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LOYALTY: THE KOALA IN THE BOARD
ROOM**

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NYRA Trustees and the Corporate Duty of Loyalty

For much of my lifetime, I've heard horseplayers complain about the management of the New York Racing Association [NYRA]. The prototypical attitude from a horseplayer is that all these bad practices and decisions would terminate if only he or she could serve on the NYRA Board. From this attitude, it seems that serving on the NYRA Board would be the dream goal of any New York horseplayer. You'd be sipping champagne at the buffet in the Trustee's Room while having your ideas to improve racing implemented by your peers.

But it may not be a dream position any more. With increasing demands and oversight placed on corporate boards, (plus a federal court imposed corporate monitor in place at NYRA) the board position at NYRA may place a person under considerable burdens. It may be more of a booby trap than a dream job. The problem is that the board position is at NYRA, and nobody knows what NYRA is or how to treat its board members.

At a hearing before the New York State Racing and Wagering Board, in January of 1989, then NYRA President Gerard McKeon tried to explain what NYRA was. To him, NYRA was like a koala bear. It looked like a mammal, but it was actually a marsupial and thus absolutely unique in the animal kingdom. NYRA was the koala of racing; it was a nonprofit racing association and consequently absolutely unique in the world of racing.¹

So, just what is a nonprofit racing association, and under what strictures do you judge the actions of the members of the NYRA Board? Some people have analogized NYRA to another government agency. The Albany Times Union has called it a "quasi-public agency."² Newsday has called it "a widely criticized state agency,"³ and "one of those murky, off-budget entities of state government."⁴ Former Attorney General Dennis Vacco's press spokesman said of, NYRA's president, Ken Noe, "Noe wants to run NYRA like a business, but in this business the shareholders are the taxpayers."⁵ Under legislation proposed by the Comptroller and the Attorney General and introduced in the State legislature, NYRA would be treated as a State public authority.⁶ A federal court has

¹ A description of the hearing appears at Paul Moran, "Kill NYRA Power Play," Newsday, February 1, 1989, Pg. 104. The koala description is this writer's recollection of the McKeon testimony.

² "End the Secrecy," Albany Times Union, January 6, 2004, Pg. A8.

³ Robert E. Kessler, "Rudy to Help Rein in NYRA?," Newsday, December 14, 2003, Pg. A03.

⁴ Raymond J. Keating, "Get the State Out of New York's Race Tracks," Newsday, December 16, 2003, Pg. A34.

⁵ Edward Fitzpatrick, "NYRA Head Fires Back at Critics," Albany Times Union, August 29, 1997 Pg. B2.

⁶ James M. Odato, "State Authorities Target of Reform," Albany Times Union, February 25, 2004, Pg. A1. Assembly Bill No. 11414 (2004); Senate Bill No. 7301 (2004). But see Saumell v. New York Racing Ass'n., 58 N.Y.2d 231, 239-240 (N.Y., 1983). "NYRA has directors or trustees and stockholders, not

once found a symbiotic relationship between NYRA and the State terming NYRA “merely a conduit through which money passes from the betting public to the state's coffers.”⁷

Yet, Section 202.3 of the Racing, Pari-Mutuel Wagering and Breeding Law [Racing Law], under which NYRA was established, creates a different non-public operating system for a nonprofit racing association. Under this provision, nonprofit racing associations “shall have all the general powers of corporations created under the laws of this state, including the powers and obligations of stock corporations and shall not be governed by the not-for-profit corporation law insofar as it is derived from the membership corporation law.”

Pursuant to this section, NYRA is a corporation, but it is unclear whether NYRA is to be governed under the Business Corporation Law [BCL] which pertains to profit-making corporations or under the Not-For-Profit Corporation Law [N-PCL] pertaining to corporations with other than for profit motives. The problem is that NYRA was formed in 1955 before either the BCL (1961) or the N-PCL (1969) were enacted. Thus, it is unclear at times which of these two laws governs NYRA’s actions. For example, NYRA is to have the “powers and obligations of stock corporations.” Much, however, of the BCL is not derived from the former Stock Corporation Law. Does the BCL govern in those instances when the BCL is not derived from the Stock Corporation Law?

