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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

IN RE WIRELESS FACILITIES, INC.,
DERIVATIVE LITIGATION

Case No. 04-CV-1663 JAH (NLS)

**NOTICE OF PENDENCY AND
SETTLEMENT OF DERIVATIVE
ACTIONS**

This Document Relates to:

ALL ACTIONS.

TO: ALL HOLDERS OF KRATOS DEFENSE & SECURITY SOLUTIONS, INC. (FORMERLY KNOWN AS WIRELESS FACILITIES, INC.) (“KRATOS” OR THE “COMPANY”) CAPITAL STOCK AS OF JANUARY 5, 2010 (“CURRENT KRATOS STOCKHOLDERS”). PLEASE READ THIS NOTICE CAREFULLY. IT MAY AFFECT YOUR RIGHTS.

THIS NOTICE RELATES TO A PROPOSED SETTLEMENT OF STOCKHOLDER DERIVATIVE ACTIONS AND RELATED CLAIMS. CURRENT KRATOS STOCKHOLDERS ARE ENTITLED TO OBJECT, IF THEY DESIRE, TO THE SETTLEMENT AS DESCRIBED HEREIN.

IF THE COURT APPROVES THE SETTLEMENT, YOU WILL BE BARRED FROM CONTESTING THE FAIRNESS, REASONABLENESS, OR ADEQUACY OF THE PROPOSED SETTLEMENT, AND FROM PURSUING THE SETTLED CLAIMS.

YOU ARE HEREBY NOTIFIED, pursuant to Federal Rule of Civil Procedure 23.1 and an Order of the United States District Court for the Southern District of California (the “Court”), that a proposed settlement (the “Settlement”) has been reached among Plaintiffs,¹ on behalf of

¹ For purposes of this Notice, the Court incorporates by reference the definitions in the Parties’ Stipulation and Agreement of Settlement of Derivative Claims (“Stipulation”), and all

(Footnote continues on next page.)
CASE NO. 04-CV-1663 JAH (NLS)

1 nominal defendant Kratos, Individual Defendants, and Kratos in connection with *In re Wireless*
2 *Facilities, Inc. Derivative Litigation*, Master File No. 04-CV-1663 JAH (NLS) (the “Federal
3 Action”), currently pending in this Court, and *In re Wireless Facilities, Inc. Derivative Litigation*,
4 GIC 834253 (the “State Action”), currently pending in the Superior Court of the State of
5 California, County of San Diego (collectively, the “Derivative Actions”).²

6 The Derivative Actions have been brought derivatively on behalf of Kratos to remedy the
7 harm allegedly caused to the Company by the defendants’ alleged violations of Federal and State
8 law and breaches of fiduciary duties. The proposed Settlement, if approved by the Court, would
9 fully, finally, and forever resolve the Derivative Actions on the terms and conditions summarized
10 in this Notice.

11 A hearing (the “Settlement Hearing”) shall be held before this Court on March 29, 2010 at
12 2:30 p.m. or as soon thereafter as counsel may be heard in the courtroom of the Honorable John
13 A. Houston of the United States District Court for the Southern District of California, 940 Front
14 Street, San Diego, CA 92101 to determine: (i) whether the proposed Settlement of the litigation
15 as set forth in the Stipulation, should be approved in all respects as fair, just, reasonable, and
16 adequate to, and in the best interests of, Kratos, Kratos Stockholders, and Plaintiffs; (ii) whether
17 the Final Judgment and Order of Dismissal approving the Settlement should be entered; and (iii)
18 whether the agreed-to Fees and Expenses Payment should be awarded to Plaintiffs’ Counsel.

19 This Notice is not intended to be and should not be construed as an expression of any
20 opinion by the Court with respect to the truth of the allegations of the claims in the Derivative
21 Actions or the merits of the claims or defenses asserted. This Notice is merely to advise you of
22 the pendency and proposed Settlement and of your rights thereunder.

23 _____
(Footnote continued from previous page.)

24 capitalized terms used herein shall have the same meanings as set forth in the Stipulation. A copy
25 of the Stipulation may be found at the websites of Robbins Umeda LLP at
www.robbinsumeda.com and the Company's website at www.kratosdefense.com.

26 ² In September 2008, this Court preliminarily approved settlement of the 2004 Federal Class
27 Action. In January 2009, the Court granted final approval of the proposed settlement terms,
issued its final judgment on the matter, and entered an order dismissing the case with prejudice.

1 **I. SUMMARY OF THE DERIVATIVE ACTIONS**

2 In August 2004, Kratos announced, following an extensive analysis of its contingent tax
3 liabilities, its intention to restate its financial statements for fiscal years ended 2000 through 2003
4 to accrue for certain foreign tax contingencies. The day after the Company’s August 2004
5 announcement, and roughly a month before it released the full details of the restatement, the first
6 of fourteen lawsuits — ten federal securities class actions, two federal derivative actions, and two
7 state derivative actions — was filed. The ten securities class actions were subsequently
8 consolidated into a single action before this Court — *In re Wireless Facilities, Inc. Securities*
9 *Litigation*, Master File No. 04-CV-1589 JAH (NLS) (S.D. Cal) (the “2004 Federal Class
10 Action”). Similarly, in 2005 the two federal derivative lawsuits, brought separately by Michael
11 Roth and Rosario Pedicini (“Federal Plaintiffs”), were consolidated into the Federal Action. The
12 two state derivative lawsuits, brought separately by Mary Beth Joseph and Robert Casden (“State
13 Plaintiffs”), were consolidated into the State Action (State Plaintiffs and Federal Plaintiffs are
14 collectively referred to herein as “Plaintiffs”).³

