Morgan Lewis

Steptoe

October 8, 2019

By NYSCEF and Email

Hon. Joel M. Cohen
Supreme Court, New York County
60 Centre Street, Room 570
New York, New York 10007
sfc-part3@nycourts.gov

Re: *In re Letitia James v. iFinex Inc., et al*., Index No.: 450545/2019 (N.Y. Sup. Ct.)
Response to OAG Request for Further Discovery and Injunction Extension

Dear Justice Cohen:

We write on behalf of the Respondents in the above matter, "Bitfinex" (collectively, iFinex Inc., BFXNA Inc., and BFXWW Inc.), and "Tether" (collectively, Tether Holdings Limited, Tether Operations Limited, Tether Limited and Tether International Limited), in response to the letter of October 1, 2019 from the Office of Attorney General ("OAG"), which seeks (1) to compel the Respondents to search for and collect huge volumes of discovery immediately, and (2) to extend the preliminary injunction in this matter (the "OAG Letter").

First, OAG's requests concerning discovery must be denied because the First Department issued an Order staying these proceedings pending appeal. (Ex. A.)

Despite the stay, OAG asks the Court — citing to *no* authority — to direct the Respondents to "search for and collect" the discovery material at the heart of this dispute, so that the material is ready to be produced immediately if OAG prevails in the First Department and the stay is lifted. (OAG Letter, at 1.) This is an audacious attempt to have this Court countermand the First Department's Order, which granted in full the Respondents' motion for a stay, without any qualification as to the stay's scope. The Respondents' stay motion was based, in part, on avoiding the very burdens of collecting documents that OAG is demanding the Respondents undertake now and that could be rendered pointless if the Respondents prevail on appeal.

OAG appears to assume that these collection burdens are meaningless, and that it suffices for the stay to relieve the Respondents from *only* the burden of actually turning over the discovery material to OAG. This distinction is illogical, and in all events is not reflected in the First Department's Order. If OAG wanted a more limited stay from the First Department, reaching only the act of producing documents, OAG should have made that request to the First Department. It chose not to. This Court cannot grant OAG a "do over," particularly where doing so would drastically rewrite a ruling from the First Department.

Second, the Respondents do not oppose OAG's request to extend the injunction in this case through the period of the First Department stay and, if OAG prevails on appeal, until 90 days thereafter.

Background

As the Court will recall, this is a proceeding under Gen. Bus. L. § 354, which authorizes OAG to apply to the Court for discovery and injunctive relief after OAG has "determined" to bring a civil action under the Martin Act, but before actually doing so.

On April 24, 2019, Justice Debra James signed, without any material alteration, an Order that OAG had presented *ex parte* requiring that the Respondents produce huge volumes of discovery and subjecting them to a broad injunction that (among other restrictions) indefinitely prohibited either Respondent from "access[ing]" or making any "claim" on the reserves backing tethers for any reason. (Doc. 35, at 4 (the "§ 354 Order").) The case was assigned to this Court.

On April 30, 2019, three business days after receiving the §354 Order, the Respondents moved to vacate or modify the preliminary injunction. (Docs. 23-52.) On May 16, 2019, the Court granted, in part, the Respondents' motion. (Doc. 76.) The injunction was substantially narrowed both in its substantive scope and duration. The Court revised the broad prohibition on accessing Tether's reserves so as to only prohibit related party transactions outside the ordinary course of business. (*Id*. at 17.) The Court also ruled that the injunction would expire in 90 days, subject to OAG's right to request an extension. (*Id*. at 17-18.)

On May 21, 2019, the Respondents moved by order to show cause to dismiss these proceedings for lack of personal and subject matter jurisdiction (among other grounds), and the same day the Court granted the Respondents' request to halt the discovery component of the § 354 Order, except as to jurisdictional discovery, while the motion was pending. (Doc. 80.)

Between May and July, the Respondents produced 70,000 pages of documents, involving 15 custodians across 10 different communication platforms. The Respondents turned over to OAG all responsive material concerning customers with any New York operations or controlling shareholders. They did so notwithstanding their belief that this goes far beyond what is relevant for personal jurisdiction. The Respondents do not do business with any New York entities, and the fact that some of the Respondents' foreign entity customers have shareholders with New York ties should not be relevant, since those shareholders are not themselves parties to the transactions at issue. But the Respondents, acting in good faith, produced material concerning those entities anyway.

