

**STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL**

**An Examination of Employee Misconduct at the New
York Racing Association, Inc., and Management's
Response**



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I. INTRODUCTION

In early 2000, the Attorney General's Office ("OAG"), the New York State Police ("NYSP"), and the New York State Office of the Inspector General ("OSIG"), began an investigation into money laundering at the three racetracks operated by the New York Racing Association, Inc. ("NYRA"): Belmont Park racetrack; Aqueduct racetrack; and Saratoga Thoroughbred racetrack.

The investigation found that tellers in NYRA's Mutuel Department were laundering cash by exchanging small bills for large bills. A State Police investigator posing as a drug dealer laundered more than \$300,000 through mutuel clerks at NYRA betting windows. In September 2000, the investigative team executed a search warrant at Belmont Park and searched the boxes and bags used by mutuel clerks to store cash during racing meets. Thereafter, a Saratoga County grand jury indicted four NYRA mutuel clerks. Three were later convicted on multiple counts of Attempted Money Laundering, Falsification of Business Records, and Conspiracy. The fourth died of natural causes while his case was pending.

In addition, sixteen of NYRA's mutuel clerks have pleaded guilty to federal tax evasion charges. And within the last month, state indictments voted by a Saratoga County grand jury were unsealed charging two additional NYRA mutuel clerks with forgery. These convictions and indictments are all for crimes committed at NYRA racetracks.

Some of the state defendants cooperated with the investigation. In addition to confirming the money laundering and tax frauds, the clerks laid bare a host of other schemes. They described

ways that employees cheated NYRA and its customers. They described how outsiders could exploit NYRA's lax procedures to commit crimes of their own. The defendants' accounts were corroborated by interviews with current and former employees, consultants, and customers. They were additionally corroborated by documentary evidence.¹

_____As important as individual criminal liability is, this culture of criminality within a government-chartered not-for-profit corporation raised larger questions of corporate accountability and transparency.

The evidence shows an organization that is, at best, indifferent to corruption. Insistent that no one understands racing but they, NYRA's top officers have resisted reform, misled regulators and, when forced to address glaring deficiencies -- including criminal conduct -- adopted only weak measures. NYRA's insularity led its president to insist, during the investigation, that it was proper to incur thousands of dollars of meal expenses at luxury restaurants for him, his family, and employees, and thousands more for meals entirely lacking documentation. When the expenses were questioned, the President of NYRA responded, "Social life and racing life are two sides of the same coin."

The investigative findings were shared with NYRA's President in two interviews in May 2003, and a third in June 2003, where he offered responses and provided additional information. The President was accompanied at those meetings by both internal and external counsel. Several days before the first meeting, the issues were outlined to counsel, which had already attended

¹ Many other aspects of NYRA's operations are not covered by this report, including: NYRA's budgeting and overall profitability; NYRA's subcontracting process; NYRA's financial dealings with the New York State Thoroughbred Racing Capital Investment Fund; NYRA's simulcasting arrangements; and NYRA's federal or state tax compliance.

nearly every investigative interview of current NYRA employees. The President was offered an opportunity to supplement any answers or make a written submission. He has declined to do so. His responses, and those provided by other of NYRA's current officers (also represented by NYRA's counsel), are included below.

II. NYRA'S OPERATIONS

NYRA is a not-for-profit private stock corporation governed by Section 202 of the New York Racing, Pari-Mutuel Wagering and Breeding Law ("Racing Law"). NYRA operates three racetracks: Belmont Park racetrack in Nassau County; Aqueduct racetrack in Queens County; and Saratoga Thoroughbred racetrack in Saratoga County. In 1955, New York State gave NYRA two franchises that permit NYRA to run thoroughbred races in the State and to conduct pari-mutuel wagering on those races. Since its inception, these franchises have been continually extended, and are now due to expire on December 31, 2007.²

By any measure, NYRA is a major business enterprise. Its racetracks occupy more than 950 acres of land. NYRA employs more than 2,000 people. Its live racing season, composed of race meets that move from track to track, lasts for more than ten months. Since 1999, the total amount wagered on NYRA races from all sources exceeds three billion dollars a year.³ Every

² In 2002, the New York State Legislature agreed to extend NYRA's franchises until December 31, 2012, pending the installation of Video Lottery Terminals ("VLTs") at Aqueduct racetrack by April 1, 2003. On April 17, 2003, NYRA announced that MGM Mirage had been selected to install and operate 4,500 VLTs at Aqueduct racetrack at a projected cost of \$100 million. As of this date, no VLTs have yet been installed. The Legislature has since given NYRA an extension of its franchises until December 31, 2013, if the VLTs are in operation at Aqueduct by March 1, 2004.

³ Between 1995 and 1998, the total amount wagered on NYRA races from all sources exceeded two billion dollars a year.

year about two and a half million people go to NYRA racetracks and wager more than \$500 million. Over the last nine years, NYRA's total revenues have averaged more than \$250 million a year.

The Racing Law mandates NYRA's corporate structure, controls many of its methods of operation and specifies its financial obligations to the State of New York. Under Section 208 of this law, NYRA is required to "take such steps as are necessary to ensure that it operates in a sound, economical, efficient and effective manner so as to produce a reasonable revenue for the support of government."

The Racing Law imposes various monetary obligations upon NYRA for the benefit of the State of New York. To begin with, there is a pari-mutuel tax on the money wagered at NYRA racetracks. Out of these betting pools, NYRA must pay a percentage to the New York State Thoroughbred Breeding and Development Fund.⁴ In addition, NYRA must pay the State all the money due on winning but unclaimed betting tickets that are not cashed before March 31st of the following year. NYRA must also allocate the first \$2 million of its entire adjusted net income to horsemen's purses and awards. Finally, any remaining income is paid as a franchise fee to the New York State Thoroughbred Racing Capital Investment Fund ("CIF"), a public benefit corporation created to finance capital improvements at NYRA racetracks. In turn, any funds accumulated by CIF that exceed \$7 million must be remitted to the State Treasury.

⁴ The purpose of the fund is to promote thoroughbred breeding and racing in New York State and to expand the agricultural land used for producing and improving the quality of thoroughbred race horses in New York State. The New York State Thoroughbred Breeding and Development Fund, which is a public benefit corporation, provides incentive awards each year to breeders and owners of New York thoroughbreds.

Since 1993, NYRA has posted disappointing financial results. From 1993 through 2001, NYRA has had losses every year except two.⁵ During this period, its total expenses averaged 103% of its net revenues. As of the end of 2001, NYRA had an accumulated deficit of more than \$50 million, and owed more than \$70 million to CIF and other lenders. Although NYRA has paid its pari-mutuel taxes, it has paid the State franchise fees in only five of the nine years ending in 2001. In none of those five years did franchise fee amounts reach the threshold for remittance by CIF to the State Treasury.

NYRA's organizational structure consists of an Executive Staff and ten departments, four of which are relevant here:

- The Mutuel Department is responsible for all aspects of pari-mutuel wagering.
- The Security Department is responsible for security at the racetracks and for criminal investigations.
- The Internal Audit Department is responsible for conducting internal audits of NYRA departments as well as providing auditing assistance to outside accounting firms conducting NYRA's yearly audit.
- The Parking and Admissions Department is responsible for NYRA's parking areas and admissions gates.

_____ Two people served as President of NYRA during the years relevant to this report.

Kenneth Noe, Jr. was President from 1994 to 1996, when he was elevated to Chief Executive Officer ("CEO") and Chairman of the Board of Trustees. Noe retired as CEO and Chairman in October 2000, within three weeks of the search warrant execution.⁶

⁵ The net profit of \$1.6 million which occurred in 2000 did not come from operations, but came as result of a refund on overpaid real estate taxes in Nassau County.

⁶ Noe stated publicly at the time that he was in poor health and wanted to spend more time with his family. He remains on the Board of Trustees. Noe has not been interviewed during the inquiry; NYRA's lawyers provided a doctor's letter stating that an interview would be "deleterious" to his health.

Terence J. Meyocks replaced Noe as President in 1996. Meyocks had previously served as Noe's Vice President of Operations, with authority over every department at NYRA. Meyocks reports that he and Noe were extremely close: "Kenny Noe was good to me. Everything I knew, he knew." Said Meyocks, "We thought alike."

NYRA's officers currently report to a board of 26 trustees that is charged with managing the business and property of NYRA.⁷ See By-Laws, The New York Racing Association, Art. III, Sec. 1 (1999). NYRA's By-Laws provide that the Chairman of the Board is also the CEO of the corporation, who "exercise[s] general management and direction" of NYRA. Id., Art. V, Sec. 4. The President is the Chief Operating Officer ("COO") and is "subject to the directions of the Chairman of the Board." Id. at Art V, Sec. 6. Barry Schwartz is the current Chairman of the Board and CEO.

The By-Laws provide that any officer of the corporation may be removed by a majority of the Board, "with or without cause." Id. at V, Sec. 16.

III. NYRA's Product: Wagers by the Public

Virtually all of NYRA's revenue comes from wagers placed by the betting public. Taking bets, therefore, is NYRA's main product line. To understand how crimes are committed, it is

⁷ The Racing, Pari-Mutuel Wagering and Breeding Law ("Racing Law") provides that NYRA's Board of Trustees must have at least five, but not more than twenty trustees who are stockholders, and that New York State Racing and Wagering Board must approve any such trustee who is nominated to fill a vacancy on the Board of Trustees. See Racing Law §202 (3). In addition, the Racing Law requires that the governor appoint eight additional members to the Board of Trustees, one of whom shall be appointed upon nomination of the temporary president of the New York State Senate, and one of whom shall be appointed upon nomination of the speaker of the New York Assembly. See Racing Law § 202(4).

necessary to understand how bets are made and processed, and what happens to the money at different stages.

A. Betting at NYRA

Approximately two-thirds of NYRA's betting revenues comes from betting that occurs at its racetracks, where customers can bet both on live races and on races that are simulcast from other tracks.⁸ The balance comes from off-track betting; customers can bet on NYRA races at New York Off Track Betting ("OTB") parlors and at racetracks that allow "simulcast wagering" on NYRA races.⁹

NYRA uses a pari-mutuel betting system. Pari-mutuel means "betting among ourselves." At NYRA racetracks, NYRA has no stake in the outcome of a race. Customers do not bet against the "house" in the way that customers do, for example, at a casino. Instead, customers bet their choice in a race against the choices of every other customer. For every type of bet that NYRA offers on a race, a separate betting pool is created.

The betting odds reflect how much is wagered on each horse or combination of horses in proportion to the amount of money in the pool. Once the race is completed, NYRA deducts a percentage from each dollar wagered to pay for race purses and expenses and to satisfy its financial obligations to the State. The money remaining in the pool is then distributed to winning bettors.

⁸ Customers with "Telebet Accounts" at NYRA can also bet "at" NYRA by telephoning in their wagers, with the amount of the wager deducted from an existing account.

⁹ "Simulcast wagering" is wagering on the results of a live race which is televised to another licensed track, or that track's off-track betting facility.

NYRA offers customers the opportunity to make simple, complex, or exotic wagers. In a simple wager, a customer bets on one horse and a single outcome. Examples of simple wagers would be wagers on a single horse to win, place or show. In these wagers, the customer bets that a horse will come in first, come in first or second, or be one of the top three finishers in the race.

