SUPREME COURT OF THE STATE OF NEW YORK
COUNTRY OF NEW YORK

| | |
|---|---|
| THEO CHINO and CHINO LTD,<br><br>Plaintiffs-Petitioners,<br><br>-against-<br><br>THE NEW YORK DEPARTMENT OF FINANCIAL SERVICES and ANTHONY J. ALBANESE, in his official capacity as Superintendent of the New York Department of Financial Services and MARIA T. VULLO, in her official capacity as the Superintendent of the New York Department of Financial Services,<br><br>Defendants-Respondents. | Index No. 101880/2015<br>Hon. Victoria St. George<br><br>ORAL ARGUMENT REQUESTED |

**REPLY MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS-PETITIONERS' CROSS-MOTION FOR LIMITED DISCOVERY AND FOR HOLDING DEFENDANTS-RESPONDENTS' CROSS-MOTION TO DISMISS IN ABEYANCE**

PIERRE CIRIC
*Attorney for Plaintiffs-Petitioners*
17A Stuyvesant Oval
New York, NY 10009
Phone: (212) 260-6090
Fax: (212) 529-3647

## TABLE OF CONTENTS

**Page**

## TABLE OF AUTHORITIES

### CASES



### STATE STATUTES



### STATE RULES

## PRELIMINARY STATEMENT

On August 2, 2017, pursuant to Section 408 of the New York Civil Practice Law and Rules ("CPLR"), Plaintiffs-Petitioners Theo Chino and Chino LTD (collectively "Plaintiffs-Petitioners") submitted a Cross-Motion for Limited Discovery, hereinafter cited to as "Pls.'s Disc. Mem." On September 6, 2017, Defendants-Respondents The New York Department of Financial Services ("DFS") and Maria T. Vullo, in her official capacity as the Superintendent of DFS (collectively "Defendants-Respondents") filed an opposition to the Cross-Motion for Limited Discovery.

This Cross-Motion for Limited Discovery is necessary because Defendants-Respondents' Cross-Motion to Dismiss filed on June 23, 2017 cannot be resolved without making further factual determination as to whether Bitcoin is a "financial product or service" and whether the "Virtual Currency" regulation promulgated by the New York State Department of Financial Services at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (cited as "NYCRR") (the "Regulation") was designed and issued by Defendants-Respondents in an arbitrary and capricious fashion.

## PROCEDURAL HISTORY

On October 16, 2015, Theo Chino filed the above-entitled action. Defendants-Respondents filed a Cross-Motion to Dismiss on April 22, 2016. Theo Chino filed his response to the Cross-Motion to Dismiss on October 31, 2016, hereinafter cited to as "Pl.'s Mem." On January 20, 2017, Defendants-Respondents filed a reply in further support of their Cross-Motion to Dismiss, hereinafter cited to as "Defs.' First Reply Mem." On May 24, Plaintiffs-Petitioners filed an Amended Verified Complaint and Article 78 Petition. On June 23, 2017, Defendants-Respondents filed a Cross-Motion to Dismiss the Amended Verified Complaint and Article 78

Petition. Plaintiffs-Petitioners filed their response to the current Cross-Motion to dismiss on July 14, 2017, hereinafter cited to as "Pls.' Second Mem."

## ARGUMENT

### A. Plaintiffs-Petitioners should be granted leave to conduct the requested limited discovery.

According to Defendants-Respondents' response to Plaintiffs-Petitioners' Cross-Motion for Limited Discovery, they should be entitled to live in a legal world where virtually no one has standing to challenge a regulation involving new technology or new markets, and where no plaintiff ever has grounds to seek limited discovery.

Although discovery is not always granted in Article 78 proceedings, this Court should grant a request for leave to conduct discovery where the disclosure "sought [is] likely to be material and necessary to the prosecution or defense of the proceedings." *Stapleton Studios v. City of New York*, 7 A.D.3d 273, 275 (1st Dep't 2004). Discovery is appropriate in Article 78 proceedings when the moving party demonstrates "ample need" for the requested discovery. *N.Y. Univ. v. Farkas*, 121 Misc. 2d 643, 646, 468 N.Y.S.2d 808, 811 (N.Y. Civ. Ct. 1983). Furthermore, courts have granted motions for disclosure because the operative facts necessary for a judicial determination are within the respondent's knowledge and because the petitioner needed the information to mount a proper defense during those proceedings. *Smilow v. Ulrich*, 11 Misc. 3d 179, 183, 806 N.Y.S.2d 392, 396 (N.Y. Civ. Ct. 2005). In fact, "a presumption favors granting disclosure when the opposing party has exclusive possession of material facts." *Id.* This threshold issue has largely been met here because Defendants-Respondents' motion to dismiss cannot be decided without making a factual determination as to Bitcoin's economic nature, and without clarifying the circumstances surrounding the preparation of the Regulation,

given the direct conflicts between the evidence brought up during DFS's hearings on the Regulation held on January 28 and January 29, 2014 and the Regulation's promulgation.

