

# 14-4140

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**United States Court of Appeals  
for the Second Circuit**

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**INDIANA PUBLIC RETIREMENT SYSTEM, INDIANA STATE  
TEACHERS' RETIREMENT FUND, and INDIANA PUBLIC  
EMPLOYEES' RETIREMENT FUND,**

*Plaintiffs-Appellants,*

*(caption continued on inside cover)*

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK

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**PETITION FOR PANEL REHEARING AND REHEARING EN  
BANC OF DEFENDANT-APPELLEE SAIC, INC.**

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**CITY OF WESTLAND POLICE AND FIRE RETIREMENT SYSTEM, On  
Behalf of Itself and All Others Similarly Situated, LOCALS 302 AND 612 OF  
THE INTERNATIONAL UNION OF OPERATING ENGINEERS-  
EMPLOYERS CONSTRUCTION INDUSTRY RETIREMENT FUND, On  
Behalf of Themselves and All Others Similarly Situated, IBEW LOCAL  
UNION NO. 58 ANNUITY FUND AND THE ELECTRICAL WORKERS  
PENSION TRUST FUND OF IBEW LOCAL UNION NO. 58,**

*Plaintiffs,*

v.

**SAIC, INC., MARK W. SOPP, and WALTER P. HAVENSTEIN,**

*Defendants-Appellees,*

**GERARD DENAULT, KENNETH C. DAHLBERG, and DEBORAH H.  
ALDERSON,**

*Defendants.*

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## **CORPORATE DISCLOSURE STATEMENT**

Pursuant to Federal Rule of Appellate Procedure 26.1, the undersigned counsel state that on September 27, 2013, the corporate defendant in this matter changed its name from SAIC, Inc. to Leidos Holdings, Inc. Leidos Holdings, Inc. is a publicly held company that has no parent corporation. No publicly held corporation owns 10% or more of its stock.

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### **RULE 35(B) STATEMENT**

This petition seeks Panel rehearing or rehearing en banc of a decision that: (1) conflicts with Circuit standards for pleading corporate scienter in the securities fraud omission claim context; (2) applies an incorrect standard under Financial Accounting Standard (“FAS”) 5 regarding when corporations are required to disclose loss contingencies relating to potential claims; (3) conflicts with a decision by a sister panel of this Court in *Welch v. Havenstein* 553 F. App’x 54 (2d Cir. 2014) involving similar allegations; and (4) throws into disarray Circuit precedent regarding whether corporations must disclose ongoing investigations.

Plaintiffs in this case brought claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 against SAIC, Inc. (“SAIC”) and certain of its employees alleging misstatements and omissions in more than 40 public filings, relating to SAIC’s engagement by the City of New York to modernize its employee payroll system. Unbeknownst to SAIC and its senior management, two of its employees had conspired with subcontractors and New York City Office of Payroll Administration consultants working on the project (known as “CityTime”) to engage in an illegal kickback scheme. In decisions in September 2013 and January 2014, the district court dismissed all of the Plaintiffs’ claims in their Amended Complaint (“AC”) with prejudice. It held that Plaintiffs’ claims were entirely hindsight driven, noting that “hindsight pleading” was “a hallmark of the

instant complaint.” *See* SPA-19, 21, 37. It further held, on reconsideration of its original decision to let claims pertaining to a single SAIC March 25, 2011 Form 10-K (“March 2011 10-K”) proceed, that Plaintiffs’ claims regarding that filing failed because, “at best” Plaintiffs pled “a potential difference in professional judgment” regarding FAS 5 and Item 303 of Regulation S-K (17 C.F.R. § 229.303) (“Item 303”) accounting judgments, rather than “a state of mind approximating actual intent” for the alleged omission. SPA-53-54.

In March 2014, after entry of judgment in favor of Defendants, Plaintiffs filed a motion for relief from judgment and for leave to file a Proposed Second Amended Complaint (“PSAC”). The PSAC included additional allegations acknowledging, among other things, that the two SAIC employees involved in the CityTime fraud, Gerard Denault and Carl Bell, were ultimately found guilty of affirmatively defrauding SAIC. *See* PSAC ¶¶ 40(a), 42(a) (JA-110-11).<sup>1</sup> The PSAC also referenced testimony from Denault’s criminal trial noting the

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<sup>1</sup> Denault was convicted in November 2013 following trial. *See* Jury Instructions, *U.S. v. Mazer*, No. 11-cr-121 (S.D.N.Y.), ECF No. 303 at 5343:7-10 (JA-1017) (instructing the jury on the charge that Denault committed honest services fraud against SAIC that: “A scheme to defraud, . . . is a plan to deprive another of honest services by accepting bribes and kickbacks without the employer’s or principal’s knowledge and consent.”) (emphasis added); Jury Verdict, *U.S. v. Mazer*, No. 11-cr-121 (S.D.N.Y. Nov. 22, 2013) (convicting Denault of defrauding SAIC); PSAC ¶ 31(b) (JA-106). Bell pled guilty to defrauding SAIC in June 2011. *See* Criminal Information, *U.S. v. Mazer*, No. 11-cr-121 (S.D.N.Y.), ECF No. 75 at 4 (Bell pled guilty to Count 3 – defrauding SAIC and depriving SAIC of his honest services).



extraordinary lengths to which Denault and Bell went to conceal their efforts from SAIC, including establishing shell companies to receive kickbacks, routing payments through banks in India, agreeing never to disclose the kickbacks to SAIC, and constructing a cover story to tell SAIC if it ever discovered the payments. JA-1021-24, 1027-35. In denying Plaintiffs' post-judgment motions, and after writing more than 65 pages on Plaintiffs' claims, the district court properly found that: (1) the Rule 60(b) motion failed to provide any basis for disturbing the judgment (SPA-64-67); and (2) the PSAC, like the AC, was still "marred by hindsight pleading and speculation" (SPA-68).

On appeal, the Panel affirmed the dismissal of all of Plaintiffs' claims, except for two against SAIC. The two surviving claims assert that SAIC omitted disclosures required under Item 303, which concerns discussion of "known trends . . . or uncertainties" in financial reports, and under FAS 5, which concerns financial accounting and reporting for loss contingencies. The Panel held that the district court erred in finding that the omission claims pertaining to SAIC's March 2011 10-K were futile. Op. 4, 28. SAIC seeks rehearing of that holding on two bases.

*First*, the Panel erred substantially in finding *scienter* with respect to the FAS 5 and Item 303 omission claims. The Panel incorrectly inferred corporate scienter for SAIC without requiring particularized allegations that an individual responsible for issuing the March 2011 10-K had the requisite intent, in direct

contravention of the standards announced in *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 195 (2d Cir. 2008). The Panel's scienter analysis also incorrectly failed to acknowledge that in the context of omission claims based on FAS 5 and Item 303 accounting judgments, the standard for alleging scienter is *heightened*. The Panel's decision contradicts this Court's decisions in *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 269 (2d Cir. 1996) and *In re Bank of Am. AIG Disclosure Sec. Litig.*, 566 F. App'x 93, 94 (2d Cir. 2014), which hold that plaintiffs must adequately allege that an accounting omission was "highly unreasonable" and "violative of a known or obvious duty" under FAS 5 or Item 303 to state a claim. It also incorrectly ignores this Court's holdings that "where a complaint 'does not present facts indicating *a clear duty to disclose*' it does not establish *strong* evidence of conscious misbehavior or recklessness" "approximating actual intent." *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 106-7 (2d Cir. 2015) (quoting *Kalnit v. Eichler*, 264 F.3d 131, 144 (2d Cir. 2001)) (emphasis added); *S. Cherry St., LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 109 (2d Cir. 2009). The Panel's scienter determination was substantially flawed.

*Second*, the Panel erred in finding that Plaintiffs adequately pled a FAS 5 violation pertaining to the March 2011 10-K. The Panel reasoned that the district court mistakenly applied FAS 5's "probable" claim disclosure standard in lieu of its "reasonably possible" loss contingency standard because "there ha[d] been no

manifestation by a potential claimant of an awareness of a possible claim or assessment.” Op. 18 (quoting FAS 5 ¶ 10). The Panel concluded that instead “the ‘reasonable possibility’ standard applie[d] in view of the PSAC’s allegation that by March 2011 the City had manifested an awareness of a possible, sizable claim against SAIC.” Op. 18. The Panel erred in coming to that conclusion.