On August 19, 2019, the Court denied the Respondents' motion to dismiss, lifted its stay of discovery, and extended the expiration date of the preliminary injunction to October 14. (Doc. 115, at 27.)

Two days later, on August 21, 2019, the Respondents filed a motion with the First Department for a stay pending appeal.[1] (Ex. B.) The motion did not seek a narrow stay that would cover only the act of turning over material to OAG; it asked that the First Department "immediately stay **any** discovery proceedings before the trial court" pending appeal. (*Id*. at 5 (emphasis added); *see also* at 35 (concluding sentence requesting "that the Court stay **all proceedings** until this Court resolves the Companies' appeal") (emphasis added).)

The motion explained that if the Respondents were "forced to complete the very burdensome discovery that they will be arguing on appeal was ordered without authority," then any relief the First Department "may order will likely be meaningless." (*Id*. at 18.) Further, the Respondents were clear that they sought to avoid the document collection expense that OAG now askes this Court to foist upon them:

> Notably, the discovery at hand is also hugely burdensome. The Companies have already spent well over $500,000 responding to just those portions of the document demands that were carved out from the [trial court's] stay—*i.e*., those requests that bear on personal jurisdiction. (Ex. 21 at 2.) This is not a document production that simply entails pressing a button and collecting emails from a centralized server. On the contrary, the companies and their personnel use more than 10 different communications platforms—several of which are encrypted and pose substantial collection and review challenges. (*Id*.) As a result, the process of responding to the carve-out from the stay involved an **immensely complex document collection**, unprecedented in size, involving over 60 lawyers. (*Id*.) The costs of complying with the remaining parts of the § 354 Order's very broad document demands could be orders of magnitude higher.

(*Id*. at 18-19 (emphasis added).)

In opposing the motion, OAG did not argue, as it does now, that the Respondents should be required to search for and collect documents responsive to the § 354 Order, even if a stay as to production were entered. (Ex. C.) To the contrary, OAG argued that "litigation expense, even substantial and unrecoupable cost, does not constitute irreparable injury" (*id*. at 21) — implicitly recognizing that granting the Respondents' motion *would* spare them the "unrecoupable cost[s]" of document collection. The motion was fully briefed as of September 6, 2019. (Ex. D.)

[1] On August 21, 2019, the Respondents also sought an interim stay from the First Department pending its decision on the motion to stay, but that request was denied.

In the meantime, the parties met with Special Referee Liebman on September 13 to discuss discovery. He ordered the Respondents to produce certain categories of material that was not in dispute within two weeks, and scheduled a follow up conference on September 27 to coincide with the deadline. Special Referee Liebman indicated that individual requests that were subject to disputes would be resolved through briefing, assuming no stay issued in the meantime.

On September 24, 2019, before Special Referee Liebman's production deadline, the First Department granted the Respondents' stay motion. (Ex. A.) It did so without *any* reservation or qualification as to the scope of the stay, or any indication that the Respondents' motion was only granted in part. The only limitation in the Order is the condition that the Respondents perfect their appeal by November 4 (which they will do):

> An appeal having been taken from an order of the Supreme Court, New York County, entered on or about August 19, 2019,
>
> And respondents-appellants having moved to stay enforcement of the aforesaid order pending hearing and determination of the appeal taken therefrom,
>
> Now, upon reading and filing the papers with respect to the motion, and due deliberation having been had thereon,
>
> It is ordered that the motion is granted on condition the appeal is perfected on or before November 4, 2019 for the January 2020 Term.

(*Id*.)

The Court Must Honor the First Department's Stay

OAG's demand to compel the Respondents to engage in document collection must be rejected for the simple reason that the First Department has stayed these proceedings.

OAG cites no authority for its demand for proceedings to continue in any form in the face of the stay. And indeed, we have seen no case in which one party obtained a stay of trial court proceedings pending appeal, but was nonetheless ordered to engage in document collection, just in case that party were to lose the appeal and the stay were lifted.

OAG tries to justify its unprecedented demands by arguing that the "harm" sought to be avoided by the stay in this case was merely "production to the OAG" — *not* the burdens associated with document collection. (OAG Letter, at 3.) The immediate problem with this argument is that nothing in the stay Order indicates that it covers only "production to the OAG," or that *any* discovery proceedings are authorized. The stay Order is categorical, and it granted in full a motion which had expressly asked that the First Department "immediately stay **any** discovery proceedings before the trial court." (Ex. B, at 5 (emphasis added).) There is no

qualification to the stay Order, except the condition that the Respondents perfect their appeal by November 4. (Ex. A.)

