To Be Argued By:
Pierre Ciric

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New York Supreme Court

APPELLATE DIVISION — FIRST DEPARTMENT

Cal. 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.

BRIEF FOR PLAINTIFFS-PETITIONERS-APPELLANTS

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PRELIMINARY STATEMENT

Today, the public at large has become familiar with the cryptocurrency concept and easily recognizes the name Bitcoin because it has been splashed across so many news stories over the past couple of years. However, in 2013, when Bitcoin was only known to a small community of technology developers, Theo Chino ("Theo") sought to change this and decided to create a business focused on increasing Bitcoin's adoption. In November 2013, to grow the nascent cryptocurrency industry and trigger a broader adoption in the State of New York, Theo started a small business, Chino LTD, to allow more people to specifically use Bitcoin in everyday life. (A44, §72; A45, ¶78).

Theo's concept was simple. He wanted New York City bodegas, small grocery, and convenience stores to be able to accept Bitcoin as a form of payment for everyday items. (A45, ¶78). Chino LTD processed Bitcoins on behalf of convenience stores by processing Bitcoin payments and converting Bitcoins to U.S. dollars on their behalf. (A256, ¶11). Theo also formed another company to set up ongoing business relationships with the convenience stores by selling calling cards to support the Bitcoin payment system. (A4, ¶77-78). Theo's desire to encourage small businesses to use Bitcoin was another iteration of the entrepreneur's efforts to ensure this new technology would reach more consumers, in the same vein as PayPal did two decades ago.

By May 2015, Theo entered into seven contracts with convenience stores in New York and had set up the infrastructure to achieve his goal. (A45, ¶78). However, Theo would soon discover that the New York Department of Financial Services ("DFS"), of its own initiative and without the New York State Legislature's mandate or instructions, was rushing a regulation to quash the growth of cryptocurrency in New York. (A146, ¶58). DFS's "virtual currency" regulation promulgated by DFS at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations ("NYCRR") (the Regulation") took effect June 24, 2015. (A138, ¶28).

As a responsible business person, Theo chose to immediately file for a license under the Regulation, which he submitted on August 7, 2015. (A46-47, ¶88). Realizing, through the application process, the incredible burdens of this Regulation, as well as DFS's overreach to create law outside of the New York State Legislature's mandate, and while his application was pending, Theo filed a *pro se* Verified Complaint and Petition under New York Civil Practice Law and Rules ("CPLR") Article 78. (A47, ¶91). Theo's action addressed the constitutionality of the Regulation, within the New York statute of limitations timeframe, by challenging DFS's statutory authority to promulgate this Regulation, as well as, challenging the significant costs it imposed on his fledgling businesses.

Theo's DFS application was returned without further processing on January 4, 2016. (A47, ¶93). Theo stopped his Bitcoin processing business on the same date to avoid running afoul of the Regulation. (A47-48, ¶94). On October 31, 2016, Theo retained counsel to assist him in his litigation. (A15). After stipulating to convert to e-filing, on May 26, 2017, an Amended Verified Complaint and Article 78 Petition were filed for Theo and Chino LTD (collectively, "Appellants"). (A15). Appellants argued that the Regulation: (i) violates the separation of powers doctrine; (ii) is arbitrary and capricious; (iii) is preempted by federal law; and (iv) contains disclosure requirements that violate commercial speech rights under the First Amendment to the United States Constitution and New York Constitution. DFS, Anthony J. Albanese, in his official capacity as Superintendent of DFS, and Maria T. Vullo, in her official capacity as Superintendent of DFS (collectively, "Respondents") filed a Cross-Motion to Dismiss the action on August 15, 2017. (A129). Appellants filed a Cross-Motion for Limited Discovery under CPLR §408. (A266). All motions were argued before the Supreme Court on October 10, 2017. The Supreme Court issued a Decision, Order and Judgment on December 21, 2017 ("Decision"), holding Appellants lacked standing to bring their Amended Verified Complaint and Article 78 Petition against Respondents and denied the Cross-Motion for Limited Discovery as moot. (A6-24). Appellants timely filed a Notice of Appeal from the Decision on February 4, 2018. (A4).

Theo and Chino LTD submit this brief in support of their appeal from the Decision of the Supreme Court of the State of New York, New York County, by Honorable Carmen Victoria St. George ("Supreme Court"), dismissing Appellants' challenge because: (i) Appellants were not required to exhaust administrative remedies before filing their action against Respondents; (ii) Appellants have established an injury in fact; and (iii) Appellants' limited discovery request is material and necessary to sharpen the facts and issues in this action.

QUESTIONS PRESENTED

1. Whether Appellants have standing to bring their Amended Verified Complaint and Article 78 Petition against Respondents challenging Respondents' Regulation?

