business activity subject to the Regulation and FinCEN's registration requirements, DFS recognized that, in some cases, entities could potentially be subject to the Regulation but not required to register with FinCEN. The challenged reporting requirement simply ensures that those entities are required to file the same types of SARs that FinCEN requires. This provision is neither arbitrary nor capricious because any entity involved in the global transmission of funds—whether denominated in dollars or virtual currency—risks facilitating illegal transactions.

Chino also takes issue with the Regulation's minimum capital requirements, arguing that they "unreasonably prevent[] startups and small businesses from participating in 'virtual currency business activity,'" and are improperly imposed on all licensees. Opp'n Br. 30. But there is nothing arbitrary or capricious about these requirements. Financial services companies regulated by DFS are typically required to meet minimum standards to obtain a license. *See, e.g.*, 23 NYRCRR §§ 401(b)(1), (3) (licensed lenders must maintain liquid assets of $50,000 and a line of credit of at least $100,000); 400.1 (c)(6)(iv), (v) (check cashers must have a $100,000 line of credit and $10,000 in cash at each location); 406.13 (money transmitters must maintain a surety bond of at least $500,000). These are commonly applied, basic consumer protection requirements.

Chino argues that the Regulation imposes a "blanket," "one-size-fits-all" capital requirement on licensees that fails to take into account a licensee's size or the nature of its business activities. Opp'n Br. 30–32. Elsewhere in his papers, Chino characterizes these same capital requirements as improperly "vague" and "open-ended." *Id.* Neither of these self-contradicting descriptions of the Regulation's minimum capital requirements is accurate. The Regulation does not impose a uniform, "one-size-fits-all" capital requirement. To the contrary, the Regulation adopts a flexible approach, 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). Nor does the Regulation impose capital requirements that are "vague" and "open-ended." 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.

Chino argues that the Regulation imposes a minimum capital requirement on his business that is "disproportionate to risks associated with the activities Chino is conducting" because Chino LTD "is processing small purchases made with bitcoins in small retail stores." Opp'n Br. 34. But this argument is based on nothing but speculation. Chino failed to provide DFS with enough information to ascertain whether his business needed a license to operate under the Regulation—let alone enough information to assess the amount and form of capital that would be needed to ensure his Chino LTD's financial integrity. Chino simply assumes that *if* he had properly applied for a license, he would have eventually been required to maintain a minimum capital requirement that was "disproportionate" to the risks he was taking. This entire line of reasoning is premised on a chain of hypothetical events that never occurred, and has no basis in the text of the Regulation or in the facts and circumstances giving rise to this litigation.

Moreover, in his attempts to portray the Regulation as arbitrary and capricious, *see* Opp'n

Br. 30–32, Chino (once again) overlooks DFS's authority under Section 200.4(c) to issue conditional licenses to entities that do not meet the full requirements of the Regulation. *See* DFS's Moving Br. 25–26. 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.

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.

As detailed in DFS's cross-motion papers, Chino's argument that the Regulation is pre-empted by federal law relies on a complete misreading of the Dodd Frank Act. *See* DFS's Moving Br. 26–29. Dodd-Frank 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).

In his opposition, Chino argues that implied preemption exists in this case because Dodd Frank's definition of "'financial service or product' is sufficiently comprehensive to reasonably infer that Congress left no room for supplementary state regulation." Opp'n Br. 35. 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, *see, e.g.*, *N.Y. SMSA LTD P'Ship v. Town of Clarkstown*, 612 F.3d 97, 104 (2d Cir. 2010)—and nothing in the provisions of Dodd-Frank evinces a Congressional intent to preempt state consumer protection laws. *See* DFS's Moving Br. 27–29.

Chino nevertheless claims that the Consumer Financial Protection Board (CFPB) "has exclusive authority" under Dodd Frank "to determine if a financial product or service falls into its regulating authority." Opp'n Br. 36. But as the CFPB itself has acknowledged, Dodd Frank "did not supplant the states' historic role in protecting consumers in the financial marketplace," and Congress "expressly preserved states' authority to enact and enforce laws that provide consumers greater protection." 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) .

For these reasons, as well as those outlined in DFS's cross-motion papers, Chino's federal-preemption claim is meritless, and should be dismissed.

