UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,	
Plaintiff,	
v.	CIVIL ACTION NO. _____
BRIAN J. KEARNS and BRUCE J. VAN FOSSEN,	COMPLAINT
Defendants.	

The Securities and Exchange Commission ("Commission") alleges the following against Defendants Brian J. Kearns ("Kearns") and Bruce J. Van Fossen ("Van Fossen"):

SUMMARY OF ALLEGATIONS

1. This is a case in which Defendants participated in a secret fraudulent billing scheme in order to improve the financial performance of MedQuist Inc. ("MedQuist" or "Company") and deceive investors. From 1999 to 2004, MedQuist, a medical transcription company based in New Jersey, systematically and secretly inflated its bills to customers in order to increase revenues and profit margins. MedQuist inflated the bills by increasing the number of lines it claimed to have transcribed. The Company was able to carry out this scheme for several years because the unit of measure upon which many bills were based—known as an AAMT line—included invisible characters and computer keystrokes that could not be verified by MedQuist's customers. Knowing that its customers were unable to verify line counts on bills, the Company stopped actually counting AAMT lines and started secretly manipulating the line counts on bills to reach specific revenue and margin targets.

2. Defendants Kearns and Van Fossen knew of this billing scheme and, instead of stopping the fraud, took steps to further and conceal the scheme. Defendants Kearns and Van Fossen misled MedQuist's independent auditors into believing that the Company was actually counting AAMT lines, just as it was required to do under its customer contracts. Defendants also lied to the auditors by telling them they knew of no allegations of fraud or problems with internal controls, when in truth they knew the AAMT line billing process lacked audit trails and knew of employee and customer complaints of overbilling and line count manipulation. Defendants also misled shareholders and the public by stating in Commission filings, press releases and earnings calls, that the Company's revenues were based on contracted rates and increased sales to customers and that its strong financial performance was the result of conservative and disciplined business practices. In truth, the Company's revenues and financial performance were due in part to its secret manipulation of AAMT line counts to meet revenue and profit margin targets.

VIOLATIONS

3. By engaging in the conduct described below, Defendants Kearns and Van Fossen violated Section 17(a) of the Securities Act and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1, and 13b2-2(a) [15 U.S.C. §§ 77q(a), 78j(b), and 78m(b)(5) and 17 C.F.R. §§ 240.10b-5, 204.13b2-1, 240.13b-2-2(a)], and aided and abetted violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), and 78m(b)(2)(B) and 17 C.F.R. §§ 204.12b-20, 204.13a-1, 240.13a-11, and 240.13a-13]. Defendant Van Fossen also, in the alternative, aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5.

JURISDICTION AND VENUE

4. The Commission brings this action pursuant to Sections 20(b), 20(d), and 20(e) of the Securities Act and Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. §§ 77t(b), 77t(d), 77t(e), 78u(d), and 78u(e)], seeking a judgment:

a. Permanently restraining and enjoining each of the Defendants from further violations of the relevant provisions of the securities laws;

b. Requiring Defendants Kearns and Van Fossen to pay a civil money penalty pursuant to Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act [15 U.S.C. §§ 77t(d) and §78u(d)]; and

c. Prohibiting Defendants Kearns and Van Fossen from acting as an officer or director of any issuer that has a class of securities registered under Section 12 of the Exchange Act [15 U.S.C. §78l] or that is required to file reports by Section 15(d) of the Exchange Act [15 U.S.C. §78o(d)].

5. The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d), 20(e) and 22 of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d), 77t(e) and 77v] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa]. Venue is proper under Section 22 of the Securities Act [15 U.S.C. § 77v] and Section 27 of the Exchange Act [15 U.S.C. § 78aa].

6. Defendants Kearns and Van Fossen, directly or indirectly, made use of the means and instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange in connection with the acts, practices, and courses of business alleged herein. Certain of

these transactions, acts, practices and courses of business occurred in the Southern District of New York, including, among other things, public sales of MedQuist stock on the NASDAQ stock market based in New York City.

DEFENDANTS

7. **Brian J. Kearns**, age 42, was the Treasurer and Chief Financial Officer of MedQuist from October 2000 through July 2004. Kearns resides in Moorestown, New Jersey.

8. **Bruce J. Van Fossen**, age 47, was Vice President and Controller of MedQuist from 1995 through 2005. Van Fossen resides in Marlton, New Jersey.

STATEMENT OF FACTS

The Billing Scheme

9. MedQuist performs medical transcription services by receiving dictated medical records from customers, usually hospitals, and keying them into computer programs called transcription platforms. MedQuist has contracts with its customers governing how MedQuist will measure and bill the work. Each contract specifies the unit MedQuist uses to measure the work (such as word, line, or report), the definition of the unit of measure (such as how many characters constitute a "line"), and the price per unit. The contracts require that MedQuist bill the customer an amount equal to the number of units transcribed multiplied by the price per unit.

10. From 1998 to 2006, many of MedQuist's contracts required MedQuist to use a unit of measure called the AAMT line. MedQuist's contracts defined an AAMT line as follows:

> any line having 65 'characters,' [where a] character is defined as any letter, number, symbol or function key necessary for the final appearance and content of a document including, without limitation, the space bar, carriage return, underscore, bold, and any character contained within the macro, header, or footer. A defined line is calculated by counting all characters contained within a document and simply

dividing the total number of characters by 65 to arrive at the number of defined lines.

