

UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

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)  
**U.S. SECURITIES AND EXCHANGE** )  
**COMMISSION,** )  
**100 F. Street, NE** )  
**Washington, D.C. 20549-6030** )

**Plaintiff,** )

v. )

**FLOWSERVE CORPORATION** )  
**5215 North O'Connor Blvd.** )  
**Suite 2300** )  
**Irving, Texas 75039** )

**Defendant.** )  
\_\_\_\_\_)

Case: 1:08-cv-00294  
Assigned To : Sullivan, Emmet G.  
Assign. Date : 2/21/2008  
Description: General Civil

**COMPLAINT**

Plaintiff, U.S. Securities and Exchange Commission (the "Commission"), alleges:

**SUMMARY**

1. From approximately 2001 through 2003, Flowserve Corporation ("Flowserve") violated the books and records and internal controls provisions of the Foreign Corrupt Practices Act (the "FCPA") [15 U.S.C. §§ 78dd-1, et seq.] when two of its foreign subsidiaries entered into twenty contracts involving the payment of kickbacks totaling approximately \$820,246 in connection with sales of industrial equipment to Iraqi government entities under the United Nations Oil for Food Program. Flowserve, through its subsidiaries, authorized or paid these kickbacks in the form of under-the-table "after sales service fees" ("ASSFs") through third-party agents. Approximately \$646,488 of the kickback payments were made, and another \$173,758 were authorized.

2. Flowserve either knew or was reckless in not knowing of the kickbacks. The company also knew that the ASSF payments were prohibited by the Oil for Food Program, as well as under U.S. and international trade sanctions.

3. The Oil for Food Program was intended to provide humanitarian relief to the Iraqi population, then subject to comprehensive international trade sanctions. The Program allowed the Iraqi government to purchase necessary humanitarian goods, but required that all purchases be made through a U.N.-controlled escrow account. The kickbacks paid in connection with Flowserve's foreign subsidiaries' Oil for Food contracts had the effect of diverting funds out of the escrow account and into an Iraqi slush fund.

4. In accounting for certain of its Oil for Food Program transactions, Flowserve failed to accurately record the nature of the ASSF payments as kickbacks to the Iraqi regime. Flowserve also failed to devise and maintain a system of internal accounting controls sufficient to detect and prevent the illicit ASSF payments.

5. As a result of the conduct above, Flowserve violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B)].

#### **JURISDICTION**

6. This Court has jurisdiction over this action under Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa]. Flowserve made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange in connection with the transactions, acts, practices, and courses of business alleged in this Complaint.

7. Venue is appropriate in this Court under Section 27 of the Exchange Act [15 U.S.C. § 78aa] because Flowserve does business in this judicial district.

### **DEFENDANT**

8. **Flowserve** is a New York corporation with its executive offices in Irving, Texas. Flowserve supplies pumps, valves, seals, and related automation and services to the power, oil, gas, and chemical industries. Flowserve trades on the New York Stock Exchange under the symbol “FLS,” and its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act [15 U.S.C. § 781(b)]. Two Flowserve subsidiaries were involved in sales to Iraq under the Oil for Food Program.

### **RELEVANT ENTITIES**

9. **Flowserve Pompes** is a wholly-owned French subsidiary of Flowserve’s Pumps Division. Flowserve Pompes is based in Arnage, France. Throughout the relevant period, Flowserve Pompes’ financial results were included in the consolidated financial statements that Flowserve filed with the Commission.

10. **Flowserve B.V.** is a wholly-owned Dutch subsidiary of Flowserve’s Seals Division. Flowserve B.V. is based in Roosendaal, Netherlands. Throughout the relevant period, Flowserve B.V.’s financial results were included in the consolidated financial statements that Flowserve filed with the Commission.

### **FACTS**

#### **I The United Nations Oil for Food Program**

11. Following Iraq’s invasion of Kuwait in 1991, the United Nations Security Council and the United States imposed comprehensive economic sanctions on Iraq. Over the following years, the sanctions triggered a humanitarian crisis, with severe shortages

of food and medical supplies. In response, the U.N. Security Council authorized a relief program under which the Iraqi government would be permitted to sell crude oil and use the proceeds to purchase humanitarian supplies.