V. The Regulation's disclosure requirements do not violate First Amendment rights.

Chino argues that the Regulation violates the First Amendment by requiring licensees to disclose certain information to their customers. *See* Am. Pet'n ¶ 14; Opp'n Br. 37–42. As demonstrated in DFS's cross-motion papers, Chino's First-Amendment claim is baseless. DFS's Moving Br. 29–30. Under well-settled precedent, 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). Here, every disclosure required under the Regulation is factual, accurate, and objectively verifiable. And since 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 v. Office of Disciplinary Counsel*, 471 U.S. 626, 651 (1985); *Nat'l Elec. Mfrs. Ass'n v. Sorrell*, 272 F.3d 104, 113–14 (2d Cir. 2001).

In his opposition, Chino disputes the applicable standard of review governing his First-Amendment claim, arguing that "many of the Regulation's sections fall under the" intermediate scrutiny level of review established in "*Central Hundson Gas & Electric Corp.* test instead of the *Zauderer* test," which is akin to rational-basis review. Opp'n Br. 38.

As support, Chino cites the United States Supreme Court's recent decision in *Expressions Hair Design v. Schneiderman*, __ U.S. __, 137 S.Ct. 1144 (2017). *Id.* 37–38. Chino's reliance on *Expressions Hair Design* is perplexing, however, as it is wholly irrelevant to Chino's First-Amendment claim. Chino argues that the Regulation violates the First Amendment by compelling licensees to make certain disclosures. Yet *Expressions Hair Design* has nothing to do with compelled disclosures. It merely holds that the First Amendment is implicated by a New York statute that prohibits merchants from imposing a surcharge on credit card users. *See* 137 S.Ct. 1144. Here, there is no dispute that the First Amendment is implicated by the challenged disclosures. The issue instead is whether those disclosures withstand First Amendment scrutiny. And because *Expressions Hair Designs* does not reach this issue, it is inapplicable here.

Chino asserts that the *Expressions Hair Designs* Court "concluded that the statute failed the test for constitutional commercial speech under *Central Hudson Gas*." Opp'n Br. 37. This is false. The Supreme Court expressly declined to reach the question of whether the challenged statute violates the First Amendment, instead "remand[ing] for the Court of Appeals to analyze [the statute] as a speech regulation." 137 S.Ct. 1144, at *5. When analyzed under the standard for regulations requiring the disclosure of commercial speech, Chino's challenge to the Regulation fails.

A. ***Zauderer*** sets the standard for regulations requiring the disclosure of commercial speech.

Zauderer sets the standard for regulations requiring the disclosure of commercial speech. *See, e.g.*, 471 U.S. at 651. Under *Zauderer*, 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). This deferential standard is similar to rational basis review. *See, e.g.*, *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 250 (2010) (citing *Zauderer*, 471 U.S. at 651); *Safelite Group, Inc. v. Jepsen*, 764 F.3d 258, 262 (2d Cir. 2014); *CTIA - The Wireless Assoc. v. City of Berkeley*, 139 F.Supp.3d 1048 (N.D. Cal. Sept. 21, 2015) (collecting cases), *aff'd* 2017 WL 141650, (9th Cir. Apr. 21, 2017).

Zauderer's deferential standard aligns with the purposes animating the First Amendment's commercial speech generally—"the value *to consumers* of the information such speech provides." *Zauderer*, 471 U.S. at 651 (emphasis added); *see also Va. Pharmacy Bd. v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 765 (1976); *Cent. Hudson*, 447 U.S. at 563

("The First Amendment's concern for commercial speech is based on [its] informational function"). Commercial speech holds a "subordinate position ... in the scale of First Amendment values." *Clear Channel Outdoor, Inc. v. City of New York*, 594 F.3d 94, 104 (2d Cir. 2010) (citations and internal quotation marks omitted). It is protected not because of any liberty or autonomy interest of the speaker, but because "the free flow of commercial information" promotes "intelligent and well informed" "private economic decisions." *Va. State Bd. of Pharmacy*, 425 U.S. at 764–65. In short, commercial speech is a listener-focused, rather than a speaker-focused, protection.

