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The Dual Nature of Fiduciary Duties for  
Public Authorities

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# The Dual Nature of Fiduciary Duties for Public Authorities

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## INTRODUCTION

### **The Road to Reform - Mismanagement, Corruption and PARA**

In 2004, Assemblyman Richard Brodsky, then-Attorney General Elliott Spitzer, and then-Comptroller Alan Hevesi led investigations into the mismanagement of public authorities.<sup>1</sup> At issue was the role of the board of directors of each authority; oversight and transparency of the authority's actions; and the board's accountability to the authority, the public, and the entity which appoints the members.<sup>2</sup> At the time, authorities were responsible for approximately \$43 billion in state-funded debt (consisting of both general obligation and moral obligation debt), though the financial transactions of only eleven public authorities were subject to statutory limits and review by the Public Authorities Control Board.<sup>3</sup> And while the public was funding many of these authorities, information about their finances was largely inaccessible. Even in the course of a government investigation, Assemblyman Brodsky could not obtain information from at least one public corporation without subpoena.<sup>4</sup> It was unconscionable that a publicly funded entity was so removed from public scrutiny that a high ranking official was afforded minimal accessibility to the authority.

The need to better regulate public authorities led to the enactments of the Public Authorities Accountability Act of 2005 ("PAAA") and the Public Authorities Reform Acts of 2009 ("PARA").<sup>5</sup> Among other significant provisions, PARA established an Independent Authorities Budget Office ("ABO") to increase transparency with state and local authorities,

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<sup>1</sup> Public Authorities in New York State: Accelerating Momentum to Achieve Reform 3 (N.Y. Off. of the St. Comptroller Feb. 2005) [hereinafter *Comptroller's Report*].

<sup>2</sup> Letter from the N.Y. St. S., dated August 18, 2009, Bill Jacket, L. 2009, ch. 505, at 5.

<sup>3</sup> *Comptroller's Report*, *supra* note 1, at 9.

<sup>4</sup> *Comptroller's Report*, *supra* note 1, at 10.

<sup>5</sup> Unless otherwise specified, all laws and analysis will focus on the Public Authorities Reform Act of 2009.

clarify the fiduciary duty of board members, and establish standards of conduct. While these measures did not go into effect until March 2010, the effects of a more transparent and structured system are more than likely to increase public trust in the government and ensure more efficient use of public resources.

One issue remains unclear, and that is the fiduciary duty of board members. Principles of corporate law, the Public Authorities Law, and the Public Officers Law all play a part in defining the duties owed by board members to the authority and the public. But what happens when the authority's interest and the public's interest are in conflict? To whom does the board member owe a greater duty? And what entity should decide these issues when conflict arises? After all, public authorities function as independent corporations, but exist to serve the public. In this paper, I will first describe the nature of public authorities and how they function in New York. Next, I discuss the nature of fiduciary duty, its value, and how it applies to public authorities. And finally, I explain existing oversight and enforcement entities, and explore potential actions to increase accountability.

## **Public Authorities in New York**

In 2005, when reform was initiated, the Comptroller's office identified 733 public authorities and their subsidiaries.<sup>6</sup> By the most recent count, there are 480 state and local public authorities in New York, and more than 200 local development corporations.<sup>7</sup> Public Authorities include state and local authorities, public benefit corporations and their subsidiaries, and not-for-

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<sup>6</sup> *Comptroller's Report*, *supra* note 1, at 6.

<sup>7</sup> Authorities Budget Office *2010 Annual Report on Public Authorities in New York State* 3 (2010). One potential explanation for the decrease in authorities is that reform measures resulted in the consolidation or elimination of many authorities that were found inefficient, wasteful or unnecessary.

profits sponsored by or created by a county, city, town, or village government.<sup>8</sup> The objective of these quasi-government entities is to “finance, construct and operate revenue-producing facilities for the public benefit, assist the public sector with projects intended to spur economic development, provide financial support for non-profit sector projects that serve public needs, and/or coordinate the development or management of resources that transcend traditional political boundaries.”<sup>9</sup> In short, public authorities are created by and exist for the state, and therefore must serve the interests of the public.

Because public authorities were created first, and regulation followed, they exist in various forms. Generally, a “state authority” is a public authority or public benefit corporation with at least one of the board members appointed by the governor.<sup>10</sup> Alternatively, that board member could serve as an *ex officio* member where a public official is made a member of the board by virtue of holding a certain civil office.<sup>11</sup> A “local authority” is a public authority or public benefit corporation whose board members are generally appointed by the local government.<sup>12</sup> A local authority may also be a not-for-profit corporation affiliated with a local government (county, city, town or village), a local industrial development agency or other local benefit corporation, or an affiliate of a local authority.<sup>13</sup>

Authorities differ significantly from agencies and other government offices in a number of ways, most notably in that they operate independently of elected officials and political

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<sup>8</sup> N.Y. Pub. Auth. Law § 2(1), (2) (2011).

<sup>9</sup> *Comptroller’s Report*, *supra* note 1, at 8.

<sup>10</sup> N.Y. Pub. Auth. Law § 2(1).

<sup>11</sup> *Id.* For example, three of the five board members of the Buffalo and Fort Erie Public Bridge Authority serve *ex officio* by virtue of their respective offices. They are the New York State Department of Transportation Commissioner, the Niagara Frontier Transportation Authority Chairman, and the New York State Attorney General – or their respective designees.

<sup>12</sup> N.Y. Pub. Auth. Law § 2(2).

