SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Inquiry of LETITIA JAMES, Attorney General of the State of New York, Petitioner, *—against—* iFINEX INC., BFXNA Inc., BFXWW INC., TETHER HOLDINGS LIMITED, TETHER OPERATIONS LIMITED, TETHER LIMITED, TETHER INTERNATIONAL LIMITED, Respondents.	Index No.: 450545/2019

RESPONDENTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION, BY ORDER TO SHOW CAUSE, TO VACATE OR MODIFY THE APRIL 24, 2019 *EX PARTE* ORDER, AND FOR AN IMMEDIATE STAY OF THE ORDER

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INTRODUCTION

By this motion, the respondents, a group of affiliated companies in the virtual currency industry, seek to vacate or modify a highly-disruptive preliminary injunction and document demand order that the New York Attorney General obtained last week in connection with an anticipated enforcement proceeding under the Martin Act. The order effectively freezes a line-of-credit transaction among the respondents indefinitely, and orders them to produce huge volumes of documents by this Friday.

The Attorney General's application was made without any prior notice or opportunity to be heard, even though the respondents and their counsel have been ***cooperating for months*** with the Attorney General's investigation. The papers supporting the Attorney General's *ex parte* application were riddled with factual and legal errors. When the true facts are considered under the correct legal standards, it is clear that the order never should have issued.

Three of the respondents, iFinex Inc., BFXNA Inc., and BFXWW Inc. (collectively, "Bitfinex"), operate one of the world's largest virtual currency trading platforms, Bitfinex. The other respondents, Tether Holdings Limited, Tether Operations Limited, Tether Limited and Tether International Limited (collectively "Tether"), are the companies that created and administer a virtual currency called "tether." Bitfinex and Tether have some overlapping ownership with Bitfinex, and share certain personnel.

Tethers are a form of "stablecoins," which means their value is pegged to traditional currency (such as U.S. Dollars or Euros), which is referred to in the industry as "fiat" currency. Stablecoins are generally not bought for investment purposes, but provide a medium of exchange across virtual currency platforms that is often more convenient than traditional currency.

The Attorney General's allegations in this matter center on a supposedly "conflicted" $900 million revolving line of credit that Tether recently entered into with Bitfinex. The preliminary injunction prohibits Bitfinex from accessing this line of credit indefinitely.

According to the Attorney General, the line of credit needed to be frozen because it improperly impairs the reserves Tether would use for redemptions. The Attorney General appears to believe that Tether must hold $1 in cash fiat currency for every dollar of tether. These allegations are wrong on multiple levels.

For starters, contrary to the portrayal in the Attorney General's motion papers of a "conflicted" transaction, the terms were negotiated on an arm's length basis on commercially reasonable terms, with each company represented by sophisticated, independent counsel. The line of credit earns interest, and is backed by the ownership shares in the parent company of Bitfinex, one of the largest virtual currency exchanges in the world.

More fundamentally, the Attorney General has no authority to dictate how Bitfinex and Tether do business with one another, or the amount of reserves that Tether must hold. The Martin Act is an antifraud statute enacted to ensure that there is proper disclosure about the risks associated with the sale of securities and commodities. So long as there is disclosure, the members of the public can decide for themselves whether to buy or sell. Here, there *was* disclosure of the relevant information. Tether states plainly on its website that tethers are backed by reserves in various forms, specifically including "loans" to "affiliated entities." This fact was widely covered in industry press. Any tether holder dissatisfied with this arrangement could have freely redeemed his or her tethers for cash, or exchanged their tether for another virtual currency on various virtual currency platforms, and can still do so today.

While the Attorney General claims it needed to take "immediate action to protect New York investors," it has not named a single one harmed in any way. Nor could it. There are no "investors" in tether. Further, the value of Tether's reserves is more than sufficient to cover the outstanding tether in the market. In fact, Tether's reserves of cash and cash equivalents alone (without the line of credit) would cover approximately 74 percent of the outstanding amount of tether. This sort of "fractional" reserving arrangement is similar to how commercial banks work. No bank holds in liquid cash more than a small percentage of depositors' money. The funds are invested. The markets clearly remain confident in tether, as it currently trades just shy of $1 dollar per U.S. Dollar tether — even after the Attorney General's highly inflammatory and misleading public application. Any suggestion that tether holders face liquidity risk is unsupported speculation.

The Attorney General's preliminary injunction application not only misrepresents the line-of-credit transaction as a fraud, but is also highly misleading in portraying Bitfinex and Tether as stonewalling the investigation. In fact, the complete opposite is true. Omitted from the Attorney General's application is the Attorney General's extensive correspondence with Bitfinex and Tether showing that Bitfinex and Tether have cooperated fully, and have produced huge volumes of information. More candor should be expected of the Attorney General, particularly when proceeding *ex parte*.

That the Attorney General obtained an *ex parte*, indefinite preliminary injunction without even a date for Bitfinex and Tether to be heard is inconsistent with basic due process protections, and grounds alone for the April 24, 2019 Order to be vacated.