Similarly, NYRA is not supposed to be governed by the N-PCL when its provisions are derived from the former Membership Corporation Law. Again, much of the N-PCL is not derived from Membership Corporation Law. Which law should govern NYRA?

The problem becomes heightened when dealing with the specific duties of directors of a corporation. The applicable sections of the N-PCL are §715 dealing with interested directors and §717 dealing with the duties of directors. Both borrow heavily from the applicable provisions of the BCL. §717 is new legislation, and §715 is a specific repudiation of former §47 of the Membership Corporation Law. Thus, the N-PCL provisions on the duties of directors are not derived from the Membership Corporation Law.

The applicable provisions of the BCL are §713 dealing with interested directors and §717 dealing with duties of directors. Neither of these provisions is derived from the Stock Corporation Law. Both the BCL provisions and the N-PCL provisions are similar. In the N-PCL, “the duty of care and liability of directors and officers follow the language of the Business Corporation Law, as does the provision that directors and officers when

members, and is a private corporation (Racing, Pari-Mutuel Wagering and Breeding Law, § 202, subd 3), not a public benefit corporation.” Also see Thaler v. Murphy, 42 Misc. 2d 1, 4 (Sup. Ct. Albany Co. 1964) “The business of racing is one which is affected by the public interest but racing associations are, nevertheless, private corporations.”

⁷ Stevens v. New York Racing Assoc., 665 F. Supp. 164, 172 (E.D.N.Y., 1987) But see, Murphy v. New York Racing Assoc., 76 F. Supp. 2d 489 (S.D.N.Y., 1999).

acting in good faith may rely upon the financial statements of the corporation prepared by corporate officers or an independent public or certified public accountant.”⁸ Nonetheless, there are some differences between the BCL and the N-PCL provisions.

There are differences between BCL §713(b) and N-PCL §715 (b) dealing with the fairness of contracts involving interested directors. There is also still some question as to whether the doctrine of usurpation of corporate opportunities – which works generally to prevent directors from taking personal advantage of corporate opportunities - applies to not-for-profits. In the case of American Baptist Churches of Metropolitan New York v. Galloway,⁹ the Appellate Division overruled a lower court determination which found that a not-for-profit “could never sustain compensable damages from the loss of a corporate opportunity.”¹⁰ The court instead found that “it would be unfair and counterproductive for a charitable organization to have no recourse against a dishonest fiduciary who thwarts the organization’s endeavors.”¹¹ Additionally, the Attorney General has far greater authority over not-for-profits than over profit-making corporations. Compare §§719 and 720 of the N-PCL with §§719 and 720 of the BCL.¹²

The Responsibilities of a Corporate Director

Under the N-PCL, “directors ... shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.”¹³ A nearly identical standard governs under the BCL.¹⁴

Cases have interpreted this standard to impose a broad duty of loyalty on directors.¹⁵ “Corporate officers and directors owe a duty of undivided and unqualified loyalty to the corporation which they serve.”¹⁶ “The officers and directors of a

⁸ Explanatory Memoranda on Not-For-Profit Corporation Law, Joint Legislative Committee to Study Revision of Corporation Laws, Memorandum No. 1 at Pg. XXIII, McKinney’s Not-For-Profit Corporation Law (1997).

⁹ 271 A.D. 2d 92 (1st Dept. 2000)

¹⁰ Id. at 95.

¹¹ Id. at 97.

¹² Under both §706 of the BCL and the N-PCL, the Attorney General is authorized to bring an action to remove directors. Should these sections be applicable to NYRA when the Racing Law already has specific provisions governing the removal of NYRA directors? Section 202.3 of the Racing Law has the NYRA board remove or dismiss directors “upon request of the state racing and wagering board.” Should this specific grant of authority to the Racing and Wagering Board be seen as displacing the authority of the Attorney General?

¹³ N-PCL § 717.(a)

¹⁴ BCL §717.(a) As stated in 7 White, New York Corporations, ¶ 717.01, “the statutory norm is now virtually the same for both business and not-for-profit corporations.”