<sup>13</sup> *Id.*

influence.<sup>14</sup> For this reason, authorities are not under the direct control of elected officials and therefore, each authority can create its own management style based on its individual needs and policies.<sup>15</sup> Authorities do enjoy some benefits as government agents, such as tax exemptions and tax-based financing to pay the debt service on authority-issued debt.<sup>16</sup> However, authorities are not subject to the same traditional oversight, transparency requirements, and accountability that apply to other government operations since they do not fit within the same category as other government entities. While the public pays into a few authorities with taxes, most of them receive an indirect public benefit through tax offsets.<sup>17</sup> No matter how the authority is publicly financed, however, the public is never afforded traditional consumer protection since authorities have exclusive control over certain services.<sup>18</sup> Therefore, no competition exists to ensure certain standards or to allow the public to express dissatisfaction.<sup>19</sup> Because there are no stockholder meetings or proxy votes, authorities can operate virtually unchecked.<sup>20</sup> This laissez faire existence has allowed, on occasion, mismanagement of resources and instances of potential corruption within authorities.

Because authorities operate as corporations, not government agencies, they are governed by a board of directors who owe a fiduciary duty to the authority. The most basic role of board members is to monitor the managers who run the corporation, while allowing them flexibility in making business decisions.<sup>21</sup> In doing so, the board prevents self-dealing and mismanagement.

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<sup>14</sup> Charles Brecher, *What Happened to Authority Reform?*, 11 N.Y.S.B.A. Gov't, Law & Pol. J. 25, 26 (Fall 2009).

<sup>15</sup> *Comptroller's Report*, *supra* note 1, at 9.

<sup>16</sup> Brecher, *supra* note 14 at 36.

<sup>17</sup> *Id.*

<sup>18</sup> *Comptroller's Report*, *supra* note 1, at 9.

<sup>19</sup> Although, public influence is not unprecedented. In 2003, the Hudson River-Black River Regulating District proposed a 1,000% fee increase for access to the Sacandaga Reservoir. When the public criticized the measure and the issue garnered widespread attention, the authority revoked the proposal. *Comptroller's Report*, *supra* note 1, at 13 (citing "Agency to Consider Water-Access Hikes," *The Times Union*, December 14, 2003.).

<sup>20</sup> *Comptroller's Report*, *supra* note 1, at 9.

<sup>21</sup> Jeffrey D. Bauman, Alan R. Palmiter & Frank Partnoy, *Corporations Law and Policy* 137-38, 302 (6th ed. 2007).

On behalf of the shareholders – or the electing or appointing body – board members are traditionally responsible for keeping the financial records in order and regularly reviewing the financial statements to determine accuracy and completeness; providing advice and counsel to management; and establishing and reviewing the adequacy of internal controls.<sup>22</sup> In contrast to the authority’s corporate nature, the authority also serves as a government entity, and members of the board are appointed not by shareholders, but by the Governor, the Legislature, or local officials.<sup>23</sup> In this latter role, board members have a duty of trust, honesty and fair dealing to the general public and to the “statutory mission of the authority.”<sup>24</sup> By one estimate, public authorities are responsible for over \$133 billion in debt.<sup>25</sup> With such a huge financial stake, the public has an even stronger interest in ensuring that authorities operate efficiently and that all officers are making decisions to further each authority’s mission and purpose.

## **FIDUCIARY DUTIES**

Fiduciary duty governs the relationship between different corporate actors and is derived from the law of trusts.<sup>26</sup> The duty has different meanings depending on the context of the person or entity with the duty, and to whom the duty is owed. Two types of fiduciary duties are recognized by corporate law – the duty of loyalty and the duty of care – and both are evaluated within the context of the business judgment rule.<sup>27</sup> By the basic tenets of business law, corporations are to be organized and managed primarily for the profit of stockholders. Public

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<sup>22</sup> *Id.* at 640-61.

<sup>23</sup> *Comptroller’s Report*, *supra* note 1, at 12.

<sup>24</sup> Letter from Assem. Richard L. Brodsky, dated September 17, 2009, Bill Jacket, L. 2009, ch. 505, at 8.

<sup>25</sup> Ira M. Millstein, Cathy A. Bell, Scott N. Fein, Nancy H. Henze, Marvin E. Jacob, Lee Smith, Thomas R. Suozzi, *Governor’s Task Force on the Implementation of the 2009 Public Authorities Reform Act – Report*, 1 (2009), <http://www.abo.state.ny.us/aboTaskForce/ParaTaskForceFinalReport.pdf>.

<sup>26</sup> Bauman, Palmiter & Partnoy, *supra* note 21, at 29.

<sup>27</sup> *Id.*

benefits – if any – are to be limited as incidental to that primary purpose.<sup>28</sup> As a corporation designed around the public interest, authorities have their own definition and parameters of fiduciary duty. This is discussed more in the following section.

## **The Duty of Loyalty**

The duty of loyalty is premised on the avoidance of conflicts of interests through disinterested board members.<sup>29</sup> A disinterested member is one who has no personal or professional stake in a business deal and does not stand to derive personal gain from any business decision.<sup>30</sup> Conflicting loyalties can manifest in the context of executive compensation, transactions by controlling shareholders, insider trading, and protection of control of the corporation.<sup>31</sup> For example, while PARA allows a board member to serve as both the CEO and Chair, it prohibits the CEO/Chair from participating in discussions to determine compensation for the CEO.<sup>32</sup> This is an obvious safeguard to prevent actual or apparent conflicts of interest where a decision-maker is in a position to act for personal gain.

To further ensure that the duty of loyalty is honored, every state authority is required to maintain a contemporaneous record of all lobbying contacts made with any member, officer or employee of the authority.<sup>33</sup> The record is to include a general summary of the substance of the

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<sup>28</sup> For example, Henry Ford, president of Ford Motor Company, after the huge financial success of his company which resulted in large profits, expressed his intent to employ more men and spread the benefits of industry to the public over increasing the profits to the company's shareholders. The court found that he breached his duty to the shareholders and required that he pay the profits to them rather than use them for public interest projects. "The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employees [sic]... and a general purpose and plan to benefit mankind at the expense of others, is obvious... A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end." *Dodge v. Ford Motor Co.*, 204 Mich. 459, 468, 506-07, 170 N.W. 668, 671, 684 3 A.L.R. 413 (1919).

