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To be argued by:
ERIC R. HAREN
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Supreme Court of the State of New York
Appellate Division – First Department

In the Matter of the Application of

THEO CHINO AND CHINO LTD,

Plaintiffs-Petitioners-Appellants,

v.

THE NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES, et al.,

Defendants-Respondents-Respondents,

For a Judgment Pursuant to Article 78 of the Civil Practice Law & Rules.

No. 2018-998

BRIEF FOR RESPONDENTS

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PRELIMINARY STATEMENT

Theo Chino and Chino LTD ("petitioners")[1] brought this proceeding to challenge regulations promulgated by the New York State Department of Financial Services ("DFS") to protect New York consumers and financial markets from the known and developing risks of virtual currencies such as Bitcoin. *See* Virtual Currency Regulation, 23 N.Y.C.R.R. §§ 200.01-200.22 (the "Regulation"). Supreme Court, New York County (Carmen Victoria St. George, J.) dismissed the petition due to the absence of any final agency action and petitioners' lack of standing, and further concluded that petitioners' request for discovery was moot. This Court should affirm.

As Supreme Court correctly concluded, there was no final agency action here because DFS never reached a definitive position on whether the Regulation applies to petitioners' businesses. To the contrary, in response to petitioners' patently deficient application for a license under the Regulation, DFS noted only that the application was incomplete,

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[1] Theo Chino and Chino LTD filed this hybrid action under article 78 and C.P.L.R. 3001. This brief refers to the Amended Petition and Complaint as the "Petition." This brief also refers to Defendants-Respondents-Respondents DFS and Superintendent Maria T. Vullo as "respondents."

returned it without further processing, and emphatically declined to conclude whether petitioners were subject to the Regulation. DFS's response comes nowhere close to the type of definitive agency action that would support relief under C.P.L.R. article 78.

Supreme Court also correctly found that petitioners lack standing to challenge the Regulation. As noted, DFS has made no final determination about whether the Regulation even applies to petitioners, and petitioners have failed to show that they are otherwise subject to the Regulation. Moreover, as Supreme Court properly found, petitioners have made no showing that they suffered any concrete financial injury as a result of the Regulation.

Finally, Supreme Court appropriately denied petitioners' broad request for discovery. That request was moot in light of Supreme Court's jurisdictional rulings. And, in any event, petitioners have not shown that Supreme Court abused its discretion in denying extremely broad third-party and documentary discovery.

QUESTIONS PRESENTED

1. Whether Supreme Court correctly held that petitioners failed to identify any final agency action warranting relief under C.P.L.R. article 78?

2. Whether Supreme Court correctly held that petitioners lacked standing to challenge the Regulation?

3. Whether Supreme Court properly exercised its broad discretion to deny petitioners' requests for discovery?

Supreme Court answered each question in the affirmative.

STATEMENT OF THE CASE

A. Statutory and Regulatory Background

1. The Department of Financial Service's (DFS) broad authority to regulate financial products

The Legislature vested DFS with broad authority to "supervise the business of, and the persons providing, financial products and services" in New York. Financial Services Law (FSL) § 201(a). DFS is specifically charged with "ensur[ing] the continued safety and soundness of New York's banking, insurance and financial services industries, as well as the prudent conduct of the providers of financial products and services, through responsible regulation and supervision." *Id.* § 102(i). The Legislature thus directed the Superintendent of DFS (the "Superintendent") to take such actions as the Superintendent deems necessary to, among other things, "eliminate financial fraud, other criminal abuse and unethical conduct in the industry," engage in "judicious regulation and vigilant supervision," and "educate and protect users of financial products and services." *Id.* § 201(b); *see also id.* § 301(c).

The Legislature also specifically contemplated that DFS would "provide for the regulation of *new* financial services products." *Id.* § 102(f) (emphasis added). And DFS was authorized to apply the full panoply of

its regulatory authority to such new products, including the promulgation of "rules and regulations" and the issuance of "orders and guidance involving financial products and services . . . effectuating any power given to the superintendent under the provisions of this chapter, the insurance law, the banking law, or any other law." *Id.* § 302(a).

2. DFS's regulation of virtual currencies

This case concerns petitioners' challenge to DFS's Regulation, 23 N.Y.C.R.R. §§ 200.01-200.22, which was promulgated on June 24, 2015. Perhaps the most widely known virtual currency, Bitcoin, has been described as a "peer to peer" version of electronic cash that allows "online payments to be sent directly from one party to another without going through" a "trusted third-party." (Record on Appeal (R.) 135 (quoting Satoshi Nakamoto,[2] *Bitcoin: A Peer-to-Peer Electronic Cash System* at 1 (2008), *at* https://bitcoin.org/bitcoin.pdf).) Virtual currency is a medium of exchange that may be used to store value or to buy or sell goods or services. (*See also* R. 159-165 (describing DFS's authority and virtual

[2] Satoshi Nakamoto is a pseudonym for the founder or founders of Bitcoin.

currencies); R. 171-184 (further describing the Regulation's consistency with established practice and Legislature's mandate).)

