



**IN THE
COURT OF CHANCERY
OF THE
STATE OF DELAWARE**

MICHAEL D. JUDY)
)
 Plaintiff,)
)
 v.) **CA #: 4721-CC**
)
 PREFERRED COMMUNICATION)
 SYSTEMS, INC., and)
 CHARLES M. AUSTIN)
)
 Defendants.)

**ANSWER TO COMPLAINT
AND
DEFENDANTS' COUNTERCLAIMS**

(1) The Plaintiff, Michael D. Judy ("Plaintiff" or "Judy") has filed a complaint ("Complaint") against Defendants Preferred Communication Systems, Inc. ("Preferred" or the "Company") and Charles M. Austin ("Austin"), which has been designated as the case styled and numbered above. The following is the Defendants' answer to that complaint.

NATURE OF THE ACTION and COUNTERCLAIMS

(2) The Plaintiff's action seeks a declaration that the board of directors of the Company (the "Board") is not currently empowered to take action on behalf of the Company and its shareholders. The action further seeks to enjoin Defendants from entering into a "settlement agreement" (in the "FCC Proceeding" discussed below, the Plaintiff's Complaint refers to this matter as the "FCC Hearing") or other agreement whereby the Company would generally sell or transfer its FCC licenses. The Plaintiff claims (without a shred of factual foundation) that "Austin" is personally motivated to a settlement with the FCC that includes the sale or transfer of the Company's FCC licenses.

(3) This action was purportedly prompted by the Plaintiff's "interest" in the Company being a party to a proceeding before the Federal Communications Commission ("FCC"), herein referred to as the "FCC Proceeding." The Plaintiff claims that Austin's efforts and objectives in the FCC Proceeding are not in the best interests of the Company. To the contrary, it is the Plaintiff who has a hidden agenda that, if successful, will be exceedingly damaging to the Company and all of its investors. The Defendants believe that the Plaintiff has been endeavoring to manipulate the Chancery Court of Delaware (and the Administrative Law Judge at the FCC) into enabling him to be injected into the FCC Proceeding and to inappropriately influence and alter prudent decisions made by the Company . Furthermore, the Defendants believe that the Plaintiff (in his Complaints)

knowingly and willfully based his Complaints on false and misleading information in an effort to provide artificial substance and a “shock value” to his Complaint.

(4) On information and belief, it is the Defendants’ contention and counterclaim that the Plaintiff is part of a **multifaceted conspiracy** to subversively obtain control the Company and to interfere with its business interests; and in that process, is committing **fraud** and is **tortuously interfering** with the Defendants’ business endeavors. The participants in the conspiracy (and thus the fraud and tortuous interference) and thus parties to the counterclaims include: (a) **the Plaintiff - Michael Judy**, (b) **Pendleton C. Waugh**, (c) **Carole Downs**, (d) **Smartcomm LLC and its affiliates** (e) **Preferred Spectrum Investments, LLC** (not related to the Company), and (f) **other possible co-conspirators to be named later**. Further discussion and details of the “conspiracy,” “fraud” and “tortuous interference” are included below.

(5) The Plaintiff’s Complaint (and his attempt to manipulate this Court) is focused on the *FCC Proceeding* and any related settlement. The Plaintiff claims that the Company (via Austin) is pursuing a settlement that will require: (a) a sale of its FCC licenses and (b) a withdrawal of a Petition for Review in the District Court Action. **These claims are false and misleading**. Neither of these is, or ever was, part of any proposed settlement, **a fact that is confirmed by the FCC**. In the *FCC Proceeding*, the Plaintiff filed a “motion to intervene” using his Delaware Complaints as a justification. The Enforcement Bureau (“EB”) of the FCC vigorously opposed this motion (per FCC

Opposition filed July 23, 2009 in EB Docket No. 07-147). The FCC didn't simply oppose Judy's motion, they were very critical of the substance of his filings (both in Delaware and in the FCC Proceeding). **The FCC specifically commented on the Plaintiff's claims of an "asset sale" and "dropping the appeals" case as being a part of any settlement, thereby confirming the Plaintiff's statements as being false and misleading, by stating:**

"No party has filed a settlement to that effect, and thus, these claims are specious." (*"FCC Opposition," paragraph 9, page 5*)

The following are two additional quotes from the FCC's opposition filing (as noted above) to the Judy (*the "Plaintiff" in the instant case, the "Movant" in the FCC Proceeding*) "Motion to Intervene" in the FCC Proceeding:

"...a thorough reading of the Motion makes clear that it represents a subterfuge to apply pressure in a private contract dispute." (*"FCC Opposition," paragraph 8, page 4*)

"Movants' intervention now appears to be nothing more than an attempt to use two unrelated proceedings to gain leverage

over PCSI and Austin for their own private purposes.

Consequently, the Movants' purported justifications are

suspect." (*FCC Opposition*, paragraph 11, page 5)

(6) It would be sufficiently problematic if the Plaintiff was innocently using inaccurate information. However, that is not the situation here, which makes the Plaintiff's claims so egregious and damaging. The Defendants, on information and belief, claim that the Plaintiff knowingly made false and misleading statements/claims in his Complaint in an effort to manipulate this Court.

(7) The veracity (as it relates to the Plaintiff himself) of the Plaintiff's claims regarding PCSI's proposed settlement with the FCC remains, most certainly, as an issue. In particular, the "source" and foundation of the Plaintiff's claims is a key issue. It remains as an issue regarding the Defendants' counterclaims of conspiracy, fraud and tortious interference. However, any conjecture or supposition regarding what is, or is not, included in any "proposed settlement" is moot, since the FCC and PCSI have now executed a settlement agreement that has been approved by the judge in the FCC Proceeding.

(8) On August 6, 2009, subsequent to the Plaintiff's Complaint being filed, the Administrative Law Judge ("ALJ") in the FCC Proceeding issued his Order approving the Settlement Agreement ("Agreement") between PCSI and the FCC.

Contrary to the “Chicken-Little like,” false and misleading claims of the Plaintiff, the Company is not selling its licenses, nor has it dropped its Appeals case. Furthermore, there is nothing self-serving regarding Mr. Austin, as was further falsely claimed by the Plaintiff.