15 In March 2005, Federal Plaintiffs filed their Consolidated Verified Shareholder Derivative
16 Complaint for violations of California Corporations Code, Breach of Fiduciary Duty, Abuse of
17 Control, Gross Mismanagement, Waste of Corporate Assets, Unjust Enrichment and Violation of
18 the Sarbanes-Oxley Act of 2002 (“Consolidated Complaint”) against sixteen current or former
19 officers, directors, and employees of Kratos. Federal Plaintiffs alleged that these individuals
20 failed to properly account for foreign tax contingencies, failed to exercise appropriate oversight,
21 engaged in unlawful insider trading, and breached their fiduciary duties to the Company. Six of
22 the individual defendants named in the Consolidated Complaint asserted they do not live in
23 California and moved to dismiss the Consolidated Complaint on the ground that the Court lacked
24 personal jurisdiction over them. The Court did not require any response from the remaining
25 individual defendants who were not contesting the Court’s jurisdiction until after the Court had

26
27 ³ Prior to any response by the defendants to the State Action, the matter was stayed (and
28 remains so) by the San Diego Superior Court pending resolution of the Federal Action.

1 decided the jurisdictional issue. In March 2007, following jurisdictional discovery, the Court
2 granted the motion to dismiss for lack of personal jurisdiction as to five of the six contesting
3 defendants and dismissed them from the case.

4 In March 2007, Kratos announced that it was conducting an internal investigation into its
5 historical stock option grant practices going back to 1998. Kratos also announced that it had
6 identified some option “grants issued between 1998 and 2003 that require[d] further review
7 because their historical measurement dates appear[ed] incorrect and [were] expected to result in
8 adjustments affecting previously issued financial statements.” The announcement stated that it
9 was likely that Kratos would restate its financial statements for fiscal years 2000 to 2005.

10 Two weeks after the Company’s public announcement that it was conducting the internal
11 stock option review, Federal Plaintiffs filed their Verified Consolidated Amended Shareholder
12 Derivative Complaint for violations of California Corporations Code, Breach of Fiduciary Duty,
13 Abuse of Control, Gross Mismanagement, Waste of Corporate Assets, Unjust Enrichment,
14 Violation of the Sarbanes-Oxley Act of 2002, Accounting, Rescission and Constructive Trust
15 (“Amended Complaint”) against all of the individuals originally named in the prior Consolidated
16 Complaint, including those previously dismissed for lack of jurisdiction. Federal Plaintiffs also
17 added nine new defendants, including an additional defendant who asserted that he did not live in
18 California.

19 The Amended Complaint contains the same financial reporting and accounting allegations
20 arising from the 2004 restatement as the prior Consolidated Complaint. As for the amended
21 allegations, Federal Plaintiffs added allegations that certain defendants “backdated” or
22 “springloaded” employee stock option grants so that the options were granted at less than fair
23 market value.⁴

24 ⁴ In April 2007, purported Kratos stockholder Eamen Hameed filed a federal derivative
25 complaint purportedly on behalf of Kratos and against a subset of the same current and/or former
26 officers and directors named in the Federal and State Actions — *Hameed v. Tayebi*, No. 07-CV-
27 0680 BTM (RBB) (S.D. Cal.) (the “Hameed Action”). The Hameed Action arose from Kratos’
28 March 2007 announcement that it was conducting the internal stock option review and alleged
that certain defendants allowed company insiders to backdate stock option grants, so that stock
options were priced below fair market value on the day they were actually granted, and that as a
result, Kratos’ relevant U.S. Securities and Exchange Commission (“SEC”) filings were false and

(Footnote continues on next page.)

1 In July 2007, the five defendants previously dismissed for lack of personal jurisdiction,
2 joined now by an additional defendant who asserted lack of personal jurisdiction, moved to
3 dismiss the Amended Complaint on the ground that the Court still lacked jurisdiction over them
4 despite the new stock option allegations. Again, the remaining defendants were not required to
5 respond to the Amended Complaint until the Court determined the jurisdictional issues.

6 In February 2008, the Court granted the jurisdictional motion to dismiss as to the
7 previously-dismissed defendants and again dismissed them from the Federal Action, but denied
8 the motion as to newly-added defendant (“February 2008 Order”). Federal Plaintiffs
9 subsequently moved the Court for certification and entry of final judgment of the Court’s
10 February 2008 Order so that Federal Plaintiffs might appeal the February 2008 Order to the Ninth
11 Circuit Court of Appeals. In July 2008, the Court granted Federal Plaintiffs’ motion for
12 certification. Federal Plaintiffs filed a notice of appeal of the February 2008 Order in August
13 2008. Due to the concurrent settlement efforts described below, Federal Plaintiffs have not filed
14 their opening appellate briefs and none of the defendants named in the Federal Action have
15 responded to the Consolidated Complaint or Amended Complaint.

16 **II. THE SETTLEMENT EFFORTS**

17 In August 2008, in an effort to resolve the Derivative Actions, Kratos, Plaintiffs (on behalf
18 of themselves and Kratos), and each of the Individual Defendants (the “Settling Parties”), along
19 with Kratos’ directors and officers liability insurance carriers, mediated the matters before Judge
20 Daniel Weinstein (Ret.) of JAMS, a highly skilled and experienced mediator. While a settlement
21 agreement was not reached during the mediation, the Settling Parties and the insurers, along with

22 (Footnote continued from previous page.)