The Supreme Court answered "No," and argued that Appellants did not have standing to sue Respondents because they had not exhausted administrative remedies. While the Supreme Court noted there is an exception to the exhaustion of administrative remedies requirement, it misapprehended the exception and held that it did not apply to Appellants, and that Appellants did not suffer any injury due to the Regulation.

2. Whether Appellants' Cross-Motion for Limited Discovery was warranted?

The Supreme Court answered "No," and denied the motion as moot.

STATEMENT OF FACTS

Five years ago, in November 2013, Theo incorporated Chino LTD in Delaware, and in February 2014, Theo submitted an application to conduct business in New York. (A44, ¶72-73). To get Chino LTD up and running, Theo purchased computer equipment and hardware, hired an employee, and together, Theo and Chino LTD began distributing surveys to small business owners to identify potential clients. (A44 ¶74-75; A46, ¶85-86). Theo also formed a company to allow convenience stores to accept Bitcoins as payment for calling cards in order to set up long-lasting business relationships with them. (A45, ¶77). By May 2015, formal contracts were entered into with seven small grocery and convenience businesses in New York City. (A45, ¶78).

As Theo worked to grow his businesses, and bring the Bitcoin technology to consumers' everyday life, DFS, of its own accord and without the New York State Legislature's explicit direction, developed the Regulation to control cryptocurrency use in New York. (A146, ¶58). On July 23, 2014, DFS published its first proposed virtual currency regulation in the New York State Register, and a revised version of the proposed regulation followed on February 25, 2015 (A138, ¶26-27). DFS crafted the proposed regulation without a mandate from the elected members of the

New York State Legislature. (A146, ¶58). A revised version of the proposed regulation followed on February 25, 2015. (A138, ¶27).

DFS's proposed regulation received comments from individuals and industry leaders, such as the Bitcoin Foundation, asking for more information and pointing out issues with the proposed regulation. (A288, ¶5). After "limited additional revisions," the final version of the Regulation was published and took effect on June 24, 2015. (A138, ¶28).

Under the final Regulation, anyone engaging in "virtual currency business activity" must obtain a license from DFS's Superintendent. 23 NYCRR §200.3(a). The Regulation, in 23 NYCRR §200.2(q), defines a virtual currency business activity as:

> any of the following activities involving New York or a New York Resident:
> (1) receiving Virtual Currency for Transmission or Transmitting Virtual Currency, except where the transaction is undertaken for non-financial purposes and does not involve the transfer of more than a nominal amount of Virtual Currency;
> (2) storing, holding, or maintaining custody or control of Virtual Currency on behalf of others;
> (3) buying and selling Virtual Currency as a customer business;
> (4) performing Exchange Services as a customer business; or
> (5) controlling, administering, or issuing a Virtual Currency.

The cost to apply for, and maintain, a license is significant, beginning with a non-refundable $5,000 application fee. 23 NYCRR §200.5. (A33, ¶39-40, A52). After obtaining a license, licensees must comply with ongoing additional requirements, such as maintaining capital, and a surety bond or trust account "in an amount and form as the superintendent determines is sufficient." 23 NYCRR §200.8(a) and §200.9(a). A licensee also must have someone "qualified" to handle monitoring compliance with the Regulation, day-to-day compliance with DFS's anti-money laundering program, and a "Chief Information Security Officer responsible for overseeing and implementing… cyber security program and enforcing its cyber security policy." 23 NYCRR §200.7, §200.15(c)(3), and §200.16(c) and (g). The Regulation goes further, and dictate how a licensee is to interact with customers before any relationship is established or a transaction begun, and providing written materials "in the English language and in any other predominant language spoken by the customers of the licensee…." 23 NYCRR §200.19(b) and (c).

Appellants extensively described all the provisions that represented a significant burden on small businesses, derived from the Regulation, in their papers below. (A191-A240). In fact, the Regulation's promulgation triggered a real exodus of Bitcoin startups from New York State, and forced them to severe ties with New York citizens. (A41, ¶60). Theo's activities clearly fell under the

Regulation because of its residency requirement and because all business was conducted in New York with New York residents. Furthermore, Chino LTD's processing of Bitcoin payments required Chino LTD to store, hold, and control Bitcoin on behalf of the convenience stores until the cash conversion was made for the store owners. (A46, ¶83-84; A255-256, ¶11). Knowing full well that his business was subject to the Regulation, Theo submitted an application to DFS, on behalf of Chino LTD, on August 7, 2015. (A46-47, ¶88).