The PSAC contains no allegations reflecting any “manifestation” by the City to SAIC of a potential claim against it. The Panel’s holdings that: (1) online blogs and public statements not alleged to have been seen by SAIC; and (2) ongoing investigations in which SAIC was not identified as a target, can constitute “manifestation” under FAS 5, directly contradict multiple district court decisions in this Circuit recognizing that “manifestation” must be made *to the disclosing party* and must be in the form of *threatened litigation*.<sup>2</sup> The Panel’s decision invites corporations to speculate wildly regarding the outcome of ongoing investigations (in contravention of Circuit precedent), and applies a presumption that individuals responsible for issuing financial statements at corporations have reviewed every single public online article and statement about them. This cannot be the law regarding disclosure obligations. It is also inconsistent with this Court’s decision

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<sup>2</sup> See *In re Lions Gate Ent. Corp. Sec. Litig.*, No. 14-cv-5197 (JGK), 2016 WL 297722, at \*15-16 (S.D.N.Y. Jan. 22, 2016); *City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.*, 928 F. Supp. 2d 705, 718 (S.D.N.Y. 2013); *Pa. Pub. Sch. Emps.’ Ret. Sys. v. Bank of Am. Corp.*, 939 F. Supp. 2d 445, 453 (S.D.N.Y. 2013).

in *Welch v. Havenstein*—a parallel lawsuit arising from the same core facts as this one—which affirmed a holding that similar allegations regarding online articles, not alleged to have been seen by any SAIC board members, were insufficient to plead constructive or actual knowledge. 533 F. App'x 54 (affirming a 37-page decision in *SAIC Deriv. Litig.*, 948 F. Supp. 2d 366 (S.D.N.Y. 2013) (Oetkin, J.)).

Panel rehearing or rehearing en banc is “necessary to secure and maintain uniformity of the court’s decisions” because “the panel decision conflicts with” multiple other decisions of this Court (Fed. R. App. P. 35(b)(1)(A)), including: *Stratte-McClure*, 776 F.3d 94 ; *Bank of America AIG Disclosure*, 566 Fed. App'x 93; *Welch*, 533 F. App'x 54; *Dynex*, 531 F.3d 190; and *Chill*, 101 F.3d 263.

Rehearing is also appropriate because the proceeding involves questions of exceptional importance, including at least: (1) the standard for alleging corporate scienter in the securities fraud context for omission claims; and (2) whether corporations are required to speculate regarding ongoing investigations where they are not identified as targets. Fed. R. App. P. 35 (b)(1)(B). Rehearing is also necessary to address: (3) whether under FAS 5 the “manifestation” of a potential unasserted claim must be made to the issuing party, and whether it must be in the form of threatened litigation, to trigger the more lenient “reasonably possible” loss contingency disclosure standard; and (4) whether corporations and senior management are presumed to be aware for disclosure and scienter purposes of

every public statement and online news article about their company. As is, the Panel's decision throws established Circuit law on all of these issues into disarray.

## ARGUMENT

### **I. The Panel's Scierter Holding Contradicts This Circuit's Standards Set Forth In *Dynex*, *Bank of America*, *Stratte-McClure* And *Chill*.**

The Panel's scierter analysis with respect to the March 2011 10-K was substantially flawed. First, in contravention of this Court's decision in *Dynex*, the Panel erred in not requiring Plaintiffs to plead that someone responsible for issuing the March 2011 10-K had the requisite intent for purposes of establishing corporate scierter. Second, the Panel failed, in contravention of this Court's decisions in *Bank of America AIG Disclosure*, *Stratte McClure*, and *Chill*, to apply a heightened scierter standard to Plaintiffs' claims challenging accounting judgments under FAS 5 and Item 303.

#### **A. The Panel's Decision Conflicts With Circuit Precedent Regarding The Standard For Pleading Corporate Scierter.**

In *Dynex*, this Court held that "[w]hen the defendant is a corporate entity. . . the pleaded facts must create a strong inference that someone whose intent could be imputed to the corporation acted with the requisite scierter." 531 F.3d at 195. It suggested that plaintiffs must allege that "one responsible for the statements made to investors had reason to believe" that the statements were not correct. *Id.* at 197. It noted that "merely careless mistakes at the management level" do not create a strong inference of scierter on the part of a corporation. *Id.*

The Panel applied incorrect standards to find that the PSAC adequately alleged that “by March 9, 2011, when SAIC received the results of its internal investigation but before it filed its 10-K, SAIC knew about Denault’s kickback scheme, the extent of the CityTime fraud, and . . . that it risked civil and criminal fines, [and] losing a significant number of . . . government contracts.” Op. 26. The Panel’s conclusion is not supported by the PSAC’s allegations.

The Panel primarily based its scienter holding on the PSAC’s allegations regarding a March 9, 2011 internal audit memorandum, which the PSAC asserts indicated that an SAIC audit team could not accurately calculate the amount of time that Denault worked on the CityTime project because he routinely recorded set hours each day rather than the actual hours. *See* Op. 19, 26; PSAC ¶¶ 393, 397-99. The Panel failed to acknowledge, however, that PSAC does not allege: (1) that anyone responsible for issuing the March 2011 10-K ever saw the memo before the 10-K was issued; or (2) that the memo reflected Denault’s, Bell’s or any other SAIC employee’s involvement in the fraudulent kickback scheme, or that anyone at SAIC knew about the scheme in March 2011.

In failing to require particularized allegations reflecting that someone responsible for the March 2011 10-K had knowledge about the memo or its contents before the 10-K was issued, the Panel contradicted this Court’s standards announced in *Dynex*. Moreover, the PSAC’s allegations regarding the memo do

not support the Panel's conclusion that "SAIC knew about Denault's kickback scheme [and] the extent of the CityTime fraud" by March 25, 2011. Op. 26.

Rather, they reflect that on March 9, 2011, an audit team completed a memo suggesting that it could not verify all of Denault's time. They do not reflect SAIC knowledge of the elaborately concealed kickback scheme or the extent of the fraud.

**B. The Panel Applied An Incorrect Scierter Standard To The Omission Claims Challenging Accounting Judgments Under FAS 5 And Item 303.**

In *Chill*, this Court recognized that to plead scierter based on circumstantial evidence, a plaintiff must allege "*strong* circumstantial evidence of conscious misbehavior or recklessness." 101 F.3d at 268 (emphasis added). It noted that "reckless conduct is, at the least, conduct which is *highly unreasonable* and which represents *an extreme departure* from the standards of ordinary care...." *Id.* at 269 (emphasis added). It further held that "[a]llegations of a violation of GAAP provisions or SEC regulations, without corresponding fraudulent intent, are not sufficient to state a securities fraud claim." *Id.* at 270. Similarly, in *Bank of America*, this Court recognized that to plead scierter in connection with ASC 450 (i.e., FAS 5) omission claims, plaintiffs "must adequately allege conduct that was "highly unreasonable" and "violative of a known or obvious duty" to disclose. 566 Fed. App'x at 94. In *Stratte-McClure*, this Court reiterated that where plaintiffs rely solely on a "conscious recklessness" theory, they must allege "a state of mind approximating actual intent, and not merely a heightened form of negligence." 776

F.3d at 106 (quoting *S. Cherry St.*, 573 F.3d at 109). It further held that with respect to omission claims under Item 303, “where a complaint ‘does not present facts indicating a clear duty to disclose’ it does not establish ‘*strong* evidence of conscious misbehavior or recklessness.” 776 F.3d at 107 (quoting *Kalnit*, 264 F.3d at 144) (emphasis in original).

The Panel’s decision contradicts these well-established standards. None of the allegations that the Panel relied on from the PSAC come close to pleading “a state of mind approximating actual intent” to deceive with respect to FAS 5 or Item 303 accounting judgments, or that that SAIC’s failure to include a FAS 5 or Item 303 disclosure relating to CityTime in the March 2011 10-K was “highly unreasonable” in the face of “a clear duty to disclose.” *Bank of Am.*, 566 F. App’x at 94; *Stratte-McClure*, 776 F.3d at 106-7. Rather, contrary to the Panel’s holding, “the most likely inference from the facts alleged is that [SAIC] did not make certain disclosures . . . because they believed they were under no obligation to do so,” and not because of any intent to deceive. *In re Bank of Am. AIG Disclosure Sec. Litig*, 980 F. Supp. 2d 564, 587 (S.D.N.Y. 2013),<sup>3</sup> *aff’d* 566 Fed. App’x at 94.

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<sup>3</sup> Other district courts in this Circuit also recognize the heightened standard in the accounting judgment context. In *In re Lions Gate*, for example, the court recognized that the standard for pleading scienter in connection with FAS 5 and Item 303 accounting omission claims is “rigorous[.]” 2016 WL 297722, at \*17 (S.D.N.Y. Jan. 22, 2016). It recognized that “only where allegations of GAAP violations are coupled with evidence of corresponding fraudulent intent . . . might  
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The Panel's inference that SAIC engaged in a *three-month* securities fraud is much *less* plausible than the direct and strong inference that SAIC applied good faith judgment to complex accounting standards regarding an unfolding investigation.

