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FILED - SOUTHERN DIVISION
CLERK, U.S. DISTRICT COURT
OCT 27 2006
CENTRAL DISTRICT OF CALIFORNIA
BY [Signature] DEPUTY

2:00

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA - SOUTHERN DIVISION

[Redacted]
[Redacted] Individually and on Behalf
of All Others Similarly Situated,

Plaintiff,

v.

QUEST SOFTWARE, INC.,
VINCENT C. SMITH, M.
BRINKLEY MORSE, and MICHAEL
J. LAMBERT,

Defendants.

Case No. *CV06-6863 SJO (Ex)*
By FAP
CLASS ACTION COMPLAINT
FOR VIOLATIONS OF THE
FEDERAL SECURITIES LAWS

JURY TRIAL DEMANDED

DOCKETED ON CM
NOV - 3 2006
BY [Signature] 002

1

1 Plaintiff, individually and on behalf of all others similarly situated, by its
2 attorneys, alleges the following based upon the investigation of its counsel, except as
3 to allegations specifically pertaining to Plaintiff and its counsel, which are based on
4 personal knowledge. The investigation of counsel is predicated upon, among other
5 things, a review of Quest Software, Inc.'s ("Quest" or the "Company") public filings
6 with the United States Securities and Exchange Commission ("SEC"), press releases
7 issued by the Company, media reports about the Company, publicly available
8 trading data relating to the price and volume of Quest's common stock and a review
9 of reports issued by analysts who follow Quest.

10 NATURE OF THE ACTION

11 1. Plaintiff brings this action as a class action on behalf of itself and all
12 other persons or entities who purchased Quest securities on the open market, other
13 than Defendants and certain related persons and entities, during the period
14 November 9, 2001 through July 3, 2006 (the "Class" and "Class Period,"
15 respectively), to recover damages caused to the Class by Defendants' violations of
16 the federal securities laws.

17 2. Plaintiff alleges in this action that during the Class Period, Defendants
18 knowingly or with deliberate recklessness, failed to disclose and concealed through
19 various false statements and omissions that they did not properly account for issuing
20 stock option grants at prices which were below fair market value on the actual grant
21 date.

22 3. Accounting Principles Board ("APB") Statement No. 25, requires that
23 issuers accrue a compensation expense upon the issuance of employee stock options
24 on the difference between fair market price of the underlying shares on the date of
25 the grant and the option exercise price. In order for the Company to incur \$0
26 compensation expense as a result of awarding employee stock options, it was the
27 Company's stated policy to grant stock options to its employees equal to or greater
28 than the price of the underlying stock on the date of grant. Issuers of financial

1 statements are required under Generally Accepted Accounting Principles ("GAAP")
2 to establish a compensation expense equal to the aggregate amount by which the
3 option grant price is below the market price on the date of grant.

4 4. Defendants, however, during the Class Period, knowingly or with
5 deliberate recklessness, failed to properly account for the issuance of below market
6 price options and therefore understated compensation expense and overstated
7 operating and net income. Defendants' failure to properly account for below market
8 price options and the issuance of false financial statements caused Quest common
9 shares to trade at inflated prices.

10 5. A strong inference of fraudulent intent is raised that Quest's option
11 grants were knowingly issued at below market prices and that Defendants failed to
12 properly account for compensation expense, as follows:

13 a. Quest issued approximately four million options with a stock
14 price based on the April 14, 2000 closing market price. This stock price was the
15 lowest stock price of the year for Quest's price per share. One month later, the stock
16 was trading 62.97% higher than the price on the grant date.

17 b. Quest issued over 8.9 million options during 2001 (on
18 March 28, 2001, April 4, 2001, and October 1, 2001).

19 i. March 28, 2001 -- this was only seven days before the
20 lowest stock price of the first six months of the year for Quest's price per share.
21 One month later, the stock was trading at 143.09% higher than its price on the grant
22 date.

23 ii. April 4, 2001 -- this was the lowest stock price of the first
24 six months of the year for Quest's price per share. One month later, the stock had
25 risen 123.16% from its price on the grant date.

26 iii. October 1, 2001 -- this was two days after the lowest stock
27 price of the year for Quest's price per share. One month later, the stock had risen
28 41.99% from its price on the grant date.

1 c. Quest issued approximately 6.5 million options with a stock
2 price based on the August 7, 2002 closing market price. This was only two days
3 after and a mere three cents above the lowest price per share of the first eight months
4 of that year. One month later, the stock had risen 34.94% from its price on the grant
5 date.

6 6. Quest, on July 5, 2006, belatedly acknowledged that these options had
7 been granted on effective dates at below market prices.

8 7. As a result of issuing options at below market prices, the Company
9 under-reported the corresponding compensation expense and over-reported net
10 income on its financial statements.

11 8. As a result of Defendants' actions, the market price of Quest common
12 stock was artificially inflated during the Class Period.

13 9. After the revelations of Defendants' failure to properly account for
14 issuing options at below fair market prices began entering the marketplace on
15 May 19, 2006, Quest's share price fell 20.10%.

16 JURISDICTION AND VENUE

17 10. This Court has jurisdiction over the subject matter of this action
18 pursuant to § 27 of the Securities Exchange Act of 1934 (the "Exchange Act"), 15
19 U.S.C. § 78aa and 28 U.S.C. § 1331. The claims asserted herein arise under
20 §§ 10(b) and 20(a) of the Exchange Act, as amended, § 78j(b) and § 78t(a), and Rule
21 10b-5, 17 C.F.R. § 240. 10b-5, promulgated thereunder by the SEC.