In a complex wager, a customer links the outcomes of two or more horses or two or more races. Two examples of complex wagers would be the Trifecta and the Daily Double. In a Trifecta, the customer selects the top three finishers in a race. In a Daily Double, the customer selects the winners of consecutive races.

In an exotic wager, a customer links the outcomes of four or more horses either in the same race or in consecutive races. Two examples of exotic wagers would be a Superfecta and a Pick 6. In a Superfecta, the customer selects four horses to finish first, second, third, and fourth in exact order. In a Pick 6, the customer selects winners of six designated races in succession. The return on complex and exotic wagers can be quite large.

Odds at NYRA are quoted based upon the amount a customer would have to wager to earn a given return. So, if the odds on a horse winning a race are 2 to 1, a customer who wagered \$1 and won would receive a payoff of \$3, representing an initial investment of \$1 and a return of \$2.¹⁰ For an inexperienced customer, however, calculating winnings where the return is not an even multiple of the money bet can prove difficult. For example, if the odds of a horse winning a

¹⁰ All payoff odds are displayed in whole numbers, for example, 2 to 1 or 3 to 2. However, the actual amount of money in a given betting pool may cause these odds to be slightly higher, for example, 2.1 to 1 instead of 2 to 1, or 3.3 to 2 instead of 3 to 2. Thus, the actual amount won on any bet may be slightly higher than the posted odds indicate.

race are 3 to 2 and the customer wagered \$115, then the customer would have to multiply the \$115 by 5/2 in order to compute a total payout of \$287.50.

At NYRA racetracks, customers who place wagers receive pari-mutuel tickets (“tickets”). These tickets list the racetrack where the bet was made, the time the bet was made, the specific race bet upon, the type of bet made, the number of bets made on the race, and the total amount of money bet on the race. A customer can purchase a ticket using cash or a betting voucher (“voucher”). Winning tickets can be redeemed for cash or a voucher up until March 31st of the following year at any of the three NYRA racetracks.

At NYRA racetracks, a customer may place a wager either at an electronic terminal or with a mutuel teller at a pari-mutuel betting window (“window”). Screen Activated Machines (“SAMs”) are located throughout the tracks. SAMs (which resemble ATM machines) permit a customer to place a wager on a touch screen and to receive a ticket. SAMs will not accept cash. For placing bets, they will only accept vouchers.¹¹ For winning tickets, SAMs will only issue a voucher in return.¹²

Cash purchases or redemptions can be made only from pari-mutuel tellers. These tellers work inside of mutuel “bays,” large self-contained and enclosed structures spread throughout the tracks that usually have ten to twenty betting windows. Mutuel tellers staff these windows. They take bets, issue tickets, pay out winnings, and sell and redeem vouchers.

¹¹ There are voucher machines located throughout the tracks. Customers can insert \$1, \$5, \$10 or \$20 bills into these machines and receive a voucher. There is no limit as to the amount of money a customer can insert into a voucher machine.

¹² Customers can also apply for a NYRA Telebet account, deposit money into their account, and receive a NYRA One card, similar to a debit card. They can then use this card to place bets at SAMs and the amount bet will be automatically deducted from their account balance. Only a minority of customers at NYRA racetracks have these NYRA One cards.

Mutuel tellers use electronic terminals called Ticket Issuing Machines (“TIMs”) to take bets. When a customer places a bet, the teller enters the wager into it, and the TIM prints out the ticket. For multiple wagers, the TIM will keep a running total of the amount the customer owes, and then print out the tickets at the end of all the transactions. TIMs also calculate winnings. When a customer presents a winning ticket, the mutuel teller inserts it into a TIM, which reads it and automatically calculates the payout due the customer. At the conclusion of a transaction, the mutuel teller is supposed to hit the “Total” button on the TIM. This function clears the TIM screen so that a new transaction can be initiated. In the back of the TIM, facing the customer, there is a small LCD Screen that displays the amounts wagered or won.

TIMs are the front-end of a complex, integrated hardware and software system provided by Autotote Systems, Inc. (“Autotote”) that centrally processes all wagers placed on NYRA races. Based on the wagering data transmitted to Autotote’s central computer system, the Autotote software calculates the odds on a race and the payout on winning tickets. The Autotote system electronically stores every financial transaction conducted during a race day.

B. Cash Handling in NYRA’s Mutuel Department

Over the past nine years, Aqueduct, Belmont and Saratoga racetracks have handled, on average, approximately \$2 million of on-track wagering per day. The majority of this on-track wagering is in cash. In this respect, NYRA functions like other cash intensive businesses. Effective cash controls, which are standard for businesses from banks to department stores to fast food restaurants, were absent at NYRA.¹³

¹³ The procedures described below apply to permanent NYRA employees only. NYRA also uses temporary clerks and other non-permanent clerks, to whom other, more stringent, money handling procedures apply.

Within the Mutuel Department, mutuel clerks perform one of two functions in a mutuel bay: (1) A “teller” processes wagers at betting windows; (2) a “mini-dealer” acts as cashier to a group of tellers. There are hundreds of tellers and over a dozen mini-dealers. Both tellers and mini-dealers are stationed in bays on every floor of the three or four story racetracks, as well as in bays located in the restaurants and private betting areas.

These hundreds of dispersed clerks were and are supervised by six “Bay Supervisors.”¹⁴ These six must also monitor customers as they use the SAMs and voucher machines located throughout each racetrack. Indeed, the Bay Supervisors state that their primary job is customer service, and that, consequently, they spend the majority of their day outside of the bays.¹⁵ In addition, they report that tellers would often yell out “shark in the bay,” or “willet in the bay” to alert other tellers when a supervisor entered the bay.

From 1980 to October 2002, NYRA used an extremely deficient set of cash handling procedures, a system that enabled the crimes described by the cooperating witnesses. At the beginning of a racing meet (which could last from six to ten weeks), tellers received a box filled with cash (“cash box”) and mini-dealers received a bag filled with cash (“cash bag”). On average, tellers received approximately \$315 and mini-dealers approximately \$15,000. During business hours, tellers and mini-dealers had sole possession of their cash boxes and bags. At night, they were stored, unchecked, in a vault. The next day, tellers and mini-dealers reclaimed their boxes and bags. No one counted, audited, examined, or otherwise verified their contents.

¹⁴ NYRA hires an additional one or two Bay Supervisors for the six week Saratoga meet to help supervise the additional 400 or so temporary tellers hired to work that meet.

¹⁵ The Vice President of Regulatory Compliance (formerly Vice President of Mutuels) confirms this dual role for supervisors, “one-half customers’ issues, one-half oversight.” Indeed, he reports that “customer service problems could require a whole day.”

On racing days, mini-dealers received additional cash from NYRA's money room simply by requesting it. Similarly, tellers could receive additional cash from the mini-dealer simply by requesting it. Over the course of a racing meet, the amount of money that accumulated in a cash box or cash bag fluctuated, depending on the cash tellers drew from mini-dealers and the size of bets made by and paid out to customers.¹⁶

The amount of money that tellers or mini-dealers have at any moment should exactly equal their opening balances plus the amount of money that they have received minus the amount of money paid out. If the amount in the cash box or bag is negative, there is a "shortage." If positive, there is an "overage." Depending on its size, a shortage may mean that a teller or mini-dealer has made an error, stolen the money, is using it to finance criminal activity, or, as discussed below, is engaged in tax fraud. Large or consistent overages are a leading indicator of a common register theft, that is, failing to record (or later voiding) a transaction and storing money in the register for removal later.¹⁷ They can also be an indicator of theft from a customer,¹⁸ or profits from, for example, a money laundering operation conducted with NYRA money.¹⁹

At NYRA, permanent tellers and mini-dealers were required to "balance out" their cash boxes and cash bags only at the end of the six to ten-week racing meets. During the meets, shortages or overages were detected primarily either by self-reporting or spot checks performed

¹⁶ NYRA had a procedure in place requiring management to remove excess cash from tellers. This was, as shown below, honored in the breach.

¹⁷ In a common retail register fraud, the customer receives the goods, but the teller -- not the store -- receives the money. At a betting window, a teller who voids a sale to pocket the money is predicting that the customer placed a losing bet.

¹⁸ See pages 38-45, below.

¹⁹ See pages 14-15, below.

by mutual management. As to the spot checks, out of the hundreds of clerks, the Mutual Department would select a sample that, over the years, ranged from two to ten to do a full count-out at the beginning of each day.

Cash shortages and overages could, consequently, go undetected for months at a time. In contrast, banks and other businesses where employees handle large amounts of cash require, virtually without exception, that tellers and cashiers “balance out” and turn in all their cash on a daily basis.

NYRA tellers’ shortages and overages could be huge. For example, NYRA documents show that in 1996, a single teller had shortages in excess of \$49,000 and overages in excess of \$37,000 (scores of others had shortages over \$10,000). Similarly, in 1998, one teller had shortages in excess of \$28,000, and overages in excess of \$22,000.

Between 1996 and 1999, no permanent teller was discharged for shortages or overages. Instead, NYRA developed a bookkeeping system to add overages to clerks’ paychecks and deduct shortages. NYRA payroll records show that, many weeks, some tellers would not be entitled to any net salary at all. In 1999, one clerk received no paycheck at all for 14 pay periods.

IV. CRIME AT NYRA

These lax controls facilitated employee and customer crime. First, NYRA practices functionally financed criminal operations, essentially allowing tellers to borrow seed money to run money laundering, gambling, or loan sharking operations. In addition, lax controls fostered an environment where tellers cheated the betting public through a host of swindles. Finally, NYRA’s culture of indifference created an atmosphere enabling yet other crimes.

A. Teller Crimes Financed with NYRA Money

As set forth above, NYRA's control over money dispensed to permanent tellers was poor. For months at a time, these tellers were permitted unfettered use of NYRA's cash, able to draw money when they needed it in whatever denominations they desired. Significant percentages of these tellers took advantage of this public "seed money" to run money laundering, gambling, or loan sharking schemes. Some used NYRA money as a horn of plenty to finance their own gambling, unlawfully betting on races and "doubling up" to cover their losses. Still others used the license to run "short" to perpetrate systematic tax fraud.

1. Money Laundering

Criminals such as drug dealers and bookmakers can generate large amounts of cash in small denominations. Converting cash from small denominations into larger ones makes it easier to store, hide and dispose of the cash. NYRA employees are in a position to help.

From January 2000 through March 2000, the investigative team conducted surveillances of betting windows at Aqueduct racetrack. During those surveillances, investigators observed one-sided cash exchanges bearing the earmarks of money laundering. The investigators observed individuals giving mutual tellers large amounts of cash without receiving either cash, a ticket, or a voucher in return. Similarly, the investigators observed tellers at windows handing individuals large amounts of cash or thick envelopes without receiving either money, a ticket, or a voucher in return.

Beginning in April 2000, undercover operations began at NYRA. In these operations, an undercover State Police Investigator from the Special Investigations Unit ("SIU") posed as a drug dealer. In this role, he told tellers that the small bills he wanted to launder were proceeds from

cocaine sales, and that he would use the large bills he received to buy more cocaine. For the next five months, at all three NYRA racetracks, the undercover investigator laundered more than \$300,000, in amounts ranging from \$4,000 to \$100,000, in fifteen transactions with four tellers.