Regardless of whether he expected to receive a license, Theo concluded that DFS had overstepped its authority when it promulgated the Regulation because DFS did not receive authority, from the New York Legislature, to regulate Bitcoin activities. (A26, ¶26; A48-49, ¶95-102). In order to challenge the promulgation of a regulation, an action must be filed within four months of the date the regulation became final, so Theo, individually, commenced a *pro se* action against Respondents in the New York County Supreme Court on October 16, 2015, 8 days before the four-month deadline. (A26, ¶6; A256, ¶12).

While waiting for a license, Theo continued operating his business and began to see cryptocurrency use occurring under his contracts. (A47, ¶92). His enterprise would be short-lived as Theo received a letter on January 4, 2016, from DFS stating it was unable to evaluate Appellants' current or intended business activity from the licensing application. (A47, ¶93). Theo immediately stopped

offering Bitcoin-processing services when he did not receive a license. (A47-48, ¶94).

PROCEEDINGS BELOW

After filing his *pro* se action against Respondents in October 2015, and receiving the DFS letter on January 4, 2016, Theo hired outside counsel to assist him. The Ciric Law Firm, PLLC appeared on behalf of Appellants and submitted an Amended Verified Complaint and Article 78 Petition, dated May 25, 2017, challenging the DFS Regulation on the following grounds: (i) that it violates the separation of powers doctrine; (ii) that it is arbitrary and capricious; (iii) that it is preempted by federal law; and (iv) that it contains disclosure requirements that violate commercial speech rights under the First Amendment to the United States Constitution and New York Constitution. (A25-128).

Respondents filed a Cross-Motion to Dismiss dated June 23, 2017, asserting, *inter alia*, that Appellants lacked standing because Appellants failed to allege he suffered an injury in fact. (A129-190). Appellants filed a reply to the Cross-Motion to Dismiss on July 14, 2017, and a Cross-Motion for Limited Discovery, pursuant to CPLR §408, dated August 2, 2017, seeking limited discovery on the issues of the economic nature of Bitcoin and whether the Regulation were issued in an arbitrary and capricious fashion. (A266-314). Appellants requested Respondents'

Cross-Motion to Dismiss be held in abeyance until after their Motion for Limited Discovery could be decided. (A266-314).

After briefing and arguments were filed, the Supreme Court rendered the Decision, dated December 21, 2017, granting Respondents' Cross-Motion to Dismiss and denying Appellants' Cross-Motion for Limited Discovery. (A6-24). The Supreme Court granted Respondents' Cross-Motion to Dismiss on the grounds that Appellants did not exhaust available administrative remedies, and failed to demonstrate an injury in fact. (A6-24). The Supreme Court denied Appellants' Cross-Motion for Limited Discovery on the grounds that it was moot and unwarranted. (A6-24).

After entry of the decision, order and judgment in the Supreme Court, Appellants filed a timely Notice of Appeal on February 4, 2018. (A4).

ARGUMENT

Scope and Standard of Review

The powers of the Appellate Division are co-extensive with those of the court below in this case. Thus, "the Appellate Division has the same power to review the record and decide the questions of fact as the trial court." *Kilgus v. Bd. of Estimate of City of New York*, 308 N.Y. 620, 627 (1955). The Appellate Division reviews all questions of law *de novo*, including questions of statutory interpretation. *Toys R Us v. Silva*, 89 N.Y.2d 411,419 (1996). Furthermore,

because it is "vested with the same power and discretion" as the lower court, it may "substitute its own discretion even in the absence of abuse." *Brady v. Ottaway Newspapers*, Inc., 63 N.Y.2d 1031, 1032 (1984); *Kover v. Kover*, 29 N.Y.2d 408, 415 n.2 (1972).

When considering a motion to dismiss, a court must "accept the facts as alleged in the complaint as true, accord to plaintiffs the benefit of every possible favorable inference, and determine only whether the facts alleged fit within any cognizable legal theory*." Leon v. Martinez*, 84 N.Y.2d 83, 87-88 (1994).

It follows that this Court owes the lower court no deference on the issues of whether the Appellants have standing to challenge the promulgation of the Regulation, and whether Appellants' Cross-Motion for Limited Discovery was warranted. Further, this Court should extend every favorable inference to Appellants and determine if the facts as alleged fit any cognizable legal theory.

POINT I. Theo and Chino LTD Have Standing to Bring Their Action Against Respondents

a. Theo and Chino LTD Were Not Required to Exhaust Administrative Remedies Before Filing Their Action Against Respondents

As noted by this Court, "[i]t is well established that a person aggrieved by the action of a government agency is generally required to exhaust the available administrative remedies before seeking judicial review of the agency's action." *Bankers Trust Corp. v. New York City*, 750 N.Y.S.2d 29, 34 (1st Dep't 2002)

(citations omitted). *See also Young Men's Christion Assoc. v. Rochester Pure Waters Dist.*, 37 N.Y.2d 371, 375 (1975). The Court of Appeals noted "[t]he exhaustion rule, however, is not an inflexible one." *Watergate II Apts. v. Buffalo Sewer Auth.*, 46 N.Y.2d 52, 57 (1978).

