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RUDY'S WORDS AND NYRA'S WORLD

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Rudy's Words and NYRA's World

Rudy Giuliani at the Jockey Club Roundtable on August 17 issued a call for increased accountability in the racing business.¹ He advised his listeners that the “City of New York needed to be run like an accountable business so that standards were understood by everyone, they were transparent and they could be described to people.” He observed that “once there's public scrutiny, there's much better performance.” He found a lost sense in certain private sector businesses “of the responsibility to the public in running a public company or to the investors.”

The point according to Mayor Giuliani is that when dealing with a crisis “you're going to confront it realistically and honestly and deal with it and do exactly what you've achieved [the racing industry in dealing with the Pick Six crisis], which is to take something bad and to use it to accomplish something good and actually to use it as a focus of reform in the industry.”

While Mayor Giuliani's words might read like an introductory lecture in Business Ethics 101, it is high time that his words serve as a framework to resolving the crisis of New York racing, which has become the endless saga of what is to happen with the New York Racing Association. Shouldn't we be applying Rudy's words to NYRA? How do we bring about accountability, transparency, responsibility, and reform to the New York Racing Association?

Many wonder today whether there will be a New York Racing Association in the months to come. There has been more than considerable speculation that NYRA will be indicted by the federal government for its role in authorizing pari-mutuel clerks at the NYRA tracks commit tax fraud and money laundering. NYRA has allegedly been negotiating to pay a civil fine in lieu of a criminal indictment.² An indictment would certainly lead to NYRA's inability to install video lottery terminals at its Aqueduct Racetrack since no casino corporation would be allowed to contract with an indicted corporation.³ Additionally, the New York State Racing and Wagering Board might be obliged to summarily suspend NYRA's racing franchise if NYRA were to be charged with a federal felony.

Both alternatives – the civil fine and the NYRA indictment – hopefully will be avoided. The civil fine is basically only works to harm the State of New York and the horsemen at NYRA. NYRA's bottom line under the Racing, Pari-Mutuel Wagering and Breeding Law goes exclusively to the State and the horsemen. The first \$2 million of NYRA profits goes to purses, and any additional profits would go to the State Thoroughbred Capital Investment Fund which serves as a revolving loan fund for

¹ See remarks of Mayor Giuliani at http://www.thejockeyclub.com/roundtable_03.asp?section=13

² James M. Odatto, “NYRA appeals for settlement”, The Times Union (Albany, NY) August 6, 2003, p. A1; “NYRA's track record”, The Times Union (Albany, NY) August 10, 2003, Pg. B4.

³ Dennis Yusko And James M. Odatto, “NYRA speaks, horsemen listen”; The Times Union (Albany, NY) August 9, 2003 Pg. A1

NYRA.⁴ If the Capital Investment Fund has over seven million on hand at the end of the calendar year, the excess is paid to the State's general fund.⁵ As was once said, "In a real sense, defendant [NYRA] is merely a conduit through which money passes from the betting public to the state's coffers."⁶ The State's taxpayers, by operation of law, will bear the brunt of any fine or civil penalty imposed on NYRA. That makes no sense. Similarly, from an equitable standpoint, it makes little sense to penalize the current NYRA for the crimes of the past. The scheme by which the pari-mutuel clerks were allowed to go short and get the shorts deducted from their paychecks was devised at NYRA a quarter-century ago, and it is hardly unique to NYRA.⁷ If the present NYRA executives simply continued a long-standing, albeit illegal policy, the corporation should not be punished. This isn't just throwing out the baby with the bathwater. It's throwing out the horse with the manure. If NYRA officials profited from the tax evasion scheme or if they continued the scheme when they knew of its illegality, these individuals ought to be prosecuted. But the organization itself should be spared.⁸

If the federal charges against NYRA extend significantly beyond the fraudulent tax scheme utilized by the pari-mutuel clerks, then there is little reason to seek mercy for NYRA. If NYRA's financial records are fundamentally fraudulent in a WorldCom/Enron manner, or if there is evidence that NYRA's contractual practices regularly involve fraud and/or kickbacks, then NYRA may merit the death penalty.

But assuming NYRA is not targeted for criminal prosecution, the time should still be ripe for a Giuliani-inspired move to bring accountability, transparency, responsibility, and reform to NYRA. We suggest an eight point plan to apply these Giuliani principles to NYRA.