22 11. Venue is proper in this District pursuant to § 27 of the Exchange Act,
23 and 28 U.S.C. § 1391(b). Defendant is a California corporation whose principal
24 offices are located within this District. Further, many of the acts and transactions
25 giving rise to the violations of law complained of herein, including the preparation
26 and dissemination to the investing public of false and misleading information,
27 occurred in this District.

28 12. In connection with the acts, conduct and other wrongs alleged in this

1 Complaint, Defendants, directly and indirectly, used the means and instrumentalities
2 of interstate commerce, including the mails, telephone communications and the
3 facilities of a national securities exchange.

4 THE PARTIES

5 13. Plaintiff [REDACTED]

6 [REDACTED]
7 [REDACTED]
8 14. As set forth in the attached Certification, Plaintiff purchased the
9 common stock of Quest during the Class Period at artificially inflated prices and was
10 damaged thereby.

11 15. Defendant Quest is a California corporation with its principal
12 executive offices located at 5 Polaris Way, Aliso Viejo, California 92656. The
13 Company purportedly delivers products that help organizations get more
14 performance and productivity from their applications, databases and Windows
15 infrastructure. Quest claims its products are used by more than 18,000 customers
16 worldwide. At all relevant times, Quest's common stock actively traded on the
17 NASDAQ National Market under the symbol "QSFT."

18 16. Defendant Vincent C. Smith ("Smith") has served as Chairman of the
19 Board of Directors since 1998 and as Chief Executive Officer since April 1997.
20 Smith has served as a director of the Company since 1995. For the Forms 10-K and
21 10-Q issued from August 14, 2002 through the end of the Class Period, Smith
22 signed the Certification of CEO Pursuant to Exchange Act Rule 13A-14 and 15D-14
23 as adopted pursuant to § 302 of the Sarbanes-Oxley Act of 2002, and the
24 Certification pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the
25 Sarbanes-Oxley Act of 2002. In each of these certifications, Smith falsely certified
26 that he reviewed the financial statements included in the SEC filing, that there were
27 no untrue statements of material fact, and that the financial information included in
28 the report "fairly present in all material respects the financial condition, results of

1 operations and cash flows of the [company].”

2 17. Defendant M. Brinkley Morse (“Morse”) has served as Senior Vice
3 President, Corporate Development since April 2005 and previously served as Vice
4 President, Finance and Operations of the Company from January 2001 through April
5 2005 and as Chief Financial Officer since May 2003 through April 2005. For the
6 Forms 10-K and 10-Q issued from August 14, 2002 through March 16, 2005, Morse
7 signed the Certification of CFO Pursuant to Exchange Act Rule 13A-14 and 15D-14
8 as Adopted Pursuant to § 302 of the Sarbanes-Oxley Act of 2002, and the
9 Certification Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to § 906 of the
10 Sarbanes-Oxley Act of 2002. In each of these certifications, Morse falsely certified
11 that he reviewed the financial statements included in the SEC filing, that there were
12 no untrue statements of material fact, and that the financial information included in
13 the report “fairly present in all material respects the financial condition, results of
14 operations and cash flows of the Company as of, and for, the periods presented.”

15 18. Defendant Michael J. Lambert (“Lambert”) has served as Senior Vice
16 President, Chief Financial Officer since November 2004. For the Forms 10-K and
17 10-Q issued from May 10, 2005 through the end of the Class Period, Lambert signed
18 the Certification of CFO Pursuant to Exchange Act Rule 13A-14 and 15D-14 as
19 Adopted Pursuant to § 302 of the Sarbanes-Oxley Act of 2002, and the Certification
20 Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to § 906 of the Sarbanes-Oxley
21 Act of 2002. In each of these certifications, Lambert falsely certified that he
22 reviewed the financial statements included in the SEC filing, that there were no
23 untrue statements of material fact, and that the financial information included in the
24 report “fairly present in all material respects the financial condition, results of
25 operations and cash flows of the Company as of, and for, the periods presented.”

26 19. Defendants Smith, Morse, and Lambert are collectively referred to
27 herein as the “Individual Defendants.”

28 20. By virtue of their positions at Quest, the Individual Defendants had

1 access to the adverse and undisclosed information about the operating results and
2 financial condition of the Company. The Defendants directly participated in the
3 management of Quest, were directly involved in the operations of Quest at the
4 highest levels, including devising, knowing of, or with deliberate recklessness
5 ignoring the deficient internal controls surrounding the administration of the stock-
6 based compensation plan, were privy to information concerning the operating results
7 and financial condition of the Company, and were involved in the dissemination of
8 the materially false and misleading statements and information alleged herein.

9 21. By reason of their positions as the senior most executive officers and a
10 director of Quest, the Individual Defendants were at all relevant times controlling
11 persons within the meaning of § 20 of the Exchange Act. Because of their executive
12 and directorial positions at Quest, the Individual Defendants had access to adverse,
13 non-public and specific information about the Company's operating results and
14 financial condition. Further, as particularized herein, the Individual Defendants
15 were able to and did control the contents of various reports and public statements
16 regarding Quest and its operating results and financial condition. Any acts
17 attributed to Quest were caused and/or influenced by the Individual Defendants by
18 virtue of their controlling-person positions at the Company.