<sup>29</sup> Bauman, Palmiter & Partnoy, *supra* note 21, at 736.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> Scott Fein, *The Public Authorities Reform Act of 2009* 11 (n.2) N.Y.S.B. Assoc. Gov., Law & Policy J. 102, 103 (Fall 2009).

<sup>33</sup> N.Y. Pub. Auth. Law § 2987 (2011).

contact, and it must be kept on file for at least seven years so that they may be reviewed to determine whether lobbying contacts influenced decisions made by the authority.<sup>34</sup> This rule is important to determine whether a board member acted with independent judgment or was improperly influenced by a third party representing interests other than those of the authority and the public. Additionally, board members are subject to the anti-conflict provisions of the State Public Officers Law or the General Municipal Law.

As sometimes seen in business law, new directors can be brought on just to create a majority of “disinterested” directors. In these cases, the danger lies with board members who are independent and disinterested in form, but not substance. The subsequent violation is not of board members deriving personal benefit, but of violating principals of equity and loyalty.

### **The Duty of Care**

The duty of care involves good faith efforts of management.<sup>35</sup> Specifically, board members must take reasonable efforts to be attentive and prudent in making business decisions, and must apply diligence to the “ordinary and extraordinary needs of the corporation.”<sup>36</sup> This includes taking reasonable care in discharging their responsibilities, rather than “rubber-stamping” a decision without properly considering it.<sup>37</sup> The ABO cites improper oversight as a significant cause to breaches of fiduciary duty.<sup>38</sup> To avoid this, and to be in compliance with the

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<sup>34</sup> N.Y. Pub. Auth. Law § 2987 (2011).

<sup>35</sup> Bauman, Palmiter & Partnoy, *supra* note 21, at 29.

<sup>36</sup> Bauman, Palmiter & Partnoy, *supra* note 21, at 29, 641.

<sup>37</sup> “Rubber-stamping” or acting as a “dummy director” are two ways that a director might try to protect him/herself from participating in decision-making under the false assumption that doing so will absolve him or her from liability. *Id.*

<sup>38</sup> Authorities Budget Office, *supra* note 7, at 12-13.

duty of care, board members should be more involved in reviewing and determining the accuracy of the authority's annual reports.<sup>39</sup>

There have been numerous reported examples of board members breaching this duty. The Comptroller's March 2004 audit of the Rochester-Genesee Regional Transportation Authority (RGRTA) revealed that the authority made significant decisions regarding the proposed Rochester Central Station without sufficient study or documentation to support such choices.<sup>40</sup> This greatly increases the risk of entering into needlessly expensive contracts when a lower bid might exist, underestimating construction hazards (and thereby exposing the authority to liability), and overpaying in services and supplies. In similar cases, the New York Power Authority's poor planning and reliance on questionable cost estimates in constructing the Poletti Power Plant in New York City inflated the expected cost of the project by 73% (\$275 million),<sup>41</sup> and the board of Nassau Health Care Corporation failed to authorize or ratify decisions made by its officers, including pay raises and a proposed severance package for the former CEO.<sup>42</sup> If it were later determined that personal dealings were involved, such as granting a contract to a family member or granting pay raises above the value of the employees' service, the board members would not be absolved of responsibility simply because they didn't inform themselves of the conflicts of interest or mismanagement.

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<sup>39</sup> *Id.*

<sup>40</sup> Comptroller Rep. No. 2005-F-9, at 2-3 (March 8, 2006) (reviewing the 2004 audit and following up on recommended courses of action).

<sup>41</sup> *Comptroller's Report, supra* note 1, at 15.

<sup>42</sup> *Id.*

## **The Business Judgment Rule**

The business judgment rule is generally a defense to breach of duty accusations.<sup>43</sup> The rule preserves the discretion of directors to manage the authority without undue interference from outside parties, and protects directors when well-meaning decisions result in failure.<sup>44</sup> Generally, when a reasonable purpose for a decision can be found, objecting parties must defer to the judgment of the board members.<sup>45</sup> After all, if the ABO or the appointing entity were to investigate every decision based on a belief that a better choice should have been made, authorities would become inefficient and overburdened. The business judgment rule allows board members – who are chosen specifically for their expertise, experience or other qualifications – to exercise independent judgment under the presumption that their decisions are well informed, serve a rational business purpose, are disinterested and are made independently.<sup>46</sup>

## **TO WHOM FIDUCIARY DUTIES MIGHT BE OWED**

As directed in PARA, board members must sign an Acknowledgement of Fiduciary Duty, which provides notice of each member’s legal obligations, facilitates understanding of their duties, and ensures that official action will be in accordance with the mission of the authority.<sup>47</sup> The language of the Acknowledgement is clear; by signing, the board member acknowledges “his or her role and fiduciary responsibilities” and the “duty of loyalty and care to the organization and commitment to the authority’s mission and the public interest.”<sup>48</sup> The Acknowledgement sets forth the mission of each authority to achieve a public purpose on behalf

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<sup>43</sup> Arther R. Pinto & Douglas M. Branson, Understanding Corporate Law 122 (3d ed. 2009).

<sup>44</sup> Bauman, Palmiter & Partnoy, *supra* note 21, at 29.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> N.Y. Pub. Auth. Law § 2824(1)(h) (2011).