The Regulation sets forth a regime for DFS to regulate and supervise those engaged in business activities involving virtual currency in New York. 23 N.Y.C.R.R. §§ 200.2(q), 200.3. DFS promulgated the Regulation to address the known risks of virtual currencies, which have harmed consumers and have also been used to facilitate serious criminal conduct or to launder the proceeds thereof. (*See* R. 164 (describing collapse of largest Bitcoin exchange resulting in loss of more than $450 million worth of Bitcoins, nearly ninety percent of which belonged to consumers, and describing use of Bitcoin to launder hundreds of millions of dollars in 'dark' online marketplace Silk Road[3]).) *See* 37 N.Y. Reg. 7, 7-9 (June 24, 2015).

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[3] A similar site, denominated by federal law enforcement as "Silk Road 2.0," also required all transactions to be paid for in Bitcoins in order to obscure its users' identities and evade detection by law enforcement." Press Release, United States Department of Justice, Operator Of "Silk Road 2.0" Website Charged In Manhattan Federal Court (Nov. 6, 2014) (internet). (For authorities available on the internet, full URLs appear in the Table of Authorities.) Likewise, Bitcoin was used to launder illegal proceeds by Backpage, which was described by the U.S. Department of Justice in an indictment as a notorious online hub of sex trafficking,

The Regulation was the result of extensive consideration by DFS and engagement with the public. "In 2013, the Department launched a fact-finding inquiry concerning virtual currency, considering whether further regulations, in addition to current money transmission regulations, are necessary. In August, the Department requested information from over 20 virtual currency participants, ranging from service providers to investors. In November, the Department announced notice of its intent to hold public hearings on virtual currencies and the potential issuance of a 'BitLicense.'"[4] DFS held more than seven hours of public hearings over the course of two days in January 2014.[5] DFS released a proposed rule in July 2014, a revised proposed rule in February 2015, and the final rule on June 24, 2015. *See* 37 N.Y. Reg at 8. DFS received and considered more than 3,700 comments[6] on the proposed rules "from virtual currency

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including of children. *See* Indictment ¶¶ 1, 12, 147, 155, *United States v. Lacey, et al.*, No. 2:18-cr-00422 (D. Ariz. Mar. 28, 2018), ECF No. 3.

[4] New York State Department of Financial Services, *Annual Report* at 9 (2013) (internet).

[5] Videos of the public hearings are available on DFS's YouTube page, which is located here: https://www.youtube.com/channel/UC1tiZ29 LR9ZTM022tr1CPLA.

[6] All of these comments are publicly available here: https://www.dfs. ny.gov/legal/vcrf_ comments_ 3749_up.htm.

businesses, other financial services businesses, merchants, retailers, researchers, academics, policy centers, governmental agencies, and private individuals." *Id.*

During that extensive process, DFS added several provisions to the Regulation to clarify its scope. For example, an amended provision stated that the Regulation would not apply to any transaction that is "undertaken for *non-financial purposes* and [that] does not involve the transfer of more than a nominal amount of Virtual Currency." 23 N.Y.C.R.R. § 200.2(q)(1) (emphasis added). In addition, the Regulation does not apply to "merchants and consumers that utilize Virtual Currency solely for the purchase or sale of goods or services or for investment purposes." *Id.* § 200.3(c)(2). "For example, a coffee shop that accepts Bitcoin for payment and one of the coffee shop's customers, who pays with Bitcoin, would be exempt from the Virtual Currency Regulation. . . . [M]erchants and consumers that are merely *users* of virtual currency are not persons engaging in activities requiring licensing under the Financial Services Law." (R. 146.) Furthermore, "[t]he development and dissemination of software in and of itself does not constitute Virtual Currency Business Activity." 23 N.Y.C.R.R. § 200.2(q).

3. DFS's licensing requirements

Subject to various exemptions and exceptions, the Regulation requires a person to obtain a license from DFS in order to engage in various types of business activity involving virtual currency—known collectively as Virtual Currency Business Activity—in New York or with New York residents. *Id.* §§ 200.2(q), 200.3(a). In order to obtain a license, a person is required to submit an application to DFS. *Id.* § 200.4.

DFS regulations impose multiple requirements for such an application. As relevant here, one of those requirements is that an applicant describe in detail its business. The Regulation states that an applicant must provide

> a description of the proposed, current, and historical business of the applicant, including detail on the products and services provided and to be provided, all associated website addresses, the jurisdictions in which the applicant is engaged in business, the principal place of business, the primary market of operation, the projected customer base, any specific marketing targets, and the physical address of any operation in New York.