19 22. As the senior officers and a director of a publicly-held company whose
20 common stock was, at all relevant times, registered with the SEC pursuant to the
21 Exchange Act, traded on the NASDAQ National Market, and governed by the
22 provisions of the federal securities laws, the Individual Defendants had a duty to
23 promptly disseminate accurate and truthful information about Quest's operating
24 results and condition, so that the market price of Quest's publicly-traded securities
25 would be based upon truthful and accurate information. The Individual Defendants'
26 numerous misrepresentations and omissions during the Class Period violated these
27 specific requirements and obligations. By virtue of their positions of control and
28 authority at Quest, the Individual Defendants had the power to and did control the

1 content of the various public statements concerning Quest and its operating results
2 and condition during the Class Period and indeed made many of the challenged
3 statements described herein. Accordingly, the Individual Defendants were
4 responsible for the accuracy of the public statements and releases detailed herein and
5 are primarily liable for the misrepresentations contained therein.

6 SUBSTANTIVE ALLEGATIONS

7 Background

8 23. On June 9, 1999, the stockholders of Quest adopted the Stock Option
9 Plan. Under the provisions of this plan, all of the options granted could be
10 purchased at 85% of the lower of (i) the fair market value per share of common
11 stock on the start date of the purchase period or (ii) the fair market value per share of
12 Common Stock on that purchase date. Under this Plan, (i) there would be no
13 compensation expense to the Company, and (ii) there would be an incentive for the
14 employee to do his or her part to increase the value of the stock from the grant date
15 so that the option would have value. This Plan was attached as an exhibit to the
16 Company's Schedule 8 filed with the SEC on November 22, 1999.

17 Defendants' Materially False And Misleading Statements

18 Forms 10-Q

19 24. Defendants Smith and Morse caused the Company to file its Forms
20 10-Q for the second quarter of fiscal 2001 through the end of fiscal 2004, with the
21 SEC.

22 25. Each Form 10-Q for the second quarter of fiscal 2001 through the end
23 of fiscal 2004 was false and misleading as a result of Defendants Smith and Morse
24 knowingly or with deliberate recklessness allowing Company employees to
25 fraudulently manipulate the grant dates on employee stock options in order to enrich
26 themselves by receiving more favorable strike prices on the options. Defendants
27 Quest, Smith, and Morse's collective actions caused the Company's financial
28 statements to under-report charges to its stock-based compensation expense, which

1 in turn inflated the Company's net income during the Class Period.

2 26. Defendants Smith and Morse both signed certifications for each Form
3 10-Q for the second quarter of fiscal 2002 through the end of fiscal 2004 pursuant to
4 Exchange Act Rule 13A-14 and 15D-14 as Adopted Pursuant to § 302 of the
5 Sarbanes-Oxley Act of 2002, and the Certification Pursuant to 18 U.S.C. § 1350,
6 falsely certifying that they reviewed the Form 10-Q; that the report did not contain
7 any untrue statements of material fact; and that the financial statements fairly
8 presented in all material respects the financial condition, results of operations and
9 cash flows of the Company.

10 27. Defendant Smith and Lambert caused the Company to file its Forms
11 10-Q for the first quarter of fiscal 2005 through the first quarter of fiscal 2006, with
12 the SEC.

13 28. Each Form 10-Q for the first quarter of fiscal 2005 through the first
14 quarter of fiscal 2006 was false and misleading as a result of Defendants Smith and
15 Lambert knowingly or with deliberate recklessness allowing Company employees to
16 fraudulently manipulate the grant dates on employee stock options in order to enrich
17 themselves by receiving more favorable strike prices on the options. Defendants
18 Smith and Lambert's collective actions caused the Company's financial statements
19 to under-report charges to its stock-based compensation expense, which in turn
20 inflated the Company's net income during the Class Period.

21 29. Defendants Smith and Lambert both signed certifications for each
22 Form 10-Q for the first quarter of fiscal 2005 through the first quarter of fiscal 2006
23 pursuant to Exchange Act Rule 13A-14 and 15D-14 as Adopted Pursuant to § 302 of
24 the Sarbanes-Oxley Act of 2002, and the Certification Pursuant to 18 U.S.C. § 1350,
25 falsely certifying that they reviewed the Form 10-Q; that the report did not contain
26 any untrue statements of material fact; and that the financial statements fairly
27 presented in all material respects the financial condition, results of operations and
28 cash flows of the Company.

1 Forms 10-K

2 30. Defendants Smith and Morse caused the Company to file its Forms 10-
3 K for the year ended December 31, 2002, the year ended December 31, 2003, and
4 the year ended December 31, 2004, with the SEC.

5 31. Each Form 10-K for December 31, 2002, December 31, 2003, and
6 December 31, 2004 was false and misleading as a result of Defendants knowingly or
7 with deliberate recklessness allowing Company employees to fraudulently
8 manipulate the grant dates on employee stock options in order to enrich themselves
9 by receiving more favorable strike prices on the options. Defendants Smith and
10 Morse's collective actions caused the Company's financial statements to under-
11 report charges to its stock-based compensation expense, which in turn inflated the
12 Company's net income during the Class Period.