(9) The terms and conditions of the “Agreement” are objectively, and by any measure applied, highly favorable to the Company and clearly in the best interest of the Company and all of its investors. From an investors perspective there are no settlement terms that could be construed as objectionable; it is a very positive resolution for the Company. The settlement is such that there is no finding of any wrongdoing and certain impediments affecting the Company’s FCC licenses have been lifted. Subsequent to its public release, the Defendants have disclosed, provided copies and discussed the terms of the “Agreement” with individual investors (or their legal representatives) representing over ninety percent (over 90%) of the total invested capital in the Company. Each and everyone contacted, in effect one hundred per cent (100%) of them, was in full support of the Agreement and were generally exceedingly pleased with the outcome and offered “congratulations and appreciation” on the effort and the result.

GENERAL DENIAL and DEFENSE(S)

(10) The Plaintiff's Complaint is focused on the *FCC Proceeding* and any related settlement. In particular, the Complaint focused on what might be included in said settlement. Since a settlement has been reached, which is devoid of any of the items that were of concern to the Plaintiff, all such concerns (real or fabricated) are rendered moot.

(11) The Plaintiff's Complaint is focused on the *FCC Proceeding* and any related settlement. In particular, the Complaint focused on the authority of Mr. Austin to represent the Company in that matter. The Complaint only challenges the composition of the Board, not Austin's position as "President," which is the authority by which he currently represents to Company. Under the By Laws of Preferred and its Certificate of Incorporation, Austin is the duly elected President, which is unassailable.

(12) **Austin's Authority in general and in the FCC Proceeding is unassailable.** Nearly two years ago, Preferred was required to file a "Notice of Appearance" in that proceeding. On August 17, 2007, Preferred filed their Notice of Appearance, which was executed by Austin as "**President.**" Nothing has occurred to change this. To the contrary, an Order in the FCC Proceeding has recently affirmed Austin as proper representative for Preferred. In an Order issued on July 16, 2009, denying another group of investors the right be interveners, this Order stated that – *"Interests of PCSI (Preferred) shareholders are being represented by corporate parties*

and by a corporate officer.” Additionally, the FCC Enforcement Bureau (“FCC EB”) after more than two years of investigation (including all forms of discovery, document production, interrogatories and depositions) and months of settlement discussions, continues to recognize Austin’s Authority (see “FCC’s Opposition to Motion” in this proceeding, filed July 23, 2009).

(13) Due to extraordinary circumstances beyond the Company’s control, it is impractical and not in the Company’s best interests to expand the number of members elected to its Board at this time. Furthermore, if forced to do so (by virtue of an order of this Court) there would be no fundamental impact or practical change since the Company’s current sole-director personally holds a supermajority (over 75%) of the Company’s voting stock, thus any “expanded” Board will continue with the Company’s current philosophy.

(14) The Company has previously made an effort to recruit “qualified” individuals to serve on its Board, but was unsuccessful. There were simply too many problems and significant uncertainties facing the Company for it to be able to attract quality candidates. The matter of mutually agreeable compensation was also an issue. The Company’s status is “pre-operational,” thus it has no revenues. Furthermore, as a result of the uncertainties created by the FCC Proceeding, capital funding from its historical resources has been minimal. Consequently, any outlay of funds for an “expanded” Board would be an added financial burden. Particularly when the

“expanded” Board would (as noted above) have no impact on the composition of the Company’s executive officers and overall business philosophy.

SPECIFIC ANSWERS TO PLAINTIFF’S ALLEGATIONS

(15) Regarding Plaintiff’s “Allegation” in paragraph # 1 of the Complaint, the Defendants contests the allegation that Austin cannot take valid action on behalf of the Company and its stockholders.

(16) Regarding Plaintiff’s “Allegation” in paragraph # 2 of the Complaint, the Defendants denies the allegation that Austin is negotiating the sale of its FCC licenses.

(17) Regarding Plaintiff’s “Allegations” in paragraph # 3 to # 5 of the Complaint, the Defendants do not contest the Plaintiff’s general description of the “Parties.”

(18) Regarding Plaintiff’s “Allegations” in paragraph # 6 - # 16 of the Complaint, the Defendants do not contest the Plaintiff’s general description of the “Background” and do not contest the Plaintiff’s general description of FCC’s 800Mhz Rebanding Proceeding and related Orders.

(19) Regarding Plaintiff's "Allegation" in paragraph # 17 of the Complaint, the Defendants deny the allegation that the FCC Proceeding included issues regarding ownership interests such that an outcome would (or could) "affect Austin's purported control over the Company." The bottom line is that Austin's stock ownership and/or his control of the Company were never an issue (or at risk) in the FCC Proceeding. Accordingly, the Plaintiff is making false and misleading statements.

(20) Regarding Plaintiff's "Allegations" in paragraph # 18 of the Complaint, the Defendants were approached by an attorney who purportedly represented some unidentified number of Preferred investors. Despite requests, this attorney would not specifically identify who he represented. It was the Defendants' belief that this attorney was linked to Pendleton C. Waugh and Michael Judy who were (are) engaged in various nefarious business activities (see conspiracy discussion below) and any monies from them would be tainted and could be considered as "ill-gotten," thus the Defendants rejected any involvement or financial support. Additionally, the Defendants deny that "Austin has sought to settle the FCC Proceeding" on terms that could be considered to be "unfavorable to the Company and its shareholders."

(21) Regarding Plaintiff's "Allegations" in paragraph # 19 of the Complaint, the Defendants deny that Austin's motivations in the pursuit of a settlement in the FCC Proceeding were ever to "avoid further scrutiny" or affected by any matters as to his control of the Company. Furthermore, the Defendants again note (see paragraph # 19,

above) that the Plaintiff is making false and misleading statements by again suggesting that Austin's control of the Company was an issue in the FCC Proceeding, since it was not. Additionally, the Defendants deny that any actions by Austin have (a) jeopardized the FCC licenses, (b) been in violation of FCC regulations, or (c) been a breach of fiduciary duties.

(22) Regarding Plaintiff's "Allegations" in paragraph # 19 to 22 of the Complaint, the Defendants deny that Austin is (or ever was) negotiating a settlement of the FCC Proceeding that included: (a) a sale of FCC licenses, and (b) a withdrawal of the Company's Petition for Review in the District Court Action. Furthermore, the Defendants again note (see paragraph # 5, above) that the Plaintiff is making false and misleading statements by again making these claims.

