IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

VGS, INC.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	C.A. No. 17995
	)	
DAVID CASTIEL, VIRTUAL GEOSATELLITE HOLDINGS, INC., and ELLIPSO, INC.,	)	
	)	
Defendants,	)	
	)	
VIRTUAL GEOSATELLITE HOLDINGS, INC., and ELLIPSO, INC.,	)	
	)	
Counterclaim Plaintiffs,	)	
	)	
and	)	
	)	
VIRTUAL GEOSATELLITE, LLC,	)	
	)	
Counterclaim Plaintiff-Intervenor,	)	
	)	
v.	)	
	)	
VGS, INC., PETER D. SAHAGEN, THOMAS QUINN, NEEL HOWARD, and SAHAGEN SATELLITE TECHNOLOGY GROUP, LLC,	)	
	)	
Counterclaim Defendants.	)	

MEMORANDUM OPINION

Submitted: February 23, 2004
Decided: April 22, 2004

Thomas R. Hunt, Jr., Esquire, MORRIS, NICHOLS, ARSHT & TUNNELL, Wilmington, Delaware; William H. Jeffress, Jr., Esquire, Jamie Steven Kilberg, Esquire, BAKER BOTTS, L.L.P., Washington, D.C., *Attorneys for Defendant-Counterclaim Plaintiffs David Castiel, Virtual Geosatellite Holdings, Inc. and Ellipso, Inc., Counterclaim Plaintiff-Intervenor Virtual Geosatellite LLC and Reply Counterclaim Defendant Mobile Communications Holdings, Inc.*

Brian A. Sullivan, Esquire, WERB & SULLIVAN, Wilmington, Delaware; William A. Brewer, III, Esquire, Daniel F. Perez, Esquire, Thomas M. Corea, Esquire, BICKEL & BREWER, Dallas, Texas, *Attorneys for Counterclaim Defendants and Reply-Counterclaim Plaintiffs Peter D. Sahagen and Sahagen Satellite Technology Group LLC.*

Lamb, Vice Chancellor

I.

The history of this litigation is reflected in a series of earlier opinions of this court.[1] In 2000, after an expedited trial, the court rescinded a purported merger of a Delaware limited liability company into a Delaware corporation on grounds of fiduciary misconduct. The court later granted a motion for summary judgment as to nearly all of the remaining claims contained in the multifaceted pleadings in this case. On reargument of that motion, the court was persuaded that trial was appropriate to resolve a claim for fraudulent inducement that turned on the legal status, as of January 1999, of a governmental license that was crucial to the businesses involved. Trial on those issues was held over three days in December 2003.

At trial, the parties who prevailed on the motion for reargument entirely failed to meet their burden of proof. The nearly undisputed facts show that the governmental license was in full force and effect as of January 1999. After receipt and consideration of the parties' proposed findings of fact and conclusions of law,

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[1] *VGS, Inc. v. Castiel*, 2000 WL 1277372 (Del. Ch. Aug. 31, 2000) (decision, *inter alia*, rescinding the merger of VGS, Inc. and Virtual Geosatellite, LLC); *VGS, Inc. v. Castiel*, 2001 WL 1154430 (Del. Ch. Sept. 25, 2001) (granting in part the defendants' motion to recover attorneys' fees); *VGS, Inc. v. Castiel*, 2003 WL 723285 (Del. Ch. Feb. 28, 2003) (granting in part defendants-counterclaim plaintiffs' motion for summary judgment); *VGS, Inc. v. Castiel*, 2003 WL 1794210 (Del. Ch. Mar. 27, 2003) (partially withdrawing order of summary judgment and ordering trial on the issue of fraudulent inducement).

the court now decides that the defendants-counterclaim plaintiffs are entitled to judgment in their favor on the remaining claims.

II.