13 32. Defendants Smith and Morse both signed certifications for each Form
14 10-K for December 31, 2002, December 31, 2003, and December 31, 2004 pursuant
15 Exchange Act Rule 13A-14 and 15D-14 as Adopted Pursuant to § 302 of the
16 Sarbanes-Oxley Act of 2002, and the Certification Pursuant to 18 U.S.C. § 1350,
17 falsely certifying that they reviewed the Form 10-K; that the report did not contain
18 any untrue statements of material fact; and that the financial statements fairly
19 presented in all material respects the financial condition, results of operations and
20 cash flows of the Company.

21 33. Defendants Smith and Lambert caused the Company to file its Form
22 10-K for the year ended December 31, 2005, with the SEC.

23 34. The December 31, 2005 Form 10-K was false and misleading as a
24 result of Defendants knowingly or with deliberate recklessness allowing Company
25 employees to fraudulently manipulate the grant dates on employee stock options in
26 order to enrich themselves by receiving more favorable strike prices on the options.
27 Defendants' collective actions caused the Company's financial statements to under-
28 report charges to its stock-based compensation expense, which in turn inflated the

1 Company's net income during the Class Period.

2 35. Defendants Smith and Lambert each signed certifications pursuant
3 Exchange Act Rule 13A-14 and 15D-14 as Adopted Pursuant to § 302 of the
4 Sarbanes-Oxley Act of 2002, and the Certification Pursuant to 18 U.S.C. § 1350,
5 falsely certifying that they reviewed the Form 10-K; that the report did not contain
6 any untrue statements of material fact; and that the financial statements fairly
7 presented in all material respects the financial condition, results of operations and
8 cash flows of the Company.

9 Proxy Statements

10 36. The proxy statement which Defendants Smith and Morse caused the
11 Company to file on April 30, 2001 stated in pertinent part in reference to the option
12 grants made in fiscal year 2000: "The options were granted at an exercise price
13 equal to the fair market value of Quest Common Stock on the grant date. These
14 options vest as follows: options to purchase 16,000 shares become exercisable on
15 each of April 1, 2002, 2003 and 2004, and options to purchase the remaining 32,000
16 shares become exercisable on April 1, 2005."

17 37. The proxy statement from 2002 represented that the value of the stock
18 options was "[c]alculated on the basis of the fair market value of our Common Stock
19 on the exercise date."

20 38. The proxy statements from 2003 through 2005 also each represented
21 that the value of the stock options was "an exercise price equal to the fair market
22 value of Quest common stock on the grant date."

23 Grants to Individual Defendants

24 39. Defendant Smith received 1,585,000 option grants for below fair
25 market value for when the options were actually granted and for which the Company
26 failed to establish a compensation expense.

27 40. Defendant Morse received 850,000 option grants for below fair market
28 value for when the options were actually granted and for which the Company failed

1 to establish a compensation expense.

2 **The Market Begins to Learn the Nature and Magnitude of the Wrongdoing**

3 41. On May 19, 2006, a Goldman Sachs research report revealed that
4 Quest had highly suspicious stock option grant dates. This report stated in part:

5 In an attempt to put some likelihood behind a backdating issue we have
6 reviewed and sorted our coverage group based on how advantageous
7 option grant dates (between 1998 and 2002) were for their
8 recipients . . . Our preliminary analysis looks at the price of the stock
9 on the grant date (which is also the exercise price of the option) and
10 compares this price to the lowest stock price within 20 trading days
11 before and after the grant date (40 total trading days). We subsequently
12 compared the number of grants that were within 5% of the low stock
13 price within this period. The company whose option grants appear to
14 be the best timed is [Mercury Interactive]. [Mercury Interactive's]
15 option grants were within 5% of the low price for the specified period
16 75% of the time. 63% of these grants were exactly equal to the lowest
17 stock price in the period. We know that Mercury misdated option
18 grants during this period which gives us comfort that our analysis flags
19 grants which may be out of the ordinary. *We are concerned that Quest*
20 *is also flagged for having unusually well-timed option grants. 67% of*
21 *Quest's option grants are within 5% of the 20-trading day post and 20-*
22 *trading day prior low. 33% of Quest's grants are at the lows for these*
23 *periods. It should be noted that we discussed the implications of these*
24 *well-timed grants with Quest management who explained that these*
25 *grant dates are tied to specific board meetings and were thus not*
26 *chosen at a later date.*

27
28 Should a company have to restate options due to improper selection of

1 option grant dates, negative tax implications would most likely follow.
2 The IRS treats a stock option grant as an expense – thus the higher the
3 value of the grant, the higher the tax break. The implication here is that
4 when a company is forced to restate options due to a higher strike price,
5 the options are less valuable, and the tax break the company should
6 have received is lower. Thus, the company will need to pay additional
7 taxes . . . *It is our view that in the event that (Quest) is required to*
8 *restate option grants, the cash implications would not be insignificant.*

9 (Emphasis added).

10 42. After the Goldman Sachs report was published on May 19, 2006,
11 Quest's stock price declined \$1.82 per share, from \$15.98 per share to \$14.16 per
12 share, down 11.39%. Additionally, on May 17, 2006, trading had suddenly
13 increased to nearly four times its average volume for the period and the stock price
14 declined \$1.20 per share from \$16.70 to \$15.50 per share, down 7.19%. This raises
15 an inference that information about Quest's backdating actually began entering the
16 marketplace on May 17, since no other news was released around that time that
17 could account for this drastic change in trading patterns.