Beyond the due process issue, this Court has broad discretion to vacate or modify the April 24, 2019 Order, and should do so. Specifically, the April 24, 2019 Order should be

vacated entirely or, at a minimum, the portion disrupting the companies' daily business (subparagraph "(i)" on page 4) should be deleted. The Attorney General has failed to even attempt to meet the necessary elements for a preliminary injunction: that it is likely to succeed on the merits, that there is a risk of irreparable harm, or that the balance of equities favors the Attorney General. While the Attorney General claims that these standards are inapplicable in a Martin Act special proceeding like this one, that is wrong, and contrary to controlling authority from the Court of Appeals.

The Attorney General is not likely to succeed because it has failed to even show how tether could be a security or commodity covered by the Martin Act. Beyond that fundamental problem, the supposedly hidden information (that reserves would be deployed to affiliate loans) was, in fact, disclosed by Tether publicly, and so there is no fraud. Nor is there a risk of harm to anyone, much less harm that is irreparable, given that Tether is more than adequately reserved. Tether customers have at all times been able to freely redeem their tethers. The balance of equities favors Bitfinex and Tether because the line-of-credit transaction is important to ensuring that Bitfinex customers have ready access to cash. On the other side of the ledger, the Attorney General's injunction serves no useful purpose, except to generate headlines (as appears to be the purpose of the exercise).

Given the urgency of the matters in this application, the Court should sign the accompanying Order to Show Cause, immediately suspending the April 24, 2019 Order pending a prompt hearing date on this application.

BACKGROUND

Bitfinex and Tether

Bitfinex is among the largest virtually currency trading platforms in the world. (April 30, 2019 Affirmation of Stuart Hoegner ("Hoegner Aff.") ¶ 3.) It was founded in 2012, and it is the world's largest exchange by volume for trading Bitcoin against the U.S. Dollar. (*Id.*)

Tether operates a platform to store, send, and make purchases of a digital token known as tether, and is also responsible for issuing tether. (*Id.* ¶ 4.) Tethers are a form of "stablecoins," which means their value is pegged to traditional currency (U.S. Dollars, Euros, or Japanese Yen). (*Id.* ¶ 6.) With certain restrictions, tethers can be redeemed on a one-to-one basis for the traditional currency in which they are denominated. (*Id.*)

Stablecoins, such as tether, provide significant utility in the virtual currency market, allowing users to convert cash into digital currency, and to anchor (or tether) the value of digital currency to the price of traditional fiat currencies. (*Id.* ¶ 7.) Tethers also provide a medium of exchange across a wide range of trading platforms that is often more convenient than traditional currency. (*Id.* ¶ 8.) Stablecoins are generally not bought for investment purposes; their main function is to facilitate other virtual currency transactions. (*Id.* ¶ 9.)

Bitfinex's Banking Relationships and Dealings with Crypto Capital

Virtual currency exchanges and businesses face significant challenges in identifying and maintaining traditional banking relationships, due in large part to heavy compliance costs. (*Id.* ¶ 11 & Ex. A.) Bitfinex and Tether have faced these problems from time to time.

In light of such difficulties, Bitfinex and Tether have continued to seek long-term relationships with traditional financial institutions, while further relying on third-party payment processors. (*Id.* ¶ 14.) To that end, Bitfinex established a relationship with payment processor known as Crypto Capital in or about January 2015. (*Id.* ¶ 15.) Bitfinex strengthened its

relationship with Crypto Capital in the immediate aftermath of a service disruption from a traditional bank (Wells Fargo). (*Id.*) Indeed, in or about 2017 and 2018, Crypto Capital processed hundreds of millions of dollars' worth of transactions on behalf of Bitfinex. (*Id.*)

In light of Crypto Capital's provision of once reliable payment-processing services, Bitfinex opened additional accounts with Crypto Capital thereafter for the purpose of processing Euro, Pound Sterling, and Japanese Yen transactions, among other currencies. (*Id.* ¶ 16.) Likewise, Bitfinex entrusted Crypto Capital with an increasing amounts of funds. (*Id.*)

In or about mid-2018, other virtual currency trading platforms purportedly using Crypto Capital began to experience delays in withdrawal requests. (*Id.* ¶ 17.) In or about August 2018, Crypto Capital continually represented to senior executives of Bitfinex that funds had been the subject of a partial governmental seizure and were expected to be released shortly. (*Id.* ¶ 18.) Since this time, at least one governmental entity has confirmed that it was involved in the seizure of Crypto Capital funds. (*Id.*)

Notwithstanding the foregoing, Crypto Capital continued to provide payment-processing services to Bitfinex through approximately October 2018. (*Id.* ¶ 19.) As recently as April 2019, Crypto Capital representatives continued to respond promptly to requests for information and documents from Bitfinex. (*Id.*)

The Line-of-Credit Transaction

Beginning in or about August 2018, and continuing through in or about November 2018, Bitfinex entered into a series of transactions whereby tethers issued by Tether to Bitfinex were purchased through account transfers between Bitfinex and Tether's accounts at Crypto Capital. (*Id.* ¶ 21.) Throughout these transactions, all U.S. Dollar tether issued or redeemed was reserved by an equivalent amount of value in U.S. Dollars. (*Id.*) Additionally, customer requests to purchase, sell, or redeem for cash value U.S. Dollar tether continued unabated. (*Id.*)