11. Because MedQuist's contracts specifically stated that AAMT lines would be calculated by "counting all characters" and "simply dividing . . . by 65", MedQuist was required to count AAMT characters in order to bill in accordance with contracts.

12. Because AAMT lines include invisible characters and formatting codes peculiar to the transcription platforms, MedQuist's customers could not independently verify the AAMT line totals in their bills by looking at their transcribed documents.

13. From 1999 to 2004, MedQuist exploited the lack of transparency in AAMT line counts to secretly inflate line counts on bills.

14. Between December 1998 and January 1999, MedQuist established an internal policy to stop counting AAMT characters and lines. Its new policy was to derive the number of AAMT lines billed to a customer from the number of lines it paid its transcriptionists to transcribe that customer's work.

15. MedQuist calculated transcriptionists' pay by using a measure called the "payroll line." A payroll line is not equal to an AAMT line.

16. MedQuist's newly adopted internal policy stated that for any piece of transcription work, an AAMT line count equals twice the payroll line count. This policy became known throughout the Company as the "2-to-1 ratio" or the "2-to-1 Bill to Pay [BTP]" ratio.

17. Because the change from counting AAMT lines to applying the 2-to-1 line ratio had the potential to increase billed line counts enough to be noticed by customers, the Company did not

implement the policy uniformly across all its AAMT customers. The Company increased the line count ratios of some customers gradually over time.

18. By mid 1999, in addition to the 2-to-1 BTP ratio policy, MedQuist instituted a second internal billing policy, which required that every AAMT account should be billed $3.00 for every $1.00 MedQuist paid to a transcriptionist. This policy became known as the "3-to-1 ratio" or 3-to-1 margin ratio."

19. In mid 1999, MedQuist began further adjusting line count ratios in order to increase bills to customers and to reach its revenue and margin targets set by the 3-to-1 ratio policy. MedQuist continued to secretly adjust line count ratios until 2004 or later.

20. In or before August 2000, MedQuist created a special internal unit called Financial and Operational Audit ("FOPA") to ensure compliance with the 2-to-1 BTP ratio and 3-to-1 margin ratio policies. FOPA was comprised of four or five business analysts who reviewed billing at each MedQuist office and prepared written reports detailing, among other things, how well an office was following the 2-to-1 BTP ratio policy and meeting the revenue and gross margin targets established by the 3-to-1 margin ratio policy. These reports showed that many line count ratios were set higher than the unfounded 2-to-1 BTP ratio. Many of the reports explicitly recommended that offices (1) secretly or gradually increase line count ratios in order to improve profit margins and (2) set up customer accounts as AAMT accounts in order to improve management's ability to manipulate line counts and margins. These reports also recommended that the offices exercise care in making changes because many clients pay close attention to bills. The result of these recommendations was

that customers were billed more than they would have been billed had the Company actually counted AAMT lines in accordance with contract terms.

21. The 2-to-1 BTP ratio policy and the 3-to-1 margin ratio policy worked a fraud on customers by secretly nullifying contracted rates through inflated line counts. As a result, customers unknowingly paid higher bills than they would have paid if the Company had counted lines in accordance with contracts.

22. MedQuist did not inform customers or the investing public of its ratio adjustments. In order to conceal the adjustments from customers, MedQuist sometimes timed increases to line count ratios to occur in times of high work volume, when customers would be less likely to question larger bills. MedQuist sometimes secretly increased a customer's line ratio after agreeing to a decrease in line price, in order to maintain revenues and gross profit margins. MedQuist monitored the effect of these increases to line ratios to ensure its target gross margin on revenue was met.

23. The billing scheme came to light after an employee complaint on November 12, 2003, caused MedQuist's auditors to refuse to sign off on the Company's financial statements, and prevented MedQuist from filing its 2003 annual report. MedQuist's first indication to the public of any potential wrongdoing came on March 16, 2004, when MedQuist disclosed that "an employee made assertions of potential improper billing practices by the Company," and that it had "delayed the filing of [its] Form 10-K for the year ended December 31, 2003 pending completion of the review as to the impact of these billing issues on [its] financial statements, and finalization of [its] audited financial statements as of and for the year ended December 31, 2003." Prior to March 16,

2004, MedQuist concealed its billing scheme from the investing public and shareholders. The public finally learned of the Company's fraudulent billing practices on July 30 and August 3, 2004, when MedQuist issued a press release and filed a Form 8-K with the Commission disclosing MedQuist's secret use of ratios to affect profit margins.

24. Since MedQuist's March 2004 disclosure, the Company has approved payment of $75.8 million in cash and credits to customers to resolve billing disputes arising from the fraud. MedQuist has also paid $7.5 million to settle a customer class action lawsuit (South Broward Hosp. Dist., et al. v. MedQuist Inc., No. CV-04-7520-TJH-VBKx (D. Cal. filed Sept. 9, 2004) and paid $6.6 million to settle claims of various agencies and departments of the United States Government. In addition, MedQuist restated its financials for the period of the conduct to reflect a $9.8 million reduction in revenue.