(23) Regarding Plaintiff's "Allegations" in paragraph # 22 of the Complaint, the Defendants deny that Austin is (or ever was) negotiating a settlement of the FCC Proceeding in a manner that could be construed as "acting in his self-interest" or "to avoid further scrutiny." Additionally, the Defendants deny the allegation that the FCC Proceeding included any question or issue as to Austin's being the "controlling stockholder." Accordingly, the Plaintiff is once again making false and misleading statements. Finally, the Defendants contest that any "personal interests" of Austin preclude him from entering into any settlement agreement on behalf of the Company.

(24) Regarding Plaintiff's "Allegations" in paragraph # 23 of the Complaint, the Defendants deny that Austin's lacks authority to take actions on behalf of the Company and its stockholders.

(25) Regarding Plaintiff's "Allegations" in paragraph # 24 of the Complaint, the Defendants deny that Austin's has somehow precluded the "Series A holders" from exercising any of their rights.

(26) Regarding Plaintiff's "Allegations" in paragraph # 25 of the Complaint, the Defendants deny that Austin has ever acted inappropriately in regards to his ownership interests, vis-à-vis those of other shareholders. Additionally, the Defendants deny the allegation that the FCC Proceeding included any question or issue as to Austin's being the "controlling stockholder." Accordingly, the Plaintiff is once again making false and misleading statements. Additionally, the Defendants deny Austin as breached his fiduciary duties and/or failed to keep stockholders reasonably informed.

(27) Regarding Plaintiff's "Allegations" in paragraph # 26 to 29 of the Complaint, the Defendants deny that Austin has ever acted inappropriately in regards to his ownership interests, vis-à-vis those of other shareholders. The Defendants do not claim that all of the Company's record keeping and administrative functions have been perfect. However, the Defendants deny that any administrative shortcomings reflect any malicious intent or have in any way affected the realities of any individual investor's

investment. Additionally, the Defendants deny the allegation and challenge the statement that there is any legitimate challenge to Austin's holding a "controlling interest" and that this issue is in "fact" an "unsettled" matter. Accordingly, the Plaintiff is once again making false and misleading statements.

(28) Regarding Plaintiff's "Allegations" in paragraph # 30 & 31 of the Complaint, the Defendants deny that any of Austin's actions have been intended to "disenfranchise" any stockholders. The Company's denial of Michael Judy's "section 220" request was done so with a solid foundation of justification and was a well-reasoned response that is in the best interest on the Company. The Company's "Answer" to Judy's Complaint (case # 4662-CC) in this court provides full details.

(29) Regarding Plaintiff's "Allegations" in paragraph # 32 of the Complaint, the Defendants deny that any tax issues the Company may have are a result of Austin being "derelict in his management of the Company."

(30) Regarding Plaintiff's "Allegations" in paragraph # 33 of the Complaint. The Plaintiff merely summarizes his allegations in this paragraph. The Defendants deny each of these "repeated" allegations and refers to the paragraphs above that have already addressed these allegations in detail.

“WAUGH-JUDY” CONSPIRACY / DEFENSES RE: DEFENDANTS

(31) The objective of the Plaintiff’s Complaint is not for the stated reasons. Instead, the Plaintiff is part of a **multifaceted conspiracy** to subversively obtain control the Company. A comprehensive discussion of this conspiracy, supplemented by documentation, is beyond the scope of this filing. A thorough and complete presentation will be presented to this Court (via briefs and evidence at trial) after the discovery process is complete, which will include but not be limited to depositions of all relevant parties.

(32) **On information and belief, the Defendant believes that upon gaining control, the Conspirators intend to enter into a series of self-serving actions and transactions that will be detrimental to the Company and its creditors and shareholders.** One of these actions will be to approve or otherwise effectuate an **exorbitant compensation package to Pendleton Waugh**, which has previously been **rejected by the Company and was at issue with the FCC**. Another will be to obtain a substantial equity position in the Company by creating a sweetheart deal using the guise of a “loan” to obtain heavily discounted “bargain” stock warrants.

(33) The Plaintiff (Judy) is part of a **multifaceted conspiracy** focused on executing a master plan that is intended to exploit the circumstances of the Defendant, which will cause damage to the Defendant and its shareholders and creditors.

Furthermore, Judy and his co-conspirators have, and will, endeavor to manipulate this Court and the FCC into mandating and/or facilitating an outcome (regarding the Defendant) to which they would not otherwise be entitled.

(34) The Plaintiff (Judy) is in the middle of the conspiracy and is executing “his” part of the plan; however, the Defendant has reason to believe the “mastermind” of the conspiracy is a individual named – Pendleton C. Waugh (“Waugh”). **The following will describe Waugh’s involvement with the Defendant (and Plaintiff) that has evolved into a conspiracy.**

(35) Waugh was a consultant to the Company (Defendant), with his compensation premised on a value-added basis. Waugh represented himself as an expert in matters related to business, FCC regulations, FCC licensing, etc. Furthermore, he convinced the Company that, with his involvement, and by following his “expert” advice, the Company would realize enhanced value of such a magnitude as to justify his receiving a substantial stock position in the Defendant. Unfortunately, reality was quite the opposite. In hind-site, his involvement and advice has been exceedingly costly. The Company’s position is that amount of compensation Waugh claims is due in the form of cash and stock, is simply unjustifiable.

(36) The matter of the amount (and form) of further compensation, if any, to Waugh for his services as a consultant is an exceedingly contentious matter. Waugh

summarized his current relationship with the Defendant (Preferred) quite clearly in his deposition, dated January 26, 2009, in the FCC Enforcement Bureau (EB) action against Preferred, et al. In his deposition Waugh described the “possibility of litigation” (with Preferred) regarding his compensation as “.....a highly likely probability of litigation.” and further stated that litigation was a “virtual certainty.”

