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## Turning the Lights On: An Analysis of the Fiduciary Duty Provisions of the New York State Public Authority Reform Act

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ADAM PAUL GORDON

Turning the Lights On:  
An Analysis of the Fiduciary Duty  
Provisions of the New York State Public  
Authority Reform Act

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## TURNING THE LIGHTS ON

### I. INTRODUCTION

Public authorities<sup>1</sup> have a controversial history in New York State.<sup>2</sup> Responsible for the creation and maintenance of the state's most important infrastructure, including bridges and housing, public authorities have often been criticized for a lack of transparency, accountability, and improper governance.<sup>3</sup> In 2005, the New York State Assembly passed the Public Authorities Accountability Act of 2005 (the "Public Authority Accountability Act").<sup>4</sup> The legislation sought to remedy the "shadow-like" activity of state authorities by creating an independent watchdog agency, instituting mandatory reporting requirements and limiting expenditures.<sup>5</sup> However, subsequent to its enactment, after several high-profile cases of public authority misconduct, it became clear that the Public Authority Accountability Act was not meeting its objectives.<sup>6</sup> According to the 2010 annual report by the Authorities Budget office, "the law lacked basic enforcement language that could ensure compliance, improve board member performance, and strengthen the oversight role of the [Authorities Budget Office]."<sup>7</sup> In response to this criticism, members of the New York State Legislature recommended that additional changes be implemented to the statute.<sup>8</sup> In 2009, Governor David Paterson signed the Public Authorities Reform Act of 2009 (the "Reform Act"), which amended the Public Authority Accountability Act.<sup>9</sup>

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1. "Public authorities are agencies that governors and legislatures establish outside the main structure of government to escape the restrictions that elected leaders and the people place on 'regular' state agencies." ROBERT B. WARD, *NEW YORK STATE GOVERNMENT: WHAT IT DOES, HOW IT WORKS* 300 (2002); BLACK'S LAW DICTIONARY 152 (9th ed. 2009) (defining public authorities).
  2. WARD, *supra* note 1, at 284.
  3. See Lynn Wilson & Clayton Eichelberger, *New York State Public Authority Reform: Where We Have Come From and Where We Need to Go*, 11 N.Y. ST. B. ASS'N GOV'T L. & POL'Y J., 1, 15 (2009) [hereinafter *Wilson Memo*].
  4. 2005 N.Y. Sess. Laws 1789 (codified as amended at N.Y. PUB. AUTH. LAW §§ 2-4002 (McKinney 2011)); Press Release, N.Y. State Authority Budget Office, Governor Signs Public Authorities Accountability Act (Jan. 16, 2006) *available at*, [http://www.abo.state.ny.us/archives/PressReleaseforChapter766%20\\_S5927.pdf](http://www.abo.state.ny.us/archives/PressReleaseforChapter766%20_S5927.pdf); Press Release, N.Y. Governor's Office, David Paterson, Governor Paterson Signs Public Authorities Reform into Law (Dec. 11 2008), *available at* <http://www.weil.com/news/newsdetail.aspx?news=38465>.
  5. See *Wilson Memo*, *supra* note 3, at 19-20.
  6. See Stephen Ceasar, *A Magnifying Glass on Public Authorities*, N.Y. TIMES CITY ROOM BLOG (July 12, 2010, 12:37 PM), <http://cityroom.blogs.nytimes.com/2010/07/12/putting-a-magnifying-glass-to-public-authorities>.
  7. N.Y. STATE AUTHS. BUDGET OFFICE, *ANNUAL REPORT ON PUBLIC AUTHORITIES IN NEW YORK STATE* (2010) [hereinafter 2010 ABO REPORT], [www.abo.state.ny.us/reports/annualreports/ABO2010AnnualReport.pdf](http://www.abo.state.ny.us/reports/annualreports/ABO2010AnnualReport.pdf).
  8. Sponsor's Memorandum, 2009 Legis. Bill Hist. N.Y. A.B. 2209 (McKinney).
  9. 2009 N.Y. Sess. Laws 1349-1384 (codified at N.Y. PUB. AUTH. LAW §§ 2-3957 (McKinney 2011)); Press Release, *supra* note 4.

Notably, the amended law codified the fiduciary duties of authority board members in the hope of achieving model governance.<sup>10</sup> In the three years since the law was enacted, no New York state court has had the opportunity to review the fiduciary duty provisions of the Reform Act. Thus, it remains to be seen how these duties can be judicially enforced.

This note will examine the fiduciary provisions of the Reform Act and evaluate, specifically, whether the new obligation to act “in the best interest of the authority . . . and the public interest”<sup>11</sup> will play a meaningful role in influencing board member decisionmaking and deterring misconduct. In assessing the effectiveness of the fiduciary duty provisions, this note will examine when the duties will be implicated, how they will be enforced, and, most importantly, the consequences of noncompliance. After addressing these questions, this note argues that the fiduciary duty provisions enacted under the Reform Act fall short of achieving the act’s purpose, which is to eradicate the self-dealing and irresponsible decisionmaking that have too often characterized New York public authorities.<sup>12</sup> Thus, the New York legislature and the courts must not only redress the harms that will be caused by misconduct on the part of public authorities, but also further strengthen the enforcement provisions of the Reform Act. This note contends that the imposition of significant fines on negligent and self-dealing board members will strike a proper balance between redressability and deterrence, thereby serving the underlying goals of the Reform Act.

Part II explores the historical role and importance of public authorities in New York State, as well as the problems and abuses that led to the enactment of the Public Authority Accountability Act and, later, the Reform Act. Part III examines the Reform Act and illustrates, first, why the fiduciary provisions cannot be effectively enforced by the public and, second, the limitations of the Reform Act’s current enforcement mechanisms. Part IV proposes a limited role for citizen enforcement, without compromising notions of sovereign immunity, through the imposition of fines.

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10. N.Y. PUB. AUTH. LAW § 2824; *see also* Senior Partner Ira M. Millstein *Applies Foundational Corporate Governance Experience to Groundbreaking State Legislation*, WEIL GOTSHAL NEWS (Mar. 9, 2006), <http://www.weil.com/news/newsdetail.aspx?news=25745>.

The Model Corporate Governance Principles that Mr. Millstein eventually presented to the governor had its foundations in the federal Sarbanes-Oxley Act, but drew significantly on the governance best practices he usually prescribes to his corporate clients. Touching on subjects including the training of public authority board members, the separation of oversight and executive functions, and the ethical conduct of all public authority directors, officers and employees, Mr. Millstein helped to establish a set of principles which ensure that public authorities in New York State are held to the strictest standards of ethics and professional responsibility.

*Id.*

11. PUB. AUTH. § 2824 (McKinney 2011).

12. N.Y. STATE OFFICE OF THE STATE COMPTROLLER, PUBLIC AUTHORITY REFORM, REINING IN NEW YORK’S SECRET GOVERNMENT (2004) [hereinafter REINING IN NEW YORK’S SECRET GOVERNMENT], <http://www.osc.state.ny.us/press/releases/feb04/publicauthorityreform.pdf>.

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### II. HISTORY OF PUBLIC AUTHORITIES IN NEW YORK STATE

#### *A. Introduction to Public Authorities*

Public authorities are state-chartered public benefit corporations created “to finance, build, manage, or improve capital assets and further public works.”<sup>13</sup> They supplement the legislature’s work by spearheading public projects through a corporate-like model. Public authorities accomplish this by arranging financing for projects and overseeing important government infrastructure.<sup>14</sup> These entities, which are usually overseen by a board of directors, typically issue bonds to fund important public projects such as transportation infrastructure, housing, and hospitals.<sup>15</sup> The creation and need for public authorities evolved from the government’s obligation to provide adequate public services.<sup>16</sup> Because of constitutional restraints on debt issuance that prohibit the State from borrowing excessively, the State found it more convenient to use public authorities to fund these projects.<sup>17</sup> The birth of independent public authorities allowed for the issuance of debt to finance capital projects without the State having to assume the liabilities.<sup>18</sup>

The first modern public authority in New York State was the Port Authority of New York and New Jersey, created in 1921 to enhance regional port facilities.<sup>19</sup> However, the real potential of public authorities emerged under master-builder Robert Moses, who used, among others, the Triborough Bridge and Tunnel Authority to finance and build much of New York’s modern infrastructure.<sup>20</sup> Over a forty-four year period, Moses’s projects included the Triborough Bridge, Jones Beach State Park, and the Verrazano-Narrows Bridge.<sup>21</sup> While celebrated for influencing

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13. IRA M. MILLSTEIN ET AL., NEW YORK STATE COMMISSION ON PUBLIC AUTHORITY REFORM REPORT (2006) [hereinafter COMMISSION ON PUBLIC AUTHORITY REFORM REPORT], <http://www.abo.state.ny.us/commissionPublicAuth/FinalReport.pdf>.

14. See CITIZENS BUDGET COMM’N, NEW YORK’S PUBLIC AUTHORITIES: PROMOTING ACCOUNTABILITY AND TAMING DEBT (2006) [hereinafter CBC PUBLIC AUTHORITY PROBLEMS], [http://www.cbcny.org/sites/default/files/reportssummary\\_authorities\\_06012006.pdf](http://www.cbcny.org/sites/default/files/reportssummary_authorities_06012006.pdf).

15. See CITIZENS BUDGET COMM’N, PUBLIC AUTHORITIES IN NEW YORK STATE (2006) [hereinafter CBC 2006 REPORT], [http://www.cbcny.org/sites/default/files/report\\_authorities\\_04012006.pdf](http://www.cbcny.org/sites/default/files/report_authorities_04012006.pdf) (highlighting the historical problems of public authorities and suggesting reforms).

16. *Id.*

17. *Id.* at 2.

18. *Schultz v. State*, 84 N.Y.2d 231, 244 (1994) (Noting that public authorities would “protect the State from liability and enable public projects to be carried on free from restrictions otherwise applicable” (quoting *In re Plumbing, Heating, Piping & Air Conditioning Contrs. Ass’n v. N.Y. State Thruway Auth.*, 5 N.Y.2d 420 (1995)).

19. CBC 2006 REPORT, *supra* note 15, at 1.

20. See Paul Goldberger, Obituary, *Robert Moses, Master Builder, is Dead at 92*, N.Y. TIMES, July 30, 1981, at A1.

21. *Id.*

the “planning of cities around the nation,” Moses’s power highlighted the potential for abuses in authority governance.<sup>22</sup>

In carrying out their mandates, New York public authorities differ from other state agencies because they have traditionally been exempt from certain oversight and accountability requirements.<sup>23</sup> For example, key decisions relating to expenditures and large projects are often not subject to outside voter approval.<sup>24</sup> The public authorities’ autonomy balances “political accountability and political independence” by allowing an authority “to make difficult and unpopular decisions outside the arena of elected politics.”<sup>25</sup> Consequently, over the years some New York public authorities have abused this autonomy, as evidenced by excessive spending, insufficient disclosure, and the accumulation of massive debt.<sup>26</sup> To understand the magnitude of this, it was reported that public authority expenditures equal eighty-four percent of New York’s general fund spending.<sup>27</sup>

### *B. How Public Authorities Operate*

As of August 2010, there were 323 state authorities and 771 local authorities in New York.<sup>28</sup> New York authorities vary in spending levels, mission, and governance. Among the largest in size, as measured by annual spending, are the New York

22. *Id.*; see generally ROBERT A. CARO, *THE POWER BROKER: ROBERT MOSES AND THE FALL OF NEW YORK* (Vintage Books ed. 1975).