Id. § 200.4(a)(8). In addition, an applicant must provide detailed information about the applicant's business structure. *See, e.g., Id.* § 200.4(a)(2), (6).

Individuals in principal positions with the applicant must also provide a number of categories of information concerning their personal and professional history and provide "a background report prepared by an independent investigatory agency." *Id.* § 200.4(a)(3)-(5). An applicant likewise must provide certain financial information concerning the applicant and individuals in principal positions with the applicant. *Id.* § 200.4(a)(7), (9), (12), (13). Finally, an applicant must pay an application fee of $5,000 "to cover the cost of processing the application, reviewing application materials, and investigating the financial condition and responsibility, financial and business experience, and character and general fitness of the applicant." *Id.* § 200.5.

Under the Regulation, DFS will conduct an investigation on an applicant's suitability for a license after "the filing of an application for licensing under this Part, payment of the required fee, and demonstration by the applicant of its ability to comply with the provisions of this Part upon licensing." *Id.* § 200.6(a). If DFS determines that the application warrants the belief

> that the applicant's business will be conducted honestly, fairly, equitably, carefully, and efficiently within the purposes and intent of this Part, and in a manner commanding the confidence and trust of the community,

> the superintendent shall advise the applicant in writing of his or her approval of the application, and shall issue to the applicant a license to conduct Virtual Currency Business Activity.

Id.

A licensee has a series of obligations. For example, a licensee must "designate a qualified individual or individuals responsible for coordinating and monitoring compliance with this Part and all other applicable federal and state laws, rules, and regulations." *Id.* § 200.7(b). A licensee must also "maintain and enforce written compliance policies, including policies with respect to anti-fraud, anti-money laundering, cyber security, privacy and information security." *Id.* § 200.7(c). In addition, a licensee must "maintain at all times such 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." *Id.* § 200.8(a). A licensee also must maintain books and records to allow the Superintendent to determine whether the licensee is complying with the regulation. *Id.* § 200.12(a).

A full license is not the only avenue for entities to begin engaging in Virtual Currency Business Activity. In addition, to provide "an

appropriate on ramp for smaller entities while being able to ensure that licensees have appropriate safeguards in place," 37 N.Y. Reg. at 9, DFS included in the Regulation a procedure for an applicant to obtain a "conditional license," 23 N.Y.C.R.R. § 200.4(c). Under this procedure, an applicant who "does not satisfy all of the regulatory requirements upon licensing" may nevertheless obtain a license and engage in Virtual Currency Business Activity in New York. *Id.* § 200.4(c)(1). Such a license is operative for renewable two-year periods, *id.* § 200.4(c)(3), and may be subject to additional conditions and heightened review, *id.* § 200.4(c)(6), (2).

In addition, the Regulation provides for a transitional period. Under this transitional period, any person already engaged in Virtual Currency Business Activity, who applied for a license within forty-five days of the effective date of the Regulation, could continue operating during the license-application process. Such an applicant would be "deemed in compliance with the licensure requirements of this Part until it has been notified by the superintendent that its application has been denied." *Id.* § 200.21.

B. Factual Background

Petitioners are an individual (Theo Chino) and a Delaware corporation (Chino LTD) formed by that individual. (R. 44, 63.)

In early August 2015, shortly after DFS's promulgation of the final Regulation, petitioners submitted an application for a virtual currency license to DFS. That application was patently deficient and failed to comply with the Regulation's unambiguous requirements in numerous material respects. (R. 88-106.)

In particular, the application contained no "description of the proposed, current, and historical business," 23 N.Y.C.R.R. § 200.4(a)(8), of petitioners. Indeed, the application did not even identify what, if any, business petitioners engaged in that would involve virtual currency. For example, petitioners crossed out the area on the application to describe their "[f]irm [n]ame," "[b]usiness [a]ddress," and even the "*[n]ature of [their] [b]usiness*[.]" ." (R. 99 (emphasis added).)

The application also suffered from numerous other deficiencies, including but not limited to the following:

- Petitioners failed to give DFS authorization for one year to obtain information concerning them from various sources as part of DFS's investigation into petitioners' suitability for a license. (R. 91.)
- Petitioners failed to provide a copy of a background check. (R. 92.)
- Petitioners failed to provide three personal references "who can attest to [their] character, fitness, and reputation," or professional references "who can attest to [their] character, fitness, reputation, professional competence and business skills." (R. 101.)
- Petitioners failed to fill in the portion of their application on their educational background. (R. 100.)
- Petitioners refused to disclose their employment records. (R. 100.)
- Petitioners refused to disclose whether they were employed in a professional capacity with any institution already subject to DFS supervision or with New York State. (R. 101.)
- Petitioners failed to provide financial information for Chino LTD, and instead disclosed only Theo Chino's personal finances. (R. 93-95.)
- Petitioners did not make clear who the actual applicant is. In the field asking for the applicant's full name and address, the

application states "Chino, LTD," with no address. The subsequent page states that the applicant is "Theo Chino." (R. 88-89.)

