

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,)	
)	
Plaintiff,)	
)	CIVIL ACTION NO. _____
v.)	
)	COMPLAINT
MEDQUIST INC. ,)	
)	
Defendant.)	
)	
)	

The Securities and Exchange Commission (“Commission”) alleges the following against Defendant MedQuist Inc. (“MedQuist” or “Company”):

SUMMARY OF ALLEGATIONS

1. From 1999 until 2004, Defendant (“MedQuist” or “the Company”), a New Jersey-based medical transcription company, claimed in SEC filings, press releases and earnings calls that the Company’s strong financial performance was due to its disciplined and conservative business practices, while at the same time it was systematically and secretly inflating customer bills to increase revenues and profit margins. Beginning in about 1999, Defendant fraudulently overbilled customers by inflating the number of lines of medical test it purportedly transcribed. The scheme was able to continue for several years because the unit of measure upon which bills to many customers were based—known as an "AAMT" line—included invisible characters and computer keystrokes that could not be verified by customers. Knowing that its customers were unable to verify line counts on bills, the Company stopped actually counting AAMT lines and secretly used formulas to manipulate line counts on customer bills to reach specific revenue and margin targets.

2. Defendant misled customers and independent auditors into believing that the Company's bills were based on AAMT line counts as required by customer contracts. At the same time, Defendant misled shareholders and the public by stating in Commission filings, press releases and earnings calls, that the Company's revenues were based primarily on contracted rates and that its strong financial performance was the result of conservative and disciplined business practices.

3. As disclosed in Defendant's filings with the Commission, since the billing scheme came to light in 2004, Defendant approved payment of \$75.8 million in cash and credits to customers to resolve billing disputes arising from the conduct described herein. Defendant also paid \$7.5 million to settle a customer class action lawsuit (Steiner v. MedQuist Inc., No. 1:04-cv-05487-FLW (D.N.J. filed Nov. 8, 2004) and paid \$6.6 million to settle claims of various agencies and departments of the United States Government. In addition, Defendant restated its financials for the period of the conduct with a \$9.8 reduction in revenue.

VIOLATIONS

4. By engaging in the conduct described below, Defendant violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13 [15 U.S.C. §§ 77q(a), 78j(b), 78m(a), 78m(b)(2)(A), and 78m(b)(2)(B) and 17 C.F.R. §§ 240.10b-5, 204.12b-20, 204.13a-1, 240.13a-11, and 240.13a-13].

JURISDICTION AND VENUE

5. 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 permanently restraining and enjoining the Defendant from further violations of the relevant provisions of the securities laws.

6. 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].

7. Defendant, 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

8. **MedQuist Inc.** is a New Jersey corporation headquartered in Marlton, New Jersey. MedQuist's stock is currently registered pursuant to Section 12(b) of the Exchange Act. It was previously registered under Section 12(g) and traded on the NASDAQ National Market until it was delisted on June 16, 2004. For four years, MedQuist traded on the Pink Sheets. On July 17, 2008, MedQuist began trading on the NASDAQ Global Market.

STATEMENT OF FACTS

Background

9. Defendant performs medical transcription services by receiving dictated medical records from customers, usually hospitals, and keying them into computer programs called transcription platforms. Defendant has contracts with its customers governing how it will measure and bill the work. Each contract specifies the unit Defendant 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 Defendant 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 Defendant’s contracts required it to use a unit of measure called the AAMT line. Defendant’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.

(emphasis added).

11. Because Defendant’s contracts specifically stated that AAMT lines would be calculated by “counting all characters” and “simply dividing . . . by 65”, Defendant 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, Defendant's customers could not independently verify the AAMT line totals in their bills by looking at their transcribed documents.

13. Defendant calculated transcriptionist pay by a unit of measure called a "payroll line," which was not equal to an AAMT line.

14. By 1999, Defendant stopped actual counting of AAMT characters and lines. It derived the number of AAMT lines billed to customers by applying multiples to the number of payroll lines in the customer's work.

15. By 1999, Defendant adopted an internal policy stating that for any piece of transcription work, a purportedly "correct" AAMT line count equaled two times the number of payroll lines, and should result in the customer being billed \$3.00 for every \$1.00 paid to the transcriptionist. Defendant adjusted line count multiples on customer accounts to reach its desired revenue and margin targets. Defendant monitored the effect of changes to line count multiples to ensure that it met its revenue and margin targets.