¹⁵ In the leading Delaware case of Guth v. Loft, Inc., it was stated that “the rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.” 5 A.2d 503, 510 (Del., 1939)

¹⁶ Brodsky and Adamski, Law of Corporate Officers and Directors : Rights, Duties, and Liabilities, §3.01 (1999 supp.) See also 3 White, NY Corporations, ¶ 713.01 “Directors are deemed to be fiduciaries of the corporation they serve.”

corporation stand in a fiduciary relationship to the corporation, owe to the corporation their individual loyalty, and are not permitted to derive a personal profit at the expense of the corporation (cf. Fender v Prescott, 101 AD2d 418, affd 64 NY2d 1077; Schachter v Kulik, 96 AD2d 1038, appeal dismissed 61 NY2d 758). An officer or director, acting in good faith, is not precluded from participating in a business similar to that of his corporation, but he must not act so as to cripple or injure the corporation; if he does, he is answerable for the damages it sustains because of that conduct.”¹⁷

“Directors and officers are bound by their duty of undivided and unqualified loyalty to their corporations, a duty which encompasses good faith efforts to insure that their personal profit is not at the expense of their corporations. (Business Corporation Law, § 717; see 19 CJS, Corporations, § 761, and cases cited.) In such instances of self-dealing, defendants have the burden of demonstrating the fairness of the transactions.”¹⁸

“‘Directors and officers shall discharge the duties of their respective positions in good faith.’ (Business Corporation Law, § 717.) They may not assume and engage in the promotion of personal interests which are incompatible with the superior interests of their corporation. (See 19 C. J. S., Corporations, § 761, and cases cited.) ‘Officers and directors of a corporation owe it to their undivided and unqualified loyalty. * * * They should never be permitted to profit personally at the expense of the corporation. Nor must they allow their private interests to conflict with the corporate interests. These are elementary rules of equity and business morality. Courts of equity must ever enforce strict compliance with these rules.’” Lyon v. Holton, 167 Misc. 585, 587 (Pecora, J.); see, also, Turner v. American Metal Co., 268 App. Div. 239, 273; Evangelista v. Queens Structure Corp., 27 Misc. 2d 962, 964.)¹⁹

Similar statements abound in other cases.²⁰ They also appear in cases involving not-for-profit corporations.²¹

Thus, the NYRA directors owe NYRA a duty of unqualified loyalty and they are not permitted to profit at the expense of NYRA.

Loyalty to the Corporation Issues and NYRA

Without trying to oversimplify the issues, there are three basic types of cases where a director’s loyalty to the corporation is implicated. These are issues: (a) where the director is on both sides of a transaction involving the corporation (self-dealing); (b)

¹⁷ Bertoni v. Catucci, 117 A.D.2d 892, 894-895 (3rd Dept. 1986)

¹⁸ Limmer v. Medallion Group, Inc., 75 A.D.2d 299, 303 (1st Dept. 1980)

¹⁹ Foley v. D’Agostino, 21 A.D.2d 60, 66-67 (1st Dept. 1964)

²⁰ Levandusky v. One Fifth Ave. Apartment Corp., 75 N.Y.2d 530,538 (N.Y., 1990) Howard v. Carr, 222 A.D.2d 843, 845 (3rd Dept. 1995); Greenberg v. Greenberg, 206 A.D.2d 963, 964 (4th Dept. 1994); Alexander & Alexander v Fritzen, 147 A.D.2d 241 (1st Dept. 1985) aff’d 68 N.Y.2d 968 (N.Y., 1986).

²¹ See S.H. Helen R. Scheuer Family Foundation, Inc. v. 61 Assoc., 179 A.D.2d 65, 70 (N.Y. App. Div., 1992)

usurping corporate opportunities – taking away business opportunities that otherwise should belong to the corporation, and (c) engaging in a competitive business.²²