The Court of Appeals outlined four examples when the exhaustion rule did not apply to a petitioner: (1) when an agency's action is challenged as unconstitutional; or (2) when an agency's action is wholly beyond its grant of power; or (3) when resorting to an administrative remedy would be futile; or (4) when pursuit of an administrative remedy would cause irreparable injury. *Watergate II Apts.*, 46 N.Y.2d at 57. The Appellate Division, First Department ("First Dept") has previously determined exhaustion of administrative remedies is "not required where only an issue of law is involved, or where the issue involved is 'purely the construction of the relevant statutory and regulatory framework.'" *Coleman v. Daines*, 913 N.Y.S.2d 83, 89 (1st Dep't 2010) (quoting *Matter of Herberg v. Perales*, 585 N.Y.S.2d 1, 2 (1st Dep't 1992)).

The factual record below, as well as the case law related to Appellants' action to challenge the Regulation, supports Appellants standing under several exceptions to the administrative remedy exhaustion rule.

i. Appellants Are Exempt from the Exhaustion Rule Because DFS Acted Beyond its Legislative Grant of Power

It is well established a delegated agency may only adopt regulations that are consistent with its enabling legislation, and its underlying purposes. *See Greater N.Y. Taxi Assn. v. N.Y.C. Taxi & Limousine Commn.*, 25 N.Y.3d 600, 608 (2015). DFS cites eight sections of the New York Financial Services Law ("FSL"), which Respondents claim authorized adoption of the Regulation. 23 NYCRR §200-Notes. *See also* (A133-134, §7-12). However, the FSL statutes only authorize DFS's Superintendent to promulgate "rules and regulations . . . *involving* financial products and services." FSL §201(a) and §302(a) (emphasis added). As Appellants extensively argued in response to Respondents' Cross-Motion to Dismiss, the definition of financial products and services is certainly not written in a way that includes virtual currency. (A209-210).

Appellants challenged DFS's action in promulgating the Regulation as being "wholly beyond its grant of power". In *Bankers Trust Corp.*, the First Dept concurred with the Supreme Court's legal conclusion that challenges asserting an administrative action as beyond an agency's statutory authority fell within exceptions to the "exhaustion-of-remedies doctrine." *Bankers Trust Corp.*, 750 N.Y.S.2d at 34. (Despite the concurrence, the First Dept concluded the city acted within its statutory authority). Here, Appellants have outlined the relevant statutes and advanced a sound legal argument that Respondents acted beyond their statutory authority, and Respondents admitted they did not have a statute from the

New York State Legislature requiring the promulgation of this Regulation. (A209-218; A146, ¶58). Therefore, Appellants do not have to comply with the exhaustion rule, and have standing to move forward on their claim that Respondents overstepped their legislative grant of power in promulgating the Regulation.

ii. Appellants Are Exempt from the Exhaustion Rule Because the Regulation Is Unconstitutional

Appellants claim the Regulation contains disclosure requirements that violate commercial speech rights under the First Amendment to the United States Constitution and New York Constitution are not subject to the administrative exhaustion rule. (A54-58, ¶129-144).

In *Martinez 2001 v. N.Y.C. Campaign Fin. Bd.*, the First Dept. agreed with the appellants and noted that the exhaustion doctrine was inapplicable to the case. 829 N.Y.S.2d 55, 58 (1st Dep't 2007). "Our review of the cases reveals that this exception is limited to situations where the statute or administrative scheme itself is alleged to be unconstitutional, thus undermining the legality of the entire proceeding." *Id.* at 59 (citations omitted). In the present case, while the Supreme Court cited *Martinez 2001* in its decision for the proposition that there are exceptions to the exhaustion rule, it misapplied the *Martinez 2001* holding to the facts at hand.

From the start, Theo challenged the constitutionality of the Regulation in the action, and explained his desire to challenge the constitutionality of the Regulation in his affidavit dated July 14, 2017, which was a part of the Amended Verified Complaint and Article 78 Petition, dated May 25, 2017. (A254-255, ¶ 24; A54-58, ¶129-144). As in *Martinez 2001*, Appellants are challenging the Regulation's constitutionality, which undermines DFS's regulatory scheme. Therefore, Appellants have standing to bring their action because they are exempt from the exhaustion rule due to their claim the Regulation is unconstitutional.

iii. Appellants Are Exempt from the Exhaustion Rule Because Pursuit of Administrative Remedy Would Be Futile