In nearly every case, the undercover investigator handed the teller cash inside a paper bag, and the teller told him to return a couple of races later. When the undercover investigator returned, the teller simply handed the undercover investigator an envelope or a paper bag with the laundered funds inside. The charge for laundering the money was approximately 5% of the amount of cash the undercover laundered. Sometimes, instead of giving the undercover officer cash, the teller provided a voucher, which could be redeemed at another betting window for large bills.

Interviews with the clerks convicted of money laundering and other clerks within the Mutuel Department revealed that money laundering has been occurring at NYRA for years. Investigators also learned that tellers did not always launder this money by themselves, but sometimes did so in collusion with mini-dealers, who received a portion of the customary 5% fee. For while a teller is in a position to make contact with a criminal seeking to launder money, only a mini-dealer could get the amount of cash from NYRA's money room that was sometimes needed to complete an illegal transaction.

2. Illegal Gambling and Loan Sharking

In interviews, cooperating defendants, and current and former NYRA employees admitted that clerks routinely ran illegal gambling and loan sharking operations from betting windows. These illegal gambling operations involved taking bets on NYRA races and other sporting events. The loan sharking operations took the form of short term loans in return for "tips." These "tips"

amounted to interest rates that, on an annualized basis, ran from 52% to 156% of the loan principal.

Those interviewed reported that the funds to bankroll the illegal gambling and loan sharking belonged to NYRA. Since clerks knew that they had until the end of a racing meet to make good on any shortages, they could use NYRA funds to pay out on bets and to finance short term loans at usurious rates. If clerks had a shortage at the end of the racing meet, they would make up the shortage by putting their own money into their cash box, or simply by having NYRA deduct the shortage from their paychecks.

Tellers were also able to use NYRA money to finance their own gambling habits, wagering on races throughout the day. Of course tellers are not supposed to use NYRA money for any private purposes, but they are also forbidden – even using their own money – to bet on races at all. Teller wagering is unlawful. See 9 NYCRR § 4005.4.

According to a former NYRA consultant, not only were NYRA managers aware that tellers bet, they quietly condoned it because the additional wagers increased NYRA's profits. The consultant said that a manager told him: "If the mutuel clerks did not bet, we would not have a handle." (The "handle" is the racing term for the total amount bet.) The consultant reported being told of one clerk who put his child through dental school by betting, but had to resign after running up a large deficit.

In September 2000, investigators executed a search warrant at Belmont, and seized the cash boxes and cash bags assigned to all tellers and mini-dealers at NYRA. The contents corroborate the witnesses' accounts.

First, the search showed the vast amount of seed money available to tellers. In total, more than \$1.3 million in cash was seized from these cash boxes and cash bags. All of this cash reflected transactions that occurred during the first 16 days of the fall racing meet at Belmont, which lasts for eight weeks. The teller drawers contained more than \$479,000. A large number of tellers had more than \$5,000 in their boxes, which was more than 15 times the \$315 received at the beginning of the meet. The mini-dealer cash bags contained more than \$897,000, an average of \$47,000, or more than three times the \$15,000 that mini-dealers usually received at the beginning of a racing meet. One mini-dealer cash bag contained \$91,597, and another \$114,481.

Second, the search produced written records of crime. Seventeen of 227 cash boxes for tellers working that day held slips of paper or envelopes that appeared to be loan sharking or bookmaking records, slightly over 7% of tellers. Of the same 227 boxes, as many as 175 (over 77%) were under or over count or contained: bookmaking or loan sharking records; unprocessed betting slips (e.g., evidence of unlawful teller wagering); or uncashed vouchers. The box of one of the convicted tellers contained not only bookmaking and loan sharking records, but also a gold watch the teller was holding as customer collateral.

It is notable that tellers stored records of illicit activity in NYRA cash boxes at all. These boxes were NYRA property, which NYRA had a right to search at any time. Plainly, the tellers had no fear that, in fact, NYRA would.

3. Committing Income Tax Fraud by “Going Short”

A large number of NYRA tellers exploited NYRA procedures to evade payment of federal and state income taxes. When a teller had a shortage, NYRA allowed the teller to have it deducted from the teller’s paycheck. Other than repayment, there was no meaningful penalty for

going short, even by thousands of dollars. Instead, at the end of each year, NYRA issued its employees short certifications, certifying the dollar amount received from its employees as reimbursements for account shortages. In 1998 alone, the short certificates totaled \$1.8 million.

This procedure became the basis for a tax fraud scheme. In essence, clerks declared as taxable income only the amount of their paychecks after the shorts had been subtracted, functionally taking the amount they were “short” as untaxed income.²⁰ Based in part on the information supplied by our informants and the documents seized from teller cash boxes at Belmont in September 2000, sixteen tellers have been convicted of federal tax evasion.

Without tellers’ ability to hold money long enough to run up significant shortages, NYRA’s shortage repayment program, and the yearly issuance of short certifications, these crimes could never have occurred. Although NYRA’s own role was initially unwitting, as discussed below, even after its President was put on direct, personal notice of the likelihood of employee tax fraud, NYRA never reported it to regulators or law enforcement.

4. NYRA’s Response

When state money laundering indictments were announced in 2001, NYRA’s public position was that little was wrong. John Russo, then general counsel of NYRA, was quoted stating: “When you ask if there are going to be changes, you presuppose there’s a problem with NYRA’s handling of money. . . . We’ve been doing this for 46 years, and we’re very good at handling our money.” Dennis Yusko, After Arrests, NYRA Mum on Procedure: Saratoga

²⁰ To accomplish this, tellers improperly claimed their repayment of the shorts to NYRA (through the payroll subtraction) as unreimbursed employee expenses on their tax returns. Some even provided the NYRA-issued short certifications to the IRS as documentation.

Springs Officials Aren't Talking About Possible Changes after Clerks are Indicted, The Times Union, July 21, 2001, at B-1.

This has proved untrue. By any objective standard, NYRA was not “very good” at handling its money. Moreover, in the years before the indictments, NYRA was repeatedly told of its shortcomings and how to fix them. In the main, NYRA ignored these cautions. Worse, NYRA withheld critical warnings from its regulator, the Racing and Wagering Board, even in the face of its specific inquiries. Knowing the truth about its failures – and even about pervasive criminality in its work-force – NYRA nevertheless assured the regulator that its practices were sound.

a. Richard A. Eisner & Co.’s 1995 Draft Report

As early as 1995, NYRA management was placed on notice of deficiencies in their operations through the work of Richard A. Eisner & Co., LLP consulting firm.

Eisner & Co. is a management consulting firm that was retained by CIF to examine NYRA as NYRA was seeking additional funding mechanisms from the State. The firm studied NYRA from late 1994 to early 1995, and submitted a draft report of its findings in January 1995.

The draft catalogued a host of NYRA’s poor practices, and focused much of its criticism on the Mutuel Department. The firm attributed many deficiencies to NYRA’s being frozen in the past: “Curiously, many [NYRA managers] appear to take pride in following procedures that are identical to those established 40 or more years ago.” Draft Report at 16. Eisner and Co.’s conclusion was blunt: “NYRA is not functioning as an efficiently managed profit-making organization would function facing similar financial difficulties. . . . To do so, NYRA must change its operating approach.” Id. at 16-17. Among its criticisms, the draft pinpointed one

deficiency that, nearly nine years later, was still enabling crimes: that “Clerks are responsible for their own cash reconciliation.” Id. at 66.

The consultants specifically identified and memorialized the widespread problem of shorts:

‘[S]horts’ are a common occurrence. It is our understanding that shortages are deducted from a clerk’s weekly pay. It is our further understanding that if the shortage amount is more than a clerk’s weekly pay, the individual must reimburse NYRA for the total amount before he/she is permitted to work again. A review of payroll records for the week ending December 11, 1994 revealed that 137 clerks (approximately 40% of the mutuel workforce paid that week) were indeed short, by up to \$550. For this weekly period, per clerk shortages averaged \$275. Id. at 66.

Thus, as early as 1995, NYRA was told that forty percent of tellers were running short.

Moreover, the consultants recorded NYRA management’s belief, even then, that the shortages were an indicator of teller misconduct: “Management believes that most shorts are the result of losing wagers placed by mutuel clerks, a practice prohibited by the rules of the New York State Racing and Wagering Board.” Id. at 66-67.

The consultants documented a number of other managerial flaws, including that “security practices are highly questionable,” id. at 21, that parking and admissions controls needed tightening, id. at 20, and that “Key management and financial controls are inadequate,” id.

The Eisner firm also noted NYRA’s reluctance to accept proposed reforms in the past: “The New York State Comptroller’s Office and other state agencies have in the past proposed recommendations (some of which were similar to those presented herein), that if adopted could have significantly improved the cost effectiveness and/or internal controls of NYRA’s operations.” Id. at 22. In an observation that would foreshadow the fate of their own work as well, the consultants noted: “It would appear that many such recommendations have met with resistance or have been ignored by NYRA’s management.” Id. As later events would show, the

report understated NYRA's response to criticism; by 1999 management would be hiding information from its regulators.

In any event, the Eisner report was never issued in final form. After delivering the draft, Eisner's staff had a brief meeting with two NYRA trustees and a member of CIF, and were told that if Noe (then a new president), thought any of the ideas were worthwhile, he would implement them. Eisner and Co. was not asked to put the draft into final, and, indeed, was not initially paid. According to the firm, it had to negotiate to receive partial payment of its bill.

The firm did, however, receive a dismissive letter from Noe. Although conceding that there was "some justified criticism," Noe wrote: "there were a couple of items that I believe, if the auditors had knowledge of certain procedures that are performed in the daily operations, it would have been much clearer to them."

Terence Meyocks said that he only "breezed over" the consultant's work once quickly in 2003, in preparation for being interviewed in connection with the OAG's investigation. He further said that he may have spoken earlier to NYRA's former CFO about the report, but could recall no specifics. (In preparing the draft, Eisner's staff had interviewed Meyocks -- then Vice President of Racing -- on two separate dates for a total of over 7 hours.)

b. NYRA's Routine Paycheck Adjustments for Overages and Shortages

NYRA was also on notice of substantial overages and shortages – often by the same clerk – because of its practice of adding overages to clerks' paychecks and deducting shortages.

Over the years, clerks' shortages and overages were documented primarily by non-random spot counts conducted by NYRA Mutuel Department managers or by tellers' self-reporting.

NYRA personnel have stated that up until 1992, NYRA did two such teller counts a day. After

1992, the counts increased to approximately six a day, and in 1999, they increased to approximately 10, all out of a teller population that numbered in the hundreds.

To get the money back, NYRA mutual managers sent paperwork reflecting the shortages and overages to NYRA's payroll department, where shortages would be deducted and overages added to clerks' paychecks. In other words, rather than regarding the continuing shortages as serious red flags, NYRA instead developed an internal mechanism to continuously adjust tellers' paychecks.

c. Internal Audit's Surprise Cash Counts

All of these findings were echoed by spot audits NYRA's internal auditors conducted between 1994 and 2001, called surprise cash counts. Periodically, NYRA's internal auditors selected six clerks (five tellers and one mini-dealer) for a surprise box count. The reports, copies of which were sent to Noe and, later, Meyocks, bore statements that shortages were subtracted from the tellers' pay. Some of the shortages were sizeable: a 1999 audit sent to Meyocks showed a teller short \$620 for that audit alone. Meyocks said that he reviewed the audits, but concluded that "these were not abuses."

d. Teller's 1997 Arrest for Theft

A NYRA teller was arrested in 1997 for stealing approximately \$93,000 from the till. In essence, the teller used NYRA money to place bets and kept losing. Although he booked bets from his window far in excess of what his cash on hand would have allowed, NYRA did not identify any irregularity. Instead, the teller went to management and confessed.