23. For an overview of how public authorities work, see *What Is a Public Authority?*, N.Y. OFFICE OF THE STATE COMPTROLLER, <http://www.osc.state.ny.us/pubauth/whatisauthority.htm> (last visited Feb. 8, 2012).

24. See CBC 2006 REPORT, *supra* note 15, at 14–22. This note uses “outside voter approval” to refer to those other than the public authority board members.

25. See *id.* at iv.

26. See Casey Seiler, *Shadow Government Debt Hits \$52 Billion*, TIMES UNION (Albany), Aug. 11, 2010, at A3, available at <http://www.timesunion.com/local/article/Shadow-government-debt-hits-52-billion-612662.php>; see also N.Y. OFFICE OF THE STATE COMPTROLLER, *NEW YORK’S PUBLIC AUTHORITIES BY THE NUMBERS (2010)* [hereinafter *NEW YORK’S PUBLIC AUTHORITIES BY THE NUMBERS*], [www.osc.state.ny.us/pubauth/reports/pub-auth-num.pdf](http://www.osc.state.ny.us/pubauth/reports/pub-auth-num.pdf).

27. Seiler, *supra* note 26; see also Ceasar *supra* note 6.

28. *NEW YORK’S PUBLIC AUTHORITIES BY THE NUMBERS*, *supra* note 26. “State” and “local” authorities are statutorily defined under N.Y. PUB. AUTH. LAW § 2 (McKinney 2011).

1. “state authority” shall mean a public authority or public benefit corporation created by or existing under this chapter or any other law of the state of New York, with one or more of its members appointed by the governor or who serve as members by virtue of holding a civil office of the state, other than an interstate or international authority or public benefit corporation, including subsidiaries of such public authority or public benefit corporation.

2. “local authority” shall mean (a) a public authority or public benefit corporation created by or existing under this chapter or any other law of the state of New York whose members do not hold a civil office of the state, are not appointed by the governor or are appointed by the governor specifically upon the recommendation of the local government or governments; (b) a not-for-profit corporation affiliated with, sponsored by, or created by a county, city, town or village government; (c) a local industrial developmental agency or authority or other local public benefit

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Dormitory Authority, Metropolitan Transit Authority (MTA), and New York State Thruway Authority.<sup>29</sup> However, lower-spending authorities—which incur substantially less debt—such as local public works and community development authorities, play an equally pivotal role in serving New Yorkers and are equally prone to excessive spending and debt accumulation.<sup>30</sup>

The three principal ways public authorities borrow to accomplish their goals and fund their projects are project revenue debt, private conduit debt, and state-supported debt.<sup>31</sup> Revenue bonds are repaid with the funds or revenue generated by the authority's projects. For example, an authority may issue bonds to build a bridge; thereafter, toll-collecting serves to repay the debt incurred by the project.<sup>32</sup> In this case, the public authority is “self-supporting, able to meet debt obligations through revenues obtained from its own valuable assets, such as fares and user fees.”<sup>33</sup>

Public authorities also issue conduit debt “on behalf of a private individual or firm in order to take advantage of federal tax exemptions.”<sup>34</sup> In this situation, the private entity, such as a university or hospital, not the government, becomes the source for repaying the debt.<sup>35</sup> The private entity takes on the responsibility of the debt, rather than the public entity. Conduit debt is often used for financing housing, healthcare, or educational infrastructure because these public institutions stand to benefit most from the favorable tax treatment.<sup>36</sup>

The third type of authority debt, state-supported debt, is the largest portion of public authority debt and the most controversial because it implicates tax dollars. In this category, general government revenue—notably tax dollars—is annually appropriated to repay the interest and principal of this debt.<sup>37</sup> The bonds issued are

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corporation; (d) an affiliate of such local authority; or (e) a land bank corporation created pursuant to article sixteen of the not-for-profit corporation law.

*Id.*

29. N.Y. STATE AUTHS. BUDGET OFFICE, ANNUAL REPORT ON PUBLIC AUTHORITIES IN NEW YORK STATE (2011) [hereinafter 2011 ABO REPORT], [www.abo.state.ny.us/reports/annualreports/ABO2011AnnualReport.pdf](http://www.abo.state.ny.us/reports/annualreports/ABO2011AnnualReport.pdf). The MTA is one of the hundreds of public authorities in New York State. The MTA's spending accounts for roughly twenty-two percent of the state's authority debt. *Id.* at 17.
30. For example, the Trust for Cultural Resources of the County of Onondaga “is an authorized issuer of bonds for non-profit cultural organizations” and “offers a local, convenient and more economical financing opportunity for the Onondaga County's non-profit establishments.” *Onondaga County Trust for Cultural Resources, Economic Development Services*, SYRACUSE CENTRAL, <http://www.syracusecentral.com/Economic-Development-Services-Trust-for-Cultural-Resources.aspx> (last visited Feb. 18, 2012).
31. CBC PUBLIC AUTHORITY PROBLEMS, *supra* note 14. For more information and specific figures on public authority debt, see *Data on Public Authority Debt*, N.Y. STATE COMPTROLLER, [http://www.osc.state.ny.us/pubauth/data/pa\\_debt\\_june2010.pdf](http://www.osc.state.ny.us/pubauth/data/pa_debt_june2010.pdf) (last visited Mar. 9, 2012).
32. CBC PUBLIC AUTHORITY PROBLEMS, *supra* note 14, at 6.
33. *Schultz v. State*, 84 N.Y.2d 231, 244 (1994).
34. CBC PUBLIC AUTHORITY PROBLEMS, *supra* note 14, at 6.
35. *Id.* at 6.
36. COMMISSION ON PUBLIC AUTHORITY REFORM REPORT, *supra* note 13, at 12.
37. *Wilson Memo*, *supra* note 3.

“backed by appropriations of state controlled revenues to secure projects set forth in the State’s capital plan,” which can range from schools to highways.<sup>38</sup>

State-supported public authority debt per household in New York reached \$7,900 in 2009.<sup>39</sup> This public authority debt is problematic not only because of the amount outstanding, but also because it is issued largely through “backdoor” borrowing.<sup>40</sup> Backdoor borrowing (or spending) refers to state-supported debt that is not subject to voter approval.<sup>41</sup> In 2009, the Office of the New York State Comptroller reported that “more than 94 percent of all long-term State-funded debt outstanding was issued by public authorities.”<sup>42</sup> This means that in New York, voters had approved only about six percent of state-supported debt.<sup>43</sup>

Critics contend that such borrowing by public authorities “limits accountability and transparency by circumventing public participation and transferring control over the spending of billions of taxpayer dollars to largely autonomous public authority boards.”<sup>44</sup> A second problem with backdoor debt is that it “has been applied to cover the State’s operating expenses rather than for capital investments” without proper government oversight and functions without voter approval.<sup>45</sup>

### *C. Events Leading to the Public Authority Accountability Act*

A 2004 report by State Comptroller Alan Hevesi<sup>46</sup> noted that “past practices by [New York] authorities reveals a history of unethical and, at times, illegal activities.”<sup>47</sup> These “practices” by appointed authority board members included bribery, nepotism, funding and resource misuse, excessive pay, ethical misconduct, and negligent decisionmaking. In the last twenty years, numerous scandals and illegal public authority practices have been exposed, often including a recurrence of wrongdoings.<sup>48</sup>

38. COMMISSION ON PUBLIC AUTHORITY REFORM REPORT, *supra* note 13, at 12. “After the State’s capital budget is negotiated, specific capital projects are assigned by the legislature to designated Authorities.” *Id.* at 12 n.5.

39. NEW YORK’S PUBLIC AUTHORITIES BY THE NUMBERS, *supra* note 26, at 2.

40. *Wilson Memo*, *supra* note 3, at 21.

41. Assemblywoman Nancy Calhoun, *Crushing Debt Fed by Unlawful Borrowing*, N.Y. STATE ASSEMBLY (Mar. 18, 2011), <http://assembly.state.ny.us/mem/Nancy-Calhoun/story/41558/>.

42. NEW YORK’S PUBLIC AUTHORITIES BY THE NUMBERS, *supra* note 26, at 2.

43. *See id.*

44. *Wilson Memo*, *supra* note 3, at 21.

45. CBC 2006 REPORT, *supra* note 15, at 14.

46. Ironically, though “the State Comptroller is responsible for ensuring that the taxpayers’ money is being used effectively and efficiently to promote the common good,” *What are the Comptroller’s Responsibilities?*, OFFICE OF THE STATE COMPTROLLER, <http://www.osc.state.ny.us/about/response.htm> (last visited Feb. 18, 2012), in 2006 Alan Hevesi pled guilty to corruption charges stemming from a pension investment, *see* Michael Cooper, *Hevesi Pleads Guilty to a Felony and Resigns*, N.Y. TIMES, Dec. 23, 2006, at B1, available at <http://www.nytimes.com/2006/12/23/nyregion/23hevesi.html>.

47. REINING IN NEW YORK’S SECRET GOVERNMENT, *supra* note 12, at 29.

48. *Id.* The Executive Director of the New York State Bridge Authority was investigated and audited in 1986 and 2003 for “inappropriate business expenses.” *Id.* Similarly, the New York Convention Center

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There have been noteworthy examples of past authority misconduct over the years. For instance, a board appointed a former state assemblyman with no experience in energy matters as chairman of the New York Power Authority.<sup>49</sup> Also significant was the New York Dormitory Authority's loss of \$21 million due to inappropriate and ill-advised investments by unqualified employees.<sup>50</sup> The New York State Thruway Authority's decision to sell to a private developer exclusive access rights to the Erie Canal for only \$30,000 when they were likely valued at a much higher amount was another example of controversial decisionmaking.<sup>51</sup>

While the range of authority misconduct is diverse, authority board members often play central roles.<sup>52</sup> It eventually became clear to New York lawmakers that misconduct by public authority board members, and the failure to discover it, could be attributed to lax statutory oversight and accountability requirements. A report by the Citizens Budget Commission highlighted five recurring problems with public authority governance in New York State: “[i]nsufficient reporting and accountability,” “[i]nsufficient independence in governance,” “[m]isuse of the power to incur government-backed debt,” “[i]nsufficient oversight and coordination of project revenue debt,” and “[i]neffective use of private conduit debt.”<sup>53</sup> The Public Authority Accountability Act sought to address these problems. In addition to the creation of the independent Authorities Budget Office, which was charged with overseeing authority operations, practices and reports to ensure compliance, the Public Authority Accountability Act codified model board governance principles.<sup>54</sup> These principles and guidelines, derived from governance models used by the private sector, included training on ethical duties and responsibilities, establishment of codes of conduct, and strategies to minimize conflicts of interest.<sup>55</sup>

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Operating Corporation, which operated the Javitz Center at the time, faced racketeering and extortion charges throughout the 1990s. *Id.*

49. *Id.* at 33.

50. *Id.* at 30; see Susan Chira, *College Project Put Off as Agency Faces Fiscal Woes*, N.Y. TIMES, Oct. 18, 2006, at A3.

