New York County Clerk's Index No. 101880/15

New York Supreme Court

APPELLATE DIVISION — FIRST DEPARTMENT

Case No. 2018-998

THEO CHINO and CHINO LTD,

Plaintiffs-Petitioners-Appellants,

against

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,

Defendants-Respondents-Respondents.

REPLY AFFIRMATION TO MOTION FOR LEAVE TO APPEAL TO THE NEW YORK STATE COURT OF APPEALS

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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION: FIRST DEPARTMENT

THEO CHINO and CHINO LTD, Plaintiffs-Petitioners-Appellants, -against- THE NEW YORK DEPARTMENT OF FINANCIAL SERVICES, et al., Defendants-Respondents-Respondents.	**AFFIRMATION IN FURTHER SUPPORT OF MOTION FOR LEAVE TO APPEAL** Index No. 101880/15

I, Pierre Ciric, being duly sworn, deposes and says:

1. I am the attorney for the Plaintiffs-Petitioners-Appellants ("Appellants") and produce this affirmation in support of the motion for leave to appeal to the Court of Appeals from the decision of affirmance of this Court.

I. BACKGROUND

2. On October 31, 2008, a paper titled "Bitcoin: A Peer-to-Peer Electronic Cash System" was posted online by Satoshi Nakamoto, who released the software in January 2009. Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (2008), https://bitcoin.org/bitcoin.pdf. Bitcoin and other cryptocurrencies did not become well known until more recently, when the Bitcoin price reached its all-time high value of $19,783.06 on December 17, 2017.

3. In November 2013, Theo Chino formed a Bitcoin processing business, Chino LTD. Record on Appeal (R.) 44. Between December 2014 and May 2015, Appellants entered into formal contracts with seven convenience stores in New York City offering Bitcoin-processing services to allow customers to pay for things like a gallon of milk and other everyday

items with Bitcoin. R. 45. Appellants spent a substantial amount of money on research and development, bought computers, rented equipment, and developed custom operating systems to run the business. By the time the Regulation was promulgated, Appellants had already invested close to $100,000 into the business. R. 46.

4. The New York Department of Financial Services ("DFS"), of its own initiative and without the New York State Legislature's mandate or instructions, rushed a regulation to quash the growth of Bitcoin and other cryptocurrencies in New York. The "virtual currency" regulation promulgated by DFS at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (cited as "NYCRR") (the "Regulation") took effect on June 24, 2015.

5. Appellants immediately filed for a license under the Regulation in August 2015. Realizing, through the application process, the incredible burdens of this Regulation, and while their application was pending, Appellants brought this action in the Supreme Court, New York County, challenging the Regulation.

II. ARGUMENT

A. THE STANDARD OF REVIEW FOR GRANTING LEAVE TO APPEAL TO THE COURT OF APPEALS

6. The Court of Appeals should hear issues that are "novel or of public importance, present a conflict with prior decisions of this Court, or involve a conflict among the departments of the Appellate Division." 22 NYCRR 500.22(b)(4); *see also In re Shannon B.*, 70 NY2d 458, 462 [1987] (granting leave based on an "important issue" involving police authority to detain a truant student); *Town of Smithtown v Moore*, 11 NY2d 238, 241 [1962] (granting leave based on a question of "state-wide interest and application" involving the application of state equalization rate for a town under the real property tax law); *Neidle v Prudential Ins. Co. of Am.*, 299 NY 54,

56 [1949] (granting leave based on "far-reaching consequences" involving an insurance company payout for military personnel).

i. ISSUE OF PUBLIC IMPORTANCE

7. This case, involving the first attempt by any state to regulate cryptocurrency businesses, has been the subject of intense attention from the industry, and other states have been watching its evolution to determine whether it should adopt statutes similar to the Regulation. On March 25, 2019, the Uniform Law Commission (ULC) withdrew its model act titled the Uniform Regulation of Virtual-Currencies Businesses Act (URVCBA), after backlash from the industry and other states vehemently opposition to ULC's approach. NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, UNIFORM REGULATION OF VIRTUAL-CURRENCIES BUSINESSES ACT (2017), https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=ef45a10b-ac62-ad3d-2f42-588d7eac3e40&forceDialog=0. The URVCBA was finalized in 2017 essentially using the Regulation as a template, requiring an entity to apply for a license and be approved after a thorough review of its policies, procedures, and background. To date, no state has adopted URVCBA's approach, based on the New York framework. Clearly, the regulatory approach to cryptocurrencies is the subject of an important debate, not only in New York, but also throughout the country and many states have clearly signaled their opposition to New York's framework. Caitlin Long, *Seismic News About State Virtual Currency Laws: ULC Urges States to Withdraw Model Act* (Mar. 25, 2019), https://www.forbes.com/sites/caitlinlong/2019/03/25/seismic-news-about-state-virtual-currency-laws-ulc-urges-states-to-withdraw-model-act/#2cc2c3625fda.