- Petitioners omitted any mention of Conglomerate Business Consultants (CBC), a separate corporate entity set up by Theo Chino that evidently would be involved in the proposed business.[7]

On January 4, 2016, DFS sent a letter to petitioners stating that DFS had performed an "initial review" of the application, but that "the submitted Application documentation is exceptionally limited." (R. 108.) DFS highlighted that, "[a]mong other issues, the Application does not contain any description of the company's current or proposed business activity." (R. 108.) DFS thus concluded that it was "unable to evaluate whether the Company'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." (R. 108.) DFS accordingly returned the application to petitioners "without further processing," "emphasiz[ing] that the instant letter does

[7] In this proceeding, petitioners claim that CBC "entered into formal contracts with seven bodegas in New York to offer Bitcoin processing services provided by Chino, LTD." (R. 25.)

not offer any opinion as to whether or not any business activity of the Company requires or would require licensing in New York." (R. 108.) In doing so, the letter provided the contact information of a DFS official responsible for reviewing license applications and invited petitioners to contact the official if they had any questions. (R. 108.)

Petitioners never took up this invitation. Indeed, they did nothing in response to DFS's letter: they never supplemented the application to correct any of its numerous deficiencies, sought a conditional license, or otherwise communicated with DFS. Instead, petitioners voluntarily "stopped offering Bitcoin processing services," purportedly because "NYDFS did not approve [petitioners'] application." (R. 47-48.)

C. Procedural History

While DFS was still considering petitioners' application, petitioners filed the current proceeding *pro se* on October 16, 2015. (R. 26.) Counsel appeared for petitioners more than a year later. (R. 15.) On May 25, 2017, petitioners filed an amended petition. (R. 25.)

The amended petition alleges four causes of action. First, it alleges that the Regulation violates the separation of powers because they are beyond the scope of DFS's statutory authorization. (R. 48-49.) Second, it

alleges that the Regulation is "arbitrary and capricious." (R. 49-53.) Third, it alleges that the Regulation is preempted by the federal Dodd-Frank Act. (R. 53-54.) Fourth, it alleges that certain disclosure provisions of the Regulation violate federal and state free speech protections.[8] (R. 54-58.) Petitioners sought a judgment declaring the Regulation invalid in its entirety, enjoining DFS from implementing or enforcing the Regulation, and awarding attorney's fees. (R. 58-59.)

Petitioners also moved for a discovery order "compelling Paul Krugman [the noted economist and *New York Times* columnist] to testify before the Court," "compelling Benjamin Lawsky [former Superintendent of DFS] to attend a deposition," and compelling production of "all internal emails" (among other things) from DFS "supporting how they reached their regulatory conclusion." (R. 266-267.)

On December 21, 2017, Supreme Court, New York County (Carmen Victoria St. George, J.) granted respondents' motion to dismiss the

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[8] The petition refers to "the First Amendment" of the U.S. and New York Constitutions. (R. 54.) However, the New York Constitution's protection of free speech is contained in article I, § 8.

petition and denied petitioners' request for discovery.[9] (R. 20.) On the motion to dismiss, Supreme Court agreed with respondents that "petitioner has no right to commence an Article 78 proceeding and lacks standing to challenge the underlying regulation." (R. 20.)

The court held that article 78 relief was unavailable because DFS had "not reach[ed] a final decision" on petitioners' patently incomplete and defective application but had simply noted that the application was incomplete and returned it without further processing. (R. 20.) Because petitioners had failed to exhaust the application process, Supreme Court concluded that there was no final agency action for it to review. (R. 20.)

Supreme Court further found that petitioners lacked standing to challenge the Regulation. The court noted that "petitioner did not apply for certification" (i.e., licensure) and "has not shown sufficient economic loss" from the Regulation—indeed, petitioners did not even pay the application fee. (R. 23.)

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[9] The copy of Supreme Court's opinion in the record produced by petitioners is incomplete. The full decision is available at *Chino v. New York Dept. of Fin. Servs.*, 2017 N.Y. Slip. Op. 51908(U), 2017 WL 6568010 (Sup. Ct. N.Y. County Dec. 21, 2017).

Finally, Supreme Court denied petitioners' motion for discovery as moot, finding that none of the requested discovery was relevant to petitioners' standing. The court further concluded that, even ignoring petitioners' lack of standing, none of the requested discovery was necessary to adjudicate the merits of their claims. (R. 23.)