18 43. On May 22, 2006, after trading closed, Quest issued a press release
19 announcing the formation of a special committee to investigate the stock option
20 grant dates prompted by the release of the Goldman Sachs report of May 19, 2006
21 above. The press release stated in part:

22 Quest Software, Inc. (NASDAQ: QSFT) today announced that its board
23 of directors is forming a special committee comprised of independent
24 directors to investigate the company's historical stock option grant
25 practices and related accounting. The special committee will be
26 assisted by independent legal counsel and advisors, and the company
27 will not be in a position to comment on these matters until after the
28 special committee has completed its investigation. The company is

1 initiating this investigation following the release of a third party
2 research report regarding practices related to the timing and pricing of
3 stock option grants (presumably the Goldman Sachs report of May 19,
4 2006).

5 44. Following Quest's press release after trading closed on May 22, 2006,
6 the price per share for Quest dropped even further to \$13.32, the third consecutive
7 day in which the stock fell since the Goldman Sachs report was released on May 19,
8 leaving the stock down 16.65% since the close on May 18.

9 45. A report by an analyst for Stifel, Nicolaus & Company issued on
10 May 23, 2006, after Quest Software announced that its Board would be investigating
11 its historical stock option grant practices and related accounting, in relevant part
12 stated that: "we do not believe this news will come as a surprise to the market given
13 that it has been widely speculated that Quest could be thrown into the mix of
14 companies. We believe this is reflected in the 6% decline in the shares last week
15 and the additional 11% decline in the shares this week." Thus, the analyst directly
16 attributed the decline in stock price since at least May 19, 2006 to growing
17 knowledge in the marketplace of Quest's misstatements in its financial reports
18 following the Goldman Sachs report. The analyst further noted Quest's continuing
19 position "that it did not believe that it had backdated options and that the majority of
20 executive option grants were done following board meetings."

21 46. On the morning of June 1, 2006, Quest announced that it had been
22 contacted by the SEC regarding an informal inquiry relating to Quest's past stock
23 option grant practices and that Quest would cooperate fully with the inquiry.

24 47. Before trading began on July 5, 2006, the Company issued a press
25 release revealing, based on the special committee's preliminary analysis, that
26 previous stock options which were granted to certain Quest employees were
27 improperly dated and as a result, the Company would restate its historical financial
28 statements for the periods from 2000 through 2005 and for the quarter ended

1 March 31, 2006. This was in direct contrast to the position previously taken by
2 Quest's management that the Company had been devoid of wrongdoing with regard
3 to the option grants. The press release stated in part:

4 The special committee's initial review has focused on administrative
5 processes used to establish the option exercise price and obtain required
6 approvals of stock option grants, and the related measurement dates
7 used for financial reporting purposes. Its preliminary conclusion is that
8 the administrative approvals required to establish the accounting
9 measurement dates for many of the company's stock option grants
10 awarded during the period from the fall of 1999 and into 2002 were
11 actually obtained subsequent to the measurement dates used for
12 financial reporting purposes. *As a result, the special committee has*
13 *determined, based on its preliminary analysis, that non-cash stock-*
14 *based compensation expense should have been recorded with respect to*
15 *those stock option grants and recognized over the vesting period of the*
16 *options, and that the amount of such additional expense is expected to*
17 *be material.*

18
19 Accordingly, Quest Software's management and the audit committee of
20 Quest Software's Board of Directors, in consultation with the special
21 committee, have determined, based on their preliminary analysis, that
22 Quest Software will restate its annual and interim financial statements
23 for the periods from 2000 through 2005 and for the quarter ended
24 March 31, 2006.

25 (Emphasis added).

26 48. The Company further represented in the July 5 press release that
27 "Quest's annual and interim financial statements and any related reports of its
28 independent registered public accounting firm for the periods from 2000 through

1 2005 and for the quarter ended March 31, 2006 *should no longer be relied upon.*”
2 (Emphasis added.)

3 49. The Company also admitted in the July 5 press release that “[a]ny
4 stock-based compensation expenses incurred as a result of the restatement would
5 have the effect of decreasing reported amounts of income from operations, net
6 income, net income per share and retained earnings contained in Quest’s historical
7 financial statements for the periods subject to restatement.”

8 50. Following this announcement, the price of Quest’s common stock
9 dropped to a low of \$12.86 at the end of trading on July 5, 2006 – totaling a 20.10%
10 drop in the Company’s stock price since May 18, 2006, the last trading day before
11 the Goldman Sachs report was released.

12 51. The 20.10% stock drop is due to the unveiling of the knowing and
13 fraudulent scheme whereby Defendants allowed Company employees to manipulate
14 the grant date on stock options in order to garner more favorable strike prices on the
15 options. This resulted in the Company issuing financial statements that did not
16 accurately reflect the charges to its stock-based compensation expense, which in turn
17 inflated the Company’s net income during the Class Period.

18 52. There was no downturn in the market generally when the May 19,
19 2006 and July 5, 2006 drops in Quest’s stock occurred as can be seen by the
20 NASDAQ National Market during this time frame, which was up 3.18% during this
21 same period, and the Russell 2000 Technology Index, which was only down 2.29%.