Defendants' Participation in and Failure to Stop the Fraudulent Billing Scheme

25. Defendant Van Fossen was the Company's controller from 1995 through 2005. As Controller, Defendant Van Fossen was responsible for billing accuracy and financial reporting.

26. Defendant Van Fossen knew in 1999 of MedQuist's 2-to-1 BTP ratio policy and the 3-to-1 margin ratio policy. Defendant Van Fossen also knew no later than 1999 that customer contracts specified that AAMT lines should be measured by counting AAMT characters and dividing by 65, that AAMT lines were not visually verifiable, and that the Company was secretly using ratios to derive line counts rather than actually counting AAMT characters and lines. Van Fossen also knew that the Company was manipulating those ratios specifically to meet certain revenue and margin targets, and frequently used ratios that exceeded the Company's 2-to-1 BTP

ratio, which it instituted as a replacement for counting AAMT lines as required in customer contracts.

27. On or about July 14, 1999, Defendant Van Fossen asked the Chief Operating Officer whether MedQuist should enter into a contract with a month-to-month customer who was already paying a premium price per line. The Chief Operating Officer directed Defendant Van Fossen to enter into the contract, but to set the customer's line count ratio at a level higher than 2-to-1. Defendant Van Fossen did not object and permitted the artificially high line count ratio.

28. On or about May 7, 2001, Defendant Van Fossen received an email from the Chief Operating Officer informing him that one customer's line count ratio was so inflated that the Company billed 87 lines to the customer for 29 actual lines of type, and that the customer had been overbilled by at least $125,000. Nevertheless, Defendant Van Fossen did nothing to investigate or correct the clear failure of internal billing controls or to prevent future inflations of billed AAMT line counts.

29. In or about July 2002, an employee told Defendant Van Fossen that a MedQuist office in Oregon had been directed to secretly increase line count ratios, even above the unfounded 2-to-1 ratio, in order to increase revenues and margins. Nevertheless, Defendant Van Fossen did nothing to audit line count accuracy in that office or throughout the Company and did nothing to prevent future manipulations of billed AAMT line counts.

30. In or about April or May 2003, another employee told Defendant Van Fossen that a MedQuist office in Alabama had been directed to increase line count ratios to increase billed line counts, and thereby increase bills and profitability. Nevertheless, Defendant Van Fossen did

nothing to audit line count accuracy in that office or throughout the Company and did nothing to prevent future manipulations of billed AAMT line counts.

31. Defendant Kearns joined MedQuist as its Treasurer and Chief Financial Officer on or about October 16, 2000. On or about October 18, 2000, Defendant Kearns attended a meeting during which the Chief Operating Officer discussed MedQuist's 2-to-1 BTP ratio and the 3-to-1 gross margin policies.

32. From about October 2000 through March 2002, Defendant Kearns discussed with the Chief Operating Officer the 2-to-1 BTP ratio policy, the revenue and gross margin targets established by the 3-to-1 margin ratio policy, the fact that the 2-to-1 BTP ratio was not applied uniformly across accounts, and the content of FOPA reports including office financial performance and margins.

33. From about October 2000 through 2001, Defendant Kearns discussed with Defendant Van Fossen the 2-to-1 BTP ratio policy and the use of ratios instead of counting AAMT lines. Both Defendants Kearns and Van Fossen regularly saw management reports that presented customer billed AAMT line totals in terms of ratios rather than counts.

34. From about October 2000 through early 2002, Defendant Kearns discussed with the director of FOPA the 2-to-1 BTP ratio policy, the revenue and gross margin targets established by the 3-to-1 margin ratio policy, the fact that the 2-to-1 BTP ratio was not applied uniformly across accounts, and the content of FOPA reports including office financial performance and margins. In addition, the two discussed the Company's adjustments to ratios to increase line counts and revenue.

35. In or about December 2000, Defendant Kearns received three FOPA reports from the director of FOPA. One of these reports recommended that the line count ratios for certain AAMT line customers be increased gradually and surreptitiously to comply with MedQuist's 2-to-1 BTP ratio policy. The result of this recommendation was that customers were billed more than they would have been billed had the Company actually counted AAMT lines in accordance with contract terms.

36. In or about February 2002, FOPA analysts sent copies of all final reports to Defendant Kearns, who was preparing to assume responsibility for the group. These reports showed that AAMT line count ratios varied from account to account and that many AAMT line customers had line count ratios set higher than the unfounded 2-to-1 BTP ratio. Several reports explicitly recommended that offices secretly or gradually increase line count ratios, even above 2-to-1, in order to improve profit margins. The result of these recommendations was that customers were billed more than they would have been billed had the Company actually counted AAMT lines in accordance with contract terms.

37. In or about March 2002, Defendant Kearns received at least three emails from FOPA analysts and two FOPA reports. These reports contained recommendations to increase line count ratios on AAMT line accounts to meet or exceed the 3-to-1 gross margin policy and increase revenues, to make these ratio increases in times of high volume so that customers would not notice the resulting billing increases, and to set customer accounts on the AAMT line unit of measure in order to improve management's ability to manipulate line counts and margins. These reports also recommended that the offices exercise care in making changes because many clients pay close

attention to bills. The result of these recommendations was that customers were billed more than they would have been billed had the Company actually counted AAMT lines in accordance with contract terms.

