MASSACHUSETTS LAWYERS WEEKLY

Cell-tower partners found liable for fiduciary breach

Limited partner of close corporation awarded damages

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April 10, 2015

In a decision that may cost them millions, two Marblehead businessmen have been found to have breached their fiduciary duty to a former partner and the cell-tower company they started together, while also willfully violating G.L.c. 93A in their dealings with a construction firm.

In November 2001, after being laid off by American Tower, plaintiff John W. Strachan enlisted colleague Matthew Sanford to help him build a small, independent tower-development business.

Strachan and Sanford had two major challenges.

“They had little experience operating a business, and did not have substantial financial resources or access to capital,” U.S. District Court Judge F. Dennis Saylor IV wrote in his 205-page ruling in Butler, et al. v. Moore, et al. (Lawyers Weekly No. 02-144-15).

Enter Edward T. “Ted” Moore and, eventually, Lawrence Rosenfeld. Moore, a real estate developer with a J.D. and MBA from Harvard, knew a bit about cell towers already, as he owned one in Marblehead. Rosenfeld brought additional business acumen — as well as financial resources —to the venture.

Eventually, “Eastern Towers” was launched with all four as equal partners. While Moore and Rosenfeld provided the initial capital, Strachan and Sanford agreed to work for free for six months and contribute the rights they had acquired to build a new tower in Beverly.

The first sign of trouble came in early March 2002. Unbeknownst to Strachan and Sanford, Moore and Rosenfeld had consulted an attorney to create a new entity, Eastern Towers LLC.

A clause in the LLC’s operating agreement, §5.2, allowed Moore and Rosenfeld to “engage or have an interest in other business ventures which are similar to or competitive with the business of [Eastern Towers].” Under the section, Moore and

Rosenfeld would no longer have to present investment opportunities to Eastern Towers, even ones involving cell towers.

Also proposed was having Sanford and Strachan's interest in the LLC vest over time, while non-compete clauses were inserted in Sanford and Strachan's employment contracts.

Around the same time, Rosenfeld called Strachan, saying he and Moore deserved a 60-40 split of the business, as they were doing "more work than they had had originally planned."

Strachan said the request stunned him, but with business in the pipeline and families to care for, Strachan and Sanford agreed to the creation of the LLC, with their 40-percent share vesting over four years.

While the relationship between Eastern Towers LLC and Eastern Towers Inc. was unclear, the judge said this much was: Moore got it wrong on tax forms, which he had signed "as attorney for the corporation." Contrary to Moore's statements on the form, the existence of Eastern Towers LLC had not even been recognized, nor had the LLC acquired 1,000 shares of Eastern Towers Inc. stock.

"Moore's representation to the IRS on Form 2553 concerning the ownership of shares of Eastern Towers, Inc., was false," Saylor wrote.

Cash infusion needed

By October 2002, Sanford and Strachan were no longer working for free, and opportunities were proving harder to come by than anticipated. Moore and Rosenfeld's initial $520,000 was running out, and Eastern Towers needed cash.

To help obtain financing, Moore proposed creating a new company, owned solely by him and Rosenfeld, to buy towers built by Eastern Towers. Eastern Towers would retain the right to repurchase the towers at a cost determined by a formula.

At the June 2, 2003, closing, Strachan and Sanford received a couple of shocks. First, they discovered checks issued from Eastern Towers Inc. to entities owed or controlled by Moore and Rosenfeld, purporting to repay the pair's initial $520,000 investment, an apparent violation of the LLC's operating agreement. The withdrawal, Strachan told Rosenfeld, was "going to virtually kill our company." Nonetheless, Strachan and Sanford eventually "reluctantly agreed" to allow the closing to continue.

Then, Strachan and Sanford unwittingly signed documents cloaked in legalese, resulting in their removal as managers of Eastern Towers LLC and authorizing Rosenfeld and Moore's company, Glover Property Management Inc., to purchase the

towers on behalf of Eastern Properties. Their positions were restored the next day, but the damage had been done.

In essence, the tower purchase agreement bound Eastern Towers to sell to Eastern Properties any towers it had acquired at what Saylor concluded was “less than half their fair market value,” while provisions that might appear to be favorable to Eastern Towers — including rights to repurchase towers and receive commissions — were “essentially worthless,” given their onerous terms.

