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THE COMPTROLLER'S REPORT AND NYRA

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The Comptroller's Report and NYRA

In mid-September the State Comptroller issued two reports on NYRA. One is its traditional audit on NYRA's franchise fee.¹ While the statute calls for the Comptroller to "not less than once in each year examine the books and accounts of such association,"² it has become customary for the Comptroller to issue a report every other year auditing NYRA's franchise fee. The second was a separate report entitled "The New York Racing Association: The Case for Reform."³ That additional "report" is the basic subject of this article.

The second report is far different than the audit. It is a summary of the public case against NYRA. It hardly breaks any ground in that it is based on material that is in the public record. The report is basically a history of NYRA racing – with accompanying barbs aimed most frequently at NYRA and occasionally at the State Racing and Wagering Board. The report points out that while NYRA's net revenues have increased since 1997, its "overall financial condition has deteriorated. The primary cause of NYRA's weak financial condition is that its expenses have grown faster than its revenue."⁴ The Comptroller finds that NYRA's difficulties are not due to the State tax system but are due to NYRA's expenses.⁵ The Comptroller finds that "NYRA could curtail overly generous pension, entertainment and travel expenses, and adopt additional revenue-generating initiatives."⁶ Per the Comptroller, the NYRA owed the Capital Investment Fund [CIF] an accumulated \$47.5 million in principal and \$17 million in interest as of the end of 2001.⁷ NYRA's net capital deficiency was approximately \$70 million as of 2003.⁸

The Comptroller then reviewed the gaming regulatory systems in place in New Jersey and Nevada,⁹ reviewed the racing regulatory system in New York,¹⁰ reviewed his office's prior audits,¹¹ summarized the recent reports of the Racing Board and the Attorney General,¹² reviewed NYRA's responses to the problems raised by the reports,¹³ and listed recent newspaper articles on NYRA.¹⁴

¹ New York State Comptroller, Division of State Services, Report 2002-S-31, (2003) hereinafter referred to as the "audit."

² Racing, Pari-Mutuel Wagering and Breeding Law, §208.4. hereinafter referred to as the "Racing Law."

³ New York State Comptroller, "The New York Racing Association: The Case for Reform," Office of Budget and Policy Analysis, (September 2003) hereinafter referred to as the "report."

⁴ *Id.* at p. 5.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* at p. 10.

⁸ *Id.* at p. 5.

⁹ *Id.* at pp. 14-16.

¹⁰ *Id.* at pp. 17-20.

¹¹ *Id.* at pp. 21-24.

¹² *Id.* at pp. 25-33.

¹³ *Id.* at pp. 34-35.

¹⁴ *Id.* at pp. 35-37.

Based on this evidence, the Comptroller made three recommendations. He recommended: (1) the appointment of an independent private sector inspector general [IPSIG] for NYRA, (2) the continued development of the Aqueduct racino, and (3) strengthening the Racing and Wagering Board.¹⁵ The Comptroller stated that he would conduct further audits on the Racing and Wagering Board and additional audits of NYRA.¹⁶

. Unfortunately, the report is somewhat sloppy. There are a number of inaccuracies. NYRA has already pointed out that the Comptroller's statements about NYRA board members getting free year-round board for their horses was inaccurate.¹⁷ But there are a host of inaccuracies throughout the report. Here are inaccuracies in two paragraphs from page one of the report.

The earliest forms of head-to-head wagering on horse racing were later supplanted by bookmakers, who provided for all of the wagers on each race to be pooled together, on a "parimutuel" basis, with the winners receiving shares of the losses suffered by those who had bet on the losing horses. During most of New York's history, wagering on horse racing was either informal or illegal, and it was not until 1939 that the New York State Constitution was amended (Article 1, Section a) for the express purpose of generating revenue for the State by allowing "pari-mutuel betting on horse races as may be prescribed by the legislature and from which the state shall derive a reasonable revenue for the support of government."