<sup>48</sup> *Id.*, see also Acknowledgment of Fiduciary Duty, 10-01 Pol. Guidance Auth. Budget Off. 2 (2010).

of the state.<sup>49</sup> Also included is an agreement to maintain a duty of care and a duty of loyalty by exercising independent judgment on all matters before the board, even when interested parties come before the board in an attempt to influence decision making.<sup>50</sup> Board members agree to attend board and committee meetings, and engage fully in the decision-making process.<sup>51</sup> This is consistent with corporate law, where board members cannot merely “rubber-stamp” decisions of the board and thereby absolve themselves of any liability arising from those decisions. The Acknowledgement also contains a confidentiality provision and disclosure requirements in the event of any actual or perceived conflicts of personal, financial, ethical or professional interests.<sup>52</sup> Furthermore, each board member must agree, in writing, that he or she does not have “any interest, financial or otherwise, direct or indirect, or engage in any business or transaction or professional activity or incur any obligation of any nature, which is in substantial conflict with the proper discharge of my duties in the public interest.”<sup>53</sup>

There are three potential beneficiaries of the board member’s fiduciary duty: the public official or entity which appointed the board member, the authority itself, and the public to which the authority serves. While explicit duty is limited to the authority and the public, not to the individual or entity which appoints the board member, the potential for influence from the appointer this is still great.

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<sup>49</sup> Acknowledgment of Fiduciary Duty, 10-01 Pol. Guidance Auth. Budget Off. 2 (2010).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

## **Fiduciary Duty to the Appointing Public Official or Entity**

Board members have no fiduciary duty to the person or entity which appointed them to their position – neither in practice nor by statute.<sup>54</sup> However, board members are susceptible to the interests of the appointing or designating party since their service beyond their initial term of appointment depends on performing a satisfactory job from the perspective of the appointer or designator.<sup>55</sup> This is not to suggest that board members cannot consider the interests of individuals outside the authority. To the contrary, the fiduciary duty of care actually requires members to consider the views and policies of public officials, government bodies, and any other individual during the decision-making process.<sup>56</sup>

However, a fine line exists between input and influence. The influence by a public official over a board member may manifest in facially neutral ways – such as implied expectations of the appointer or displays of gratitude by the board member – but nonetheless compromise the integrity of the board member and breach the public’s trust in government. This power is exacerbated by the appointing party’s removal power of any appointed board member for inefficiency, breach of fiduciary duty, neglect of duty or misconduct in office.<sup>57</sup> While certain procedural safeguards exist, the law gives the public official discretion on whether to pursue charges.<sup>58</sup>

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<sup>54</sup> “Board members of state and local authorities shall... [acknowledge] that he or she understands his or her duty of loyalty and care to the organization and commitment to the authority’s mission and the public interest.” N.Y. Pub. Auth. Law § 2824(1)(h) (2011).

<sup>55</sup> Millstein et al., *supra* note 25, at 15.

<sup>56</sup> Board members must act “in good faith and with the degree of diligence, care and skill which an ordinarily prudent person in like position would use under similar circumstances” when considering the issue before them. N.Y. Pub. Auth. Law § 2824(1)(g) (2011).

<sup>57</sup> N.Y. Pub. Auth. Law § 2827 (2011).

<sup>58</sup> The public officer or public body must follow Due Process procedures by giving the board member a copy of the charges against him and an opportunity to be heard in person or by counsel in his or her defense. *Id.*

Improper influence is prohibited on both sides; first, the board member is required to exercise independent judgment and act in the interests of only the authority and the public,<sup>59</sup> and secondly, the public official is prohibited to use his or her position to influence another public official. As written under the standards of the Public Officers Law, public officials should not be in a position where they “incur any obligation of any nature” which could constitute a conflict of interest with their public duties, use or attempt to use their official position “to secure unwarranted privileges or exemptions,” give the impression that they can be influenced, or raise suspicion that they are untrustworthy.<sup>60</sup> Each of these standards address issues of trust, transparency, and honesty – as public officials, these values are to be upheld at all costs. Even the appearance of undue influence can damage the public’s perception of a disinterested board member working for the public interest. Therefore, public officials must be especially prudent when interacting with board members since their position lends itself considerably to the potential for improper influence, regardless of either party’s intention.<sup>61</sup>

And finally, the ABO exists to oversee not just the actions of board members, but those of the appointing officers as well. If a board member breaches his or her fiduciary duty and the appointing official refuses to remove the member, the ABO can issue a recommendation to the appointing entity for the suspension or dismissal of the board member.<sup>62</sup> In the event that the ABO suspects that criminal activity is involved – such as a public officer’s refusal to discipline a board member because that board member provides a financial or personal benefit to the officer – the activities are reportable to the attorney general and other law enforcement agencies.<sup>63</sup> This

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<sup>59</sup> N.Y. Pub. Auth. Law § 2824(1)(g).

<sup>60</sup> N.Y. Pub. Off. Law § 74 (2011).

<sup>61</sup> Millstein et al., *supra* note 25, at 18.

<sup>62</sup> *Id.* (citing N.Y. Pub. Auth. Law § 6(2)(a) – (j) (2011).

<sup>63</sup> N.Y. Pub. Auth. Law § 6(2)(h).

is an important role of the ABO to ensure that improper influence does not persist when both parties are equally at fault and therefore unwilling to raise the issue.

### **Fiduciary Duty to the Public**

When considering the ‘public’ as the beneficiary of fiduciary duty, one must determine *which* public interest is to be served. After all, every characterization of ‘the public’ – whether local, state-wide or national – includes a variety of conflicting interests. From this viewpoint, it is increasingly difficult to specify to whom allegiance is owed. For example, when a board decides to sell authority-owned assets below market value, its motive might be to encourage economic development in disadvantaged communities.<sup>64</sup> Allowing flexibility in price setting (as long as the discount was properly disclosed) could actually facilitate board members’ ability to serve the interests of the public.<sup>65</sup> Conversely, selling the land at or above market value would better serve the financial interests of the authority and potentially lessen its reliance on tax-based financing.