Even if it were appropriate to look behind the plain language of the stay Order, any suggestion that the stay was intended only to address the act of producing documents to OAG is false. As detailed above, the Respondents argued at length in their stay motion that they would be prejudiced by burdens associated with "immensely complex **document collection**" that could be rendered pointless if the Respondents were to prevail on appeal. (Ex. B, at 18-19 (emphasis added).) While the First Department issued only a summary order, it is fair to infer that the First Department agreed that the Respondents had at least raised legitimate issues on appeal that could be resolved in the Respondents' favor, sparing them the exact burdens raised in the motion.

OAG's attempt to rewrite the language and intention of the stay Order is all the more galling, since OAG never even attempted to advance before the First Department the imaginative gloss on the stay Order that it now asks the Court to adopt. OAG's opposition to the Respondents' stay motion did not anywhere argue that a stay should be limited to the act of producing material to OAG, or that document collection obligations should be carved out of any stay. (Ex. C.) If OAG wanted the First Department to draw that distinction, it could have asked for that relief at the time. OAG never did. This is not the appropriate venue for reconsideration of First Department rulings.

As a fallback, OAG argues in a footnote that "[a]t the very least," the Court should compel the Respondents to catalogue "in detail" their collection efforts to date, and then "delineate how those materials are responsive" to each individual request. (OAG Letter, at 2 n.2) This request should be denied for the same reasons as above: it is flatly inconsistent with the First Department's stay Order.

Beyond that, Gen. Bus. L. § 354 does not authorize OAG to demand that a respondent provide a narrative response to questions, as if answering an interrogatory. Instead, the statute contemplates that a witness would "appear before" a special referee and "produce such papers, documents and books concerning the alleged fraudulent practices to which the action which he has determined to bring relates" Gen. Bus. L. § 354, to the extent such documents are "in his possession or under his control," *id*. § 355. This statutory language allows only for the production of preexisting documents. It does not come close to authorizing OAG to demand a respondent provide written, narrative answers to OAG's questions. *Cf.* CPLR 3120, Practice Commentaries ¶ C3120:2B (recipients of document demands under CPLR 3121 are "only obligated to produce 'preexisting and tangible' items," and need not create new material); *Thompson v. Nat'l Union Fire Ins. Co*., 14 Civ. 259, 2015 WL 753721, at *5 (D. Conn. Feb. 23, 2015) (rejecting document request calling for a "narrative response consistent with an interrogatory").

Finally, OAG bemoans the alleged delay caused by the stay. (OAG Letter, at 3.) But OAG raised the same points to the First Department, which evidently concluded that the reasons

in favor of a stay outweighed any alleged prejudice from the delay. (Ex. C, at 2 (complaining that OAG will "suffer significant harm if a stay issues" because of "Respondents' delay tactics"); *id*. at 20 ("further delay of its investigation, which has languished for months while respondents have repeatedly and unsuccessfully tried to end OAG's investigation").)

OAG's allegations concerning delay are in all events misleading, and unfairly attack the motives of the Respondents and their counsel. To correct the factual record, the Respondents note the following:

- OAG complains of "seriatim" and "duplicative" motions from the Respondents as party of a "litigation strategy . . . to delay" (OAG Letter, at 1, 3), but the Respondents brought only two motions before this Court. The first was granted in part, resulting in a substantial narrowing of the injunction (Doc. 76), and the second, the Respondents' motion to dismiss, is the subject of an appeal that the First Department has apparently considered serious enough to merit a stay of these proceedings. (Ex. A.) Any suggestion that these two motions were brought for delay or any other improper purposes is baseless.

- OAG complains of "several weeks of delay" in August and September after the motion to dismiss was denied (OAG Letter, at 1-2), but fails to tell the Court that the Special Referee had initially scheduled a first conference after the ruling for September 26, unless the parties agreed on an earlier appearance date. (Ex. E, at 2.) The Respondents nonetheless agreed to meet two weeks *sooner*, on September 13 (*id*. at 1), and then at the conference agreed to make an initial production two weeks later, exactly as the Special Referee directed. These facts reflect the Respondents' diligence, not any effort to delay.