Eastern Towers then rapidly descended into insolvency. Saylor adopted the opinion of the plaintiffs’ expert, who testified that Eastern Towers Inc. and Eastern Towers LLC were worthless as of June 2, 2003, the date of the closing.

As a practical matter, Eastern Towers ran out of funds on Sept. 9, 2003.

You’re fired

The chain of events that forced Strachan out of the company he helped found began with a letter seeking to terminate a ground lease in Wayland. The lease was eventually salvaged, but what mattered more to Moore and Rosenfeld was that Strachan neglected to tell them about the letter, which they deemed a firing offense.

But Saylor wrote that the “principal reason that Moore and Rosenfeld terminated Strachan was to freeze him out of the business, in order to remove a troublesome minority shareholder and permit them to assert greater control over the affairs of the business and reap a greater share of the rewards.”

Under threat of suit from Strachan, Moore and Rosenfeld then created a new entity, eventually renamed “Horizon Towers,” to “permit Moore and Rosenfeld to continue in the cell-tower business without the participation of Strachan or Sanford.”

With Moore signing documents on behalf of both companies, Eastern Towers LLC on July 23, 2004, sold the work-in-process for seven “hard-to-zone” Massachusetts sites to Horizon Towers for $50,000, including a prized one in the wealthy suburb of Wayland. Neither Strachan nor Sanford was consulted prior to the transaction. Sanford ultimately approved it but “under circumstances that were coercive and unfair,” according to Saylor.

In October 2004, Moore and Rosenfeld caused TD Banknorth’s $1 million construction line to be transferred to Horizon Towers. The bank had been led to believe that Eastern Towers had “ceased daily operations” by “Moore or Rosenfeld or someone acting under their direction,” Saylor noted.

The judge also found that, in December 2004, Moore and Rosenfeld formed yet another entity, the 5G Investment Trust, to insulate their holdings if Strachan sued them. The new entity was also added as a co-borrower on Eastern Properties' loans, which would aid subsequent acquisitions.

By 2008, Moore and Rosenfeld's entities had acquired 33 towers: Eastern Properties held 17, including nine transferred from Eastern Towers; 5G Investment Trust held 13; and 5G Investment Trust LLC, Horizon Towers and Tower Acquisition Trust held one each.

Meanwhile, Timberline Construction Corp. had been building nine towers on Eastern Towers' behalf. After the June 2003 closing that devastated Eastern Towers' finances, payments to Timberline slowed. By the spring of 2004, the company was owed approximately $100,000.

Moore and Rosenfeld assured Timberline's president, Steven Kelly, that the company would be paid, inducing it to keep working.

"Moore and Rosenfeld knew those promises were false, as they did not intend to make sufficient funds available to pay all of Timberline's invoices," Saylor wrote.

Settlement talks failed.

No 'freeze-outs'

After establishing that the court had jurisdiction, Saylor discussed the nature of fiduciary duties in a closely held corporation, noting that majority shareholders like Moore and Rosenfeld owe a "more rigorous duty," which includes not "taking actions that oppress or disadvantage minority stockholders, often called 'freeze-outs.'"

"No court in Massachusetts appears to have clearly and explicitly held that the members of a closely held LLC owe one another fiduciary duties analogous to the duties imposed on the shareholders of a closely held corporation," Saylor said.

But doing so made sense here, he concluded.

"As a matter of logic and fairness, there is no reason why the fiduciary duties of members of a closely held LLC should be materially different from those of shareholders of a closely held corporation," Saylor wrote.

To self-deal, Moore and Rosenfeld would have had to disclose to their partners "material details" of their ventures and then "either receive the assent of disinterested directors or shareholders, or otherwise prove that the decision was fair to the corporation." In almost all cases, Moore and Rosenfeld could not meet that burden, Saylor found.

Saylor concluded that Moore and Rosenfeld had been on solid ground through the creation of the LLC and the institution of the 60-40 split, but their subsequent actions were far more problematic.

Clause doesn't save pair

While "Massachusetts law generally permits members of an LLC to modify the fiduciary duty of loyalty by contract," Saylor rejected Moore and Rosenfeld's contention that §5.2 of the LLC operating agreement sanctioned their self-dealing.

"Moore and Rosenfeld contend that §5.2 contains a broad waiver of the duty of loyalty, and that among other things it permitted them to divert business opportunities away from Eastern Towers and exploit those opportunities for their own personal benefit," Saylor wrote. "The clear language of §5.2 does not, however, support such a broad interpretation."