**i. Plaintiffs-Petitioners have largely satisfied any standing test.**

Contrary to Defendants-Respondents' arguments, Plaintiffs-Petitioners have largely established standing and New York's two-prong test for evaluating a petitioner's standing to challenge a governmental agency's actions. *See e.g. N.Y. State Ass'n of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211 (2004); *Dairylea Coop., Inc. v. Walkley*, 38 N.Y.2d 6, 9 (1975). Under this test, a petitioner need only show: (1) that there is "injury in fact," meaning that petitioner will actually be harmed by the administrative action; and (2) that the interest the petitioner asserts falls "within the zone of interests or concerns sought to be promoted or protected by the statutory provision under which the agency has acted." *Novello*, 2 N.Y.3d at 211; *Dairylea*, 38 N.Y.2d at 9. The purpose of a standing analysis is to determine whether a party should have access to the court system. *See Soc'y of Plastics Indus. v. Cty. of Suffolk*, 77 N.Y.2d 761, 769, 794 (1991). Its purpose is not to assess the merits of a party's claim. *See id.*

Courts have relaxed their standing analyses in light of the increasingly pervasive role that administrative agencies play in impacting the daily lives of citizens. *See Dairylea*, 38 N.Y.2d at 10; *Sun-Brite Car Wash, Inc. v. Bd. of Zoning & Appeals*, 69 N.Y.2d 406, 413 (1987). "A fundamental tenant of our system of remedies is that when a government agency seeks to act in a manner adversely affecting a party, judicial review of that action may be had." *Dairylea*, 38 N.Y.2d at 10. Plaintiffs-Petitioners have largely satisfied their burden under this test.

Defendants-Respondents' claim that Plaintiffs-Petitioners have not established standing is mind-boggling. Plaintiffs-Petitioners have sufficiently alleged that they have been irreparably harmed by the Regulation because it effectively forced Theo Chino to close his Bitcoin

processing business, Chino LTD. Theo Chino implemented a Bitcoin-processing business before the Regulation was promulgated. His business certainly falls within "virtual currency business activity" under the Regulation, so he would have been required to obtain a license to continue offering Bitcoin processing services. Theo Chino, on behalf of Chino LTD, submitted an application for a license to engage in "virtual currency business activity," as defined in 23 NYCRR § 200.2(q), but DFS returned Chino LTD's application without further processing after DFS performed an initial review. Plaintiffs-Petitioners immediately stopped offering Bitcoin-processing services when DFS did not approve Chino LTD's application. Chino LTD suffered losses due to not being able to offer Bitcoin processing services. The Regulation caused particularized and immediate economic harm to Plaintiffs-Petitioners.

As previously established in Plaintiffs-Petitioners Amended Verified Complaint and Article 78 Petition and in their response to Defendants-Respondents' Cross-Motion to Dismiss, the interests that the Plaintiffs-Petitioners assert falls "within the zone of interests or concerns sought to be promoted or protected by the statutory provision under which the agency has acted." *Novello*, 2 N.Y.3d at 211; *Dairylea*, 38 N.Y.2d at 9. Here, it has been widely established that a genuine controversy between adversarial parties who have an interest in the outcome exists. Plaintiffs-Petitioners, by taking steps to comply with the Regulation and by filing suit promptly upon realizing that the compliance costs of the Regulation would be exorbitant, recognized that the business they engaged in would effectively be proscribed by the Regulation. Before the Regulation was enacted, Plaintiffs-Petitioners engaged in Bitcoin-processing services in New York. As a result of the Regulation, Plaintiffs-Petitioners are now effectively barred from continuing their business without obtaining a license. Therefore, an actual controversy regarding the legal basis of the Regulation exists, and Plaintiffs-Petitioners have a genuine stake

in the outcome. Therefore, Plaintiffs-Petitioners have standing to seek declaratory relief.

In fact, Defendants-Respondents have not submitted any documentary evidence to contradict the facts submitted in Plaintiffs-Petitioners' complaint supporting standing. Therefore, the court must accept the facts alleged as to standing, as true, and accord Plaintiffs-Petitioners the benefit of every possible favorable inference. Under this standard, Plaintiffs-Petitioners have set forth viable grounds to challenge the Regulation. Therefore, the Court should not dismiss this matter on standing grounds since Plaintiffs-Petitioners have alleged sufficient facts to establish standing.