For the sake of discussion, a parallel can be drawn between the government lawyer and a public authority.<sup>66</sup> Both have broad authority to act in a way that affects the public as a whole by creating legislative initiatives, regulation, and advisory opinions on issues before the authority.<sup>67</sup> The purpose of both the authority and the government lawyer is not to represent the interests of an individual client, but to carry out statutory mandates. The issue then becomes how to

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<sup>64</sup> Letter from the N.Y. St. Assoc. of Counties, dated July 24, 2009, Bill Jacket, L. 2009, ch. 505, at 44.

<sup>65</sup> PARA does not completely prohibit authorities from selling land below market value when the sale is consistent with the authority’s mission. Rather, the proposal must first be reviewed by the Comptroller to verify the motives behind the deal, and publicly disclose the nature and value of the subsidy. Richard L. Brodsky, *The Public Authorities Reform Act of 2009: Brining Transparency, Accountability, and a System of Checks and Balances to New York’s Shadow Governments*, 11 N.Y.S.B.A. Gov’t, Law & Pol. J. 23, 24 (Fall 2009).

<sup>66</sup> Jeffrey Rosenthal, *Who is the Client of the Government Lawyer?*, in *Ethical Standards in the Public Sector* 17, 17 (Patricia E. Salkin ed., 2008).

<sup>67</sup> *Id.* at 18.

interpret the goals of the statute, since competing interests will invariably identify different methods to fulfilling statutory requirements. At the same time, there remains an ethical consideration “to preserve, advocate, and advance the interests of the ‘client’.”<sup>68</sup> Identifying the client – and therefore, the interests of the client – is of utmost importance since the government lawyer must interpret the statute, and tailor his strategy and advice, based on these interests.<sup>69</sup>

The second issue with the public as a client is determining who decides what constitutes the public interest. One perspective is that allowing a government lawyer to decide the public interest would result in arbitrary and inconsistent enforcement which will lead to public distrust.<sup>70</sup> “Although the public interest as a reified concept may not be ascertainable, the Constitution establishes procedures for approximating that ideal through election, appointment, confirmation, and legislation. Nothing systematic empowers lawyers to substitute their individual conceptions of the good for the priorities and objectives established through these governmental processes.”<sup>71</sup> In this sense, the public authority, by creating its own mission statement within the parameters of the statute, is interpreting the public interest according to its own priorities. Furthermore, the statute itself could not represent the public interest since legislation is always the result of compromise, a balancing of interests, and the often the self-interest of a particular constituency. Lobbying efforts, budgetary constraints and political favors only compound the impossibility that a statute might serve only the public interest. While the public interest is always in consideration, it alone does not dictate the actions of government.<sup>72</sup>

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<sup>68</sup> Rosenthal, *supra* note 66, at 19.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 19-20 (citing Geoffrey P. Miller, *Government Lawyers’ Ethics in a System of Checks and Balances*, 54 U. Chi. L. Rev. 1293 (1987)).

<sup>71</sup> *Id.*

<sup>72</sup> “[T]he government, over-all and in each of its parts, is responsible to the people in our democracy with its representative form of government. Each part of the government has the obligation of carrying out, in the public interest, its assigned responsibility in a manner consistent with the Constitution, and the applicable laws and regulations. In contrast, the private practitioner represents the client’s personal or private interest... [W]e do not

Just as the government lawyer is charged with the great task of upholding justice in its entirety, the authority must consider the long-term goals of the government business at hand over the immediate interests of some members of the public.

For the above reasons, it is impractical to identify the broad and varying ‘public interest’ as the focus of a government lawyer’s responsibility. Instead, like employees of the authority, the duty lies with the government organization itself.

In addition to the statutory requirement that directors sign the Acknowledgment of Fiduciary Duty, board members are also required to review and consider the intended purpose of the authority and file a statement defining that mission and a plan for evaluating their performance against the mission.<sup>73</sup> These policies are considered to further define each board member’s duty to the public, in light of the authority’s mission and purpose. Using the authority’s own mission, each board member can identify which public interest it must serve, and when a conflict arises, the board must use their judgment to choose the best option.

One example where the ABO found that the authority neglected its fiduciary duty to the public involved the Duchess County Resource Recovery Agency.<sup>74</sup> By law, this agency is tasked with ensuring that all solid waste generated within the county is sent to the agency’s waste-to-energy facility.<sup>75</sup> By failing to enforce these statutory requirements, investigations revealed that the agency was not able “to maximize the use of its facility or to generate sufficient tipping fee revenue to meet its operating expenses” and required county subsidies – through

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suggest, however, that the public is the client as the client concept is usually understood. It is to say that the lawyer’s employment requires him to observe in the performance of his professional responsibility the public interest sought to be served by the government organization of which is a part.” Rosenthal, *supra* note 66, at 29 (citing Federal Bar Association Ethics Committee, *The Government Client and Confidentiality: Opinion 73-1*).

<sup>73</sup> Authorities Budget Office, *supra* note 7, at 2.

<sup>74</sup> *Id.* at 7.

<sup>75</sup> *Id.*

taxpayer money – to cover the deficit.<sup>76</sup> In this case, the agency breached its fiduciary duty by failing to adopt certain management practices and internal control procedures which would have served the public’s needs without any additional cost. Instead, their mismanagement resulted in \$1.2 million in lost revenue and unnecessary operating costs.<sup>77</sup>

There is another parallel to be drawn when comparing the fiduciary duties of appointed members of a board to elected officials and *ex officio* members of a board. Elected members are directly accountable to the citizens who elect them – the citizenry of the municipal entity that creates the authority. However, appointed members are equally accountable to the public for their performance both directly (since they can be removed for cause) and indirectly (since they are generally appointed by elected officials such as legislators). As public officers, board members – whether appointed or elected – are governed by ethical rules and regulations, and they have a fiduciary duty to the municipal entity they serve.<sup>78</sup> For example, the Port Authority consists of 12 Commissioners that act as board members, and each must file oaths of office as public officers and obey the laws governing public officers.<sup>79</sup>

### **Fiduciary Duty to the Authority**

By law, a board member has a simultaneous duty to the authority’s mission and the public interest.<sup>80</sup> Therefore, these board members serve a dual role as director of a corporation and public official. While the responsibilities to each may often overlap since the authority’s mission is ideally that of the public interest, there are bound to be situations of competing

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<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 8.

