

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE MONSTER WORLDWIDE, INC.
SECURITIES LITIGATION

Civil Action No. 07 CV 2237 (JSR)

**MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT
ANDREW J. McKELVEY'S MOTION TO DISMISS
THE AMENDED COMPLAINT FOR FAILURE TO STATE A CLAIM**

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Andrew J. McKelvey submits this Memorandum of Law, along with the Declaration of Cristina M. Posa and accompanying exhibits previously filed on April 18, 2007,¹ in support of his Motion to Dismiss the Amended Complaint for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6).

Preliminary Statement

The initial Complaint in this action failed to allege scienter against defendant Andrew J. McKelvey because it lacked any specific allegations about McKelvey's: (1) involvement in the purported backdating of stock options at Monster or (2) his knowledge of the accounting and disclosure implications of that backdating. In the Amended Complaint, plaintiff strives mightily to allege that McKelvey was involved in backdating options – an act that plaintiff concedes is not illegal – but remains silent on the dispositive issue of whether McKelvey knew or should have known the relevant accounting and disclosure rules applicable to Monster's allegedly backdated options and whether he deliberately or recklessly violated those rules.

In failing to allege both sides of this equation, plaintiff has failed its burden of pleading facts sufficient to raise a strong inference of scienter. Because backdating stock options is perfectly lawful so long as certain accounting and disclosure requirements are met, plaintiff cannot survive this motion to dismiss simply by alleging that backdating occurred and that McKelvey participated in it. More – much more – is required. This is especially true in light of the Supreme Court's recent decision to raise the bar on pleading scienter in Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. ___, 127 S.Ct. 2499, 2502 (2007), which requires plaintiff to allege facts giving rise to an inference of scienter that is "more than merely 'reasonable' or

¹ The Posa Declaration and accompanying exhibits were filed as part of McKelvey's motion to dismiss the original complaint in this action. The Posa Declaration and exhibits are incorporated by reference in this motion to dismiss the Amended Complaint.

‘permissible’ – it must be cogent and compelling, thus strong in light of other explanations.”

Nothing in the Amended Complaint gives rise to either a cogent or compelling inference of scienter, and dismissal with prejudice is now appropriate.

Essentially conceding the lack of evidence of actual wrongdoing by McKelvey (the purported theory of the original complaint), plaintiff now seeks refuge in the theory that McKelvey had a motive and opportunity to commit fraud. This new theory fails as well. If McKelvey had been driven by such a motive, one would have expected him to line his own pockets with backdated options. *But McKelvey never received a single stock option from Monster, backdated or otherwise.* Thus unable to allege any direct motive, plaintiff attempts to support its theory with three irrelevant and insufficient allegations:

- Plaintiff asserts that McKelvey sought to inflate the share price because of his extensive holdings in Monster stock. But because that alleged aspiration is shared by *all* stockholders, it cannot demonstrate motive as a matter of law and is routinely held as insufficient to make out scienter.
- Plaintiff alleges that McKelvey had a motive to artificially inflate earnings per share (EPS) because his bonus was tied to EPS. That allegation fails because McKelvey received these bonuses only in 2004 and 2005, *after* the end of the alleged backdating activity between 1997 until 2003.
- Plaintiff accuses McKelvey of being motivated by a desire to attract and retain talented employees and boost employee morale. If that motive were sufficient to support a securities fraud claim, however, every successful corporate manager throughout the business world would face liability and America would face a crime wave of unprecedented proportions. This motive could not possibly serve as evidence of scienter. To the contrary, it is precisely the goal that is *supposed* to motivate successful CEOs and sustain American businesses.

Simply put, plaintiff again has failed to allege, as the law requires, either strong circumstantial evidence that McKelvey knew or was involved in improperly accounting for or disclosing stock option grants, or alternatively, that McKelvey had both the opportunity and concrete financial motive to commit fraud. Without these critical allegations, plaintiff’s claims have failed, and the Amended Complaint should be dismissed with prejudice.

Factual Background

McKelvey's Role in Granting Stock Options

In the Amended Complaint, plaintiff introduces new allegations about McKelvey's role in Monster's stock option program, characterizing him as the program's "architect and primary cheerleader." (Am. Cmplt. ¶ 65) Plaintiff concedes that McKelvey's chief goal was to keep talent within the company by ensuring that all Monster employees, regardless of their level in the company, participated in the options program. (Id. ¶¶ 68, 119, 120) Indeed, plaintiff now alleges that after the company went public in 1996, McKelvey personally reached out to the Monster rank-and-file by embarking on a "road show" in offices throughout the country to explain how the stock options program would benefit employees, consistent with his philosophy that "[i]f you do not have good people, you have absolutely nothing." (Id. ¶¶ 66-69, 119) Plaintiff also now finally concedes that McKelvey did not receive a single stock option, backdated or otherwise. (Id. ¶ 146)

In addition to his role as "architect," McKelvey also purportedly allocated option "pools" to Monster's various divisions; the division heads then would divide the pools amongst their individual employees. (Id. ¶ 71) According to the Amended Complaint, the "grant date," which determined the strike price, should have been calculated as the date when the "identities of the individual optionees and the number of shares underlying each option was determined." (Id. ¶ 72) In an omission that is fatal to its claims against McKelvey, however, plaintiff fails to allege that McKelvey knew or should have known that this was the "appropriate" method for calculating the grant date.