When a petitioner's challenges cannot be meaningfully addressed in an administrative hearing, resorting to an administrative remedy is futile. *Lehigh Portland Cement Co. v. N.Y.S. Dept. of Envtl. Conservation*, 87 N.Y.2d 136 (1995); *Mulgrew v. Bd. of Educ. of the City Sch. Dist. of the City of NY*, 928 N.Y.S.2d 269, 274 (1st Dep't 2011); *Martin A. v. Gross*, 546 N.Y.S.2d 75, 79 (1st Dep't 1989). Here, Appellants challenged the Regulation because it violates the separation of powers doctrine, is arbitrary and capricious, is preempted by federal law, and contains disclosure requirements that violate commercial speech rights under the First Amendment. (A25-63).

In this instance, Appellants' pursuit of an administrative remedy would be wholly futile. It is highly unlikely the agency that promulgated the Regulation, and decided it had the authority to regulate virtual currency can meaningfully address Appellants' challenges through the application process. The issue is not if DFS would make a final determination as to Appellants' application, but the fact that going through the administrative process would have been futile. *See Watergate II Apts.*, 46 N.Y.2d at 57; *Lehigh Portland Cement Co.*, 87 N.Y.2d at 140-143.

iv. Appellants Are Exempt from the Exhaustion Rule Because Pursuit of Administrative Remedy Would Cause Irreparable Harm

When a petitioner challenges a regulation for being inconsistent with the governing statutes and is, therefore, irrational, arbitrary and capricious, the petitioner is governed by the four-month statute of limitations applicable to CPLR article 78 proceedings. *NY City Health & Hosps. Corp. v. Bane*, 621 N.Y.S.2d 539, 543-544 (1st Dep't 1995). *See also* CPLR §217.

Here, Appellants filed this action challenging the Regulation because it: (i) violates the separation of powers doctrine; (ii) is arbitrary and capricious; (iii) is preempted by federal law; and (iv) contains disclosure requirements that violate commercial speech rights under the First Amendment to the United States Constitution and New York Constitution. (A25-63). Appellants are not challenging DFS's letter stating DFS was unable to evaluate if Chino LTD's business activity

would be considered a virtual currency business that requires licensing under the Regulation. Rather, Appellants are challenging DFS exercising authority beyond its statutory power, and the constitutionality of the Regulation itself, and not DFS's determination as to how the Regulation applies to the Appellants. As such, Appellants had to file an action within four months of the Regulation's final promulgation, which Theo in fact purposefully and scrupulously did. (A26, ¶6).

The final version of the Regulation was published in the New York State Register on June 24, 2015, with an effective date of June 24, 2015. (A138, ¶28). Theo commenced this action in October 16, 2015, within the four-month period for filing an Article 78 proceeding challenging the promulgation of a regulation. (A26, ¶6).

If Appellants had waited for a "final decision" on the application, Appellants would have lost their right to file an Article 78 challenge of the Regulation because the statute of limitations would have run. Appellants submitted an application for a license in August 2015 and did not get an initial response for nearly five months. (A46-47, ¶88; A47, ¶93). Appellants would have lost their right to file an action if they had waited for a determination, and subsequently followed up and exhausted all administrative remedies.

b. Appellants Have Established an Injury in Fact

A two-prong test allows courts to evaluate a petitioner's standing to

challenge a governmental agency's actions. A petitioner need only show: (1) that there is "injury in fact," meaning 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." *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 two-prong test, a petitioner must demonstrate an "actual legal stake in the matter," that the petitioner has "suffered an injury in fact, distinct from that of the general public." *Novello*, 2 N.Y.3d at 211-12; *Transactive Corp. v. N.Y. State Dep't of Soc. Servs.*, 92 N.Y.2d 579, 587 (1998). A petitioner does not have to prove actual and present harm, rather, he needs only demonstrate that "it is reasonably certain that the harm will occur if the challenged action is permitted to continue." *Police Benevolent Assn. of N.Y. State Troopers, Inc. v. Div. of N.Y. State Police*, 29 A.D.3d 68, 70 (3rd Dep't 2006). Moreover, a petitioner is not required to describe injury "with specific quantification." *N.Y. Propane Gas Ass'n v. N.Y. State Dep't of State*, 17 A.D.3d 915, 916 (3rd Dep't 2005).

The purpose of this test is to determine whether a party should have access to the court system, and is not to assess the merits of a petitioner's claim. *Soc'y of Plastics Indus. v. Cty. of Suffolk*, 77 N.Y.2d 761, 769 and 794 (1991).