51. Michael Cooper, *State Cancels Deal to Develop Erie Canal*, N.Y. TIMES, May 11, 2004, at B1 (“After defending the contract for months, officials at the Canal Corporation, a subsidiary of the New York State Thruway Authority that [had] awarded the contract three years ago, decided to end it.”). Regarding this transaction, which was later voided by Governor Pataki, one legislator commented, “This state is selling used trucks for more than” that amount. Lydia Polgreen, *Selling Off Access to the Erie Canal; Developer’s \$30,000 Purchase Raises Concerns About the Process*, N.Y. TIMES, Sept. 29, 2003, at B1, available at <http://www.nytimes.com/2003/09/29/nyregion/selling-off-access-erie-canal-developer-s-30000-purchase-raises-concerns-about.html?pagewanted=2>.

52. See generally REINING IN NEW YORK’S SECRET GOVERNMENT, *supra* note 12.

53. CBC PUBLIC AUTHORITY PROBLEMS, *supra* note 14, at 2.

54. 2011 ABO REPORT, *supra* note 29. See generally N.Y. PUB. AUTH. LAW § 2824 (McKinney 2011). In addition to the codification of fiduciary duties, the law provides that an authority board member must understand “his or her duty of loyalty and care to the organization and commitment to the authority’s mission and the public interest.” *Id.* § 2824(1)(g).

55. *Id.*; Sponsor’s Memorandum, *supra* note 8.

*D. The Public Authority Reform Act*

Even after the Public Authority Accountability Act was passed, several legislators found that public authority board members still “operated in secret, mismanaged resources, and showered developers with sweetheart deals.”<sup>56</sup> Therefore members of the New York State Assembly believed it was necessary to amend the law in order to address the abuses initially contemplated in the Public Authority Accountability Act. In 2009, the New York State Assembly amended the Public Authority Accountability Act by passing the Reform Act to both give the Authorities Budget Office (ABO) more oversight power and strengthen the ethical obligations and disclosure requirements of public authority directors.<sup>57</sup>

Under the Reform Act, all board members now have a fiduciary duty that is arguably enforceable by the Authorities Budget Office Director.<sup>58</sup> The law states in pertinent part that board members must perform their duties

in good faith and with that degree of diligence, care and skill which an ordinarily prudent person in like position would use under similar circumstances, and may take into consideration the views and policies of any elected official or body, or other person and ultimately apply independent judgment in the best interest of the authority, its mission and the public.<sup>59</sup>

Additionally, the Sponsor’s Memorandum calls for board members to execute an acknowledgement of these fiduciary duties, obligating board members to possess a basic command of their duties, specific to each board, and competency to carry out their functions.<sup>60</sup>

Corporate governance expert Ira Milstein developed the Reform Act’s fiduciary duty provisions based on the private corporate governance model.<sup>61</sup> Under Delaware

56. Press Release, N.Y. State Legislature, Senators Urge Governor to Sign Authorities Reform Bill (Aug. 21 2009), available at <http://www.nysenate.gov/files/pdfs/AuthorityReformPressRelease.pdf>. After the passage of the Public Authority Accountability Act it was found that, “[a]dditional reforms and fixes are necessary to make the system more accountable and transparent.” Legislative Memo, 2009 N.Y. Sess. Law News Ch. 505 (McKinney). The amended law also established whistleblower protections, additional debt issuance limits, and rules for the disposition of authority property. See Press Release, *supra* note 4.

57. See Scott Fein, *The Public Authorities Reform Act of 2009*, 11 N.Y. ST. B. ASS’N GOV’T L. & POL’Y J. 102, 103 (2009).

58. See Sponsor’s Memorandum, *supra* note 8.

59. PUB. AUTH. § 2824(1)(g).

60. See Sponsor’s Memorandum, *supra* note 8.

61. See GOVERNOR’S TASK FORCE ON THE IMPLEMENTATION OF THE 2009 PUBLIC AUTHORITIES REFORM ACT 10 (2010) [hereinafter TASK FORCE REPORT], <http://www.abo.state.ny.us/aboTaskForce/ParaTaskForceFinalReport.pdf>.

Over the years, the Delaware courts have articulated and enforced fiduciary duties of directors under state law on a case-by-case basis. This body of law has become the backbone of best practices for boards of public corporations. In recent times, it has also been recognized as applicable to not-for-profit corporations, irrespective of the fact that not-for-profit corporations have no shareholders, on the grounds that they have identifiable constituents that are highly dependent on them. If anything, the case is even

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law, company shareholders may judicially challenge a board member's breach of fiduciary duty.<sup>62</sup> These duties require that board members act "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."<sup>63</sup> If challenged, board members may then defend their conduct pursuant to the business judgment rule. The business judgment rule "exists to protect and promote the full and free exercise of the managerial power."<sup>64</sup> Where "the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith . . . the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders."<sup>65</sup> A failure of the directors to meet this burden results in liability.<sup>66</sup> Courts have found directors liable for a violation of their fiduciary duties based on conduct that amounts to gross negligence or blatant disregard for shareholder interests.<sup>67</sup> Loosely analogizing taxpaying state citizens to shareholders of a corporation suggests that public authority directors could be found liable for taking action against the public's best interests if it was made without justification. From this perspective, it was easy to see the appeal of utilizing the private sector model for the Reform Act, as misconduct by directors of public sector boards could potentially hurt tax-paying citizens.<sup>68</sup>

The drafters of the Reform Act codified these fiduciary duties to focus authority boards "on their legal obligations, including understanding that these duties are the means by which the board carries out the mission of the authority."<sup>69</sup> The legislature believed that the establishment of the fiduciary duties of loyalty and care were essential to improve authority governance and deter negligence and self-dealing.<sup>70</sup>

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stronger for public authorities—the identifiable constituents in this instance are the citizens of the State and the resources public authorities expend, are the State's resources.

*Id.*

62. See DEL. CODE ANN. TIT. 8, § 102(b)(7) (2011).

63. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

64. Smith v. Van Gorkom 488 A.2d 858, 872 (Del. 1985).

65. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006). Private shareholders may obtain information about board member actions from the website of the Securities Exchange Commission. *Search*, U.S. SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/search/search.htm> (last modified July 19, 2011) (follow "Search" hyperlink; then search by "Company Filings," "SEC Documents," or by a general "Search Engine"). New Yorkers do not have this right against public authority board members.

66. See *In re Walt Disney Co.*, 906 A.2d at 53.

67. See *Smith*, 488 A.2d 858 (holding company directors liable for gross negligence). Although this case has been overturned via statute, it still stands for a proposition that board directors can be held liable for breach of their fiduciary duty. DEL. CODE ANN. TIT. 8, § 102(b)(7) (2011).

68. See Adam P. Gordon, *Suggested Best Practices for Municipal Issuers in Light of Recent Enforcement Trends*, 24 J. TAX'N & REG. FIN. INSTITUTIONS 33 (2011).

69. 2011 ABO REPORT, *supra* note 29, at 1.

70. Sponsor's Memorandum, *supra* note 8. The drafters believed that "with 'good' governance and the effectuation of fiduciary duties, it is far more likely that 'bad' performance will be avoided." TASK FORCE

The government Task Force on the Implementation of the 2009 Public Authorities Reform Act (the “Task Force”) led by Millstein made recommendations regarding the Reform Act’s implementation and explained when the fiduciary duties are implicated. The duty of loyalty is breached when a board member’s judgment “is, or could be, influenced by a factor (fear, friendship, personal gain).”<sup>71</sup> Regarding the duty of care, the Task Force noted that board members must make informed, independent decisions that do not waste the authority’s assets.<sup>72</sup> Millstein further clarified the fiduciary duties as follows:

The business judgment rule . . . means: you don’t have to be right. You can make a mistake. And you can even make a decision where [] the ABO says, [w]e didn’t think that was a good idea or [y]ou shouldn’t have done that. That’s not going to get you into trouble. What’s going to get you into trouble is when you didn’t pay attention, you didn’t have a process, you didn’t think about it, and you didn’t make up your mind independently about what to do.<sup>73</sup>

While the fiduciary provisions of the Reform Act are clearly defined, because they were recently enacted, the statute’s enforcement mechanisms have yet to be tested. Consequently, it is essential to identify and remedy any apparent weaknesses in these provisions. Adequate oversight and compliance are critical to meaningful public authority reform. Yet it remains to be seen whether the statute will be able to meet its objectives.

### III. A WEAK ENFORCEMENT REGIME

A hypothetical example of a breach of fiduciary duty by a director of a New York public authority illustrates the limited public remedies available to taxpayers seeking redress, and how the Reform Act’s fiduciary duty provisions would be enforced.

In conjunction with an urban redevelopment proposal, a hypothetical state-run public authority in New York agrees to sell its land to a politically connected private developer for \$250,000 less than the fair market value, deliberately failing to conduct research because the developer is one of the top campaign donors of one of the state’s prominent mayors (the “Mayor”). The authority’s directors know that the Mayor has pledged to “take care” of them when their terms on the board expire. Despite cries from angry locals protesting the sale, the redevelopment project moves forward with the board’s approval. With their objections ignored, citizens seek judicial intervention

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REPORT, *supra* note 61, at 10.

71. See TASK FORCE REPORT, *supra* note 61, at 11.

72. See *id.*

73. Norman Oder, *What’s Violating Fiduciary Duty for a Public Authority?*, ATLANTIC YARDS REPORT (July 16, 2010), <http://atlanticyardsreport.blogspot.com/2010/07/whats-violating-fiduciary-duty-for.html> (quoting Ira Millstein, Senior Partner, Weil, Gotshal & Manges, Panel Discussion at the Albany Law School Symposium: Discussion of the Public Authorities Reform Act of 2009 (Apr. 27, 2009), available at <http://www.totalwebcasting.com/view/?id=albanylaw>). To illustrate the point, Millstein offers an example of a board member sleeping during a meeting. Such conduct would only be actionable if the board member went to the board meeting with the intention of sleeping. *Id.*

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to both halt the sale and hold the board members responsible for potentially negligent and self-serving actions relating to the sale.<sup>74</sup>

However, New York State law currently provides a limited public remedy. Specifically, in this hypothetical, the law would likely deny citizens standing to obtain the relief they seek and would provide no private right of action. Furthermore, despite the Reform Act's stated purpose to increase the transparency and accountability of public authority boards, taxpaying New Yorkers and the authorities are unlikely to find themselves with legal recourse under the statute; this is partially due to the bureaucratic and inefficient enforcement mechanisms already in place.<sup>75</sup> Part A of this section examines how citizens will likely be found to lack both standing and a private right of action, thus precluding them from challenging board decisions. Part B analyzes the likely operation and effect of the Reform Act's built-in enforcement provisions after alleging a breach of fiduciary duty. This includes an analysis of the official empowered with removal and whether those enforcement provisions actually achieve the goals of the statute. This note concludes that the Reform Act, as passed, lacks the capability to successfully deter and prevent misconduct by public authority board members.

### *A. A Limited Public Remedy*

#### *1. Lack of Standing*

The hypothetical above is loosely based on a case decided shortly before the Reform Act's passage. In *Montgomery v. Metropolitan Transportation Authority*, the petitioners, who included a community advocacy group, alleged that the MTA failed to comply with the competitive bidding provisions under the Public Authority Accountability Act by selling a government rail yard to a private developer without getting an appraisal and soliciting additional bids.<sup>76</sup> The community group claimed associational standing stemming from an interest in the Public Authority Accountability Act's "purpose of promoting accountability, transparency and ethics."<sup>77</sup>

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74. See the competitive bidding provisions of N.Y. PUB. AUTH. LAW § 2897 (McKinney 2011).