As a result, Richard Giancola, NYRA's Director of Internal Audit, issued a memo in late 1997 addressing NYRA's control weaknesses. Giancola made a series of recommendations to

better monitor “the cash levels of the mutuel clerks.” One of these included requiring management to electronically monitor cash balances throughout the day. Another was establishing cash limits for tellers and requiring management to retrieve cash over that limit.

After over a year of software development, NYRA finally adopted an enhanced “teller alarm” system sometime in 1999. As set forth below, the new, improved alarm system was roundly ignored.²¹

e. The 1999 Racing and Wagering Board Request for a Special Audit

NYRA’s failures to address these issues began coming to a head in 1999 as a result of pressure from its regulator, the New York State Racing and Wagering Board (“Racing and Wagering”). Concerned about teller misconduct, Racing and Wagering pressed NYRA for a specific review of what NYRA was doing to control it. The evidence shows, however, that NYRA had decided that teller misconduct was an acceptable cost of doing business, as long as – in NYRA’s view – it could secure any verifiable teller loss with deductions from that teller’s paycheck. NYRA’s response to regulatory inquiries was first to delay, then to mislead, and, when faced with the inevitability of the truth emerging, to take steps to minimize embarrassment. At no time was its response to stop unlawful teller conduct simply because it was and is unacceptable.

This chapter of NYRA’s indifference to misconduct began when representatives of Racing and Wagering observed what appeared to be open teller betting at the racetracks. As a result, the Acting Director of Audits for Racing and Wagering called in writing for NYRA’s outside auditor to conduct a “special audit” to cover “the internal controls over the money room and teller windows and compliance with pertinent . . . [l]aws (including teller betting).” Letter from

²¹ See pages 29-30, below.

Thomas V. Casaregola, Acting Director of Audits, State of New York Racing and Wagering Board, to Terence J. Meyocks, President/COO, NYRA (Jan. 19, 1999).

According to interviews, NYRA did not welcome this request. First, interviews disclose that NYRA management fully believed that its tellers were, indeed, wagering in violation of the rules. Former Mutuel Department Director Vince Hogan has reported that it was universally known, including by management, that tellers were betting. Hogan volunteered that the tellers “were my customers before I hired them.” Formerly a police officer, Hogan reports that he had asked NYRA for more supervisors to try to better manage the clerks, but had been turned down. As a result, he did not focus on teller misconduct unless it directly effected NYRA’s income: “My job was to make money for NYRA and the state.” This included allowing clerks to pay back their shortages from their paychecks, even if it took more than one paycheck.

Second, Alec Ingle, CFO at the time, has reported that Meyocks’s resistance to regulation was “a cultural thing.” He described Meyocks as “frustrated” with Racing and Wagering’s attempts to regulate NYRA. He stated that Meyocks felt that Racing and Wagering was “tying his hands when he just wanted to run a racetrack.”

This reported frustration was evidenced by Meyocks’s response. He resisted the audit, protesting directly to the Chairman of the Racing and Wagering Board about an “overlap” of “perceived authorities” with another regulator, the New York State Comptroller. Letter from Terence J. Meyocks to Michael Hoblock, Chairman, Racing and Wagering Board (Feb. 8, 1999) (“RE: Mr. Casaregola’s Letter of January 19, 1999). Meyocks also characterized Racing and Wagering’s request as a “direct challenge” to the work of NYRA’s outside auditor.

Richard Giancola, Director of NYRA's Internal Audit Department since 1982, attempted in an interview to explain NYRA's reservations about Racing and Wagering's request. He contended that, in NYRA's view, neither the \$93,000 teller theft nor persistent shortages were signals that anything was wrong. So, to NYRA, Racing and Wagering's request was unwarranted.

Racing and Wagering continued to insist. It pointed out that the normal external audit did not focus on issues such as teller betting, and listed the problems it perceived at NYRA. Foremost was "NYRA's practice of allowing permanent tellers to not submit their drawers to have the cash verified at the end of each day." Thomas Casaregola, Acting Director of Audits for Racing and Wagering, noted NYRA's practice of allowing permanent tellers to submit their drawers only at the end of meets. He wrote: "This means that they are relied upon, on an honor system, to count their own drawer at the end of every day. At any one time there is between \$800,000 to \$1 million in cash 'out on the floor.'" Letter from Thomas V. Casaregola, Acting Director of Audits to Terence Meyocks (Feb. 16, 1999) (emphasis in original).²²

With Racing and Wagering undeterred, Meyocks abandoned his objection. He nonetheless continued to describe NYRA's practices as "appropriate and adequate." Letter from Terence J. Meyocks to Thomas V. Casaregola (Feb. 27, 1999). Moreover, he assured Racing and Wagering that "NYRA prosecutes every clerk who goes short." Meyocks now concedes that by no means was every NYRA clerk who went short prosecuted. To the contrary, NYRA had

²² In that letter, Casaregola additionally reported to Meyocks other instances evidencing a lack of teller controls, including one instance where a teller was found \$200 short (NYRA conducted no review), and another where, before the start of an audit of a drawer, the teller was allowed to remove cash that he said was his own.

developed a whole system to deduct shortages from permanent clerks' paychecks, a process well-known to Meyocks because of his review of internal audit's surprise cash counts.²³

Soon, disagreement over the planned audit resurfaced. Meyocks wrote Racing and Wagering that there had been a "misunderstanding" as to what NYRA had agreed to, and that, "The scope of this audit will not include a conclusion on 'NYRA's compliance with pertinent statutes and rules concerning'" the teller betting rule. Letter from Terence J. Meyocks to Thomas V. Casaregola (Mar. 22, 1999). Racing and Wagering insisted once again: "[W]e specifically stated that a special audit **must** be performed on NYRA's mutuel department and money room covering the internal controls and compliance with pertinent Racing, Pari-Mutuel Wagering and Breeding Laws." Letter from Thomas V. Casaregola to Terence J. Meyocks (Apr. 30, 1999) (bold and underline in original).

NYRA's external auditors undertook the special audit. And, indeed, they documented teller misconduct. However, what they found was more serious even than what Racing and Wagering had suspected; the audit showed that tellers were engaged in tax fraud. In a document dated September 14, 1999, and stamped "draft," the outside auditor and the Director of NYRA's Internal Audit Department wrote to NYRA's then-CFO:

On a regular basis Mutuel Clerks go short. A significant number of clerks have large cumulative shortages each year which reduce their taxable income. The top twenty shortages by clerks totaled over \$360,000 for 1998. And the top individual clerks for the last four years, each were short over \$80,000. (emphasis added)

²³ See page 22, above.

Meyocks stated that he saw this document on approximately September 20, 1999, and that he was told that the shortages for 1998 totaled \$1.8 million. Meyocks stated in an interview that he viewed this as an important matter. He said that, “The game changed that day.”

By Meyocks’s own account, he was, at that moment, in possession of evidence of teller criminality. Both what he did and did not do at that juncture are telling. As for what he did do, Meyocks directed that a memorandum be prepared, which would – for the first time – lay out a penalty schedule for tellers going short. Meyocks stated he then wanted those new penalties negotiated with the union. Meyocks has characterized this direction that a memo should be prepared as “swift” action on his part.

As to what Meyocks did not do, he did not take action as to individual tellers. He did not change NYRA’s issuance of short certifications for the 1999 calendar year (the very forms that enabled the tax fraud). He did not change tellers’ cash handling controls. He did not, by his account, “focus” on the many remedial recommendations in the September 14, 1999, memorandum.²⁴

Moreover, Meyocks did not contact the Internal Revenue Service, the New York State Department of Taxation and Finance, or any other law enforcement agency. He does not recall whether or not he told his own trustees. He is sure, however, that he did not report the findings of teller misconduct to Racing and Wagering. As to why, Meyocks stated in an interview that this was not, in his view, a matter of regulatory concern.

²⁴ These included placing the functions of the mini-dealers under management, increasing the role of Bay Supervisors, and studying the possibility of installing video cameras in the bays.

Racing and Wagering, however, was still awaiting the results of NYRA's special audit. NYRA had -- obviously -- not received a clean bill of health from its external auditor on the subject of teller compliance with the law. Therefore, NYRA did not answer Racing and Wagering's simple question about "compliance with pertinent . . . [l]aws."

Instead, NYRA answered a question that Racing and Wagering had not asked. It assured Racing and Wagering that sufficient controls existed to "safeguard the Association's assets," and received confirmation from the outside auditor to that effect. This statement was internally justified through resort to NYRA's long-standing procedure of deducting teller shortages from their paychecks. In other words, the unstated essence of the reported finding was that tellers could be short all they wanted -- whether because of betting or tax fraud or some other reason -- as long as NYRA had recourse to their paychecks.

NYRA's lack of communication with others about the widespread teller crime, and the presentation instead of the misleading clean bill of health, effectively concealed the damaging information.

Racing and Wagering, however, was unwilling to accept the audit findings at face value, and demanded to review the external firm's work papers. Although NYRA initially resisted, it ultimately had no choice under accepted auditing practices but to agree to the request.

This prospect caused concern at NYRA. Internal documents reflect nervousness that its effort to hide the teller tax evasion scheme would be revealed. On October 17, 1999, the then-CFO wrote a memorandum to Meyocks and others (it bears a handwritten "draft" at the top) apprising them that Racing and Wagering "appears to be highly skeptical of the audit, its findings and its conclusions." The memo warned that Racing and Wagering would discover what NYRA

already knew about teller crime: “They want confirmation that the clerks aren’t betting. What they will conclude from the work papers is that the clerks are probably betting, but worse, the clerks are going short for personal gains.”

The former CFO stated in an interview that he was “worried about embarrassment.” He could not, he said, understand how things had gotten to such a state.

Racing and Wagering did, indeed, review the work papers. Shortly afterwards, by November 1999, it made a referral to the State Inspector General and the State Police, which led to both state and federal investigations.

In February 2000, NYRA issued the new shortage policy. Among other things, it permitted tellers six \$600 shortages in a 12-month period before being terminated. NYRA still did no nightly count-out.

Two months later, starting in April 2000, the State Police undercover investigator was able to launder \$300,000 through NYRA’s same, unchecked teller population.

f. 2001 Racing and Wagering Follow-up Findings

In 2001, Racing and Wagering began an independent review of NYRA’s Mutuel Department. Between August and November 2001, Racing and Wagering staff auditors visited all three tracks to make observations, conduct interviews and review documents. Racing and Wagering reports that it communicated its observations to NYRA as they were made.

The auditors found that NYRA’s Mutuel Department controls remained poor. There was still ineffective supervision by Bay Supervisors, because there were simply too few of them. NYRA had yet to create written definitions of their responsibilities. Teller alarm reports were being ignored; in hundreds of instances tellers exceeded their maximum balances without being

required to return the excess money. There were virtually no limits on the cash balances that could be carried by mini-dealers.