38. By about July 2002, a new director of FOPA had seen the recommendations in prior reports about secretly increasing line count ratios to improve profit margins. He met with Defendant Kearns in or about July 2002, pointed out that recommendation language in a report, and told Defendant Kearns that he found it troubling. Specifically, he pointed Defendant Kearns to a recommendation that an office increase ratios in times of work volume increases to avoid customer notice. This report also recommended the office bill clients on the AAMT line to "increase management's leverage in adjusting ratios and account setups" and increase revenues. Defendant Kearns agreed with the new director that future reports should not contain similar language, but took no further steps.

39. Defendants Kearns and Van Fossen knew or were reckless in not knowing that the Company was not measuring AAMT lines by counting in accordance with contracts, and that it was secretly increasing line count ratios to improve revenues and profit margins. Defendants Kearns and Van Fossen assisted or failed to stop the secret manipulation of line counts.

Customer and Employee Complaints About Billing

40. From 1999 to 2004, Defendants Kearns and Van Fossen knew of numerous complaints of billing fraud, allegations of overbilling and unverifiable line counts. Despite their knowledge, Defendants Kearns and Van Fossen did nothing to audit line counts, ensure AAMT line

count accuracy and billing accuracy, or ensure appropriate internal controls over the billing process to prevent and detect billing fraud through manipulation of line count ratios.

41. In or about October 1999, Defendant Van Fossen knew of a dispute with a customer who alleged that MedQuist had overbilled them by inflating its AAMT line counts, and as a result, had withheld payment for six months of invoices totaling $850,000.

42. In or about April 2000, another customer complained to Defendant Van Fossen that it could not verify its AAMT line counts and that the Company had errors in its billing process. Defendant Van Fossen told the customer that "an AAMT count is based on the number of characters on the page and do [sic] not represent just visible characters." Defendant Van Fossen, however, did not tell the customer that MedQuist based its bills on ratios designed to reach revenue and margin targets rather than on AAMT character counts.

43. In or about March 2001, Defendant Van Fossen knew of yet another dispute with a customer who alleged overbilling and terminated its relationship with MedQuist as a result.

44. On or about September 10, 2001, Defendants Kearns and Van Fossen received a copy of a senior staff meeting presentation that included a report on why customers had left MedQuist for other transcription companies. The report showed that of the sixteen former customers who gave reasons for leaving, ten described billing problems and irregularities, including: MedQuist's "fraudulent billing practices"; that MedQuist "could not justify billing"; and that MedQuist was "unable to reconcile billings."

45. In or about March 2002, MedQuist's Chief Operating Officer informed Defendants Kearns and Van Fossen that MedQuist employees were "jockeying" bill-to-pay ratios and losing customers.

46. In or about March 2002, Defendants Kearns and Van Fossen were told by the Company's General Counsel that another AAMT line customer had sued MedQuist for $200,000 alleging fraudulent overbilling.

47. In or about July 2002, an employee told Defendant Van Fossen that a MedQuist office in Oregon had been directed to secretly increase line count ratios, even above the unfounded 2-to-1 ratio, in order to increase revenues and margins.

48. On or about December 12, 2002, a MedQuist vice president complained of billing irregularities, claiming that she "and other MedQuist employees have been asked to impose general bill increases to clients as a way of increasing MedQuist's revenue without any basis in the underlying client contracts."

49. In or about December 2002, Defendants Kearns and Van Fossen and other Company officers and executives learned of the Vice President's complaint. Defendants Kearns and Van Fossen conducted a purported review of the Vice President's complaint. However, the review did not examine the accuracy of line counts or the validity of adjustments to line count ratios, and Defendant Van Fossen reported that he found no billing problems. Defendant Kearns and Van Fossen knew that the review did not examine the accuracy of line counts or the validity of adjustments to line count ratios. Defendants Kearns and Van Fossen knew or were reckless in not knowing that without such an examination, the review was ineffective.

50. As a result of her complaint and the company's lack of remedial actions, the Vice President refused to sign internal certifications of Company accounts for the fourth quarter of 2002 and the first two quarters of 2003. Defendants Kearns and Van Fossen knew that she refused to sign these certifications.

51. Between February 7 and February 10, 2003, Defendants Kearns and Van Fossen, and other Company officers and executives, learned that an employee in a MedQuist office in Pennsylvania had complained of intentional secret adjustments to line count ratios and billing overcharges. On or before February 21, 2003, Defendants Kearns and Van Fossen knew that the employee had made a previous complaint of billing fraud at the Pennsylvania office that had not been investigated. In this earlier complaint, the employee alleged that the MedQuist office in Pennsylvania had overbilled approximately 34 customer accounts over a four-year period of time for a total of $7.22 million.

52. Soon after learning of the employee's February 2003 complaint, Defendant Kearns and Van Fossen directed another Company employee to conduct a purported review of the allegations. Defendant Van Fossen helped design the review procedure, and Defendant Kearns approved it.

53. On or before February 11, 2003, Defendant Van Fossen looked at the line ratios of customers at the Pennsylvania office and saw that ratios varied from 1.4 to 1 to 4.56 to 1 and that approximately 37% of the customers had ratios that exceeded 2 to 1.