McKelvey's Alleged Involvement in Backdating Stock Options

Lacking that necessary element, the Amended Complaint instead relies largely on new allegations that McKelvey engaged in backdating when he "predetermined" the grant date of

various company-wide option grants before the allocation information was finally determined. (Id. ¶¶ 71, 72) McKelvey allegedly approved the addition of new names to previously-made company-wide option grants, enabling those new optionees to receive in-the-money options based on the prior grant date. (Id. ¶¶ 96-102) Plaintiff also alleges that McKelvey was responsible for approving backdated option grants to new hires. (Id. ¶¶ 103, 106) Finally, plaintiff now claims that McKelvey and/or the Compensation Committee allegedly signed unanimous written consents (UWCs) granting options “as of” dates that had been backdated. (Id. ¶ 73)

Even taking plaintiff’s new allegations as true, as we must, the Amended Complaint demonstrates unequivocally that neither McKelvey nor anyone else at Monster made any effort to conceal the alleged backdating. Plaintiff alleges that in his road show presentations, McKelvey told Monster employees that the strike prices of their options would be determined by “looking back during certain periods” to choose a grant date. (Id. ¶ 69) And, in a January 15, 1999 meeting, McKelvey allegedly “announced” to the executive committee that he wanted to grant options at a \$25 strike price, leading an employee in Human Resources to select December 9, 1998 as the grant date with an exercise price of \$26.875. (Id. ¶ 77) Thus, according to plaintiff, Monster’s option grant practices were open and transparent throughout the company and no one at the company made any effort to conceal any alleged backdating. This evidence powerfully undermines plaintiff’s unsupportable notion that McKelvey knew his alleged actions were unlawful.

Plaintiff’s new allegations about the so-called backdating scheme make clear that the practices about which plaintiff complains were openly carried out and evident to a broad range of Monster employees; on at least two occasions, in 1999 and 2001, Monster’s Corporate Human

Resources division allegedly circulated memos to *division heads throughout the company* setting grant dates and strike prices before option allocation information was determined. (Id. ¶¶ 75, 83) Thus, by plaintiff's own admission, the selection of "predetermined" grant dates for the company-wide grants was common practice and publicized throughout the company. As for allegedly backdated option grants for new Monster hires, the Amended Complaint claims that it was common practice for Monster's Human Resources department to select the lowest quarterly strike price. (Id. ¶ 105) Moreover, Monster's Chief Operating Officer was copied on all proposed grants that went to McKelvey for approval (id. ¶¶ 104, 105, 107) and McKelvey was not the only individual to sign the UWCs with the purportedly backdated "as of" dates – the Compensation Committee also signed these forms. (Id. ¶ 73)

The Amended Complaint makes plain that the alleged backdating was completely out in the open and involved employees, executives and directors throughout the company, and is utterly devoid of any allegations that anyone at Monster ever raised any question about that alleged practice with McKelvey, much less discussed any corresponding accounting or disclosure requirements with him. Notwithstanding its myriad new allegations, the Amended Complaint does not add *even one* allegation that could support an inference that McKelvey knew or should have known the accounting rules for backdated options.

The totality of these allegations leads inescapably to the inference that McKelvey believed Monster's options practices to be perfectly lawful.

McKelvey's Stock Ownership and Incentive Compensation

In the Amended Complaint, plaintiff introduces a host of new allegations about McKelvey's personal finances. According to these allegations, by 2001, McKelvey owned more than 24 million shares of Monster stock, which he leveraged to obtain margin loans and credit facilities. (Id. ¶¶ 129-130) McKelvey allegedly controlled 30% of the company's voting interest

through his ownership of those shares, including non-transferable Class B stock. (Id. ¶ 136) Plaintiff now claims that a margin call and forced sale of this stock in 2001 would have cut his voting interest to 6%. (Id.) A margin call also allegedly would have threatened the company's favorable "pooling method" accounting treatment for acquisitions, which prohibited McKelvey and other "affiliates" of the company from selling stock during pooling periods. (Id. ¶ 138-41) Plaintiff does not allege, however, that any of these purported threats ever came to pass. There are no allegations that McKelvey was ever forced to sell his stock in response to a margin call, or that his controlling interest or the pooling accounting was ever in jeopardy. Moreover, given plaintiff's concession that McKelvey took no Monster options for himself – backdated or otherwise – the inference to be drawn from McKelvey's margin position is weak, indeed.

Plaintiff also now attempts to link McKelvey's incentive-based bonus compensation in 2004 and 2005 to the alleged backdating scheme. (Id. ¶ 146-147)² Plaintiff, however, claims that the backdating started in 1997 and ended by 2003. (Id. ¶ 51) On its face, these allegations are insufficient to withstand a motion to dismiss.