Likewise, Bitfinex and Tether also engaged in a series of transfers of fiat currency previously deposited with Crypto Capital from Bitfinex's account to Tether's account there. (*Id.* ¶ 22.) In turn, Tether transferred equivalent amounts to Bitfinex between the companies' respective accounts at Deltec Bank & Trust Limited. (*Id.*)

At the time, Bitfinex and Tether believed that withdrawals at Crypto Capital would resume, and the companies would once more have unencumbered access to the funds entrusted to Crypto Capital. (*Id.* ¶ 23.) It is only with the benefit of hindsight that the Attorney General now claims that the transfers were inadequate, or that some undefined harm *might* have occurred then (or now) if every holder of the more than $2 billion in U.S. Dollar tether in circulation were to redeem their tether at once. (*Id.*)

In any event, it was for the protection of the market that, when in December 2018 senior executives of Bitfinex grew concerned that Crypto Capital may fail to return funds held there, the companies began to negotiate a credit facility through which Tether would extend Bitfinex a secured, revolving line of credit of up to $900 million. (*Id.* ¶ 24.)

Separate, independent counsel were retained for both Bitfinex and Tether. (*Id.* ¶ 25.) White & Case LLP represented Tether and Herbert Smith Freehills represented Bitfinex. (*Id.*) In addition, final authority to negotiate and approve the transaction on the Tether side was delegated to a Tether executive who was not an officer, employee or shareholder in Bitfinex. (*Id.*) Over the next three months the credit facility was negotiated and memorialized. (*Id.*) While the Attorney General wonders what "benefit[s] would accrue to Tether, or holders of tethers, from this transaction" (NYAG Br. 10), the obvious answer is that Tether and holders of tether are keenly interested in ensuring that one of the dominant trading platforms of tethers has sufficient liquidity for normal operations. (Hoegner Aff. ¶ 25.) Further, as the companies are

known to be affiliated, disruption to Bitfinex's operations would naturally risk creating negative spillover to Tether, as well. (*Id.*)

Without any obligation or request to do so, counsel for Bitfinex and Tether voluntarily disclosed the nature of the transaction approximately one month before it was closed, providing the Attorney General a general overview of the anticipated deal. (*Id.* ¶ 27.)

Contrary to the Attorney General's portrayal, it was for Tether's protection that the amounts transferred from Bitfinex's Crypto Capital account to Tether's Crypto Capital account (totaling $675 million) were incorporated into the credit facility, and deducted from the $900 million of credit made available to Bitfinex. (*Id.* ¶ 28.) Put differently, the credit facility obligated Bitfinex to repay Tether the amounts held in Tether's Crypto Capital account on commercially reasonable terms (*i.e.*, a term of three years and interest rate of 6.5%). (*Id.*) The credit facility further provides clear terms governing future requests by Bitfinex to utilize any portion of the remaining line of credit, and provides terms for the repayment. (*Id.*)

Tether's Disclosures

In February 2019, well before the line-of-credit transaction closed, Tether updated the disclosures on its website to specify that its reserves "may include other assets and receivables from loans made by Tether to third parties, which may include affiliated entities." (*Id.* ¶ 31 & Ex. B, at 6 (Item 1.1.32).) The website also made clear that risks in buying tether included risks associated with the reserves: "Assets backing digital assets such as Tether Tokens, including loan receivables owed to Tether, are subject to the risk of default, insolvency, inability to collect, and illiquidity." (*Id.* Ex. C, at 2 (Item 7).)

The industry press covered these changes. In March 2019, *Bitcoin Magazine* published an article under the headline, "Tether Updates Website, Says USDT Backed by 'Reserves,' Not

Just Cash." (*Id*. Ex. D.) The same day, *Marketwatch* published an article with the headline, "Tether reverses claim of 100% dollar backing, sparking criticism." (*Id*. Ex. E.)

For whatever alleged "criticism" the change engendered, however, the markets remained confident in tether, as it continued to trade at par or better (*i.e*., $1 for every U.S. Dollar Tether, or USDT) after the reporting. (*Id*. ¶ 32 & Ex. F, at 2 (showing closing price of tether at $1.00 and $1.01 on March 14 and 15, 2019, respectively).)

Tether Holders Are Not at Risk

Neither the updated disclosure nor the line-of-credit transaction itself has impeded Tether's ability to process redemptions. (*Id*. ¶ 33.) At present, Tether has cash and cash equivalents (*i.e.*, short-term securities) on hand totaling approximately $2.1 billion, representing approximately 74 percent of the current outstanding tethers. (*Id*.) Between December 2018 and April 29, 2019, the average daily fiat redemption has been $566,066.00, with the largest being $24.2 million. (*Id*.) The vast majority of redemption requests of Tether are for less than $1 million. (*Id*.) Even if Bitfinex fully draws on the remaining amount of the line of credit, the reserves will still be just below $2 billion, representing approximately 68% percent of the current outstanding tethers. (*Id*.)