54. On or before February 12, 2003, the Company employee who was performing the review told Defendant Kearns that a January 2002 internal FOPA review of the Pennsylvania office

had recommended secret changes to line count ratios to increase revenue and profit margins and that line count ratios at that office had in fact been increased without any audit trails or documentary support. That same day, Defendant Kearns learned from the manager of the Pennsylvania office that line count ratios had been changed. The Company employee who performed the review also told Defendants Kearns and Van Fossen that the billing process had no audit trails, making it difficult or impossible to determine if there was overbilling. Despite knowing of ratio changes and the lack of audit trails, Defendants Kearns and Van Fossen did not examine, or direct the examination of, line count accuracy or the validity of adjustments to line count ratios. Defendants Kearns and Van Fossen also did not take steps to correct the absence of audit trails. Defendants Kearns and Van Fossen knew or should have known that without such an examination, the review was ineffective.

55. On or about February 21, 2003, Defendant Kearns told the Audit Committee of MedQuist's Board of Directors and the Company's external auditors, in the presence of Defendant Van Fossen, that the internal review of the Pennsylvania office billing complaint showed no billing irregularities. Neither Defendant Kearns nor Defendant Van Fossen told the Audit Committee or the external auditors about the undocumented increases to line count ratios or the lack of audit trails of which they knew. Defendants Kearns and Van Fossen knew or were reckless in not knowing that Defendant Kearns' statements to the Audit Committee and external auditors were incomplete and misleading.

56. In or about March 2003, Defendants Kearns and Van Fossen learned that another employee had complained of suspicious billing in a MedQuist office in Ohio. A member of the

Company's internal FOPA group reviewed the office's billing. Her written report dated April 3, 2003, stated, among other things:

- It was possible to alter the number of billed lines and the total billed amounts by altering ratios, while keeping the price per line constant;
- The office routinely changed line count ratios after contracts were in place in order to change the number of billed lines;
- The billing system had multiple control weaknesses, including no record of ratio changes;
- Office staff spoke openly of changing line count ratios to manipulate profit margins; and
- In at least one instance, the office had increased the line count ratio to offset a decrease in contract line price.

The changes to line count ratios at the Ohio office increased the amounts billed to customers above the amount called for in MedQuist's customer contracts. Defendant Kearns knew the content of the report and Defendant Van Fossen received a copy in or about April 2003 from the director of FOPA.

57. In or about April or May 2003, an employee told Defendant Van Fossen that a MedQuist office in Alabama had been directed to increase line ratios to increase billed line counts, and thereby increase bills and profitability.

58. In about October 2003, Company management did an analysis of the line count ratios of customers who had previously terminated accounts with MedQuist. The analysis showed

that nearly one-third of the lost customers had been billed for four or more lines for each line paid to a transcriptionist. That is, their line count ratios were 4-to-1 or greater, resulting in bills that exceeded the amount called for in MedQuist's customer contracts. On or about October 28, 2003, Defendants Kearns and Van Fossen received a copy of this analysis, which said, among other things: "23 of 71 clients had B:P [bill to pay] ratios greater than 4:1"; "59 of 71 accounts lost had B:P $$ greater than 3:1"; "a large B:P should result in commensurate large GM [gross margin]"; "we had substantially larger margins and/or B:P than our targets." In a series of email messages between October 28 and 29, 2003, a group of senior managers that included Kearns and Van Fossen discussed the implications of the report for the Company's client base, revenues and margins.

59. In or about November 2003, MedQuist management directed the Vice President who had been refusing to sign internal certifications to sign her certifications with exceptions. She did so by letter dated November 12, 2003. In her written exceptions, she refused to certify that she knew of no instances of fraud, no violations of law and regulations, no false statements, no material adverse effects on financials, and no violations of contractual agreements. She reiterated in writing her complaint that she and other employees "were specifically instructed to impose general bill increases to clients as a way of increasing MedQuist's revenue in violation of the underlying contracts. . . ." Defendants Kearns and Van Fossen, and other Company officers and executives, received the Vice President's reiterated complaint and her exceptions to the internal certification in or about November 2003.

60. Following the Vice President's reiterated complaint and written exceptions to certification, Defendants Kearns and Van Fossen defended the Company's billing practices to

external auditors and during a subsequent independent internal investigation. In an internal memorandum dated December 11, 2003, Defendant Van Fossen stated that the issue of unverifiable billing was not new, and that "any line count which is billed at less that 2.3 to 1 payroll lines, would on average be at or below a fair level," notwithstanding the requirements of individual customer contracts.

61. Defendants Kearns and Van Fossen knew or should have known of repeated customer and employee complaints of high line counts, ratio manipulations, and other billing irregularities from 1999 to 2004. Nevertheless, Defendants Kearns and Van Fossen failed to audit the accuracy of line counts anywhere at the Company and failed to test or implement internal controls on billing.

Material Misrepresentations to Auditors

62. Defendants Kearns and Van Fossen had a duty to the Company's shareholders to ensure accuracy and integrity in the Company's billing and financial reporting and in its dealings with its external auditors.

63. From October 2000 to 2004, Defendant Kearns knew or was reckless in not knowing that no Company transcription platform actually counted AAMT characters and divided by 65 as provided in Company contracts, but did not tell the auditors. From 1999 to 2004, Defendant Van Fossen knew or was reckless in not knowing that no Company transcription platform actually counted AAMT characters and divided by 65 as provided in Company contracts, but did not tell the auditors. This omitted disclosure was material to the auditors' work and public statements about the Company.

