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Presented By SheppardMullin

OFAC, BIS Double Up Flow Serve: What the Flowserve Settlement Says About Corporate Compliance Programs

October 24, 2011 by Thaddeus McBride, Mark Jensen, & Corey Phelps

In late September, Flowserve Corporation ("Flowserve") and a number of its subsidiaries agreed to settle alleged export violations with the Department of Commerce, Bureau of Industry of Security ("BIS") for $2.5 million, and to remit $502,408 to the U.S. Department of the Treasury, Office of Foreign Assets Control ("OFAC") to settle alleged U.S. sanctions violations. Flowserve, including its subsidiaries, is an oil, gas, and chemical services company with operations around the world. The settlement underscores the value of compliance measures specifically tailored to a company's operations, and provides yet another example of the U.S. government vigorously enforcing U.S. law overseas.

Alleged Violations

Export. The Export Administration Regulations ("EAR"), administered by BIS, govern exports and re-exports of U.S.-origin commodities, technology, and software. In a series of agreements, Flowserve and its subsidiaries settled alleged BIS violations involving:

- failing to obtain a license for shipments of products with an Export Commodity Classification Number ("ECCN") of 2B350, controlled for export for chemical and biological weapons purposes;

- the unlicensed transshipment of EAR99 goods to Iran (by subsidiaries in France, Germany, the Netherlands, Spain, and the United Kingdom);

- the unlicensed shipment of EAR99 goods to Syria (by subsidiaries in France, Germany, the Netherlands, and the United Kingdom); and
- a failure to comply with reporting requirements for activities involving items that may have been illegally exported to Libya.

Sanctions. OFAC administers economic sanctions programs against specifically designated countries, governments, entities, and individuals. As reported by OFAC, Flowserve and undisclosed subsidiaries allegedly engaged in indirect shipments that violated the Iranian Transaction Regulations, 31 C.F.R Part 560, the Sudanese Sanctions Regulations, 31 C.F.R. Part 538, and the Cuban Assets Control Regulations, 31 C.F.R. Part 515. OFAC noted in its settlement that several of the apparent violations reflected a reckless disregard for U.S. sanctions requirements, and involved awareness by facility supervisors of conduct giving rise to alleged violations.

Previously, in 2008, Flowserve and a French subsidiary reached a settlement for alleged Foreign Corrupt Practices Act violations related to activities under the U.N. Oil for Food Program. In that settlement, Flowserve paid $10.5 million in penalties and disgorgement to the U.S. Department of Justice and U.S. Securities and Exchange Commission.

Analysis

Maybe the most striking aspect of the Flowserve settlements with BIS and OFAC are the extent and character of the violations. BIS alleged that Flowserve and its subsidiaries engaged in transactions resulting in 288 violations of the EAR, and OFAC alleged 58 violations of U.S. economic sanctions programs. In both cases, many or all of the violations appear to have resulted from indirect shipments of U.S.-origin items made by or through foreign subsidiaries. Many of the violations involved valves and pumps covered by ECCN 2B350.

On these facts, it appears that Flowserve failed to systematically classify and track its exports—especially those for which an export license was required—through its foreign subsidiaries. Flowserve does not appear to have been the victim of a bad or overly aggressive actor within the company; for example, OFAC indicated in its settlement that

the violations were non-egregious. Rather, it seems likely that Flowserve's internal processes for export compliance were simply insufficient.

Given the number of alleged violations in the underlying conduct, it is probably not a surprise that Flowserve's settlement agreement with BIS stipulated that Flowserve must complete an external audit of its entire export controls compliance program. The export controls audit is to be performed by an unaffiliated third party consultant, cover the 12-month period beginning with the settlement agreement, and is to be "in substantial compliance" with the sample audit module on BIS's website, which is specifically referenced in the settlement. *See* http://www.bis.doc.gov/complianceandenforcement/revised_emcp_audit.pdf. The company is required to present its audit findings to BIS within three months of the 12-month period covered by the audit.

This type of self-directed but highly proscribed audit of the compliance function is similar to compliance obligations imposed by other U.S. government agencies in recent months. Indeed, recent posts in this blog have addressed heightened compliance program requirements from OFAC and under the FCPA. *See* OFAC Settles Alleged Sanctions Violations for $88.3 Million, *available at* http://www.governmentcontractslawblog.com/2011/09/articles/ofac/ofac-settles-alleged-sanctions-violations-for-883-million/; Getting Specific About FCPA Compliance, Law360, *available at*: http://www.sheppardmullin.com/assets/attachments/973.pdf.

The expansion of directed compliance requirements underscores the extent to which U.S. government agencies are monitoring and depending on corporate compliance programs as part of their regulatory strategy. In this environment, the compliance function must be tailored to the specific operations of the company: as a start, companies should understand which of their U.S.- origin items are controlled and how those materials are transmitted to and by non-U.S. entities, and make sure that non-U.S. personnel and affiliates understand their obligations under U.S. law. It may be necessary to focus considerable resources on operations outside of the United States. Such general steps might not catch a rogue actor, but they likely would mitigate the risk of broad, continuing compliance violations.

Finally, the settlement serves as a reminder of the potential benefits of voluntary self disclosure and cooperation if violations are uncovered. Flowserve voluntary disclosed its conduct to BIS and OFAC, and the BIS press release encourages parties "who may have been involved in violations of the EAR" to submit a voluntary self-disclosure. Similarly, OFAC references a "Market Withdrawal Program" that resulted in Flowserve voluntarily ending business with sanctioned countries as a factor that led to a penalty reduction of approximately $150,000 (based on the base penalty for the alleged violations), in spite of allegations of "reckless" conduct. Ultimately, proactive, transnational efforts to comply with U.S. law are the best means to avoid penalties and legal fees, and the hassle of externally imposed deadlines on compliance reform efforts.

Authored By:

Thaddeus McBride
(202) 469-4976
tmcbride@sheppardmullin.com

Mark Jensen
(202) 469-4979
mjensen@sheppardmullin.com

Corey Phelps
(202) 469-4981
cphelps@sheppardmullin.com