Beyond Tether's cash on hand and cash equivalents, additional reserves are available, though in less liquid form. (*Id*. ¶ 34.) That Tether does not keep liquid, cash reserves equal to 100 percent of the outstanding tethers is not only disclosed to customers, but hardly a novel concept. (*Id*.) Commercial banks operate under a "fractional reserve" system whereby they keep cash on hand representing only a small fraction of customer deposits, deploying the rest via investments. (*Id*.) According to the Federal Reserve website, the banks must keep cash reserves representing, at most, only 10 percent of their liabilities. (*Id*. & Ex. G, at 1.) Tether's cash

reserves far exceed that, and the company has never lacked the funds to process a redemption. (*Id*. ¶ 34.)

The Attorney General's Investigation and Respondents' Extensive Cooperation

In November 2018, Bitfinex and Tether learned that the Attorney General was conducting an investigation, and counsel for the companies proactively reached out to the Attorney General's office to offer their cooperation. (April 30, 2019 Affirmation of Jason Weinstein ("Weinstein Aff.") ¶ 5.) Contrary to the highly misleading portrayal in the Attorney General's *ex parte* application, Bitfinex and Tether have been fully cooperative since that time. (*Id*. ¶¶ 5-48.) The companies' cooperation includes making 12 separate document productions, comprising over 19,000 pages of material. (*Id*.) On top of that, Bitfinex and Tether provided 26 pages of written responses to the Attorney General's information requests. (*Id*. ¶¶ 43, 47.)

The Attorney General's *ex parte* application suggests that Bitfinex and Tether were not forthcoming about the line-of-credit transaction, but that is false. As shown by correspondence, the Attorney General chose to omit from the *ex parte* application, counsel for Bitfinex and Tether proactively and voluntarily disclosed the existence of the contemplated loan transaction, and then promptly produced the deal documents after it happened. (*See id*. ¶ 4 & Ex. 12, at 3.)

The Attorney General's *Ex Parte* Application

Without any prior warning or notice to Bitfinex and Tether, the Attorney General on April 24, 2019 filed an application in this matter under N.Y. Gen. Bus L. § 354 to require Bitfinex and Tether to produce additional information by this Friday, May 3, 2019, and for a preliminary injunction. The same day, Justice Debra James signed the Attorney General's proposed order without any substantive alteration. (Weinstein Aff. Ex. 1.) The April 24, 2019 Order requires Bitfinex and Tether to appear at a hearing on Friday, May 3, 2019, and to produce sixteen broad categories of information. (*Id.* at 2-4.) The Order also indefinitely enjoins (among

other things): "Further action by Bitfinex or Tether to access, loan, extend credit, encumber, pledge, or make any other claim, of any variety or description, on the U.S. dollar reserves held by Tether." (*Id.* at 4 (item (i)).) The injunction also prohibits certain "distribution[s] or dividend[s]," and requires Bitfinex and Tether to preserve documents. (*Id.* at 4-5 (items (ii) and (iii)).)

The Attorney General immediately issued a press release to boast of the Order. (Weinsten Aff. Ex. 16.) The Order was widely covered in the press, including an article in the *Wall Street Journal*, which sourced some of its information to "people close to the attorney general's investigation." (Hoegner Aff. ¶ 35 & Ex. H, at 3.) Clearly, the Attorney General was aiming to make a public "splash" without giving Bitfinex or Tether a chance to defend themselves.

Despite the inflammatory nature of the application, and the many false or misleading statements, tether continued to trade at just below par thereafter. (Hoegner Aff. ¶ 35 & Ex. F, at 2 (showing closing price of tether at $0.997 on April 25, 2019).) The volume of trading was far higher than normal, which shows that tether holders who thought the news was grounds to sell had a highly-liquid market in which to do so. (*Id.* ¶ 35.) Since the news, tether has processed redemptions with no interruption. (*Id.*)

DISCUSSION

I. THE COURT HAS BROAD DISCRETION TO IMMEDIATELY STAY AND ULTIMATELY VACATE OR MODIFY THE APRIL 24, 2019 ORDER

The Court is authorized "at any time" to "vacate or modify" a preliminary injunction, *see* CPLR 6314, and whether to do so is left to the Court's "sound discretion." *Rosemont Enters. v. Irving*, 49 A.D.2d 445, 448 (1st Dep't 1975). Bitfinex and Tether bring this motion via an order to show cause instead of the ordinary notice procedures, which litigants may do "in a proper

case." CPLR 2214 (d). Whether to sign the order to show cause is "entirely in the judge's discretion." *Id*. Practice Commentaries § C2214:25.

As discussed below, an order to show cause is necessary here because of the immediate harm wrought by the April 24, 2019 Order's legally-invalid terms. Bitfinex and Tether cannot wait the weeks or months typically necessary for a motion to be briefed and decided.