64. From October 2000 to 2004, Defendant Kearns knew or was reckless in not knowing that the Company had inadequate controls on its billing process, including no audit trails on ratio changes, but did not tell the auditors. From 1999 to 2004, Defendant Van Fossen knew or was reckless in not knowing that the Company had inadequate controls on its billing process, including no audit trails on ratio changes, but did not tell the auditors. This omitted disclosure was material to the auditors' work and public statements about the Company.

65. From October 2000 to 2004, Defendant Kearns knew or was reckless in not knowing that the Company manipulated line count ratios to reach revenue and gross margin targets, but did not tell the auditors. From 1999 to 2004, Defendant Van Fossen knew or was reckless in not knowing that the Company manipulated line count ratios to reach revenue and gross margin targets, but did not tell the auditors. This omitted disclosure was material to the auditors' work and public statements about the Company.

66. From October 2000 to 2004, Defendant Kearns knew or was reckless in not knowing of customer and employee complaints of billing fraud and other billing irregularities, but did not tell the auditors of these complaints. From 1999 to 2004, Defendant Van Fossen knew or was reckless in not knowing of customer and employee complaints of billing fraud and other billing irregularities, but did not tell the auditors of these complaints. This omitted disclosure was material to the auditors' work and public statements about the Company.

67. Defendant Van Fossen undermined the efforts of the Company's external auditors with misrepresentations during the 1999 annual audit. Defendant Van Fossen discussed AAMT line billing with the auditors but did not tell them of MedQuist's company-wide and exclusive use

and manipulation of ratios to meet revenue and gross profit margin targets. Instead, Defendant Van Fossen allowed the auditors to believe, incorrectly, that a MedQuist transcription platform actually counted AAMT characters and lines as required by MedQuist's contracts. The auditors unwittingly used this platform to check AAMT line counts derived by ratio on other platforms. Because of Defendant Van Fossen's deception, the auditors never knew that the platform used to test AAMT counts did not in fact count AAMT, but rather used ratios to calculate billed lines from transcriptionist paid lines.

68. Defendants Kearns and Van Fossen misled company auditors during the 2002 annual audit. In January 2003, they knowingly permitted a subordinate to give the auditors a fabricated document falsely purporting to show how a MedQuist transcription platform actually counted AAMT characters and lines, even though they knew that no MedQuist platform counted AAMT lines. The fabricated document was titled "Bournewood Sample Document." The subordinate created the document between October and December 2002 for use in defending against a customer lawsuit that, among other things, alleged inflated AAMT line counts. The fabricated document displayed invisible and visible characters, as well as their counts, which MedQuist supposedly used to calculate billed AAMT lines. Nothing on the document revealed that it was a fabrication, that MedQuist did not count characters to calculate billed AAMY lines, or that MedQuist instead always used ratios to meet revenue and gross margin profit targets. Defendants Kearns and Van Fossen knew of the document, had seen the document, and knew that the document was fabricated. They also knew or were reckless in not knowing that the document was false and misleading because it presented a counting methodology that the Company did not use.

69. Defendants Kearns and Van Fossen signed representation letters to external auditors, falsely stating that they:

- had provided all relevant information to auditors;
- knew of no false statements to auditors;
- knew of no internal control deficiencies; and
- knew of no allegations of fraud by employees or others.

Defendant Kearns signed false representation letters for each quarterly and annual audit from the third quarter of 2000 through the third quarter of 2003. Defendant Van Fossen signed false representation letters for each quarterly and annual audit from the first quarter of 2001 through the third quarter of 2003. Defendants Kearns and Van Fossen knew at the time they signed the letters that they contained material falsehoods.

70. On or about February 21, 2003, Defendant Kearns told the Company's external auditors, in the presence of Defendant Van Fossen, that the internal review of the Pennsylvania office billing complaint showed no billing irregularities. Defendants Kearns and Van Fossen knew or were reckless in not knowing that (a) the review failed to check the accuracy of line counts, (b) the office had made undocumented increases to line count ratios and (c) the office lacked audit trails. However, Defendant Kearns did not disclose these facts to external auditors. Defendants Kearns and Van Fossen knew or were reckless in not knowing that Defendant Kearns' statements to the external auditors were incomplete and misleading.

71. In about December 2003, the Company's external auditor asked Company management for information relating to the Vice President's November 12, 2003, billing complaint.

Defendant Kearns was a principal source of information to the external auditors from about December 2003 through about March 2004. Despite knowing that customer contracts specified that AAMT lines be counted; that the Company did not count AAMT but derived line counts as a ratio of paid transcription lines; that the company made line ratio changes without internal controls or audit trails; that the company manipulated line count ratios to increase revenues and profit margins; that some customers had line count ratios higher than 4-to-1; and that both customers and employees had repeatedly complained of billing irregularities, Defendant Kearns told external auditors that the Company had done nothing wrong, that its line counts were justified and legitimate, and any potential overbilling was inadvertent and immaterial. Defendant Kearns knew or was reckless in not knowing that his statements to external auditors were incomplete and misleading.