## **II. The Panel's FAS 5 Decision Applied An Incorrect "Manifestation" Standard And Conflicts With This Court's Decision In *Welch***

In holding that FAS 5's "reasonable possibility" standard applied because the PSAC alleged that "by March 2011, the City had manifested an awareness of a possible sizeable claim against SAIC," the Panel made multiple errors. Op. 18. First, it incorrectly held that the "manifestation" need not be made to the disclosing party. Second, it incorrectly held that an ongoing investigation and federal lawsuit not targeting SAIC or its employees supported "manifestation." Both of these holdings contradict Circuit precedent. The FAS 5 holding is incorrect because no allegations in the PSAC reflect that the City manifested an awareness of a possible claim against SAIC to the company before the March 2011 10-K was filed.

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they be sufficient to state a claim." *Id.* at 15 n.6 (quoting *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000)), 17. It noted that "there was authority that supported [defendant's] failure to disclose the ongoing [] investigation" and held that "[b]ecause there is no clear case law that would require [obvious] disclosure . . . the plaintiff cannot show that the defendants acted in reckless disregard of the securities laws." *Id.* at 18. It concluded that "the more cogent inference [was] that Lions Gate did not specifically disclose the investigation . . . because it did not believe that there was a requirement to do so." *Id.* (citing *Stratte-McClure*, 776 F.3d at 107). The Panel should have applied the same standards and analysis here.

**A. The Panel’s Assumption That Corporations Are Aware Of Every Public Statement And Article About Them Sets A Dangerous Precedent.**

The Panel found sufficient for “manifestation” under FAS 5 the PSAC’s allegations regarding: (1) a statement in a December 16, 2010 press release noting that Mayor Bloomberg’s office and the State Comptroller were beginning a forensic audit of CityTime to determine whether they could recover improperly paid funds; and (2) a December 20, 2010 online blog attributing a statement to Mayor Bloomberg that the City was determining what future role SAIC could have on the CityTime project and was reviewing options for a forensic auditor to evaluate whether it could recoup funds outside of the DOJ-DOI investigation. Op. 19; (PSAC ¶¶ 370-71, JA-208-9). The PSAC does not allege, however, and the Panel did not identify any allegations suggesting, that anyone at SAIC responsible for the March 2011 10-K was ever aware of the statements before March 25, 2011. Indeed, the PSAC alleges that the Mayor’s first direct communication to SAIC was on June 29, 2011, which SAIC promptly disclosed. PSAC ¶ 14 (JA-101).

The Panel’s inclusion of the December statements in its “manifestation” analysis, without accompanying allegations of SAIC management awareness of the statements, was error. The manifestation contemplated by FAS 5 must be made to the issuing party, or else parties could be held responsible for disclosure obligations when they have no knowledge of such manifestations. *Cf. Pa. Pub. Sch. Emps.’ Ret. Sys.*, 939 F. Supp. 2d at 453 (finding there was “manifestation by

a potential claimant” where the executive defendants received multiple pre-litigation demand letters from claimants).

The Panel’s decision is also inconsistent with this Court’s decision in *Welch v. Havenstein*, 553 F. App’x 54. There, the Court agreed that online articles were insufficient to show knowledge because “Plaintiffs d[id] not allege that any member of the Board actually read, or learned the contents of,” the articles. *In re SAIC Inc. Derivative Litig*, 948 F. Supp. 2d at 385. The Panel similarly should have concluded that statements not allegedly made to SAIC or known about at SAIC, were insufficient to “manifest” awareness of a potential claim by the City.

**B. The Panel’s Holding That Corporations May Be Required To Disclose Ongoing Government Investigations Contradicts Circuit Precedent.**

The Panel also erred in its FAS 5 determination by relying on the PSAC’s allegations regarding: (1) the filing of a criminal complaint by *federal* authorities against *non-SAIC* individuals in December 2010; and (2) the government’s ongoing investigation consisting of subpoenas from *federal* authorities requesting documents from SAIC and Denault that did not identify either as a target (PSAC ¶ 341, JA-199).<sup>4</sup> Op. 18. As a threshold matter, while the PSAC’s allegations assert

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<sup>4</sup> As SAIC noted in its briefing before the district court, Denault and SAIC were merely subpoenaed for records and testimony in December 2010 connection with “*United States v. Mazer*” (an action against non-SAIC personnel), *not* identified as targets. Department of Justice policies require the U.S. Attorney’s Office to send a “target letter” to any witness called to testify before a grand jury, if in the judgment  
(*Cont'd on next page*)

that the criminal complaint reflected that invoices submitted to NYC were inflated by fraud (*see, e.g.*, PSAC ¶ 334), the PSAC's allegations do not support the Panel's finding that the December 2010 criminal complaint "alluded to SAIC's improper actions." Op. 18. Nor did anything in the *federal criminal* complaint, or *federal* grand jury subpoenas issued to SAIC and Denault (failing to identify either as a target), "manifest" the *City's* awareness of a potential *civil* claim against SAIC.

Further, virtually every single district court in this Circuit to consider the "manifestation" language in FAS 5 ¶ 10, has held that an ongoing investigation, including the issuance of multiple subpoenas to a company, is insufficient. Rather, they hold that the manifestation must be in the form of threatened litigation. In *In re Lions Gate*, for example, the plaintiffs contended that Lions Gate should have disclosed an ongoing SEC investigation (including the receipt of multiple subpoenas and multiple Wells notices) under FAS 5, because it knew of "the SEC's awareness of a possible claim." 2016 WL 297722, at \*15. The court rejected that argument, noting that while "under ASC 450, threatened litigation

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of the prosecutor, the witness is a putative defendant. *See* No. 12-cv-01353 (S.D.N.Y.), ECF No. 110, at 9 n.3; *U.S. Attorneys' Manual, Chapter 9-11.151, Advice of "Rights" of Grand Jury Witnesses, available at: <https://www.justice.gov/usam/usam-9-11000-grand-jury#9-11.151>*. In the absence of allegations that Denault and/or SAIC received "target" letters in December 2010, the inference that SAIC knew they were targets of the criminal investigation is not plausible or reasonable.

may qualify as a loss contingency when a potential claimant has manifested awareness of the claim,” “the plaintiffs’ argument fails because . . . the investigation was not pending or threatened litigation.” *Id.* at 15; *see also City of Westland*, 928 F. Supp. 2d at 711, 718 (holding that disclosure of a multi-state investigation, in which multiple of defendant’s executives testified, was not required under FAS 5 because “the state investigations were not pending or threatened litigation.”). These decisions make sense. If “manifestation” is not a clear threat of litigation, it would lead to broad speculation regarding ongoing investigations and potential claims. This is inconsistent with Circuit precedent holding that “there is no duty to disclose litigation that is not ‘substantially certain to occur.’” *Lions Gate*, 2016 WL 297722, at \*7 (quoting *Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 273-74 (S.D.N.Y. 2012); and citing *In re Citigroup, Inc. Sec. Litig.*, 330 F. Supp. 2d 367, 377 (S.D.N.Y. 2004), *aff’d sub nom.*, *Albert Fadem Trust v. Citigroup, Inc.*, 165 F. App’x 928 (2d Cir. 2006); *In re Marsh & McLennan Sec. Litig.*, 501 F. Supp. 2d 452, 471 (S.D.N.Y. 2006)).

## CONCLUSION

Rehearing is necessary to avoid considerable disarray and loosening of the standards for pleading corporate scienter and securities fraud in this Circuit. Rehearing is also appropriate because the facts alleged in the PSAC simply do not adequately allege securities fraud against SAIC.

Dated: April 12, 2016

Respectfully submitted,

/s/ Andrew S. Tulumello

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**CERTIFICATE OF COMPLIANCE WITH  
TYPEFACE AND TYPE STYLE REQUIREMENTS**

This petition complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because this petition has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font.

Dated: April 12, 2016

/s/ Andrew S. Tulumello  
Andrew S. Tulumello

**CERTIFICATE OF SERVICE**

I hereby certify that on Tuesday, April 12, 2016, I caused service of the foregoing to be made by electronic filing with the Clerk of the Court using the **CM/ECF** System, which will send a Notice of Electronic Filing to all parties with an e-mail address of record, who have appeared and consent to electronic service in this action.

          /s/ Andrew S. Tulumello            
Andrew S. Tulumello



# APPENDIX

14-4140-cv  
Ind. Pub. Ret. Sys. v. SAIC, Inc.