Moreover, teller betting was still flagrant. On multiple occasions, auditors observed tellers leaving their mutuel bays to watch races on television screens, cheering for horses and pulling betting tickets from their pockets. They observed tellers punch up tickets on their TIMs and place them in their pockets, and they observed tellers who kept their betting windows closed in order to scan mutuel tickets in their possession. Indeed, in interviews with the auditors, many tellers claimed that NYRA management still condoned tellers betting. One teller told Racing and Wagering – even as late as 2001 – that NYRA management saw teller betting as “another dollar in the drawer.”

g. NYRA’s Belated Response to the Criminal Investigations

In 1995, after receiving the Eisner draft report, NYRA made no changes to its cash handling procedures. In September 1999, NYRA tried to suppress information about teller corruption from its regulators. In September 2000, the State Police and the Attorney General’s office executed a search warrant at Belmont. In 2001, Racing and Wagering performed a regulatory audit that found lax cash controls and continued teller misconduct.

Finally, in October 2002, in the face of mounting state and federal criminal convictions, NYRA changed some teller practices. However, even at this late stage, NYRA embraced measures that are inadequate.

A relevant measure by which to judge NYRA's reforms is the set of controls used by a different gambling industry, casinos.²⁵ In neighboring New Jersey, casinos are regulated by the New Jersey Casino Control Commission ["the Commission"]. According to Daniel Heneghan, Director of Communications for the Commission, when gaming was legalized in New Jersey, the state imposed a series of careful controls to realize two main goals. One is assuring control over the money. Just as New York has a financial interest in NYRA's profits, New Jersey has a financial interest in casino profits. The state's rules, therefore, were designed to ensure that money is fully accounted for at every step from the betting table to the final count-out. A second interest, reports Heneghan, is ensuring public confidence. If the public fears that the games are unfair or that the people dealing the cards and running the games are dishonest, it will not come and play. Both goals, tight fiscal control and the need to ensure bettor confidence, are equally applicable to NYRA.

Heneghan described New Jersey's system as beginning outside the casino walls. No one is permitted to be hired by a casino without obtaining a license from the Commission, which entails a background check that, according to Heneghan, is more thorough than that for most gubernatorial appointees. First line supervisors such as "pit bosses" receive an even more thorough check, focusing particularly on any financial difficulties that might create an incentive to cheat.

Once hired, employees are carefully trained, and subject to constant supervision and correction. For example, New Jersey regulations dictate the maximum number of dealers that

²⁵ As described above in note 2, NYRA is authorized to install Video Lottery Terminals ("VLTs") at Aqueduct, which will additionally implicate the types of controls that casinos use for slot machines, controls not discussed here.

each “floorman” may supervise and the maximum number of floormen that each “pit boss” may supervise. Rules govern even dealers’ hand movements. In order to prevent them from “palming” chips, dealers are required to turn their palms face up each time they touch chips and before they move their hands back to their bodies. This constant showing of palms is carefully monitored by floormen, who correct any of their dealers who fail to do so. Constantly monitoring the dealers and the floormen and their supervisors, the pit bosses, are multiple video cameras throughout the casino. They can view and record every table from multiple angles, and can zoom in close enough to read the face of a dime.

Dealers do not retain any money when dealing with the betting public. They immediately deposit money down a slot into a “drop box” locked to the table. The box is secured by two keys: one belongs to the casino and the other to the Commission. At the end of the shift, each box is unlocked from the gaming table (in the presence of a Commission inspector) and locked onto a cart.

With the boxes from the tables locked onto it, the cart is then rolled into a counting room. Everyone entering the room is required to wear a one-piece, pocketless jump suit. The room is monitored by multiple cameras, and everything that takes place is both audio and videotaped. One inside the room, the Commission’s key is attached to the table, which is made of clear plexiglass so that nothing can be hidden beneath it. A single box is unlocked from the cart and placed on the table, where a casino employee opens it using the two keys. The contents are emptied onto the table, and the employee holds the box up to the camera to verify that it is, indeed, empty.

The currency is then fed into an automatic counting machine. When the machine has finished, an employee -- without announcing the total -- records it on a piece of paper. The currency is then passed across the table to a second employee, who places it into a second counting machine. When the second machine is finished, that employee records the total on a different piece of paper. With both totals recorded, they are compared. If they agree, the next box is counted in the same manner, and so on, until all the boxes are counted. A Commission inspector is present for the entire count.

These procedures are reinforced by additional measures. First, throughout the operation, casinos employ the principle of “incompatible functions,” namely that each different person involved in a transaction reports to a different supervisor in a different chain of command. For example, when a dealer needs new chips for a table, they are counted out by a cashier (who works for a different department), and delivered by security (who works for yet a different department). This intentional segregation of functions is designed to make collusion -- like that described above between NYRA’s tellers and mini-dealers -- more difficult. Second, the entire system is backed up by forceful deterrence. Heneghan reports that when a dealer is detected stealing, standard procedure is to time the arrest for when the employee is on duty; the New Jersey State Police officers arrest and handcuff him on the floor of the casino in full view of all of his co-workers.

Heneghan reports that the crafting of the rules and regulations -- which currently run over 500 pages -- was the result of much thought, study, and the input of outside professionals. They have been continually updated and refined in the quarter century since they were initially drafted.

In contrast, NYRA’s current reforms, according to the person who designed and implemented them, involved no such study. Indeed, he was given no explicit directions to

implement reforms, had no personal background in the financial end of racing, and was never told of specific problems that needed repair.

The architect of NYRA's current system is James Gallagher, who Meyocks hired in 2002 as Vice President of Mutuel Operations, a post that had been vacant for years.²⁶ Gallagher had worked for decades at Racing and Wagering, and upon retirement worked for two years for the National Thoroughbred Racing Association. According to Gallagher, while at Racing and Wagering, his expertise was in equine doping, not money handling. According to Meyocks, he did no search or advertising for the job. He hired Gallagher because he viewed him as the best person for the job; Gallagher had a regulatory background and Meyocks had previously found him to be "open minded."

Gallagher states that Meyocks gave him free reign as a manager, and Gallagher revamped operations in the Mutuel Department. Gallagher stated that he was never told to do so because of any past or current problems, but that he had a general notion that things needed to be improved. According to Meyocks, the only mandate he gave Gallagher was "learn what you are responsible for."

Gallagher reported no efforts to determine best practices elsewhere before crafting NYRA's new rules. Nor, notwithstanding the money laundering indictments, did he consult anyone with money laundering expertise. He states that he relied instead on his experience in the racing industry, which, he conceded, did not involve cash control. Even now, Gallagher reports that he is unaware of whether or not other racetracks control cash in the manner that he has designed. Gallagher instituted these new rules in the latter part of 2002.

²⁶ Gallagher is now Vice President of Regulatory Compliance.

Under the new controls, little changed with respect to the mini-dealers. As under the old regime, they receive cash at the beginning of the meet, and cash out at the very end. Currently, NYRA employs about 12 mini-dealers during the week, and 18 over the weekend. According to management, two mini-dealers are now “spot audited” daily.

As to the tellers, the rules now restrict the period that they have access to uncounted cash. At the beginning of each race day, the tellers draw whatever cash they need from the mini-dealers. At the end of the day, they split their drawer into two parts and deliver the contents two different places: (1) any currency that can be put into bundles of bills (for example a stack of 25 \$20 bills totals \$500) gets returned to the mini-dealers; and (2) any loose currency gets placed in a sealed plastic bag to be counted the following day in the money room by “account balancers.”

There is a big, and obvious, flaw in this system. Because mini-dealers are not counted out nightly, NYRA still has no daily count out. As if playing a shell game, NYRA management has merely shifted the uncounted money from the custody of one set of employees to another. At the end of each day, NYRA still does not know how much money it has.

NYRA’s new measures compare unfavorably to those used in New Jersey casinos. However, they also fall below measures used in normal retail establishments. Many such businesses count out -- in full -- each day’s receipts either that evening or the following day. For example, Wendy’s Old Fashioned Hamburgers counts out nightly, and Nordstrom’s department store counts out the following day.

Moreover, retail businesses employ a host of methods to prevent the types of misconduct present in this case. For example, cash register abuse -- like that seen here -- is a common form of retail theft. Consequently, managers in fast food restaurants are taught to recognize warning

signs, using methods that range from examining patterns of voided transactions to watching for scratch notes kept by register operators. Other places use different measures: Macy's department store, for example, forbids clerks from bringing even handbags or coats to their stations; they must put all personal items in the company locker room, and bring any necessary personal effects to their stations in a company-provided clear plastic bag. (Mere failure to use the clear bag is grounds for counseling; failure to properly store personal items in the company's locker room can result in immediate termination without prior notice.) And at Wendy's Old Fashioned Hamburgers, register operators are required throughout their shift to put excess cash into a drop box, which managers must empty and count hourly.

NYRA, therefore, not only falls short in comparison to a casino, but also in comparison to a department store or a fast food chain. Moreover, NYRA's new controls have been placed in the hands of two groups of employees about whom integrity issues have been raised in the past: the mini-dealers and newly appointed account balancers. As set forth above, there is evidence of mini-dealer collusion with tellers in the money laundering schemes; yet the new procedures entrust them with a huge portion of NYRA's money each night. As for the loose currency, the new procedures vest responsibility for counting their peers' work in seven account balancers. NYRA records disclose that six of those seven themselves ran significant shortages from 1995 to 1999, several over \$10,000 a year.

When shown documents reporting the repeated shorts of those now responsible for counting, Meyocks responded, "You need to speak with Jim Gallagher about these people. Every track has legitimate shorts. I don't get involved with this." When asked, Gallagher reported that he intentionally had not looked at tellers' shortage records because he did not want to "bias"

himself: “I didn’t want to look back, I wanted to go forward.” NYRA also states that collective bargaining rules mandate the arrangement.

Documents show that NYRA remains resistant to accepting responsibility for the conduct of its operations. As recently as February 2003, Meyocks corresponded with Racing and Wagering regarding the final draft of Racing and Wagering’s 2001 audit.²⁷ Meyocks blamed others for NYRA’s delay in implementing the flawed reforms described above. This time he blamed law enforcement, claiming: “NYRA was instructed by the law enforcement agencies to forestall the implementation of any new policies and procedures until the conclusion of the pending matters.” Letter from Terence J. Meyocks to Michael J. Hoblock (February 20, 2003) (emphasis added).

When Meyocks was challenged in May 2003 about the accuracy of this statement, NYRA’s outside counsel conceded in a meeting that NYRA did not receive an instruction to forestall tightening failed controls. Counsel said NYRA was instead asked not to interfere with the investigations by conducting parallel interviews.

A few days later, Meyocks sent a letter to Racing and Wagering to “clarify” his position. He now states that his letter was “not intended to be a direct quote.” Nor, he says, “was it intended to be directly attributable to any single representative of any governmental agency, either federal or state.” Rather, he claims, he was reporting his own understanding of the “combined directions” of law enforcement.

²⁷ The report appeared in final form as an information item on Racing and Wagering’s April 2003, meeting agenda.

Moreover, Meyocks insisted that law enforcement rendered him unable to make meaningful reform. He asserted that without being able to interview the subjects of the criminal investigation, “NYRA was not in a position to effectively devise and implement new policies and procedures” Given the long history of NYRA’s knowledge of the nature and extent of the problem, this claim is not credible. As set forth above, numerous reports (including: the 1995 Eisner draft report; NYRA’s own draft September 14, 1999 memorandum; and the 2001 Racing and Wagering audit) provided detailed guidance as to how to “effectively devise and implement new policies and procedures.” NYRA, of course, had ignored all these recommendations for years.