(37) Separate from the dispute between the Defendant and Waugh regarding him ever being a shareholder in Preferred, **the Federal Communications Commission (FCC) has a serious problem with Waugh being an FCC licensee. This extends to his participating in the management of an FCC licensee or owning stock in any FCC licensee.**

(38) As the Plaintiff notes in his Complaint, Preferred (aka PCSI) and Waugh and others were named in an Enforcement Bureau Action, E.B. Docket No. 07-147 (“EB Action” or “FCC Hearing”). The Plaintiff conveniently ignores the circumstances that precipitated the EB Action. Furthermore, many who have followed the proceeding are of the opinion that if wasn’t for Waugh, the Company wouldn’t have been drawn into the proceeding. This conclusion is abundantly clear by simply looking at the **FCC’s “Order to Show Cause...”** filing (document # 07-125 released on July 20, 2007) that launched the FCC Hearing (Docket # 07-147). The following is a direct quote from the FCC’s description of their actions: **... the Commission’s Enforcement Bureau (“Bureau”) received information suggesting that PCSI may have transferred control of all of its**

licenses to Waugh without prior Commission authorization. The Bureau immediately commenced an investigation...(see paragraph 16 of said document).

(39) The FCC's "Order to Show Cause..." filing (document # 07-125 released on July 20, 2007, at page 3-5) describes Waugh's background as follows:

- a) **In 1990, Waugh, an attorney** who was licensed to practice law in Texas, formed Express Communications, Inc. ("Express") and several affiliated entities, to acquire wireless licenses.¹ Waugh became president and was a majority owner of Express. **In 1993, Waugh came under investigation by federal authorities for activities relating to his involvement in Express.** As a result of that investigation, **Waugh was indicted in 1994** in the United States District Court for the Northern District of Texas on one count of conspiracy to structure financial transactions to evade securities and banking reporting requirements and one count of money laundering, both felonies. Waugh ultimately pled guilty to the first count, and the second count was dismissed.² **In 1995, as a result of the plea agreement, Waugh was sentenced to 21 months in federal prison,** followed by three years of probation, and payment of \$20,000 in fines.³ As part of his plea agreement, Waugh agreed not to violate any federal, state, or local laws, and specifically regulations or orders issued by the United States Securities and Exchange Commission ("SEC") or any equivalent state agency. He also agreed to divest himself, without compensation, of any ownership interests in Express and its affiliated entities.
- b) **Thereafter, in 1997,** the United States District Court for the District of Columbia granted the **SEC summary judgment against Waugh** for violations of various securities regulations stemming from his involvement in Express.⁴ **Waugh was ordered to pay the federal government nearly \$13 million of illegally acquired funds.** He also was permanently enjoined from violating various securities laws.⁵

¹ See *U.S. v. Waugh*, Indictment, Case No. 3:94-CR-160-T (N.D. Tex. May 11, 1994).

² See *U.S. v. Waugh*, Plea Agreement, Case No. 3:94-CR-160-T (N.D. Tex. July 13, 1994).

³ See *U.S. v. Waugh*, Judgment, Case No. 3:94-CR-160-T (N.D. Tex. Jan. 25, 1995).

⁴ See *Securities and Exchange Commission v. Express Communications, Inc.*, Complaint by Securities and Exchange Commission, Case No. 95-CV-2268 (D.D.C. Dec. 13, 1995).

⁵ See *Securities and Exchange Commission v. Express Communications, Inc.*, Revised Final Judgment of Permanent Injunction and Other Relief Against Defendant Pendleton C. Waugh, Case No. 95-CV-2268 (D.D.C. Mar. 7, 1997).

- c) **In 1999, Waugh was convicted of securities fraud**, a felony, in a case brought by the State of Texas, arising from his failure, in 1993, to disclose to a potential investor that he was under investigation by federal authorities for activities relating to his involvement in Express.⁶ **Waugh was sentenced to four years in state prison**, all of which were suspended pending successful completion of probation.⁷ He also was ordered to pay \$72,000 in restitution and to complete 500 hours of community service.⁸

- d) **Later in 1999**, Waugh was determined to have **violated the terms of his parole** from federal prison and his probation on his state conviction by traveling to Puerto Rico to engage in activities relating to cellular telephone securities.⁹ As a result, **Waugh was sentenced to six additional months in federal prison and four years in state prison**.¹⁰

(40) The above excerpts from the **FCC's "Order to Show Cause..."** filing (document # 07-125 released on July 20, 2007) can certainly be seen as an indication of the FCC's opinion of Mr. Waugh. Additionally, **Waugh has been disbarred** by the Securities and Exchange Commission (SEC) and by the State of Texas and the State of Georgia.

⁶ See *Texas v. Waugh*, Judicial Confession and Consent to Stipulation of Evidence, Case No. F-9703517 (Crim. Dist. Ct. Dallas, TX Mar. 5, 1999).

⁷ See *Texas v. Waugh*, Judgment, Case No. F-9703517 (Crim. Dist. Ct. Dallas, TX May 17, 1999).

⁸ See *Texas v. Waugh*, Judgment, Case No. F-9703517 (Crim. Dist. Ct. Dallas, TX May 17, 1999).

⁹ See *U.S. v. Waugh*, Judgment in a Criminal Case (For Revocation of Probation or Supervised Release), Case No. 3:94-CR-160-T (N.D. Tex. N.D. Tex. July 9, 1999).

¹⁰ See *U.S. v. Waugh*, Order Granting in Part and Denying in Part Defendant's Motion to for Authorization to Travel, Case No. 3:94-CR-160-T (N.D. Tex. N.D. Tex. Aug. 26, 1996). In particular, the court noted that "[t]he probation office has informed the Court that Waugh may be engaged in calling and sending information to potential investors to solicit their money, in violation of a previous order of this Court." See *id.* See also *Texas v. Waugh*, Judgment Revoking Community Supervision, Case No. F-9703517 (Crim. Dist. Ct. Dallas, TX Jan. 11, 2001).

(41) **At the very center of the Judy/Waugh conspiracy is Preferred's (Defendant) denial of any further compensation (in particular in the form of stock) owed to Waugh, in contrast to Waugh's claims.** Instead of pursuing the matter as a contractual dispute between a "consultant" and a company (by negotiating with the company or taking it to civil court), Waugh has chosen to take a more disturbing path. Waugh is delaying and not cooperating at all in a settlement of the FCC Hearing, and was arguably using his position to hold the FCC and Preferred hostage (i.e. the FCC and Preferred were prepared to "settle" for many weeks). At the same time Waugh is thumbing his nose at the FCC, he has convinced Judy (Plaintiff) to do his bidding in the Chancery Court. The Waugh/Judy "plan" is to somehow remove Mr. Austin as majority shareholder, CEO and director, in order to affirm Waugh's disputed compensation package. Additionally, they plan on other self-serving actions.