Material Misrepresentations to Shareholders and the Public

72. Defendant Van Fossen from 1999 to 2004, and Defendant Kearns from October 2000 to 2004, did not disclose to shareholders or public investors that no Company transcription platform actually counted AAMT characters and divided by 65 as provided in Company contracts. They did not disclose to shareholders or public investors that the company had inadequate controls on its billing process, including no audit trails on line ratio changes. They did not disclose to shareholders or public investors that customers and employees had made repeated complaints of billing fraud and other billing irregularities. They did not disclose to shareholders or public investors that the Company manipulated line count ratios to reach revenue and gross margin targets, or that improving financial performance was due, at least in part, to manipulation of line count

ratios. Each of these omitted disclosures was material, in that a reasonable investor would consider them important to his investment decisions about the Company.

73. Defendant Van Fossen from 1999 to 2004, and Defendant Kearns from October 2000 to 2004, affirmatively misled shareholders and the investing public in the Company's public filings. The Management Discussion and Analysis ("MD&A") sections of each of the Company's Forms 10-K and 10-Q filed with the Commission from 1999 to 2004 stated that the Company's revenues were "based primarily on contracted rates," and that its improved financial and revenue performance was due to legitimate business practices such as increased sales to existing and new customers, acquisitions, or growth in its transcription business generally. In truth, the Company's improved revenues and financial performance were also based, at least in part, on and due to the Company's secret manipulation of billed line counts through the use of the 2-to-1 BTP ratio and the 3-to-1 margin ratio, which violated the terms of MedQuist's contracts with customers. These misleading statements were material because a reasonable investor would consider it important to his investment decisions to know whether the Company obtained revenue by legitimate business practices or by fraudulent billing.

74. Defendant Kearns reviewed all financial statements and signed all of MedQuist's Forms 10-K and 10-Q filed with the Commission from October 2000 to 2004. Defendant Van Fossen prepared the financial statements and drafted the MD&A material for all of MedQuist's filings, including the Forms 10-K and 10-Q filed with the Commission from 1999 to 2004.

75. From 1999 to 2004, MedQuist also engaged in several public offerings and filed Forms S-3 and S-8 with the Commission. These offerings incorporated the materially misleading

Forms 10-K and 10-Q and associated financial statements that Defendant Van Fossen prepared and Defendant Kearns reviewed and signed. Defendant Kearns signed and Defendant Van Fossen helped prepare the Forms S-8 filed with the Commission on November 13, 2000, July 16, 2001, September 11, 2003, and October 6, 2003, each of which incorporated the Company's materially misleading periodic filings. Defendant Van Fossen also helped prepare the Forms S-3 and S-3A filed on March 25, 1999, April 6, 1999, April 27, 1999 and September 2, 1999, as well as Form S-8 filed on August 23, 1999, each of which incorporated the Company's materially misleading periodic filings.

76. Defendants Kearns and Van Fossen affirmatively misled shareholders and the investing public in the Company's quarterly investor conference calls on the Company's financial results for the third quarter of 2000 through the second quarter of 2002, and the Company's Forms 8-K, which contained the content of the calls. In these calls and filings, MedQuist claimed it was working to grow revenues and expand margins through a number of initiatives, and then attributed the growth and expansion it achieved to a "back to basics management discipline," "disciplined business practices," and the experience and "discipline" of the Company's management team. In truth, the Company's improved revenues and financial performance were also based, at least in part, on and due to the Company's secret manipulation of billed line counts through the use of the 2-to-1 BTP ratio and the 3-to-1 margin ratio, which violated the terms of MedQuist's contracts with customers. These misleading statements were material because a reasonable investor would consider it important to his investment decisions to know whether the Company obtained revenue by legitimate business practices or by fraudulent billing.

77. Defendant Kearns prepared the scripts for and participated in the quarterly conference calls with investors from the third quarter of 2000 through the second quarter of 2002. Defendant Kearns also signed the Forms 8-K containing the scripts for the investor conference calls for the fourth quarter of 2000 through the second quarter of 2002. Defendant Van Fossen assisted with the preparation of the Forms 8-K containing the scripts of the conference calls for the third quarter of 2000 through the second quarter of 2002, and the financial information disclosed during the conference calls and in the related Forms 8-K.

78. Defendants Kearns and Van Fossen knew or were reckless in not knowing that their public statements, including those described in paragraphs 72 through 77 above, were materially misleading to investors.

FIRST CLAIM FOR RELIEF

Violations by Kearns and Van Fossen of the Antifraud Provisions Contained in Section 17(a) of the Securities Act

79. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 78 herein.

80. By reason of the foregoing, Defendants Kearns and Van Fossen, directly or indirectly, singly or in concert, by use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails, in the offer or sale of securities: (a) knowingly or recklessly employed devices, schemes and artifices to defraud; (b) obtained money or property by means of untrue statements of material fact or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and/or (c) engaged in transactions, practices or courses of business

which operated or would operate as a fraud or deceit upon the purchasers of MedQuist securities and upon other persons, in violations of Section 17(a) of the Securities Act [15 U.S.C. §§ 77q(a)].

SECOND CLAIM FOR RELIEF

Violations by Kearns and Van Fossen of the Antifraud Provisions Contained in Section 10(b) of the Exchange Act and Rule 10b-5

81. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 78 herein.