Argument

In considering a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), a district court must construe the complaint liberally, accept all factual allegations in the complaint as true and draw all reasonable inferences in plaintiff's favor. See Gregory v. Daly, 243 F.3d 687, 691 (2d Cir. 2001). In deciding a Rule 12(b)(6) motion, "courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by

² Although the Amended Complaint initially refers to "annual bonuses for 2003 through 2005" (Am. Cmplt. ¶ 146), plaintiff provides specific bonus information only for 2004 and 2005, perhaps indicating that the so-called 2003 bonus was actually money paid in 2004 to reward performance in 2003.

reference, and matters of which a court may take judicial notice.” Tellabs, 127 S.Ct. at 2509. In examining scienter allegations on a Rule 12(b)(6) motion, the Court must consider “plausible nonculpable explanations for the defendant’s conduct.” Id. at 2510.

I.

PLAINTIFF FAILS TO STATE A CLAIM AGAINST MCKELVEY FOR VIOLATION OF SECTION 10(B) OF THE SECURITIES AND EXCHANGE ACT OF 1934

Plaintiff has failed to remedy the shortcomings of the initial Complaint. The allegations in the Amended Complaint that McKelvey violated Section 10(b) of the Securities and Exchange Act of 1934 and 17 C.F.R. § 240.10b-5 (Rule 10b-5) do not state a claim.

To state a cause of action under Section 10(b) and Rule 10b-5, a plaintiff must plead that, “in connection with the purchase or sale of securities, the defendant, *acting with scienter*, made a false material representation or omitted to disclose material information and that plaintiff’s reliance on defendant’s action caused [plaintiff] injury.” Acito v. IMCERA Group, Inc., 47 F.3d 47, 52 (2d Cir. 1995) (emphasis added).³ Further, as a securities fraud action, this action is subject to the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (“PSLRA”), Pub. L. No. 104-67, 109 Stat. 737 (1995); see Novak v. Kasaks, 216 F.3d 300, 306-307 (2d Cir. 2000). The PSLRA requires that a complaint in a securities fraud action “state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2) (emphasis added).

³ This action also is governed by Federal Rule of Civil Procedure 9(b), which provides that, in all fraud claims, “the circumstances constituting fraud or mistake must be stated with particularity.” While Rule 9(b) provides that “malice, intent, knowledge and other conditions of mind of a person may be averred generally,” the Second Circuit holds that “we must not mistake the relaxation of Rule 9(b)’s specificity requirement regarding condition of mind for a license to base claims of fraud on speculation and conclusory allegations.” Acito, 47 F.3d at 52. Plaintiff still has the “burden of pleading circumstances that provide at least a minimal factual basis for [its] conclusory allegations of scienter . . . [and] must allege facts that give rise to a strong inference of fraudulent intent.” Chill v. General Elec. Co., 101 F.3d 263, 267 (2d Cir. 1996).

Plaintiff may demonstrate the requisite “strong inference” of fraudulent intent by

- (i) alleging facts to show that defendant had both “motive and opportunity to commit fraud” or
- (ii) alleging facts that constitute “strong circumstantial evidence of conscious misbehavior or recklessness.” Kalnit v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001) (quotation and citation omitted); see also Novak, 216 F.3d at 307; In re Axis Capital Holdings Ltd. Secs. Litig., 456 F. Supp. 2d 576, 591 (S.D.N.Y. 2006). In Tellabs, the Supreme Court raised the bar on pleading scienter yet again. The Court defined “strong inference” as “powerful or cogent,” holding that “the inference of scienter must be more than merely ‘reasonable’ or ‘permissible’ – *it must be cogent and compelling, thus strong in light of other explanations.*” 127 S.Ct. at 2510 (emphasis added). The Supreme Court instructed lower courts to engage in a comparative inquiry in deciding Rule 12(b)(6) motions:

The strength of an inference cannot be decided in a vacuum. The inquiry is inherently comparative: How likely is it that one conclusion, as compared to others, follows from the underlying facts? To determine whether the plaintiff has alleged facts that give rise to the requisite “strong inference” of scienter, a court must consider plausible nonculpable explanations for the defendant’s conduct, as well as inferences favoring the plaintiff.

Id. at 2510. Thus, on the present motion, opposing inferences and nonculpable explanations must be considered in determining whether plaintiff’s allegations give rise to a powerful or cogent inference of fraudulent intent.

Plaintiff has not carried its burden of alleging scienter under the PSLRA and Tellabs because plaintiff has not alleged facts constituting “strong circumstantial evidence of conscious misbehavior or recklessness” by McKelvey (plaintiff’s primary, but now largely abandoned, theory in the original Complaint) or facts showing that he had both “motive and opportunity to commit fraud” (plaintiff’s new theory in the amended complaint). Novak, 216 F.3d at 307. As a result, plaintiff’s Section 10(b) claim against McKelvey cannot stand.

A. Plaintiff Has Failed To Allege Facts Constituting “Strong Circumstantial Evidence Of Conscious Misbehavior Or Recklessness” By McKelvey

To plead conscious misbehavior or recklessness, plaintiff must allege facts showing that McKelvey’s conduct was “highly unreasonable, representing an *extreme departure* from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.” In re WorldCom, Inc. Secs. Litig., 294 F. Supp. 2d 392, 412 (SDNY 2003) (emphasis added). Even as amended, plaintiff’s allegations fall far short.