A. The Parties

The defendants-counterclaim plaintiffs are David Castiel and companies associated with him. Castiel is the founder, majority shareholder, and CEO of Ellipso, Inc., a Delaware corporation. He is also the controlling shareholder of Virtual Geosatellite Holdings, Inc. ("Holdings"), a Delaware corporation. Holdings is, in turn, a member of the Delaware limited liability company, Virtual Geosatellite, LLC ("Virtual Geo"). Ellipso also wholly owns Mobile Communications Holdings, Inc. ("MCHI"), another Delaware corporation that is joined in the action as a reply counterclaim defendant. Ellipso, Holdings, Virtual Geo and MCHI (collectively the "Castiel Companies") all operate primarily in Washington, D.C.

In the late 1990s, the Castiel Companies' plan of operation was to develop and operate a network of communications satellites. The companies held a series of patents for technology that would allow satellites to travel around the earth in elliptical orbits, rather than the geostationary orbits commonly used by other satellites. The technology would, it was believed, allow the Castiel Companies' satellites to cover a wider area than their competitors. This new satellite business

was to be split between narrowband and broadband systems. Ellipso was to hold the narrowband business, focusing on technologies requiring relatively small transmission streams, such as pagers. Virtual Geo was to hold the broadband business, focusing on systems requiring large data streams, such as video.

The plaintiffs-counterclaim defendants are Peter Sahagen and VGS, Inc., a corporation Sahagen controls. Sahagen is a sophisticated investor who, according to his testimony, previously turned around another broadband company from bankruptcy to a successful IPO. Sahagen wholly owns counterclaim defendant Sahagen Satellite Technology Group, LLC ("SST"), a Delaware LLC he created as a vehicle for his investment in the Castiel Companies.

B. The FCC License

Satellite communications systems serving United States customers require a license from the Federal Communications Commission ("FCC"). The FCC grants these licenses only to companies who have both the technical and financial capabilities to use them to serve the public, and who demonstrate the intent to do so. To that end, the FCC includes milestones in licenses to create a schedule for bringing a licensed system up and running. A company that misses a milestone loses its license unless the FCC grants it a variance.

On June 30, 1997, the FCC granted MCHI a license to construct a 16-satellite network (the "License"). As the License was one of only five outstanding

at the time, it was a very valuable asset. The License contained four milestones: (1) to begin construction on the first two satellites by July 1998, (2) to complete those satellites by July 2001, (3) to begin construction of the remaining 14 satellites by July 2000, and (4) to complete all construction by July 2003.

There are only a handful of companies in the world with the massive resources needed to launch a satellite network. Recognizing this, the FCC allows a licensee to satisfy milestones through a binding construction contract with a capable company. On April 22, 1998, MCHI and Boeing formed a memorandum of agreement for Boeing to construct the satellites and to allow Boeing to invest in MCHI. On June 17, 1998, MCHI and Boeing signed a Satellite Construction and System Definition Contract for Boeing to build the first two satellites ("Construction Contract"). This agreement satisfied the first milestone of the License.

C. The Construction Contract And The November Amendment

The Construction Contract called for MCHI to pay Boeing $2 million up front and to reimburse Boeing for the cost of constructing the first two satellites plus an additional 11%, up to $20 million. Boeing was to provide a firm price proposal for development of the entire network by December 1998.

By late fall of 1998, it was clear that Boeing would neither meet the deadline for the fixed proposal nor stay under the $20 million. The problem was that MCHI

wanted Boeing to take responsibility for ensuring that all parts of the network worked together, which meant warranting the work of other contractors. Boeing wanted to conduct a cost analysis to determine if it should assume the added responsibility. By November 1998, Boeing had spent $15.7 million on analyses to make its proposal, and estimated that it needed another $10 million to complete the job.

In November 1998, MCHI and Boeing amended the Construction Contract in three ways (the "November Amendment"). The first two changes were relatively simple: MCHI extended Boeing's proposal deadline to February 1999 and authorized it to spend an additional $6 million to complete the proposal.