"WAUGH - JUDY et al" CONSPIRACY CONNECTION

(42) In any "*good old fashioned*" conspiracy, one can usually find a fair amount of back-ally wheeling and dealing. There is no shortage of that here. After Waugh's termination from the Defendant (Preferred) in 2008, he immediately began concocting how to: (a) exploit FCC licensing to his personal benefit, and (b) get control of Preferred. It wasn't long before he hatched an interconnected scheme that would accomplish both. A comprehensive discussion of Waugh's scheme, supplemented by

documentation, is beyond the scope of this filing; however, a brief overview is appropriate.

(43) The first part of Waugh's scheme involves a company called "**Smartcomm LLC**" (or some form of affiliate), which apparently Waugh co-owns and co-manages with an individual named Carole Downs. In this one, Waugh is using a scheme from the early and mid-nineties that is often referred to as an **FCC license "application mill."**

(44) In years past the Federal Trade Commission (FTC), the Securities and Exchange Commission (SEC) and other **governmental agencies worked cooperatively to close the so-called application mills.** The following is from an FCC filing (*Memorandum Opinion and Order*, paragraph 10, Released: July 31, 1998 as document # 98-167) that included the following description:

On January 11, 1994, the Federal Trade Commission (FTC) filed a Complaint for a permanent injunction and other relief against a number of **application preparation companies** in the United States District Court, Southern District of New York (U.S. District Court).¹¹ Prior to the FTC action, the application preparation companies used television commercials and telemarketing solicitations to promote SMR licenses as "investment opportunities" for individuals with little or no experience in the communications industry.

In a typical solicitation, the company representative would tout the potential value of SMR licenses, representing that, once obtained, the licenses could be resold for a profit. The representative would then **offer to prepare license**

¹¹ *FTC v. Metropolitan Communications Corp., et al.*, No. 93 CIV 0142 (JFK) (S.D.N.Y., filed January 11, 1994) (*FTC v. Metropolitan Communications Corp.*).

applications for a substantial fee, usually \$7,000 per application.

Typically, the company representative did not disclose obligations and restrictions that the Commission's rules imposed on SMR licensees.

On January 14, 1994, the U.S. District Court issued a preliminary injunction freezing the assets of the application preparation companies, and appointed Goodman as the Receiver (Receiver) for four of these companies (Receivership Companies).¹²

(45) A clear understanding of the FCC's opinion of "application mills" is reflected in the following comments of Reed E. Hundt (then Chairman of the FCC, see NEWSReport No. DC 95-85, Released June 15, 1995)

As numerous newspaper articles and federal and state investigations have demonstrated, the Commission's wireless cable lotteries have done "**more to enrich con artists** than to grant ordinary citizens entree into the cable business." A. Crenshaw, "No Jackpot in This Lottery," Washington Post, Apr. 19, 1992.

The mechanism for the con is the "application mill." The Commission's MDS lotteries have led to an "**explosion in abusive application mills that seek to reel in unwary small investors with the lure of the latest in high tech and the promises of quick riches.**" Investor Alert, p. 1.

(46) Waugh's first scheme involves a company called "Smartcomm LLC" (or an affiliate – Smartcomm License Services, LLC), which is charging between sixteen thousand dollars (\$16,000) and thirty thousand dollars (\$30,000) to prepare FCC license applications that virtually anyone could fill-out and file with and FCC fee of a few hundred dollars.

¹² Goodman was appointed Receiver for Metropolitan Communications Corp., Nationwide Digital Data Corp., Columbia Communications Services, and Stephens Sinclair, Ltd. (Receivership Companies). *FTC v. Metropolitan Communications Corp.* No. 93 CIV 0142 (JFK) (S.D.N.Y., filed January 11, 1994) at 15.

(47) **The above comparison of Smartcomm’s current activities to past “application mills” that were deemed fraudulent is obvious.** A full analysis of the economics and legalities of Waugh’s scheme is beyond the scope of this filing; however, a few brief further comments are appropriate.

(48) The “applications” are for a tiny amount of spectrum in the 800 MHz band. These are for a group of 4 or 5 channels with significant operating restrictions. Each application is for approximately one-quarter of a megahertz of spectrum. By comparison, most major cell phone operations have minimum of 25 MHz in all markets with an overall average of 60 MHz. Thus Waugh’s “applications” are in the range of one-half of one percent to one percent of the spectrum used in cell phone operations. Any other application has very limited revenue generating potential or value.

(49) The second part of Waugh’s plans is much more complicated and somewhat diabolical as its focus is on how he gains control of a company (the Defendant) that fired him for incompetence. Because of his problems with the FCC and other reasons, he could not pursue his goal directly. Instead, he needed to create a situation whereby someone else (person and/or entity) would carryout portions of his plan. Thus enters Michael Judy (the Plaintiff) as a co-conspirator.

(50) Waugh needed to have co-conspirators in order to effectuate his plan; but they also serve a second purpose. Additionally, Waugh is attempting to insulate himself

from certain legal risks (civil and criminal) by having Judy be the front man for certain components of Waugh's master plan. Waugh's plan puts Judy (and others) front and center for certain legal risks (civil and criminal).

(51) Waugh's master plan involves multiple steps and multiple persons and/or entities. **Step One of the Master Plan** was to generate discretionary funds. He does this by having Smartcomm LLC operating an "application mill" as described above.

(52) **Step Two of the Master Plan** was to conceptually devise a structure/entity that would serve as a vehicle raise funds and participate in the takeover of Preferred (Defendant). To that end, Waugh "created" (conceptually) an entity known as "Preferred Spectrum Investments, LLC" (hereinafter referred to as "PSI LLC"). Despite the use of a name similar to that of the Defendant (Preferred Communication Systems, Inc.) there is no connection between the two. It appears the name was selected in order to help convince investors that there was a connection, thus enabling Waugh and Judy to tie in Preferred's financial prospects into those of PSI LLC.