Traditionally, the self-dealing issue comes up in the context of the corporation purchasing or leasing property from a director or the director selling or leasing property to the corporation.²³ In the racetrack context, it would regularly come up when the racetrack uses a bank controlled by a director as its bank, when the racetrack uses an investment firm affiliated with a racetrack's director as its investment banker, when the racetrack borrows funds from a director's financial institution, when the racetrack uses a director's law firm, or where it is alleged that the racetrack supplied employees to work for free on the director's property.²⁴ In more recent years, this issue has come up with simulcast contracts. For example, Charles Bidwill Jr. is a director of Churchill Downs, Inc. and chairman of the National Jockey Club. The National Jockey Club together with Hawthorne Park runs Hawthorne National which conducts racing at Hawthorne Park outside Chicago. Hawthorne National simulcasts racing from Churchill's tracks, and the Churchill tracks simulcast Hawthorne. Thus, Mr. Bidwill is on both sides of the simulcast transaction between Churchill and Hawthorne. For several years, David Vance, an official with the DeBartolo group of racetracks,²⁵ served on the NYRA board. Mr. Vance would have had a conflict of interest involving simulcast arrangements between NYRA and the DeBartolo tracks.²⁶

The self-dealing issue also arises in more mundane matters. There would have been a self-dealing issue when Ken Noe served with compensation as both the chairman and the president of NYRA in the late 1990's. How would the NYRA board go about setting its Chairman's salary? During the late 1960's and early 1970's, the association representing NYRA horsemen frequently complained that NYRA's allocation of stalls significantly benefited Jockey Club members and members of the NYRA board.²⁷ Again, this raises issues of self-dealing between NYRA as a corporation and the members on its board. Other self-dealing issues could involve the receipts of admissions, box seats and meals by NYRA board members.

Perhaps, the most intriguing corporate loyalty issue involves the corporate opportunity doctrine. Directors are not supposed to divert corporate opportunities for

²² See generally American Law Institute, Principles of Corporate Governance, §§5.02, 5.05 and 5.06. Committee on Corporate Laws, American Bar Association, Corporate Director's Guidebook, (4th ed. 2004) Pg. 14 –17; Henn and Alexander, Law of Corporations §235 (1983); Pat Chew, Directors' and Officers' Liability, §§ 4 and 5 (2003 supp).

²³ See generally Mitchell, "Fairness and Trust in Corporate Law", 43 Duke L.J. 425, 481 (1993).

²⁴ Sydney H. Schanberg, "The Raceway Scandal Is Back in the News," Newsday, March 12, 1991, Pg. 81. Charles V. Zehren, "Investigating Remodeling Of House By Track Owner," Newsday, November 21, 1990, Pg. 7.

²⁵ The three DeBartolo Corporation racetracks were Remington Park, Louisiana Downs, and Thistledown.

²⁶ Similarly, former NYRA trustee Earle Mack served for a time as a member of the board of Magna Entertainment. Richard Eng, "Company to Jockey for Position," Las Vegas Review-Journal January 28, 2000, Pg. 10C.

²⁷ Karlinsky v. New York Racing Assoc., 517 F.2d 1010 (2d Cir., 1975); Halpern v. Lomenzo, 81 Misc. 2d 467 (Sup. Ct. N.Y. Co., 1975).

themselves.²⁸ At NYRA, the issue might have come up in 2001 when the Giuliani administration commenced the process of selling New York City OTB. NYRA formally placed a serious bid for the OTB system. Arguably, any NYRA trustee who would have pursued a purchase of OTB in opposition to NYRA would have been usurping NYRA's corporate opportunity.

A similar prospect may take place if any of the trustees wished to participate in obtaining the State franchise at the NYRA racetracks. NYRA's franchise to run the racetracks expires in 2007, and there has been some speculation that some NYRA trustees might wish to bid on the franchise by forming a for-profit corporation that would essentially take NYRA private.²⁹ The idea that NYRA should be run as a for-profit corporation was advanced previously by the Advisory Commission on Racing in the 21st Century.³⁰ Arguably, if current trustees of NYRA were to pursue the franchise on their own, this could be seen as an usurpation of NYRA's corporate opportunity to pursue its franchise extension. Additionally, the trustees who pursue their own separate franchise might risk criticism that as NYRA trustees, they would have a motive to take actions that would lessen the value of the NYRA franchise – thus reducing the amount they might have to pay in order to win the franchise.