1. Backdating Options Is Not Illegal

Plaintiff’s new Complaint is dedicated to documenting McKelvey’s purported involvement in the practice of backdating options. (Am. Cmplt. ¶¶ 69-118) But plaintiff itself acknowledges that backdating is not illegal, conceding that, “[u]nder applicable accounting rules, the amount by which a stock option is ‘in the money’ at the time of grant must be recorded as a compensation expense.” (Id. ¶ 4) In other words, a company *may grant* “in the money” options, as long as the value is recorded as an expense. Accounting Principles Board Opinion No. 25 (“APB 25”), one of the accounting rules in effect during the period of the alleged backdating, confirms that issuing in-the-money options is acceptable provided they are properly accounted for and reported. (Id. ¶ 34, 36) Even SEC Commissioner Paul Atkins has emphasized that “[b]ackdating of options sounds bad, but the mere fact that options were backdated does not mean that the securities laws were violated.”⁴ Simply put, allegations that McKelvey participated in backdating options cannot provide the “strong circumstantial evidence of conscious misbehavior or recklessness” required to raise a strong inference that McKelvey

⁴ Paul Atkins, *Remarks Before the International Corporate Governance Network 11th Annual Conference*, July 6, 2006, <http://www.sec.gov/news/speech/2006/spch070606psa.htm>, last visited July 11, 2007.

intentionally or recklessly violated accounting and disclosure rules. Kalnit, 264 F.3d at 138.

Plaintiff has not and cannot provide the additional element necessary to state a claim: that McKelvey not only participated in backdating but did so knowing the applicable accounting and disclosure rules.

2. “As Of” Dating Cannot Raise A Strong Inference Of Scienter

Plaintiff also attempts to raise an inference of scienter by highlighting the practice of dating the UWCs signed by McKelvey and the Compensation Committee “as of” a predetermined date. But nothing in this language raises the requisite “powerful or cogent” inference that McKelvey intended to violate accounting and disclosure requirements. Tellabs, 127 S.Ct. at 2510. It is commonly accepted that using “[t]he phrase ‘as of’ in connection with a date generally refers to a designated date of contractual significance, a date mutually agreed upon for contracting purposes. . . .” Rosner v. Metropolitan Property and Liability Insur. Co., 236 F. 3d 96, 100 (2d Cir. 2000). In other words, “as of” dating is simply evidence of a desire to make a document effective as of a particular date. “When a written contract provides that it shall be effective ‘as of’ an earlier date, it generally is retroactive to the earlier date.” Viacom Int’l, Inc. v. Tandem Productions, Inc., 368 F. Supp. 1264, 1270 (SDNY 1974) (citing, *inter alia*, Matthews v. Jeremiah Burns, Inc., 129 N.Y.S. 2d 841, 846 (Sup. Ct. 1954) (under New York law, it is “fundamental that where parties to an agreement expressly provide that a written contract be entered into ‘as of’ an earlier date than that on which it was executed, the agreement is effective retroactively ‘as of’ the earlier date”)).

Given these plainly lawful purposes, a UWC effective “as of” a certain date – without more – cannot provide an inference of wrongdoing to survive a motion to dismiss. “As of” dating is not a red flag here because the act of backdating a stock option alone is not illegal. Backdating stock options is only illegal when it is not properly accounted for or disclosed.

Absent the additional necessary allegation that McKelvey knew of and disregarded the applicable accounting and disclosure rules, plaintiff's reliance on "as of" dating is insufficient.

Under Tellabs, on a Rule 12(b)(6) motion, the Court must consider not only the inference put forth by plaintiff – that McKelvey's signing of UWCs dated "as of" a prior date indicated an intent to conceal the accounting and reporting implications of backdating – but also compare that inference to other "plausible nonculpable explanations." Tellabs, 551 U.S. at 2510. The obvious explanation to be drawn from the totality of plaintiff's allegations is that McKelvey believed that dating UWCs "as of" certain dates was as lawful as the use of "as of" dating in other areas of law. In the absence of evidence that McKelvey knew or should have known the accounting and disclosure consequences of using "as of" language in dating the UWCs, the "as of" allegations do not sustain an inference – let alone a strong inference – of conscious misbehavior or recklessness. See SEC v. Durgarian, 477 F. Supp. 2d 342, 352 (D. Mass. 2007) (mutual fund trades dated "as of" earlier date not *per se* illegal; in that case inference of scienter raised only because plaintiff further alleged that defendant met to "discuss a plan to conceal" accounting and reporting implications of the "as of" trades).