<sup>78</sup> Letter from Darrell Buchbinder, Gen. Counsel, Port Auth. of New York & New Jersey, to Elizabeth M. Murphy, Secretary, Sec. & Exch. Comm’n (Feb. 18, 2011) (on file with Albany Law School).

<sup>79</sup> *Id.*

<sup>80</sup> N.Y. Pub. Auth. Law § 2824(1)(h) (2011), *see also* Acknowledgment of Fiduciary Duty, 10-01 Pol. Guidance Auth. Budget Off. 2 (2010).

interests. Here, the board member must choose loyalty to one at the risk of breaching his or her duty to the other. Since every board member owes a fiduciary duty to the public authority, which exists for the public benefit, the board must act within accordance with public interest. In other words, the board members – regardless of whether they are appointed, serve *ex officio* or elected – are directly accountable to the citizens of the locality served by the authority.

For example, the Comptroller’s July 2004 audit of the Metropolitan Transportation Authority (“MTA”) concentrated on the MTA’s consideration of a price hike for MetroCards and service cuts to close a \$540 million budget deficit, just fourteen months after the largest fare hike in the history of New York City.<sup>81</sup> An additional fare increase would over burden the public and thereby work against its interest. However, the authority’s budget was overstretched and needed additional financing. Since the public interest should be served first, and the authority’s mission should be that of the public interest, a solution keeping with the board’s fiduciary duty would be focused on increasing efficiency, scaling back on costs, and improving operations with less cost.

Unlike corporate boards, Public Authority Boards are not given absolute discretion in managerial decisions. For example, state authorities are required to submit for review by the Office of the State Comptroller every contract valued at more than \$1 million.<sup>82</sup> Additionally, state authorities are required to comply with state standards in awarding contracts to qualified minority and women owned businesses.<sup>83</sup> These mandates serve the public interest by ensuring oversight of large contracts and encouraging certain types of businesses, but do not necessarily serve the immediate financial interests of the authority.<sup>84</sup> This is another example of the

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<sup>81</sup> *Comptroller’s Report*, *supra* note 1, at 15.

<sup>82</sup> N.Y. Pub. Auth. Law § 2879-a (2011).

<sup>83</sup> N.Y. Exec. Law § 310 (2011).

<sup>84</sup> Authorities which focus on large construction and development projects might actually be overburdened by increased regulations. For example, over a three year period, the Dormitory Authority of New York (“DASNY”) executed more than 400 construction and procurement contracts that exceeded \$1 million (the total value was estimated at \$2.2 billion). DASNY asserted that the Comptroller’s review process would cause undue delays; as a

difficulty facing board members who must comply with a dual fiduciary duty to both the public and a corporate-like authority, and tailor the authority's priorities to serve the public interest.

## OVERSIGHT OF BOARD MEMBERS

Board members, of any type of corporation, are generally responsible for the management and staff of the corporation, and must ensure that the overall activities of employees are consistent with the corporation's policy mission and in compliance with statutory and regulatory mandates. Prior to reform measures, board members had independent discretion on whether to voluntarily adopt recommended measures to improve their operations, and some authorities created their own code of ethics to ensure compliance with other statutory principles.<sup>85</sup> These practices had varying levels of success within the authority itself, though some continue today. For example, the Port Authority's Code of Ethics incorporates applicable law in governing the conduct of the Board of Commissioners, including requirements for disclosure of financial and personal interests.<sup>86</sup> The code is more similar to NY law governing unsalaried public officers since the Commissioners are appointed and unpaid.<sup>87</sup> This is important because regardless of compensation, each member still has professional, personal and

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result, lost economic activity was estimated to cost \$170 - \$432 million, and added construction costs would be \$80 to \$100 million annually. Letter from the N.Y. Dormitory Auth., dated August 12, 2009, Bill Jacket, L. 2009, ch. 505, at 43. Whether these estimates will be realized remains to be seen. The DASNY 2010-11 operating budget decreased by 2.74% and internal operating expenditures increased 6.98% (\$5.46 million). Dormitory Auth. of the St. of N.Y., *Public Authorities Accountability Act Annual Report – Operations and Accomplishments* at 12 (2010), available at <http://www.dasny.org/dasny/accountability/20092010/200910%20Authority%20highlights%20061610%20FINAL.pdf>. However, most recent reports reveal that at the close of Fiscal Year 2010, DASNY had 715 projects valued at more than \$6.75 billion; expenditures on projects increased from \$839 million the previous year, to \$993 million in 2010. Dormitory Auth. of the St. of N.Y., *Annual Report 2010* at 24 (2010), available at [http://www.dasny.org/2010AnnualReport/2010\\_DASNY\\_Annual\\_Report.pdf](http://www.dasny.org/2010AnnualReport/2010_DASNY_Annual_Report.pdf).

<sup>85</sup> For example, the Port Authority maintains an Ethics Charter, enforced by a Governance and Ethics Committee, to formalize certain guidelines to ensure compliance with the authority's by-laws and general ethical duties. (The charter is available at <http://www.panynj.gov/corporate-information/government-ethics-committee-charter.html>.)