Finally, there is the separate, but related, issue of competing with the corporation.³¹ Traditionally, a director could be affiliated with a second business that competed in part with the first corporation's business so long as the director served in good faith.³² "The general rule is that directors and officers, especially directors, may engage in independent businesses, but if such independent business competes with the business of the corporation, equitable limitations apply."³³

In the not-too distant past (15 years ago) racetracks occupied their own static geographic areas. The only significant competition was against the other racetracks in their immediate geographic area. Now, times have changes. NYRA has account wagering,³⁴ and many other racetracks and off-site businesses which do not run live races also offer account wagering. Is working with – or affiliating with - another racetrack or a non-racetrack offering pari-mutuel wagering a conflict of interest? Can a director of one racetrack corporation now serve in good faith on the board of another racetrack corporation?

Look at the Charles Bidwill situation. A decade ago when the Bidwill family ran Sportsman's Park and Churchill Downs had one track in Louisville, Kentucky, there were limited issues of competition. Now, Churchill owns Arlington Park in the suburbs of

²⁸ Branson, Corporate Governance, §8.22 (1993)

²⁹ Matt Graves, "Schwartz Had Saddled Enough Burden," Albany Times Union. October 13, 2004, Pg. C1; David Grening, "Smith Says No to NYRA," Daily Racing Form, The Sports Network September 6, 2004.

³⁰ Advisory Commission on Racing in the 21st Century, "Racing into the 21st Century," (1993) Pg. 24. "Racing and wagering in New York State should be operated in an integrated profit-driven structure."

³¹ American Law Institute, Principles of Corporate Governance, §5.06.

³² Brodsky and Adamski, supra note 16 at §4.14 (1999)

³³ Henn and Alexander supra note 22 §236. pg. 628.

³⁴ See Racing Law, §1012.

Chicago which competes with Hawthorne National for racing dates. Arlington's OTB's also compete for bettors against OTB's which Bidwill has an interest in. Churchill's Hoosier Park runs a thoroughbred racing meet that overlaps the Hawthorne National meet; there is competition for horses between these two tracks. Throughout the nation, Hawthorne National's races are competing for betting dollars against Churchill's tracks at simulcast sites and in people's houses. Is Bidwill now in direct competition with Churchill?

A similar situation might also have prevailed at Churchill with Dennis Swanson who recently resigned as a member of the Churchill board. Swanson was the long-time head of ABC Sports. He currently serves as the COO of the Viacom Television Stations Group. Viacom is the parent company of CBS. With NBC holding the rights to the Kentucky Derby, it could be argued that Swanson's corporation would have an adversary interest to Churchill. It would be in Viacom's interest to see a decrease in viewership and public interest in the Kentucky Derby coupled with an increase in the viewership at that particular time slot for CBS.

In terms of NYRA, it now becomes appropriate to ask whether a NYRA board member can serve any longer on the board of a racetrack. There now is competition between most every racetrack. NYRA has also since 2001 been on the brink of opening up a large video lottery facility at Aqueduct. Should a NYRA board member be able to serve on the board of a casino corporation which is operating in Atlantic City and might be in competition with Aqueduct?³⁵

On the micro-level, should a NYRA board member invest in an entity that operates an account wagering business? Any account wagering business is now in competition with NYRA's own account wagering business. If a NYRA board member has a horse that can run either in a race at Monmouth Park in New Jersey or at Saratoga, shouldn't the duty of loyalty oblige the board member to run his or her horse at Saratoga, the track operated by NYRA? If that board member is in New Jersey at Monmouth, should the board member be wagering via phone with NYRA rather than at a racetrack that is competing with NYRA? Where does the duty of loyalty end?

Resolving the Loyalty Issues

If NYRA is, in fact, a State agency, as suggested by the Comptroller and the Attorney General, then the conflict of interest issues present generally simple legal issues. A NYRA board member would be hard-pressed to justify any conduct or position that could be perceived as a conflict of interest. For example, a NYRA board member could only sell goods or services, with a value of over \$25 to NYRA pursuant to a public bidding process.³⁶ A violation of this provision would subject the officer to a civil penalty

³⁵ Many casino corporations also operate horse racing books in Nevada and Atlantic City which could also be seen as competing with NYRA.