(53) **Step Three of the Master Plan** was to find someone that Waugh could manipulate to formally create and then serve as the Manager/Principal of PSI LLC; this person was Mr. Michael Judy (the Plaintiff).

(54) **Step Four of the Master Plan** was to have PSI LLC (i.e. Judy at the behest of Waugh) raise a limited amount (\$150,000) of funds from “friendly” investors to be used to launch an extended fund raising effort to provide the \$3 million necessary to effectuate the master plan. Of this amount, \$1,197,500 would be used to acquire certain FCC licenses at an inflated price from Smartcomm (Waugh’s company) that are a byproduct of the “application mill” described above. These would include 9 channels (less than ½ of a megahertz) in 25 markets. (*See comments below, in paragraph 40 to 42, regarding PSI LLC, Waugh, and Judy’s false and misleading statements on this element*). **Secondly**, approximately \$1.2 million will be used to obtain a substantial equity position in the Defendant (Preferred) by creating a sweetheart deal using the guise of a “loan” to obtain heavily discounted “bargain” stock warrants.

(55) The materials that are being circulated by Smartcomm, Waugh and Judy to induce investors are lathered with false and misleading information. One example is a stated value of the licenses to be obtained via the “application mill.” “They” (Smartcomm, Waugh and Judy) use \$1.49 per MHz/pop as the valuation measure. (Note: a “per MHz/pop” dollar amount is commonly used in the industry, a parallel is stating land at a value “\$ per acre”). Not only is the \$1.49 amount **unrealistically too high**, but “they” state that the “source” of that value is the “FCC’s Appraised Value.” **This statement could not be any further from the truth**. First, the FCC doesn’t “appraise” spectrum. Second, Waugh and Judy have creatively, and improperly, latched onto the \$1.49 amount.

(56) In the FCC's 800 MHz Rebanding Proceeding (WT 02-55), the FCC had to make a determination of the value of certain portions of Nextel's spectrum. The \$1.49 per MHz/pop was a determination by the FCC that was unique to Nextel, it was not for spectrum in general. Furthermore, it was based on Nextel's spectrum not only being "cellular" qualified, but also being used in Nextel's "high-density cellular" system. In contrast, the spectrum available via Smartcomm's "application mill" has been re-designated (i.e. downgraded) to the "non-cellular" segment of 800 MHz bandwidth. It has restricted use, and most significantly, **cannot be used in a "high-density cellular"** system (i.e. Nextel, Sprint, AT&T, Verizon, etc. can't use it). Waugh and Judy have "cherry-picked" data from the FCC and, with willful intent, are misusing the data to induce investors. It is simply an "apples-and-oranges" abuse of information. The manner in which certain data is included in materials circulated by Judy, Waugh and Smartcomm, an innocent investor will be duped into thinking that the FCC (a governmental agency) has, not only valued the spectrum they are investing in, but at an extraordinarily high price; thus virtually guaranteeing a massive financial return. **This is unquestionably false and misleading.**

(57) The materials that are being circulated by Smartcomm, Waugh and Judy to induce investors include calculations and extrapolations using (incorrectly) the \$1.49 per MHz/pop as the valuation measure. As an example of the magnitude of its misuse, Smartcomm, Waugh and Judy claim the FCC licenses that PSI LLC is going to acquire from Smartcomm for \$1,197,500 (described above, P38) are actually worth at least forty-

two million two hundred sixty five thousand dollars (\$42,265,000), which by their calculations is a Return on Investment to PSI LLC of **37.87 times, or 3,787%**.

(58) **Step Five of the Master Plan** was for Waugh to find someone that he could manipulate into pursuing the removal of Charles M. Austin (described in P 14, above) as founder, principal shareholder, sole officer and sole director; this person was Mr. Michael Judy (the Plaintiff). **Austin's removal is a critical part of the "Waugh-Judy master plan" for two reasons.** **One**, Austin refuses to acquiesce to Waugh's demands (see paragraph 40, above) of his entitlement to stock in the Defendant. Austin's position is in the best interest of the Defendant (Preferred) and its creditors and shareholders. Thus, Waugh is pushing Judy to oust Austin, to be replaced by person or persons who will retroactively approve an exorbitant compensation package (including stock ownership) for Waugh. **Second**, Austin (and the Defendant) want nothing to do with Smartcomm and/or PSI LLC (or any funds they suggest "loaning" to Preferred) due in large part to the persons involved and the manner by which they are raising funds, which may be considered as **"ill-gotten gains."** PSI LLC's business plan is predicated on interacting with Preferred (Defendant), thus Judy as Managing Member of PSI LLC is endeavoring to oust Austin.

(59) Waugh is at the center of the conspiracy. He has problems with the FCC and has an intractable business dispute with the Defendant regarding past compensation as a consultant. Waugh is upset that the Defendant has not taken up his cause with the

FCC. Waugh is upset that the Defendant has not acquiesced to his compensation demands. As a result, Waugh has enlisted the participation of Judy (and others) to pursue a manipulation of the Chancery Court to have it unwittingly injected into matters properly before the FCC, or in matters between Waugh and the Defendant.

SPECIAL CIRCUMSTANCES/ DEFENSES RE: DEFENDANTS

(60) A full discussion of the Companies history and its relationship with its investors is beyond the scope of this filing; however, a brief summation is applicable due the criticisms (regarding a lack of information and conducting formal shareholder meetings) included in the Plaintiff's "Complaints." As the Plaintiff himself describes in paragraph #4 of the Complaint – **"Preferred is in the early stages of development to become a full service wireless telecommunications provider..."**. Certain events beyond the Company's control have stalled its efforts to construct and operate wireless phone systems on its FCC licensed frequencies.

(61) In its early days, many years ago, the Company focused on developing a mobile phone system in Puerto Rico. It first acquired site licenses, then it participated in FCC Auction #34 in which in bid and paid approximately \$32 million for geographic Economic Area ("EA") licenses in Puerto Rico and in certain other markets in the U.S. In addition to Puerto Rico, the company acquired licenses in nine markets, in two clusters (central and northern California cluster and the Washington DC/Virginia cluster).