Thoroughbreds have been racing at Saratoga since 1847, and the current racetrack, built in 1875, is one of the most historic in the world. In 1894, Aqueduct Racetrack was opened in Ozone Park, Queens. Belmont Park dates back to 1905, and it soon after became home to major stakes races, including the Belmont Stakes, which had been run at Jerome Park in Sheepshead Bay, Brooklyn.

Here are the inaccuracies in these two paragraphs alone. First, bookmaking is by its very nature head-to-head wagering. The bookmaker bets directly against the bettor. The bookmakers may try to balance their books to try to insure a positive financial return

¹⁵ Id. at pp. 38-41. The agenda is best described in the Comptroller's press release, "Hevesi Plan: Inspector General for NYRA, Strengthen the Racing & Wagering Board, Ensure Video Lottery Comes to Aqueduct," September 17, 2003.

¹⁶ We would first note a particular bias. We were fortunate enough to serve on the Racing and Wagering Board for more than a decade, and we like and respect the members of the Board and the work of the staff of the Racing Board.

¹⁷ Paul Moran, The Inside Track, Newsday, September 19, 2003, p. A68.

regardless of the results of the contest, but it is no shape or manner pari-mutuel. After the Constitutional amendment in 1939, bookmaking was clearly replaced by the pari-mutuels.

Second, the citation to the Constitutional amendment is incorrect. It is Article 1, Section 9. There is no Section a.¹⁸

Third, the current racetrack at Saratoga was not built in 1875. While there were some minor changes made in the structure then in place in 1875, (a roof was added to the public stands, and the grandstand seats were recushioned and rebacked), most people use 1892 – when a new grandstand, clubhouse, and betting ring were added, as the date of the current racetrack in Saratoga.¹⁹

Fourth, the Belmont Stakes was never run at Jerome Park. It was run at Morris Park in the Bronx which closed at the time that Belmont opened.²⁰

There is similar sloppiness in the conclusions of the report. Here, you have a report that basically reiterates the public record of reports on NYRA. Reciting this litany of government reports, audits, and newspaper articles simply does not prove any of the conclusions that the Comptroller wants to draw from the data. You need to explain why the data establishes your conclusions. The Comptroller barely tries to link his conclusions to his data.

Additionally, the conclusions in the press release accompanying the report and the audit do not match the text of the report. For example, the press release has the Comptroller stating, “If NYRA does not agree to hire an IPSIG, I will step up my own Office’s oversight of NYRA...”²¹ But in the report itself, there is nothing conditional about the further audits of the Comptroller. The report has the Comptroller committing “to enhance his office’s oversight of NYRA.”²² In the report, the Comptroller commits himself to conducting “several audits or studies of NYRA, prior to the scheduled sunset of NYRA’s franchise.”²³ Finally, additional audit topics for NYRA will be developed based on issues identified by the IPSIG.²⁴ In the report, the Comptroller commits himself to further audits. The IPSIG will even help identify audit topics. In the press release, the Comptroller claims that his further audits and reviews depend on whether NYRA has agreed to an IPSIG. They don’t match up.

¹⁸ See Robert Alan Carter, New York State Constitution: Sources of Legislative Intent, pp. 8-10 (1988). While there are currently two subdivisions in Article 1, Section 9, at the time of passage of the 1939 amendment there was only one subdivision. The second subdivision was added when bingo was authorized by referendum in 1957. See I, New York State Constitution Annotated, New York State Constitutional Convention Committee pp. 10 –11 (1938)

¹⁹ Edward Hotaling, They’re Off! Horse Racing at Saratoga, p. 112 and p. 147(1995)

²⁰ Frank Eltman, “Whoa! Long Island officials stake claim to Belmont track”, Associated Press, June 6, 2003.

²¹ Press Release, *supra*.

²² Report at p. 40.

²³ Id.

²⁴ Id.