The Court of Appeals relaxed the standing analysis, in *Dairylea*. The Court of Appeals noted "[t]he increasing pervasiveness of administrative influence on daily life... necessitates a concomitant broadening of the category of persons entitled to judicial determination" and that "[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. *See also Sun-Brite Car Wash, Inc. v. Bd. of Zoning & Appeals*, 69 N.Y.2d 406, 413 (1987) (noting that standing principles "should not be heavy handed." Given the continued increase in governmental regulations in the over 40 years since *Dairylea*, the relaxation of the two-prong standing test seems apropos here.

The Supreme Court misapprehended Appellants' standing under this test. Appellants meet the zone of interests, so the only prong at issue is Appellants' injury in fact. First, Appellants suffered actual economic harm because of the Regulation. When Theo formed his Bitcoin processing business, Chino LTD, Bitcoin-based start-ups required small initiation costs, which, at the time, attracted developers like Theo. 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 in Bitcoin. (A45, ¶78). Theo spent money on research and development, bought computers, rented equipment, and developed custom operating systems to

run the business, and he offered proof of his expenses and investments. (A46, ¶85-86).

Appellants could not reap the benefits of their investment because of the Regulation. After engaging in contracts, the first transaction was processed in January 2016. (A47, ¶92). It is likely more transactions would have taken place considering the surge in popularity of Bitcoin and other cryptocurrencies over the following years. However, Appellants had to stop offering services in January 2016 because they did not have a license and had begun their action against Respondents. (A47-48, ¶94).

Second, it is also reasonably certain harm would continue if the Regulation is permitted to continue. First, the record below shows the challenged Regulation applies to Appellants because, in processing Bitcoin for the retail stores, Appellants have custody of the Bitcoin key transferred by customers to pay for retail items. (A255-256, ¶11). That custody of the Bitcoin key, as well as the exchange services performed on behalf of the retail stores, triggers a number of provisions from the Regulation. 23 NYCRR § 200.2(q)(2)-(q)(4).

Additionally, the amount of resources and money to comply with the Regulation are significant and overwhelming for Appellants' small business. The license application cost is a non-refundable $5,000 fee, with some companies reporting they have spent $50,000-$100,000 to comply with the Regulation. (A33,

¶39-40, A52). *See also* 23 NYCRR § 200.5. Furthermore, the costs of staying in compliance, if granted a license, are significant and excessive for Appellants, between the maintenance of a capital account of unknown amount and form and the requirements for a surety bond or trust account. 23 NYCRR §200.8(a) and §200.9(a). These vague, open-ended requirements unreasonably impede cash-strapped startups and small businesses from being able to engage in "virtual currency business activity."

Additional requirements include the hiring of a compliance officer as well as burdensome reporting obligations as discussed above. *See* Statement of Facts, *supra*. These are a few of the costly requirements under the Regulation. Unless licensees operate a high-volume business with a significant size, these compliance costs are designed to prevent all but large financial institutions[1] from engaging in cryptocurrency in the State of New York.

Appellants have sufficiently demonstrated they suffered an injury in fact through actual harm, and evidence they are reasonably certain harm will continue if the Regulation is upheld. Therefore, the case should not have been dismissed based on the lack of an injury in fact.

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[1] It is interesting to note the Regulation exempts banks, and other entities chartered under the New York Banking Law, from the Regulation. *See* 23 NYCRR §200.3(c)(1)

Therefore, this Court should reverse the Supreme Court's Decision and hold that Appellants have standing to bring their action because it falls within the exemption to the exhaustion rule, and because they have demonstrated an injury-in-fact.

POINT II. Appellants Should Be Granted Limited Discovery Under CPLR §408 Because Discovery is Material and Necessary to Sharpen the Facts and Issues in This Action

Discovery in special proceedings is governed by CPLR §408, is not automatically granted and requires leave of court. Most special proceedings, such as an Article 78 petition, are utilized for rapid determinations under the law, but "[d]iscovery is not inherently 'hostile to the nature of a summary proceeding.'" *N.Y.U. v. Farkas*, 468 N.Y.S.2d 808, 811 (Civ. Ct., New York County 1983) (quoting *42 W. 15th St. Corp. v. Friedman*, 143 N.Y.S.2d 159, 160 (App. Term 1st Dep't1955)).

"[T]he Supreme Court has broad discretion to grant or deny this type of discovery." *In re Matter of Petition of Administrators for the Professions, Inc. v. Vullo, et al.*, N.Y. Index No.: 3068/2017 page 18 (Sup. Ct. Nassau County, 2018) (citing *Matter of Bramble v. N.Y. City Dept. of Edu.*, 4 N.Y.S.3d 238, 240 (2d Dep't, 2015)). When deciding to grant or deny discovery under CPLR §408, a Court "must balance the needs of the party seeking discovery against such opposing interests as expedition and confidentiality." *Town of Pleasant Val. v. N.Y.*

State Bd. of Real Prop. Servs., 685 N.Y.S.2d 74, 79 (2d Dep't 1999) (citation omitted). *See also Matter of Bramble*, 4 N.Y.S.3d 238 at 240 (citing *Grossman v. McMahon*, 699 N.Y.S.2d 582, 584 (3rd Dep't 1999)).