23 misleading. On August 18, 2008, Hameed voluntarily dismissed the Hameed Action pursuant to
24 Federal Rule of Civil Procedure 41(a). Additionally, in November 2007, a consolidated federal
25 class action securities lawsuit — *In re Wireless Facilities, Inc. Securities Litigation II*, Master
26 File No. 07-CV-00482-BTM (NLS) (S.D. Cal.) (the “2007 Federal Class Action”) — was filed in
27 this Court, alleging that Kratos backdated or springloaded employee stock option grants. On
28 September 3, 2008, this Court preliminarily approved settlement of the 2007 Federal Class
Action. On December 19, 2008, this Court granted final approval of the proposed settlement
terms, issued its final judgment on the matter, and entered an order dismissing the case with
prejudice.

1 the assistance of the mediator, continued to pursue extensive good-faith settlement negotiations.
2 In addition, certain of the Settling Parties participated in further in-person meetings with the
3 mediator in February 2009. While a settlement agreement was not reached following the
4 February 2009 meetings, the Settling Parties, along with the assistance of the mediator, continued
5 to pursue additional extensive good-faith settlement negotiations. In October 2009, the Settling
6 Parties agreed in principle to settle the Derivative Actions on terms set forth in the Stipulation, as
7 summarized below, and subject to Court approval.

8 **III. PLAINTIFFS' CLAIMS AND BENEFITS OF SETTLEMENT**

9 Plaintiffs believe that the claims asserted in the Derivative Actions have merit. However,
10 Plaintiffs' Counsel recognize and acknowledge the expense and length of continued proceedings
11 necessary to prosecute the Derivative Actions on behalf of Kratos through at least one appeal and
12 potentially through trial. Plaintiffs' Counsel have conducted an investigation of the claims
13 asserted in the Derivative Actions, including research of publicly available information and
14 review of certain documents requested by and provided to Plaintiffs' Counsel by Kratos and
15 certain defendants. Plaintiffs' Counsel also have taken into account the uncertain outcome and
16 the risk of any litigation, especially in complex actions such as the Derivative Actions, as well as
17 the difficulties and delays inherent in such litigation. Plaintiffs' Counsel also are mindful of the
18 inherent problems of proof of, and possible defenses to, the causes of action asserted in the
19 Derivative Actions. Plaintiffs' Counsel believe that the Settlement set forth in the Stipulation
20 confers substantial benefits upon, and is in the best interest of, Kratos, its stockholders, and
21 Plaintiffs.

22 **IV. SETTLING DEFENDANTS' DENIAL OF WRONGDOING AND LIABILITY**

23 Kratos and each of Individual Defendants (collectively, "Settling Defendants") have
24 denied and continue to deny each and all of the claims and contentions alleged in the Derivative
25 Actions. The Individual Defendants expressly have denied and continue to deny all charges of
26 wrongdoing or liability against them or any of them arising out of any of the conduct, statements,
27 acts, or omissions alleged, or that could have been alleged, in the Derivative Actions. The
28 Settling Defendants also have denied and continue to deny, *inter alia*: (i) that they violated the

1 federal securities laws, violated state law, or breached their fiduciary duties; (ii) the allegations
2 that Kratos has suffered damage; (iii) that the price of Kratos securities was artificially inflated by
3 reason of alleged misrepresentations, non-disclosures, or otherwise; (iv) that Kratos was harmed
4 by any of the conduct alleged in the Derivative Actions; and (v) that a majority of the Board of
5 Kratos was not independent and disinterested during the relevant periods.

6 Nonetheless, the Settling Defendants have concluded that further conduct of the
7 Derivative Actions would be protracted, expensive, and distracting to themselves, Kratos, and its
8 management, and that it is desirable and beneficial to them that the Derivative Actions be fully
9 and finally settled in the manner and upon the terms and conditions set forth in the Stipulation, in
10 order to limit further expense, inconvenience, and distraction, and to dispose of the burden of
11 protracted litigation. The Settling Defendants have also taken into account the uncertainty and
12 risks inherent in any litigation, especially in complex cases like these Derivative Actions. Kratos
13 has determined that it is in its best interest to enter into the Stipulation because Kratos will receive
14 substantial benefits from the agreed-upon Settlement.

15 **V. THE PROPOSED SETTLEMENT**

16 Plaintiffs (on behalf of themselves and derivatively on behalf of Kratos), nominal
17 defendant Kratos, and the Individual Defendants, by and through their respective counsel or
18 attorneys of record, have stipulated and agreed that, subject to the approval of the Court, the
19 Derivative Actions and the Released Claims, as defined below, shall be finally and fully
20 compromised, settled, and released, and the Derivative Actions shall be dismissed with prejudice
21 as to the Settling Parties, upon and subject to the terms and conditions of the Stipulation, as
22 summarized below.

23 **A. Return of Stock Options**

24 In connection with the Settlement of the Derivative Actions, the individuals indentified
25 immediately below agree to provide the following consideration to Kratos within thirty days from
26 the date the Judgment become Final.

27 1. Masood Tayebi and Massih Tayebi agree to forfeit, collectively, a total of 50,000
28 shares of Kratos stock to Kratos.

1 2. Scott I. Anderson agrees to forfeit a total of 2,000 shares of Kratos stock to Kratos.

2 3. Scot Jarvis agrees to forfeit a total of 2,000 shares of Kratos stock to Kratos.

3 4. Farhad Farjood agrees to forfeit to Kratos any and all claims relating to 10,000
4 options to purchase shares of Kratos stock.

5 5. To the extent that Brad Weller still owns or controls any options to purchase
6 shares of Kratos stock, he agrees to forfeit to Kratos any and all claims relating to 10,000 options
7 to purchase shares of Kratos stock, or all options to purchase shares of Kratos stock if Mr. Weller
8 holds less than 10,000 options.