Given the urgency, the proposed order to show cause requests that the Court immediately stay the previously-issued order pending a hearing at the Court's earliest convenience. A "stay is an appropriate remedy, and can be included in an order to show cause," under either CPLR 2201, which authorizes a stay "in a proper case," or CPLR 5015, which authorizes relief from an order "upon such terms as may be just." *See* CPLR 2214, Practice Commentaries § C2214:26.

Because a request for a stay "affects activity within the litigation" only — as opposed to a temporary restraining order, which "affects the adverse party's out-of-court conduct" — stays may be issued immediately without the proponent having to show irreparable injury or otherwise meeting the traditional standards for interim relief under Article 63. *Id*.

II. THE APRIL 24, 2019 ORDER SHOULD BE VACATED OR MODIFIED

A. The Indefinite *Ex Parte* Order Was Issued Without Basic Due Process Protections

The April 24, 2019 Order should be vacated at the outset because of the improper means by which it was obtained. Under basic due process principles, the government cannot deprive a person of property without notice and an opportunity to be heard, "except for extraordinary situations where some valid governmental interest is at stake that justifies postponing the hearing until after the event." *Fuentes v. Shevin*, 407 U.S. 67, 82 (1972); *see also Matter of Fosmire v. Nicoleau*, 144 A.D.2d 8, 12 (2d Dep't 1998) (recognizing "due process implications caused by proceeding without notice"). An *ex parte* temporary restraining order can qualify as the type of

"extraordinary" situation authorizing action before notice, but the affected party must always be given a "prompt judicial or administrative hearing that would definitely determine the issues." *Barry v. Barchi*, 443 U.S. 55, 64 (1979).

These strictures are reflected in the CPLR. After a temporary restraining order is issued, the court must "set the hearing for the preliminary injunction at the earliest possible time." CPLR 6313. That is because "[t]he purpose of a temporary restraining order is to preserve an existing situation in status quo until the court has an opportunity to pass upon the merits of the demand for a preliminary injunction." *Pan Am. World Airways, Inc. v. Flight Engineers' Int'l Ass'n*, 306 F.2d 840, 842-43 (2d Cir. 1962).

While the April 24, 2019 Order in this case is nominally a preliminary injunction, it is the equivalent of an *ex parte* temporary restraining order — except one without any contemplated expiration date or hearing. That is flatly inconsistent with due process.

Any reading of Gen. Bus. L. § 354 that would authorize an open-ended *ex parte* injunction should be rejected. The court in *Dairymen, Inc. v. Hardin*, 369 F. Supp. 1102 (E.D. Tenn. 1974), faced a similar situation, and appropriately recognized that due process must control. There, a Tennessee statute relating to milk cooperatives appeared to "mandate ex parte relief" and bar "hearing upon the plaintiff's application for a preliminary injunction," but the court concluded that a "literal reading of the statute" would "raise due process issues." *Id*. at 1104. Accordingly, the court read the statute as "not modifying requirements of notice, hearing or the usual equitable principles applicable to the granting of preliminary injunctive relief." *Id*.

The same reasoning applies here. The April 24, 2019 Order purports to impose an indefinite injunction without the traditional right to be heard. For that reason alone, it should be

vacated, and any further application from the Attorney General should be required to comply with the standard procedures for preliminary injunctive relief.

B. The Attorney General's *Ex Parte* Application Should Have Been Governed by the Traditional Standards for a Preliminary Injunction

The Attorney General's initial *ex parte* application was brought under a Gen. Bus. L. § 354, which is part of the Martin Act. By statute, the CPLR governs in Martin Act matters: "The provisions of the civil practice law and rules shall apply to all actions brought under this article except as herein otherwise provided." Gen. Bus. L. § 357.

Recognizing this point, the Court of Appeals has held that a "preliminary injunction under the Martin Act, as under CPLR article 63, should be granted only upon a showing of a likelihood of success on the merits, irreparable injury if the relief is not granted, and a balancing of the equities." *State v. Fine*, 72 N.Y.2d 967, 968-69 (1988). The Attorney General did not cite *Fine*, nor attempt to meet its standards.

Instead, the Attorney General relies upon a nonbinding trial court decision, *Schneiderman v. Eichner*, No. 451536/2014, 2016 WL 3057994, at *1 (N.Y. Sup Ct. May 26, 2016), which concluded that the language in Gen. Bus. L. § 354, authorizing a preliminary injunction where "proper and expedient," supplanted the traditional Article 63 standards.

Respectfully, *Eichner* was incorrectly decided and should not be followed. The more natural reading of the "proper and expedient" clause is that it supplements (not replaces) the ordinary standards. How would a court determine the "prop[riety]" of a preliminary injunction, except by reference to the traditional standards for one?

There are other contexts where the term "proper" refers to existing standards. For example, the CPLR provision authorizing a venue change for cases not brought in the "proper county" is understood to mean that the trial court must determine whether the original venue

choice complied with the venue "rules specified in [the] CPLR" or "some other venue-regulating statute." CPLR 510, Practice Commentaries C501:1. It does not mean the trial court can jettison the existing venue rules and send cases to any county that it considers to be "proper."