For a petitioner to be granted a request for discovery under CPLR §408, petitioner must demonstrate the requested discovery is material or necessary to the claims at hand. *Matter of City of Glen Cove Industrial Dev. Agency v. Doxey*, 915 N.Y.S.2d 95, 97 (2d Dep't 2010); *Stapleton Studios, LLC v. City of N.Y.*, 776 N.Y.S. 2d 46, 47 (1st Dep't 2004); *Roth v. Pakstis*, 785 N.Y.S.2d 917, 918 (1st Dep't 2004) (citing *Matter of Goldstein v. McGuire*, 443 N.Y.S.2d 730 (1981). The terms "'material and necessary' should be 'interpreted liberally to require disclosure…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.'" *Town of Pleasant Val.*, 685 N.Y.S.2d at 79 (quoting *Allen v. Crowell-Collier Publ. Co.*, 21 N.Y.2d 403, 406 (1968)).

Appellants filed their Cross-Motion for Limited Discovery pursuant to CPLR §408, and requested: (1) Paul Krugman be subpoenaed as an expert witness to address the economic nature of Bitcoin to the Supreme Court; (2) Respondents produce all written documentation, including emails, supporting how they reached their conclusion Bitcoin was a "financial product or service;" and (3) a deposition of Benjamin Lawsky, DFS's Superintendent when the Regulation was promulgated

to clarify and resolve Respondents' contention Bitcoin is a "financial product or service" within the statutory authority conferred by FSL §104(a)(2). (A266-A267). In the Decision, Appellants were denied their Cross-Motion for Limited Discovery as moot because they lacked standing. Then, the Supreme Court went further in the Decision and stated that, even if Appellants had standing, discovery was unwarranted because there was no need to analyze whether DFS had the power to regulate Bitcoin. (A23).

Assuming Appellants have standing, for the reasons provided in Point I above, Appellants' Cross-Motion for Limited Discovery under CPLR §408 is warranted. The discovery requested is material and necessary to Appellants' allegations in their Amended Verified Complaint and Article 78 Petition. Respondents' Cross-Motion to Dismiss cannot be resolved without making further factual determinations as to whether Bitcoin is a "financial product or service" and Respondents' purported authority to regulate Bitcoin under FSL §104(a)(2). (A293-314). Additionally, the same set of facts are key in determining whether Respondents acted in an arbitrary and capricious fashion when designing the Regulation.

Paul Krugman ("Krugman") should be subpoenaed as an expert witness to appear before the Supreme Court because there are fundamental differences between how Appellants and Respondents view the economic nature of Bitcoin.

Krugman is a prominent figure in the field of economics and has written extensively on Bitcoin. 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. (A308-309). Therefore, the testimony of Krugman is material and necessary.

The email production will assist the Supreme Court in determining how Respondents reached their conclusion that they had the power to regulate Bitcoin. Respondents did not address the issue of Bitcoin's economic nature during their hearings on the Regulation, so they must have obtained information internally or discussed the economic nature of Bitcoin to conclude it fit in the FSL statutory definition of a "financial product or service." (A310-A311). These documents and correspondence will show how Respondents reached the conclusion they had the power to regulate Bitcoin under the FSL, and is a central contention to Appellants action. Therefore, the email production is material and necessary.

The deposition of Benjamin Lawsky ("Lawsky") will aid in determining facts related to the action because he was the Superintendent of DFS at the time of the proposed Regulation and when the Regulation was promulgated. He was central in making the determination that Bitcoin is a "financial product or service" and is the most knowledgeable person on this matter. (A312). Lawsky's deposition will clarify and resolve the factual dispute over whether Bitcoin is a "financial

product or service" within the statutory authority conferred onto DFS by FSL §104(a)(2). (A311-313). This is central to Appellants' argument and reason for beginning this action because they disagree with Respondents notion that they had the authority to regulate Bitcoin. Additionally, Lawsky's testimony will elucidate whether Respondents acted in an arbitrary and capricious fashion when designing the Regulation. Lawsky has exclusive, personal knowledge, not available to Appellants, about the basis for Respondents' determination of the economic attributes and nature of Bitcoin. As Superintendent of DFS when the Regulation was promulgated, Lawsky was central in determining Bitcoin is a "financial product or service" and must have knowledge of the research and analysis DFS utilized. (A312). Therefore, his testimony is material and necessary for the determination of the economic nature of Bitcoin that allowed Respondents to reach the decision they could enact this Regulation without the New York State Legislature's enactment of a statute. Therefore, the deposition of Lawsky is material and necessary.