Accountability

Step one in the move to accountability is to conduct a strong public investigation of NYRA. We need to know what NYRA has done right, what it has done wrong, and what it is expected to do. The only vehicle to accomplish this move to accountability is a Moreland Act commission established by the Governor. Under Section 6 of the Executive Law, the governor is authorized to appoint individuals to examine and investigate the management and affairs of any department, board, bureau or commission of the state." This commission has specific subpoena powers and was used frequently during the first two-thirds of the twentieth century to investigate corruption and waste in New York State. While use of the Moreland Commission has diminished significantly in the last thirty years, the power and authority of Moreland Act commission to effect change is still significant. It was used most effectively by the Carey administration to

⁴ Section 208.1.a, Racing Law.

⁵ Section 257.2, Racing Law.

⁶ *Stevens v. New York Racing Association, Inc.*, 665 F. Supp. 164, 172 (E.D.N.Y. 1987).

⁷ Wells Tower, "Almost City"; The Washington Post, July 27, 2003 MAGAZINE; Pg. W06; Statement By Denis J. McInerney, Counsel to the New York Racing Association, <http://www.nyra.com/belmont/news.asp?track=B&id=1107>

⁸ This assessment is also based on a personal belief that NYRA's main competitors in the horse racing business do not offer racing products or services that are markedly better than the racing and services offered by NYRA. There simply are no Ritz Carltons or Four Seasons out there in the racing world.

investigate nursing homes and to review public authorities. It can play a similarly strong role in reviewing NYRA policy.

It would not be a criminal investigation. It would establish the basic facts of the operation of NYRA. It would focus on finance, compliance, and ethics. First, what is the actual financial condition of NYRA? Is it making money? What is the arrearage due the Capital investment Fund? What is the status of the NYRA's pension system? Are pensions over-funded so that profits to the state are reduced? What is the physical condition of NYRA's property?

On the compliance issue, the investigation would determine whether NYRA is in compliance with the assorted contractual requirements contained in the Racing Law. Are concession contracts bid properly under Section 208.7 of the Racing Law? Are contracts in excess of \$250,000 being bid properly?⁹ Has NYRA stopped any of its contracting practices which were criticized in 1997 by Comptroller McCall and Attorney General Vacco?¹⁰ Is NYRA in compliance with safety and fire codes, and is it adhering to state and federal environmental regulations?

Finally, there is a need to focus on ethics. For decades, there have been rumors about kickbacks at NYRA. These rumors need to be investigated and hopefully be resolved. Policies on nepotism must be put into place. The role of the trustees has to be clarified. Are the trustees, who are horsemen, given benefits not given to other horsemen? NYRA's policy on tickets, passes, and perks for public officials need to be reviewed to assure compliance with the requirements of the ethics laws.¹¹

Some people may argue that Governor Pataki is not the person who should be appointing an investigations commission since he has tipped his hand and sent his former counsel to argue against an indictment of NYRA.¹² A careful view of the Governor's record shows he has taken a more nuanced view of his situation. Two of the agencies he controls (the Racing and Wagering Board and the Capital Investment Fund) have been among the leaders in taking actions against NYRA. The Racing and Wagering Board started the investigation that has brought about NYRA's plight, and the State Police and the Governor's Inspector General's Office participated in the report on NYRA issued by the Attorney General.¹³ These agencies would hardly be expected to be taking actions that deleterious to NYRA without some form of approval from the Governor's office.

⁹ Racing Law, §213.5. This issue has been raised in some of NYRA's more recent contracts. See James M. Odatto, "NYRA allegedly violated state law", The Times Union (Albany, NY) August 14, 2003, Pg. A1

¹⁰ See New York Racing Association - Capital Program Operations and Selected Contract Award Practices (1997) http://nysosc3.osc.state.ny.us/nsaa/states/New_York/093098/96j89.htm

¹¹ For a somewhat analogous note dealing with the racing commission in Kentucky, see Janet Patton, "Hirings, firings, track passes, spending plague commission," Lexington Herald Leader (Kentucky) August 21, 2003Pg. a12,

¹² Michael Gormley, "Pataki rep tells feds NYRA indictment would hurt economy", The Associated Press August 7, 2003; James M. Odatto, "NYRA gets a show of support", The Times Union (Albany, NY) August 7, 2003, Pg. A1.

¹³ See James M. Odatto, "Spitzer challenges NYRA's control", The Times Union (Albany, NY) June 24, 2003, Pg. A1.

They are not likely to be off the reservation. A Moreland Commission appointed by Governor Pataki to study NYRA could work.