1 **UNITED STATES COURT OF APPEALS**  
2 **FOR THE SECOND CIRCUIT**

3  
4 August Term, 2015

5  
6 (Argued: October 6, 2015 Decided: March 29, 2016)

7  
8 Docket No. 14-4140-cv

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13 INDIANA PUBLIC RETIREMENT SYSTEM, Indiana State  
14 Teachers' Retirement Fund, Indiana Public  
15 Employees' Retirement Fund,

16  
17 *Plaintiffs-Appellants,*

18  
19 City of Westland Police and Fire Retirement  
20 System, on Behalf of Itself and All Others Similarly Situated,  
21 Locals 302 and 612 of the International Union of  
22 Operating Engineers-Employers Construction  
23 Industry Retirement Fund, on Behalf of Themselves and  
24 All Others Similarly Situated, IBEW Local Union No. 58  
25 Annuity Fund and the Electrical Workers Pension  
26 Trust Fund of IBEW Local Union No. 58,

27  
28 *Plaintiffs,*

29  
30 v.

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32 SAIC, INC., Mark W. Sopp, Walter P. Havenstein,

33  
34 *Defendants-Appellees,*

35  
36 Gerard Denault, Kenneth C. Dahlberg, Deborah H. Alderson,

37  
38 *Defendants.*  
39  
40 \_\_\_\_\_

1 Before:

2  
3 LYNCH, LOHIER, and CARNEY, *Circuit Judges*.

4  
5 Plaintiffs-appellants Indiana Public Retirement System, on behalf of  
6 themselves and a class of other similarly situated investors, appeal from an  
7 order of the District Court (Batts, J.) denying their motions to vacate the  
8 judgment and to amend their complaint. Plaintiffs brought a securities fraud  
9 suit pursuant to Section 10(b), 15 U.S.C. § 78j(b), and Section 20(a), 15 U.S.C.  
10 § 78t(a), of the Securities Exchange Act of 1934 against SAIC, Inc., Walter P.  
11 Havenstein, Mark W. Sopp, and others, alleging material misstatements and  
12 omissions in SAIC's public filings regarding its exposure to liability for  
13 employee fraud in connection with SAIC's contract work for New York City's  
14 CityTime project. Because amendment of Plaintiffs' FAS 5 and Item 303  
15 claims based on SAIC's March 2011 Form 10-K would not be futile, we  
16 **VACATE** the order denying the postjudgment motion with respect to those  
17 claims and **REMAND** for further proceedings consistent with this opinion.  
18 We **AFFIRM** the decision of the District Court with respect to Plaintiffs' other  
19 claims.

20  
21 DOUGLAS WILENS, Robbins Geller  
22 Rudman & Dowd LLP, Boca Raton, FL;  
23 Samuel H. Rudman, Joseph Russello,  
24 Sean T. Masson, Robbins Geller  
25 Rudman & Dowd LLP, Melville, NY, *for*  
26 *Plaintiffs-Appellants*.

27  
28 ANDREW S. TULUMELLO (Jason J.  
29 Mendro, *on the brief*), Gibson, Dunn &  
30 Crutcher LLP, Washington, DC; Eric  
31 Robert Delinsky, Zuckerman Spaeder  
32 LLP, Washington, DC *for Defendants-*  
33 *Appellees* SAIC, Inc. and Mark W. Sopp.

34  
35 Mark Filip, P.C., Vikas Didwania,  
36 Kirkland & Ellis LLP, Chicago, IL; Beth  
37 A. Williams, Emily P. Hughes, Kirkland  
38 & Ellis LLP, Washington, DC *for*  
39 *Defendant-Appellee* Walter P. Havenstein.

1 LOHIER, *Circuit Judge*:

2           The Indiana Public Retirement System, the Indiana State Teachers’  
3 Retirement Fund, and the Indiana State Public Employees’ Retirement Fund,  
4 on behalf of themselves and a class of other similarly situated investors  
5 (“Plaintiffs”), appeal from an order of the United States District Court for the  
6 Southern District of New York (Batts, L) denying their motions to vacate the  
7 judgment and to amend their complaint. Plaintiffs sued SAIC, Inc.;<sup>1</sup> Walter P.  
8 Havenstein, its Chief Executive Officer; Mark W. Sopp, its Chief Financial  
9 Officer; and others (collectively, “Defendants”) for securities fraud in  
10 violation of Section 10(b) of the Securities Exchange Act of 1934 (the  
11 “Exchange Act”), 15 U.S.C. § 78j(b), Section 20(a) of the Exchange Act, 15  
12 U.S.C. § 78t(a), and Securities and Exchange Commission (“SEC”) Rule 10b-5,  
13 17 C.F.R. § 240.10b-5. Their lawsuit arose from a series of alleged material  
14 misstatements and omissions in SAIC’s public filings regarding its exposure  
15 to liability for employee fraud in connection with SAIC’s contract work for  
16 New York City’s CityTime project. On appeal, we address principally four  
17 issues arising from Plaintiffs’ motion to file a Proposed Second Amended

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<sup>1</sup> SAIC is now known as Leidos Holdings, Inc.

1 Complaint (“PSAC”): (1) SAIC’s alleged failure to comply with Generally  
2 Accepted Accounting Principles (“GAAP”) by failing to disclose appropriate  
3 loss contingencies associated with the CityTime project, in violation of  
4 Financial Accounting Standard No. 5 (“FAS 5”); (2) SAIC’s alleged failure to  
5 disclose a known trend or uncertainty reasonably expected to have a material  
6 impact on its financial condition, in violation of Item 303 of SEC Regulation S-  
7 K, 17 C.F.R. § 229.303(a)(3)(ii) (“Item 303”);<sup>2</sup> (3) SAIC’s scienter; and  
8 (4) among other remaining issues, SAIC’s allegedly misleading statements  
9 regarding its commitment to ethics and integrity contained in its 2011 Annual  
10 Report to shareholders.

11 We conclude that the District Court improperly denied Plaintiffs’  
12 postjudgment motion to amend their FAS 5 and Item 303 claims based on  
13 SAIC’s March 2011 Form 10-K. We therefore vacate the District Court’s order  
14 denying the motion with respect to those claims and remand for further

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<sup>2</sup> Regulation S-K required SAIC’s periodic reports to the SEC, including its reports on Forms 10-K and 10-Q, to contain a section devoted to “management’s discussion and analysis of the financial condition and results of operations.” 17 C.F.R. § 229.303(a)-(b).

1 proceedings consistent with this opinion. We affirm the judgment of the  
2 District Court with respect to Plaintiffs' remaining claims.

### 3 BACKGROUND

4 We accept as true the facts alleged in the PSAC because Plaintiffs  
5 appeal from the denial of leave to amend on the ground of futility. See In re  
6 Advanced Battery Techs., Inc., 781 F.3d 638, 641-42 (2d Cir. 2015).

#### 7 1. Facts

8 SAIC provided defense, intelligence, homeland security, logistics, and  
9 other services primarily to government agencies. In 2000 SAIC became the  
10 prime government contractor on a project with New York City to develop and  
11 implement an automated timekeeping program known as CityTime for  
12 employees of various City agencies. SAIC anticipated that the project, if  
13 successful, would attract business from municipalities across the United  
14 States with similar timekeeping requirements and would lead to contracts  
15 unrelated to timekeeping in the City. As a result, SAIC kept a close eye on the  
16 project's progress.

17 In 2002 SAIC hired Gerard Denault as Deputy Program Manager in  
18 charge of the CityTime project. In 2003 Denault enlisted Technodyne, a small,

1 relatively unknown company, to provide staffing services on the project, but  
2 the relationship soon gave rise to an elaborate kickback scheme in which  
3 Technodyne illegally paid Denault and Carl Bell (SAIC's Chief Systems  
4 Engineer) for each hour a Technodyne consultant or subcontractor worked on  
5 CityTime. The scheme encouraged Denault and Bell to hire more  
6 Technodyne workers than the project required and to inflate billable hours  
7 and hourly rates.

8         Although SAIC initially suffered large losses under the CityTime  
9 contract, the contract became profitable in 2006 after Denault negotiated an  
10 amendment to the contract that transferred the risk of any cost overruns to  
11 the City. As a result of the amendment and the cost overruns associated with  
12 the kickback scheme, SAIC billed the City approximately \$635 million for  
13 CityTime through May 2011, well over the \$63 million that the City initially  
14 budgeted for the contract.