The third change is the point of contention in this case. Boeing was considering the purchase of Ellipso, and by extension MCHI, so that it could reap continuing profits from operating the satellite system rather than just one-time construction profits. The record indicates that Boeing engineers were spending time considering how to improve the system rather than simply designing it as instructed. Already 30% over budget and behind the schedule designed to meet the FCC's strict milestones, MCHI negotiated an amendment to the Construction Contract to prohibit Boeing from doing any work other than designing the network as specifically authorized by MCHI.

D. Sahagen Invests

Sahagen first became interested in the Castiel Companies in the late summer of 1998, when one of his lawyers recommended them to him as a potential investment. Sahagen retained another lawyer to conduct a due diligence review of Ellipso before his purchase. Ellipso granted Sahagen's counsel due diligence access to its files, which included the Construction Contract and the November Amendment. In addition, Ellipso's corporate counsel testified that she specifically warned Sahagen's counsel that the project's success was contingent upon its ability to meet the FCC milestones and Ellipso's ability to raise approximately $1 billion in investment capital.

After due diligence and meeting with Castiel and various other officers several times, Sahagen offered to invest $10 million. Sahagen claims that he only wanted to invest in broadband technology, that is, in Virtual Geo, but that Castiel would allow him to invest only if he split the money between Virtual Geo and Ellipso. On January 29, 1999, Sahagen, through SST, signed a Stock Purchase Agreement to buy 20,000 shares of Ellipso for $4.2 million. He also bought 120 units of Virtual Geo, about 20% of the company, for $5 million.

Paragraph 2.07 of the Stock Purchase Agreement warrants that Ellipso knew of no problems with the License except those specifically noted in an attached disclosure statement. The 45-page disclosure statement does not mention the

November Amendment to the Construction Contract. All of the defense witnesses testified that the November Amendment was not disclosed because they did not think it adversely affected the License; rather, they thought that the amendment enhanced MCHI's ability to meet the milestones by guaranteeing continued construction and by prohibiting Boeing from billing MCHI for unwanted design changes.

E. Boeing's Takeover Offer And The Collapse Of The Project

From December 1998 to February 1999, Boeing began ordering long-lead items needed to build the satellites and continued its design work, spending another $18 million. By then, Boeing was seriously considering buying Ellipso and had engaged its own outside consultant to evaluate the possible transaction. MCHI and Boeing amended the Construction Contract a second time on February 26, 1999 (the "February Amendment") to grant Boeing another $2 million to continue work while the sales talks took place.

On May 7, 1999, Boeing offered a written proposal to purchase 73% of Ellipso for $750 million. Ellipso indicated that it was very interested in the deal but wanted to negotiate protections for its minority shareholders and employees. Unfortunately, while these negotiations were pending in late May 1999, Iridium, a subsidiary of Motorola Corp. and one of the five companies that held a satellite license similar MCHI's, announced that it was bankrupt. Its financial woes had

been well concealed, and its bankruptcy caused a considerable market shock. Shortly thereafter, a second satellite company and FCC satellite license holder, ICO, declared bankruptcy. These two bankruptcies practically destroyed the satellite investment market that led to an extremely disappointing launch of a third satellite company, Globalstar.

These adverse developments caused Boeing to withdraw its offer to purchase Ellipso on June 8, 1999. Unable to raise cash through investment, and thus unable to finance continued construction, MCHI and Boeing signed a third amendment to the Construction Contract on June 30, 1999 (the "June Amendment"). The June Amendment granted Boeing another $6 million to pay for all the work it had already completed. It also prohibited Boeing from doing any additional work not expressly authorized by MCHI. The two companies tried over the next few months to find a way to finance the system, but to no avail.

