

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----- x
IN RE MONSTER WORLDWIDE, INC. : 07 Civ. 2237 (JSR)
SECURITIES LITIGATION :
----- x MEMORANDUM

JED S. RAKOFF, U.S.D.J.

This is a private securities fraud action principally alleging violations of Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.¹ It arises from a \$339.6 million restatement of earnings by defendant Monster Worldwide, Inc. ("Monster"), resulting from disclosure of the company's backdating of stock options. Lead plaintiffs, the Middlesex County Retirement System and the Steamship Trade Association-International Longshoremen's Association Pension Fund, bring claims against Monster, Andrew J. McKelvey (former CEO and Chairman of Monster), and Myron Olesnycky (former General Counsel, Senior Vice President, and Secretary of Monster).

In April 2007, defendant McKelvey moved to dismiss the original complaint. In June, 2007, on consent of the parties, the Court granted plaintiffs leave to file an amended complaint and deemed McKelvey's motion to dismiss withdrawn without prejudice to refile a revised motion after the complaint was amended. Plaintiffs filed an Amended Complaint in July, 2007, and, shortly thereafter, McKelvey filed a motion to dismiss the amended complaint for failure to state a claim. After receiving briefs and hearing oral argument, the

¹Plaintiffs also allege a violation of Section 20(a) of the Exchange Act, discussed infra.

Court, by Order dated November 13, 2007, denied McKelvey's motion. This Memorandum explains the reasons for that Order.

Under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), a plaintiff must 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). So far as section 10(b) and Rule 10b-5 are concerned, the required state of mind is "scienter," defined in this context as "a mental state embracing intent to deceive, manipulate, or defraud." Tellabs, Inc. v. Makor Issues & Rights, LTD, 127 S.Ct. 2499, 2507 (2007) (internal quotation marks omitted). A plaintiff may plead a strong inference of scienter by alleging facts "(1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." ATSI Communications, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 99 (2d Cir. 2007).

When deciding a motion to dismiss a § 10(b) action, a Court must determine "whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." Tellabs, 127 S.Ct. at 2509 (emphasis in original). The "facts alleged" include not only those alleged in the complaint itself, but also those set forth in any "statements or documents incorporated into the complaint by reference," ATSI, 493 F.3d at 98. See also Chambers v. Time Warner, Inc., 282 F.3d 147, 153 (2d Cir. 2002). However, in

assessing all these allegations, a court must balance reasonable inferences favoring the plaintiff against those favoring the defendant. Tellabs, 127 S.Ct. at 2510. "A complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." Id.

Here, the Amended Complaint ("Am. Compl.") contains no fewer than ninety new paragraphs detailing McKelvey's role in the backdating scheme. According to the Amended Complaint, when it came to the annual determination of stock option grants, McKelvey would initially select an artificial "grant date," and then direct division heads to use that date in allocating their division's options among their employees. Am. Compl. ¶ 71. Typically, months passed between the date McKelvey selected as the "grant date" and the date on which the options were actually granted, id. ¶ 74, with the average period between the "as of" date and the actual grant date being ninety-seven days. Id. For example, at a January 15, 1999 meeting, McKelvey announced that he wanted to grant company-wide options at \$25 per option, even though the company's stock closed that day at \$42.38. December 9, 1998 was then chosen as the option "grant date," because it had a closing stock price of \$26.875, the closest to \$25 available during the previous month. Id. ¶ 77. The options were not actually granted until some time after March 12, 1999, when the company's stock was trading at \$64.06. Id. ¶¶ 75, 79-80.