As a result, Saylor found that Moore and Rosenfeld had breached that duty not just with respect to towers that Eastern Towers had identified, but with 18 additional towers that they should have presented to Eastern Towers as business opportunities.

Saylor also found that Moore and Rosenfeld breached their fiduciary duty to Strachan personally.

"It is particularly ironic that Moore and Rosenfeld claimed [after firing him] that they were unwilling to work with a person who they felt had been dishonest with them," the judge wrote. "As detailed at considerable length, Moore and Rosenfeld had engaged in an extensive pattern of deceit, concealment, and manipulation for most of the short existence of Eastern Towers."

In fashioning a remedy, the judge noted the challenge of creating an alternate universe "in which Strachan had not been terminated, and Moore and Rosenfeld had acted in good faith from the outset."

Ultimately, Saylor decided it was "more than probable" that Strachan would have worked at least four years, causing his full 20-percent stake in the LLC to vest. Strachan also holds a 25-percent stake in Eastern Towers Inc., the judge said.

As for Timberline's claim, Saylor noted that a "mere breach of contract, without more, is not sufficient to create liability under Chapter 93A. … However, a party who breaches a contract in a deliberate attempt to obtain a benefit to which it is not entitled may commit an unfair or deceptive act under Chapter 93A."

Specifically prohibited, Saylor noted, is "the use of the breach of contract as a lever or wedge to enhance one party's bargaining power or exact control over another party."

Moore and Rosenfeld contended that their actions were a “mere failure to pay” due to “financial distress,” but Saylor rejected that notion.

“The inability of Eastern Towers to pay the invoices of Timberline was a direct consequence of the actions of Moore and Rosenfeld,” he said.

Judgment rendered

Saylor granted the bankruptcy trustee’s requests for an equitable accounting from all defendants and the establishment of a constructive trust for the benefit of all plaintiffs.

Saylor declared that the ownership interests and rights of the various entities controlled by Moore and Rosenfeld in 32 towers and related facilities “were improperly acquired, by fraudulent conveyance or transfer, wrongful diversion or usurpation of corporate or business opportunities, or both.”

He ordered those assets to be made available to the bankruptcy trustee “to be liquidated and distributed or otherwise used to satisfy the creditors of debtor Eastern Towers, Inc.”

Moore and Rosenfeld now have 90 days to make a “full and complete accounting” to the bankruptcy trustee of all of the “assets and opportunities” related to the 32 towers.

Moore and Rosenfeld also have been ordered to pay $520,000 to the bankruptcy trustee for withdrawals from Eastern Towers Inc. and Eastern Towers LLC in violation of their fiduciary duties, while Strachan was awarded $141,346.13 in lost salary. Timberline is to recover double the $264,774.24 it is owed, or $529,548.48, due to the willful Chapter 93A violation, along with “reasonable attorneys’ fees and costs.”

While the accounting will determine the true value of the 32 towers, a reasonable estimate is that each may be worth around $1 million, perhaps more if there are several carriers paying rent for space on them. According to assessor’s records, Moore’s tower on Tioga Way in Marblehead is valued at $803,700, for example.

‘An important case’

Strachan’s attorney, Michael F. Connolly of Boston’s Mintz, Levin, called the case important given the “long history of the heightened duty of good faith and loyalty for individuals who come together in closely held business enterprises.”

He declined further comment on the ruling while the case is pending.

Michael T. Marcucci of Jones Day, attorney for defendants Moore and Rosenfeld, declined to be interviewed. Moore did not respond to an email seeking comment.

There is at least one lesson to be learned from the decision, according to Boston lawyer Michael P. Connolly, who has worked extensively with closely held businesses.

“It’s always important to know who you are getting into business with,” Connolly said. “A little more due diligence and [investigation] into their past dealings would have helped.”

He added that if Strachan or Sanford had engaged counsel of their own before entering into any agreements, “it would have helped alert them to possible pitfalls.”

By adding to a developing line of cases holding partners in closely held LLCs to the same type of fiduciary duties as those in closely held corporations, the Murtha Cullina attorney said, Saylor has provided valuable guidance as to the limits of what is generally the wide berth given to members of an LLC to craft any deal they are able to negotiate, so long as they are engaged in a lawful enterprise.

Lawyers Weekly No. 02-144-15