³⁶ Public Officers Law, §73.4.

of up to \$10,000, or the State Ethics Commission could refer such violations to a local prosecutor to be pursued as a Class A misdemeanor.³⁷

The State's general Code of Ethics³⁸ would prevent a NYRA board member from having any interest or engaging in any business "which is in substantial conflict with the proper discharge of his duties in the public interest."³⁹ Under the standards established in the Code of Ethics a state employee or office, among other duties, (a) can not accept other employment which would impair his independence of judgment,⁴⁰ (b) engage in a transaction with any business entity that he had a financial interest in that might reasonably tend to conflict with his state duties,⁴¹ (c) must abstain from making investments in enterprises directly involved in decisions made by him or which would create substantial conflicts between the public interest and his private interest,⁴² and (d) should endeavor to pursue a course of conduct that will not raise suspicion that he is engage in acts in violation of his trust.⁴³ A state officer or employee who violates these standards could be fined, suspended or removed from office in the manner provided by law.⁴⁴

Under these strict state standards, it is a certainty that all the racetrack loyalty questions – self-dealing, usurping corporate opportunities, and engaging in a competing business, - would all be illegal. If NYRA was a state agency, NYRA board members would be virtually banned from any non-trivial self-dealings or competitive dealings vis-à-vis NYRA.

But the corporate world is a far different one than the state. There are inherent conflict of interests that face all corporate directors. For example, corporate directors resisting a takeover attempt of their corporation would have a conflict. (Were they resisting the takeover in order to maintain their positions?) There are certainly times when deals between an interested director and a corporation are of mutual benefit to both the director and the corporation.⁴⁵ There is a recognition that conflicts of interest in the business world are inevitable, free competition and entrepreneurship are to be encouraged,⁴⁶ and the thrust of corporate law is how to resolve and manage these ethical problems.

Most every state now has an "interested director" statute under which a safe harbor is established for transactions between the corporation and the firm or business

³⁷ Public Officers Law, §73.14.

³⁸ Public Officers Law, §74.

³⁹ Public Officers Law, §74.2.

⁴⁰ Public Officers Law, §74.3.a.

⁴¹ Public Officers Law, §74.3.e.

⁴² Public Officers Law, §74.3 g.

⁴³ Public Officers Law, §74.3.h.

⁴⁴ Public Officers Law, §74.4.

⁴⁵ Hornstein, *Corporation Law and Practice*, §439 (1959) Pg. 542; Legislative Notes, "The 'Unfair Interested Directors' Contract Under the New York Business Corporation Law," 16 *Buffalo L. Rev.* 840, 845 (1966-67).

⁴⁶ Chew, *supra* note 22 at §5:2.2.

interest of a director.⁴⁷ These statutes were necessary in order to terminate the common law rule that transactions between a corporation and an interested director were voidable. The formula for the safe harbor is similar in most states. “Under these statutes... voidability is abrogated if the fiduciary proves that the transaction in question was approved by an informed body of independent directors, approved by stockholders, or is fair to the corporation.”⁴⁸

In New York State, §715 of the BCL establishes the safe harbor provision for corporations.⁴⁹ Under this statute, there are three ways to validate the interested director contract. The contract can be approved after full disclosure of its material facts by a vote of the disinterested members of the board,⁵⁰ after full disclosure by a vote of the shareholders,⁵¹ or if the parties establish affirmatively that the contract was “fair and reasonable” to the corporation.⁵² Thus, for instance if NYRA were selling its simulcast to an entity with which a NYRA director was associated, it could be validated if the facts of the transaction were fully disclosed and approved by disinterested directors or even if there had been no vote and/or disclosure, if the contract was fair and reasonable.⁵³

Similar standards would apply in the case of directors pursuing a corporate opportunity or directors engaging in a competitive business with NYRA. If the director with the potential conflict fully disclosed the material issues to the corporation, and the disinterested directors approved it, there should be no violation of the duty of loyalty. “Disclosure to and informed approval by the board may insulate a director for liability where the corporate opportunity doctrine otherwise applies.”⁵⁴

While full disclosure and board approval should exculpate NYRA directors who wish to pursue their own bid for the thoroughbred racing franchise in New York State, even without such disclosure and approval, it might not be currently necessary for those NYRA board members seeking their own racing franchise to obtain permission of the disinterested members of the NYRA board. Again, there is no Court of Appeals decision in New York State on whether the corporate opportunity doctrine applies to not-for-profit corporations. If the Court of Appeals were to reject the rationale of American Baptist Churches of Metropolitan New York v. Galloway, then the corporate opportunity doctrine would not apply to NYRA. Even if a court believed that the corporate opportunity doctrine applied to not-for-profit corporations, it could legitimately rule that it did not apply to NYRA. Given NYRA’s unique koala bear status, with its profits

⁴⁷ 46 states according to Mitchell, note 23 *supra* at 440.