Notwithstanding this total artificiality, McKelvey, according to the Amended Complaint, certified the accuracy of each of the company's 10-Q and 10-K forms filed during the Class Period (beginning May 6, 2005), even though each of these 10-Q and 10-Ks contained information regarding the stock options that was materially false. Id. ¶¶ 166-170. For example, each 10-Q and 10-K stated that:

The Company's financial statements are presented in accordance with Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees. Under APB 25, generally no compensation expense is recognized in connection with the awarding of stock option grants to employees provided that, as of the grant date, all terms associated with the award are fixed and the quoted market price of the stock is equal to or less than the amount an employee must pay to acquire the stock as defined. As the Company has only issued fixed term employee stock option grants at or above the quoted market price on the date of the grant, there has been no compensation expense associated with stock options recognized in the accompanying financial statements.

Id. ¶ 169. At the time McKelvey signed these 10-Qs and 10-Ks, he had allegedly been participating in a backdating scheme for eight years and knew that on the actual grant dates (i.e. the dates on which employees actually received the stock options), the quoted market price of the stock was materially above the option price. Am. Compl. ¶¶ 59-118. These facts alone raise a strong inference that McKelvey either knew, or was severely reckless in not knowing, that these 10-Qs and 10-Ks were false when he signed the certifications. See Novak v. Kasaks, 216 F.3d 300, 308 (2d Cir. 2000) ("securities fraud claims typically have sufficed to state a claim based on recklessness when they have specifically alleged defendants' knowledge of facts or access to information contradicting their public statements").

McKelvey nonetheless argues that this does not raise a strong inference of scienter, chiefly because it is equally plausible, in his view, that McKelvey did not know that the words "grant date" referred to the date on which employees actually received the options and that McKelvey either honestly believed that these words referred to the date he had chosen or else did not have a belief either way and simply deferred to the determinations of his lawyers and accountants as to the appropriateness of the statements in the 10-Ks and 10-Qs. Reply Memorandum of Law in Further Support of Defendant Andrew J. McKelvey's Motion to Dismiss the Amended Complaint for Failure to State a Claim ("Reply") at 3-4. But, given the totality of the allegations in the Amended Complaint, neither of these alternative inferences is remotely as plausible as the strong inference of scienter. Quite aside from the glaring fact that, as alleged in great detail in the Amended Complaint, McKelvey orchestrated the backdating for years on end, Am. Compl. ¶¶ 59-118, McKelvey, after the fraud began to surface, admitted to the Wall Street Journal that he was "completely responsible" for the option grants, Am. Compl. ¶ 60. Furthermore, co-defendant Olesnyckyj, in pleading guilty to the fraud, stated that those involved in backdating the grants (which would include McKelvey) intentionally "concealed the backdating from the company's financial records," id. ¶ 9. Further still, the company itself, after completing its investigation of the backdating, publicly stated (after McKelvey had left the company) that "The Company believes that this practice was done intentionally, by persons formerly in positions of

responsibility at the Company[,] for the purpose of issuing options at a higher intrinsic value than would have otherwise been the case.” Id. ¶ 72.

Taken as a whole, all of this is more than sufficient to raise a strong inference of scienter, an inference that is “at least as compelling as any opposing inference one could draw from the facts alleged.” See Tellabs, 127 S.Ct. at 2510. Thus, McKelvey’s motion to dismiss for failure to adequately allege scienter under section 10(b) and Rule 10b-5 must be denied.

As for the alleged violation of Section 20(a), 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 marks omitted). McKelvey argues that the Amended Complaint has not adequately pleaded his culpable participation for the same reasons that it has not raised a strong influence of scienter under Tellabs, 127 S.Ct. 2499. Because, as discussed above, the Court finds that plaintiffs have raised a strong influence of scienter and that the motion to dismiss the Section 10(b) and Rule 10b-5 claims must be denied, the motion to dismiss the 20(a) claim must likewise be denied.

For the foregoing reasons, the Court, by Order dated November 13 2007, denied McKelvey’s motion to dismiss in its entirety.

The parties are reminded that oral argument on plaintiffs' motion for partial summary judgment will be held on March 19, 2008 at 4 p.m.



JED S. RAKOFF, U.S.D.J.

Dated: New York, New York
March 4, 2008