ARGUMENT

POINT I

SUPREME COURT CORRECTLY DISMISSED PETITIONERS' ARTICLE 78 CLAIMS BECAUSE PETITIONERS FAILED TO DEMONSTRATE THAT DFS TOOK FINAL AGENCY ACTION THAT INJURED THEM

A precondition of maintaining an action under article 78 is that an agency determination be "final and binding upon the petitioner." C.P.L.R. 217. The Court of Appeals has adopted a two-part test to decide if an agency action is "final and binding": "First, the agency must have reached a definitive position on the issue that inflicts actual, concrete injury and second, the injury inflicted may not be prevented or significantly ameliorated by further administrative action or by steps available to the complaining party." *Matter of Best Payphones, Inc. v. Department of Info. Tech. & Telecom. of City of New York*, 5 N.Y.3d 30, 34 (2005). Here, Supreme Court correctly dismissed petitioners' article 78 claims on the

ground that petitioners failed to demonstrate that DFS took any final agency action that aggrieved them.

On its face, DFS's response to petitioners' application did not reach any "definitive position" on petitioners' request for a license. Instead, DFS returned the application as incomplete—DFS's letter noted that the documentation submitted with the application was "exceptionally limited," identified one particular major deficiency (the application's failure to describe petitioners' "current or proposed business activity"), and explained that the application was "being returned to [petitioners] without further processing by" DFS. (R. 108.) In addition, DFS's letter made a point of "emphasiz[ing]" that the "letter does not offer any opinion as to whether or not any business activity of [petitioners] requires or would require licensing in New York." (R. 108.)

Supreme Court correctly concluded that "DFS did not reach a final decision" in this letter, and thus "did not take any action" that would warrant review under article 78. (R. 20.) "Administrative actions as a rule are not final unless and until they impose an obligation, deny a right or fix some legal relationship as a consummation of the administrative process." *Matter of Essex County v. Zagata*, 91 N.Y.2d 447, 453 (1998)

(quotation marks omitted). DFS's letter noting specific deficiencies in petitioners' incomplete application did none of these things. Indeed, DFS did not even take a position on whether petitioners' proposed business would or would not be covered by the Regulation. And the reason DFS's letter was so noncommittal, as Supreme Court correctly observed, was that petitioners had effectively "obstructed" any effort by DFS to determine the nature of their business because "petitioner[s] did not provide it with most of the information it sought" and prevented DFS from "obtain[ing] further information about [petitioners]." (R. 21.) DFS thus did not reach any "definitive position" on petitioners' license application "that inflict[ed] actual, concrete injury" on petitioners. *Matter of Best Payphones, Inc.*, 5 N.Y.3d at 34.

Petitioners further failed to identify any final agency action because alternative avenues for relief were and are available before DFS. A legal claim against a state agency "cannot be ripe if the claimed harm may be prevented or significantly ameliorated by further administrative action or by steps available to the complaining party." *Church of St. Paul & St. Andrew v. Barwick*, 67 N.Y.2d 510, 520 (1986). Here, petitioners failed to pursue the most basic form of administrative relief: simply completing their application, or reaching out to the DFS official identified in the

letter to raise any concerns they may have had with the application process or the Regulation itself. Petitioners also never sought a conditional license, a means provided by DFS for small businesses and startups to become licensed even if they do not satisfy one or more requirements in the Regulation, including the requirement to pay the application fee. 23 N.Y.C.R.R. § 200.4(c). In addition, petitioners have not shown that they were not covered by the Regulation's transitional provisions for businesses already engaged in Virtual Currency Business Activity. *Id.* § 200.21. In light of petitioners' failure to pursue these further grounds for relief before the agency, they have failed to identify any final agency action that would warrant article 78 review.

On appeal, petitioners appear to argue that they were not required to show final agency action because they are covered by various exceptions to the requirement that applicants exhaust administrative remedies. These arguments are both unpreserved and beside the point.

Petitioners failed to present below any of the arguments they now raise about exceptions to the exhaustion requirement. *See Matter of Castillo v. Town of Oyster Bay*, 70 A.D.3d 939, 939 (2d Dep't 2010). Exhaustion was discussed at some length at oral argument (Supplemental Record

(SR) 393-394),[10] but petitioners at that time raised none of the exhaustion exceptions they now invoke. Petitioners' attempt to raise these arguments for the first time before this Court should be rejected.