The same mismatch between the report and the press release occurs in the recommendation on the Racing and Wagering Board. In the press release, the Comptroller states, “The State should create a Gaming Commission to oversee other forms of gambling so that the Racing and Wagering Board can focus on racing. That is the successful model utilized in New Jersey and Nevada.”²⁵ Yet in the report there is no such recommendation. Instead, the report says “consideration should be given to creating an entity in New York State which functions in a manner more similar to ...” the New Jersey and Nevada models.²⁶ It does not call for a separate gaming commission. Instead, the report reads as if the Comptroller wants the Racing and Wagering Board to exercise powers similar to those of the aforementioned commissions in New Jersey and Nevada. The gist of the report is that penalties on gambling entities, like NYRA, in New York should be as stiff and sure as they allegedly are in New Jersey and Nevada.²⁷

The three recommendations all raise some questions. The concept of an IPSIG can be a very good one. If you have a situation where the regulated entity is guilty of misconduct – short of warranting a license suspension or revocation – and it needs to be put on ethical probation, an IPSIG is a fine concept. The report, however, does not develop the case that NYRA is guilty of anything other than being mismanaged financially. And if you think that NYRA has been mismanaged in the extreme, why would you want an IPSIG? Why wouldn’t you want a new manager? You need to develop the case for an IPSIG. The Comptroller’s report doesn’t do that. All, as said previously, the report does is to cite the existing public record. In this instance, it appears that the Comptroller’s conclusions on an IPSIG have been superimposed on the report.

Additionally, the description of the workings of an IPSIG at NYRA are glossed over. The primary purpose of an IPSIG is to ensure compliance with ethical and legal requirements.²⁸ Yet, much of what the Comptroller wants this IPSIG to do has little with ethics. The Comptroller wants the NYRA IPSIG to establish benchmarks involving such areas as outstanding loans to the CIF, revenue enhancement, compensation of board members and senior staff, Board governance, and performance standards.²⁹ Much of what the Comptroller suggests for NYRA is an overall managerial performance review rather than an assurance of future ethical conduct. Does the Comptroller really want an IPSIG to ensure legal compliance by NYRA or a managerial consultant or a financial control board to improve NYRA’s finances?

Finally, under the Comptroller’s version of an IPSIG, the IPSIG is appointed by and reports solely to the Comptroller. Why the Comptroller? Here, you have an office which audits NYRA on an intermittent basis – even though the Racing Law specifies an annual audit. Prior comptrollers seem to have been uninterested in NYRA. Why should an uninterested agency determine NYRA’s IPSIG? It would make more sense that the

²⁵ Press Release, *supra*.

²⁶ Report at p. 40.

²⁷ *Id.*

²⁸ *Id.* at p. 38.

²⁹ *Id.* at p. 39.

IPSIG – if any – should be selected by a grouping of those agencies which by statute have constant and ongoing oversight roles. If you had an IPSIG, it ought to be selected jointly by the Comptroller which audits NYRA, the Racing Board which regulates NYRA’s racing operations, and the Tax Department which actually determines NYRA’s franchise tax and is supposed to be in charge of the financial administration of pari-mutuels.³⁰

On the second recommendation to guarantee VLT’s at Aqueduct, the Comptroller assumes that NYRA’s contract with MGM-Mirage is valid. Yet, the Comptroller also has criticized the SafirRosetti contract for not having been subject to competitive bidding.³¹ If the SafirRosetti contract is invalid for exceeding the requirement in the Racing Law that NYRA has to competitively bid any contract for goods or services over \$250,000, how can the MGM-Mirage contract be valid?³² Moreover, even if you assume that the VLT contract is valid, shouldn’t you be developing the assurances needed to keep VLT’s active? If the Comptroller believes in the need for Aqueduct VLT’s shouldn’t he be contacting the regulators in Nevada and New Jersey to determine what conditions they require to be met to keep the construction going? Can MGM-Mirage enter into an agreement directly with the Division of the Lottery, regardless of who operates the tracks? Do they need the approval of the CIF? Do they need a law ratifying the VLT contract at Aqueduct regardless of who operates the tracks? It’s not hard to say that the VLT’s should come in. It is much harder to create the conditions that would allow the VLT’s to come in.