9 6. To the extent that Thomas Munro still owns or controls any options to purchase
10 shares of Kratos stock, he agrees to forfeit to Kratos any and all claims relating to 10,000 options
11 to purchase shares of Kratos stock, or all options to purchase shares of Kratos stock if Mr. Munro
12 holds less than 10,000 options.

13 7. To the extent that Terry Ashwill still owns or controls any options to purchase
14 shares of Kratos stock, he agrees to forfeit to Kratos any and all claims relating to 10,000 options
15 to purchase shares of Kratos stock, or all options to purchase shares of Kratos stock if
16 Mr. Ashwill holds less than 10,000 options.

17 **B. Corporate Governance Measures**

18 In full and final settlement of the Derivative Actions, the Board of Directors (the “Board”)
19 of Kratos has agreed to adopt, or to maintain where already implemented, the corporate
20 governance measures outlined below within thirty days from the date the Judgment becomes
21 Final and will keep such measures in force and effect for a period of no less than four years from
22 the date the Judgment becomes Final, except as stated otherwise in section 10(b) below. Kratos
23 acknowledges that Plaintiffs’ actions were a direct and material factor in the corporate
24 governance policies that have been enacted since the filing of the Derivative Actions and were a
25 material factor in the enactment of the measures that will be adopted within thirty days from the
26 date the Judgment becomes Final.

27 1. The Board of Directors

28

1 (a) The Board shall adopt a resolution that requires all directors, including the
2 current Board, to attend annually at least one corporate governance class that is designed to keep
3 corporate directors abreast of trends in governance and aware of their fiduciary, legal, and ethical
4 responsibilities.

5 (b) The Board shall adopt the appropriate resolutions to implement the
6 following corporate governance reforms:

7 (i) the Company's Board shall be increased by two Independent
8 Directors within eighteen months from the date the Judgment becomes Final;

9 (ii) each director of the Company shall be elected to the Board by
10 majority vote;

11 (iii) no individual member of the Board shall be the Chairman of more
12 than one Board committee;

13 (iv) each director of the Company shall be required to certify in writing
14 annually that he or she has received, read, and understands the guidelines for directors set forth in
15 the Company's Code of Legal and Ethical Conduct;

16 (v) the performance of the Chairman of the Board shall be evaluated by
17 the Board annually. Should the remaining directors determine that the Board Chairman is not
18 sufficiently active or successful in providing meaningful leadership for the Board, he or she shall
19 be replaced as the Chairman;

20 (vi) the Company's independent registered public auditing firm may not
21 perform any consulting work for the Company, other than tax consulting work;

22 (vii) the Company's Chief Executive Officer ("CEO") and Chief
23 Financial Officer ("CFO") shall be responsible for ensuring that the Company's revenue
24 recognition policy, which conforms to the requirements of GAAP as currently in effect or as
25 amended, is implemented and utilized throughout the Company. The CEO and CFO shall report
26 to the Board on an annual basis regarding the implementation and operation of this policy. The
27 CEO and CFO shall distribute the Company's revenue recognition policy to each such Company
28 employee who records or reviews the recording of revenue and ensure that each such Company

1 employee completes an employee training program concerning the Company's policy on revenue
2 recognition. Any questions regarding that policy or training program, or the application of the
3 policy, shall be directed to the Company's CFO, who shall inform the CEO; and

4 (viii) at each regularly scheduled Board meeting, the Company's CFO (or
5 his or her designee) shall provide a report as to the Company's financial condition and prospects,
6 including, but not limited to, a discussion of any material decreases in revenues and earnings, if
7 any, management plans for ameliorating or reversing such negative trends and the success or
8 failure of any such plans presented in the past.

9 2. Responsibilities of the Independent Directors

10 (a) The Board shall adopt a resolution requiring that a majority of the members
11 of the Board shall be Independent Directors, as defined fully in the Stipulation.

12 (b) The Independent Directors shall meet separately from the rest of the Board
13 on a quarterly basis.

14 3. Board Committees

15 (a) The Board will re-institute its Nominating and Corporate Governance
16 Committees consisting of no less than two Independent Directors to oversee the nomination of the
17 additional director(s), and to implement and oversee appropriate corporate governance reforms.

18 (b) The Board's committees shall have standing authorization, in their own
19 discretion, to retain legal or other advisors of their choice, who shall report directly to the Board
20 or committee.

21 (c) The Bylaws of the Company shall be revised to include specific limits on
22 outside board memberships. The CEO of the Company shall not participate on the board of
23 directors of any more than one additional for-profit corporation (either publicly traded or
24 privately held) for a period of two years,⁵ and a majority of Independent Directors shall not serve

25 _____
26 ⁵ The CEO will be permitted to serve on the board of directors of not more than one
27 additional company with advance consent of the Nominating and Corporate Governance
28 Committee. In general, however, the CEO shall devote his or her full energies to running the
Company.

1 on more than three boards of directors of publicly held companies, including the Company. Any
2 CEO or other full-time senior corporate officer of another company serving on the Company's
3 Board shall be limited to not more than two public company boards of directors in total, including
4 the boards of directors of such person's own employer and the Company.

5 4. Compensation Committee

6 (a) The Company shall have a Compensation Committee Charter that
7 expressly vests in the Compensation Committee the responsibility and obligation to:

8 (i) approve the Company's stock option grants, including the approval
9 of employees and parties who are to receive stock option grants and the details of those option
10 grants; and

11 (ii) prevent the granting, issuance, or approval of any stock options that
12 have been or can be market-timed, backdated, or otherwise manipulated.