⁴⁸ *Id.* See also “Interested Director’s Contracts – Section 713 of the New York Business Corporation Law and the ‘Fairness’ Test,” 41 Fordham L. Rev. 639 (1972-73)

⁴⁹ A nearly identical safe harbor exists in §715 of the N-PCL.

⁵⁰ BCL §713.(a)(1). The interested directors can be counted in determining a quorum for the board meeting. BCL §713.(c)

⁵¹ BCL §713.(a)(2)

⁵² BCL §713.(b)

⁵³ NYRA has no true shareholders or members so the provision allowing approval of the “interested director” contract by the shareholders or - in the case of a no-for-profit corporation by the members (See N-PCL § 715.(a)(2)) would not apply.

⁵⁴ 1 Block, Barton, and Radin, The Business Judgment Rule, (5th ed. 1998) Pg . 301.

flowing almost totally to the state, a court could conceivably rule that the corporate opportunity doctrine had no conceivable application to NYRA.

Additionally, the corporate opportunity doctrine is especially confusing⁵⁵ with courts propagating a wide variety of tests governing whether a corporate opportunity has been usurped.⁵⁶ Some cases have maintained that there is no usurpation of corporate opportunity when the corporation lacked the financial ability to take advantage of that opportunity.⁵⁷ NYRA's current financial condition may be so desperate that it cannot possibly take advantage of the opportunity to apply for a franchise extension.⁵⁸ Additionally, preparatory work by corporate officers and directors before they leave the corporation and actively pursue the corporate opportunity, according to some courts, is not a violation of the corporate opportunity doctrine.⁵⁹ Nonetheless, if in preparation for such corporate opportunity the officers/directors used corporate assets, solicited customers or employees of the corporation, and/or used trade secrets or confidential information of the corporation, it is likely that the officers/directors will be found to have usurped a corporate opportunity.⁶⁰

In short, the point is that while the better practice would be for any NYRA board members who wish to bid on the thoroughbred racing franchise in New York to obtain the advance approval of the disinterested board members of the NYRA,⁶¹ it is not necessarily the case that pursuit of the franchise by such board members - without obtaining NYRA board approval - is a violation of the corporate opportunity doctrine.

Conclusion

The concept that board members owe a duty of loyalty to the New York Racing Association ought to be an issue for everyone concerned with New York racing. While board members of NYRA do owe that organization a duty of loyalty, it is currently unclear what standards apply to these NYRA board members. How much loyalty do Board members owe NYRA? The standards are different if NYRA is thought of as a business corporation, a state agency, or a not-for-profit corporation. The NYRA Board's federal monitor - working with the State Comptroller and the NYRA board itself - should be establishing specific guidelines and standards to enable NYRA's board members to understand exactly what the duty of loyalty means to them. Board member understanding of their duties at NYRA can only help create a more transparent, better-

⁵⁵ Chew, *supra* note 22 at §§5:2.2 and 5:2.7

⁵⁶ Branson, *supra* note 28 at §8.22. See eg. *Miller v. Miller*, 222 N.W.2d 71 (Minn. 1974).

⁵⁷ See cases cited in Branson, *supra* note 28 at §8.29.

⁵⁸ See "NYRA Opens Up," *Albany Times Union*, July 24, 2004 Pg. A6, NYRA lost \$20 million in 2003 and owes the State \$70 million.

⁵⁹ See generally *Maryland Metals Inc. v. Metzner*, 382 A. 2d 564 (Md. 1978). See also *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503 (Tex. App., 2003); *Feddeman & Co. v. Langan Assocs., P.C.*, 260 Va. 35 (Va., 2000); *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503 (Tex. App., 2003); *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky., 1991)

⁶⁰ *Abetter, Id.* at 512; *Feddeman, Id.* at 42.;

⁶¹ Chew, *supra* note 22 at § 5:2.7

governed NYRA, which should be in the best interest of the sport of horse racing in New York State.