Further belying Meyocks’s recitation of his “understanding,” NYRA did implement a series of (still ineffectual) measures, and did so without seeking law enforcement’s prior permission.²⁸ Moreover, the Director of the Mutuel Department from 1996 to early 2003 reports that at no time did he receive any instruction to slow any reform. Meyocks’s most recent explanation, therefore, appears to be an after-the-fact rationalization for NYRA’s delay.

B. Teller Crimes against Customers

Not only did tellers use NYRA money to fund their own criminal schemes, they exploited a more general lack of oversight to cheat the betting public. According to the witnesses, tellers at betting windows use a variety of schemes to shortchange customers. The two most common are

²⁸ Moreover, NYRA protested on a variety of occasions about the investigation itself. For example, initially, NYRA told the OAG that it would provide documents voluntarily. When promised documents were repeatedly not produced, the OAG began using formal process. Upon receiving subpoenas, NYRA’s internal counsel told an OAG lawyer that until they knew where the investigation was going, NYRA would not comply. NYRA did not comply until new subpoenas were issued to named persons rather than to NYRA Departments (as previously requested by counsel) and penalties for non-compliance were pointed out to counsel.

“dropping the customer” and the “mystery voucher” scam. NYRA’s response to the problem has been similarly lacking.

1. Dropping the Customer

The lines at NYRA betting windows can be noisy and crowded affairs. An inexperienced customer can find himself in long lines sandwiched between impatient customers, who are eager to lay down their bets or pick up their winnings as quickly as possible and who have little compunction about complaining if they feel the line is moving too slowly. Inexperienced customers not only feel pressure to complete their transactions quickly, but can find it difficult to mentally calculate how much they owe or how much is due them on a complex or exotic wager. As a result, inexperienced customers are vulnerable to corrupt tellers who can and do steal from them by misrepresenting (either explicitly or implicitly) the amounts due on a wager or owed on a winning ticket.

There are three ways in which a customer might get independent information about how much is due on a complex or exotic wager. None of them, however, really protects customers from theft.

At the end of a race, the return on a winning two dollar bet appears on a large Tote Board located in the middle of the track and on television monitors located throughout track viewing areas. Since many inexperienced customers simply trust tellers not to cheat them, they do not look at the Tote Board or the television monitors. Even if they know the payout on a two dollar wager, for wagers greater than two dollars, they still have to calculate their winnings, which many find difficult to do.

The second way for an inexperienced customer to get accurate information is to use a SAM. SAMs automatically calculate winnings but will not process cash transactions. After a SAM reads a ticket, it will only return winnings in the form of a voucher or by adding the winnings to an existing voucher. Since most customers wager in cash, they rely on tellers to pay them their race winnings.

Finally, when a teller enters a bet or inserts a winning ticket into a TIM, the amount due or to be paid out is supposed to be displayed on an LCD screen in the back of the TIM, which faces most customers at waist level. So, if a customer looks down at the LCD screen, then the customer should have accurate information. However, tellers use simple methods, discussed below, to produce a false output on the LCD screen.

Our interviews disclosed that it is quite common for tellers at NYRA to steal from inexperienced customers who do not know what they owe on bets or what is due them in winnings. Years of experience working at betting windows enables tellers to identify inexperienced customers. Once inexperienced customers are identified, there are a number of methods that tellers use to steal from them. These methods are referred to by NYRA mutuel clerks as “dropping the customer.” Because inexperienced customers will often never know that they have been taken advantage of, these techniques rarely, if ever, give rise to a formal complaint.

- a. Failure to Clear and Error Messages.

One method that tellers use to steal is to use the TIM machine to generate faulty output on the LCD screen. This can be done in two ways, either by failing to clear a TIM or by generating an error message from a TIM.

When a customer makes multiple bets, a TIM will keep track of the running total of these bets and continuously display that total on the LCD screen. Indeed, it will display this total even as it prints out all the tickets the customer has requested, because there is always a chance that the customer will change his mind and make additional bets or cancel them.

A new transaction can be initiated with a TIM only once a teller clears the machine, which is done by pressing the “Total” button. Until the machine is cleared, the LCD screen continues to display the amount of the last transaction. By failing to clear a TIM, a teller can use the amount posted from the previous transaction to deceive the next customer.

For example, if a previous customer has won \$135, the LCD screen will show \$135. If the next customer hands the teller a winning ticket for \$200, the teller will simply give the customer the \$135 shown on the LCD screen. Once the customer has left, the corrupt teller inserts the winning ticket into a TIM and pockets the balance of the customer’s winnings (in this example \$65).

Another way that tellers generate false output is by inserting a winning ticket into a TIM multiple times. This generates an error message on the LCD screen. The teller then pays the inexperienced customer only a portion of what is owed. Once the customer leaves, the teller clears the TIM, properly inserts the winning ticket into the TIM, and pockets the difference between the true amount of winnings and what was paid to the inexperienced customer.

b. The Slow Hand

An alternative to using the LCD screen to deceive customers is a technique that tellers call the “slow hand.” Here, the corrupt teller provides the customers with their change or their winnings in an exceedingly slow fashion, hoping that the customers will become distracted and

walk away thinking they have received all their money. If a customer catches on and complains, the teller will simply state that he has not finished and pay the full amount due the customer.

c. Palming

Another method of stealing from customers is known as “palming.” Often customers make more than one bet on a race, and receive a number of tickets in return. When an inexperienced customer goes to a window to collect on a number of winning tickets, the corrupt teller will insert some, but not all, of the tickets into the TIM and give the customer the amount shown on the LCD screen. When the window is clear of customers, the teller will then insert the rest of the tickets and pocket the winnings.

d. NYRA’s Response

As discussed more fully above, during the state and federal investigations, NYRA hired a new Vice President for Mutuel Operations, James Gallagher. Upon being hired, Gallagher quickly learned the phrases described above, including “dropping the customer.” He said that the nomenclature was common from clerks “on up.” Gallagher volunteered that another common phrase at NYRA for the same swindle is “clipping” the customer. Indeed, these schemes and terminology are known throughout the industry. NYRA’s new Mutuel Department Director, who has worked in mutuel departments for nearly four decades, described them in a recent interview in detail.

NYRA’s former Mutuel Department Director, Vince Hogan, has said that he knew that there was a “serious problem” with teller integrity. Indeed, Hogan reported that he hired tellers from the ranks of horse players, and “they used to try to drop the clerks themselves” before they were hired, and described tellers as a “devious bunch.” Hogan stated that he believed that the

only way to staunch teller crime was hiring more Bay Supervisors, and that he had wanted a supervisor in each bay. He asked to hire more, but was told that it would cost too much.

Gallagher, on the other hand, reported that he has concluded that actual fraud is not a problem. He based this conclusion largely on the dearth of customer complaints, a curious metric for a scheme designed to never let the customer know he'd been victimized. As to new controls, Gallagher said that his main change has been to "energize" the Bay Supervisors. He also reported that NYRA had discussed putting up signs, but stated: "Customers need to do some mathematics."

2. The "Mystery Voucher" Scam

Another opportunity for teller fraud is created by a NYRA promotion called "Mystery Vouchers." Mystery vouchers are mass mailed to a list of preferred customers, and are worth from \$2 to \$1,000. A mystery voucher can be redeemed and its value revealed only at a specified racetrack on a particular date. This mystery voucher promotion is conducted approximately ten times a year.

The only way that a customer can redeem a mystery voucher for cash is to present it at a teller window. Interviews disclosed three methods by which corrupt tellers steal from customers redeeming mystery vouchers. First, tellers take advantage of the fact that all mystery vouchers are time stamped. These time stamps are placed on the mystery vouchers when they are printed. As a rule, all mystery vouchers of a particular denomination are printed at the same time, and are produced in batches by tellers. Thus, a teller can determine just by looking at the time stamped on the voucher what its value will be. In other words, because of the time stamp, the value of a mystery voucher is a mystery only to customers, not to tellers.

To take advantage of this information, tellers use their TIMs to print out a number of \$2 vouchers at the beginning of a mystery voucher day. When a teller spots a mystery voucher which, based on its time stamp, is likely to be worth more than \$2, the teller swaps it for one of the preprinted \$2 vouchers. Instead of inserting the mystery voucher into the TIM, the teller inserts the \$2 voucher. A \$2 amount will show up on the LCD screen, and the teller will pay \$2 to the unsuspecting customer. Once the betting window is clear of customers, the teller inserts the customer's mystery voucher into the TIM, and pockets the difference between the \$2 voucher and the value of the mystery voucher.

In the second method, the teller inserts the mystery voucher into the TIM the wrong way or upside down. This causes an "error message" to be shown on the LCD screen. The teller tells the customer that the TIM cannot read the mystery voucher and that to determine the value of the mystery voucher its serial number needs to be entered into the TIM. The teller then types the serial number of a preprinted \$2 voucher into the TIM. The unsuspecting customer is then paid \$2, and the teller pockets the difference in value between the two vouchers.

The third method takes advantage of the fact that TIMs allow tellers to cancel wagers. The teller takes the mystery voucher, but does not insert it into the TIM. Instead, the teller enters a \$2 wager into the TIM, which causes \$2 to be displayed on the LCD screen. The teller then hands the customer \$2, and when the customer leaves, cancels out the \$2 wager. The teller is then free to insert the mystery voucher into the TIM and cash in on the fraud.

Numerous witnesses report that the mystery voucher scam has been occurring at NYRA for years and is well known to tellers in the Mutuel Department. It could be stopped easily by

basic reforms. NYRA management professes no knowledge of the problem, and has taken no steps to prevent it.

3. Unclaimed Ticket Theft

Customers have until March 31st of the year following the date of purchase to redeem a winning ticket. On April 1st of that year, winning tickets are no longer redeemable, and the winnings are paid over to New York State. NYRA routinely gives New York State more than \$1,000,000 in unclaimed ticket revenue.

Managers in the Mutuel Department (directors, assistant directors, managers and bay supervisors) can identify unclaimed tickets by using the Autotote system. At any time, a manager can request Autotote reports containing information about tickets that have been purchased at any NYRA racetrack. These reports require special computer runs which must be requested from Autotote.

The information in these reports includes the window where the ticket was sold, the type and amount of wager made, and whether the ticket has been cashed. Thus, a manager can easily identify tickets with large payoffs that have been unclaimed for months (and hence because of the passage of time are unlikely to be claimed).

It is possible as well for tellers to acquire winning ticket information from customers who have lost them. Customers often report a lost ticket to the teller who sold it to them. When they do, tellers can mislead them into believing that the ticket was found by someone else and already cashed. Using the information supplied by the customer, the teller can then enlist a manager to request a special Autotote report to obtain specific information about the wager.

All tickets are identified by a thirteen digit serial number. As a security precaution, the Autotote reports provide only the first twelve digits of the serial number. To get the thirteenth digit, all a manager needs to do is request it on the phone from Autotote. On an average day, Autotote personnel reply to between two and twelve requests for the thirteenth digit, but keep no record of who makes such requests. If Autotote personnel are too busy to handle the request, a manager can personally retrieve the thirteenth digit from computers located in the Autotote office at each racetrack.

With all thirteen serial numbers on the ticket, a manager can go to a teller and order the teller to manually input the serial number into a TIM and give the manager the winnings. Managers are not required to explain why they are cashing out the ticket or, for that matter, make any record concerning the identity of the customer for whom it was cashed. They can simply redeem the ticket and keep the cash. Since managers often pay out on lost tickets, the teller will not know whether this is a legitimate or an illegitimate transaction.