13 (b) The Compensation Discussion and Analysis written for the Company's
14 annual Proxy Statement shall address efforts undertaken by the Compensation Committee to
15 design and implement systems and controls to prevent the granting, issuance, and/or approval of
16 market-timed, backdated, or manipulated stock option grants.

17 (c) The Compensation Committee shall not delegate its authority to grant stock
18 options to a Stock Option Administrator unless the delegated Stock Option Administrator is a
19 member of the Compensation Committee of the Board. If a Stock Option Administrator is
20 delegated the authority to grant stock options, any stock option grant by the Stock Option
21 Administrator must be approved by the entire Compensation Committee.

22 (d) The Compensation Committee shall select and retain an independent
23 compensation consultant to provide advice and guidance to the Committee as needed. In
24 addition, the consultant shall, at such times as requested by the Committee, conduct a
25 comparative market study of the Company's executive compensation policies, practices, and
26 procedures. This study shall be delivered to the Compensation Committee for its use in
27 evaluating and revising, if necessary, the compensation structure for the Company's executives.
28

1 5. Enhanced Internal Audit Function

2 (a) The Company shall implement and maintain an enhanced internal audit
3 function. The Company's outside auditor shall not provide this service. The Internal Auditor,
4 who shall be approved by the Board and report directly to the Audit Committee at least annually,
5 shall review the Company's internal control environment. The Internal Auditor shall be
6 responsible for devising an Internal Audit Plan for each fiscal year that will be presented to the
7 Audit Committee.

8 (b) A written report shall be prepared for each internal audit performed
9 describing the internal audit's findings, opinions, and recommendations, if any. These written
10 reports shall be directed to the CEO, CFO, and the Audit Committee for review and, if necessary,
11 remedial action.

12 6. Audit Committee

13 (a) The Audit Committee shall use its best efforts to have at least two members
14 with an accounting or financial management background. If an Audit Committee member
15 possessing such accounting or financial background resigns, is terminated, or otherwise is
16 removed from his or her directorship on the Audit Committee, the Board shall use its best efforts
17 to replace such director within ninety days of his or her departure with another director that has an
18 accounting or financial management background. These best efforts shall include the
19 commencement of a search to locate an additional Board member with an accounting or financial
20 management background.

21 (b) The Audit Committee shall have a charter which includes the following
22 provisions:

23 (i) meetings to be held, among other times, prior to the commencement
24 and prior to the completion of the annual audit;

25 (ii) each meeting shall include a meeting with appropriate Company
26 management, followed by an executive session with no management present; and

27 (iii) each meeting shall have a written agenda.

28 (c) The Audit Committee's responsibilities shall include:

1 (i) meeting with the Company's independent registered public
2 accounting firm concerning:

3 (1) the reliability of the Company's forward-looking statements
4 contained in interviews with media agencies, investor conference calls, committee reports,
5 quarterly and annual reports, proxy statements, and press releases disseminated by the Company;
6 and

7 (2) the reliability of the Company's statements relating to
8 internal financial control mechanisms contained in interviews with media agencies, investor
9 conference calls, committee reports, quarterly and annual reports, proxy statements, and press
10 releases disseminated by the Company.

11 (ii) meeting with management to ascertain the Company's primary
12 business exposure risks; and

13 (iii) meeting with the Company's Internal Auditors at year-end
14 regarding:

15 (1) the nature of the internal audit plan, including the
16 effectiveness and continued use of the policies and procedures of the internal audit plan;

17 (2) the appropriate staffing levels for the internal audit function;

18 (3) whether the Company's financial reporting policies and
19 practices are sufficiently transparent; and

20 (4) whether the Company's financial reporting policies and
21 practices are unusually aggressive.

22 7. Stock Option Granting Policies and Procedures

23 (a) The following stock-option related controls, that already have been
24 implemented by the Company, will be maintained for a period of no less than four years from the
25 date of entry of the Judgment:

26 (i) segregating certain responsibilities related to option granting and
27 the execution of stock option exercise transactions, including, but not limited to, the Director of
28 Financial Reporting being required to approve exercises and the Assistant Controller/Director of

1 Financial Reporting being required to separately review all entries to the Company's Equity Edge
2 database by the Stock Option Administrator;

3 (ii) documenting and assessing the design and operating effectiveness
4 of key internal controls over the stock administration function;

5 (iii) establishing processes and procedures to increase communications
6 between the stock administration, human resources, and accounting functions, including, but not
7 limited to, requiring communications between human resources and accounting/finance related to
8 any separation agreement that might result in a modification of terms;

9 (iv) adding independent reviews and reconciliations of stock option
10 activity separate from the stock administration function;

11 (v) establishing a consistent, formalized procedure for stock option
12 award procedures including limiting the authority to approve stock option grants;

13 (vi) upgrading the equity tracking software program and system
14 controls that support the processes and continuing to maintain the most current version of the
15 option tracking software;

16 (vii) requiring and arranging for training for those employees who utilize
17 the Company's equity tracking software program, as well as all those involved in the stock option
18 granting process, to enhance awareness and understanding of legal, tax, and accounting
19 implications;

20 (viii) requiring that only an employee independent of the stock
21 administration function be allowed to communicate stock option exercise instructions to the
22 Company's transfer agent;

23 (ix) requiring quarterly reconciliation of exercises according to transfer
24 agent records versus exercises according to the Equity Edge database to identify any
25 discrepancies;

26 (x) requiring approval by the Company's Compensation Committee
27 during meetings rather than by use of Unanimous Written Consents;

28

1 (xi) requiring the development of an annual option granting plan and
2 option granting matrix;

3 (xii) dissolving the Company's non-officer stock option committee; and

4 (xiii) the grant date of all stock options shall be the fifteenth trading day
5 of the month after which they are approved.