22 53. Quest did not file a Form 10-Q for the second quarter of 2006 because
23 its internal investigation of its historical financial statements was ongoing and it had
24 yet to determine what restatements of its historical financial information would be
25 made. Instead, Quest filed a Form NT 10-Q on August 10, 2006, explaining its
26 failure to timely file a Form 10-Q, stating in pertinent part that: “Quest will have to
27 restate its annual and interim financial statements for the periods from 2000 through
28 2005 and for the quarter ended March 31, 2006. The Company intends to file its

1 quarterly report on Form 10-Q for the quarter ended June 30, 2006 and amend its
2 previously filed annual and quarterly reports for periods from 2000 through 2005
3 and for the quarter ended March 31, 2006 as soon as practicable after the completion
4 of the special committees investigation.”

5 54. On August 17, 2006, Quest filed a Form 8-K with the SEC stating that
6 the failure to file its Form 10-Q had led to a NASDAQ determination that Quest
7 would be delisted from the NASDAQ Global Select Market and that Quest had
8 requested a hearing to review that decision. The Company further stated that
9 “[t]here can be no assurance that the hearing panel will grant Quest’s request for
10 continued listing.”

11 55. On October 26, 2006, Quest filed a Form 8-K with the SEC reporting
12 that Kevin E. Brooks was reassigned from his role as Corporate Controller and
13 Principal Accounting Officer of the Company as of October 20, 2006, “in
14 connection with Quest’s ongoing special committee investigation of stock option
15 matters and was an interim decision pending completion of the special committee
16 investigation and related restatement.”

17 56. During the Class Period, the Company and its management knowingly
18 concealed:

- 19 a. Fraudulent conduct throughout the Company, including at the
20 highest levels of management;
- 21 b. A material weakness in internal control over financial reporting
22 within the Company;
- 23 c. The Company had issued materially false and misleading
24 financial statements whereby the Company’s financial statements under reported
25 charges to its stock-based compensation expense, which in turn inflated the
26 Company’s net income during the Class Period. In addition, the Company’s
27 financial statements were not in compliance with GAAP as it was purported to be
28 because they were the result of deficient and defective control;

- 1 d. The Company would be required to issue restated financials; and
2 e. The Company would incur expenses relating to (i) thorough
3 investigation of its internal controls surrounding compensation and (ii) additional
4 audit procedures due to the necessity of issuing restatements.

5 **SCIENTER**

6 57. The Individual Defendants, who directed the preparation and
7 dissemination of the Company's public statements alleged to be false and
8 misleading herein, were responsible for ascertaining that it was materially accurate.
9 As detailed above, these public statements were materially false and misleading
10 because, *inter alia*, the Company's operating results disclosed therein were
11 overstated by virtue of a misstated compensation expense. The Individual
12 Defendants knowingly engaged in the improper conduct alleged herein. As a result
13 of this conduct, Defendants knew or with deliberate recklessness ignored that the
14 Company's compensation expense was misstated because the Defendants did not
15 maintain adequate internal controls and allowed for the manipulation of the grant
16 dates on the stock options given to employees with the effect of there being a higher
17 compensation expense than actually reported. The Individual Defendants had access
18 to all internal data concerning the Company's stock option plans, directed the
19 administration of the grant date used to determine the exercise price of the stock
20 options, and knew or with deliberate recklessness disregarded information that the
21 internal controls surrounding the administration of the stock option plan were
22 inadequate and produced financial statements not in conformity with GAAP.

23 58. As Chief Financial Officers of Quest, Defendants Lambert and Morse,
24 in conjunction with their direct supervisor, Defendant Smith, were responsible for
25 the preparation of Quest's financial statements and for ensuring that the periodic
26 reports filed with the SEC containing such financial statements complied fully with
27 the disclosure requirements of the federal securities laws. The Individual
28 Defendants signed and/or reviewed Quest's SEC filings containing the Company's

1 financial results, as alleged herein. Because the under reporting of compensation
2 expense and over reporting of net income is a departure from the general rule of
3 GAAP, the Individual Defendants – persons responsible for preparation and filing of
4 Quest's financial statements – had the responsibility to verify underlying facts of
5 any publicly released financial statements. In addition, given the fact that the
6 accounting irregularities involved accounting for the expenses incurred in
7 connection with the Company's employee stock option program – a program which
8 these Defendants were fraudulently manipulating for their own economic benefit –
9 the Individual Defendants as senior executive officers and directors of the Company,
10 approved, knew of, or with deliberate recklessness ignored the improper conduct
11 complained of herein.

12 59. As described above, the Special Committee of the Board of Directors'
13 preliminary analysis has found stated stock option grant dates that were different
14 from the actual stock option grant dates producing consistently favorable results to
15 the recipients of the options. In the financial statements purported to be in
16 accordance with GAAP, the compensation expense associated with these was
17 recorded lower than what actually took place such that the resulting financial
18 statements were not in accordance with GAAP.

19 60. The Individual Defendants knowingly or with deliberate recklessness
20 made and directed the making of materially false and misleading statements
21 concerning Quest's operating results, financial condition and projected earnings
22 which the Individual Defendants knew would artificially inflate the value of the
23 Company's securities. The Individual Defendants had and used their influence and
24 control to further the scheme alleged herein. Defendants' actions in doing so
25 resulted in damage to Plaintiff and the Class.