According to Defendants-Respondents' misconstrued approach, if Plaintiffs-Petitioners do not have standing, then no Plaintiff ever would. If the Court were to side with Defendants-Respondents' position, anyone challenging a regulation involving new technology or involving brand new markets would never have their day in court, because plaintiffs would not have time to establish their business to the extent Defendants-Respondents argues is required before the limited window to challenge new regulation expired. In essence, such a position would allow a regulator to completely escape judicial scrutiny just because a plaintiff does not behave like a firmly established ongoing business in an industry which requires someone to take the first risk in a new technology. The Court cannot allow such a result where current or future plaintiffs would never be able to ever challenge new regulations or regulations involving new technologies, which would allow the government to exercise unchecked and unlimited power to implement arbitrary regulations.

**ii. Plaintiffs-Petitioners have set forth viable grounds to challenge the Regulation.**

Defendants-Respondents cannot have it both ways -- have the Court believe that Plaintiffs-Petitioners discovery motion should be thrown out just because of the absence of any

merit to Plaintiffs-Petitioners' case and argue Plaintiffs-Petitioners' petition should be dismissed on an unresolved threshold issue. Either Defendants-Respondents should not have filed their Cross-Motion to Dismiss or limited discovery is necessary on the threshold issue as to the economic nature of Bitcoin. Although not a regulatory challenge, the court in *Florida v. Espinoza*, No. F14-2923 (Fla. 11th Cir. Ct. July 22, 2016), was faced with the same situation. When deciding a motion to dismiss criminal charges, the *Espinoza* court agreed to allow limited discovery on whether Bitcoin is money through an expert witness prior to deciding whether the criminal charges could be dismissed. This Court is facing a similar situation.

Under the first *Farkas* factor, Plaintiffs-Petitioners have established a cause of action. Plaintiffs-Petitioners have established that DFS acted beyond the scope of its authority because DFS is only authorized to regulate "financial products and services." As laid out more extensively in Plaintiffs-Petitioners' Amended Verified Complaint and Article 78 Petition and in their responses to Defendants-Respondents' Cross-Motion to Dismiss, if Bitcoin is not a "financial product or service," then Defendants-Respondents' recent Cross-Motion to Dismiss must be denied and relief must be granted to Plaintiffs-Petitioners without further review. Even if the Court decides Bitcoin is a "financial product or service," this limited discovery will assist the court in evaluating whether the Regulation was promulgated in an arbitrary and capricious fashion.

Plaintiffs-Petitioners have established that the Regulation is arbitrary and capricious because: (1) the scope of the Regulation is irrationally broad, (2) the Regulation's recordkeeping requirements are without sound basis in reason, (3) the Regulation irrationally treats "virtual currency" transmitters differently than fiat currency transmitters, and (4) there is no rational basis underlying a one-size-fits all Regulation that unreasonably prevents startups and small

businesses from participating in "virtual currency business activity," and imposes capital requirements on all licensees. And finally, the Regulation's disclosure requirements violate Theo Chino's First Amendment rights.

**iii. Plaintiffs-Petitioners have demonstrated that the discovery sought is material and necessary.**

New York courts have determined that "material and necessary" should be "interpreted liberally to require disclosure, upon request, of any facts bearing on the controversy which will assist preparation for trial by sharpening the issues and reducing delay and prolixity. The test is one of usefulness and reason." *Smilow,* 11 Misc. 3d at 190 (citing *Allen v. Crowell-Collier Publ. Co.*, 21 N.Y.2d 403, 406 (1968)). The term necessary has even been given a broad interpretation to mean "needful and not indispensable. *Allen*, 21 N.Y.2d at 407 (citing *Taylor* v. *L. C. Smith & Corona Typewriters, Inc.*,179 Misc. 290, 292 (Sup. Ct., Herkimer County 1942). All of the information sought is material and necessary.

All of the previous memoranda of law exchanged by both parties are an obvious indication that that the Court cannot address the issues raised in Plaintiffs-Petitioners' Amended Verified Complaint and Article 78 Petition or Defendants-Respondents' Cross-Motion to Dismiss without issuing an order for limited discovery regarding Bitcoin's economic nature. It is obvious by now that there are fundamental factual disputes between the parties as to the economic nature of Bitcoin. It is highly disputed between the parties whether Bitcoin should be considered a "financial product or service" as defined in FSL § 104(a)(2). The exact economic nature of Bitcoin, for which considerable legal uncertainty already exists due to divergent determinations made by federal agencies and other courts, requires clarification for the Court to determine whether Defendants-Respondents have the proper regulatory authority under FSL § 104(a)(2) to regulate Bitcoin. Furthermore, there are significant factual issues as to the basis that