6 (b) All stock option plans adopted by the Company shall clearly define the
7 exercise price, grant date, and the fair market value of stock. The exercise price or value of any
8 equity award shall be determined by fair market value of the Company's stock on the date of the
9 grant. The fair market value of the Company's stock shall be the closing price (or closing bid, if
10 no sales were reported) for a share of the Company's stock on such days as quoted by the
11 exchange or over-the-counter market on which the stock is listed.

12 (c) Any and all stock option plans that permit market timing or backdating of
13 stock options are void and shall be without force or effect.

14 (d) Any substitute stock option plan(s) adopted by the Company in the future
15 must expressly prohibit market timing and backdating of stock options.

16 (e) Any stock option plans shall give the Compensation Committee the sole
17 and exclusive power and duty to administer the Company's stock option plans.

18 (f) Any and all disclosure requirements concerning executive compensation
19 and stock option grants, including the Sarbanes-Oxley Act of 2002 disclosure requirements, shall
20 be followed by the Company.

21 (g) All requirements of the Internal Revenue Code as they relate to the
22 granting, issuance, timing, pricing, and treatment of stock options shall be observed and followed
23 by the Company.

24 (h) The substance of the following clauses shall be included in any current
25 and/or subsequent equity incentive plan, whether subject to stockholder approval or not:

26 (i) The exercise price for each stock option grant shall be at least 100%
27 of the fair market value on the date of the grant;

28

1 (ii) the Company shall give notice of the determination to each
2 employee or consultant to whom a stock option is so granted as soon as reasonably practicable,
3 but in no event shall such notice be given more than thirty days after the date of such grant; and

4 (iii) authority to grant stock option awards shall be limited to the full
5 Board or the Compensation Committee, consisting of three or more independent directors, and
6 shall not be delegated to any other person or body.

7 8. Insider Trading Policy

8 The Company shall adopt an Insider Trading Policy that provides as follows:

9 (a) The Insider Trading Policy shall specifically prohibit all Company
10 directors, officers and employees from trading in Company securities while in possession of
11 material, non-public information regarding the Company, including, but not limited to: (i)
12 material, non-public information regarding actual or estimated results of operations and earnings;
13 (ii) material, non-public proposals or agreements relating to mergers, acquisitions or divestitures;
14 and (iii) material, non-public information regarding significant contracts, patents, or new product
15 development.

16 (b) The Insider Trading Policy shall encourage all directors and Section 16
17 officers who wish to trade in Company securities to adopt a valid trading plan pursuant to SEC
18 Rule 10b5-1, 17 C.F.R. § 240.10b5-1.

19 (c) The Insider Trading Policy shall require all other Company employees who
20 wish to trade in Company securities to do so only within prescribed trading windows, to be
21 established by the Board. All Company employees who have not adopted a valid Rule 10b5-1
22 trading plan shall be prohibited from trading in Company securities except during open trading
23 windows.

24 9. Related-Party Transactions

25 (a) The Company shall maintain its policy entitled "Conflict of Interest and
26 Related Party Transactions," which became effective on October 9, 2007.

27 (b) Any material changes to the Conflict of Interest and Related Party
28 Transactions Policy may be made only with the approval of the Board.

1 10. Additional Controls

2 (a) The following additional controls that already have been implemented by
3 the Company will be maintained for a period of no less than four years from the date of the entry
4 of Judgment:

5 (i) The Company shall continue to maintain its internal Contracts
6 Administration Department, which has been established to ensure that complete contract files are
7 maintained to support the project estimate-at-completion computation. This is accomplished
8 using a database in which all relevant contract administration documents are maintained. As a
9 part of the revised revenue recognition procedures, the database is accessed to update information
10 needed in the period-end estimate-at-completion.

11 (ii) In conjunction with the Company's month-end and year-end
12 closing procedures, the Company has implemented additional monitoring and review controls
13 over its estimate-at-completion calculations, as well as its invoicing/customer billings procedures
14 and its valuation of accounts receivable balances.

15 (iii) Shareholder Nominated Director Process. The Independent
16 Directors shall consider and evaluate recommendations for director nominees proposed by a
17 qualified stockholder. The stockholder must submit its director nominee recommendation to the
18 Corporate Secretary in writing and provide the following information:

19 (1) a statement by the stockholder that: (i) the stockholder is
20 the holder of at least 1% of the Company's capital stock; (ii) the stock has been held for at least
21 one year prior to the date of the submission; and (iii) the stockholder will continue to hold the
22 shares through the date of the annual stockholder meeting;

23 (2) the candidate's name, age, contact information, and current
24 principal occupation or employment;

25 (3) a description of the candidate's qualifications and business
26 experience during, at a minimum, the last five years, including the candidate's principal
27 occupation or employment, and the name and principal business of any corporation or other
28 organization in which the candidate was employed;

1 (4) the candidate's resume; and

2 (5) three references.

3 (iv) to be evaluated in connection with the Company's established
4 procedures for evaluating potential director nominees, the qualifying stockholder must provide
5 the stockholder's director nominee recommendation to the Company at least 120 days prior to the
6 anniversary of the date proxy statements were mailed to stockholders in connection with the prior
7 year's annual stockholder meeting.

8 (b) The Chairman of the Board must not simultaneously hold the position of
9 CEO. Given the importance of finding an appropriate Chairman of the Board, the Company will
10 have four years from the date the Judgment becomes Final to begin complying with this
11 provision. This provision shall remain in effect for a period of no less than four years from the
12 date on which the provision is first implemented.