This reason for protecting listeners' interests in information explains the difference between the lenient scrutiny afforded to mandatory disclosures by *Zauderer* and the more exacting scrutiny of *Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557 (1980). *Central Hudson* prescribes a more exacting scrutiny for restricting or silencing commercial speech—allowing for regulation, but only where the government has a sufficiently strong reason to quell the information. *Zauderer,* by contrast, mandates only that a factual disclosure—which by its nature gives the consumer more information rather than less—must bear a "reasonable relationship" to an important state interest. 471 U.S. at 651; *see also Milavetz,* 559 U.S. at 249. *Zauderer's* lenient standard reflects the principle that a commercial speaker's "constitutionally protected interest in *not* providing any particular factual information in his advertising is minimal." 471 U.S. at 651; *see also 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.").

B. The Regulation easily meets *Zauderer's* reasonableness standard because the challenged disclosures are factual and accurate.

Under *Zauderer's* reasonableness standard, the Regulation's disclosure requirements are constitutional. The disclosures are "factual" and "reasonably related" to the substantial state interest of informing New Yorkers about the transactional risks of virtual currencies and the terms and conditions of the licensee's business products and services. Chino has not demonstrated how a simple requirement to disclose such information could possibly be deemed burdensome. Nor has he even tried to show that the disclosures "chill" his protected speech. And as shown below, every challenged disclosure is factual, accurate, and objectively verifiable.

"The nature of Virtual Currency may lead to an increased risk of fraud or cyber attack."

This statement is factual and obviously true. While virtual currencies represent a new financial product or service with the potential to benefit consumers, they also expose consumers to an increased risk of serious harm, as the Mt. Gox incident demonstrated.

Chino argues that this disclosure "is blatantly false" because "[u]sing virtual currencies puts [people] at no greater risk of fraud or cyber-attack than using a credit card or online shopping." Am. Pet'n ¶ 134. But Chino mischaracterizes what the disclosure actually says. The disclosure provides that the nature of virtual currency *may* lead to an increased risk of fraud or cyber attack for those who use it—*not* that virtual currency is more or less susceptible to fraud or cyber attacks than other mediums of exchange. Chino implies that DFS must demonstrate that the use of Bitcoin is more dangerous than other forms of payment to survive First Amendment scrutiny, but the First Amendment plainly does not require the State to establish the accuracy of statements it does not compel others to make.

"There is no assurance that a Person who accepts a Virtual Currency as payment today will continue to do so in the future."

There is no dispute that a business or individual who accepts a virtual currency as payment today may not do so in the future. Indeed, the same is true for any medium of exchange. Chino argues that "[t]his compelled disclosure is speculative because using Bitcoin does not trigger a business continuity risk higher or lower than using other forms of payment." Am. Pet'n 136. But this misses the point.

Nothing in this disclosure draws a comparison between the "business continuity risk" of virtual currencies and other forms of payment. To the contrary, it simply states that people who accept a virtual currency as a form of payment today may decline to do so tomorrow—a fact that Chino readily admits. *See Id.* ¶ 33 ("[B]ecause Bitcoin is not issued by a government, no entity is required to accept it as payment.").

Even so, Chino maintains that the "disclosure is both unjustified and unduly burdensome because [he] contracted with each bodega customer to provide Bitcoin processing services for each transaction, which is no more or less riskier [sic] than any other service used by [his] customers …." *Id.* ¶ 136. Yet the disclosure is objectively accurate and one sentence long. To suggest that it is unjustified or unduly burdensome is baseless. And as noted above, the disclosure does not compare the risks of conducting transactions in virtual currencies versus other mediums of exchange. It merely addresses the use of virtual currencies as a method of payment using incontrovertible language.

"The volatility and unpredictability of the price of virtual currency relative to fiat currency may result in significant loss over a short period of time."

There is no dispute that virtual currencies are susceptible to dramatic fluctuations in price. In fact, Chino himself repeatedly recognizes this fact in his petition. Am. Pet'n ¶¶ 27 ("the value of Bitcoin is highly volatile and dependent on supply and demand."), 32 ("Bitcoin value fluctuates much more than that of the typical government-backed fiat currency." (quoting *United States v. Petix*, No. 15-CR-227A, 2016 WL 7017919, at *5 (W.D.N.Y. Dec. 1, 2016))).