Transparency

Steps two and three involve transparency. Part of the problem in dealing with NYRA is that there is no public record of NYRA's actions. NYRA is supposed to be a non-profit organization which is to furnish revenue to the State. But the fact is that we lack the basic knowledge of NYRA's to know how NYRA is performing this function. We know far more about the finances of NYRA's private sector rivals in horse racing, Magna Entertainment and Churchill Downs than we know about NYRA which is supposed to be a near partnership with New York State. Step 2 is that the basic financial records of NYRA should be available to the public. These include NYRA's bylaws, its profit and loss statement, its balance sheet, and the report of its auditors. Salaries to NYRA's top employees and officers should be disclosed as well as NYRA's contracts with its consultants. NYRA's major payments for services also should be made available to the public. There is no reason why NYRA finances should be treated like major secrets of state.

Step 3 is to make the role of the trustees more transparent. We ought to know just what NYRA's trustees actually do at NYRA. There should be public agendas of their meetings, and minutes should be available of the trustees' actions. The votes of the trustees and their attendance records should be made available to the public. Even the political officials that have criticized NYRA have generally aimed their criticism at NYRA management¹⁴ and not the trustees who individually and jointly represent significant political and economic power.¹⁵ The fact, however, is that the trustees are NYRA, and their work product – or their lack of work product – should be made transparent to the people of New York. NYRA does not have to be subject to the state's Open Meetings and Freedom of Information Law, but sunlight on NYRA's financial records and meetings could only prove helpful.

Responsibility

The state has its own problems in dealing with NYRA. Responsibility for dealing with NYRA is diffused throughout the state. Everyone has some regulatory authority over NYRA, but since everyone has only partial jurisdiction, nobody is responsible for the big picture. NYRA is over regulated in the sense that it has to deal with a multitude of agencies, but it is under regulated in that no single agency has complete authority over NYRA. The Racing Board has the power to license NYRA, its employees, and participants in racing. Yet it is hardly alone. The State Tax Department is

¹⁴ A recent example of this is the recent report of the Attorney General which savages current NYRA President Terry Meyocks while largely ignoring the possibility that NYRA's Board, its former chairman, NYRA's auditing firm, and the State Comptroller could also justifiably have been held responsible for NYRA's failures.

¹⁵ James C. McKinley Jr. with Joe Drape, "HORSE RACING; Powerful Racing Association Gets New Scrutiny in Albany", The New York Times, August 14, 2003 Section D; Page 1

“charged with the financial administration of pari-mutuel betting,”¹⁶ and it ultimately determines NYRA’s franchise tax. The Comptroller audits NYRA. The Division of the Budget prescribes standards for competitive bidding by NYRA on concession contracts and the capital expenditure plans of nonprofit NYRA “shall be subject to the approval of the director of the budget.”¹⁷ There is a thoroughbred racing commission, a thoroughbred breeding fund, and a capital investment fund which lends money to NYRA. Soon the Division of the Lottery will have authority over NYRA and its video lottery terminals. Nobody is in charge.

There really is no need for this overlap. Under Step 4, the Racing and Wagering Board should be regarded as the one agency responsible for regulating NYRA. It should have the overall power that the state’s Public Service Commission possesses in regard to utilities. The Racing and Wagering Board should be a one stop shop for racing issues. There is little need for the Budget Division’s or the Tax Department’s involvement. Their interests can be protected by the Racing Board. The Racing Board could select an auditor for NYRA and obtain higher quality audits than the Comptroller. The Racing Commission serves little function, and the breeding fund’s role should be performed by the private sector. There would still be a need for an independent Capital Investment Fund, but that leads to step 5.

For nearly two decades, the Capital Investment Fund and NYRA have been engaging in a series of turf wars over the appropriate jurisdiction of the Fund. Should the Fund be serving as a bank for NYRA or its overseer? These turf wars need to be put to an end. Quickly, we need to settle which capital projects the Fund has jurisdiction over, what are the appropriate criteria for the Fund to apply when NYRA seeks deferrals of its loan payments, and what criteria should be applied when NYRA seeks approval of its overall capital improvement plan.¹⁸ The State of New York needs to be in a position to assess who is responsible for capital improvements at NYRA.