13 **C. Restriction of Voting Rights**

14 In connection with the Settlement of the Derivative Actions, Masood Tayebi and Massih
15 Tayebi hereby agree that for a period of no less than three years from the date the Judgment
16 becomes Final, they will not exercise any of the voting rights associated with any of the shares of
17 Kratos stock that they personally own or that they control through any trust or other entity.
18 Masood Tayebi and Massih Tayebi shall provide the Company with a signed certification each
19 year stating that they did not exercise any of the voting rights associated with any of the shares
20 they own or control and did not make any material recommendations to anyone exercising voting
21 rights in Kratos stock with respect to the exercise of those rights.

22 **VI. DISMISSAL AND RELEASES**

23 The full terms of the dismissal and release of claims are set forth in the Stipulation. The
24 following is only a summary.

25 Upon the Effective Date, the Individual Defendants, Kratos, and Plaintiffs, on behalf of
26 themselves and, to the fullest extent permitted by law, on behalf of all Kratos Stockholders shall
27 be deemed to have released the Released Claims against the other Individual Defendant
28 Releasees, except for the obligations imposed by the Stipulation in connection with the

1 Settlement. Moreover, the Final Judgment and Order of Dismissal with Prejudice (“Judgment”),
2 to be entered upon approval of the Settlement, will preclude the filing of any action purporting to
3 litigate the Released Claims against the Individual Defendant Releasees and Kratos Releasees.
4 Upon the Effective Date, Kratos and the Individual Defendants shall be deemed to have released
5 Plaintiff Releasees from all claims arising out of, based upon or related to the institution,
6 prosecution, assertion, settlement, or resolution of the Derivative Actions and/or the Released
7 Claims, except for the obligations imposed by the Stipulation in connection with the Settlement.
8 Also upon the Effective Date, each of the Individual Defendants and Plaintiffs, on behalf of
9 themselves and, to the fullest extent permitted by law, on behalf of all Kratos Stockholders, shall
10 be deemed to have released Kratos Releasees from all claims arising out of, based upon or related
11 to the institution, prosecution, assertion, settlement, or resolution of the Derivative Actions and/or
12 the Released Claims, except the Individual Defendants shall not be deemed to have released
13 Kratos from any claims or causes of action for indemnification, including but not limited to
14 insurance indemnification, and/or advancement of attorneys’ fees and expenses.

15 As part of the Settlement, within five business days from the date on which the Judgment
16 approving the Settlement becomes Final, Plaintiffs’ Counsel, on behalf of State Plaintiffs, shall
17 file a Stipulation of Dismissal with prejudice in the State Action, signed by all parties to the State
18 Action, and request an order dismissing the State Action. State Plaintiffs shall file and serve
19 notice of any dismissal order within five business dates of entry by the State Court.

20 As used above, “Effective Date” means the first date by which all the following events
21 and conditions shall have occurred or been met: (1) execution of the Stipulation; (2) entry of the
22 Preliminary Approval Order; (3) entry of the Judgment; (4) payments by Kratos and/or its D&O
23 Insurer(s) in accordance with ¶5.1 of the Stipulation; (5) the Judgment has become Final; and (6)
24 dismissal of the State Action with prejudice in accordance with ¶8.4 of the Stipulation.

25 As used above, “Individual Defendant Releasees” means Individual Defendants and each
26 of their past, present, or future directors, officers, employees, partners, insurers, co-insurers,
27 reinsurers, principals, agents, controlling shareholders, attorneys, accountants or auditors,
28 advisors, investment advisors, personal or legal representatives, predecessors, successors, parents,

1 subsidiaries, divisions, joint ventures, assigns, spouses, heirs, related or affiliated entities,
2 immediate family, and any trusts in which Individual Defendant Releasees, or any of them, are
3 the settlors or which are for the benefit of any Individual Defendant Releasees and/or members of
4 their/his/her immediate family, and any entities in which Individual Defendants, or any of them,
5 have a controlling interest (directly or indirectly).

6 As used above, “Kratos Releasees,” which does not include Individual Defendant
7 Releasees, means Kratos and each of its past, present, or future directors, officers, employees,
8 partners, insurers, co-insurers, reinsurers, principals, agents, controlling shareholders, attorneys,
9 accountants or auditors, advisors, investment advisors, personal or legal representatives,
10 predecessors, successors, parents, subsidiaries, divisions, joint ventures, assigns, spouses, heirs,
11 related or affiliated entities, immediate family, and any trusts in which the Kratos Releasees, or
12 any of them, are the settlors or which are for the benefit of any Kratos Releasees and/or members
13 of their/his/her immediate family, and any entities in which Kratos has a controlling interest
14 (directly or indirectly).

15 As used above, “Plaintiff Releasees” means each of Plaintiffs and each of their past,
16 present, or future directors, officers, employees, partners, insurers, co-insurers, reinsurers,
17 principals, agents, controlling shareholders, attorneys, accountants or auditors, advisors,
18 investment advisors, personal or legal representatives, predecessors, successors, parents,
19 subsidiaries, divisions, joint ventures, assigns, spouses, heirs, related or affiliated entities,
20 immediate family, and any trust of which any Plaintiff Releasees, or any of them, are the settlors
21 or which is for the benefit of any Plaintiff Releasees and/or members of their/his/her immediate
22 family, and any entity in which Plaintiffs, or any of them, have a controlling interest (directly or
23 indirectly).