In September 2000, the FCC ordered MCHI to submit its satellite construction contracts for review. By then MCHI had stopped work on the project for more than a year. After review, the FCC revoked MCHI's License on May 31, 2001, finding that it failed to meet the second milestone of the License. The FCC found that the Boeing contract had been abrogated by June 30, 1999 and that MCHI thus did not have a contract to build the remaining 14 satellites. MCHI appealed the FCC decision, but lost.

F. Sahagen's Fraudulent Inducement Claim

Sahagen claims that the November Amendment effectively abrogated the Construction Contract because it limited Boeing to previously approved spending unless specifically authorized by MCHI. This, says Sahagen, changed the agreement from a binding contract to a mere "agreement to agree" and thus imperiled the License. The alleged fraud arises because the Stock Purchase Agreement warranted that Ellipso knew of no problems with the License except those in the disclosure statement, and the disclosure statement does not mention the November Amendment. Because Sahagen bought his stock on January 29, 1999, everything that occurred after that date is irrelevant to the question of fraudulent inducement.

III.

The parties agree that New York law applies. To establish a fraud claim under New York law, the plaintiff must prove by clear and convincing evidence that the defendant misrepresented material facts and intended to deceive the plaintiff, and that the plaintiff reasonably relied upon and was damaged by the misrepresentation.[2] For the following reasons, Sahagen has failed to meet this burden.

[2] *See McKinnon v. International Fid. Ins. Co.*, 704 N.Y.S. 2d 774 (1999).

A. Existence Of A Misrepresentation

Sahagen's sole support for the idea that the failure to include the November Amendment on the disclosure schedule amounted to a misrepresentation is a single line of the FCC opinion revoking MCHI's License. In discussing why it was revoking the License, the FCC examined the history of the Construction Contract, noting that the November Amendment "required Boeing to develop and submit a proposal for a re-negotiated construction contract . . . and forbade it from performing any other task without authorization from MCHI."[3] Sahagen claims that this phrase shows that the FCC believed that the November Amendment changed the Construction Contract into a mere "agreement to agree" and thus impaired the License.

This is a clear misreading of the FCC opinion. The FCC based its revocation decision on MCHI's failure to meet the second milestone, that is, to have a binding agreement for the construction of the 16-satallite system. The November Amendment could only have affected (and almost certainly did not affect) the first milestone, which is not the basis for the revocation. It was the June Amendment that ordered Boeing to stop constructing the network and led to the failure to meet the second milestone. The FCC acknowledged this when it said,

[3] Pl. Ex. 1 at ¶ 7.

"MCHI did not meet the milestone requirement to commence construction of all of its sixteen proposed satellites by the end of July 2000 [because i]ts contract with Boeing for construction of two satellites was essentially abrogated *on* June 30, 1999."[4] This impairment occurred six months after Sahagen's purchase, and cannot be the basis for this claim.

Looking beyond Sahagen's misreading of the FCC opinion, the facts overwhelmingly show that the November Amendment did not impair the License. The November Amendment authorized Boeing to spend an additional $6 million to finalize its design for the system, and Boeing actually spent $18 million over the next three months, evidently with MCHI's consent. There is no reason to suppose that MCHI expressly approved $6 million and tacitly authorized $18 million in spending on a license it believed to be materially impaired. Also strongly persuasive is Boeing's May 7, 1999 offer to purchase MCHI. It is impossible to believe that Boeing would have offered $750 million to purchase a company whose primary asset was an FCC license with which Boeing was intimately familiar if that license was materially impaired by a contract to which Boeing was a party.

The Castiel Companies' interpretation of the November Amendment as one intended to promote the successful completion of the project is far more

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[4] Joint Pretrial Order ¶ 24; Pl. Ex. 1 at ¶ 7 (emphasis added).

persuasive. It is entirely reasonable for a company to order its contractor to spend its money as directed and not on ancillary items, particularly if that contractor is two months behind a rigid schedule and 30% over budget. Such an order would not have materially impaired the License, but was meant to ensure that Boeing would finish the 16-satellite system design in time to meet the second milestone rather than dawdle on designs that would only become relevant if Boeing bought Ellipso. In the meantime, Boeing continued to order long-lead items needed to construct the first two satellites.