3. APB 25 Is Notoriously Opaque

Although plaintiff acknowledges the centrality of APB 25 to its case (Am. Cmplt. ¶¶ 34-38), plaintiff fails to attribute any specific knowledge or understanding of APB 25 to McKelvey. This failure is not surprising, given the widespread confusion surrounding APB 25. See In Re Sportsline.com Secs. Litig., 366 F. Supp. 2d 1159, 1168-1169 (S.D. Fla. 2004) ("the Court finds that interpretations of the measurement date criteria embodied in APB No. 25 are far from obvious"). Indeed, plaintiff concedes that "many public corporations" came under scrutiny for similarly problematic accounting under APB 25. (Am. Cmplt. ¶ 44) In September 2006, the Office of the Chief Accountant at the SEC sought to diminish this confusion by issuing guidance

on calculating the “measurement date” and “grant date” in accounting for past options grants under APB 25. (Posa Decl. Ex. 7) This guidance demonstrates that the very same procedures alleged in the Amended Complaint – approving option grants before the allocation information was finalized and adding recipients to prior grants – are far from unusual:

We understand that some companies may have approved option awards before the number of options to be granted to each individual employee was finalized. For example, the compensation committee may have approved an award by authorizing an aggregate number of options to be granted prior to the preparation of a final list of individual employee recipients. In these cases, the allocation of options to individual employees was completed by management after the award approval date, or the unallocated options were reserved for grants to future employees.

[. . .]

The staff also has become aware that some companies may have changed the list of recipients or the number of options allocated to each recipient subsequent to the preparation of the initial list at the award approval date.

The sheer pervasiveness of these practices further demonstrates that plaintiff’s allegations are simply not the stuff of fraudulent intent. Indeed, among the “many public corporations” (Am. Cmplt. ¶ 44) caught up in the backdating scandal are Microsoft Corp. and Barnes & Noble, which have acknowledged that their misunderstanding of APB 25 led them to restate earnings based on improprieties in accounting for options. In its 1999 Form 10-K, Microsoft took a \$219 million charge to earnings under APB 25 to account for its practice of granting options at the lowest price within 30 days of annual grants or grants to new hires. (Posa Decl. Ex. 4) In a June 16, 2006 *Wall Street Journal* article, Microsoft was quoted as saying that, notwithstanding this charge to earnings, the company believed that this practice was “perfectly legal” and in fact was blessed by its outside auditors, Deloitte & Touche. (Posa Decl. Ex. 5) In the same vein, an April 5, 2007 *Wall Street Journal* article quoted Barnes & Noble as blaming its pervasive backdating

problem on a “widespread misconception among senior management” that the practices were proper. (Posa Decl. Ex. 6) In light of the apparently widespread nature of these practices, it is no wonder that plaintiff has failed to claim that McKelvey understood and deliberately violated APB 25.

4. Plaintiff Has Failed To Allege McKelvey’s Knowledge or Reckless Disregard Of Accounting And Disclosure Implications Of Backdating

The closest plaintiff comes to charging McKelvey with knowledge of the governing accounting principles is alleging that he signed and certified certain of Monster’s Forms 10-Q and 10-K, but plaintiff acknowledges that McKelvey’s certification was expressly limited to information that was “based on [his] knowledge” at the time. (Am. Cmplt. ¶ 170) Other than recycling the original Complaint’s defective, boilerplate references to defendants’ collective access to unspecified “internal corporate documents,” “reports and other information” and “confidential proprietary information” (*id.* ¶¶ 21, 22), the Amended Complaint contains no new allegations regarding the scope of McKelvey’s knowledge or understanding of the accounting and disclosure consequences of granting in-the-money options, and cites no specific information that McKelvey allegedly knew but withheld from the investing public. “If plaintiffs rely on allegations that the defendants had access to facts contradicting their public statements, plaintiffs must *specifically identify* the reports or statements containing this information.” WorldCom, 294 F. Supp. 2d at 412 (internal citation and quotation omitted) (emphasis added); see In re Yukos Oil Co. Secs. Litig., No. 04 Civ. 5243 (WHP), 2006 WL 3026024, *20 (S.D.N.Y. Oct. 25, 2006) (dismissing securities fraud claim because allegations that CEO had “access” to internal documents and undisclosed information were found to be “insufficient as a matter of law to establish [executives’] conscious misbehavior and recklessness”). By failing to allege that McKelvey had access to this specific information, plaintiff once again has failed to show that

McKelvey engaged in “an egregious refusal to see the obvious, or to investigate the doubtful, [which] may in some cases give rise to an inference of recklessness.” Chill, 101 F.3d at 269 (citing Goldman v. McMahan, Brafman, Morgan & Co., 706 F. Supp. 256, 259 (S.D.N.Y. 1989)).⁵ Plaintiff’s own amended pleading – just like the initial pleading before it – demonstrates that there was nothing “obvious” or “doubtful” about the accounting for options under APB 25 for McKelvey to have seen or investigated.

Nor can plaintiff rely upon the mere fact that McKelvey was CEO to infer fraudulent intent. See In re Health Mgt Secs. Litig., 970 F. Supp. 192, 205 (E.D.N.Y. 1997) (if court were to infer scienter from “senior management position,” “the executives of virtually every corporation in the United States would be subject to fraud allegations”). Moreover, although McKelvey is alleged to have signed three Form 10-Qs filed with the SEC in 2005 and one Form 10-Q filed with the SEC in 2006 (Am. Cmplt. ¶ 170), these signatures are not sufficient to allege scienter to commit securities fraud. See WorldCom, 294 F. Supp. 2d. at 417-18 (plaintiff failed to allege scienter despite fact that audit committee members signed 10-K forms); In re Crimi Mae, Inc. Secs. Litig., 94 F. Supp. 2d 652, 661 (D. Md. 2000) (inference that individual defendants who signed company’s public filings “must have known” statements at issue were false did not establish scienter); In re Cendant Corp. Secs. Litig., 76 F. Supp. 2d 539, 547 (D.N.J.