Chino nevertheless claims this disclosure is irrelevant, unduly burdensome, and unjustified because he "contracted with each bodega customer to eliminate the exchange rate risk from the bodega customer." Am. Pet'n ¶ 137. But this argument fails for two reasons. First, the mandated disclosure is factual, accurate, and one sentence long, so Chino's claim it is unduly burdensome and unjustified is far-fetched. Second, Chino overlooks the fact that these required disclosures are not exhaustive. So to the extent Chino disputes the relevance of this disclosure in the context of his business operations, nothing in the Regulation prevents him from providing his customers with information beyond what is required under the mandated disclosures. *See CTIA-The Wireless Assoc. v. City of Berkeley*, 2017 WL 1416507, at *11 (9th Cir. Apr. 21, 2017) (in rejecting First Amendment challenge, observing that "[i]f the retailer is concerned … that the term 'RF radiation' is inflammatory and misleading, the retailer may add to the compelled disclosure any further statement it sees fit to add."); *Conn. Bar Ass'n v. United States*, 620 F.3d 81, 98 (2d Cir. 2010) (rejecting argument that a "statute compels inaccurate or misleading disclosures" because, among other reasons, nothing in the statute precluded the plaintiffs from providing an individual with more information "to ensure accurately informed choice").

Licensees must disclose the relevant terms and conditions associated with their products, services, and activities, and any transactions made for, on behalf of, or with their customers.

Chino also claims it is unconstitutional to require him to make specific disclosures about:

- The customer's liability for an unauthorized Bitcoin transaction;
- The customer's right to stop a pre-authorized Bitcoin transaction;
- The type and nature of a Bitcoin transaction; and
- The ability to undo a Bitcoin transaction.

See Am. Pet'n ¶¶ 136–142 (citing 23 NYCRR § 200.19(b)(1)–(2), (c)(3)–(4)). Chino argues these disclosures are invalid for two reasons. First, Chino posits that the disclosures relating to a customer's liability for unauthorized Bitcoin transactions and the type and nature of a Bitcoin transaction are overly broad and unduly burdensome "because [he] would be unable to identify specifically a given customer liability when the bodega customer uses Bitcoin as compared to using other forms of payment," and "cannot guarantee more than what the bodega provides to its current customer under existing New York law." Am. Pet'n ¶¶ 139, 141. Put differently, Chino argues these disclosure requirements are unconstitutional because he—as a licensee—would have no knowledge of or control over the policies and procedures that his customers—as merchants—would impose on their customers. But Chino misconstrues the reach of these requirements, which cover what a licensee must disclose to its customers—*not* what a licensee's customer must disclose to *its* customers.

Second, Chino argues that the disclosures concerning a customer's right to undo a Bitcoin transaction and to stop a pre-authorized Bitcoin transaction are irrelevant and overly broad because they do not apply to the products and services being offered by his businesses. *Id.* ¶¶ 137, 139. But this argument rests on fundamental misunderstanding of what the disclosures actually require. These particular disclosures are not blanket requirements. In fact, licensees only have to make these disclosures *when they apply* to their products, services, or activities. *See* 23 NYCRR 200.19 (providing that "each Licensee shall disclose … all relevant terms and conditions with its products, services, and activities … including at a minimum, the following, *as applicable*" (emphasis added)). So to the extent the disclosures are inapplicable to the products and services being offered by a licensee, the Regulation imposes no burden on the licensee to make them.

Finally, Chino suggests that the very flexibility afforded by these disclosures renders the Regulation impermissibly vague because they "hamper[] his ability to market Bitcoin processing services." Am. Pet'n ¶ 139. This argument is meritless. The provisions provide explicit notice of the disclosures required, and, to the extent they afford flexibility, nothing in the Regulation prevents a licensee from providing its customers with *more* information than is contained in the mandated disclosures. *See CTIA-The Wireless Assoc.*, 2017 WL 1416507, at *11; *Conn. Bar Ass'n*, 620 F.3d at 98. In light of the fact that the challenged disclosures do not purport to be exhaustive, Chino's argument that they hamper the ability of his businesses to advertise their services is baseless.[9]

CONCLUSION

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.

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[9] Chino also argues that the Regulation requires him "to make a specific disclosure about fraud prevention," and that this "compelled disclosure" is irrelevant, overbroad, and "would trigger enormous administrative" costs. Am. Pet'n ¶ 143. The challenged provision (23 NYCRR § 200.19(g)) requires licensees to establish and maintain a written anti-fraud policy. It does not compel licensees to disclose anything. Thus, Chino's argument—which essentially challenges a "compelled disclosure" that does not exist on the grounds that it is invalid under a constitutional provision that does not apply—is devoid of merit.

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Respectfully submitted,

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