(62) Within months of the Company's acquisition of its EA licenses, it was hit with its first "stifling event." This was the FCC's nationwide "800 MHz Rebanding Proceeding" (WT 02-55), which caused the Company to be effectively precluded from developing (i.e. constructing and launching commercial operations) its licenses, due to the uncertainties as to its "new" frequency assignments. Specifically, the FCC's "rebanding proceeding" has generated a series of new rules and orders, which mandate the relocation of all licensees (including those of the Company) in the 800 MHz band pursuant to a "Rebanding Plan" adopted by the FCC in 2004. The "Rebanding Plan" was to have been completed in June 2008; the FCC has extended it into 2010. To date, the Company has not received its new channel (frequency) assignments from the FCC. Preferred (and several other companies) believe that its treatment in the FCC Orders in the "800 MHz Rebanding Proceeding" is inequitable, discriminatory, anti-competitive and not in accordance with the stated objectives of the Proceeding. Accordingly, Preferred (and several other companies) have filed appeals in the U.S Court of Appeals for the District of Columbia. These cases are still pending.

(63) A second, and more ominous, "stifling event" was the FCC's EB Action (i.e. the "FCC Proceeding") which began in July 2007. A possible end result of this proceeding could have been the revocation and/or cancellation of all of the Company's FCC licenses. Such an outcome would effectively delete the Company from existence and totally wipeout over \$40 million of invested capital. Thus for the past two years, the Company has effectively been precluded from virtually doing anything, other than

dealing with the FCC Proceeding. This proceeding added a second layer of suppression in the Company's development effort since its timing overlaps with that of the FCC Rebanding Proceeding. In effect, just as the Company was beginning to emerge from the shadows of the FCC Rebanding Proceeding, the EB Action was commenced.

(64) As is quite common for a small company, Preferred has a single individual who was the "founder" of the company and who individually holds the vast majority of the stock. Prior to 2005, the Company had only a handful of common stock shareholders; thereafter the number of shareholders has increased by a limited number. **In total there are only twenty (20) shareholders who own "common stock," which affords them general and traditional voting privileges.**

(65) The Company's "founder" is an individual – Charles M. Austin ("Austin"). **Austin holds approximately of seventy-five percent (75%) of the voting stock of the Company.** Another individual holds approximately twenty percent (20%). Thus, two individuals hold approximately ninety-five (95%) of the Company's voting stock. In contrast, the **Plaintiff only holds less than one percent (< 1%) of votes for common stock**. Consequently, the Plaintiff (and all other minority shareholders) are well aware of their limited position with the Company; thus (by law), their involvement in the Company is, and should be, exceedingly limited.

(66) The Company contends that it has kept its shareholders informed by making all reasonable and appropriate disclosures. The limited number of shareholders, combined with its having no operations to report on, along with the stifling events discussed above, has enabled the Company to provide all necessary information to shareholders using a combination of formal and informal modes of communication. At times, the disclosures were necessarily limited due to the fact that the FCC Proceeding was a legal proceeding and the Company's attorneys and the FCC both advised the Company that it could not openly discuss the case. The Company maintains ongoing communications (generally on a weekly basis) with investors who collectively represent approximately **ninety percent (90%)** on the invested capital (debt and equity) in the Company.

(67) The Plaintiff's focus is the composition of the Company's Board of Directors ("BoD") in his Complaint. The Plaintiff contends that the BoD must have at least four (4) members, one of which is to be elected solely by the "Series A – Preferred Stockholders," and that the Company refuses to address this matter. He paints a distorted picture of this issue by failing to present all the facts. First, prior to 2007, the Company's By Laws and Certificate of Incorporation only required the BoD to have a single member. Thus prior to 2007, this is a non-issue. In 2007, the Certificate of Incorporation was amended to provide for a BoD to be comprised of from four (4) to nine (9) members. Also in 2007, prior to the Company's holding an annual meeting and conducting a BoD election, the FCC EB Action commenced. As noted above, this action effectively

precluded the Company from conducting “business-as-usual.” One consequence was that, despite trying, the Company could not find any “qualified” individuals willing to serve on the BoD. Accordingly, the Company has been forced to temporarily suspend its efforts to add members to the BoD until the Company’s situation improves to the point where it can attract quality candidates to serve on its BoD. Thus, contrary to the Plaintiff’s contentions that the Company “refuses” to do certain things, the Company has been precluded from certain actions due to circumstances beyond its control.

(68) **In summation, the Company, through no fault of its own, has been in a holding pattern unable to predict when it can begin to construct any commercial operating facilities. Consequently, there has been limited information to disseminate to its shareholders and creditors.**

PLAINTIFF’S “FIRST CAUSE OF ACTION” (para. 34 to 39 of the Complaint) IS MOOT

(69) The Plaintiff asks this Court to issue a “Declaration of Austin’s Inability to Act on Behalf of the Company.” However, his only challenge is to the composition of the Company’s Board of Directors (“BoD”) in his Complaint. The Complaint only challenges the composition of the Board, not Austin’s current position as “President,” which is the authority by which he currently, and has been, representing the Company. Under the By Laws of Preferred and its Certificate of Incorporation, Austin is the duly elected President, which is **unassailable**.

(70) The Plaintiff’s Complaint is focused on the FCC Proceeding and any related settlement. In particular, the Complaint focuses on the authority of Mr. Austin to represent the Company in that matter. As noted above, Austin’s authority to represent the Company is unassailable and furthermore, that proceeding has been settled and all matters have been closed.

(71) **The Plaintiff does not challenge Mr. Austin as being:** (a) President of Preferred, (b) a Director of Preferred, or (c) the single largest shareholder, with a personal supermajority common stock position constituting **over 75% of the votes** on all corporate matters. The Plaintiff merely pursues the holding of an Annual Meeting of Shareholders at which the “**Common Stock**” shareholders will elect three (3) individuals

to the Board of Directors by a simple majority vote. Additionally, the Plaintiff pursues the enforcement of the “single-issue” voting right afforded to a particular class of “Preferred Stock,” specifically the “**Series A Preferred Stock**.” This class of stock does not have general voting privileges on corporate matters. However, they have a right to elect (as a single class vote) a single member to the Board of Directors.