Tellers reported that the details of this scheme were well known within the Mutuel Department. Many tellers also reported that it was quite common for some managers to come to see them near the March 31st deadline for redeeming lost tickets, and to ask them to pay out on unclaimed tickets that were about to expire.

In September 2002, when NYRA managers were first interviewed about their procedures for cashing out lost tickets, there did not appear to have been any formal procedures in place for handling lost tickets. Since then, NYRA has centralized record keeping for lost ticket claims, and required that only the Director of the Mutuel Department or his assistant managers can authorize

a payout on a lost ticket. The Mutuel Department Director reports that, on a daily basis, he now scans reports of manually keyed payouts looking for suspect transactions.

C. Parking Theft

NYRA's lax business practices are echoed in its parking operation. Over the years, NYRA has derived millions of dollars in parking revenues. Here, too, NYRA employees have capitalized on lax controls to embezzle money. In response, NYRA decided to eliminate general parking fees at the track at which the embezzlement was discovered. It did not examine its procedures at the other two tracks, leaving similar corruption vulnerabilities unaltered. Nor did it discipline the supervisors on whose watch the embezzlement had taken place.

At Aqueduct, Belmont and Saratoga, there are more than 30,000 parking spaces for customers, which produce average annual revenues in excess of one million dollars. Parking supervisors travel from track to track.

As its primary control for general parking, NYRA uses a device called a treadle, a magnetic counting machine that registers the number of cars that drive over it.²⁹ In 2000 and 2001, a private investigation firm looked at paid parking at Saratoga. It found that when investigators were counting cars in full view of the parking attendants, the receipts closely matched the number of cars entering. When, however, investigators counted cars from a hidden location, receipts for nearly 100 cars for a single lot on a single day were missing. Parking operators easily defeated the treadle; they collected the parking fee, instructed the driver to drive around the treadle, and pocketed the money.

²⁹ In its preferred parking areas, NYRA instead uses tickets as a control. This system is easily defeated; an attendant takes the money, directs a customer inside the lot, does not issue a ticket, and pockets the money.

Upon receiving the investigator's report, NYRA responded by eliminating general parking fees at the Saratoga track and hiring a private security firm to supervise parking in its preferred and valet parking areas. It made no meaningful adjustments at Belmont or Aqueduct, which use the same treadle system. And it left in place -- without either discipline or retraining -- the supervisors under whose nose this scheme had been perpetrated.

Treadles aside, it remains a simple matter for attendants to overcharge customers. Signs that post rates, except at the main gates, are mobile; corrupt parking attendants can turn them away from customers' eyes. During our investigation, an undercover State Police investigator drove into Saratoga's preferred parking area in a BMW automobile. The parking attendant demanded \$20, insisting that the investigator was driving a "twenty-dollar car." The officer, who knew that the correct rate was \$6, refused to pay. Only after repeatedly insisting that \$20 was the price for parking did the attendant back down and accept the correct price.

Management has stated that it has now corrected the Saratoga problem. They do not believe that a similar problem exists at either Belmont or Aqueduct, but have done no examination of either. To this day, NYRA allows its parking attendants to keep any excess money they collect during the day.

D. Evasion of Federal Reporting Requirements

In the spheres of tax collection and money laundering, the law imposes obligations on private entities in order to deter and detect crime by the public. NYRA's lack of attention to these obligations has turned the corporation into a vehicle of criminal opportunity by dishonest outsiders.

1. Ten Percenting

To help ensure that gamblers pay income tax on their winnings, federal law imposes reporting and tax withholding obligations on racetracks for winning wagers where the odds on the wager are 300 to 1 or greater. For winnings between \$600 and \$5,000, the racetrack must file a Form W2-G with the Internal Revenue Service (“IRS”). This form contains the name, address, and the social security number of the winner, and the amount won. For winnings over \$5,000, the racetrack must not only file a Form W2-G, but must also withhold 27% percent of the winnings.

To avoid declaring income, some gamblers falsify their identity when they fill out W2-G forms. At NYRA, they have done so both through teller complicity and through lax controls. As to teller complicity, one NYRA teller reported that tellers assisting gamblers in eluding income taxes has been a well-known and fruitful scheme as far back as the 1960s, when he first began working as a teller. Tellers call this scheme “Ten Percenting,” because they normally charge 10% of the total winnings as the fee for assisting in the forgery.³⁰

One way of assisting in the forgery involves identity theft, where an innocent taxpayer’s name and pedigree information is put on the Form W2-G. There have been a number of instances where the IRS has actually contacted innocent taxpayers, who were not at the track on the day the ticket was cashed, demanding payment for the unreported taxes.

³⁰ NYRA has special IRS Windows at its racetracks to make sure it fulfills its federal reporting and withholding responsibilities. On busy race days, extra IRS Windows are added to accommodate the additional demand. Only tellers assigned to IRS Windows are permitted to cash tickets where the winnings are greater than \$600 on odds of greater than 300 to 1. Before a customer can cash one of these tickets, the customer must present two forms of valid identification, one of which must have a picture and one must have a social security number. Usually, the teller fills out the Form W2-G and then the customer must sign it.

Recently, a Saratoga County grand jury indicted two NYRA tellers for allegedly forging W2-G forms, using the names and social security numbers of five innocent taxpayers.

In addition to teller complicity, tax evasion by winners was also facilitated by poor controls. At NYRA, there are heavy gamblers who will always have gambling losses that can be set off against gambling winnings on their income tax returns. For a price, these individuals will cash tickets at IRS Windows in their own name for customers who want to evade taxes. These individuals should be easy for NYRA investigators to spot because they loiter around IRS Windows to pick up customers and because, given the odds of winning a 300 to 1 wager, they cash winning tickets at IRS Windows much too frequently. When a customer is seen continually cashing tickets with the same IRS Window teller, investigative questions should arise as to the role of the teller as well.

NYRA has ignored the role of its own procedures and employees in this wrongdoing. For example, NYRA investigators reported, when interviewed in the presence of NYRA's counsel, that when ten percenting occurred, they investigated the customer only, not the teller, and that the former Director of the Mutuel Department made the decision not to pursue tellers who were ten percenting.

NYRA's see-no-evil approach is exemplified by its conduct with respect to a repeat offender from 1996 to 2001. In 1996, NYRA investigators interviewed a man who was observed redeeming tickets at various IRS Windows and then handing the cash to other customers waiting nearby. The man admitted that he was cashing tickets for other customers as a "courtesy," and a computer check revealed that he had cashed more than \$9,000 worth of IRS tickets that month.

NYRA's only action was to forbid him from cashing further IRS tickets. It did not eject him from the track. Nor did it notify law enforcement.

The following year, 1997, NYRA investigators observed the same man cashing a ticket for a different customer at an IRS Window. This time he admitted that he was helping customers evade taxes, and a computer check revealed that he had cashed more than \$11,000 worth of IRS tickets in the previous two months. NYRA ejected the man from the racetrack. It did not notify law enforcement or do further investigation.

In 2001, on three occasions, NYRA investigators observed tellers summon this same man to their IRS Windows. On each occasion, the man was observed handing identification to the teller. Shortly afterwards, the tellers handed cash to another customer while the man stood by. On the third occasion, an investigator questioned the customer who received the cash. The customer admitted that the man had agreed to cash his ticket for fifty dollars. When interviewed, the man admitted (as he had twice in the past) using his identification to cash tickets for other customers. More importantly, he named NYRA tellers who steered customers to him. This time, the computer check revealed that he had cashed more than \$20,000 worth of IRS tickets in the previous two months. NYRA again ejected the man. It did not notify law enforcement. It did not discipline any of the tellers he identified as confederates, or, indeed, even interview them.

During part of this period, NYRA had security cameras installed at some of the IRS windows.³¹ Currently, this system consists of two cameras, one aimed at the customer, who is directed to face the camera, and one aimed at a counter where the teller places the Form W2-G

³¹ The IRS originally asked NYRA to install this camera system in 1998. NYRA did not install a system at Saratoga until 2001.

and the two forms of identification. These images are transmitted to the Mutuel Department where a secretary examines them. According to NYRA policy, before the teller can cash the ticket, the secretary is required to confirm that the identification is not fraudulent, the picture on the identification matches the customer, and the Form W2-G is filled out accurately. The secretary does all this on top of all of her other work.

NYRA has improved its procedures only to the extent that it does some after-the-fact review of duplicate social security numbers, although still not using the universe of readily available data. And it now sends the pictures to the security office as well as to the secretary, although the Security Department's documented shortcomings must be corrected if this change is to have effect.³²

Moreover, actual execution still needs improvement. Under the new system, a customer tried to use a phony identification at one window, and was correctly rejected. He took the questionable ID to repeated bays, and, each time, the secretary recognized him and rejected the transaction. However, at none of the windows was the phony ID confiscated, or even photographed. Nor was the offender. He was not questioned, and was allowed to leave the track unidentified.

2. Failures to file Money Laundering Reports

A trade or business must file a Form 8300 with the Internal Revenue Service if, in the course of its trade or business, it receives more than \$10,000 in cash in one transaction or two or more related transactions within a twelve month period. Failure to file a Form 8300 is a misdemeanor punishable by a fine of up to \$25,000 and up to one year in prison. Willful

³² See pages 56-61, below.

violations are punishable by a fine of up to \$250,000 (\$500,000 for corporations) or up to five years in prison, or both. See 26 U.S.C. 7203.

For years, it was NYRA's policy not to produce Form 8300s for cash transactions in excess of \$10,000 at betting windows. When asked why, counsel replied that NYRA had obtained a written opinion from a lawyer that Form 8300s need not be filed. NYRA has, thus far, been unable to produce the opinion. No current NYRA lawyers report that they have read, or even seen, it. NYRA's current counsel stated initially that it has never examined the issue.

After NYRA was queried by this office, current counsel orally reported that it concluded, on a preliminary basis, that NYRA is, indeed, required to file the forms. More recently, although counsel has not finalized any formal opinion, counsel reports that NYRA has begun filing 8300s because it is the "prudent" thing to do.

E. Expense Account Abuse

As shown by the many examples above, NYRA's management has failed to be proactive in its stewardship of NYRA's money. This approach extended also to expenses for which they are directly and personally responsible, as demonstrated by a review of Meyocks's expense account monies. For a four-year period, Terence Meyocks -- President and COO of NYRA and the corporate officer ultimately responsible for all NYRA's operations -- cannot produce receipts for many of his expenses, and has spent NYRA money entertaining in ways that appear injudicious.

Terry Meyocks earns an annual salary of \$375,000. On top of this, from 1999 to 2002, he additionally charged over \$140,000 on his corporate American Express card.³³ Although back-up

³³ During the same period, Meyocks received above \$10,000 in cash for additional claimed expenses, most designated as "tips, etc."

for these expenses has been subpoenaed on three separate occasions, Meyocks has still failed to produce back-up for over \$13,800 in dining alone.

Meyocks blamed his secretary for the absence of the documentation. He insisted that “No one is more meticulous on turning it in than I am,” and stated that he had instructed his secretary “to protect my back.” He also said that his secretary used his corporate credit card for other people’s travel expenses, including Kenneth Noe’s.