15         By late 2010, when the scheme began to unravel, SAIC had removed  
16 Denault from the CityTime project, placed him on administrative leave, and  
17 hired an outside law firm to conduct an internal investigation of possible  
18 fraud with the help of SAIC's internal auditors, who were tasked with

1 reviewing Denault's timekeeping practices. At the same time, then-Mayor  
2 Michael Bloomberg announced that he was reevaluating SAIC's role in the  
3 CityTime project and reviewing whether to seek recovery of the City's  
4 payments to SAIC in connection with that project. On March 9, 2011, SAIC's  
5 audit team reported the results of its findings regarding Denault's improper  
6 timekeeping practices to SAIC.

7 Notwithstanding the audit team's findings, SAIC's Form 10-K, filed on  
8 March 25, 2011, and certified by Sopp and Havenstein, did not disclose  
9 SAIC's potential liability related to the CityTime project. To the contrary, in a  
10 separate Annual Report to shareholders that same month, SAIC touted its  
11 commitment to high standards of "ethical performance and integrity." Joint  
12 App'x 252. By the end of May 2011, though, Denault, Bell, the Technodyne  
13 principals, and others were charged in a federal criminal complaint with  
14 defrauding the City.<sup>3</sup> The charges, together with the results of the internal  
15 investigation from March 2011, prompted SAIC to fire Denault in May 2011

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<sup>3</sup> Bell was interviewed about the CityTime project by SAIC's in-house and outside counsel on January 24, 2011, resigned from SAIC that same day, and pleaded guilty in June 2011, while Denault was arrested in May 2011 and was ultimately convicted. The indicted Technodyne principals fled to India.



1 and offer to repay the City the amount he had billed after the 2006  
2 amendment of the CityTime contract—a total of \$2.5 million.

3           Thereafter, in a Form 8-K filed with the SEC on June 2, 2011, SAIC  
4 finally disclosed that the United States Attorney’s Office for the Southern  
5 District of New York (the “Government”) and the New York City Department  
6 of Investigation (“DOI”) were conducting a joint criminal investigation into  
7 the CityTime contract. The 8-K further disclosed that SAIC had billed a total  
8 of \$635 million for the CityTime project, that it had \$40 million in outstanding  
9 receivables, that Denault had been arrested for fraud, and that SAIC had  
10 offered to refund the City the \$2.5 million that Denault billed as part of the  
11 kickback scheme with Technodyne. Finally, the 8-K explained that Mayor  
12 Bloomberg had

13           indicated that the City intends to pursue the recovery of costs  
14 associated with the CityTime program that the City’s investigation  
15 reveals were improperly charged to the City. The City has not filed any  
16 claim against the Company or otherwise requested reimbursement or  
17 return of payments previously made to the Company and the  
18 Company has not recorded any liabilities relating to this contract other  
19 than the approximately \$2.5 million it offered to refund. However,  
20 there is a reasonable possibility of additional exposure to loss that is not  
21 currently estimable if there is an adverse outcome. An adverse  
22 outcome of any of these investigations may result in non-payment of  
23 amounts owed to the Company, a demand for reimbursement of other  
24 amounts previously received by the Company under the contract,

1 claims for additional damages, and/or fines and penalties, which could  
2 have a material adverse effect on the Company's consolidated financial  
3 position, results of operations and cash flows.

4  
5 Joint App'x 254-55.

6 In addition to filing the 8-K on June 2, 2011, SAIC held a conference call  
7 with analysts and investors to discuss SAIC's earnings. During the call,  
8 Havenstein referred investors to the 8-K for detailed information about the  
9 CityTime project and the ongoing criminal investigation. Similarly, on June 3,  
10 2011, SAIC filed a Form 10-Q that repeated the representations made in the 8-  
11 K about the project.

12 On July 1, 2011, SAIC filed a second 8-K that included a letter from  
13 Mayor Bloomberg formally demanding that SAIC reimburse the City in the  
14 approximate amount of \$600 million. On August 31, 2011, SAIC issued a  
15 press release announcing losses for the fiscal period ending July 31, 2011, due  
16 in part to the winding down of the CityTime contract and "probable"  
17 restitution to the City for wrongful conduct. Joint App'x 260. From June 2,  
18 2011, when SAIC first disclosed the existence of a criminal investigation and  
19 the possible magnitude of its reimbursement to the City, to September 1, 2011,

1 the day after it announced the termination of the CityTime contract, SAIC's  
2 stock price fell from \$17.21 to \$12.97 per share.

3 In March 2012 SAIC entered into a deferred prosecution agreement  
4 with the Government and the DOJ, pursuant to which SAIC agreed to  
5 reimburse the City approximately \$500.4 million and to forfeit \$40 million in  
6 unpaid receivables. SAIC also agreed to cooperate with the Government's  
7 investigation of the CityTime fraud and to issue a "Statement of  
8 Responsibility" in which it acknowledged that it had defrauded the City  
9 through its managerial employees. SAIC admitted, among other things, that  
10 it should have supervised Denault's activities, controlled the cost of the  
11 project, addressed concerns about its relationship with Technodyne, and  
12 properly investigated an early anonymous internal complaint about Denault's  
13 relationship with Technodyne on the project.

## 14 2. Procedural History

15 Plaintiffs filed this lawsuit against SAIC and the individual defendants  
16 under Section 10(b) and Section 20(a) of the Exchange Act. As relevant here,  
17 they claimed that SAIC's March and June 2011 SEC filings on Forms 10-K, 10-  
18 Q, and 8-K failed to disclose SAIC's potential liability arising out of the

1 CityTime fraud or known trends or uncertainties associated with the fraud, as  
2 required by FAS 5 and Item 303. Plaintiffs also claimed that the March 2011  
3 Form 10-K contained misstatements regarding the efficacy of SAIC's internal  
4 controls, that SAIC's 2011 Annual Report contained misleading statements  
5 regarding SAIC's commitment to ethics and integrity, and that in its June 2011  
6 conference call, SAIC misrepresented its potential liability for the CityTime  
7 project.

8 By order dated September 30, 2013 (the "September 2013 Order"), the  
9 District Court denied Defendants' motions to dismiss Plaintiffs' claims  
10 alleging violations of FAS 5 and Item 303 on the March 2011 Form 10-K, but  
11 granted Defendants' motions to dismiss with respect to most of Plaintiffs'  
12 other claims for failure to state a claim. In re SAIC, Inc. Sec. Litig. (SAIC I),  
13 No. 12-CV-1353 (DAB), 2013 WL 5462289, at \*16 (S.D.N.Y. Sept. 30, 2013). It  
14 granted Plaintiffs leave to amend, within forty-five days, a subset of the  
15 dismissed claims, specifically (1) the internal control claim based on the  
16 March 2011 Form 10-K and (2) the claims against all of the individual  
17 defendants except Denault. Id. at 17. Plaintiffs elected to forgo amending  
18 their complaint to replead those claims within the forty-five-day window,

1 deciding instead to proceed with the surviving FAS 5 and Item 303 claims  
2 relating to SAIC's March 2011 Form 10-K.

3 SAIC, by contrast, moved the District Court to reconsider its decision  
4 not to dismiss Plaintiffs' FAS 5 and Item 303 claims based on the March 2011  
5 Form 10-K. On January 30, 2014, the District Court granted SAIC's motion  
6 and immediately entered judgment dismissing Plaintiffs' remaining claims  
7 with prejudice (the "January 2014 Order"). In re SAIC, Inc. Sec. Litig. (SAIC  
8 II), No. 12-CV-1353 (DAB), 2014 WL 407050, at \*1 (S.D.N.Y. Jan. 30, 2014).

9 On March 4, 2014, Plaintiffs moved to vacate or to obtain relief from the  
10 judgment pursuant to Rules 59(e) and 60(b) of the Federal Rules of Civil  
11 Procedure and moved under Rule 15(a) for leave to file a proposed amended  
12 complaint in the form of the PSAC. As relevant here, the PSAC alleged the  
13 following additional facts: (1) SAIC was aware of the Government's criminal  
14 investigation of Denault by the end of December 2010 and had agreed to  
15 advance Denault's legal fees in connection with the investigation and any  
16 criminal proceeding that emerged; (2) the December 2010 criminal complaint  
17 suggested that SAIC had engaged in improper conduct; (3) by December 19,  
18 2010, SAIC had initiated an internal investigation of Denault's timekeeping

1 practices; (4) Mayor Bloomberg announced in a press release (December 16,  
2 2010) and in a Daily News article (December 20, 2010) that he was  
3 reevaluating SAIC's role in the CityTime project and reviewing all payments  
4 the City made with a goal of recovering funds from SAIC; (5) SAIC removed  
5 Denault from the CityTime project and placed him on administrative leave on  
6 December 21, 2010; (6) the New York State Comptroller's Office and the City  
7 Mayor's Office each rejected contract awards to SAIC in December 2010 based  
8 partly on the brewing controversy surrounding the CityTime project; (7) SAIC  
9 interviewed Bell about the fraud allegations on January 24, 2011, the day Bell  
10 resigned from SAIC; (8) on February 10, 2011, the Government and the DOI  
11 announced the filing of an indictment in connection with a fraud scheme  
12 involving CityTime; (9) Bell was subpoenaed concerning CityTime, and SAIC  
13 agreed to advance his legal fees in connection with the criminal matter on  
14 February 11, 2011; and (10) SAIC's audit team issued a memorandum  
15 regarding Denault's improper timekeeping practices on March 9, 2011.