12. Under the terms of the Oil for Food Program, the Iraqi government was authorized to sell crude oil to buyers of its choosing. A U.N. committee reviewed the commercial terms of each contract and approved each sale. The proceeds were wired by the purchaser directly into an escrow account maintained by the U.N. at BNP Paribas in New York. The Iraqi government was not given direct access to the proceeds of its oil sales, but was allowed to use the funds to purchase humanitarian goods, subject to U.N. review and approval. Individual Iraqi ministries could negotiate contracts for approved categories of products. The suppliers submitted their contracts to the U.N. committee for review. Upon approval of each contract, and after verification that the goods had been received in Iraq, the committee authorized payment to the supplier from funds in the escrow account.

13. The Oil for Food Program was intended to maximize the Iraqi government's flexibility in meeting its humanitarian needs, while preventing it from undermining trade sanctions by diverting cash from the transactions. In practice, however, the Iraqi government was able to circumvent the Program's restrictions by demanding massive under-the-table payments from its contract partners. Starting around August 2000, each Iraqi ministry demanded a 10% "after sales service fee" ("ASSF") on all humanitarian goods purchased under the Program. The fee bore no relation to any actual services and was, in reality, an illicit 10% kickback to the Iraqi regime. The ASSF

payment was not identified in the official purchase contracts that the suppliers provided for U.N. review and was not made through the U.N.'s authorized payment channels.

14. According to the U.N.'s Independent Inquiry Committee, which was created to investigate corruption in the Program, the Iraqi regime collected just over \$1 billion in ASSF payments from suppliers. Payments were typically made in cash by the suppliers holding the Oil for Food contracts. The associated cost of the ASSF payments was passed along to the U.N.-controlled escrow account as the suppliers inflated their contract prices to cover the illicit payments. The ultimate economic effect of the kickbacks, therefore, was to deprive the U.N.'s humanitarian program of over \$1 billion in humanitarian resources that otherwise would have been available to it.

15. Each Iraqi ministry was responsible for collecting ASSF payments on the contracts it administered. In addition, the Ministry of Transportation ensured that no humanitarian supplies were permitted to cross Iraq's border without proof that all required ASSF payments had been paid. Because the payments violated U.N. requirements, the collection effort was handled surreptitiously. As demanded by Iraqi officials, the supplier made its ASSF payment -- either directly or through an Iraqi front company -- in cash at an Iraqi embassy or by depositing the funds into Iraqi-controlled banks, such as the Al-Rashid Bank in Lebanon or the Al-Rafidain Bank in Jordan.

16. Following the U.S. invasion and occupation of Baghdad in 2003, the Coalition Provisional Authority assumed responsibility for ongoing Oil for Food contracts. The Provisional Authority put an end to the ASSF kickback requirement and renegotiated all open contracts to remove the associated 10% markups.

## **II Flowserve's Payment of ASSF's under the Program**

17. Flowserve engaged in Oil for Food transactions through two of its European subsidiaries: Flowserve Pompes and Flowserve B.V. These Flowserve subsidiaries entered into a total of twenty contracts in which ASSF kickback payments were either made or authorized. In total, Flowserve subsidiaries, working through third-party agents, made ASSF payments of approximately \$646,488 and authorized additional payments of \$173,758.

### **A. Contracts Involving Flowserve Pompes**

18. Flowserve Pompes participated in the Oil for Food Program from approximately 1997 through 2003. The company's exclusive agent for Iraqi contracts, including those under the Oil for Food Program, was a Jordanian entity. Once the Iraqi authorities began demanding kickback payments, Flowserve Pompes and its Jordanian agent worked in concert to channel ASSF kickback payments to Iraqi ministries, while concealing the payments from the U.N.