<sup>86</sup> Buchbinder, *supra* note 78. See also <http://www.panynj.gov/corporate-information/government-ethics-committee-charter.html>

<sup>87</sup> Buchbinder, *supra* note 78.

other potential conflicts of interest that could influence their decision-making for the authority.<sup>88</sup> Their fiduciary duty to the authority is no difference than elected members of any other authority, since every board member – regardless of how they achieve the position and whether they are paid for their service – are the “embodiment of the entity, decision makers, through which it acts.”<sup>89</sup>

Without exception, however, oversight is necessary to restore public trust in authorities, and not all authorities can be trusted to monitor themselves. For example, the New York Racing Association allowed improper and illegal activity to persist until – and as a condition of deferred prosecution – a monitor was appointed by the federal court.<sup>90</sup> Similarly, when the Canal Corporation sold exclusive development rights along the canal for \$30,000, the Comptroller had to intervene and nullify the sale.<sup>91</sup> As a result, guidelines were established for the sale of property as a reasonable value and without political influence.<sup>92</sup>

Misdeeds can often highlight the need for reform and identify where oversight is most lacking. In most of these cases, increased transparency could have prevented much of the damage from misconduct. This can be achieved by separating the roles of the board chair and the CEO, making annual reports and budgets easily accessible to the public, ensuring that board members are truly independent, and making sure authorities adopt up-to-date corporate governance practices.<sup>93</sup>

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<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Comptroller’s Report, supra* note 1, at 10.

<sup>91</sup> *Id.*

<sup>92</sup> Letter from the N.Y. St. S., dated August 18, 2009, Bill Jacket, L. 2009, ch. 505, at 5.

<sup>93</sup> The suggestions are based on testimony given by Kathryn Wylde, President and CEO of Partnership for New York City. *Comptroller’s Report, supra* note 1, at 11 (citing Partnership Testimony on Public Authorities before the Senate Committee on Corporations, Commissions and Authorities. Dec. 8, 2004).

Overall, the entity with oversight and enforcement authority often has discretion of when to investigate and pursue charges against a fiduciary. In this sense, it has the ability to prioritize the values inherent in fiduciary duties and shape public perception of government activities.

### **The Authorities Budget Office**

Instances of improper influence, unfair dealings, and blatant misconduct demonstrate the need for comprehensive policies regarding oversight and accountability. It is impractical and illogical to rely on investigations to keep authorities in check. As part of PARA, the Authorities Budget Office (“ABO”) was created to collect information on public authorities’ finances and operations, review data to ensure compliance with state laws, enforce laws and regulations, train and provide guidance to public authority staff, and investigate complaints made against public authorities for “non-compliance or inappropriate conduct.”<sup>94</sup> Because the ABO is funded by special fees to public authorities, rather than legislative appropriations, it remains independent.<sup>95</sup>

The New York Legislature created the ABO to provide necessary oversight of the operations and finances of public authorities.<sup>96</sup> By providing real-time review of issues relating to management, debt, compensation of board members, the procurement process, and the disposition of property, the ABO has the authority to help prevent problems at the onset and mitigate loss, instead of just investigating violations once they occur and the damage is done.<sup>97</sup> Allowing other government branches to take temporary control of an authority’s management has been a successful approach to continuing operations while protecting the authority from financial loss. For example, in November 2004, the Agriculture and Horse Breeding

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<sup>94</sup> The 2009 Public Authorities Reform Act, Ch. 506 of the Laws of 2009. *See also* Authorities Budget Office, *supra* note 7, at 1.

<sup>95</sup> Authorities Budget Office, *Mission Statement*, available at [http://www.abo.state.ny.us/abo/about\\_mission.html](http://www.abo.state.ny.us/abo/about_mission.html).

<sup>96</sup> Sponsor’s Mem., Bill Jacket, L. 2009, ch. 505, at 11-12.

<sup>97</sup> *Id.*

Development Authority asked the Office of the State Comptroller to handle short term investments and payroll.<sup>98</sup> This occurred in response to a preliminary audit finding, which revealed that the authority needed to temporarily forfeit control to a third party to reduce damages and loss.<sup>99</sup> This action improved public opinion of the authority by showing a readiness to improve operations and protect resources from mismanagement.

The ABO maintains an inventory of all state and local authorities and ensures that each is in compliance with applicable law.<sup>100</sup> This is generally achieved through review and analysis of operations, practices and reports.<sup>101</sup> The ABO is tasked with more than just oversight responsibilities; the office continually assesses the efficiency of each authority by assisting them in improving management practices, and the procedures by which the activities and financial practices are disclosed to the public.<sup>102</sup> The ABO has authority to make recommendations to the governor and legislature for improving an authority's performance, reporting, reformation, structure, oversight, and even consolidation of authorities.<sup>103</sup> Last year, the Legislature acted on the recommendation of the ABO and proposed legislation to repeal the statutory authorization of approximately 130 public authorities.<sup>104</sup> These authorities were determined to no longer serve the public purpose for which they were originally created, and any assets should be reallocated to the local government to be put to better use.<sup>105</sup>

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<sup>98</sup> *Comptroller's Report*, *supra* note 1, at 37.

<sup>99</sup> *Id.*

<sup>100</sup> N.Y. Pub. Auth. Law § 6 (2011).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> H.R. 11106, S. 8165, 233d Sess. (N.Y. 2010). The bills were reintroduced in 2011 and are currently in committee. H.R. 2815, S. 4399, 234th Sess. (N.Y. 2011).

<sup>105</sup> Sponsor's Mem., H.R. 11106, S. 8165, 233d Sess. (N.Y. 2010); Sponsor's Mem., H.R. 2815, S. 4399, 234th Sess. (N.Y. 2011). *See also* Authorities Budget Office, *supra* note 7, at 9.