The court in *Eichner* was also wrong in failing to apply Gen. Bus. L. § 357, which, as discussed, incorporates the CPLR into Martin Act matters. The court in *Eichner* seized on the fact that Gen. Bus. L. § 357 refers to incorporating the CPLR for purposes of an "action," which the court interpreted to mean only a Martin Act lawsuit under Gen. Bus. L. § 353 (the procedural posture in *Fine*) not to a pre-complaint special proceeding under Gen. Bus. L. § 354 (the procedural posture in that case and here). 2016 WL 3057994, at *13.

This hyper-technical reading is wrong. By statute, "[t]he word 'action' includes a special proceeding," CPLR 105(b), and, except where otherwise specified, the "procedure in special proceedings shall be the same as in actions." CPLR 103(b). "This enables procedures that are applicable in terms to an 'action' to govern in special proceedings . . . without having constantly to repeat the words 'special proceeding.'" David D. Siegel, New York Practice § 4 (6th ed. 2018).

Even apart from the plain statutory language, there is no good reason to have one preliminary injunctions standard for a pre-complaint proceeding under Gen. Bus. L. § 354, and another after the complaint is filed under Gen. Bus. L. § 353. This is especially true because an injunctions issued at the pre-complaint phase will persist through the action. *Attorney General v. Katz*, 55 N.Y.2d 1015, 1017 (1982). Why would the Legislature give the Attorney General incentive to always seek the drastic remedy of an injunction at an earlier, less developed stage of a case? This would make no sense.

The Court should follow the Court of Appeals decision in *Fine* and apply the traditional preliminary injunction standards.

C. The April 24, 2019 Order Cannot Be Justified Under the Traditional Preliminary Injunction Standard

Under the traditional standards for a preliminary injunction, it is clear that there was no basis for the April 24, 2019 Order.

1. The Attorney General Will Not Succeed on the Merits

a. The Martin Act

The Martin Act was enacted in 1921 as "New York's version of the blue sky laws which, in various forms, have been enacted by every State in the country." *CPC Int'l Inc. v McKesson Corp*., 70 N.Y.2d 268, 276 (1987). The name "blue sky" refers to the aim of these laws to stop swindlers that would "sell shares of the blue sky to unsuspecting purchasers." *Anwar v. Fairfield Greenwich Ltd*., 728 F. Supp. 2d 354, 359 (S.D.N.Y. 2010) (citation omitted).

The Martin Act does not attempt to regulate the particular features of securities or the business of the issuers but instead reflects a "disclosure approach." *Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership*, 879 N.Y.S.2d 17, 21 (2009). The theory is that, if the risks of an investment are disclosed, investors can engage in "self-protection" by deciding for themselves whether to buy or sell. *Id*.

As is pertinent here, the Martin Act prohibits "fraud, deception, [and] concealment . . . where engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities." N.Y. Gen. Bus. L. § 352-c(1), and authorizes the Attorney General to bring a civil action for injunctive relief and restitution. Gen. Bus. L. § 353(1), (3).

"Although the Martin Act was enacted in 1921, its present form generally tracks the Federal securities acts of 1933 and 1934," and thus courts should "look[] to Federal court decisions construing those statutes when interpreting" the Martin Act. *People v. Landes*, 84 N.Y.2d 655, 660 (1994).[1]

b. The Attorney General Has Not Shown that Tether Is a Security or Commodity Covered by the Martin Act

The New York Attorney General's contemplated Martin Act action is unlikely to succeed based on a threshold fact that the tethers that were allegedly sold via fraud (*i.e.*, the allegedly undisclosed transaction that depleted the tether reserves) fall entirely outside the statute's reach.

As is relevant here, the Martin Act covers only transactions in "securities or commodities, as defined in section three hundred fifty-two of this article," N.Y. Gen. Bus. L. § 352-c(1), which, in turn, defines:

- securities as "any stocks, bonds, notes, evidences of interest or indebtedness or other securities"; and
- commodities as "any commodity dealt in on any exchange within the United States of America or the delivery of which is contemplated by transfer of negotiable documents of title"

N.Y. Gen. Bus. L. § 352(1). The Attorney General's papers do not attempt to explain how tether meets these definitions, except to state in passing that tethers "have characteristics of securities and commodities." (April 25, 2019 Affirmation of Brian M. Whitehurst ("Whitehurst Aff.") (ECF No. 1) ¶ 28.) Even if true, that is not the standard.

For purposes of the "securities" definition, the Court of Appeals has adopted the "so-

[1] Bitfinex and Tether dispute that this Court has jurisdiction over them for any Martin Act claims because, among other reasons, they do not operate in the United States, and because both companies bar New York residents from doing business on their platforms. The present application is focused on ameliorating the immediate harm wrought by the Attorney General's improper *ex parte* order, but should not be understood as a concession as to jurisdiction.

called '*Howey* test'" from federal securities case law, under which a transaction is a security if it involves "an investment of money in a common enterprise with profits to come solely from the efforts of others." *All Seasons Resorts v. Abrams*, 68 N.Y.2d 81, 92 (1986) (citation omitted). Tethers do not meet this definition because they are "stablecoins" used to perform the administrative function of facilitating transactions in other virtual currency. (Hoegner Aff. ¶ 9.) There is no expected "profit" from stablecoins; their reason to exist is to be redeemable at exactly par — no more — so that they can be used as a medium of exchange. (*Id*.)