⁵ Chill is instructive. There, the Second Circuit analyzed allegations that General Electric had ignored significant “red warning flags” that its subsidiary, Kidder Peabody, was engaging in sham trades to inflate profits on a massive scale. These “red flags” included a huge increase in the dollar volume of Kidder’s bond trading, the lack of records of any cash being realized from these trades, and the multi-billion dollar daily fluctuations in Kidder’s balance sheet assets. Chill, 101 F.3d at 269. Even still, the court found that “fraud cannot be inferred simply because GE might have been more curious or concerned about the activity at Kidder.” Id. McKelvey, in contrast, is not alleged to have been aware of *any* specific “red flags” that might have indicated inappropriate accounting for backdating or the non-disclosure of such backdating in Monster’s SEC filings.

1999) (allegations establishing that officer or director signed public disclosures do not establish scienter, even coupled with allegations of day-to-day involvement in company's affairs); In re Kennilworth Partners L.P. v. Cendant Corp., 59 F. Supp. 2d 417, 428 (D.N.J. 1999) (allegations that individual defendants signed company's Form 10-K not probative of scienter).

No circumstantial evidence supports a strong inference that McKelvey acted with the requisite scienter.

B. Plaintiff Fails To Allege Facts Showing McKelvey Had Motive And Opportunity To Commit The Securities Fraud Pleaded In The Complaint

In the Second Circuit, motive entails "concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged," while opportunity entails the "likely prospect of achieving concrete benefits by the means alleged." Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1130 (2d Cir. 1994). While courts in the Second Circuit "often assume that corporations, corporate officers and corporate directors would have the opportunity to commit fraud if they so desired," the same does not hold for motives "generally possessed by most corporate directors and officers." In re Espeed, Inc. Secs. Litig., 457 F. Supp. 2d 266, 281 (S.D.N.Y. 2006) (citing In re Time Warner Secs. Litig., 9 F.3d 259, 269 (2d Cir. 1993) and quoting Kalnit, 264 F.3d at 139). "[I]nstead, plaintiffs must assert a concrete and personal benefit to the individual defendants resulting from the fraud." Kalnit, 264 F.3d at 139. Plaintiff has not done so.

1. The New Allegations Regarding McKelvey's Stock Ownership And Bonuses Are Insufficient To Constitute Motive As A Matter Of Law

In the Amended Complaint, plaintiff alleges that McKelvey was motivated to inflate Monster's stock price because he is a major owner of Monster stock and maintained margin accounts and credit facilities pledged against Monster stock. (Am. Cmplt. ¶¶ 129, 130) Under plaintiff's theory, McKelvey could have lost his 30% voting interest in Monster if a sharp decline

in the share price had forced a sale of the stock pledged as collateral for his margin accounts. (Id. ¶¶ 135-37) Plaintiff further alleges that McKelvey was motivated to inflate EPS because, in 2004 and 2005, he received bonuses based on EPS performance. (Id. ¶¶ 146, 147)

Plaintiff's newly-minted "motive" allegations do not raise a strong inference of scienter. "[T]he law is clear that the desire of individual defendants 'to keep their jobs or increase their compensation by artificially inflating stock price' is not sufficient to establish motive." Axis, 456 F. Supp.2d at 593-94 (citing Davidoff v. Farina, 04 Civ. 7617 (NRB), 2005 WL 2030501, *17 n.30 (S.D.N.Y. Aug. 22, 2005)); see Chill, 101 F.3d at 268 ("If we accept this as sufficient motive, then we must accept as motive that every publicly-held corporation desires its stock to be priced highly by the market. At that point, the motive requirement becomes meaningless."); Acito, 47 F.3d at 54 ("Plaintiffs' allegation that defendants were motivated to defraud the public because an inflated stock price would increase their compensation is without merit. . . . Incentive compensation can hardly be the basis on which an allegation of fraud is predicated.").

Moreover, plaintiff's allegations about McKelvey's margin accounts are a transparent attempt to track the decision in In re WorldCom, Inc. Secs. Litig., 294 F. Supp. 2d 392 (S.D.N.Y. 2003), which found that former WorldCom CEO Bernard Ebbers' personal financial incentives were sufficiently "unique and substantial" to satisfy the pleading requirements for scienter. Id. at 416-417. This case, however, is not WorldCom, and Andy McKelvey is not Bernie Ebbers.