82. By reason of the foregoing, Defendants Kearns and Van Fossen, directly or indirectly, singly or in concert, by use of the means or instrumentalities of interstate commerce or of the mails, knowingly or recklessly, in connection with the purchase or sale of securities: (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material fact, or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading; and/or (c) engaged in acts, practices and courses of business which operated or would have operated as a fraud or deceit upon purchasers of MedQuist securities and upon other persons, in violations of Section 10(b) of the Exchange Act and Rule 10b-5 [15 U.S.C. § 78j(b) and 17 C.F.R. 240.10b-5].

THIRD CLAIM FOR RELIEF

Aiding and Abetting Violations by Van Fossen of the Antifraud Provisions Contained in Section 10(b) of the Exchange Act and Rule 10b-5

83. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 78 herein.

84. MedQuist directly or indirectly, singly or in concert, by use of the means or instrumentalities of interstate commerce, or of the mails, in connection with the offer, purchase, or

sale of securities , knowingly or recklessly: (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material fact, or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading; and/or (c) engaged in acts, practices and courses of business which operated or would have operated as a fraud or deceit upon purchasers of MedQuist securities and upon other persons, in violations of Section 10(b) of the Exchange Act and Rule 10b-5 [15 U.S.C. § 78j(b) and 17 C.F.R. 240.10b-5].

85. Defendant Van Fossen knowingly provided substantial assistance to MedQuist in the commission of these violations.

86. By reason of the foregoing, Defendant Van Fossen aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 [15 U.S.C. § 78j(b) and 17 C.F.R. 240.10b-5].

FOURTH CLAIM FOR RELIEF

Violations by Kearns and Van Fossen of the Prohibition on False Records and False Statements Contained in Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2

87. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 78 herein.

88. By reason of the foregoing, Defendants Kearns and Van Fossen:

a. knowingly circumvented or knowingly failed to implement a system of internal accounting controls or knowingly falsified books, records, or accounts;

b. directly or indirectly, falsified or caused to be falsified, books, records, or accounts subject to Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A); and

c. directly or indirectly made or caused to be made a materially false or misleading statement to an accountant, or omitted to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant, in connection with an audit, review or examination of MedQuist's financial statements, or in connection with preparation of a document or report required to be filed with the Commission;

in violation of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2 [15 U.S.C. § 78m(b)(5) and 17 C.F.R. §§ 240.13b2-1 and 240.13b2-2].

FIFTH CLAIM FOR RELIEF

Aiding and Abetting Violations by Kearns and Van Fossen of the Reporting Provisions Contained in Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13

89. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 78 herein.

90. MedQuist failed to file with the Commission such financial reports as the Commission has prescribed, and failed to include, in addition to the information expressly required to be stated in such reports, such further material information as was necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading, in violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 [15 U.S.C. § 78m(a) and 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13].

91. Defendants Kearns and Van Fossen knowingly provided substantial assistance to MedQuist in the commission of these violations.

92. By reason of the foregoing, Defendants Kearns and Van Fossen aided and abetted violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 [15 U.S.C. § 78m(a) and 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13].

SIXTH CLAIM FOR RELIEF

Aiding and Abetting Violations by Kearns and Van Fossen of the Books and Records and Internal Control Provisions Contained in Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act

93. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 78 herein.

94. MedQuist failed to:

a. make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflected the transactions and dispositions of its assets;

b. devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

i. transactions were executed in accordance with management's general or specific authorizations;

ii. transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets;

iii. access to assets was permitted only in accordance with management's general or specific authorization; and

iv. the recorded accountability for assets was compared with the existing assets at reasonable intervals and appropriate actions was taken with respect to any differences;

in violation of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), and 78m(b)(2)(B)].

95. Defendants Kearns and Van Fossen knowingly provided substantial assistance to MedQuist in the commission of these violations.

96. By reason of the foregoing, Defendants Kearns and Van Fossen aided and abetted violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), and 78m(b)(2)(B)].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

(a) Permanently restrain and enjoin Defendants Kearns and Van Fossen, and their agents, servants, employees, attorneys-in-fact, and assigns and those persons in active concert or participation with them, and each of them, from further violations of the relevant provisions of the securities laws;

(b) Order Defendants Kearns and Van Fossen to pay civil money penalties pursuant to Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act [15 U.S.C. §§ 77t(d)] and §78u(d)];

(c) Enter an order against Defendants Kearns and Van Fossen pursuant to Section 20(e) of the Securities Act and Section 21(d) of the Exchange Act [15 U.S.C. §§ 77t(e) and

78u(d)], prohibiting each of them from acting as an officer or director of any issuer that has a class of securities registered under Section 12 of the Exchange Act [15 U.S.C. §78l] or that is required to file reports by Section 15(d) of the Exchange Act [15 U.S.C. §78o(d)]; and

(d) Grant such other relief as the Court deems just and proper.

Dated: March 12, 2009

Respectfully submitted,

John J. Bowers (JB8515)
SECURITIES AND EXCHANGE COMMISSION
100 F Street, NE
Washington, DC 20549-4010
Tel. (202) 551-4645
BowersJ@sec.gov

Attorney for Plaintiff

Of Counsel:

Gerald W. Hodgkins
Moira T. Roberts
Sharan K.S. Custer
SECURITIES AND EXCHANGE COMMISSION
100 F Street, NE
Washington, DC 20549