26 CLASS ACTION ALLEGATIONS

27 61. Plaintiff brings this case as a class action pursuant to Rules 23 (a) and
28 (b)(3) of the Federal Rules of Civil Procedure, individually and on behalf of all other

1 persons who purchased or otherwise acquired Quest common stock from
2 November 9, 2001 through July 3, 2006, inclusive. Excluded from the Class are
3 Quest, its directors and officers, its subsidiaries and affiliates, the Individual
4 Defendants, members of the immediate families of each of the Individual
5 Defendants, any entities in which any of the Defendants has a controlling interest,
6 and the legal representatives, heirs, successors, affiliates or assigns of any of the
7 foregoing excluded persons and entities.

8 62. This action is properly maintainable as a class action because:

9 a. The members of the Class are so numerous that joinder of all
10 members is impracticable. During the Class Period, 101,532,204 shares of Quest
11 common stock were outstanding, over 61 million of which are publicly held and
12 actively traded on the NASDAQ National Market. Upon information and belief,
13 Plaintiff alleges that there are more than 1,000 members of the Class;

14 b. Plaintiff's claims are typical of the claims of the other members
15 of the Class, as Plaintiff and the members of the Class purchased Quest shares and
16 sustained damages as a result of the Defendants' wrongful conduct complained of
17 herein;

18 c. Plaintiff is a representative party who will fairly and adequately
19 protect the interests of the other members of the Class and has retained counsel
20 competent and experienced in class action securities litigation. Plaintiff has no
21 interests antagonistic to, or in conflict with, the Class it seeks to represent;

22 d. A class action is superior to other available methods for the fair
23 and efficient adjudication of the claims asserted herein. As the damages suffered by
24 the individual Class members may be relatively small, the expense and burden of
25 individual litigation make it virtually impossible for the Class members individually
26 to redress the wrongs done to them. The likelihood of individual Class members
27 prosecuting separate claims is remote;

28 e. The questions of law and fact common to the members of the

1 Class predominate over any questions affecting individual members of the Class.
2 The questions of law and fact which are common to Plaintiff and the Class include,
3 among others:

4 i. whether the federal securities laws were violated by
5 Defendants' acts as alleged herein;

6 ii. whether statements disseminated to the investing public
7 and to Quest's common stock holders during the Class Period misrepresented
8 material facts about the operating results and financial condition of the Company;

9 iii. whether Defendants acted with knowledge or with
10 deliberate reckless disregard for the truth in misrepresenting and/or omitting to state
11 material facts;

12 iv. whether, during the Class Period, the market price of
13 Quest common stock was artificially inflated due to the material misrepresentations
14 and/or non-disclosures complained of herein;

15 v. whether the Defendants participated in and pursued the
16 common course of conduct complained of herein; and

17 vi. whether the members of the Class have sustained
18 damages and, if so, what is the proper measure thereof.

19 63. Plaintiff anticipates no unusual difficulties in the management of this
20 action as a class action.

21 **APPLICABILITY OF PRESUMPTION OF RELIANCE:**
22 **FRAUD-ON-THE-MARKET DOCTRINE**

23 64. At all relevant times, the market for Quest common stock was an
24 efficient market for the following reasons, among others:

25 a. Quest common stock met the requirements for listing, and was
26 listed, on the NASDAQ National Market, an efficient and automated market;

27 b. During the Class Period, millions of shares of Quest common
28 stock were traded on the open market;

1 c. As a regulated issuer, Quest filed periodic public reports with
2 the SEC and the NASDAQ National Market; and

3 d. Quest was followed by several securities analysts employed by
4 brokerage firms who wrote reports that were distributed to the sales force and
5 certain customers of their respective brokerage firms. These reports were publicly
6 available and entered the public marketplace.

7 65. As a result, the market for Quest common stock promptly digested
8 current information regarding the Company from all publicly available sources and
9 reflected such information in Quest's common stock price. Under these
10 circumstances, all purchasers of the Company's common shares during the Class
11 Period suffered similar injury through their purchase of shares at artificially inflated
12 prices and a presumption of reliance applies.

13 **INAPPLICABILITY OF STATUTORY SAFE HARBOR**

14 66. The statutory safe harbor provided for forward-looking statements
15 under certain circumstances under the Private Securities Litigation Reform Act
16 ("PSLRA") does not apply to any of the allegedly false statements pleaded in this
17 Complaint. The statements alleged to be false and misleading herein all relate to
18 then-existing facts and conditions which were not fully, fairly, or adequately
19 disclosed. The allegations also concern misrepresentations of historical facts and are
20 not forward-looking. In addition, to the extent certain of the statements alleged to be
21 false may be characterized as forward-looking, they were not identified as "forward-
22 looking statements" when made, there was no statement made with respect to any of
23 those representations forming the basis of this Complaint that actual results "could
24 differ materially from those projected," and there were no meaningful cautionary
25 statements identifying relevant important factors that could cause actual results to
26 differ materially from those in the purportedly forward-looking statements.
27 Cautionary language must truthfully address specific risks, and must exhaust the
28 capacity of the positive false statements to mislead investors. Alternatively, to the

1 extent that the statutory safe harbor does apply to any forward-looking statements
2 pleaded herein, Defendants are liable for those false forward-looking statements
3 because at the time each of those forward-looking statements was made, Defendants
4 had actual knowledge that the particular forward-looking statement was false and
5 the statement was authorized and/or approved by an executive officer of Quest who
6 actually knew that those statements were false when made.