In WorldCom, plaintiffs alleged that Ebbers held \$900 million in loans secured by his WorldCom stock, and, "[i]n order to avoid or mitigate margin calls from lenders, Ebbers faced substantial pressure to maintain the price of the WorldCom stock that was serving as his collateral." Id. at 416. Likewise, in the Amended Complaint, plaintiff pleads that as of 2001, McKelvey had "nearly \$250 million" in margin loans and credit facilities, and faced "potential

calls” on those loans when the company’s stock price “began to plummet in 2001.” (Am. Cmplt. ¶¶ 130-31) This, however, is where the similarity between McKelvey and Ebbers ends – and this limited similarity is far from dispositive. “Corporate executives commonly secure personal loans with shares of stock,” and therefore the allegation that an executive’s “pledge of stock motivated him to undertake fraudulent acts intended to keep [the company’s] share price high to avoid a margin call are too general to raise a strong inference of scienter.” In re Dynergy, Inc. Secs. Litig., 339 F. Supp. 2d 804, 899 (S.D. Tex. 2004).

But this is not all. The WorldCom plaintiffs’ allegations against Ebbers and the historic scope of the fraud at WorldCom far surpass Middlesex County’s allegations against McKelvey:

- Unlike McKelvey, Ebbers was allegedly a “hands-on” manager who “repeatedly represented to the public that he was familiar with WorldCom’s accounting policies and practices” and had a “close relationship” with WorldCom’s chief financial officer. WorldCom, 294 F. Supp. 2d at 402. McKelvey is not alleged to have had *any* accounting knowledge or to have been a hands-on manager.
- Unlike McKelvey, Ebbers allegedly received a \$400 million loan directly from WorldCom to cover margin calls. Id. at 402, 416. McKelvey is not alleged to have received *any* loans from Monster, and this fact alone suggests that the risks associated with a margin call on McKelvey were not as severe as plaintiff would lead the Court to believe.
- Unlike McKelvey, Ebbers had an extremely close relationship with WorldCom’s investment bankers at Salomon Smith Barney, which “gave significant percentages of its total available retail allocation from ‘hot’ IPOs to Ebbers on multiple occasions,” from which he derived profits of \$11.5 million. Id. at 406. Ebbers also received “enormous” loans secured by WorldCom stock from SSB, loans that were deliberately concealed by using shell corporations. Id. Ebbers’ relationship with SSB depended on “sustaining WorldCom’s acquisition strategy and its stock price.” Id. at 416-417. McKelvey is not alleged to have had an improper relationship with *any* investment bank and, in the face of the reality that McKelvey received no options from Monster – backdated or otherwise – the inferences to be drawn from plaintiff’s allegations regarding McKelvey’s need to maintain Monster’s stock price are quite weak.
- Unlike McKelvey, Ebbers allegedly sold \$70 million in WorldCom stock when the company was in dire straits after government regulators blocked an important merger. Id. at 402. McKelvey, in contrast, is not alleged to have made *any* suspicious insider sales. (Am. Cmplt. ¶¶ 141, 143)

Thus, in WorldCom, the court did not find that the plaintiff had pled scienter based solely on allegations about Ebberts' margin loans. Rather, the court considered the margin account allegations along with the allegations enumerated above "as a whole" in finding that plaintiffs had sufficiently pled scienter. WorldCom, 294 F. Supp. 2d at 417. The court also considered that WorldCom's accounting fraud went to the heart of the company's business and resulted in a restatement of more than \$50 billion, which had a "catastrophic" impact on the stock's value, causing the share price to plummet from \$65 per share to "pennies" and driving the company into "the largest bankruptcy in United States history." WorldCom, 294 F. Supp. 2d at 397, 401. In contrast, plaintiff here alleges that the news of potential backdating at Monster caused the share price to drop 8.1%, from \$42 to \$38.60. (Am. Cmplt. ¶ 7) There is no allegation that Monster's eventual restatement of \$339.6 million resulted in *any* drop in share price. (Id. at 11, 17). *Taken as a whole*, the allegations against McKelvey and the magnitude of the alleged fraud at Monster are not in the same galaxy as the WorldCom allegations. Absent additional evidence of motive of the sort pled in WorldCom, allegations that McKelvey's "pledge of stock motivated him to undertake fraudulent acts to keep [the company's] share price high to avoid a margin call are too general to raise a strong inference of scienter" as a matter of law. Dynergy, 339 F. Supp. 2d at 899.

Plaintiff's new allegations regarding McKelvey's incentive compensation in the form of EPS-driven bonuses provide even less support for the inference plaintiff seeks to draw. It simply makes no sense to suggest that bonuses granted in 2004 and 2005 could have motivated McKelvey to backdate options and improperly account for and misreport the backdating *from 1997 until 2003*. See Scheuer v. Rhodes, 416 U.S. 232, 236 (1974) (on Rule 12(b)(6) motion, court must accept as true facts alleged and all *reasonable* inferences arising from those facts).

Bonuses awarded in years after the alleged period of backdating are insufficient as a matter of law to save the Amended Complaint. Cf. Axis, 456 F. Supp. 2d at 594 (scienter not sufficiently pled through allegations that insurer had motive to keep its stock price high because management bonuses were at stake).

Plaintiff's new allegations regarding McKelvey's stock ownership and bonuses do not constitute motive as a matter of law.