allowed Defendants-Respondents to reach the decision that it had jurisdiction over Bitcoin. During the hearings on the proposed regulation, Mark T. Williams's written testimony establishes that Bitcoin should be treated as a commodity, and not as a currency, yet Defendants-Respondents did not address Mark T. William's position. Pls.' Second Mem. 23. Additionally, supposedly, the Defendants-Respondents conducted "extensive research and analysis" when they proposed the Regulation, yet the research and analysis has never been produced so it is unclear how Defendants-Respondents came to the conclusion that Bitcoin could be regulated by them. Pls.' Disc. Mem. 16.

a. **Plaintiffs-Petitioners have demonstrated that the subpoena of Paul Krugman is material and necessary.**

Defendants-Respondents' theory that Paul Krugman's testimony is not material and necessary is misplaced. Krugman should be subpoenaed as an expert witness to appear before the Court because there are fundamental differences between the parties as to the economic nature of Bitcoin. Krugman is a prominent figure in the field of economics and has written extensively on Bitcoin. Defendants-Respondents cited to Krugman as an expert source supporting their proposition that Bitcoin is money. Defs.' First Reply Mem. 16. Therefore, they must also believe he is a prominent expert in this area. Krugman can testify to the economic nature of Bitcoin and whether or not it qualifies as "financial product or service" based on its economic characteristics, which is a critical fact related to the cause of action. Therefore, the testimony of Krugman is material and necessary.

b. **Plaintiffs-Petitioners have demonstrated that the email production is material and necessary.**

Similarly, Defendants-Respondents are wrong in claiming that the email production is not material and necessary. This production will assist the Court in determining how Defendants-Respondents reached their regulatory conclusion that they had the power to regulate Bitcoin.

Defendants-Respondents did not address the issue of Bitcoin's economic nature during their hearings on the Regulation so they must have obtained additional information internally or must have discussed the economic nature of Bitcoin to conclude Bitcoin would fit in the statutory definition of a "financial product or service." Additionally, under the Regulatory Impact Statement, Defendants-Respondents state they conducted extensive research and analysis to support their decision to regulate Bitcoin, however, the research and analysis has never been produced despite several requests under New York's Freedom of Information Law, N.Y. Pub. Off. Law sec. 84 et seq. Bitcoin's economic nature must have been discussed either before or after the hearings through email correspondence internally or between the Defendants-Respondents and/or with outside parties. These correspondences will show how Defendants-Respondents reached the conclusion that they had the power to regulate Bitcoin and how it falls under the definition of a "financial product or service" since the only testimony introduced in the written record during the hearings support the notion that Defendants-Respondents did not have the statutory authority to regulate Bitcoin. Therefore, the email production is material and necessary.

c. **Plaintiffs-Petitioners have demonstrated that the deposition of Benjamin Lawsky is material and necessary.**

Finally, Defendants-Respondents are wrong in stating that the deposition of Benjamin Lawsky is not material and necessary because it will aid in determining facts related to the cause of action. Lawsky's deposition will clarify and resolve the factual dispute over whether Bitcoin is a "financial product or service," and how Defendants-Respondents determined that Bitcoin was within the statutory authority conferred by FSL § 104(a)(2), which impacts whether Defendants-Respondents had the authority to regulate Bitcoin, and whether Defendants-Respondents acted in an arbitrary and capricious fashion when they designed the Regulation. His

deposition will clarify whether the Regulation was issued in an arbitrary and capricious fashion and how he arrived at the conclusion that Bitcoin is a "financial product or service." Lawsky has exclusive personal knowledge not shared with the Plaintiffs-Petitioners about the basis of Defendants-Respondents' determination of the economic attributes and nature of Bitcoin. As Superintendent of Financial Services when the Regulation was promulgated, he was central in making the determination that Bitcoin is a "financial product or service" and must have knowledge of the "extensive research and analysis" that was relied on. His testimony is material and necessary for the determination of the economic nature of Bitcoin and basis that allowed Defendants-Respondents to reach the decision that they had jurisdiction over Bitcoin.

**iv. Plaintiffs-Petitioners have not "embarked on a 'fishing expedition.'"**

When the discovery requested bears directly on disputed critical facts and is carefully tailored in scope to address those facts, such request does not constitute a "fishing expedition." *Smilow,* 11 Misc. 3d at 186. When the discovery is carefully tailored in scope, a court does not consider the request to be a fishing expedition. *See Classon Vil. LP v. Lewis*, 2009 N.Y. Misc. LEXIS 2614, at *5-6 (Sup. Ct., Kings Cnty. Aug. 12, 2009). Even when the court believes it is a fishing expedition, the court can limit the discovery in scope in order to still allow the discovery. *See Cambridge Dev. v. McCarthy*, 2003 NY Slip Op 51433[U], *26 (Civ. Ct. Bronx Cnty. 2003).