16 On September 30, 2014, the District Court denied Plaintiffs' motions for  
17 relief from judgment, concluding that any amendment as reflected in the

1 PSAC would be futile.<sup>4</sup> In re SAIC, Inc. Sec. Litig. (SAIC III), No. 12-CV-1353  
2 (DAB), 2014 WL 4953614, at \*4 (S.D.N.Y. Sept. 30, 2014).

3 This appeal followed.

#### 4 DISCUSSION

5 “[A] party seeking to file an amended complaint postjudgment must  
6 first have the judgment vacated or set aside pursuant to Rules 59(e) or 60(b).”<sup>5</sup>  
7 Williams v. Citigroup Inc., 659 F.3d 208, 213 (2d Cir. 2011). Rule 60(b)(6)  
8 authorizes a court to grant relief from a final judgment for “any . . . reason  
9 that justifies relief.” Fed. R. Civ. P. 60(b)(6). We have explained that “in view  
10 of the provision in [R]ule 15(a) that leave to amend shall be freely given when

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<sup>4</sup> The District Court also rejected Plaintiffs’ arguments that the judgment should be set aside because of the discovery of new evidence adduced in Denault’s criminal trial. Because we conclude that the District Court erred in not granting leave to amend, we do not reach this issue.

<sup>5</sup> The District Court analyzed Plaintiffs’ motion under Rule 60(b) only, explaining in a footnote that their Rule 59(e) motion was untimely because it “was filed 32 days after entry of Judgment.” SAIC III, 2014 WL 4953614, at \*2 n.5. As an initial matter, the District Court was mistaken when it held that Plaintiffs’ Rule 59(e) motion was untimely. Although the judgment was signed on January 31, 2014, it was not entered on the docket until February 4, 2014. Plaintiffs filed their motion 28 days later, on March 4, 2014, and their request to amend the judgment under Rule 59(e) was therefore timely. See Fed. R. Civ. P. 59(e) (“A motion to alter or amend a judgment must be filed no later than 28 days after the entry of the judgment.”).

1 justice so requires, it might be appropriate in a proper case to take into  
2 account the nature of the proposed amendment in deciding whether to vacate  
3 the previously entered judgment.” Williams, 659 F.3d at 213 (quotation  
4 marks omitted).

5 Here, the District Court denied leave to amend under Rule 60(b)(6)  
6 solely on the ground that amendment (in the form of the PSAC) would be  
7 futile,<sup>6</sup> a determination that we review de novo. City of Pontiac Policemen’s  
8 & Firemen’s Ret. Sys. v. UBS AG, 752 F.3d 173, 188 (2d Cir. 2014). We assess  
9 futility as we would a motion to dismiss, determining whether the proposed  
10 complaint contains “enough facts to state a claim to relief that is plausible on  
11 its face.” Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). In this case,  
12 because the PSAC alleges securities fraud, it must also satisfy the heightened  
13 pleading requirements of the Private Securities Litigation Reform Act  
14 (“PSLRA”), 15 U.S.C. § 78u-4(b)(1)-(2), and Rule 9(b) of the Federal Rules of

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<sup>6</sup>Plaintiffs also argue that the District Court erred by dismissing the remaining claims in its January 2014 Order and closing the case without granting Plaintiffs leave to replead sua sponte. We have described a similar argument in another case as frivolous, see Williams, 659 F.3d at 212, and, accordingly, we conclude that the District Court did not abuse its discretion in refusing to grant leave to replead sua sponte.



1 Civil Procedure. ECA, Local 134 IBEW Joint Pension Tr. of Chi. v. JP Morgan  
2 Chase Co., 553 F.3d 187, 196 (2d Cir. 2009). The PSAC therefore must allege  
3 with particularity facts that give rise to “a strong inference” that SAIC acted  
4 consciously and recklessly in omitting or misrepresenting financial  
5 information. Id. at 198.

6 On appeal, Plaintiffs elected to substantially shorten the class period  
7 and affirmatively waived any challenge to the District Court’s dismissal of  
8 claims arising out of alleged false statements, omissions, or other violations of  
9 the securities laws that occurred prior to March 2011. See Oral Argument Tr.  
10 at 4. We therefore affirm the District Court’s dismissal of those claims, and in  
11 the remainder of this opinion we focus only on claims arising from  
12 misstatements and omissions during the shorter class period from March 23,  
13 2011 to September 1, 2011.

14 1. Plaintiffs’ FAS 5 Claim Based on the March 2011 Form 10-K

15 To succeed on a claim under Section 10(b) of the Exchange Act and  
16 Rule 10b-5, “a plaintiff must allege that [each] defendant (1) made  
17 misstatements or omissions of material fact, (2) with scienter, (3) in  
18 connection with the purchase or sale of securities, (4) upon which the plaintiff

1 relied, and (5) that the plaintiff's reliance was the proximate cause of its  
2 injury." ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 105 (2d Cir.  
3 2007). And while "[f]inancial statements . . . which are not prepared in  
4 accordance with [GAAP are] presum[ptively] . . . misleading or inaccurate,"  
5 17 C.F.R. § 210.4-01(a)(1), "allegations of GAAP violations or accounting  
6 irregularities, standing alone, are insufficient to state a securities fraud claim."  
7 Novak v. Kasaks, 216 F.3d 300, 309 (2d Cir. 2000). "Only where such  
8 allegations are coupled with evidence of corresponding fraudulent intent  
9 might they be sufficient." Id. (quotation marks omitted).

10 Plaintiffs allege that SAIC violated GAAP by failing to comply with  
11 FAS 5, which requires the issuer to disclose a loss contingency when a loss is a  
12 "reasonable possibility," meaning that it is "more than remote but less than  
13 likely." Financial Accounting Standards Board, Statement of Financial  
14 Accounting Standards No. 5, Accounting for Contingencies ¶¶ 3, 10 (1975)  
15 (hereinafter FAS Board, Statement of FAS 5). Here, Plaintiffs assert that SAIC  
16 failed to disclose the loss contingency related to the CityTime fraud in SAIC's  
17 March 2011 Form 10-K.

1           At the outset, we note that the District Court appears to have  
2           misunderstood the standard applicable to claims under FAS 5 when it held  
3           that FAS 5 does not require disclosure “unless it is considered probable that a  
4           claim will be asserted.” SAIC II, 2014 WL 407050, at \*3 (emphasis added)  
5           (quotation marks omitted). The “probability” standard applies in lieu of the  
6           “reasonable possibility” standard only if the loss contingency arises from “an  
7           unasserted claim or assessment when there has been no manifestation by a  
8           potential claimant of an awareness of a possible claim or assessment.” FAS  
9           Board, Statement of FAS 5 ¶ 10 (emphasis added). But in this case, the  
10          “reasonable possibility” standard applies in view of the PSAC’s allegation  
11          that by March 2011 the City had manifested an awareness of a possible,  
12          sizeable claim against SAIC. With that standard in mind, we turn to the  
13          allegations in the PSAC relevant to the March 2011 Form 10-K.

14          By the time SAIC filed that 10-K, the PSAC alleges, the CityTime  
15          criminal investigation was as focused on SAIC as it was on SAIC’s individual  
16          employees; the December 2010 criminal complaint against individuals  
17          involved in the CityTime project alluded to SAIC’s improper actions; Denault  
18          had been interviewed by prosecutors, and both SAIC and Denault received a

1 grand jury subpoena for the production of documents related to the CityTime  
2 project; Mayor Bloomberg announced a reevaluation of SAIC's role in the  
3 CityTime project, including a full review of all payments the City had made  
4 to SAIC; and SAIC agreed to pay Denault's and Bell's legal fees associated  
5 with any criminal proceedings. Moreover, the PSAC alleged that by March 9,  
6 2011, when SAIC received the results of its internal investigation about  
7 possible fraud, SAIC was aware not only of Denault's wrongdoing but also its  
8 own potential liability to the City.