7 67. The statutory safe harbor provided for forward-looking statements
8 under certain circumstances, moreover, does not apply to false statements or
9 material omissions of existing facts.

10 68. Additionally, the safe harbor is statutorily inapplicable to the false,
11 misleading, and incomplete financial statements of Quest since they were reportedly
12 prepared in accordance with GAAP.

13 **COUNT I**

14 **Against All Defendants for Violation of § 10(B) of the Exchange Act**
15 **and Rule 10b-5 Thereunder**

16 69. Plaintiff repeats and realleges each and every allegation above, as if set
17 forth in full herein.

18 70. Throughout the Class Period, Defendants, individually and in concert,
19 directly or indirectly, engaged in a common plan, scheme and course of conduct
20 described herein, pursuant to which they knowingly or with deliberate recklessness
21 engaged in acts, transactions, practices and a course of business which operated as a
22 fraud upon Plaintiff and the other members of the Class; made various false
23 statements of material facts and omitted to state material facts to make the
24 statements made not misleading to Plaintiff and the other members of the Class; and
25 employed manipulative or deceptive devices and contrivances in connection with the
26 purchase and sale of Quest stock.

27 71. The purpose and effect of Defendants' plan, scheme and course of
28 conduct were to artificially inflate the price of Quest's stock and to artificially

1 maintain the market price of Quest securities.

2 72. The Individual Defendants, who were the top officers of the Company,
3 had actual knowledge of the material omissions and/or the falsity of the material
4 statements set forth above, and intended to deceive Plaintiff and the other members
5 of the Class, or, in the alternative, acted with deliberate reckless disregard for the
6 truth when they failed to ascertain and disclose the true facts in the statements made
7 by them or other Quest personnel to members of the investing public, including
8 Plaintiff and the Class, and the securities analysts.

9 73. As a result of the foregoing, the market price of Quest securities was
10 artificially inflated during the Class Period. In ignorance of the falsity of the
11 Defendants' statements concerning the operating results and performance of Quest,
12 Plaintiff and the other members of the Class relied, to their damage, on the
13 statements described above and/or the integrity of the market price of Quest stock
14 during the Class Period in purchasing Quest common stock at prices which were
15 artificially inflated as a result of Defendants' false and misleading statements.

16 74. Had Plaintiff and the other members of the Class known of the
17 material adverse information which Defendants did not disclose, they would not
18 have purchased Quest common stock at the artificially inflated prices that they did.

19 75. Defendants' concealment of this material information served only to
20 harm Plaintiff and the other members of the Class who purchased Quest common
21 stock in ignorance of the financial risk to them as a result of such nondisclosures.

22 76. As a result of the wrongful conduct alleged herein, Plaintiff and other
23 members of the Class have suffered damages in an amount to be established at trial.

24 77. By reason of the foregoing, Defendants have violated § 10(b) of the
25 Exchange Act and Rule 10b-5 promulgated thereunder, and are liable to the Plaintiff
26 and the other members of the Class for substantial damages which they suffered in
27 connection with their purchase of Quest common stock during the Class Period.

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COUNT II

**Against the Individual Defendants for Liability Pursuant to § 20(a)
of the Exchange Act**

78. Plaintiff repeats and realleges each and every allegation above, as if set forth in full herein.

79. This Count is brought pursuant to § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), on behalf of the members of the Class against the Individual Defendants.

80. During the Class Period, each of the Individual Defendants, by virtue of their offices at and directorship of Qucst, and their specific acts, was, at the time of the wrongs alleged herein, a controlling person of Quest within the meaning of § 20(a) of the Exchange Act.

81. Each Individual Defendant's positions made him privy to, and provided him with actual knowledge of, the material facts which the Individual Defendants and Quest concealed from Plaintiff and the other members of the Class during the Class Period.

82. Each of the Individual Defendants had the power and influence, and exercised same, to cause Defendants, including Quest, to engage in the unlawful conduct and practices complained of herein by causing Quest to disseminate the false and misleading information referred to above.

83. By virtue of the foregoing, the Individual Defendants are liable for the above wrongful conduct pursuant to § 20(a) of the Exchange Act.

84. By virtue of the conduct alleged above, the Individual Defendants are liable to the Plaintiff and the other members of the Class for the substantial damages that they suffered in connection with their purchases of Quest's common stock during the Class Period.

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PRAYER

WHEREFORE, Plaintiff, on its own behalf and on behalf of the other members of the Class, demands judgment against the Defendants as follows:

A. Determining that this action is properly maintainable as a class action pursuant to Rule 23 of the Federal Rules of Civil Procedure;

B. Certifying Plaintiff as the Class Representative and his counsel as Class Counsel;

C. Declaring and determining that Defendants violated the federal securities laws by reason of their conduct as alleged herein;

D. Awarding monetary damages against all Defendants, jointly and severally, in favor of Plaintiff and the other members of the Class for all losses and damages suffered as a result of the acts and transactions complained of herein, together with prejudgment interest from the date of the wrongs to the date of the judgment herein;

E. Awarding Plaintiff the costs, expenses, and disbursements incurred in this action, including reasonable attorneys' and experts' fees; and

F. Awarding Plaintiff and the other members of the Class such other and further relief as the Court may deem just and proper in light of all the circumstances of this case.

JURY DEMAND

Plaintiff demands a trial by jury.

DATED: October 27, 2006