

Securities and Exchange Commission,  
450 5th Street, N.W.  
Washington, DC 20549

V.

Defendant.

Civil Action No. \_\_\_\_\_

Plaintiff Securities and Exchange Commission alleges that:

## Summary

1. From at least the fourth quarter of 1996 through at least the second quarter of 2000, Lernout & Hauspie Speech Products N.V. ("L&H" or "Defendant") engaged in a variety of undisclosed and deceptive transactions to inflate L&H's reported income and, consequently, the price of its stock. These deceptive transactions included guaranteed and conditional sales and sales that were secretly financed by L&H. The eventual result of this fraudulent conduct was the destruction of L&H as an operating company and a financial loss, borne by investors in the U.S., Belgium and elsewhere, of at least \$8 billion in market capitalization.
2. In this action, the Securities and Exchange Commission seeks to permanently enjoin L&H from future violations of the anti-fraud, reporting and recordkeeping provisions of the federal securities laws.

## Jurisdiction

3. The Securities and Exchange Commission (the "Commission") brings this action pursuant to the authority conferred upon it by Section 20(b) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77t(b)] and Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78u(d)].

4. This Court has jurisdiction over this action, and venue is proper, pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(e) and 27 of the Exchange Act, [15 U.S.C. §§ 78u(e) and 78aa]. The Defendant, directly or indirectly, made use of the means and instrumentalities of interstate commerce or of the mails, or the facilities of a national securities exchange in connection with the acts, transactions, practices and courses of business alleged herein.

## The Defendant

5. Lernout & Hauspie Speech Products N.V., is a Belgian corporation formed in 1987. During the relevant period, L&H was a developer, licensor and provider of speech and language technologies, headquartered in Ieper, Belgium and Burlington, Massachusetts. L&H's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act [15 U.S.C. §78l(g)].

6. At all relevant times, the Defendant's common stock was listed on EASDAQ (now known as NASDAQ Europe) and the NASDAQ National Market System. Trading in L&H common stock was suspended by EASDAQ and NASDAQ on November 9, 2000. The Defendant's common stock was de-listed by NASDAQ on December 6, 2000. Subsequently, in March 2001, the Defendant voluntarily de-listed from NASDAQ Europe. The Defendant's common stock is currently quoted on the "Pink Sheets" disseminated by Pink Sheets LLC.

7. At the beginning of the relevant period, L&H was a "foreign private issuer," required to file annual and other reports on Commission Form 20-F and Form 6-K, pursuant to Section 13a-16 of the Exchange Act. In fiscal year 2000, L&H acquired two U.S. technology corporations (Dictaphone Corporation and Dragon Systems, Inc.), and, thereafter, was required to file periodic reports pursuant to Sections 13a-1 and 13a-13 of the Exchange Act.

8. After failed attempts at reorganization, the Defendant is presently in liquidation proceedings in the U.S. and Belgium.

## **Facts**

### **Dictation Consortium N.V. and Brussels Translation Group N.V.**

9. Between 1996 and 1999, L&H improperly recorded over \$60 million in revenue from transactions with two Belgian entities -- Dictation Consortium N.V. ("Dictation") and Brussels Translation Group N.V. ("BTG") -- formed for the purpose of engaging in transactions with L&H. Transactions between L&H and these two companies were arranged to allow L&H to fraudulently claim revenue from its own research and development activities, which otherwise would not have resulted in reported revenue unless and until the projects resulted in marketed products.

10. Within one day of its creation in September 1996, Dictation, which L&H disclosed in its Commission filings to be a related party, entered into a \$5 million agreement with L&H to license certain speech-to-text technology, including the right to develop applications from the technology. Approximately three months later, Dictation and L&H entered into a second agreement whereby Dictation would pay L&H \$25 million to develop software using the technology previously licensed to Dictation. This agreement gave L&H an "option" to buy back from Dictation the rights to the license and any software developed. During 1996, 1997 and 1998, the years immediately following its 1995 initial public offering, L&H recognized revenue from its purported software development agreement with Dictation of \$7.5 million (24% of reported revenue); \$18.9 million (19% of reported revenue) and \$333,333 (under 1% of reported revenue), respectively. Dictation was L&H's largest reported customer in 1996 and 1997.

11. In May 1998, before L&H developed any marketable product for Dictation, L&H purchased Dictation for \$43.3 million. Thus, L&H bought back the product of its own research and development at a premium of over \$16 million.

12. Because the transactions between L&H and Dictation were disguised loans and not sales or service contracts, L&H should not have recognized revenue from those transactions under Generally Accepted Accounting Principles ("GAAP"). By failing to properly account for its transactions with Dictation, L&H materially overstated its reported revenue for 1996 (by \$7.5 million or a 31% overstatement) and 1997 (by \$18.9 million or a 23% overstatement); consequently the financial statements filed with the Commission by L&H for 1996 and 1997 were materially false and misleading.