The ABO has the power to assess authorities, and implement a deadline for certain changes, including compensation levels for boards of directors.<sup>106</sup> This authority is crucial when the ABO discovers that poor management is leading to significant financial loss since it can make recommendations for improvement, and informally censure board members with pay cuts. In 2010, the ABO exercised this authority in relation to the New York State Theatre Institute (“NYSTI”).<sup>107</sup> After reviewing reports and meeting with staff from the Office of the State Inspector General, the ABO determined that the NYSTI board members “demonstrated a persistent pattern of neglect in the performance of its duties and fiduciary obligations.”<sup>108</sup> Based on the ABO’s recommendation, the Governor’s Office initiated action to replace the board.<sup>109</sup>

While the ABO has general oversight and investigatory authority, certain actions are reviewable by the Executive and Legislative branches. For example, if property is disposed of below fair market value to a non-governmental or private entity, or if the disposition is inconsistent with the mission of the authority, the act is subject to review and approval by the Governor and the Legislature.<sup>110</sup>

Each of these powers is designed to ensure that the public interest is being served by authorities, and that board members were acting in accordance with their fiduciary duty. By increasing transparency, disclosure requirements, and authorizing the ABO to access records and documents, the public will have greater confidence in public authorities.

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<sup>106</sup> N.Y. Pub. Auth. Law § 6 (2011).

<sup>107</sup> Authorities Budget Office, *supra* note 7, at 9.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 2. For example, when the Canal Corporation’s sale of exclusive development rights along the canal for \$30,000 prompted intervention by the Comptroller. *Comptroller’s Report, supra* note 1, at 10. Similar deals surrounded the Yankee Stadium deal, the proposed sale of the Erie Canal and the MTA 2 Broadway deal. Richard L. Brodsky, *The Public Authorities Reform Act of 2009: Brining Transparency, Accountability, and a System of Checks and Balances to New York’s Shadow Governments*, 11 N.Y.S.B.A. Gov’t, Law & Pol. J. 23, 23 (Fall 2009). However, these provisions of PARA were strongly opposed, especially by Mayor Bloomberg, who expressed his desire to direct appointees on how authority assets should be sold, especially with transactions below market-value. Letter from Assem. Richard L. Brodsky, dated September 17, 2009, Bill Jacket, L. 2009, ch. 505, at 8-9.

## **Derivative Suits – Enforcement by the Citizenry**

As established, the board members of public authorities have a fiduciary duty to the public, and many have control of large amounts of money belonging to the public, and yet, citizens have no authority over unelected board members. Individuals are not given the statutory right to examine the powers of a public authority, and such a right is not conferred by status as a citizen and taxpayer.<sup>111</sup> This essentially makes the authority of board members immune to the citizenry, even while it is the class to whom they owe a fiduciary duty. Certain lessons from corporate law's derivative action suits may apply here. With derivative suits, shareholders can make a claim on behalf of the corporation to enforce a duty or redress a wrong when the shareholder cannot get the directors to bring the action, usually because the directors are also involved in the wrongdoing.<sup>112</sup> This is distinguishable from a direct claim, since the alleged injury is not to any individual shareholder, but to the corporation itself. The purpose of these actions is to prevent individual directors from acting on personal or political motivations to the detriment of those they are meant to serve. This is achieved by permitting shareholders to bring suit for breach of fiduciary duty on the corporation's behalf. The U.S. Supreme Court recognized the validity of such actions when there is a valid claim against the directors for which the corporation could have sued, but refused to do so out of self-interest or other fraudulent reasons.<sup>113</sup> For example, a derivative suit might be necessary if the majority of the directors were involved in the unlawful action since they would likely vote not to bring suit against themselves.

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<sup>111</sup> 87 N.Y. Jur. 2d Authorities § 5 (Feb. 2011).

<sup>112</sup> Melvin Aron Eisenberg, Corporations and Other Business Organizations 913 (9th ed. 2005).

<sup>113</sup> *Ross v. Bernhard*, 396 U.S. 531, 534-35, 90 S.Ct. 733, 735-6, 24 L.Ed.2d 729 (1970).

This method also gives power to small stakeholders who otherwise have no influence over board member's decisions. For example, the average taxpayer, like a minority shareholder, has only a small financial stake in a public authority, but could use a derivative suit to force a huge expenditure in time and money on the corporation.<sup>114</sup> If the claim were valid and prevailed in court, the overall benefits to all citizens, or shareholders, would be enormous and make the action worthwhile.<sup>115</sup> The courts must carefully balance the public's interest against the overall costs. Derivative suits might never be made available to citizens against board members of public authorities for practicality reasons. First, it would be against the public interest to give every taxpayer the ability to bring suit against public authorities since the authority would have to spend taxpayer money in defending the claim. Secondly, there is legitimate concern about abuse through "strike suits" where every managerial decision is improperly challenged.<sup>116</sup> And finally, when board members of public authorities breach their fiduciary duty, recourse occurs through the ABO, or another government body given jurisdiction over the authority, such as the Governor, Comptroller or Legislature. As long as these oversight committees are performing their duties, there is little need to duplicate their efforts. However, lessons of fiduciary duties and oversight responsibilities can be learned from the principles and nature of this type of suit.

## CONCLUSION

State and local authorities make up the vast collection of quasi-corporate government entities known generally as public authorities. Although they vary greatly in function and form,

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<sup>114</sup> Eisenberg, *supra* note 112, at 913.

<sup>115</sup> *Id.*

<sup>116</sup> As a legal protection, derivative suits involve a two prong approach where the plaintiff must first make a demand for the corporation to bring the suit, unless the plaintiff can show that doing so would be futile. After the demand effort is satisfied, then the cause of action can be established and the case moves forward. This analysis is omitted for the purposes of this discussion, which strives only to explain the nature of derivative actions as they relate to fiduciary duty. *See id.* at 949-50.

each is created to perform a vital public service. For the most part, the officials in charge do an admirable job – even though it is often difficult to balance the public’s interests, their fiduciary duties to the authority, and the government officials who choose the board members. However, the board must remain focused on the authority’s greater purpose, and not be susceptible to members of the public or politicians whose priorities are inconsistent with those of the authority. To that end, oversight is extremely important to ensure that public authorities continue to further the goals for which they are created.