Even if preserved, petitioners' arguments about exhaustion should be rejected as meritless. As Supreme Court correctly recognized (R. 20-21), the exceptions to exhaustion are inapplicable here because petitioners fail to satisfy the threshold requirement that they actually be *aggrieved* by some final agency action. That is, both the exhaustion requirement and the exceptions to that requirement apply only when "a person [has been] *aggrieved by* an administrative determination." *Abreu v. New York City Police Dept.*, 182 A.D.2d 414, 414 (1st Dep't 1992) (emphasis added). In the absence of such an "actual, concrete injury" inflicted by agency

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[10] For example, Supreme Court asked petitioners' counsel repeatedly to explain why "your client did nothing to attempt to resolve the issue, which was the Department's concern was that they couldn't make a decision whether or not you even needed a license because your client did not produce enough information and they're saying that your client did nothing to follow up on that." (SR 393.) Petitioners' counsel stated that "this is not a situation where there is an administrative exhaustion requirement," but raised none of the specific exceptions petitioners now invoke on appeal. (SR 393.)

action, *Matter of Best Payphones, Inc.*, 5 N.Y.3d at 34, neither the exhaustion doctrine nor its exceptions have any application here.

In any event, none of the exceptions to exhaustion that petitioners invoke applies here. Petitioners have not shown that pursuing additional avenues for administrative relief before DFS would have been futile—indeed, DFS's letter openly invited petitioners to confer with DFS regarding their application. (R. 108.) Nor would pursuing such avenues have caused irreparable injury, because petitioners could conceivably have obtained a full or conditional license had they simply completed their application, and even if their application had been denied they would then have been able to pursue a legal challenge to an actual final agency action. *See Matter of First Natl. City Bank v. City of N.Y. Fin. Admin.*, 36 N.Y.2d 87, 93 (1975). It is no answer that petitioners raise constitutional objections to the Regulation's disclosure provisions (Br. for Plaintiffs-Petitioners-Appellants (Br.) at 14-15)—DFS has taken no position on whether those provisions even apply to petitioners (R. 108), and in any event "merely asserting a constitutional violation will not excuse a litigant from first pursuing administrative remedies that can provide the requested relief," *Matter of Schulz v. State of New York*, 86 N.Y.2d 225, 232 (1995).

Finally, petitioners' contention that Supreme Court should have invoked an exception to exhaustion for agency actions "wholly beyond [the agency's] grant of power" (Br. at 13) ignores controlling precedent holding that a court may rely on this exception only when a party demonstrates that the "challenge has substance." *Matter of People Care Inc. v. City of N.Y. Human Resources Admin.*, 89 A.D.3d 515, 516 (1st Dep't 2011); *see also Cameron v. Shah,* 140 A.D.3d 439, 439 (1st Dep't 2016), *lv. denied*, 28 N.Y.3d 914 (2017). Here, as respondents explained below, petitioners' preemption arguments border on the frivolous (R. 185-187), and petitioners' arguments that virtual currency falls outside of DFS's broad statutory authority fail in light of the Legislature's plain delegation of broad power to DFS to supervise providers of financial products or services, including *new* financial services products, and the "high degree of judicial deference" accorded to agency rulemaking. (R. 171-179.)

In any event, even assuming that petitioners' arguments about DFS's statutory authority have some substance, petitioners have not demonstrated that Supreme Court abused its discretion in declining to invoke this exception to exhaustion. *See Matter of People Care Inc.*, 89 A.D.3d at 516 ("Where the petitioner demonstrates that such a challenge

has substance, the court *has the discretion* to rely on this exception to the exhaustion requirement." (emphasis added) (internal citations omitted)). In rejecting application of this exception, Supreme Court appropriately noted petitioners' efforts to prevent DFS from even ascertaining whether petitioners' activities would be covered by the Regulation and petitioners' abandonment of their application. (R. 20-21.) Given petitioners' obstructive activities, Supreme Court was well within its discretion to decline to invoke this exception to the exhaustion requirement.

POINT II

PETITIONERS FAILED TO ESTABLISH STANDING TO CHALLENGE THE REGULATION

Supreme Court also correctly held that petitioners failed to establish any standing to challenge the Regulation itself. To establish standing, a plaintiff must demonstrate an injury in fact, meaning that the "plaintiff will actually be harmed by the challenged administrative action." *New York State Assn. of Nurse Anesthetists v. Novello*, 2 N.Y.3d 207, 211 (2004). A plaintiff has the burden of establishing standing, and the issue of standing must be considered from "the outset of any litigation." *Society of Plastics Indus. v. County of Suffolk*, 77 N.Y.2d 761, 769 (1991).

Here, petitioners failed to establish standing for several independent reasons. First, and most fundamentally, petitioners have never established that the Regulation applies to their business activities. As explained above, DFS's letter emphatically declined to take a position on whether petitioners' business activity "requires or would require licensing in New York," in light of petitioners' failure to provide any description of that activity. (R. 108.)