9 For these reasons we hold that the PSAC adequately alleged that SAIC  
10 violated FAS 5 by failing to disclose a loss contingency in its March 2011 10-K  
11 arising from the City's manifest awareness of a possible material claim  
12 against SAIC.

13 2. Plaintiffs' Item 303 Claim Based on the March 2011 Form 10-K

14 We next consider whether the PSAC adequately pleaded a violation of  
15 Item 303, which imposes specific "disclosure requirements on companies  
16 filing" reports on SEC Forms 10-K and 10-Q. Stratte-McClure v. Morgan  
17 Stanley, 776 F.3d 94, 101 (2d Cir. 2015). As relevant here, Item 303 requires  
18 that SAIC's 10-K "[d]escribe any known trends or uncertainties that have had

1 or that the registrant reasonably expects will have a material favorable or  
2 unfavorable impact on net sales or revenues or income from continuing  
3 operations.” 17 C.F.R. § 229.303(a)(3)(ii).<sup>7</sup> According to the SEC’s interpretive  
4 release regarding Item 303, “disclosure [under Item 303] is necessary ‘where a  
5 trend, demand, commitment, event or uncertainty is both presently known to  
6 management and reasonably likely to have material effects on the registrant’s  
7 financial conditions or results of operations.’” Stratte-McClure, 776 F.3d at  
8 101 (quoting Management’s Discussion and Analysis of Financial Condition  
9 and Results of Operations, Securities Act Release No. 6835, Exchange Act  
10 Release No. 26,831, Investment Company Act Release No. 16,961, 43 SEC  
11 Docket 1330 (May 18, 1989) (hereinafter SEC’s Interpretive Release)).

12 The PSAC alleges that SAIC violated Item 303 by failing to disclose: “(i)  
13 that SAIC had overbilled [the City] hundreds of millions of dollars on  
14 CityTime over a multi-year period; and (ii) that SAIC’s overbilling practices

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<sup>7</sup> In Stratte-McClure, we held that Item 303 imposes an “affirmative duty to disclose . . . [that] can serve as the basis for a securities fraud claim under Section 10(b).” 776 F.3d at 101. We explained that “failure to comply with Item 303 . . . can give rise to liability under Rule 10b–5 so long as the omission is material under Basic [Inc. v. Levinson], 485 U.S. 224 (1988)], and the other elements of Rule 10b–5 have been established.” Stratte-McClure, 776 F.3d at 103-04 (emphases added).

1 subjected it to numerous undisclosed risks, including monetary risks and  
2 reputational risks, particularly because government agencies are SAIC 's  
3 primary customers and any harm to its reputation and/or relationships with  
4 such agencies would adversely affect its current business, as well as its future  
5 revenues and growth prospects." Joint App'x 230.

6 SAIC makes two principal arguments in defense of the District Court's  
7 conclusion that Plaintiffs' Item 303 claim was inadequately pleaded. First, it  
8 argues that it must actually have known of the relevant uncertainty at the  
9 time of the March 2011 filing, but that Plaintiffs failed to plead that SAIC  
10 actually knew then about the scheme. Second, it insists that the loss of the  
11 CityTime contract was not material to SAIC's operations as a whole.

12 We have never directly addressed whether Item 303 requires that a  
13 company actually know or merely should have known of the relevant trend,  
14 event, or uncertainty in order to be liable for failing to disclose it. Instead, we  
15 appear to have assumed, without deciding, that Item 303 required an  
16 allegation or showing of actual knowledge rather than a lesser standard of  
17 recklessness or negligence. In Panther Partners, for example, we held that the  
18 complaint adequately alleged that defects in the defendant corporation's

1 semiconductor chips “constituted a known trend or uncertainty that [the  
2 defendant] reasonably expected would have a material unfavorable impact on  
3 revenues or income.” Panther Partners Inc. v. Ikanos Commc’ns, Inc., 681  
4 F.3d 114, 121 (2d Cir. 2012). We did not separately consider whether the  
5 defendant actually had to know about the existing financial uncertainty  
6 associated with the defect. Id.; see also Litwin v. Blackstone Grp., L.P., 634  
7 F.3d 706, 716 (2d Cir. 2011) (concluding that, where it was undisputed that  
8 “the downward trend in the real estate market was already known and  
9 existing at the time of the [initial public offering], . . . the sole remaining issue  
10 [was] whether the effect of the ‘known’ information was ‘reasonably likely’ to  
11 be material”).

12         The plain language of Item 303 confirms our previous assumption that  
13 it requires the registrant’s actual knowledge of the relevant trend or  
14 uncertainty. Item 303 demands that the registrant “[d]escribe any known  
15 trends or uncertainties” and also requires disclosure where “the registrant  
16 knows of events that will cause a material change in the relationship between  
17 costs and revenues,” such as a “known future increase[] in costs of labor.” 17  
18 C.F.R. § 229.303(a)(3)(ii) (emphases added). The SEC’s interpretation of Item

1 303 further confirms this plain-language reading of Item 303, insofar as it  
2 advises that the trends or uncertainties must be “presently known to  
3 management.” SEC’s Interpretive Release (emphasis added). We therefore  
4 hold that Item 303 requires the registrant to disclose only those trends, events,  
5 or uncertainties that it actually knows of when it files the relevant report with  
6 the SEC. It is not enough that it should have known of the existing trend,  
7 event, or uncertainty.

8 Here, the PSAC’s allegations support a strong inference that SAIC  
9 actually knew (1) about the CityTime fraud before filing its Form 10-K on  
10 March 25, 2011, and (2) that it could be implicated in the fraud and required  
11 to repay the City the revenue generated by the CityTime contract.<sup>8</sup> Moreover,  
12 the PSAC plausibly alleges that, in December 2010, as a result of the CityTime  
13 fraud, both the City and New York State rejected pending contract awards to  
14 SAIC valued at more than \$150 million. Exposure of the fraud also

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<sup>8</sup> This was not an “uncertainty” arising out of a run-of-the-mill civil enforcement investigation by the SEC. See In re Lions Gate Entm’t Corp. Sec. Litig., No. 14-CV-5197 (JGK), 2016 WL 297722, at \*14 (S.D.N.Y. Jan. 22, 2016). Rather, as alleged in the PSAC, by early March 2011 SAIC was aware that it faced serious, ongoing criminal and civil investigations that exposed it to potential criminal and civil liability and that ultimately did result in criminal charges and substantial liability.



1 jeopardized SAIC's existing or future relationships with other governmental  
2 entities that accounted for a significant amount of its revenue. See Panther  
3 Partners Inc., 681 F.3d at 121. Indeed, the PSAC alleges, SAIC anticipated that  
4 the potential sale of CityTime's timekeeping software to other municipalities  
5 presented a "market opportunity valued [internally] at approximately \$2  
6 billion." Joint App'x 134. SAIC was aware of the fraud by late March 2011  
7 but was uncertain about its likely effect on SAIC's current and future  
8 revenues. Under those alleged circumstances, SAIC was required under Item  
9 303 to "disclose the manner in which th[at] then-known trend[ ], event[ ], or  
10 uncertain[ty] might reasonably be expected to materially impact" SAIC's  
11 future revenues. Litwin, 634 F.3d at 719.

12 We next consider SAIC's argument that the loss of the CityTime  
13 contract was ultimately not material in view of the fact that it was a single  
14 contract out of SAIC's more than 10,000 ongoing contracts and that it was  
15 worth a fraction of SAIC's yearly revenues (\$635 million compared to \$10  
16 billion). We reject SAIC's materiality argument, which asks us to consider  
17 quantitative factors only in the narrowest light in determining the financial

1 impact of losing the CityTime project due to the fraud, and to otherwise  
2 ignore qualitative factors. See id. at 717-18.

3       When a district court is in effect faced with a motion to dismiss a  
4 complaint, we have cautioned that “[b]ecause materiality is a mixed question  
5 of law and fact, in the context of a [Rule] 12(b)(6) motion, ‘[the] complaint  
6 may not properly be dismissed . . . on the ground that the alleged  
7 misstatements or omissions are not material unless they are so obviously  
8 unimportant to a reasonable investor that reasonable minds could not differ  
9 on the question of their importance.’” ECA, 553 F.3d at 197 (quoting Ganino  
10 v. Citizens Utils. Co., 228 F.3d 154, 162 (2d Cir. 2000)). Here, as we have just  
11 observed, the PSAC alleges that SAIC anticipated that the potential sale of  
12 CityTime’s timekeeping software to other municipalities presented a “market  
13 opportunity valued [internally] at approximately \$2 billion” – twenty percent  
14 of its yearly revenue. The PSAC also points to SAIC’s possible exposure to  
15 significant civil and even criminal liability arising from the submission of  
16 fraudulent time and billing records to the City and the resulting risk of loss of  
17 revenue from future contracts for CityTime projects or debarment from other  
18 government contracts altogether. The seriousness of the CityTime fraud and

1 the alleged importance of the CityTime project to SAIC's future presence in  
2 the City and its ability to sell similar services to other municipalities around  
3 the United States makes us reluctant to conclude at this stage that the alleged  
4 misstatements were "so obviously unimportant" either quantitatively or  
5 qualitatively that they could not be material.