19. In total, Flowserve Pompes made approximately \$604,651 in ASSF payments in connection with fifteen contracts. Flowserve Pompes agreed to, but did not ultimately make, an additional \$173,758 in improper ASSF payments under four additional contracts. Delivery under these four contracts had not been completed by the time of the U.S. invasion in March 2003. Following the invasion, the Coalition Provisional Authority, acting on behalf of the Iraqi ministries, required that Flowserve Pompes amend the contracts to remove the ASSF payments and lower the prices by ten percent.

20. Senior officials at Flowserve Pompes, including the subsidiary's President, developed two different false cover stories to conceal the ASSF kickback payments. The company's internal accounting records falsely indicated that Flowserve Pompes was paying the Jordanian agent a ten percent fee on each contract to cover the cost of installing and commissioning the equipment. In reality, the agent provided no such services. The contract documents that Flowserve Pompes sent to the U.N. for approval painted a different, if equally false, picture. These documents omitted any reference to after sales services or related installation fees. Instead, to cover the cost of the illicit ASSF payments, the company inflated the unit price of each piece of equipment without disclosing the price increase, or the reason for it, to the U.N.

21. The contract documentation for Flowserve Pompes' Oil for Food contracts was prepared both at the Arnage facility and at a Flowserve Pompes sales office in Beirut, Lebanon. Once an agreement was negotiated between the Beirut sales office and the relevant Iraqi ministry, and approved by officials in Arnage, the Beirut sales office would generate a pro forma invoice reflecting the actual pricing of the goods to be shipped under the U.N. contract. To memorialize Flowserve's agreement to pay the ASSF, the Beirut Area Manager signed a side letter to the Iraqi ministry stating that Flowserve Pompes would pay ten percent of the contract price to the ministry to cover "engineering services, installation, and commissioning." Officials at Flowserve Pompes were fully aware that no engineering, installation, or commissioning services would be performed under the contract, but the internal documentation at Flowserve Pompes maintained the pretense that it would be. The side letter was not disclosed to the U.N.

22. In the documents that Flowserve Pompes prepared for U.N. approval, the company did not pretend that the agent would provide engineering, installation, and commissioning services. But the U.N. documents failed to disclose that a portion of the contract price represented a kickback to the Iraqi ministry. The contract and pro forma invoice that the U.N. received contained no reference to the company's side letter or to any payment for after sales services. Instead, the unit prices of the listed equipment were inflated by ten percent. There was nothing in the U.N. documentation to reveal that the contract prices had been inflated, or that a portion of the contract price was to be kicked back to the Iraqi authorities.

23. After the U.N. approved the contract, the Beirut sales office prepared an internal Order Entry Form and an Order Acknowledgement Form for the Iraqi ministry, both of which included false line items for "after sales services" to be provided by Flowserve Pompes' agent. The services were valued at ten percent of the contract.

24. Prior to the shipment of the goods into Iraq, the agent sent a written invoice to Flowserve Pompes in Arnage for the ASSF payment amounts to be made on pending contracts, identifying them as "payments made on your behalf." Knowing that the kickback payments had to be received by Iraqi authorities before the goods would be allowed across the border, Flowserve Pompes' President made arrangements for the agent's ASSF invoices to be paid immediately upon receipt. The payments to the agent were typically made within twenty-four hours. The agent then made the ASSF kickback payments by depositing cash into an Iraqi-controlled account in the Jordanian Housing Bank for Trade and Finance.



25. Officials at Flowserve Pompes either knew, or were reckless in not knowing, that illegal ASSF payments had been paid or offered under each of the nineteen contracts.

**B. Contracts Involving Flowserve B.V.**

26. Flowserve's Dutch subsidiary Flowserve B.V. entered into one contract involving an ASSF kickback payment of \$41,836. The contract was for the supply of water pump spare parts to the Iraqi government-owned South Gas Company. Flowserve B.V.'s agent in the transaction was a Jordanian entity other than the one used by Flowserve Pompes.