16. Defendant did not tell customers or shareholders about its change in billing methodology. Because the changed methodology had the potential to increase billed line counts enough to be noticed by customers, Defendant increased the line count multiples of some customers gradually over time and sometimes secretly increased a customer's line multiple after agreeing to a decrease in line price, in order to maintain revenues and profit margins. Defendant continued to secretly adjust line count ratios until 2004 or later.

17. Defendant's revised billing methodology resulted in overbilling customers as compared to the AAMT line counting methodology called for in Defendant's contracts.

18. From at least December 2000 through 2003, Defendant prepared internal reports on billing practices at Company offices. These reports examined the line count multiples and profit margins for each customer account. These reports showed that many line count multiples were set higher than the purportedly "correct" setting of twice the number of payroll lines. Some of the reports explicitly recommended that offices secretly or gradually increase line count multiples in order to improve profit margins, and that offices set customer accounts on the AAMT 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.

19. Defendant knew that certain customers, including many who had left MedQuist for other transcription providers, complained of billing irregularities, unjustifiable bill totals, and billing fraud on the part of the Company.

20. Defendant received allegations of billing fraud from at least two of its employees in 2002 and 2003. One of those employees, a vice president, subsequently refused to sign internal sub-certifications of accounts. Defendant did not investigate or correct its calculation of line counts on bills in response to these employee allegations.

21. By 2003, Defendant knew from its internal reports on billing practices that at least some offices lacked audit trails and adequate internal controls on changes to line count multiples and had increased line count multiples without any documentary support.

22. Defendant knew or was reckless in not knowing of repeated customer and employee complaints of high line counts, ratio manipulations, and other billing irregularities from 1999 through 2003. Defendant failed to audit the accuracy of line counts anywhere at the Company and failed to test or implement internal controls on billing.

23. Defendant also undermined the efforts of the Company's external auditors with misrepresentations. Its officials told the external auditors, incorrectly, that a MedQuist transcription platform actually counted AAMT lines. The auditors unwittingly used this platform to check AAMT line counts derived by multiples on other platforms. Because of Defendant's deception, the auditors never knew that the platform used to test AAMT counts did not in fact count AAMT, but rather used multiples to calculate billed lines from transcriptionist paid lines.

24. Defendant knew, or was reckless in not knowing, that the Company's external auditors believed incorrectly that Company transcription platforms actually counted AAMT characters and lines, and that the auditors relied on that incorrect belief in performing their audits. Defendant failed to tell its external auditors that no Company transcription platforms actually counted AAMT characters and lines. Defendant knew that it had inadequate controls on its billing processes, but did not tell its external auditors. Defendant knew that it manipulated line counts to reach revenue and margin targets but did not tell its external auditors. Defendant knew that customers had complained of billing irregularities and fraud but did not tell its auditors of these

complaints. Defendant knew, or was reckless in not knowing, that these omitted disclosures were material to the auditors' work and public statements about the Company.

25. From 1999 through 2003, Defendant told shareholders and other public investors that its strong financial performance was due to disciplined and conservative business practices and that revenues were based primarily on contracted rates. During the time period when these representations were made, Defendant was secretly not billing in accordance with contracts and was manipulating billed line counts to reach desired revenue and margin targets. Defendant knew, or was reckless in not knowing, that these statements and omissions were misleading and material in that a reasonable investor would consider them important to his investment decisions about the Company. Defendant made these material misleading statements and omissions in periodic filings with the Commission, other filings with the Commission, and quarterly investor conference calls.

FIRST CLAIM FOR RELIEF

Violations of the Antifraud Provisions Contained in Section 17(a) of the Securities Act

26. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 25 herein.

27. By reason of the foregoing, Defendant, 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 of the Antifraud Provisions
Contained in Section 10(b) of the Exchange Act and Rule 10b-5**

28. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 25 herein.

29. By reason of the foregoing, Defendant, 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

**Violations of the Reporting Provisions Contained in
Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13**

30. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 25 herein.

31. By reason of the foregoing, Defendant 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 violation 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].

FORTH CLAIM FOR RELIEF

**Violations of the Books and Records and Internal Control Provisions
Contained in Sections 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act**

32. The Commission realleges and incorporates by reference every allegation contained in paragraphs 1 through 25 herein.

33. By reason of the foregoing, Defendant 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 action 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)].

PRAYER FOR RELIEF


WHEREFORE, the Commission respectfully requests that this Court

(a) permanently restrain and enjoin Defendant and its 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; and

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

Dated: March 12, 2009

Respectfully submitted,



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