13. Brussels Translation Group N.V. ("BTG") was established on March 13, 1997, and on that same day entered into a \$3.5 million licensing agreement with L&H. The agreement was amended in May 1997 to increase the amount of the license fee to \$5 million. At the same time, BTG contracted to pay L&H \$30 million for research and development services. L&H recognized \$15 million in revenue in 1997 from its transactions with BTG (or 15% of reported revenue), \$18 million in 1998 (8.5% of reported revenue) and \$2 million in 1999 (under 1% of reported revenue). In June 1999, L&H acquired BTG for \$42 million and the assumption of \$17 million in debt.

14. Because the transactions between L&H and BTG were disguised loans and not sales or services transactions, L&H should not have recognized revenue from those transactions under GAAP. By failing to properly account for its transactions with BTG, L&H materially overstated its reported revenue for 1997 (by \$15 million or a 18% overstatement) and 1998 (by \$18 million or a 9% overstatement); consequently, the financial statements filed with the Commission by L&H for 1997 and 1998 were materially false and misleading.

15. L&H, through its senior management, knew or was reckless in not knowing that its improper accounting for the BTG and Dictation transactions rendered its periodic reports filed with the Commission for the period 1996 through 1998 materially false and misleading.

### **The Language Development Companies**

16. By late 1998, L&H could not obtain any further revenue boost from the Dictation and BTG transactions. In addition, it had not developed sufficient commercial applications for its technology to provide for continued significant revenue growth. To bolster its reported revenue, L&H launched a new and elaborate scheme to, in essence, create additional L&H customers. These new customers, dubbed "Language Development Companies" (or "LDCs"), enabled L&H to claim revenue of \$102 million in license fees and \$8.5 million in prepaid royalties from the LDCs in 1998 and 1999, giving the false impression of exponential growth. Moreover, the LDC revenues were not separately identified by L&H in its financial statements, but instead were buried in overall revenue figures.

17. The LDCs were structured in a manner that masked their actual role at the time of their creation. All were private companies. Most were incorporated in Singapore, although they had no actual operations in that country. The "managing director" of many of the Singapore LDCs was a Belgian national associated with L&H.

18. L&H, in its public disclosure, contended that the LDCs were formed to develop new markets for L&H technology by licensing the Company's basic code-generating software to start-up entities in various parts of the world. These entities were supposed to then develop speech recognition and translation software applicable to various regional languages. In actuality, the LDCs were little more than shell companies created, like Dictation and BTG, as a means for L&H to improperly fabricate revenues. The LDCs had few, if any, employees, and were dependent upon L&H personnel for research and development activities. None of the LDCs produced any significant product.

19. L&H supplied or arranged for others to supply financing for at least some of the LDCs. For example, in late 1999, L&H solicited an investment bank in Bahrain to help in the search for investors for two LDCs. The investment bank advanced L&H \$8 million for technology licenses for the LDCs, with the understanding that L&H would repurchase the licenses at a substantial premium (resulting in a 25% internal rate of return) if the investment bank was unable to locate investors to fund the LDCs.

20. Thus, to the extent L&H obtained funds from the LDCs, some or all of these funds were subject to material conditions imposing on L&H significant potential liabilities which were not reflected on its balance sheet, and which L&H did not disclose to its shareholders or the Commission. Under those circumstances, the accounting applied to the LDCs did not comply with GAAP. For the period from 1998 to 1999, L&H reported revenue from the LDCs of \$110.5 million, a material portion of which was improperly recognized.

21. L&H, through its senior management, knew or was reckless in not knowing that its improper accounting for the LDCs rendered its periodic reports filed with the Commission for the period from 1998 to 1999 materially false and misleading.

### **The Fraudulent Korean Sales**

22. From September 1999 to June 2000, L&H reported approximately \$175 million in sales revenue from its Korean operations ("L&H Korea"), the majority of which was fraudulent. The purported dramatic growth in sales from its Korean subsidiary accompanied the inflation of the price of L&H stock. The majority of this revenue was fraudulent because L&H Korea: (1) entered into oral and written side agreements with customers freeing them from any definite payment obligation; (2) disguised the uncollectibility of the receivables resulting from some of these fraudulent sales by factoring the receivables to Korean banks, subject to side agreements protecting the banks from any risk of non-collection; and (3) secretly arranged to fund the pay-down of receivables resulting from other bogus sales.

23. L&H Korea sales people were instructed to agree to whatever terms and conditions were necessary to induce customers to sign purchase orders. The result was a series of "sales" subject to written and oral side agreements that did not appear in the L&H Korea contract files. These terms included, in some instances, agreements by L&H Korea not to pursue collection of license fees unless and until the "customer" generated sufficient revenue from use of the L&H software to cover those fees. L&H Korea had no legitimate expectation of collecting payment from those customers.

24. To prevent uncollectible receivables from remaining on L&H Korea's books, thereby raising questions about the quality of the company's reported earnings, a series of transactions with four Korean banks were staged to give the impression that the receivables had been factored to those banks on a non-recourse basis. In fact, L&H Korea entered into side agreements with those banks requiring L&H Korea to maintain blocked deposits to cover the amounts of the "factored" receivables, which the banks could apply to satisfy any collection shortfalls. Thus, these transactions were essentially fully secured loans from the banks to L&H Korea, rather than sales of receivables from L&H Korea to the banks.