Reform

Step 6 is a suggestion on corporate governance. We need effective independent, outside people on the NYRA board. Most of the trustees at NYRA are racing insiders. They want more and better barn assignments for their horses and better treatment from the racing office. They have their private interests and can receive some benefits from their position as trustees. It would be better to mandate that several seats (3 to 5) of NYRA trustees be reserved for fans of racing who do not hold any racing licenses. The Racing Board could judge whether these people met the criteria of being racing fans. NYRA racing is supposed to serve the public in New York, which is basically the dwindling base of racing fans. These fans should be represented on the NYRA board. Additionally, the head of the horsemen’s association should be a de facto member of the

¹⁶ Racing Law, §227.3

¹⁷ Racing Law, §208.3.

¹⁸ Racing Law, §258.

NYRA board. The horsemen's association is charged with representing all the horsemen. The horsemen serving on NYRA's board often reflect only their personal interests. The head of the horsemen's organization can insure that NYRA responds to the needs of all the horsemen.

Step 7 is to insure that NYRA's backstretch facilities are in excellent condition. Currently, the State has a program which provides tax credits for restoration of historic barns.¹⁹ Nobody has more historic barns than NYRA. Most everyone would concede that the facilities at Saratoga are a state treasure, and all the barns at Saratoga would qualify as historic under the Tax Department's criteria. Yet, because the credit only applies to the State income tax and the corporate franchise tax, NYRA – because it only pays a franchise fee – is the only taxpayer ineligible for this credit. NYRA should be made eligible for this tax credit.

Step 8 is perhaps the most Pollyannaish step on this wish list. The officers and directors of a racetrack which holds or which has applied for a video lottery license should not be giving political contributions in New York. Too often, gambling and horse racing have been magnets for public corruption. We have witnessed the convictions of Governor Kerner in Illinois, Governor Edwards in Louisiana, and Governor Mandel in Maryland over gambling issues. In New York, in recent years, besides the NYRA mess, we have seen the convictions of Bill Carnevale and Hazel Dukes two presidents of New York City OTB, the conviction of Davis Etkin the president of Capital OTB, the conviction of the majority stockholder of Vernon Downs²⁰, and the indictment and absconding from justice of the former leadership of Alpha Hospitality²¹ which held a significant stake in Monticello Raceway. This corruption-gambling link has only been exacerbated by the large amount of money being funded to incumbents by the trustees of NYRA, and the advent of video lottery will add significantly to the cash available to racetrack interests in New York State. To prevent corruption, the directors and officers of racetracks in New York should be barred from contributing to New York State parties and candidates.

A limited political campaign contribution ban would arguably be legal under the applicable constitutional standards.²² It would only apply to a minimal number of individuals and organizations, and it would be directly aimed at both ending the actuality and the appearance of public corruption stemming from gambling.

¹⁹ Tax Law §§210.12 (l); 606 (a) (12)

²⁰ Patrick Bennett, See Stewart L. Weisman, Need and Greed: The True Story of the Largest Ponzi Scheme in American History (1999)

²¹ See Charles V. Bagli, "New Deal Puts Fresh Face on Proposal for Indian Casino in Catskills", The New York Times, April 7, 2003, Section F; Page 1;" Former hotel owners face fraud charges", The Miami Herald April 18, 2002 Section C; Pg. 3

²² See Casino Ass'n v. State, 820 So. 2d 494, (La., 2002), cert. denied 123 S. Ct. 1252 (2003); In re Petition of Soto, 236 N.J. Super. 303 (N.J. Super. Ct. 1989), cert. denied 121 N.J. 608 (1990), cert. denied 496 U.S. 937 (1990), 1997 Mich. Op. Att'y Gen. 206. See also State v. Alaska Civil Liberties Union, 978 P.2d 597, (Alaska 1999) cert denied 528 US 1153 (2000) and Jacobus v. Alaska, 2003 U.S. App. LEXIS 16435 (9th Cir, 2003).

An effort to apply the Giuliani principles of accountability, transparency, responsibility, and reform to NYRA would not solve all of NYRA's and all of New York's racing's problems. But it can go along way to assuring that NYRA will serve the goals set out by the Racing Law by "establishing thoroughbred racing and pari-mutuel betting on such racing in New York state on such a footing that it will command the interest as well as the confidence and favorable opinion of the public and so that these activities will provide reasonable revenue for the support of government in accordance with the provisions of section nine of article one of the state constitution."²³ The late industrialist, John Hanes was the principal founder of NYRA. He was fond of stressing the fact that NYRA and the state were partners in racing. By putting these steps in place, that partnership can be restored.

²³ Racing Law, § 208.9 (d) (4).