2. The New Allegations About Monster's Pooling Accounting Cannot Be Imputed To McKelvey To Constitute Motive As A Matter Of Law

Plaintiff also now tries to impute the *company's* alleged desire to preserve favorable accounting treatment for Monster's acquisitions to *McKelvey* as an individual. According to plaintiff, in the summer of 2001, McKelvey was motivated to artificially inflate Monster's stock to avoid a margin call and forced sale of his stock because such a sale would have violated the rules for "pooling accounting" that the company used for its acquisitions. (Am. Cmplt. ¶¶ 138-140) If a forced sale of McKelvey's stock had compelled the company to switch from the pooling method to the "purchase method," the company allegedly would have been required to account for more than \$300 million in acquired goodwill, resulting in an amortization expense of \$2.8 million per quarter. (Id. ¶ 139) Other than the legally irrelevant desire to drive company performance, Chill, 101 F. 3d at 26, plaintiff does not explain how the preservation of pooling accounting would have affected McKelvey's individual economic interest, the relevant inquiry for determining individual motive. See In re Health Mgt. Inc., 970 F. Supp. at 204 (finding insufficient evidence of motive to create "strong inference" of CEO's fraudulent intent where plaintiff failed to "explain how the desire to conclude various acquisitions by using inflated value of the stock as consideration for mergers and to obtain financing for such acquisitions, is in the informed economic self-interest of the Individual Defendants"). Thus, as a matter of law, the

new pooling accounting allegations cannot strengthen plaintiff's weak and ultimately unsuccessful attempt to plead McKelvey's motive to commit fraud.

3. The New Allegations About McKelvey's Desire To Keep Top Talent And Grow The Company Are Insufficient To Constitute Motive As A Matter Of Law

Unable to plead that McKelvey had a "concrete and personal" financial motive for committing fraud, Kalnit, 264 F.3d at 139, plaintiff makes a last-ditch attempt to salvage its case by claiming that McKelvey backdated Monster stock in order to ensure the company's "continued growth" and "to retain and attract key personnel." (Am. Cmplt. ¶¶ 123, 124) Amazingly enough, plaintiff seizes upon this alleged quote by McKelvey – which demonstrates that his priorities were the very priorities that *should* motivate a CEO in designing and implementing a stock option program – to demonstrate his purportedly sinister motives:

Ever since Monster Worldwide became a public company 11 years ago, we used our stock option incentive plan as an effective tool to drive our growth and foster the entrepreneurial spirit that continues to exist throughout the organization. The option grants were used to attract and retain talented and creative individuals, to recognize individual performance and facilitate strategic acquisitions. . .

(Id. ¶ 125) Plaintiff's desperate attempt to wring a negative inference from this and other purely positive statements, (id. ¶¶ 68, 119, 120), is nonsense. If the desire to improve business and motivate employees were evidence of fraudulent motive, then all right-thinking corporate executives would be held liable and the business community would be awash in criminals. Fortunately for our economy and society, this is not the law. Espeed, 457 F. Supp. 2d at 281 (motives "generally possessed by most corporate directors and officers" cannot raise a strong inference of fraudulent intent).

II.

PLAINTIFF FAILS TO STATE A CLAIM AGAINST MCKELVEY FOR VIOLATION OF SECTION 20(A) OF THE SECURITIES AND EXCHANGE ACT OF 1934

Plaintiff also claims that, by virtue of McKelvey's position as a controlling person and due to his "acts and omissions as alleged in this Complaint," McKelvey is liable pursuant to Section 20(a) of the Exchange Act. (Am. Cmplt. ¶ 219) In order to establish a *prima facie* case of liability under Section 20(a), a plaintiff must show: (1) a primary violation by a controlled person; (2) control of the primary violator by the defendant; and (3) "that the controlling person was in some meaningful sense a culpable participant" in the primary violation. Boguslavsky v. Kaplan, 159 F.3d 715, 720 (2d Cir. 1998) (internal quotation omitted). Plaintiff cannot make this showing.

In the absence of detailed allegations regarding McKelvey's state of mind as a "control person" with respect to the accounting and disclosure implications of the alleged backdating, the Section 20(a) claim must be dismissed for failure to allege culpable participation. See In re Deutsche Telekom AG Secs. Litig., No. 00 CIV 9475 (SHS), 2002 WL 244597, at *6 (S.D.N.Y. Feb. 20, 2002) ("Culpable participation must be pled to allege control person liability pursuant to Section 20(a) as a consequence of the pleading requirements of the PSLRA"). As set forth above, this is precisely what plaintiff has failed to plead with respect to McKelvey. For this reason, plaintiff's Section 20(a) claim against McKelvey also must be dismissed. See In re Razorfish, Inc. Secs. Litig., No. 00 Civ. 9474 (JSR), 2001 WL 1111502, at *3 (S.D.N.Y. Sept. 21, 2001) (dismissing Section 20(a) claim where complaint fails to allege a false statement "made with the requisite fraudulent scienter"). Consequently, the Section 20(a) claim, like the Section 10(b) claim, should be dismissed with prejudice.

Conclusion

For the foregoing reasons, we respectfully request that the Court dismiss with prejudice the Amended Complaint against defendant McKelvey.

Dated: New York, New York.
July 23, 2007

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