The papers filed in this proceeding also do not demonstrate that the Regulation applies to petitioners. The Petition makes the bare assertion that petitioners' businesses provide "Bitcoin processing services" (R. 26), and Mr. Chino's affidavit below merely parroted the precise terms of the Regulation—alleging without any detail that he stores, holds, or maintains custody or control of Virtual Currency on behalf of others. *Compare* R. 256 (Mr. Chino's statement that he "was storing, holding, and maintaining custody and control of bitcoins on behalf of third-parties") *with* 23 N.Y.C.R.R. § 200.2(q)(2) (regulatory language providing that "storing, holding, or maintaining custody or control of Virtual Currency on behalf of others" fall within definition of Virtual Currency Business Activity). Such "[c]onclusory allegations or bare legal assertions with no factual specificity are not sufficient" to establish standing. *Matter of*

Kenneth Cole Prods., Inc., Shareholder Litig., 27 N.Y.3d 268, 278 (2016) (citing *Godfrey v. Spano*, 13 N.Y.3d 358, 373 (2009)).

Second, even assuming that petitioners made a prima facie showing that the Regulation applies to their business activities, they still have not established any injury in fact from the Regulation because they have not shown whether the Regulation's various exceptions would apply to them. For example, the Regulation exempts merchant-consumer transactions, 23 N.Y.C.R.R. § 200.3(c)(2), as well as transactions "undertaken for non-financial purposes" that do "not involve the transfer of more than a nominal amount of Virtual Currency," *id.* § 200.2(q)(1). The Regulation further does not apply to "the development and dissemination of software." *Id.* § 200.2(q). Because petitioners have wholly failed to describe in detail their proposed business activities—whether in their application before DFS or in their filings in this proceeding—they have not demonstrated whether any of these exemptions might apply.[11]

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[11] Petitioners' brief on appeal for the first time asserts that petitioners have "custody of the Bitcoin *key* transferred by customers to pay for retail items," and states that "[t]hat custody of the *Bitcoin key*, as well as exchange services performed on behalf of the retail stores, triggers a number of provisions from the Regulation." Br. at 20 (emphasis added). These factual statements are again merely conclusory assertions. Moreover,

Third, to the extent that petitioners have suffered any injury, their injuries are self-inflicted and thus cannot support their standing. Petitioners appear to argue that DFS's not having approved their license application (despite its patent deficiencies) was itself a cognizable injury. But it was petitioners' own failures to comply with the unambiguous requirements of the licensing process, their abandonment of their application, and their failure to seek a conditional license that were the causes of their current lack of a virtual currency license from DFS—a license that petitioners have not even established they need. Because petitioners' own choices led to this purported injury, they cannot rely on this injury to claim standing. *See Matter of Brennan Ctr. for Justice at NYU Sch. of Law v. New York State Bd. of Elections*, 52 Misc. 3d 246, 262 (Sup. Ct. Albany County 2016); *see also Fallek v. Becker, Achiron and Isserlis*, 246 A.D.2d 394, 395 (1st Dep't 1998) (voluntary payments cannot confer standing); *Lancaster Dev., Inc. v. McDonald*, 112 A.D.3d 1260, 1261 (3d Dep't 2013) (voluntary

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they are improperly made for the first time on appeal and find no support in the evidentiary record—in particular, the cited paragraph of Mr. Chino's affidavit (R. 255-256) does not reference any "key"."

withdrawal of bid meant plaintiff lacked standing), *lv. denied*, 22 N.Y.3d 866 (2014).

Finally, as Supreme Court correctly concluded, none of the minimal financial information or other supposed documentation presented by petitioners in this proceeding demonstrates that petitioners have suffered *any* financial losses because of the Regulation. Petitioners cannot claim injury from the application fee because they have never paid that fee. (R. 23.) And while petitioners cite to supposed "proof" of losses from Chino LTD's tax returns from 2013, 2014, 2015, and 2016 (Br. at 19-20 (citing R. 46)), the tax returns do not show any such financial injury. Any losses that Chino LTD suffered *before* the Regulation took effect on June 24, 2015, obviously cannot be attributed to the Regulation. Losses incurred *after* the filing of the Petition on October 16, 2015, are also immaterial because standing must be established at "the outset of any litigation." *Society of Plastics Indus.*, 77 N.Y.2d at 769. And petitioners have not shown that any losses in the brief period between these two dates are attributable to the Regulation, in part because the Regulation's transitional provisions would have "deemed [petitioners] in compliance" until DFS actually denied their application—which DFS has never done.

See 23 N.Y.C.R.R. § 200.21. Moreover, as Supreme Court found, petitioners' claimed 2016 losses (during the period that the Regulation was in effect prior to the filing of the Petition) were consistent with the losses that Chino LTD had experienced in prior years. (R. 23.) That consistency indicates that any losses were not in fact directly caused by the Regulation.[12]

This Court should accordingly affirm Supreme Court's decision that petitioners lacked standing to challenge the Regulation.

POINT III

THE DENIAL OF PETITIONERS' BROAD REQUEST FOR DISCOVERY SHOULD BE AFFIRMED

Supreme Court did not abuse its discretion in denying petitioners' broad request to depose Paul Krugman (the noted economist and *New York Times* columnist) and Benjamin Lawsky (former DFS Superintendent), or to obtain internal DFS emails over several years.