[T]he award shall be made with reasonable promptness by notice to the responsible bidder whose bid, conforming to the invitation for bids, will be most advantageous to the state, price and other factors considered; provided, that all bids may be rejected when it is in the public interest to do so.

*Id.* This hypothetical scenario was modeled on *Montgomery v. MTA*, No. 114304/09, 2009 WL 4843782, at \*1 (Sup. Ct. N.Y. County Dec. 15, 2009). Of that case, the Reform Act sponsor, Richard Brodsky, suggested that the MTA had breached its fiduciary duty. See Norman Oder, *Brodsky: MTA Board's Acceptance of Ratner's Lesser Offer for Railyard Would Violate its Fiduciary Duty*, ATLANTIC YARDS REPORT (June 8, 2009), <http://atlanticyardsreport.blogspot.com/2009/06/brodsky-mta-boards-acceptance-of.html>.

75. See discussion *infra* Part III.B.

76. No. 114304/09, 2009 WL 4843782, at \*9. In this instance the court found that the board of directors had sufficient reasons for not soliciting additional bids. *Id.*

77. *Id.* at \*4. The court in *Montgomery* did not consider a possible breach of fiduciary duty because it had not been alleged by petitioners. Also, the Reform Act had not yet taken effect to codify the fiduciary duties. *See id.*

The court dismissed the petitioner's claims, finding they lacked standing because they could not show injury in fact. The court ruled that the petitioner's interests were "indistinguishable from those of any other member of the general public."<sup>78</sup> At the same time, however, Judge Stallman acknowledged in *dicta* that "hypothetically there could be no way of judicially challenging what could be a clear violation of the appraisal and bidding provisions."<sup>79</sup> He further noted that it "is appropriately within the province of the Court of Appeals to consider whether a different standard for standing should be applied."<sup>80</sup> The court therefore raised the question, but did not decide, whether the inability of taxpayers to challenge the Public Authority Accountability Act's competitive bidding provisions posed an insurmountable barrier to judicial review.<sup>81</sup>

The court's recognition of this issue is noteworthy because it suggests that permitting citizens to challenge the conduct of unelected board members might serve an important public purpose.<sup>82</sup> As the New York Court of Appeals asserted in *Dairylea Coop., Inc. v. Walkley*, "[a] fundamental tenet of our system of remedies is that when a government agency seeks to act in a manner adversely affecting a party, judicial review of that action may be had."<sup>83</sup> However, for now, it is clear that under *Montgomery*, ordinary citizens who cannot show injury in fact will not be able to establish standing under the Public Authority Accountability Act and likely they will be equally barred under the Reform Act.<sup>84</sup>

New York State Finance Law section 123-b, which provides an alternative mechanism for citizens to establish standing without requiring injury in fact, does not apply in the context of public authority decisionmaking.<sup>85</sup> The statute allows taxpayers

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78. *Id.* at \*4. There are compelling reasons why broadening the standing requirements to allow these suits may be dangerous. See *In re Abrams v. N.Y.C. Transit Auth.*, 39 N.Y.2d 990, 992 (1976); *Soc'y of Plastics Indus., Inc. v. Cnty. of Suffolk*, 77 N.Y.2d 761, 772 (1991) ("The existence of an injury in fact—an actual legal stake in the matter being adjudicated—ensures that the party seeking review has some concrete interest in prosecuting the action which casts the dispute 'in a form traditionally capable of judicial resolution.'").

79. *Id.* at \*4.

80. *Montgomery*, No. 114304/09, 2009 WL 4843782, at \*5; see also *Dairylea Coop., Inc. v. Walkley*, 38 N.Y.2d 6 (1975) (citing a broader standard for recognizing standing).

81. *In re Abrams*, 39 N.Y.2d 990. The court observed that "standing has been properly extended to permit an appropriate judicial proceeding to prevent an illegal disbursement or to compel a legally required disbursement of public funds. This extension has been made to prevent the erection of an impenetrable barrier to judicial review of unlawful official action." *Id.* at 992.

82. See generally *Montgomery*, No. 114304/09, 2009 WL 4843782, at \*1.

83. 38 N.Y.2d at 10.

84. To date, no one has brought suit under the Reform Act.

85. N.Y. STATE FIN. LAW § 123-b (McKinney 2011).

[A]ny person, who is a citizen taxpayer, whether or not such person is or may be affected or specially aggrieved by the activity herein referred to, may maintain an action for equitable or declaratory relief, or both, against an officer or employee of the state who in the course of his or her duties has caused, is now causing, or is about to cause a wrongful expenditure, misappropriation, misapplication, or any other illegal or unconstitutional

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to bring suit to prevent the “wrongful expenditure, misappropriation, misapplication”<sup>86</sup> of state funds when there is a “sufficient nexus to fiscal activities of the State.”<sup>87</sup> Thus, for a citizen taxpayer to sue the government alleging waste, the conduct must be more than *unwise*—it has to be illegal.<sup>88</sup> However, the New York Court of Appeals has exempted public authorities from such suits under the finance law.<sup>89</sup> In *New York Post Corp. v. Moses*, the court reasoned that public authorities are not agents of the state because “they are independent and autonomous, deliberately designed to be able to function freedom and flexibility not permitted to an ordinary State board.”<sup>90</sup> Consequently, the taxpayer waste statute affords no redress for New Yorkers seeking to challenge authority board decisions unless the conduct at issue is illegal.<sup>91</sup>

### 2. *No Private Right of Action*

While the Reform Act is silent on whether the fiduciary duty provisions confer a private right of action for breach of such a duty, the statute’s legislative history is clear that the drafters intended no such right.<sup>92</sup> Even in the absence of legislative intent, it is difficult to imagine a scenario that would satisfy the first prong of New York’s implied right of action test—that the plaintiff belonged to the class for whose particular benefit the statute was enacted—because the Reform Act was to benefit the general public.<sup>93</sup> Although the Sponsor’s Memorandum does not explain the legislature’s justification for prohibiting standing by a private citizen, we may assume it feared exposing authority boards to frivolous litigation that could impact their

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disbursement of state funds or state property, except that the provisions of this subdivision shall not apply to . . . any public corporation or public benefit corporation.

*Id.* There are other bases on which to bring citizen suits without direct injury; for example, a municipality’s failure to comply with an Environmental Impact Statement in New York can be challenged pursuant to an Article 78 proceeding.

86. *Id.*

87. *Saratoga Cnty. Chamber of Commerce, Inc. v. Pataki*, 100 N.Y.2d 801, 805 (2003) (citation omitted).

88. *Id.* at 813–814.

89. *Madison Square Garden, L.P. v. N.Y. MTA.*, 799 N.Y.S.2d 186 (1st Dep’t 2005); *New York Post Corp. v. Moses*, 10 N.Y.2d 199, 207 (1961) (holding that allowing taxpayer suits under the state finance law “destroy[s] the ‘freedom and flexibility’ necessary for [the] functioning” of public authorities).

90. 10 N.Y.2d at 203–204 (quoting *Plumbing Ass’n v. Thruway Auth.*, 5 N.Y.2d 420, 423 (1959)).

91. While poor authority decisionmaking may be unethical and wasteful to taxpayers, it is not per se illegal.

92. The legislative history states

Section 11-a of the bill would amend [the Public Authorities Law] to provide for the removal by the appointing authority of an authority member who breaches his or her fiduciary duty. Neither PAL § 2827 nor PAL § 2824(1) provide for, nor is it the intent of this bill to create, a private right of action for a breach of fiduciary duty.

Legislative Memorandum, 2009 N.Y. Sess. Laws Ch. 506, § 11-a (McKinney) [hereinafter Legislative Memorandum].

93. *Women’s Voices for the Earth, Inc. v. Procter & Gamble Co.*, 906 N.Y.S.2d 721 (Sup. Ct. N.Y. County 2010).

ability to perform.<sup>94</sup> Therefore, the legislature's refusal to provide a private right of action under the Reform Act serves as yet another barrier to citizen suits challenging public authority board members' conduct.

The legislature's decision to protect public authority boards from time-consuming and expensive citizen lawsuits was certainly rational, as opening the so-called "floodgates" might prevent board members from carrying out their duties, fearful of making necessary but unpopular decisions.<sup>95</sup> One could easily imagine self-proclaimed "citizen heroes" bringing frivolous suits alleging breached fiduciary duties.<sup>96</sup> While public authority autonomy has led to abuses, it has also fostered independent decisionmaking that has benefitted the public.<sup>97</sup> Should authority boards have to defend every decision in court, they may act or not act for fear of liability rather than for the public good.

On the other hand, if the legislature strips the public of its ability to judicially challenge negligent or self-dealing public authority boards, it should provide the oversight and resources necessary to enforce the fiduciary duty provisions of the Reform Act. However, an analysis of the Reform Act's current enforcement provisions reveals several significant weaknesses that undermine its goal of meaningful public authority reform.

#### *B. Enforcement of the Fiduciary Obligations under the Reform Act*

##### *1. Removal of Board Members for Breach of Fiduciary Duty*

The Reform Act sets forth a relatively straightforward procedure for the removal of board members for misconduct. Pursuant to section 2827 of the Reform Act, a board member can be removed for breach of fiduciary duty by "the public officer or public body which is empowered . . . to appoint such authority."<sup>98</sup> Because of the

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94. See *Howell v. New York Post Co.*, 81 N.Y.2d 115 (1993); see discussion of the legislators' fears *infra* Part IV.

95. See discussion of *Moses supra* Part III.A.

96. However, this is not the case under taxpayer waste suits pursuant to N.Y. STATE FIN. LAW § 123-b (McKinney 2011). While the statistics regarding the frequency of taxpayer waste suits in New York have not been compiled to this author's knowledge, comprehensive searches on Westlaw, New York State court web sites, and internet search engines support the inference that these claims are not frequently litigated.

97. CBC 2006 REPORT, *supra* note 15, at 4–5.

98. N.Y. PUB. AUTH. LAW § 2827 (McKinney 2011).

Removal of authority members. Except as otherwise provided in this chapter, every member of every authority or commission heretofore or hereafter continued or created by this chapter, except ex-officio members, that is, members whose membership results by virtue of their incumbency of a public office, shall be removable by the public officer or public body which is empowered by this chapter to appoint such authority or commission member, for inefficiency, breach of fiduciary duty, neglect of duty or misconduct in office, provided, however, that such member shall be given a copy of the charges against him and an opportunity of being heard in person, or by counsel, in his or her defense upon not less than ten days' notice.