6 3. Scienter

7 Next, we consider whether the plaintiffs have plausibly alleged that  
8 SAIC acted with the requisite scienter when it violated FAS 5 and Item 303 in  
9 connection with its March 2011 Form 10-K. In other words, does the PSAC  
10 allege "facts to show . . . strong circumstantial evidence of conscious  
11 misbehavior or recklessness" on SAIC's part? ECA, 553 F.3d at 198. It does.  
12 If credited, the allegations in the PSAC strongly suggest that by March 9,  
13 2011, when SAIC received the results of its internal investigation but before it  
14 filed its 10-K, SAIC knew about Denault's kickback scheme, the extent of the  
15 CityTime fraud, and, as we have already explained, that it risked civil and  
16 criminal fines and penalties, let alone losing a significant number of current  
17 and future government contracts. We conclude that the allegations support  
18 the inference that SAIC acted with at least a reckless disregard of a known or

1 obvious duty to disclose when, as alleged, it omitted this material information  
2 from its March 2011 10-K in violation of FAS 5 and Item 303.

3 SAIC responds that it is simply implausible that it (or, for that matter,  
4 any of the defendants) would deliberately conceal the “misconduct of rogue  
5 employees for just over two months, from the filing of the 10-K on March 25  
6 until [SAIC’s] disclosures on June 2, 2011,” because the benefits of a brief  
7 concealment would be low. Appellee’s Br. 53. But this “argument confuses  
8 expected with realized benefits.” Makor Issues & Rights, Ltd. v. Tellabs Inc.,  
9 513 F.3d 702, 710 (7th Cir. 2008). For it is “cogent and at least as compelling as  
10 any opposing inference of nonfraudulent intent,” Tellabs, Inc. v. Makor Issues  
11 & Rights, Ltd., 551 U.S. 308, 314 (2007), to infer that at the time it filed its 10-K  
12 in March 2011, SAIC believed it had more time before prosecutors would  
13 reveal its role in the scheme and before the City formally requested  
14 reimbursement; and if SAIC believed that it had more time, then “the benefits  
15 of concealment might [have] exceed[ed] the costs” as of March 2011. Tellabs,  
16 513 F.3d at 710. In fact, at that time, it was unclear when and to what degree  
17 SAIC’s role in the fraud would be made public. The PSAC’s theory, then—  
18 that the Government and the City uncovered SAIC’s role in the fraud sooner

1 than SAIC expected and compelled an earlier-than-expected disclosure in  
2 June 2011—is hardly implausible.

3 In sum, we disagree with the District Court’s conclusion that amending  
4 the complaint to include the FAS 5 and Item 303 claims based on the March  
5 2011 10-K would be futile.

6 4. Plaintiffs’ Remaining Claims

7 We briefly address Plaintiffs’ remaining claims on appeal.

8 First, the District Court dismissed with prejudice the FAS 5 claim based  
9 on SAIC’s June 2011 Form 8-K and then refused to grant leave to amend the  
10 claim in the PSAC. See SAIC I, 2013 WL 5462289, at \*10-11; SAIC III, 2014 WL  
11 4953614, at \*4. We agree with the District Court that amendment of this claim  
12 would be futile, notwithstanding the new facts alleged in the PSAC. SAIC’s  
13 June 2011 Form 8-K adequately disclosed the total amount that SAIC billed  
14 the City under the CityTime project, the \$40 million in outstanding  
15 receivables, Denault’s arrest for fraud, SAIC’s subsequent \$2.5 million  
16 reimbursement offer to the City, and the “reasonable possibility” of  
17 additional exposure to loss from “a demand for reimbursement of other  
18 amounts.” Joint App’x 254-55. Plaintiffs failed to identify in their complaint

1 any additional disclosures SAIC should have made in the 8-K to more  
2 accurately portray the extent of SAIC's exposure to liability from the project.

3 Second, Plaintiffs challenge the District Court's dismissal of their claims  
4 that SAIC's 2011 Annual Report contained materially false statements about  
5 SAIC's commitment to ethics and integrity. In particular, the PSAC points to  
6 representations in the Annual Report regarding SAIC's "culture of high  
7 ethical standards, integrity, operational excellence, and customer satisfaction"  
8 and its "reputation for upholding the highest standards of personal integrity  
9 and business conduct." Joint App'x 252. We affirm the District Court's  
10 dismissal of the claims based on these representations for substantially the  
11 reasons provided by the District Court. See SAIC I, 2013 WL 5462289, at \*13.  
12 On appeal, Plaintiffs argue that these general statements, while typically not  
13 actionable, are actionable in this context because Defendants were aware of  
14 facts undermining the positive statements about SAIC's commitment to ethics  
15 and integrity. But "Plaintiffs' claim that these statements were knowingly  
16 and verifiably false when made does not cure their generality, which is what  
17 prevents them from rising to the level of materiality required to form the  
18 basis for assessing a potential investment." City of Pontiac Policemen's &

1 Firemen's Ret. Sys., 752 F.3d at 183; see also ECA, 553 F.3d at 206 ("No  
2 investor would take such statements seriously in assessing a potential  
3 investment, for the simple fact that almost every investment bank makes  
4 these statements."). We cannot distinguish the statements in the Annual  
5 Report from the statements at issue in ECA, for example, in which we  
6 referred to representations in an SEC filing about a bank's reputation for  
7 integrity as "no more than 'puffery' which does not give rise to securities  
8 violations," and suggested that such statements are typically "too general to  
9 cause a reasonable investor to rely upon them," in part because an investor  
10 "would not depend on [the statements] as a guarantee that [the company]  
11 would never take a step that might adversely affect its reputation." ECA, 553  
12 F.3d at 206. This is not to say that statements about a company's reputation  
13 for integrity or ethical conduct can never give rise to a securities violation.  
14 Some statements, in context, may amount to more than "puffery" and may in  
15 some circumstances violate the securities laws: for example, a company's  
16 specific statements that emphasize its reputation for integrity or ethical  
17 conduct as central to its financial condition or that are clearly designed to

1 distinguish the company from other specified companies in the same  
2 industry.

3 Finally, we affirm the District Court's dismissal of Plaintiffs' internal  
4 control claim based on the March 2011 Form 10-K and their claims against  
5 Sopp and Havenstein. In initially dismissing these claims without prejudice  
6 in its September 2013 Order, the District Court granted Plaintiffs an  
7 opportunity to amend their complaint within forty-five days, but Plaintiffs,  
8 without explanation, failed to do so. Under the circumstances, Plaintiffs'  
9 failure to comply with the District Court's reasonable schedule was a  
10 legitimate reason to dismiss those claims with prejudice.<sup>9</sup>

## 11 CONCLUSION

12 For the foregoing reasons, we **VACATE** the judgment of the District  
13 Court with respect to Plaintiffs' FAS 5 and Item 303 claims based on SAIC's  
14 March 2011 Form 10-K and **REMAND** for further proceedings consistent with

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<sup>9</sup> Because Plaintiffs have made no specific arguments with respect to the District Court's dismissal of their claims against the individual defendants, we alternatively affirm the dismissal of these claims on the ground that they have been abandoned. See Norton v. Sam's Club, 145 F.3d 114, 117-18 (2d Cir. 1998).



- 1 this opinion. We **AFFIRM** the judgment of District Court with respect to
- 2 Plaintiffs' other claims.

**Supreme Court of the United States  
Office of the Clerk  
Washington, DC 20543-0001**

**Scott S. Harris**  
Clerk of the Court  
(202) 479-3011

March 27, 2017

Clerk  
United States Court of Appeals for the Second  
Circuit  
Thurgood Marshall United States Courthouse  
40 Foley Square  
New York, NY 10007

Re: Leidos, Inc., fka SAIC, Inc.  
v. Indiana Public Retirement System, et al.  
No. 16-581  
(Your No. 14-4140)

Dear Clerk:

The Court today entered the following order in the above-entitled case:

The petition for a writ of certiorari is granted.

Sincerely,

A handwritten signature in black ink that reads "Scott S. Harris". The signature is written in a cursive, flowing style.

**Scott S. Harris, Clerk**