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[12] The various documents presented by petitioners below do not change this result. For example, the single example of a supposedly "formal contract" (R. 75) is utterly devoid of material terms, such as price, and has only one signature. *See Express Industries and Terminal Corp. v. New York State Dept. of Transp.*, 93 N.Y.2d 584, 589-90 (1999). And the "invoice" petitioners submitted below references a single transaction that supposedly occurred long after this litigation was filed and contains no indication whether petitioners earned any revenue or profit. (R. 107.)

As a threshold matter, petitioners' discovery request was mooted by Supreme Court's conclusion that petitioners lack standing, as the court correctly concluded. (R. 23.) None of petitioners' discovery requests relates to whether they were injured or aggrieved by the Regulation. There was thus no need for Supreme Court to entertain petitioners' discovery request after rejecting their Petition on jurisdictional grounds.

In any event, Supreme Court acted well within its broad discretion here. *See Price v. New York City Bd. of Educ.*, 51 A.D.3d 277, 293 (1st Dep't) (denial of discovery reviewed for abuse of discretion), *lv. denied*, 11 N.Y.3d 702 (2008). As petitioners recognize, a discovery request in "special proceedings, such as an Article 78 petition" is "not automatically granted and requires leave of court" under C.P.L.R. 408. Br. at 22. "Because discovery tends to prolong a case, and is therefore inconsistent with the summary nature of a special proceeding, discovery is granted only where it is demonstrated that there is a need for such relief." *Matter of Town of Pleasant Val. v. New York State Bd. of Real Prop. Servs.*, 253 A.D.2d 8, 15 (2d Dep't 1999); *Matter of Council of City of N.Y. v. Bloomberg*, 6 N.Y.3d 380, 389 (2006) ("Article 78 proceedings are . . . designed for prompt resolution of largely legal issues, rather than for discovery, trials and credibility judgments." (quotation

marks omitted)). Courts examine whether the requested discovery is "material and necessary," "whether the request is carefully tailored to obtain the necessary information," and "whether undue delay will result from the request." *Matter of Suit-Kote Corp. v. Rivera*, 137 A.D.3d 1361, 1365 (3d Dep't), *appeal dismissed, lv. denied*, 27 N.Y.3d 1054 (2016).

None of those factors supports petitioners' request. Petitioners have not shown that there is "ample need" for their requested discovery, *Matter of Shore*, 109 A.D.2d 842, 843 (2d Dep't 1985), or that their discovery is "material and necessary," *Matter of Suit-Kote Corp.*, 137 A.D.3d at 1365 Indeed, their requested discovery is wholly irrelevant because any challenge to an agency rulemaking must rest on the materials before the agency. *Matter of L&M Bus Corp. v. New York City Dept. of Educ.*, 71 A.D.3d 127, 135-36 (1st Dep't 2009), *lv. granted in part, dismissed in part,* 15 N.Y.3d 889 (2010), *aff'd as modified*, 17 N.Y.3d 149 (2011); *see also Matter of Fanelli v. New York City Conciliation & Appeals Bd.*, 90 A.D.2d 756, 757 (1st Dep't 1982), *aff'd*, 58 N.Y.2d 952 (1983). Here, the materials considered and produced by DFS during its extensive rulemaking process are all publicly available, including every iteration of the Regulation, videos of DFS's public hearings, the thousands of comments submitted in connection with

the rulemaking, and DFS's responses to those comments, *see* 37 N.Y. Reg. at 8. Petitioners have made no showing that these materials are insufficient.

Petitioners' request is also far from "carefully tailored." Petitioners sought third-party subpoenas for a former head of an executive agency and a famous economist and *New York Times* columnist who has had no involvement in the Regulation. Petitioners also sought *all* internal emails, emails with third parties, and other written documentation concerning the economic nature of Bitcoin and whether it qualifies as a financial product or service covering a nearly three-year period concluding after the Regulations were finally promulgated. (R. 310.) All of that material would require extensive review for privilege and other matters.[13] "In light of the exceedingly broad and undefined nature of the information sought, together with the almost certain unduly protracted delay that would result, [this Court] cannot say that Supreme Court abused its discretion in denying [C.P.L.R.] 408 disclosure under the circumstances." *Matter of Suit-Kote Corp.*, 137 A.D.3d at 1365.

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[13] For example, much of the internal communications petitioners sought would be protected from disclosure under Public Officers Law § 87(g) as "inter-agency or intra-agency materials." Public Officers Law § 87(g); *see Matter of Town of Pleasant Val.*, 253 A.D.2d at 17.

CONCLUSION

Supreme Court's decision, order, and judgment should be affirmed.

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January 9, 2019

January 9, 2019

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