25. In another fraudulent scheme to disguise that its escalating accounts receivable did not reflect genuine sales, L&H Korea arranged to have third parties "purchase" the licensing agreements from the original customers. The transferees would then obtain loans, collateralized by L&H Korea assets but not reflected in L&H Korea's books, and use the proceeds to pay L&H Korea through the original customers. By this scheme, L&H Korea, in effect, paid down its own receivables, while creating the appearance of successfully collecting customer payments, which in fact had not been collected.

26. Through the fraudulent Korean sales, L&H overstated its revenue for the period from September 1999 to June 2000 by at least \$114 million.

27. L&H, through its senior management, knew or was reckless in not knowing that its improper accounting for the Korea sales rendered its periodic reports filed with the Commission for the period from September 1999 to June 2000 materially false and misleading.

28. As information about the company's financial fraud became public through the press, the price of L&H stock declined dramatically, falling from a lifetime high of \$72.50 in March 2000 to \$.76 on December 29, 2000. On November 9, 2000, L&H disclosed that its financial statements for 1997, 1998 and 1999 could not be relied upon and acknowledged that errors and irregularities would require the company to restate its financial statements for 1998, 1999 and the first half of 2000. A preliminary L&H report prepared at the direction of the Audit Committee, dated November 20, 2000 and made public on or about December 17, 2000, admitted that L&H had materially misstated its financial statements for 1997, 1998 and 1999 and that a significant amount of revenue recorded in the first six months of 2000 would have to be restated. That report also recommended disciplinary action against those in senior

management believed responsible for the irregularities. No such restatement has been made to this date. On November 29, 2000, L&H filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the District of Delaware. On December 27, 2000, L&H filed a voluntary petition under Belgium's insolvency statutes. Both courts subsequently determined that reorganization and recovery were not possible, and L&H is presently in liquidation proceedings in the U.S. and Belgium.

### **Claim One**

#### **Violations of Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], and Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.**

29. The Commission re-alleges and incorporates by reference the allegations contained in Paragraphs 1 through 28 above.

30. As set forth more fully above, defendant Lernout & Hauspie Speech Products N.V., directly or indirectly, by use of the means or instruments of transportation or communication in interstate commerce, or by the use of the mails or of the facilities of a national securities exchange, in connection with the offer, purchase or sale of securities or securities-based swap agreements: has employed devices, schemes, or artifices to defraud; has, to obtain money or property, made untrue statements of material fact or omitted 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; or has engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

31. By reason of the foregoing, defendant Lernout & Hauspie Speech Products N.V. has, directly or indirectly, violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### **Claim Two**

#### **Violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, 13a-13, and 13a-16 [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13, and 240.13a-16] thereunder.**

32. The Commission re-alleges and incorporates by reference the allegations contained in Paragraphs 1 through 31 above.

33. By engaging in the conduct described above, defendant Lernout & Hauspie Speech Products N.V. filed materially false and misleading annual reports on Forms 10-K and 20-F and materially false and misleading quarterly and other reports on Form 10-Q or 6-K with the Commission during the period from 1996 through June 30, 2000. By reason of the foregoing, defendant Lernout & Hauspie Speech Products N.V. violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, and 13a-16 thereunder.

34. L&H has failed to file annual, quarterly and other reports with the Commission for the period from June 2000 to the present. By reason of the foregoing, defendant Lernout & Hauspie Speech Products N.V. violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13, and 13a-16 thereunder.

### **Claim Three**

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

35. The Commission re-alleges and incorporates by reference the allegations contained in Paragraphs 1 through 34 above.

36. By engaging in the conduct described above, defendant Lernout & Hauspie Speech Products N.V. failed to make and keep books, records and accounts which accurately and fairly reflected its transactions and dispositions of its assets, in violation of Section 13(b)(2)(A) of the Exchange Act, and failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that its corporate transactions were executed in accordance with management's authorization and in a manner to permit the preparation of financial statements in conformity with generally accepted accounting principles, in violation of Section 13(b)(2)(B) of the Exchange Act.

### **Prayer for Relief**

**WHEREFORE**, the Commission respectfully requests that this Court:

#### **I.**

Enter an Order permanently enjoining defendant Lernout & Hauspie Speech Products N.V. from future violations of Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, and 13a-16 thereunder; and

#### **II.**

Grant such other relief as this Court may deem appropriate.

Respectfully submitted,

Dated: October , 2002

---

Paul R. Berger (DC Bar # 375526)

---

Richard C. Sauer (DC Bar # 441456)

---

David B. Witherspoon (DC Bar # 447071)

---

Charles C. Davis, Jr. (DC Bar # 341438)

---

William H. Kuehnle (DC Bar #7401)

Lead Trial Counsel

Attorneys for the Securities and

Exchange Commission

450 Fifth Street, N.W.

Room 9211 Mail Stop 911

Washington, D.C. 20549-0911

202-942-4678

202-942-9581(facsimile)