On the third recommendation, it makes little sense to have a separate commission functioning like the Nevada and New Jersey commissions on gambling. New York does not have private commercial casinos.³³ It has Indian casinos, and a state cannot place the same series of controls over three casinos. The State can’t shut down an Indian casino. It can’t fine an Indian tribe. It can screen or license personnel at a casino, but by the very nature of Indian gaming, a state gambling commission can not exercise the powers utilized in New Jersey or Nevada against private casinos. It makes sense to strengthen the Racing Board’s powers over racing, but a separate gambling commission accomplishes nothing to supervise gaming accomplishes nothing.

This is not to say there is nothing of interest in the Comptroller’s work. There are many interesting items, but they tend to be hidden in the interstices of the report and audit.

Here are some examples.

³⁰ Racing Law, § 227.3. The Department of Taxation and Finance determines NYRA’s franchise fee under §208.2.b. of the Racing Law.

³¹ Report at pp. 34 –35.

³² See Racing Law, § 213.5.

³³ While I might think this proposal makes little sense, it is very similar to one proposed in 1993 by the Tese Commission, formally known as the Advisory Commission on Racing in the 21st Century.

1. This is the first document that actually goes through in detail the March 2003 report of the Racing and Wagering Board on NYRA. The Racing Board report is far more substantive than the work of either the Attorney General or the Comptroller. It appears to be the most damning of all the reports finding inadequate controls throughout much of the NYRA wagering operation, a failure to follow directives on bet cancellations, inadequate use of security staff, a failure to insure compliance with the telephone wagering requirements, and material misrepresentations on financial statements.³⁴ It is hard to imagine any racing commission or board in the nation writing this tough a report, and NYRA officials surely believe that the Racing Board has singled out NYRA for scrutiny not accorded any of the other racetracks in New York State. You can understand why NYRA officials regard the Racing Board as the Antichrist

The one problem is that the report is almost too tough on NYRA for the Board's own good. By treating the report as a warning rather than punishable violations, the Board has left itself open for criticism that it has been too easy on NYRA. The Comptroller is able to criticize the Racing Board for failing to act forcefully on its findings. The Comptroller finds it "troubling" that the Board only directs NYRA to seriously consider complying with the law and policy.³⁵ Yet, what the Board has done here,³⁶ is little different than what the Comptroller advocates for his future role in the report. The Comptroller's approach of "Do what I tell you, or I'll audit you,"³⁷ is no different than the Board saying "Comply or we'll have to go after you." Both approaches are the same. "We're warning you, and if you violate this again, we'll do our job." If the Racing Board is guilty of merely throwing smoke at NYRA, so is the Comptroller.

2. The Racing Board's report points out that NYRA is claiming an excessive figure as its overall handle. For example, NYRA claimed nearly \$3.3 billion in handle in 2000 when its handle was actually \$2.8 billion.³⁸ Assuming that the Racing Board is correct, why does the Comptroller use NYRA's figures for handle in its audit?
3. The report states that one of SafirRosetti's first recommendations to the NYRA Board was to "replace its public relations firm."³⁹ This is an amazing non sequitur in the report. Which public relations firm, and what did they do to be placed first on the SafirRosetti hit list? What did the NYRA Board do when presented with this recommendation? Shouldn't the Comptroller, as NYRA's statutory auditor, be able to find out all of SafirRosetti's recommendations to the NYRA Board?

³⁴ Report at pp. 25-30.

³⁵ *Id.* at p. 30.

³⁶ One needs to bear in mind that the Racing Board's powers over NYRA are limited. It can either fine NYRA up to \$5,000 for violations under §243 of the Racing Law or revoke NYRA's franchise. See Racing Law §§208.6 and 210.

³⁷ See Press Release, *supra*.

³⁸ *Id.*

³⁹ *Id.* at p. 34.