*Id.*

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diversity of public authorities throughout New York State, “[i]ndividual authorizing statutes define the number of board members and assign responsibility for their appointment.”<sup>99</sup> In some circumstances, only the governor or county executive will have removal power.<sup>100</sup> Additionally, the Authorities Budget Office may investigate and make removal recommendations to the appointing entity if it finds breaches of fiduciary duties.<sup>101</sup> Should those recommendations be disregarded, the ABO may refer the matter to the Office of the Attorney General or local district attorney, who may bring charges.<sup>102</sup> Although this framework for enforcement initially appears logical and efficient, in practice it is unworkable due to the prospect of cronyism and the bureaucratic obstacles discussed below.<sup>103</sup>

### 2. *A Weak Authorities Budget Office*

The Authorities Budget Office may “initiate formal investigations, issue subpoenas, publicly warn and censure public authorities for non-compliance and recommend the suspension or dismissal of public authority board members and officers,” but lacks the power of removal.<sup>104</sup> Thus, while touted as a powerful, independent watchdog capable of reining in negligent and self-dealing authority boards, the ABO emerges as just a single voice with no direct removal power in a complex bureaucratic web.<sup>105</sup> Without the power of suspension or removal, it is unlikely the Authorities Budget Office will be able to enforce the statute’s fiduciary duty provisions. Consequently, without legislative action, remedies for board misconduct under the current law will have to come from outside the Authorities Budget Office.<sup>106</sup>

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99. OFFICE OF THE N.Y. STATE COMPTROLLER, PUBLIC AUTHORITIES IN NEW YORK STATE: ACCELERATING MOMENTUM TO ACHIEVE REFORM 18 (2005), <http://www.osc.state.ny.us/reports/pubauth/pubauthoritiesreform.pdf>.

100. The governor has appointment/removal power for board members of the MTA. PUB. AUTH. § 2827. See Press Release, N.Y. Governor’s Office David Paterson, Governor David Paterson Appoints Jay Walder to Serve as CEO and Chair of the Metropolitan Transportation Authority (July 14, 2009), [http://www.governor.ny.gov/archive/paterson/press/press\\_0714092.html](http://www.governor.ny.gov/archive/paterson/press/press_0714092.html).

101. PUB. AUTH. § 2827.

102. *Id.*

103. For examples of misconduct, see REINING IN NEW YORK’S SECRET GOVERNMENT, *supra* note 12, at 30–38.

104. See TASK FORCE REPORT, *supra* note 61, at 18.

105. A *New York Times* article published in 2009 reflects the political rhetoric that exaggerates the ABO’s power under the Reform Act by reporting that the ABO may “initiate the suspension or removal of board members.” There is no such statutory language. See Nicholas Confessore, *Paterson Signs Bill to Rein in State’s Free-Spending Public Authorities*, N.Y. TIMES, DEC. 12, 2009, at A14, available at [http://www.nytimes.com/2009/12/12/nyregion/12authorities.html?\\_r=1](http://www.nytimes.com/2009/12/12/nyregion/12authorities.html?_r=1).

106. Although administrative and procedural checks exist for public authorities, such as the New York Public Authorities Control Board (PACB), these checks are relatively powerless to deter breaches of fiduciary duty. For example, the PACB serves to approve any project-related financings by public authorities. See DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK REVENUE REFUNDING BONDS, SERIES 2011A, DORMITORY AUTHORITY OF THE STATE OF NEW YORK 29 (2011), [http://www.dasny.org/dasny/OS\\_fiscal\\_1112/Downloads/DOHRefundingFinalOS.pdf](http://www.dasny.org/dasny/OS_fiscal_1112/Downloads/DOHRefundingFinalOS.pdf).

In addition to its limited statutory enforcement powers, the Authorities Budget Office lacks the resources to succeed in its objectives. According to its 2010 Annual Report, the Authorities Budget Office “has neither the resources nor the time to independently evaluate the veracity of all the information it receives.”<sup>107</sup> The Task Force report on the Reform Act’s implementation corroborates this finding.<sup>108</sup> Currently, the Authorities Budget Office only employs eight full-time staff members and has an operating budget of less than \$1.8 million.<sup>109</sup> While the Reform Act assumes that the Authorities Budget Office will delegate work to state agencies, such as the Office of Comptroller and Attorney General,<sup>110</sup> it is inconceivable that these eight individuals could actively monitor the state’s 1100 plus public authorities. It is not clear if and when Albany will allocate the additional funding necessary for the Authorities Budget Office to establish a meaningful presence.

A brief examination of public authority compliance with the mandatory reporting requirements of the Reform Act, since its passage, underscores the ABO’s limited ability to provide the oversight with which it has been entrusted.<sup>111</sup> While *state* public authorities have generally adhered to the new reporting requirements, the Authorities Budget Office has failed to compel *local* public authority compliance.<sup>112</sup> In fact, for the 2010 reporting period, only fifty-six percent of local public authorities adhered to the new annual reporting requirements, up only six percent from 2009.<sup>113</sup> Under the Reform Act, each authority is responsible for the compilation and accuracy of reported data.<sup>114</sup> However, it is questionable whether boards who have violated their fiduciary duties will actively and properly disclose certain information. This note posits, the Authorities Budget Office’s rule requiring an authority’s chief financial officer to verify the data reported provides “some assurance” of accuracy is simply unrealistic because individuals are unlikely to disclose their misdeeds.<sup>115</sup> Consequently,

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107. 2010 ABO REPORT, *supra* note 7, at 12.

108. *See* TASK FORCE REPORT, *supra* note 61, at 21 (“[T]he ABO does not have sufficient staff to undertake an analysis of debt practices, study the consolidation, restructuring or reformation of authorities, conduct simultaneous on site reviews, or to focus on other issues of importance.”).

109. 2011 ABO REPORT, *supra* note 29, at 3; OFFICE OF THE N.Y. STATE COMPTROLLER, 2009–2010 EXECUTIVE BUDGET, AUTHORITIES BUDGET OFFICE (2010), <http://www.budget.state.ny.us/pubs/archive/fy0910archive/eBudget0910/agencyPresentations/appropData/authorityBudgetOffice.html> (last visited Nov. 13 2010).

110. *See* TASK FORCE REPORT, *supra* note 61, at 18.

111. 2011 ABO REPORT, *supra* note 29, at 1.

112. *Id.* at 1.

113. 2011 ABO REPORT, *supra* note 29, at 10; 2010 ABO REPORT, *supra* note 7, at 11. This figure excludes industrial development agencies and local development corporation. According to the ABO, there is an “unacceptable rate of compliance by certain categories of local public authorities—primarily urban renewal and community development agencies.” 2011 ABO REPORT, *supra* note 29, at 10.

114. 2011 ABO REPORT, *supra* note 29, at 11.

115. *See id.* (“The requirement that the Chief Executive or Chief Fiscal officer certify as to the accuracy and completeness of the data, coupled with the board’s approval, should provide the ABO with some assurance that the information is reliable for analytical and public disclosure purposes.”)

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it is expected that a chief financial officer who is responsible for authorizing or engaging in misspending will openly disclose it to the Authorities Budget Office. Although the Authorities Budget Office proclaims the ability to sanction non-complying authorities, it is not clear how those penalties will be carried out and whether they will deter non-compliance.

### 3. *Enforcement to Date*

Although the Authorities Budget Office has conducted compliance reports and published its findings, it has only fully pursued one enforcement action to date.<sup>116</sup> In April 2010, the Authorities Budget Office recommended dismissal of the entire board of the New York State Theatre Institute, but did so only after the State Inspector General reported that the director of the board improperly used state funds for personal benefit.<sup>117</sup> The Authorities Budget Office immediately reviewed the Inspector General's report and recommended the board's removal pursuant to its authority.<sup>118</sup> The next month, Governor Paterson dissolved the board.<sup>119</sup>

While this enforcement action was consistent with the Reform Act's objectives, the ABO took action per its statutory mandate only after the Inspector General made its recommendation.<sup>120</sup> Therefore, it appears that the Authorities Budget Office's responsibilities are largely duplicative of other agencies. This view echoes New York City Mayor Michael Bloomberg's belief that the Reform Act does little and merely "sets up another level of bureaucracy."<sup>121</sup> In the Theatre Institute case, it is unclear why the Inspector General could not simply recommend the dissolution of the Theatre Institute. The Authorities Budget Office did little more than "rubber stamp" the Inspector General's findings and did not pursue its own investigation. In no circumstance can such action be deemed to satisfy the rigorous exercise of meaningful enforcement envisioned by the legislature.<sup>122</sup>

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116. 2010 ABO REPORT, *supra* note 7, at 8.

117. STATE OF N.Y. OFFICE OF THE INSPECTOR GENERAL, REPORT OF INVESTIGATION OF THE NEW YORK STATE THEATRE INSTITUTE (2010), <http://ig.state.ny.us/pdfs/ReportofInvestigationoftheNewYorkStateTheaterInstitute.pdf>.

118. 2010 ABO REPORT, *supra* note 7, at 9.

119. *Id.*

120. *Id.*

121. Gabe Pressman, *Public Authority Reform Bill May Lose in City Hall*, NBC N.Y. (July 29, 2009, 7:55 AM), <http://www.nbcnewyork.com/news/local-beat/PublicAuthorityreform.html> ("The mayor's press secretary Stu Loeser said Bloomberg was opposed to this legislation for two main reasons, 'It sets up another level of bureaucracy,' he says, 'and it requires people who sit on authorities to often consider only what's best for the authority.'").

122. *See* TASK FORCE REPORT, *supra* note 61, at 18 ("The Task Force believes that the recommendation for removal power granted to the ABO under [the Reform Act] is a meaningful enforcement measure, and that the ABO should rigorously exercise it to ensure compliance.").

#### 4. *Liability as a Deterrent*

Unlike private shareholders in the corporate governance model, the Reform Act precludes taxpaying “shareholders” from challenging negligent exercises of discretion by board members relegating enforcement to an underfunded, statutorily weak agency. While private shareholders have the potential to be made whole if a director-defendant’s actions do not qualify for business judgment protection, citizens wronged by public authority board misconduct have no real remedy under the Reform Act.

The Reform Act’s sponsor, former Assemblyman Richard Brodsky, acknowledged the difficulties in enforcing the fiduciary provisions. He stated that “the consequence of [establishing that board members may be removed for violation of fiduciary duties] is not huge in the legal sense. But it was huge in the political sense—I don’t mean partisan sense—in that it reminded everybody that the board members had a fiduciary duty.”<sup>123</sup> However, such a statement cannot be reconciled with the legislative intent of effecting real, meaningful change in authority governance. Merely “reminding” public authority board members will not truly deter misconduct; holding them personally liable (i.e. legal liability) will.<sup>124</sup> Without such enforcement, the Reform Act becomes nothing more than an idealistic repackaging of the Public Authority Accountability Act.

### IV. MEANINGFUL ENFORCEMENT REQUIRES MEANINGFUL CHANGE

The Reform Act’s fiduciary duty provisions must be enforceable in a manner that will lead to positive changes in public authority governance practices. The Reform Act’s current framework and its reliance on the corporate governance model, while innovative, not only lacks the ability to deter future misconduct, but fails to provide redress to citizens harmed by improper board decisionmaking. An effective statute must have these characteristics. This section first explores proposals that could strengthen the enforcement mechanisms of the Reform Act and then advocates for solutions that can realistically achieve greater transparency and accountability in public authorities.<sup>125</sup>

#### A. *The Prospect of Citizen Enforcement*

To date, no citizen-plaintiff has alleged a violation of the fiduciary duty provisions of the Reform Act against a public authority board or board member. However, the time may soon come when the courts will see such a challenge. In fact, the pre-

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123. Norman Oder, *MTA Board’s Acceptance of Ratner’s Lesser Offer for Railyard Would Violate its Fiduciary Duty*, ATLANTIC YARDS REPORT (June 8, 2009), <http://atlanticyardsreport.blogspot.com/2010/07/whats-violating-fiduciary-duty-for.html> (quoting Richard Brodsky, PARA’s Sponsor at the Albany Law School Symposium: Public Authorities Law: Maintaining the Balance (June 3, 2009)).