Courts have found that instruments that function in an analogous fashion — as a medium of exchange between markets — are not securities under the Martin Act. For example, in *Lehman Bros. Comm'l Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 159, 164 (S.D.N.Y. 2001), the court found that foreign currency exchange transactions and interest rate swaps did not meet the definition. In both cases, the value is based on "market forces" not on the issuer's "entrepreneurial efforts." *Id*. (citation omitted).

Nor has the Attorney General shown that tether the type of "commodity" covered by the Martin Act. The statute covers only those commodities that are "dealt in on any exchange within the United States of America or the delivery of which is contemplated by transfer of negotiable documents of title." N.Y. Gen. Bus. L. § 352(1). The Attorney General has not attempted to show how these criteria are met.

c. <u>Tether Disclosed that Its Reserves Included Affiliate Loans</u>

Pervading the Attorney General's motion papers is the mistaken premise that the Martin Act's antifraud language prohibits the allegedly "conflicted" line-of-credit transaction between Bitfinex and Tether. For example, the Attorney General's brief complains that "investors remain indefinitely exposed to ongoing and highly conflicted activity that has every indication of fraud." (NYAG Br. 21.) As an initial matter, the Attorney General is confused because there are no

"investors" here—a point made 21 times throughout the Attorney General's memorandum of law. There are only customers at issue. But further, the Martin Act does not purport to regulate corporate governance or conflicts of interest; as discussed, the Act takes a "disclosure approach," *Kerusa*, 879 N.Y.S.2d at 21. Under that approach, a disclosed conflict is not fraudulent.

For example, in *In re AIG Advisor Group Sec. Litig.*, 309 F. App'x 495, 496 (2d Cir. 2009), investors alleged that financial advisors had a "conflict of interest based on their receipt of 'secret payments'" for having promoted certain securities, but the Second Circuit dismissed federal securities claims because the company website "disclosed the existence of the very 'conflict of interest'" supposedly concealed. *Id*. at 496. (As discussed, the federal cases are instructive to interpreting the Martin Act. *See Landes*, 84 N.Y.2d at 660.) Similarly, in *Wilson v. Merrill Lynch & Co., Inc.*, 671 F.3d 120 (2d Cir. 2011), the Second Circuit rejected federal securities claims challenging Merrill Lynch's practice of bidding in its own auctions for auction-rate securities — allegedly to create the false impression of demand — because "Merrill disclosed that it would 'routinely' bid on its own account." *Id*. at 135.

In both *AIG* and *Wilson*, the federal antifraud laws did not purport to address whether the underlying, allegedly "conflicted" activity was lawful. The question was whether the activity was disclosed, so that counterparties or investors could make informed decisions.

This same basic analysis applies to the Martin Act, and is exactly why there is no fraud in this case. Tether changed its website in February to make clear that tethers were backed by reserves that would include "loans" to "affiliated entities." (Hoegner Aff. ¶ 31 & Ex. B, at 6 (Item 1.1.32); Ex. C, at 2 (Item 7).) This change was widely covered in the industry press. (*Id*. ¶ 32 & Exs. D, E.) Anyone holding tether was thus on notice of the risks and could decide for

themselves whether to sell. And they have had every ability to do so; the line-of-credit transaction has not impeded redemption at all. (*Id.* ¶ 33.)[2]

d. The Attorney General Is Unlikely to Obtain Any Relief on the Merits

A preliminary injunction is also inappropriate here because the Attorney General is unlikely to obtain relief on any of its Martin Act claims. The statute authorizes injunctive relief and restitution, Gen. Bus. L. § 353(1), (3), but neither could possibly be appropriate in this case.

First, there is no evidence of any harm that would merit restitution, because the Attorney General has not identified any victim that has suffered any loss. There is not one customer identified that has been unable to transact business on Bitfinex based on the allegations in the petition, nor any customer identified that has been unable to redeem his or her tether. As discussed, Tether has been able to honor redemptions without interruption, and has ample liquid reserves to continue doing so. (Hoegner Aff. ¶¶ 33-35.)

Second, the Attorney General will not be able to obtain permanent injunctive relief because, again, the information supposedly concealed from "investors" — that Tether's reserves were deployed in part towards affiliated transactions — was disclosed prominently on Tether's website over two months ago and even discussed prominently in the press. Further details are now fully in the public domain, thanks to this very proceeding.