4. The report notes that NYRA reported it had spent, as of the end of 2001, \$6 million from accounts that held the winnings of horsemen at the track. This left only \$8.6 million in these accounts.⁴⁰ You might think that dipping into these funds would necessarily affect NYRA's financial position and its ability to conduct business. But there is no indication that this utilization of horsemen's money was factored at all into the Comptroller's audit of NYRA. Are these horsemen's funds trust funds? Can NYRA dip into them in any way? A bailee can not utilize a bailor's property for its own private purposes.⁴¹ Why is this any different? Isn't this a major issue that should be explored by the Comptroller and the Attorney General?⁴²

5. The Kenny Noe situation. Kenny Noe worked for NYRA from 1994-2000. From 1994-1995, he was the president of NYRA. In 1995, he became the CEO and chairman of the NYRA board, in addition to continuing in his position as president. In December of 1996, he relinquished the presidency but continued on as the chairman and CEO of NYRA. He remained in that title until his retirement in October of 2000. In a 1999 Comptroller's audit, it was revealed that he had been treated as an independent contractor by NYRA since he started in 1994.⁴³ This designation would likely have allowed Mr. Noe to avoid paying Medicare and Social Security taxes, unemployment insurance fees, and perhaps New York State taxes.⁴⁴ According to NYRA and the Comptroller, after the issuance of the report, Noe's status was shifted to that of an employee as of August 1, 1999.⁴⁵

Now, it once again appears that Noe's status is unclear. Apparently, the draft audit of the Comptroller argued that Noe could not receive supplemental employee retirement plan [SERP] payments because he was an independent contractor rather than an employee when NYRA authorized his SERP payments. The Comptroller wanted NYRA to recover its payments to Noe.⁴⁶ To counter this draft audit, NYRA argued that Noe was, in fact, an employee from 1995 through late 1997 based on a tax assessment issued by the State Department of Taxation and

⁴⁰ *Id.* at pp. 12 –13.

⁴¹ 8A. *Am. Jur.* 2d Bailments §74 (1997); 8 *C.J.S.* Bailment, §35(a) (1988). See also *Brown v. S&G Gross & Co.*, 13 N.Y.S. 2d 1020 (Sup. Ct., App. Term 1939); *Matter of Cooke*, 147 Misc. 528, 535 (Surrogates Ct., Westchester Co., 1933).

⁴² For example, has there been misapplication of property under §165.00 of the Penal Law?

⁴³ New York Racing Association, Inc. Audit Of The Annual Franchise Fee Report 98—S-6, pp. 19-20, (1999).

⁴⁴ *Id.* See also James C. McKinley Jr., "N.Y.R.A. Audit Finds Savings and Problems," *New York Times*, September 10, 1999, Section D; Page 4 which indicates that the payments were made to Noe through his own Florida corporation.

⁴⁵ *Id.* at p. 20. See also McKinley, *Id.*; Comptroller's Report 2000-F-38, Recommendation 10, p.5 (March 21, 2001)

⁴⁶ Joe Mahoney and Greg Gittrich, "Racing to Disaster," *New York Daily News*, August 9, 2003 at p. 3; James M. Odatto, "Audit Assails NYRA Finances," *Albany Times Union*, July 31, 2003 at p. A1.

Finance.⁴⁷ Since this portion of the Comptroller's draft report was removed from the findings of the final report, NYRA must have succeeded in its arguments that it lacked a legal basis to recover the SERP payments to Noe.⁴⁸

So what happened to Noe? NYRA's response to the draft audit leaves open Noe's status from 1997 –2000. Did he remain an independent contractor in the years subsequent to 1997? Was the report that he became an salaried employee as of August 1, 1999 accurate? How much chutzpah does it take to make the president of your corporation an independent contractor? In any event, where were the trustees at NYRA? How did they let the head person at NYRA allow himself to be treated as an independent contractor? One of the main arguments for NYRA retaining its franchise is that – unlike its rivals in horse racing - NYRA is a non-profit organization designed to further the best interests of New York racing. When you see, however, clear evidence of greed by NYRA officials in authorizing a supplemental pension for Noe⁴⁹ and allowing him free reign to declare himself an independent contractor, you have to question the performance of the trustees.

The Comptroller's report on NYRA is actually an interesting document but not for the reason articulated by the Comptroller.

⁴⁷ Audit at p. B-3 –4 and at p. B-15.

⁴⁸ Audit at p. C-7.

⁴⁹ James M. Odatto, "In Pay Deal, Ex-NYRA Chief Collects \$420,000," Albany Times Union, July 10, 2003, p. A1