124. See Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors’ Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 438–39 (2005) (discussing studies which show that “increasing the certainty of legal sanctions effectively deters [corporate] misconduct”).

125. See Sponsor’s Memorandum, *supra* note 8 (“This legislation includes many of those recommendations and others intended to improve public authority operations and oversight.”).

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Reform Act case *Montgomery*, discussed above, illustrates a situation in which the public may wish to hold public authority board members accountable for breached fiduciary duties.<sup>126</sup> As public authorities are so pervasively involved in government, there is little doubt that members of the public will seek judicial review of public authority action.<sup>127</sup> In these cases, authority board members, and not the authority itself, will likely be the defendants.

### 1. *The Case for Citizen Enforcement*

Because public authority board decisions affect the daily lives of taxpayers and their communities, citizens have a fundamental interest in preventing board misconduct. Like shareholders of a private corporation, they should have the authority to hold the board accountable for negligent and self-serving decisions that adversely affect their community.<sup>128</sup> While this is not to suggest that taxpayers have the same risks and interests at stake as private shareholders, taxpayers should be entitled to the independent and careful decisionmaking of public authority board members.<sup>129</sup> This is because authority board decisions can directly affect the lives of citizens. It is reasonable to suggest that these individuals should have a remedy for misconduct. Whether an authority board votes on an urban renewal plan, construction of a highway, or cultural initiative, board decisions can have tangible consequences—both good and bad—on state and local interests.<sup>130</sup>

Citizen involvement in the enforcement of the fiduciary duty provisions of the Reform Act may also result in better oversight of non-compliant local public authorities. This is because citizens have a vested interest in the allocation of their tax dollars and may be more willing to judicially challenge or report evidence of misconduct than government officials. Although the Authorities Budget Office maintains that it will investigate any complaint against a public authority, it lacks the resources to effectively

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126. *Montgomery v. Metro. Transp. Auth.*, No. 114304/09, 2009 WL 4843782, at \*1 (Sup. Ct. N.Y. County Dec. 15, 2009).

127. *Wilson Memo*, *supra* note 3, at 22.

It is time to return public authorities to their core mission, restore control over State-funded authority debt to New York's taxpayers and expose authority operations to systematic oversight. While public authorities provide important services and support for New York's critical infrastructure, lasting reform will help the State ensure long-term fiscal stability, affordability and transparency.

*Id.*

128. See Note, *Developments in the Law—Nonprofit Corporations: II. The Fiduciary Duties of Directors*, 105 HARV. L. REV. 1590, 1596 (1992) (“Like shareholders in a business corporation, nonprofit members have a large stake in controlling the directors’ activities because they are directly served by the organization.”).

129. Because of the infinite factual scenarios that may amount to a breach of fiduciary duty, this note contends that the question of when authority misconduct may be litigated is for the courts to decide. A general principle might be that litigation is warranted when there are measurable damages.

130. The 2010 MTA fare hikes serve an example of these tangible consequences. See Michael M. Grynbaum, *M.T.A. Approves Transit Fare Increases*, N.Y. TIMES CITY ROOM BLOG (Oct. 7, 2010, 11:31 AM), <http://cityroom.blogs.nytimes.com/2010/10/07/m-t-a-meets-to-increase-transit-fares>.

accomplish this.<sup>131</sup> The statistics representing the number of local authorities that failed to comply with reporting requirements support the inference that the Authorities Budget Office cannot enforce the Reform Act.<sup>132</sup> In July 2010, the *New York Times* reported that “175 public authorities did not provide annual reports” and “of the annual reports filed, 21 percent had significant data errors.”<sup>133</sup> The following year the Authorities Budget Office reported the persistence of significant data errors and poor compliance rates, noting “there is a continued concern that some authorities are not taking the time to ensure their information is accurate and complete.”<sup>134</sup> Thus, one could argue that those familiar with the matters before local authorities—the citizens affected by authority board decisions—may be better watchdogs than the Authorities Budget Office and could better enforce the fiduciary duty provisions through judicial intervention. Citizens have a wealth of resources available ranging from advocacy groups to self-funded initiatives that the state government does not have the resources to provide. Further, citizens, unlike public authority board members, do not have similar conflicts of interest in reporting perceived misconduct.

The alternative to citizen enforcement is the time-consuming process requiring a citizen to report the misconduct to the Authorities Budget Office; thereafter the citizen must wait for an investigation, a report, and finally a recommendation. In the time it takes the Authorities Budget Office to issue its findings, board members can continue to engage in conduct violating the Reform Act. These reasons favor giving taxpaying citizens a limited role in the enforcement of the fiduciary duty provisions of the Reform Act.

## 2. *The Case Against Citizen Enforcement*

While easing standing requirements to facilitate the bringing of suits by “harmed” community members seems like a logical and efficient way to stop misconduct, the costs may outweigh the benefits. In *In re Abrams*, the New York Court of Appeals laid out the case against granting citizen standing to challenge public authority decisions.<sup>135</sup> In finding for the MTA in a noise-related nuisance case, the court noted that “[t]o allow such actions would in effect attempt displacement . . . of the lawful acts of appointive and elective officials charged with the management of the public enterprises.”<sup>136</sup> Perhaps fearing the emergence of frivolous lawsuits, the court concluded that “the ultimate public remedy against poor government management is at the voting machine. Neglect, inefficiency, and erroneous but reasonably made exercise of judgment

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131. Ceasar, *supra* note 6.

132. *Id.*

133. *Id.* This also supports the conclusion that the ABO lacks enforcement capability. Though the 2011 Annual Report showed an improvement of approximately thirty-three percent from 2010, that number is not necessarily accurate as it reflects reports that were identified for “re-submit status,” meaning there were still significant data errors in the initial filings.

134. 2011 ABO REPORT, *supra* note 29, at 11.

135. *In re Abrams v. New York City Transit Auth.*, 39 N.Y.2d 990 (1976).

136. *Id.* at 992.

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fall short of illegality.”<sup>137</sup> Under this view, reform should come from elected representatives, not the judiciary. Broadening standing requirements to allow claims by citizens who have not suffered a direct injury “would disrupt government operation by posing the threat of litigation to challenge any governmental action.”<sup>138</sup>

Furthermore, even if New York courts were to recognize standing more broadly, a plaintiff would have to convince a court that the Reform Act contains a private right of action, a contention that runs contrary to the legislative intent.<sup>139</sup> The court in *Women’s Voices for the Earth, Inc. v Procter & Gamble Co.* recognized this principle, finding that even if the petitioners, an environmental organization, could show standing in an Article 78<sup>140</sup> proceeding, their suit could not proceed because no private right of action existed under the challenged statute.<sup>141</sup> Consequently, a claim against a public authority board is actionable as a *common law* suit alleging a breach of fiduciary duty only after standing has been shown.<sup>142</sup> However, given the legislative intent to preclude such actions, it is unlikely a court would entertain a common law suit claiming breach of fiduciary duty.<sup>143</sup> To enable a private right of action, the legislature would need to amend the Reform Act.

It remains to be seen whether broadening standing to allow citizen suits against public authority board members would in reality “open the floodgates” to litigation against public authorities. Traditionally, taxpayer waste suits have not been frivolously brought, and there is no reason to believe that claims against public authority board members would be any different.<sup>144</sup> Coupled with the high cost of litigation and strict pleading requirements, it is unlikely that allowing taxpayers to challenge board misconduct would be detrimental to public board operations.<sup>145</sup>

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137. *Id.* at 993; see *Madison Square Garden, L.P. v. N.Y. Metro. Transp. Auth.*, 799 N.Y.S.2d 186 (1st Dep’t 2005); see also *Burns Jackson Miller Summit & Spitzer v. Lindner* 59 N.Y.2d 314, 334 (1983) (stating “invasions of rights common to all of the public should be left to be remedied by action by public officials” (quoting RESTATEMENT (SECOND) OF TORTS § 821C, cmt. b (1979))).

138. *Saratoga Cnty. Chamber of Commerce, Inc. v. Pataki*, 100 N.Y.2d 801, 813 (2003).

139. Legislative Memorandum, *supra* note 92.

140. N.Y. C.P.L.R. 7803 (McKinney 2012) (An Article 78 proceeding allows a challenge to “a determination [that] was made in violation of lawful procedure, was affected by an error of law or was arbitrary and capricious or an abuse of discretion, including abuse of discretion as to the measure or mode of penalty or discipline imposed.”).

141. *Women’s Voices for the Earth, Inc. v. Procter & Gamble Co.* 906 N.Y.S.2d 721, 723 (Sup. Ct. N.Y. County 2010).

142. See *Doe v. Cmty. Health Plan-Kaiser Corp.*, 709 N.Y.S.2d 215, 218 (3d Dept. 2000) (“While a private cause of action may not be predicated on . . . [the statute], these statutes define and impose the scope of the actionable duty of confidentiality.”). Thus it could be argued that the Public Authority Accountability Act imposes an actionable common law claim for breach of fiduciary duty. A common law breach could be negligence.

143. *Id.* at 217.

144. See *supra* note 96.

145. See generally Robert Corn-Revere, *Narrow Issue of Taxpayer Standing Highlights Wide Divisions Among the Justices*, 2006–07 CATO SUP. CT. REV. 215 (2007).

### 3. *A Hybrid Solution*

While citizens should have a voice in challenging board member conduct, allowing them standing could theoretically disrupt public authority operations in a manner inconsistent with the Public Authority Accountability Act and the Reform Act.<sup>146</sup> However, this does not mean the public should be completely excluded from enforcement. Thus a scheme allowing limited citizen participation without easing standing requirements would likely serve the legislative intent.

The Authorities Budget Office should first develop a user-friendly reporting system that collects complaints about authority board conduct from concerned citizens and then responds in a reasonable period of time. Currently, the New York State Attorney General serves as the designated complaint forum against public authorities.<sup>147</sup> The Attorney General's website merely directs parties to fill out general forms, which cannot be submitted online.<sup>148</sup> It is not clear how quickly the complaints are reviewed by the Attorney General's Office and how long it takes before matters are investigated. However, it can be inferred that complaints against a public authority are somewhat delayed in reaching the Authorities Budget Office.

It is therefore essential that the Authorities Budget Office add a "citizen's corner" on its website, which explains the fiduciary duty provisions in plain English and provides an easy mechanism to submit questions and complaints. For example, if a citizen learns or suspects that a public authority board engaged in self-dealing or negligent conduct, he could then easily learn about the requisite fiduciary duties of the Reform Act and file a complaint electronically. This would allow meaningful citizen participation without broadening standing requirements or encouraging frivolous lawsuits. Additionally, this solution would lead to a more efficient and effective reporting system, which would be relatively easy and cost-efficient to implement.

If these initiatives fail, the legislature should consider either amending State Finance Law section 123-b to allow standing without establishing injury in fact, or enacting new legislation to allow taxpayer suits against public authority board members. Although fears of opening the "floodgates" are reasonable, it is far from certain whether frivolous suits will in fact be brought and whether such suits would be detrimental to public authority board operations. Given this often-cited concern,

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146. *See* *Montgomery v. MTA*, No. 114304/09, 2009 WL 4843782, at \*1 (Sup. Ct. N.Y. County Dec. 15, 2009) (finding that the delay resulting from citizens suits "would only cause uncertainty about the projects and likely increase both public and private expense"). This is contrary to objectives of the Reform Act, which called for raising "transparency standards" while maintaining "the authorities' ability to promote economic development." Press Release, *supra* note 4.