Any delay caused to the Court in the short-term for granting this discovery is outweighed by the facts that this material will allow the Supreme Court to sharpen the issue of Bitcoin's economic nature and the technical aspects involving cryptocurrencies. The discovery requested will shed light on Respondents' decision to assume, without any proper basis, that cryptocurrencies fit the

definition of a financial product, without input from the New York State Legislature, and the decision to fashion this Regulation. In turn, with these facts before the Supreme Court, and clear to all sides, it will allow for the Supreme Court to move forward on the substantive issues, without delay or long-winded arguments, just as case law intended CPLR §408 to function. *See Margolis v. N.Y.C. Transit Auth.*, 555 N.Y.S.2d 711 (1st Dep't 1990); *Goldstein v. McGuire*, 443 N.Y.S.2d 730 (1st Dep't 1981).

Therefore, Appellants' Cross-Motion for Limited Discovery is material and necessary to the prosecution of the action and providing the Supreme Court with a clear view of the facts at hand.

CONCLUSION

For all the reasons detailed herein, the Supreme Court's decision, order and judgment should be reversed both as to the cross-motion to dismiss and cross-motion for limited discovery and remanded to the Supreme Court for further proceedings.

Dated: September 06, 2018
New York, New York

Respectfully submitted,

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PRINTING SPECIFICATIONS STATEMENT

I hereby certify pursuant to 22 NYCRR § 600.10(d)(1)(v) that the foregoing brief was prepared on a computer.

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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 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,

Defendants-Respondents-Respondents.

New York County
Index No. 101880/2015

PRE-ARGUMENT STATEMENT

Plaintiffs-Petitioners-Appellants Theo Chino and Chino Ltd. (collectively "Appellants") submit this Pre-Argument Statement pursuant to section 600.17 of the Rules of the Appellate Division of the Supreme Court of the State of New York, First Judicial Department:

1. Title of Action: The title of the action is as set forth in the caption above.

2. Full Names of the Parties: The full name of the original parties were Theo Chino, Plaintiff-Petitioner, and The New York Department of Financial Services and Anthony J. Albanese, in his official capacity as the acting Superintendent of the New York Department of Financial Services, Defendants-Respondents. Chino Ltd. was added as Plaintiff-Petitioner. Anthony J. Albanese was removed as a Defendant-Respondent and Maria T. Vullo, in her official capacity as the Superintendent of the New York Department of Financial Services, was added as a Defendant-Respondent.

3. Name, Address, and Telephone Number of Attorney for the Appellants:

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4. Name, Address, and Telephone Number of Attorney for the Respondents:

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5. Court From Which Appeal is Taken: Supreme Court of the State of New York, County of New York.

6. Order Appealed From: This is an appeal from the decision, order and judgment of the Supreme Court of the State of New York, County New York, by Honorable Carmen Victoria St. George, dated December 21, 2017, and received by NYSCEF on December 27, 2017. The order and judgment addressed two different motions: (A) a cross-motion to dismiss, and (B) a cross-motion for limited discovery. Notice of entry was filed on January 14, 2018.

7. Nature of the Action: In this Article 78 proceeding, Appellants challenged the "virtual currency" regulation promulgated by the New York Department Financial Services at Part 200 of Chapter 1 of Title 23 of the New York Codes, Rules and Regulations (cited as "NYCRR") (the "Regulation") because it: (i) violates the separation of powers doctrine; (ii) is arbitrary and capricious; (iii) is preempted by federal law; and SEP (iv) contains disclosure requirements that violate commercial speech rights under the First Amendment to the United States Constitution and New York Constitution.

8. Result Reached Below: (A) The lower court granted the Defendants-Respondents cross-motion to dismiss on the grounds that Appellant lacked standing to challenge the Regulation. (B) The lower court denied Appellants cross-motion for limited discovery as moot.

9. Grounds for Reversal: The Order and Judgment appealed from should be reversed on the grounds that Appellants did not lack standing. Appellants have showed (1) that there is "injury in fact," meaning that Appellants will actually be harmed by the administrative action; and (2) that the interest the Appellants 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." If Appellants do not have standing, no business located in New York would have access to the court to challenge this Regulation. If the Order and Judgment as to the motion to dismiss is reversed the Order and Judgment as to discovery should no longer be considered moot.

10. Related Actions: Theo Chino filed a claim in the State of New York Court of Claims on August 13, 2014 alleging the defendant proposed a regulation outside the scope of their authority. The claim was dismissed on March 16, 2015. No appeal was filed.

Dated: February 03, 2018
New York, New York

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