(72) At this point irrefutable facts and simple mathematics are in focus. Even if the Plaintiff prevails on the “shareholder meeting” Complaint, result is clear and predictable and moot. The end result is that there will be no impact on Austin’s Authority (past, present or future). The most that can occur is that the Chancery Court will order the Company to conduct a shareholders meeting. At said Meeting of Shareholders, the “**Common Stock**” shareholders (of which there are a total of 20 individuals) will elect three (3) individuals to the Board of Directors by a simple majority vote; **Austin** (as the single largest shareholder with a personal supermajority common stock position constituting **over 75% of the votes**) will individually be able to cast the deciding vote for all three members of the board of directors. In essence, no other vote by any other individual (or group of individuals) is of any consequence. Obviously, Mr. Austin will elect individuals who support his position and efforts regarding the Company.

(73) Separately, the holders of “**Series A Preferred Stock**” could elect a single director, who would be the fourth member of the board. Thus, in the most extreme of predictable scenarios, a newly constituted board of directors will be at least 3 of 4 in

support of Austin. Thus there will be no fundamental change from today's authority structure.

PLAINTIFF'S "SECOND CAUSE OF ACTION" (para. 40 to 47 of the Complaint) IS MOOT

(74) The Plaintiff's "Second Cause of Action" (see para. 40 to 47 of the Complaint) is a claim that Austin has "breached his fiduciary duties." The entirety of the Plaintiff's discussion in this section is focused on the *FCC Proceeding* and any related settlement. The Plaintiff claims that the Company (via Austin) is pursuing a settlement that will require: (a) a sale of its FCC licenses and (b) a withdrawal of a Petition for Review in the District Court Action. **These claims are false and misleading.** Neither of these is, or ever was, part of any proposed settlement, **a fact that is confirmed by the FCC** (see para. # 5, above). The Plaintiff claims (without a shred of factual foundation) that "Austin" is personally motivated to a settlement with the FCC that includes the sale or transfer of the Company's FCC licenses.

(75) Any conjecture or supposition regarding what is, or is not, included in any "proposed settlement" is moot, since the FCC and PCSI have now executed a settlement agreement that has been approved by the judge in the FCC Proceeding.

(76) On August 6, 2009, subsequent to the Plaintiff's Complaint being filed, the Administrative Law Judge ("ALJ") in the FCC Proceeding issued his Order approving the Settlement Agreement ("Agreement") between PCSI and the FCC. Contrary to the "Chicken-Little like," false and misleading claims of the Plaintiff, the Company is not selling its licenses, nor has it dropped its Appeals case. Furthermore, there is nothing self-serving regarding Mr. Austin, as was further falsely claimed by the Plaintiff.

(77) The terms and conditions of the "Agreement" are objectively, and by any measure applied, highly favorable to the Company and clearly in the best interest of the Company and all of its investors. From an investors perspective there are no settlement terms that could be construed as objectionable; it is a very positive resolution for the Company. The settlement is such that there is no finding of any wrongdoing and certain impediments affecting the Company's FCC licenses have been lifted.

COMMENTS Re: RELIEF SOUGHT BY PLAINTIFF (per pgs 15,16)

(78) This Court cannot (or should not) grant any of the relief sought by the Plaintiff, since the only claims of the Plaintiff are ones which the Court cannot grant the requested relief. Any relief to the Plaintiff should be denied for all the reasons noted above, as summarized as follows:

(a) This Court cannot (or should not) eradicate the authority of the current Board or otherwise supplant its judgment as to whether or not it is practical or prudent for the Company to expand its Board at this time.

(b) This Court cannot (or should not) force the Company to expand its Board at this time, since it is impractical, financially burdensome and not in the best interest of the Company.

(c) This Court cannot (or should not) prohibit Austin from taking any action on behalf of the Company, as he is acting in his capacity as "President." The Plaintiff has made no claim against Austin being President. As noted above, Austin's position as President is unassailable.

(d) This Court cannot (or should not) issue a temporary restraining order, provide injunctive relief or otherwise interfere in the Company's settlement efforts with the FCC, or other matters, since the Plaintiff's claims are based solely on false and misleading information. Furthermore, the settlement has already been completed.

(e) This Court cannot (or should not) allow itself to, in any way, be supportive of parties who are participating in conspiracy, fraud and tortious interference.

DEFENDANTS COUNTERCLAIMS - RELIEF SOUGHT

(78) As described above, the Defendants claim that the Plaintiff (Michael Judy) in consort with his co-conspirators, is on a mission to subversively gain control of the Company and thereafter manipulate circumstances, to their personal benefit, which will exploit and be to the detriment of the Company and its other shareholders. In this conspiracy, they are committing fraud and are tortuously interfering with the Defendants and others.

(79) **WHEREFORE**, the Defendants seek the following relief.

(a) An Order by this Court prohibiting any and all co-conspirators from interfering in the business endeavors of the Defendants;

(b) An Order by this Court requiring any and all co-conspirators to invalidate and otherwise repeal any and all transactions and business endeavors that have in any way included any reference to the Defendants;

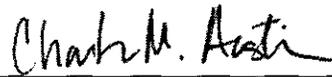
(c) An award of damages (actual, compensatory and treble) in a amount appropriate to compensate Defendants for the damages sustained or will be sustained due to the Plaintiff's (and co-conspirators) actions; and

(d) An award of attorney's fees, costs, and such further relief as the Court may deem just and proper.

Respectfully submitted,

**Preferred Communication
Systems, Inc.**

P.O Box 153164
Irving, Tx 75015-3164

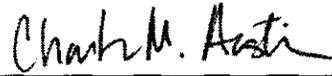


By: Charles M. Austin
Its President

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Charles M. Austin

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Charles M. Austin, Individually

214-548-3562

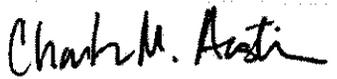
Date: August 10, 2009

AFFIDAVIT OF
CHARLES M. AUSTIN
IN SUPPORT OF
ANSWER TO COMPLAINT
AND
DEFENDANTS' COUNTERCLAIMS

I am over the age of eighteen years and fully capable of stating the following in support of the "*Answer to Complaint and Defendants Counterclaims.*"

Based on my personal knowledge, all statements and all facts included in the "*Answer to Complaint and Defendants Counterclaims.*" are true and correct to the best of my knowledge.

I declare under penalty of perjury that the foregoing is true and correct. Executed on August 11, 2009



Charles M. Austin