- OAG complains of being unable to conduct a "thorough" or "coherent" investigation (OAG Letter, at 2), but fails to mention that Respondents have already produced material pertaining to customers with New York connections. Given that the Martin Act reaches only domestic conduct — that is, "fraud, deception, [or] 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)(c) (emphasis added) — OAG has already received the primary universe of what could possibly be relevant. Further, contrary to OAG's suggestion, OAG has been conducting its investigation, including subpoenaing third parties, throughout this period. The investigation has not been stalled.

- OAG complains that the Respondents have sought to narrow certain of the overly broad requests, stating that the § 354 Order "is clear about what Respondents are required to produce." (OAG Letter, at 2.) But OAG fails to mention that the

> Court granted the Special Referee the power to "work with the parties **with respect to the scope** and timing of compliance" of the document requests. (Doc. 76, at 8 (emphasis added).) Further, the Court made clear from the bench that, if individual requests were "unreasonable or not terribly relevant," those issues could be raised to the Special Referee. (Ex. F, at 63.) The Court added that it did not "read the statute to mean that we're sort of potted plants here." (*Id*. at 67.) The parties would have surely made more progress on discovery if OAG had not stubbornly and incorrectly insisted that any discussion as to the scope of the requests was out of bounds.

In sum, OAG's accusation that the Respondents have improperly delayed the case is a baseless smear the Court should disregard, and that has nothing to do with the question at hand: whether the Court should compel discovery in the face of the First Department's stay. For the reasons stated above, the answer to that question is no. The Court should honor the First Department's stay, and reject OAG's request to compel the Respondents to collect discovery.

Duration of the Injunction

OAG asks that the injunction persist for the duration of the stay and, assuming OAG prevails on appeal, for 90 days thereafter. While OAG never bothered to ask the Respondents for their views on this proposal beforehand, the Respondents do not object to it. We understand the inclination to preserve the status quo during the stay period, and, further, that some period thereafter is necessary to give the parties and the Court the chance to assess the facts as they may exist at the time.

To be clear, however, the Respondents maintain their view that the injunction should not have issued in the first place, and expect to challenge any further extension of the injunction beyond the extension before the Court now.

As the Court will recall, the injunction arises from OAG's allegation that tether holders were led to believe their tethers were fully backed by traditional currency, when a portion of the reserves was in the form of a line of credit to Tether's affiliate Bitfinex. The Court concluded that the injunction was justified because the line-of-credit transaction (or similar related party transactions) "may undermine representations regarding tether upon which investors and traders rely" concerning the backing of tethers. (Doc. 76, at 12.) The Court's focus on the Respondents' "representations" is consistent with the underlying theory of the Martin Act, which is "disclosure" to the markets, not regulating what types of instruments can or cannot be sold. *Kerusa Co. LLC v W10Z/515 Real Estate Ltd. Partnership*, 879 N.Y.S.2d 17, 21 (2009). Investors warned of the facts can engage in "self-protection" by deciding for themselves whether to buy or sell. *Id*.

While the Respondents believe that their representations were accurate, and that they timely disclosed changes to their reserve policies, the past five months (and counting) of this

highly public proceeding would surely alleviate any possible disclosure concern. Tether holders knowing that Tether's reserve policies allow for affiliate loans have at all times been freely able to redeem their tethers for traditional currency, with the injunction barring any affiliate lending in the meantime. Tether has had no issue or disruption processing redemptions through the present day. That redemption right is exactly what Tether's customers are promised from the start — no more and no less. Customers who choose to continue holding tethers in light of these broadly publicized facts are doing so with eyes wide open and with no need for an injunction. This will become even more so over time, and the justification for the injunction will correspondingly diminish.

We note that the appeal is scheduled to be heard in January, and, even if a decision issues immediately, a further period of 90 days under the injunction will take us to April 2020 — a full *year* from when the injunction first issued. This is by any measure an excessively long period of time, and certainly more than enough time for tether holders to decide in full view of the facts whether they would like to continue holding their tethers or to redeem.

* * *

We thank the Court for its consideration of these matters.

Respectfully,

Jason Weinstein
Charles Michael
STEPTOE & JOHNSON LLP

David I. Miller
Zoe Phillips
MORGAN, LEWIS & BOCKIUS LLP

Counsel for Respondents

cc: John Castiglione, Office of the Attorney General
(by email to John.Castiglione@ag.ny.gov)

Johanna Skrzypczyk, Office of the Attorney General
(by NYSCEF and email to Johanna.Skrzypczyk@ag.ny.gov)

Brian Whitehurst, Office of the Attorney General
(by NYSCEF and by email to Brian.Whitehurst@ag.ny.gov)