The Martin Act authorizes the Attorney General to file suit to enjoin anyone "**participating in or about to participate in** [the] fraudulent practices" that form the basis for a claim "from continuing such fraudulent practices or engaging therein or doing any act or acts in

[2] It also bears emphasizing that, contrary to the portrayal in the Attorney General's brief, the supposedly "conflicted" transaction was undertaken with safeguards to ensure that the result reflected an arm's length deal. (Hoegner Aff. ¶ 25.)

furtherance thereof." N.Y. Gen. Bus. L. § 353 (emphasis added). The phrasing in the present tense means that, "[w]here the defendant is not engaged in an ongoing violation," there must be a "reasonable likelihood that the wrong will be repeated" to justify injunctive relief. *SEC v. Am. Bd. of Trade, Inc.*, 751 F.2d 529, 537 (2d Cir. 1984) (construing similar language in federal securities statutes). That necessarily means that "[i]njunctive relief should not be granted if the harmful conduct sought to be enjoined has been discontinued." *Datil v. Watson*, 97 Civ. 4970, 1997 WL 715680, at *1 (S.D.N.Y. Nov. 13, 1997).

Here, as discussed, the alleged wrongdoing within the purview of the Martin Act is not the line-of-credit transaction itself, but the alleged nondisclosure of that information. While Bitfinex and Tether do not believe they did anything wrong at any point in time, any failures to timely disclose information to customers or to holders of tether was cured when Tether updated its website over two months ago — long before this proceeding was filed. The ongoing transactions via Bitfinex and Tether are not in any sense fraudulent, nor is the line-of-credit transaction. Without any ongoing fraudulent activity, there is little likelihood that the Attorney General's contemplated enforcement action will succeed in obtaining a permanent injunction after trial. For these reasons, the preliminary injunction was improper and should be vacated.

2. The Attorney General Has Not Shown Any Irreparable Harm

The Attorney General has not shown any harm whatsoever, let alone harm that would be irreparable. The Attorney General's overarching concern appears to be the alleged depletion of Tether's reserves, but, as discussed, Tether has cash and cash equivalents (*i.e.*, short-term securities) on hand representing approximately 74 percent of the outstanding tethers, and other assets of value that more than cover the outstanding amount. (Hoegner Aff. ¶¶ 33-34.) This sort of "fractional reserving" is how commercial banks operate (*id.* ¶ 34), yet no one would contend

that a commercial bank's inability to cash out a hypothetical simultaneous request from 100% of its customers for all their money is a fraud on anyone.

The Attorney General's suggestion that redemptions will become a problem is not based on evidence; it is rank speculation. And even if the Attorney General could show that customers are "somewhat less secure," that would hardly "constitute an irreparable injury so as to require the drastic remedy of such an injunction." *Firemen's Ins. Co. of Newark, New Jersey v. Keating*, 753 F. Supp. 1146, 1154 (S.D.N.Y. 1990).

3. The Balance of Equities Favors Bitfinex and Tether

The balance of equites strongly factors Bitfinex and Tether, because the Attorney General's preliminary injunction was obtained via a misleading application, and serves no purpose except to generate headlines. On the other side of the ledger, the injunction is highly disruptive to Bitfinex's business, and will only harm the very customers the Attorney General claims to be interested in protecting. (Hoegner Aff. ¶ 40.)

D. A Preliminary Injunction Is Not "Proper and Expedient"

Even if the Court declines to review the April 24, 2019 Order under the traditional standards, the injunction remains inappropriate under the "proper and expedient" standard advocated by the Attorney General. There is scant case law on what exactly would make a preliminary injunction "proper and expedient," or why the standard would vary from the established one in ordinary cases. But regardless of how the standard is interpreted, preliminary injunctions are "'drastic' remedies," *see Uniformed Firefighters Ass'n v. New York*, 79 N.Y.2d 236, 241 (1992) (citation omitted), and reserved "extraordinary" circumstances, *Margolies v. Encounter*, 42 N.Y.2d 475, 479 (1977). The Court should not allow the one here to stand because, as discussed, there is little merit to the Attorney General's claims, and no useful purpose to be served by the injunction.

III. THE APRIL 24, 2019 ORDER SHOULD BE IMMEDIATELY STAYED PENDING A DECISION ON THIS APPLICATION

The Court should sign the accompanying, proposed Order to Show Cause immediately staying the April 24, 2019 Order because, as demonstrated above, the April 24, 2019 Order never should have been issued, and is highly disruptive to Bitfinex's business. Further, it demands a wide swath of documents be produced by Friday, which is simply not possible. (Weinstein Aff. ¶ 50.) If the Attorney General's office believes an injunction is appropriate, it should marshal the appropriate proof at a contested hearing, as contemplated by the proposed Order to Show Cause. At that point, the Court can decide on a full record whether interim relief is appropriate. A hearing is normally required before preliminary injunctive relief may be issued, and the Attorney General has failed to explain what emergency or other good reason merits a deviation from the normal procedures. Bitfinex and Tether would welcome a scheduled hearing at the Court's earliest opportunity.

CONCLUSION

For the stated reasons, the Court should vacate or modify the April 24, 2019 *Ex Parte* Order in this proceeding on the term described above.

Dated: New York, New York
April 30, 2019

Respectfully submitted,

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RULE 17 CERTIFICATION

I am the attorney who is filing this document. I hereby certify that this document, exclusive of the caption, table of contents, table of authorities, and signature block contains 6,990 words as counted by the word-processing system used to prepare the document.

/s/ Zoe Phillips
Zoe Phillips