147. The New York State Attorney General is responsible for enforcing the Public Authority Law. *See generally* ACCELERATING MOMENTUM TO ACHIEVE REFORM, *supra* note 99 (providing examples of attorney general enforcement).

148. *See Filing a Consumer Complaint*, Consumer Frauds Bureau, OFFICE OF THE ATTORNEY GENERAL, [http://www.ag.ny.gov/bureaus/consumer\\_frauds/filing\\_a\\_consumer\\_complaint.html](http://www.ag.ny.gov/bureaus/consumer_frauds/filing_a_consumer_complaint.html) (last visited Feb. 18, 2012); *see also Investigations Unit of the Legal Services Division*, OFFICE OF THE N.Y. STATE COMPTROLLER, <http://www.osc.state.ny.us/investigations/index.htm> (last visited Feb. 18, 2012).

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a first step should be a government study of taxpayer waste suits in New York that examines their frequency and estimates hardships imposed on the state.

### *B. A Stronger Authorities Budget Office*

As the Task Force acknowledged, the state should strengthen the Authorities Budget Office to accomplish its mission.<sup>149</sup> This can be achieved through additional staff, funding, and active enforcement.<sup>150</sup>

First, it is imperative that the Authorities Budget Office increase its staff significantly. Compared to other state agencies, the Authorities Budget Office is disproportionately small. For example, while the 2010 projected number of staff for the Commission on Quality of Care and Advocacy for Persons with Disabilities was 101 and the State Racing and Wagering Board was ninety-nine, the Authorities Budget Office reported only eleven.<sup>151</sup> Additionally, the Authorities Budget Office is charged with overseeing more than 490 entities that affect the entire state, while the Commission on Quality of Care administers a “statewide network of over 30 advocacy and assistive technology contract agencies”—a much smaller constituency.<sup>152</sup> As the Task Force recommends, the creation of thirty more positions is essential to meet the responsibilities of the Reform Act because the ABO “does not have sufficient staff to undertake an analysis of debt practices, study the consolidation, restructuring or reformation of authorities, conduct simultaneous on site reviews, or to focus on other issues of importance.”<sup>153</sup>

Second, increased funding for the Authorities Budget Office is essential for enforcement. The Task Force found that new funding should be directed toward “developing the capability . . . for . . . investigating potential violations of a board’s fiduciary duty, executive mismanagement, or alleged acts of misconduct uncovered during the course of its official business.”<sup>154</sup> Additionally, the Authorities Budget Office currently lacks funding to employ a deputy director for examinations and enforcement, as well as its own legal counsel.<sup>155</sup> Therefore, without additional funding, the Authorities Budget Office will not be able to attract the competent and capable experts necessary to meet the Reform Act’s objectives.

While additional funding will certainly increase the Authorities Budget Office’s ability to investigate and act against breaches of fiduciary duties, it will not in itself deter authority boards from misconduct. Given the time it takes to investigate and

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149. TASK FORCE REPORT, *supra* note 61.

150. *Id.* at 19–22. Increased education and training has also been recommended, but is not discussed here.

151. *Id.* at 20.

152. See *Strategic Plan 2008–2010*, N.Y. STATE COMMISSION ON QUALITY OF CARE AND ADVOCACY FOR PERSONS WITH DISABILITIES, available at <http://cqc.ny.gov/about/about-the-commission/strategic-plan> (last visited Jan. 18 2012); see also 2011 ABO Report, *supra* note 29.

153. TASK FORCE REPORT, *supra* note 61, at 21.

154. *Id.*

155. *Id.* at 20–21.

remove a board, it is unclear if a bigger, smarter, and better-funded Authorities Budget Office will alone influence authority board decisionmaking. This is an important issue because the Reform Act seeks deterrence as much as it seeks accountability.<sup>156</sup> As a result, it is necessary for the Authorities Budget Office to exercise, and be able to exercise, its powers to the fullest extent under the Reform Act.

*C. The IRS Enforcement Model of Private Foundation Governance*

The Internal Revenue Code (IRC) contains fiduciary duty provisions for private non-profit foundations that are similar to those contemplated under the Reform Act.<sup>157</sup> However, unlike the Reform Act, the IRC provides a strong enforcement mechanism for breaches of fiduciary duties in the form of fines.<sup>158</sup> An examination of the similarities between private non-profit boards and public authority boards suggests that the IRC model of fiduciary duty enforcement would work well when applied to public authorities.

Under the IRC, private non-profit board members have a duty of care and are subject to a prohibition on self-dealing.<sup>159</sup> Congress sought to “prevent abuses by certain privately controlled charitable entities” such as use of “such assets by the foundations to accumulate income . . . to invest in overly risky ventures, to engage in self-dealing transactions . . . or to promote political or other noncharitable objectives.”<sup>160</sup> These regulatory governance goals echo the legislative intent of the Reform Act. Like the Authorities Budget Office, the Internal Revenue Service (IRS) initially had difficulty

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156. This is evidenced by the emphasis on training as well as the acknowledgment of the fiduciary duties. N.Y. PUB. AUTH. LAW § 2824(2) (McKinney 2011).

Individuals appointed to the board of a public authority shall participate in state approved training regarding their legal, fiduciary, financial and ethical responsibilities as directors of an authority within one year of appointment to a board. Board members shall participate in such continuing training as may be required to remain informed of best practices, regulatory and statutory changes relating to the effective oversight of the management and financial activities of public authorities and to adhere to the highest standards of responsible governance.

*Id.*

157. *See* 26 U.S.C. § 4944 (2006) (imposing taxes on a private foundation and, in certain cases, its management, for making investments that “jeopardize the carrying out of any of [the foundation’s] exempt purposes”); 26 U.S.C. § 4941.

158. *See* 26 U.S.C. § 4941.

159. *Id.*

[T]here is hereby imposed on the participation of any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act, a tax equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any foundation manager who participated in the act of self-dealing.

*Id.*

160. *Hammond v. U.S.*, 764 F.2d 88, 88 (2d Cir. 1985); *see also* 26 U.S.C. § 508 (2006).

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enforcing the fiduciary duty provisions applicable to foundation managers; it also lacked the resources and remedies to ensure compliance.<sup>161</sup>

In contemplating a mechanism for the enforcement of fiduciary duty provisions on all non-profit corporation boards, a *Harvard Law Review* article posits that “a relaxation of standing requirements is unlikely to enhance the enforcement of fiduciary duties.”<sup>162</sup> The article suggests that a better approach would be to “increase deterrence by enhancing the punishment for fiduciary duty violations rather than by increasing the chance that a breaching director will be caught.”<sup>163</sup> The article concludes by proposing a remedy modeled on the IRC, which fines directors of private foundations for self-dealing.<sup>164</sup>

Under this self-dealing statute, the IRS may impose “a tax on each act of self-dealing between a disqualified person and a private foundation.”<sup>165</sup> Additionally, if corrective action is not taken, the IRS can levy a tax equal to fifty percent of the amount involved, and all board members can be held jointly and severally liable.<sup>166</sup> The organization itself is not penalized.<sup>167</sup> While the IRC does not explicitly prescribe a duty of care, a board will be sanctioned for making investment decisions that “jeopardize [its] charitable purpose.”<sup>168</sup> Officers who are found in violation of this section are subject to “a tax equal to 10 percent of the amount . . . unless such participation is not willful and is due to reasonable cause.”<sup>169</sup>

In essence, the IRC aims to deter self-dealing and breaches of the duty of care by private non-profit board members through the threat of additional taxes.<sup>170</sup> The IRC

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161. *Developments in the Law-Nonprofit Corporations: II. The Fiduciary Duties of Directors*, *supra* note 128, at 1600.

162. *Id.* at 1607.

163. *Id.*

164. *Id.*

165. 26 U.S.C. § 4941. The word “disqualified” is defined under section 4946. For the purpose of this note, we will assume a public authority board member with a conflict of interest would fall under this category. For example, if a public authority board member had a substantial investment in a corporation, he would be prohibited from voting to give a valuable contract to that corporation.

166. 26 U.S.C. § 4941.

167. JOHN A. EDIE, FORUM OF REGIONAL ASSOCS. OF GRANTMAKERS, SELF DEALING: A CONCISE GUIDE FOR FOUNDATION BOARD AND STAFF (2008), [http://www.cof.org/files/Documents/Family\\_Foundations/Legal-and-Tax-Issues/Self-Dealing-Guide-for-Foundation-Board-and-Staff.pdf](http://www.cof.org/files/Documents/Family_Foundations/Legal-and-Tax-Issues/Self-Dealing-Guide-for-Foundation-Board-and-Staff.pdf).

168. 26 U.S.C. § 4944.

169. *Id.*

170. *See Developments in the Law-Nonprofit Corporations: II. The Fiduciary Duties of Directors*, *supra* note 128, at 1607–08.

Assume that *D*, a director of a public benefit nonprofit corporation and sole owner of a bank, arranges for the corporation to obtain a loan from his bank. Interest on the loan has a present value equal to \$100 more than loans available at other banks. In other words, *D* is willing to sacrifice \$100 of the corporation’s assets to increase his bank’s profits by \$100 . . . . If *D* is a risk neutral individual who is indifferent to the means by which he makes a profit . . . he will engage in the prohibited transaction described

model has been effective because the harsh financial consequences present a strong incentive for board members to act in the best interest of their organization.<sup>171</sup> The small number of enforcement actions highlights this model's effectiveness.<sup>172</sup>

Adapting the IRC model to the public authorities law would allow for substantially better enforcement of the Reform Act's fiduciary duty provisions.<sup>173</sup> While the Authorities Budget Office does not currently have the power to fine, it does have the general power to discipline public authorities.<sup>174</sup> Even though the Authorities Budget Office does not explicitly possess the statutory power to fine delinquent authority boards and their members, a court may interpret the statute, based on the legislative intent, to infer that the Authorities Budget Office has permissible fining capabilities. Pursuant to Title II, Section 6 of the Reform Act, the Authorities Budget Office may institute a judicial proceeding to obtain requested documentation of non-compliant public authorities.<sup>175</sup> If courts decline to recognize the Authorities Budget Office's power to fine, the legislature should amend the Reform Act by specifically including such a provision allowing it.

The rationale for imposing fines on authority board directors is analogous to that of the IRS imposed fines on private non-profit foundation boards through additional taxes. First, the Authorities Budget Office, like the IRS, has limited resources to monitor a board's compliance with fiduciary duties.<sup>176</sup> Second, fine proceeds

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above as long as the expected gain from the transaction is positive. . . . If the penalty for self-dealing is set so that *D* simply returns any improperly obtained profits to the corporation, *D* will choose to breach his fiduciary duty as long as the probability of being caught is less than 100%. . . . Although *D* would not be deterred by a relaxation of the standing requirements, *D* would be effectively deterred by an increase in the penalty for the violation of fiduciary duties. Assuming that *D* will be caught 50% of the time, a penalty equal to twice the amount of *D*'s improper profit (\$200) will deter *D* from engaging in the activity altogether. With a penalty of \$200, *D*'s expected gain from the transaction equals zero, and *D* has no incentive to breach the duty of loyalty.