27. During August 2001, the principals of Flowserve B.V.'s Jordanian agent met with Flowserve B.V. officials in Roosendaal, Netherlands. At that meeting, Flowserve B.V. was advised that the agent would have to pay a ten percent kickback on the transaction on Flowserve B.V.'s behalf, for which the agent would need reimbursement.

28. Following the meeting, the agent proposed that Flowserve B.V. conceal the ASSF kickback payment by having the agent serve as a distributor, rather than as an agent, and make the payment out of its margin. Flowserve B.V. rejected this proposal.

29. Instead, Flowserve B.V.'s Controller chose to conceal the payment by increasing the cost of the purchase order by ten percent and passing the difference back to the agent. In September 2001, Flowserve B.V. agreed to pay a supplemental commission -- euphemistically labeled a "special project discount" -- to the agent to cover the amount of the kickback. The "special project discount" effectively doubled the agent's standard ten percent commission to twenty percent.

30. The agent submitted an invoice for the combined commission and “special project discount” in February 2002. Flowserve made the payment to the agent in March 2002. The agent then made the ASSF payment to the Iraqi ministry on Flowserve B.V.’s behalf. The ASSF payment was not disclosed to the U.N.

### **III Flowserve’s Failure to Maintain Adequate Internal Controls**

31. Flowserve failed to maintain a system of internal controls sufficient (i) to ensure that the company’s transactions under the Oil for Food Program were executed in accordance with management’s authorization and (ii) to maintain accountability for the company’s assets. As discussed above, Flowserve subsidiaries either made or agreed to make numerous illicit payments that contravened the Oil for Food Program, U.S. and international trade sanctions, and its own internal FCPA and anti-bribery policies.

32. Flowserve failed to devise and maintain an effective system of internal controls to prevent or detect these violations of the FCPA, as required by Exchange Act Section 13(b)(2)(B).

### **IV Flowserve’s Failure to Properly Maintain Its Books and Records**

33. As described above, Flowserve’s accounting for its Oil for Food transactions failed properly to record the nature of the ASSF payments. In nineteen Flowserve Pompes transactions, the company’s internal accounting records indicated that Flowserve Pompes was paying its Jordanian agent a ten percent fee for performing installation and commissioning activities. In reality, that money represented a series of illegal kickbacks to the Iraqi regime. In one Flowserve B.V. transaction, the company’s internal records indicated that Flowserve B.V. was paying a “special project discount” to its agent. In reality, that money also represented an illegal kickback to the Iraqi regime.

**CLAIMS FOR RELIEF**

**FIRST CLAIM**

**[Violations of Section 13(b)(2)(A) of the Exchange Act]**

34. Paragraphs 1 through 33 are realleged and incorporated by reference.

35. As described above, Flowserve, through its officers, agents and subsidiaries, failed to keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected its transactions and dispositions of its assets.

36. By reason of the foregoing, Flowserve violated Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

**SECOND CLAIM**

**[Violations of Section 13(b)(2)(B) of the Exchange Act]**

37. Paragraphs 1 through 36 are realleged and incorporated by reference.

38. As described above, Flowserve failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that payments were: (i) made in accordance with management's general or specific authorization; and (ii) recorded as necessary to maintain accountability for its assets.

39. By reason of the foregoing, Flowserve violated Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)].

**PRAYER FOR RELIEF**

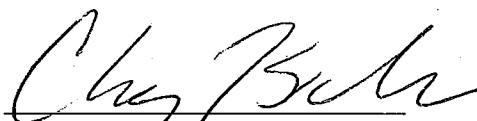
WHEREFORE, the Commission respectfully requests that this Court enter a final judgment:

A. Permanently restraining and enjoining Flowserve from violating Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A) and (B)];

- B. Ordering Flowserve to disgorge ill-gotten gains, with prejudgment interest, wrongfully obtained as a result of its illegal conduct;
- C. Ordering Flowserve to pay civil penalties pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)]; and
- D. Granting such further relief as the Court may deem just and appropriate.

Dated: February 21, 2008

Respectfully submitted,



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