24 As used above, “Released Claims” means any and all claims or causes of action, demands,
25 rights, liabilities, suits, debts, obligations, and causes of action of every nature and description
26 whatsoever, known or unknown (including Unknown Claims as defined herein), contingent or
27 absolute, mature or unmature, discoverable or undiscoverable, whether concealed or hidden
28 asserted derivatively on behalf of Kratos, or that could have been asserted directly by the Settling

1 Parties, derivatively on behalf of Kratos, or by Kratos itself based upon, arising out of, or related
2 to the allegations, facts, transactions, or claims in the Derivative Actions, and any claims in
3 connection with, based upon, or arising out of, or relating to the Settlement.

4 As used above, "Unknown Claims" means any Released Claims that a Person, including
5 Plaintiffs, may not know or suspect to exist in his, her, or its favor at the time of the release of
6 Kratos and Individual Defendants which, if known by him, her or it, might have affected his, her
7 or its settlement and release, or might have affected his, her, or its decision not to object to the
8 Settlement. With respect to any and all Released Claims, the Settling Parties stipulate and agree
9 that, upon the Effective Date, Plaintiffs, Kratos Stockholders, and Kratos shall waive and by
10 operation of the Judgment shall have waived, the provisions, rights, and benefits of California
11 Civil Code §1542, which provides:

12 **A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE**
13 **CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER**
14 **FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF**
15 **KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS**
16 **SETTLEMENT WITH THE DEBTOR.**

17 Plaintiffs, Kratos Stockholders, and Kratos shall expressly waive, and by operation of the
18 Judgment shall have expressly waived, any and all provisions, rights and benefits conferred by
19 any law of any state or territory of the United States, or principle of common law, which is
20 similar, comparable, or equivalent to California Civil Code §1542. Plaintiffs, Kratos
21 Stockholders, and Kratos may hereafter discover facts in addition to or different from those which
22 they now know or believe to be true with respect to the Released Claims, but Plaintiffs, Kratos
23 Stockholders, and Kratos shall expressly fully, finally, and forever settle and release and, upon
24 the Effective Date, shall be deemed to have, and by operation of the Judgment shall have, fully,
25 finally, and forever settled and released, any and all Released Claims, known or unknown,
26 suspected or unsuspected, contingent or non-contingent, whether or not concealed or hidden,
27 which now exist, or have existed, upon any theory of law, or equity now existing or coming into
28 existence in the future, including, but not limited to, conduct which is negligent, intentional, with
or without malice, or a breach of any duty, law, or rule, without regard to the subsequent
discovery or existence of such different or additional facts. Plaintiffs acknowledge that the

1 foregoing waiver was separately bargained for and a key element of the Settlement of which this
2 release is a part.

3 **VII. ATTORNEYS' FEES AND EXPENSE AWARD**

4 Subject to Court approval and in recognition of the benefits conferred on Kratos as a
5 direct and material factor resulting from the Derivative Actions, Kratos agrees to pay and/or cause
6 its D&O Insurer(s) to pay to Plaintiffs' Counsel \$2,000,000 (collectively, the "Fees and Expenses
7 Payment"). The agreed-to Fees and Expenses Payment will compensate Plaintiffs' Counsel for
8 their efforts in achieving the substantial benefits for Kratos as identified above and in the
9 Stipulation and for their risk in undertaking this representation on a contingency basis.

10 **VIII. CONDITIONS FOR SETTLEMENT**

11 The Settlement is conditioned upon the occurrence of certain events. Those events
12 include, among other things: (1) entry of the Judgment by the Court, as provided for in the
13 Stipulation; and (2) expiration of the time to appeal from or alter or amend the Judgment. If, for
14 any reason, any one of the conditions described in the Stipulation is not met, the Stipulation might
15 be terminated and, if terminated, will become null and void, and the parties to the Stipulation will
16 be restored to their respective positions in the litigation as of January 5, 2010.

17 **IX. THE SETTLEMENT HEARING AND YOUR RIGHTS AS SHAREHOLDERS**

18 The Settlement Hearing shall be held before this Court on March 29, 2010 at 2:30 p.m. or
19 as soon thereafter as counsel may be heard in the courtroom of the Honorable John A. Houston of
20 the United States District Court for the Southern District of California, 940 Front Street, San
21 Diego, CA 92101 to determine: (i) whether the proposed Settlement of the litigation as set forth
22 in the Stipulation, should be approved in all respects as fair, just, reasonable, and adequate to, and
23 in the best interests of, Kratos, Kratos Stockholders, and Plaintiffs; (ii) whether the Final
24 Judgment and Order of Dismissal approving the Settlement should be entered; and (iii) whether
25 the agreed-to Fees and Expenses Payment should be awarded to Plaintiffs' Counsel. The
26 Settlement Hearing may be continued or adjourned from time to time by the Court at the
27 Settlement Hearing or any continued or adjourned session thereof without further notice.
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Unless otherwise ordered by the Court, any Current Kratos Stockholder who does not make his, her, or its objection or opposition in the manner provided shall be deemed to have waived any and all objections and opposition, and shall be forever foreclosed from making any objection to the fairness, reasonableness, and adequacy of the proposed Settlement, and shall otherwise be bound by the Judgment to be entered and the releases to be given.

X. EXAMINATION OF PAPERS AND INQUIRES

This Notice contains only a summary of the terms of the proposed Settlement. For a more detailed statement of the matters involved in this action, reference is made to the pleadings, to the Stipulation and to other papers filed in this action which may be inspected at the Office of the Clerk for the United States District Court for the Southern District of California, 940 Front Street San Diego, CA 92101, during business hours of each business day. In addition, a copy of the Stipulation may be found at www.kratosdefense.com.

Inquiries regarding this action should be addressed as follows:

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DO NOT CONTACT THE COURT REGARDING THIS NOTICE.

Dated: January 21, 2010

**BY ORDER OF THE COURT
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**