*Id.* (emphasis added).

171. See *Adams v. Comm'r*, 70 T.C. 373, 384 (1978) (after determining that petitioner "engaged in acts of self-dealing," the court considered "whether the initial 5-percent excise tax imposed by section 4941(a) is applicable").
172. See 2010 ABO REPORT, *supra* note 7; 2011 ABO REPORT, *supra* note 29 (the relevant information is located under the "Enforcement" sub-heading). See generally *Developments in the Law-Nonprofit Corporations: II. The Fiduciary Duties of Directors*, *supra* note 128.
173. Self-dealing falls under the "duty of loyalty." See *Developments in the Law-Nonprofit Corporations*, *supra* note 128, at 1603.
174. See NEW YORK STATE COMMISSION ON PUBLIC AUTHORITY REFORM REPORT, *supra* note 13, at 9 ("Where the ABO has formally found an authority to be in material non-compliance or otherwise at fault, the ABO should be authorized to impose disciplinary measures ranging from formal warnings, to public censure, or to recommend . . . suspension or dismissal of officers or directors.").
175. N.Y. PUB. AUTH. LAW § 6 (McKinney 2011). The ABO may "commence a special proceeding in supreme court, when it does not receive from a state or local authority upon request information, books, records or other documentation necessary to perform its duties." *Id.* (emphasis added).
176. See *Developments in the Law-Nonprofit Corporations: II. The Fiduciary Duties of Directors*, *supra* note 128, at 1599-1600.

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compensate those who have suffered harm as a consequence of board decisionmaking. “Removal” is largely a symbolic disciplinary measure, it cannot tangibly compensate those harmed for the losses incurred. Finally, and perhaps most importantly, fines are an efficient deterrent “[b]ecause it is less expensive to increase a fine than to increase the level of enforcement, the optimal level of undeterred breaches will be lower when fines are levied on breaching directors.”<sup>177</sup> What is less clear in imposing fines under the Reform Act is who will be fined, what an appropriate fine will be, and who will benefit from the fine. To answer these questions, the following sections revisit the urban redevelopment hypothetical discussed in Part II and explore the application of the IRC’s self-dealing provisions to public authority boards.

### 1. *Who will be fined?*

In the hypothetical, a public authority board sold public land to a private developer in bad faith. Under the IRS model of fiduciary duty enforcement, fines may be levied on foundation managers (the board) who self-deal with a “disqualified person.”<sup>178</sup> Here, the developer would fall under this category because he is a “substantial contributor” to the foundation.<sup>179</sup> The transaction would be considered self-dealing because the board gets improper benefits by appeasing the Mayor. Thus, after an investigation, the Authorities Budget Office or Attorney General would be able to impose fines on the board for breaching their duty of loyalty by acting out of political pressure rather than pursuant to their fiduciary duties.

### 2. *What is an appropriate fine?*

Determining the “right” financial penalty is a difficult task because a fiduciary duty, alone, does not have a value. How does one compute the value of loyalty? The

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177. *Id.* at 1609.

178. 26 U.S.C. § 4941 (2012).

For purposes of this subchapter, the term “disqualified person” means, with respect to a private foundation, a person who is—(A) a substantial contributor to the foundation, (B) a foundation manager (within the meaning of subsection (b)(1)), (C) an owner of more than 20 percent of—(i) the total combined voting power of a corporation, (ii) the profits interest of a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation . . . .

26 U.S.C. § 4946(a).

179. 26 U.S.C. § 4946; 26 U.S.C. § 507 (2006). For purposes of this analysis, the term “foundation” should be construed to include the current political regime or those making the decisions. A “substantial contributor” refers to

any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term “substantial contributor” also means the creator of the trust.

26 U.S.C. § 507(d)(2)(A).

answer is quite subjective and will vary.<sup>180</sup> Fines too low would not deter the conduct at issue, while excessive fines might prevent members from serving on boards or engaging in “good” self-dealing transactions that would benefit the authority and the public at large.<sup>181</sup> Therefore, the logical approach is to calculate the *damages* resulting from the breach, which is precisely what the IRC prescribes.<sup>182</sup> Under the statute, “a tax equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period” is imposed on the foundation manager.<sup>183</sup>

In the hypothetical scenario, the board sold land for \$250,000 below fair market value. Applying the IRC penalty, each board member who breached his duty of loyalty by accepting the lower bid in bad faith would initially be fined \$12,500. Although this figure does not compensate for \$250,000 in damages, the IRC statute contemplates that the non-profit’s board would take remedial measures.<sup>184</sup> Furthermore, under the IRS self-dealing statute, “if a foundation manager refused to agree to part or all of the correction, there is hereby imposed a tax equal to 50 percent of the amount involved” which is to be paid by the foundation manager.<sup>185</sup> Therefore, the public authority board members could be fined up to \$125,000—a substantial sum likely to deter misconduct.

Critics of this proportional system of fines may assert that this will not deter breaches of fiduciary duty as public authority board members are indemnified by statute. Pursuant to Public Officers Law section 18, officers of public authorities are indemnified for any judgment or settlement claim against them, provided they acted within the scope of their duties.<sup>186</sup> However, as the Third Department noted in *Wyman v. Zeltins*, “[t]he statute . . . is optional and only applies if adopted by a local

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180. Jaelyn A. Cherry, *Update: The Current State of Nonprofit Director Liability*, 37 DUQ. L. REV. 557, 565 (1999). Under the IRC, “[t]he determination of whether compensation is reasonable and whether the decision to give it was adequately considered is determined on the basis of all of the facts and circumstances.” *Id.*

181. *See Developments in the Law-Nonprofit Corporations: II. The Fiduciary Duties of Directors*, *supra* note 128, at 1610.

182. 26 U.S.C. § 4941.

183. *Id.*

184. *See Adams v. Comm’r*, 72 T.C. 81 (1979) (“[T]he clear intent of Congress reflected in the language of section 4941(b)(1) and in the accompanying legislative history, is to condition a self-dealer’s liability for the second-level tax upon his failure to undertake corrective action within the correction period.”).

185. 26 U.S.C. § 4941.

186. *See* N.Y. PUB. OFF. LAW § 18 (McKinney 2011).

The public entity shall indemnify and save harmless its employees in the amount of any judgment obtained against such employees in a state or federal court, or in the amount of any settlement of a claim, provided that the act or omission from which such judgment or claim arose occurred while the employee was acting within the scope of his public employment or duties; provided further that in the case of a settlement the duty to indemnify and save harmless shall be conditioned upon the approval of the amount of settlement by the governing body of the public entity.

*Id.*

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governing body.”<sup>187</sup> In fact, most authorities will indemnify their officers unless there is a breach of fiduciary duty. For example, the MTA’s bylaws provide indemnification “*unless* such individual is determined by the Authority or its designee not to have acted, in good faith, for a purpose which he or she reasonably believed to be in the best interests of the Authority or of its subsidiaries or affiliates.”<sup>188</sup>

Even if there is no indemnification for breach of fiduciary duty, there is still a question of whether the board member “act[ed] within the scope of his public employment or duties.”<sup>189</sup> Because public authorities will usually not indemnify board members who have acted in bad faith, the imposition of fines remains an effective deterrent.

### 3. *Redressability*

The IRC model properly compensates societal “harm” caused by private non-profit foundation board misconduct through redistribution.<sup>190</sup> Since damages awarded to plaintiffs might be an incentive to bring frivolous lawsuits, a better alternative would be to direct the revenue generated by the fine to the Authorities Budget Office. The Authorities Budget Office could use a percentage of the money to take corrective measures relating the misconduct, and then fund its operating expenses. This would give the Authorities Budget Office the necessary resources to provide active enforcement and would also compensate taxpayers who have taken on the burden of policing authority board misconduct. In the hypothetical, for example, if the \$125,000 fine had been collected by the Authorities Budget Office, the money could go back to the locality and be indirectly distributed to those affected citizens pursuant to an approved formula.<sup>191</sup>

Although it is clear that public authorities are different from non-profit corporations in mission and function, both entities suffer from what Professor Harvey Goldschmid has deemed a “problematic paradox”—that their officers “generally operate under the same state fiduciary standards as their for-profit peers, but, in contrast to the for-profit world, fiduciary law plays little role in assuring accountability in the nonprofit sector.”<sup>192</sup> Therefore, the IRC model of imposing fines for breaches of fiduciary duties could be a valuable and meaningful step in “reining in” New York public authorities.<sup>193</sup>

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187. 531 N.Y.S.2d 144, 144 (3d Dep’t 1988).

188. METRO. TRANSP. AUTH., METROPOLITAN TRANSPORTATION AUTHORITY GOVERNANCE PRINCIPLES AND BY-LAWS 6 (2010) (emphasis added), [http://www.mta.info/mta/compliance/pdf/2010\\_annual/GovernancePrinciplesandBy-Laws.pdf](http://www.mta.info/mta/compliance/pdf/2010_annual/GovernancePrinciplesandBy-Laws.pdf).

189. See PUB. OFF. § 18.

190. See generally *Developments in the Law-Nonprofit Corporations: II. The Fiduciary Duties of Directors*, *supra* note 128.

191. This note does not prescribe a formula for distributing the fines collected.

192. Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 IOWA J. CORP. L., 631, 653 (1998).

193. See generally REINING IN NEW YORK’S SECRET GOVERNMENT, *supra* note 12.

## V. CONCLUSION

After the passage of the Reform Act, Assemblyman Richard Brodsky declared, “Today, we return to the control of the people of the state their most powerful institutions.”<sup>194</sup> Governor Paterson echoed these sentiments: “[f]or too long, public authorities have operated in the dark, under little or no public scrutiny. By signing this bill into law today, we are turning those lights on.”<sup>195</sup> While New York’s elected officials have spoken about returning public authorities to the people and “turning the lights on,” the Reform Act does little more than the Public Authority Accountability Act to bring public authorities out of the dark. Reform efforts must be more than bold proclamations and metaphors; they must work.

The fiduciary duty provisions of the Reform Act were incorporated to ensure that the actions and decisions of public authority boards are in the public’s best interest. While the amended law is an essential first step to achieving accountability, as the Task Force recognized, active enforcement continues to be difficult to achieve. Under the current law, the Authorities Budget Office lacks the power and the resources to ensure that board members are complying with their duties of care and loyalty. For positive change, the Authorities Budget Office must have adequate enforcement capabilities.

The new fiduciary duty provisions are not only important in a political sense, but also in a *legal* sense. The drafters of the Reform Act adopted the corporate model of board governance, but improperly cut the essential remedial measures that are central to achieving its purpose. The remedies available to shareholders of private and non-profit corporations must carry over to public authority law. Without them, public authority boards will continue to act in the dark without accountability. Real reform requires a better system, and the imposition of fines on authority boards is just that.

A system of fines for board misconduct, coupled with a limited role for citizen lawsuits and a better funded and staffed Authorities Budget Office, emerges as a realistic and efficient model that will compensate the public and deter improper actions. Such a system is cost effective and can be implemented quickly. But most importantly it will lead to change—meaningful change. We must ensure public authorities will act in the interest of the people they serve, and the active enforcement of the newly enacted fiduciary duties is a crucial first step. It’s time to turn the lights on.

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194. Confessore, *supra* note 105.

195. *See* Press Release, *supra* note 4.