8. Even in New York, the virtual currency industry has been the subject of continued interest. New York Assembly Bill A08783 was signed into law on December 21, 2018. 2018 N.Y. ALS 456, 2018 N.Y. Laws 456, 2018 N.Y. Ch. 456, 2017 N.Y. AB 8783. This law established a "digital currency task force" to provide the governor and the legislature with information on the potential effects of the widespread implementation of digital currencies on financial markets in the state. It marks the Legislature's first foray into investigating the uses of virtual currencies in the state. The enactment of New York Assembly Bill A08783 not only indicates that DFS lacks the broad power to regulate virtual currencies as it claimed since 2015, but also shows that the development of the blockchain technology and cryptocurrency-based businesses is becoming a major topic of public debate within the general population and with the New York Legislature.

9. Before the enactment of Assembly Bill A08783, the New York Senate held a roundtable discussion on cryptocurrency in February 2018 to gain insight into cryptocurrency, its marketplace, and the impact of the Regulation. Every participant to the roundtable called by the Senate expressed significant opposition to the Regulation. Stan Higgins, *New York Lawmakers Open to Revisiting the BitLicense*, COINDESK (Feb. 23, 2018), https://www.coindesk.com/bitcoin-crypto-ny-lawmaker-pledges-make-bitlicense-something-works.

10. The level of public importance around the regulatory approaches to blockchain technology and cryptocurrency businesses is similarly illustrated by multiple hearings held in the U.S. Congress over the past two years. *See e.g.* Exploring the Cryptocurrency and Blockchain Ecosystem Before the S. Comm. on Banking, Housing, and Urban Affairs, 115th Cong. (2017). Further, multiple bills have been introduced involving cryptocurrency: (1) To amend the Internal

Revenue Code of 1986 to exclude from gross income de minimis gains from certain sales or exchanges of virtual currency, and for other purposes, H.R. 3708, 115th Cong. (2017); (2) Section 12 of Combating Money Laundering, Terrorist Financing and Counterfeiting Act of 2017, S. 1241, 115th Cong. (2017); and (3) Section 1409 of SECURE Act of 2017, S. 2192, 115th Cong. (2017). The regulatory approaches around this critical technology represent an important issue of great public concern, not only in New York but also across the country.

11. This technology is an area of further public interest especially because the technology industry is promoted by New York State as an increasingly important component of its economy. *See The New York City Tech Ecosystem*, HR&A ADVISORS (Mar. 2014), https://www.hraadvisors.com/wp-content/uploads/2014/03/NYC_Tech_Ecosystem_032614_WEB.pdf; Brian Forde, *How to Prevent New York from Becoming the Bitcoin Backwater of the U.S.*, MEDIUM (May 12, 2015), https://medium.com/mit-media-lab-digital-currency-initiative/how-to-prevent-new-york-from-becoming-the-bitcoin-backwater-of-the-u-s-931505a54560. Startup entities are essential to technological innovation and growth, and in 2015, New York City was recognized as being one of the top startup ecosystems in the world. Richard Florida, *The World's Leading Startup Cities*, CITYLAB (July 27, 2015), https://www.citylab.com/life/2015/07/the-worlds-leading-startup-cities/399623/; Emily Edwards, *Financial Technology Startups Are Bringing Underbanked Into the Economy*, MEDIUM (May 16. 2016), https://medium.com/village-capital/financial-technology-startups-are-bringing-the-underbanked-into-the-economy-24978561b9ea. However, the Regulation has transformed this once welcoming New York landscape into an inhospitable environment for digital currency-related startups. Daniel Roberts, *Behind the "Exodus" of*

Bitcoin Startups from New York, FORTUNE (Aug. 14, 2015), http://fortune.com/2015/08/14/bitcoin-startups-leave-new-york-bitlicense/.

12. Permitting the Court of Appeals to review Appellants' access to the courts will allow the Court to weigh in on an issue of great public importance to New York's tech startups and will avoid a significant detrimental precedent for both the administrative exhaustion rules and the injury analysis as applied to startup entities.