Despite Defendants-Respondents' claim, this is a not a fishing expedition. There is a need to determine information directly related to the claim, the requested disclosure is carefully tailored, and it is likely to clarify the disputed facts. The information sought could resolve the factual dispute over whether Bitcoin is a "financial product or service," and how Defendants-Respondents determined that Bitcoin was within the statutory authority conferred by FSL § 104(a)(2), which impacts whether Defendants-Respondents had the authority to regulate Bitcoin,

and whether Defendants-Respondents acted in an arbitrary and capricious fashion when they designed the Regulation.

Furthermore, if the court should find that the request is not narrowly tailored enough to clarify the dispute facts, it can limit the disclosure instead of outright denying it. *See Cambridge Dev.,* 2003 NY Slip Op 51433[U], *26.

**B. Legitimate grounds exist for holding Defendants-Respondents' Cross-Motion to Dismiss in abeyance pending the resolution of Plaintiffs-Petitioners' Cross-Motion for Limited Discovery**

Here again, Defendants-Respondents appear to describe a misconstrued legal theory. Contrary to Defendants-Respondents' arguments that abeyance is strictly granted in personal jurisdiction challenges, courts have granted abeyance in a variety of situations where discovery under CPLR 408 is conducted. *See*, e.g., *Genger v. The Arie Genger 1995 Life Ins. Trust*, 2009 NY Slip Op 30902[U] (Sup. Ct. N.Y. Cnty. 2009) (abeyance was granted to allow discovery to resolve threshold issues of fact); *Matter of Social Serv. Empls. Union, Local 371, AFSCME, AFL-CIO v. City of NY*, 2010 NY Slip Op 33326[U] (Sup. Ct. N.Y. Cnty. 2010) (abeyance was granted to allow discovery to resolve factual issues of whether layoffs were made in bad faith).

In fact, in another hybrid Article 78 proceeding, limited discovery and abeyance were granted when the petitioners were seeking information from persons involved in the decision-making process for amendments to the New York Health Code. In that case, limited discovery was applied to the decision to grant or deny applications involving transgender individuals seeking amendment to their birth certificates to change the designated "sex". *Prinzivalli v. Farley*, 2012 NY Slip Op 32011[U] (Sup. Ct. N.Y. Cnty. 2012).

As addressed above, threshold factual issues exist in this matter. The Defendants-Respondents' motion to dismiss cannot be decided without the requested limited discovery.

There are factual disputes over whether Bitcoin is a "financial product or service," whether Defendants-Respondents had the authority to regulate Bitcoin, and whether Defendants-Respondents acted in an arbitrary and capricious fashion when they designed the Regulation. All of these issues could be resolved through the requested limited discovery.

Finally, contrary to Defendants-Respondents' argument that Lawsky's testimony is impermissible because of his prior job as Superintendent of DFS, such a status as prior agency head does not confer immunity from testimony. In fact, courts have allowed such testimony to be introduced in limited discovery proceedings. Our request is similar to *Prinzivalli*, where some of the information Plaintiffs-Petitioners were seeking was related to the decision-making process of the Defendants-Respondents' former employees. *Prinzivalli,* 2012 NY Slip Op 32011[U] at *11-12.

Accordingly, Plaintiffs-Petitioners' request to hold Defendants-Respondents Cross-Motion to Dismiss in abeyance pending the completion of limited discovery, which is largely justified by the factual issues before the Court and the supporting case law. Therefore, Plaintiffs-Petitioners' Motion for Limited Discovery should be granted and their request to hold Defendants-Respondents' Cross-Motion to Dismiss in abeyance pending the completion of discovery should be granted.

## CONCLUSION

For the reasons set forth in the above and in Plaintiffs-Petitioners' Cross-Motion for Limited Discovery, Plaintiffs-Petitioners respectfully requests that the Court grants its Cross-Motion for Limited Discovery and for Holding Defendants-Respondents' Cross-Motion to Dismiss in Abeyance in its entirety.

Dated: September 18, 2017
New York, New York

Pierre Ciric
THE CIRIC LAW FIRM, PLLC
17A Stuyvesant Oval
New York, NY 10009
Email: pciric@ciriclawfirm.com
Tel: (212) 260-6090
Fax: (212) 529-3647
*Attorney for Plaintiffs-Petitioners*