Some of the documentation that Meyocks did produce appears misleading. For example, on a trip to Florida, Meyocks submitted receipts for dinner with a person identified only as Paul Blair. Nowhere do the receipts identify who Blair is or why Meyocks was buying him dinner. When asked, Meyocks said that Blair was, in fact, Meyocks’s father. Meyocks stated that it was appropriate to use money to buy his father, a retired jockey agent, dinner because his father was helping to promote NYRA business. Meyocks also reported that he frequently took his spouse to dinner when he entertained in New York. He said that she, too, helped promote NYRA.

In 1993, NYRA’s Director of Internal Audit prepared and transmitted to the then-president a set of guidelines for Entertainment expenses. Those guidelines provided: “Restaurants selected are to be reasonably priced, not luxurious.” The fate of those guidelines is unclear, but in 1998, an audit by then-New York State Comptroller Carl McCall criticized NYRA for having no written travel and expense policies at all.³⁴ After the Comptroller’s report, NYRA adopted guidelines, which appear to be based largely on the 1993 version.

³⁴ The Comptroller noted that NYRA regularly paid for spousal expenses. The Comptroller’s office canvassed three out-of-state racetracks for comparison, finding that two of the three “do not pay for the meals of employee spouses or guests under any circumstances.”

NYRA's new guidelines, however, dropped the earlier draft's prohibition on "luxurious" restaurants. And, indeed, some of Meyocks's meal expenses bear earmarks of immoderation. There are expensive meals at opulent restaurants and a dinner where more was spent on alcohol than food. For example in 2002, one meal for six people at Le Cirque 2000 restaurant in midtown Manhattan cost NYRA over \$1,000. No non-NYRA personnel attended: present were Meyocks and his spouse, a trustee and his spouse, and a retiring employee and his spouse.³⁵

Meyocks did not reserve NYRA's largess for himself. For example, he also reported that if he saw others in the racing industry out to dinner at a separate table, he sometimes simply picked up their check. According to Meyocks, this was "to create good will, promote NYRA."

As to his own expenses, Meyocks justified them on the grounds that "Social life and racing life are two sides of the same coin. I am 24/7 on racing." Meyocks added that his conduct was not aberrational at NYRA; he reported that his predecessor, Kenneth Noe, ate out more than he did. Meyocks further stated that his expenses were justified because they were approved by Noe and Schwartz. "They haven't told me to stop," said Meyocks. According to Meyocks, "No one has ever abused our T&E [travel and entertainment] policy."

NYRA's Director of Internal Audit states that he reviewed the Comptroller's 1998 audit. He reports, however, that he has not conducted a review of expenses since then because, "I have not gotten to it yet."

³⁵ Over \$300 of that meal was for alcohol, including a \$250 bottle of Italian wine. On another occasions, Meyocks submitted a dinner bill where the alcohol expense was bigger than that for the food. In one dinner for ten at Sperry's in Saratoga Springs (there was no documentation showing who dined, and Meyocks could not remember), liquor constituted \$287 dollars, and food only \$262. The tab included two \$100 bottles of wine.

F. The Failure of NYRA's Internal Audit and Security Departments

Two internal checks on any organization should be the internal audit and security departments. Both have failed at NYRA. The Internal Audit Department has countenanced poor controls for over a decade, and the Security Department has engaged in conduct which may rise to the level of criminality.

1. A Toothless Auditor

NYRA's Internal Audit Department has a staff of four people, only three of whom work full-time. This small staff has extensive responsibilities. Internal Audit is responsible for auditing all of NYRA's departments and capital projects, for auditing outside vendors, and for assisting external auditors with the year-end audit. Of the three functions, internal audit spends the bulk of its time on outside vendors. Consequently, many departments at NYRA have not been audited for years.

In the relatively few audits of NYRA departments that Internal Audit has undertaken, it has displayed little proficiency. The crime, the lax controls, the lack of segregated duties, the extravagant and undocumented entertainment expenses all took place without sufficient response from internal audit.

2. A Mismanaged Security Department

The Security Department is likewise inadequate. Its primary responsibility is preventing crimes at NYRA racetracks. Within the Security Department, uniform security personnel at NYRA racetracks are responsible for crowd control, manning security checkpoints and patrolling racetrack grounds to detect and deter quality-of-life crimes such as smoking, drug use, and disorderly conduct. These security personnel are supplied to NYRA by the Wackenhut

Corporation. Depending on the racing meet, the number of uniformed security personnel at NYRA racetracks varies from 42 to 275.

In the Security Department, serious crimes are handled by investigators. These investigators are responsible for investigating race fixing, horse tampering, and crimes committed by employees, including theft, illegal gambling, loan sharking and money laundering. These investigators have peace officer status,³⁶ and as peace officers have the legal authority to make arrests, use physical and deadly force, and carry out warrantless searches.³⁷

At present, NYRA has six investigators, one of whom works part-time. Only one of these investigators has ever worked for a police department.³⁸ One worked as a jockey agent, another in a dry cleaning store, and the remainder were Wackenhut patrolmen. Except for the former police officer, these investigators have never received training in general criminal investigation, or specialized training in how to investigate employee thefts, loan sharking, gambling or money laundering. Even after the arrests and convictions of tellers on money laundering charges, the investigators were unable to explain what money laundering was or how the tellers committed this crime at NYRA.

The Department fails to follow even basic procedures. Security Department records indicate that from 1996 through 2001, NYRA gave 782 ejection notices to customers for marijuana possession. With the exception of one case, however, there are no written documents

³⁶ See New York Racing, Pari-Mutuel Wagering and Breeding Law § 215.

³⁷ See New York Criminal Procedure Law § 2.20 (1).

³⁸ Until 1996, NYRA had more than 15 investigators, who were almost all retired New York City Police Department Detectives. That year, NYRA fired all of these investigators and replaced them with individuals who had been working at NYRA as Wackenhut patrolmen.

indicating that investigators seized any marijuana or destroyed it. When interviewed, NYRA investigators claimed that there was no policy concerning the seizure and destruction of drugs, and were unable to remember specifically what they did with the drugs. The integrity risks inherent in disappearing drugs are self-apparent.

As peace officers, NYRA's patrolmen and investigators carry guns. Yet, the department has no written policy as to when a gun may be discharged. Nor does it have a policy on the use of deadly physical force; when interviewed, John Tierney, Director of Security, was unable to state the correct legal standard.

At least one investigator took a creative view of legal process during this investigation. In the Fall of 2002, NYRA was subpoenaed to produce all investigative reports prepared by its investigators between 1995 and 2001. During an interview a NYRA investigator admitted that he had changed some reports before producing them. He contended that he had simply "updated" them to be helpful.

The Security Department also fails at basic quality-of-life enforcement. For example, at Saratoga racetrack, an undercover police officer was solicited by a prostitute while he was trying to launder money with mutual tellers. And, at all three tracks, investigators discovered areas that reeked of marijuana. On a number of occasions, undercover police officers saw uniformed Wackenhut Security guards making wagers at betting windows and patrolling with betting slips protruding from their pockets.

Racing and Wagering rules require NYRA to eject from its racetracks any person who is "known or reputed to be a bookmaker" or whose conduct has been "detrimental to the best interests of racing," and "all such persons shall upon discovery or recognition be forthwith

ejected.” See 9 NYCRR § 4003.46. Nonetheless, the investigative team observed that known organized crime figures, many of whom are reputed bookmakers, were consistently present at NYRA racetracks.

Although members of the Security Department claim to patrol for the presence of organized crime figures, only a single investigator could provide the name of even one organized crime figure, and that person had been in jail for two years.

The investigation also documented a disturbing pattern of complaint referrals from the Mutuel Department to the Security Department. Even though a large portion of permanent tellers in the Mutuel Department were running shortages between 1995 and 2001, the overwhelming majority of shortage complaints referred by the Mutuel Department during this period involved temporary mutuel clerks hired for the Saratoga meet and for major races such as the Belmont Stakes. In fact, one NYRA investigator stated that only temporary tellers, not permanent ones, are investigated for shortages and that the Mutuel Department sets this policy. Many of these referrals involved retired professionals, teachers, and college students.

The investigative team interviewed fifteen temporary mutuel clerks who, between 2000 and 2002, were referred to the Security Department because of shortages and who were accused of theft. In only one of these cases did the investigators conduct any investigation to determine the temporary employee’s guilt or innocence. In each of the remaining cases, the investigators presumed guilt based simply on the existence of a shortage. Despite the temporary employees’ claims of innocence, the investigators used their peace officer status to threaten these employees with arrest and incarceration in order to coerce them into immediately paying the shortage out of their own pocket.

In one case, they lied to a temporary employee by falsely telling her that the police were on their way to her house, where she lived with her elderly parents, and that the only way to call off the police was to pay the shortage. In another case, armed investigators refused to let a temporary employee leave their office for five hours until her mother came and paid for the shortage. And in the one case where NYRA's investigative reports reveal a thorough investigation, they concluded that another employee had the motive, opportunity, and fit the description of the individual who committed the theft which resulted in the shortage. Yet they still coerced payment, with threats of arrest and jail, from the temporary employee.

Often, investigators would escort a temporary employee to an ATM, a bank, or their home to get money to pay for the shortage. After the payment was made, the employee was fired. In none of these cases are there any documents evidencing the actual return of monies paid by these employees to the Mutuel Department. Indeed, it is notable that in the majority of instances where we have discovered temporary tellers who report that they were threatened by Security Department investigators, no corresponding Security Department reports have been produced.

Director of Security, John Tierney, acknowledged the lack of training for NYRA investigative employees, including the lack of training on drug vouchering and firearm discharges. As to the drugs, Tierney contradicted his investigators, contending that drugs were "flushed down the toilet" in the presence of the "customer." As to the altered reports, he said he was "not familiar" with any alterations.

As to the coercion of temporary tellers, Tierney first denied any knowledge of it, and condemned the practice. Later, however, he conceded that investigators "may have given" rides

to people who wanted to repay missing money to the bank and did not have their own transportation. Temporary tellers reported that they were told to ride with investigators even though they had their own cars at the racetrack. They were driven back to the racetrack to get their cars.

CONCLUSION

It is clear from these facts that crime was part of the culture at NYRA. There are many reasons for this, but foremost is the lack of accountability inherent in NYRA's governance structure. There is little transparency and a habitual resistance to oversight. It is an insular, opaque, and unaccountable organization.

In light of this situation, the Attorney General makes three recommendations:

First, The facts laid out in this report make clear that current management has failed, and cannot be relied upon to restore public trust. The Attorney General, therefore, urges NYRA's Board of Trustees to appoint a new President and Chief Operating Officer. The board should select a person who has impeccable credentials and unquestioned integrity. This individual should be vested by the Board with the authority to make sweeping personnel changes and design a new, more accountable NYRA. This person should have experience beyond the tight-knit world of horse racing and be committed to implementing best practices in financial management, auditing and security.

Second, the Attorney General urges NYRA's Board of Trustees to examine how the conduct revealed in this report was permitted to go unchecked for the better part of a decade. Ensuring responsible corporate governance is the primary task of any board. The board must

consider how its own conduct, structure and procedures contributed to this failure of oversight.

The board should take any and all appropriate steps to address the situation.

Third, the legislature and the Governor should consider altogether eliminating NYRA's governance of these three important racetracks. Whether New York State empowers a fundamentally different not-for-profit corporation with a new governance structure and better financial and public disclosure requirements, or runs the tracks along the lines of a more traditional state agency, or follows New Jersey's casino example, or constructs a wholly new model, one thing is clear: The current structure has not, does not, and will not work.