B. Intent

Sahagen's claim depends entirely upon interpreting Paragraph 2.07 of the Stock Purchase Agreement, which reads in relevant part:

> [MCHI] has been licensed by the U.S. Federal Communications Commission ("the FCC") to construct, launch and operate a mobile satellite service system. Except as set forth in the Disclosure Schedule, the Ellipso License is in full force and effect, MCHI is in compliance in all material respects with the Ellipso License and, to the knowledge of [Ellipso], no event has occurred with respect to the Ellipso License which permits, or after notice or lapse of time or both would permit, revocation or termination thereof or would result in any other material impairment of the rights of MCHI under the Ellipso License or would materially impair MCHI's ability to comply with the Ellipso License requirements.[5]

[5] Pl. Ex. 25 at ¶ 2.07.

Intent is an essential element both of a fraud claim and a breach of Paragraph 2.07, whose warranty begins with the phrase, "to the knowledge of [Ellipso]." Sahagen must prove by clear and convincing evidence that the defendants knew the November Amendment had materially impaired MCHI's License.

It is clear from the evidence that the Castiel Companies did not believe the November Amendment impaired the License. First, as the court has already found, there was no misrepresentation regarding the effect of the November Amendment and hence nothing about which to lie. Second, Ellipso's counsel provided Sahagen's counsel with access to the November Amendment during his due diligence visit and testified that she specifically warned him about the importance of the milestones.

In light of the positions taken on the motion to reargue the court's summary judgment opinion, it was not a little surprising to the court that Sahagen made no effort to rebut this testimony either by deposing his former attorney or calling him as a witness. This failure of proof leaves the Castiel Companies' version of events as the only credible explanation. Moreover, Sahagen testified on numerous occasions over the course of the litigation that he "doesn't really read documents" because he is more of a "business guy." Thus, there is no basis on which the court could conclude that Sahagen read the Stock Purchase Agreement or the disclosure

schedule himself or that he was personally deceived by its failure to disclose the November Amendment.[6]

Sahagen seeks to make up for his complete and fatal lack of evidence that the Castiel Companies intended to deceive him by asking the court to infer intent from the fact that some officers of the Castiel Companies were unfamiliar with the November Amendment. This is a leap of logic that the court is unwilling to take. It is neither remarkable nor a badge of fraud that not everyone working at the Castiel Companies was kept abreast of amendments to the Construction Contract. The record is clear that those amendments were disclosed to and authorized by the appropriate persons, including the boards of directors.

C. Reasonable Reliance

Even if Sahagen had proven a misrepresentation and intent, his reliance was unreasonable. Sahagen was represented by counsel who conducted due diligence. Sahagen's counsel had full access to Ellipso's files, including the November Amendment, and there is credible, unrebutted testimony that he was specifically warned about the importance of the milestones and the need to obtain funding to meet them. If the November Amendment was material to the Stock Purchase Agreement, nothing prevented Sahagen's counsel from drawing that conclusion.

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[6] Tr. 216-17 (testimony of P. Sahagen); Def. Ex. 82 at 912, 1007 (prior trial testimony of P. Sahagen from June 2000).

Having failed to prove three of the four elements of a fraud claim, Sahagen's damages are irrelevant.

IV.

Finally, this court has previously denied the Castiel Companies' motion for summary judgment on Count IX of Sahagen's complaint, which alleged a derivative claim by Sahagen on behalf of Ellipso against Castiel for breaches of fiduciary duty. Sahagen has abandoned this claim by failing to address it at trial or in the briefing.

V.

For the foregoing reasons, judgment will be entered for the defendants. Counsel for the Castiel Parties are directed to submit a proposed form of final judgment on notice within 10 days of the this opinion.