13. As this technology continues to grow more popular and more startup entities attempt to create new business opportunities in this field, the application of the Regulation, as well as issues of standing and exhaustion, to this dynamic industry will be an ever-growing area of public interest. Furthermore, it is without question that other states will be watching New York's approach as they continue to consider their own regulatory approach to this technology.

ii. NOVEL ISSUE

14. Although standing is not a new area of law, the question of how the current laws apply to new technology has become of critical importance and is a new issue in today's economy. As the dissenting judge points out in *People v Diaz*, 33 NY3d 92 [2019], "As technology has developed, old assumptions and guideposts are ever challenged, providing doctrinal puzzles we must solve .... The old rules of thumb are deteriorating as useful metrics …." *Id.* at 114-15 (Wilson, J., dissenting). Prior assumptions about standing and its application to businesses involving cryptocurrency are a prime example of the Court of Appeals needing to solve a puzzle where old assumptions and guideposts are challenged.

15. Moreover, Appellants' business was fully operational at the time of the Regulation's promulgation, and at the time the initial action was filed, on October 16, 2015. The standing analysis must be applied as of the date of the complaint's filing, October 16, 2015, and

not at the time Appellants stopped their business activities. *See*, e.g., *Wells Fargo Bank, N.A. v Jones*, 139 AD3d 520, 523 [1st Dept 2016] [standing determined "at the time the action was commenced"].

16. The record demonstrated that the standing test was satisfied at the time of the filing of the action, and that Appellants have made significant investments to launch their business plans. The record also establishes that Appellants were not able to reap the benefits of their investments because of the Regulation. Appellants filed their action on October 16, 2015, BEFORE they decided to stop their business activities on January 4, 2016. Therefore, Appellants must have an opportunity to seek the Court of Appeals' views as to how the standing test applies in this type of new technology environment.

17. The Court of Appeals should be provided with an opportunity to determine when a startup business that has taken affirmative steps and expended a non-trivial amount of money can satisfy the standing analysis. Declining to provide an opportunity for the Court of Appeals to review the standing analysis as to startup environments would have profound implications and a severe impact on new technology sectors, where market participants effectively would be denied the opportunity to challenge new regulations.

iii. CONFLICT AMONG DEPARTMENTS

18. Leave to appeal should also be granted due to a conflict among the Appellate Division Departments regarding application of the exceptions to the exhaustion rule. Both the Second and Third Departments follow the Court of Appeals' pronouncement that exhaustion is not required where "an agency's action is challenged as either unconstitutional or wholly beyond its grant of power." *Watergate II Apartments v Buffalo Sewer Auth*., 46 NY2d 52, 57 [1978]. *See Kindlon v County of Rensselaer*, 158 AD2d 178, 180 [3d Dept 1990]; *Hamptons Hosp. & Med.*

Ctr., Inc. v Moore, 74 AD2d 30, 33-34 [2d Dept 1980], *mod*, 52 NY2d 88 [1981].

19. Yet the First Department has split with its sister departments in applying this rule, requiring petitioners to go back through an administrative appeals process even where the petition specifically alleges ultra vires acts. *See Community School Bd. Nine v Crew*, 224 AD2d 8, 13 [1st Dept 1996].

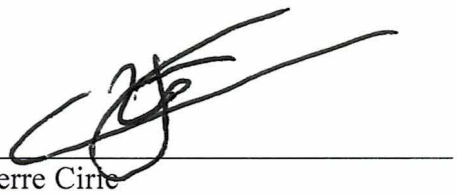
20. Further demonstrating the First Department's differential interpretation of the exhaustion requirement, in the instant action, this Court affirmed the Supreme Court's patently incorrect addition of an irreparable harm requirement to the ultra vires exception. *See Chino v New York Dept. of Fin. Services*, 58 Misc 3d 1203(A) [Sup Ct 2017] ["Moreover, even if an ultra vires or unconstitutional action were at issue, petitioner has not shown that DFS has caused it irreparable harm."].[1]

21. Under the First Department's interpretation of the exhaustion exception, all entities wishing to conduct virtual currency businesses (both Appellants, who applied for a license, and those that left New York rather than applying for a license) would be forced to endure a burdensome and expensive process just for the chance to challenge the ultra vires nature of the Regulation. Daniel Roberts, *Behind the "Exodus" of Bitcoin Startups from New York*, FORTUNE (Aug. 14, 2015) (noting that the true costs of applying for a license under the Regulation are between $50,000 and $100,000). The prohibitive cost of challenging the ultra vires nature of a regulation would in effect overturn *Watergate II* as applied to startups.

22. For these reasons, leave to appeal should be granted to resolve this conflict.

[1] Contrary to the State's assertion (Aff. in Opp'n to Mot. for Leave to Appeal n. 6), Appellants argued below that DFS acted beyond its statutory authority in issuing the challenged Regulation, and thus has not waived his argument that the ultra vires exception applies to their petition. R. 394; R. 398.

Dated: June 28, 2019
New York, New York



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