

CORPORATE ALERT:
**SEC SANCTIONS FLOWSERVE CORPORATION AND OFFICERS FOR
REAFFIRMATION OF EARNINGS GUIDANCE IN VIOLATION OF REGULATION FD**

APRIL 1, 2005

On March 24, 2005, the Securities and Exchange Commission issued a cease-and-desist order against Flowserve Corporation, its chief executive officer and its director of investor relations. The order found that Flowserve and the two officers had violated the disclosure requirements of Regulation FD and Section 13(a) of the Securities Exchange Act of 1934.¹ In connection with the order, Flowserve and its chief executive officer agreed, without admitting or denying the SEC's findings, to settlements that require Flowserve and its CEO to pay civil penalties of \$350,000 and \$50,000, respectively. No civil penalty was imposed on the director of investor relations.

The Flowserve action is the latest in a series of Regulation FD enforcement actions taken by the SEC² and the first action that specifically addresses the propriety of reconfirmation of earnings guidance.

Regulation FD

Regulation FD generally requires that whenever an issuer, or person acting on its behalf, discloses material nonpublic information to a securities market professional or a holder of the issuer's securities who may trade on the basis of that information, the issuer must make simultaneous public disclosure of that information, in the case of an intentional disclosure, or make prompt public disclosure of such information, in the case of an unintentional disclosure.³

¹ See *In Matter of Flowserve Corporation*, C. Scott Greer, and Michael Conley, *Administrative Proceedings*, File No. 3-11872 and Securities and Exchange Act of 1934 Release No. 51427.

² For additional information regarding SEC enforcement actions relating to Regulation FD, see our memorandum dated December 12, 2002 entitled "*SEC Enforcement Actions under Regulation FD*" and our memorandum dated September 12, 2003 entitled "*SEC Enforcement Action Against Schering-Plough and its Former CEO under Regulation FD*," which are available upon request or at our website: www.simpsonthacher.com.

³ For additional information concerning Regulation FD, see our memorandum dated August 24, 2000 entitled "*New SEC Rules on Selective Disclosure and Insider Trading*," which is available upon request or at our website: www.simpsonthacher.com.

Summary of Facts

Flowserve, which reports on a calendar-year basis, began 2002 by forecasting annual earnings per share in the range of \$1.90 to \$2.30. In July of that year, the company lowered its earnings estimate to \$1.70 to \$1.90 per share. On September 27, the company lowered its earnings estimate further to \$1.45 to \$1.55 per share, which the Company reaffirmed in its Form 10-Q for the quarter ended September 30, 2002 filed on October 22, 2002.

On November 19, 2002, the Flowserve CEO and IR officer met with a group of analysts from four investment and brokerage firms. During the meeting one of the analysts asked about the company's earnings guidance for the year. In response to this question, the CEO reaffirmed the guidance which had been issued by the company on October 22. Flowserve's reconfirmation of guidance for annual earnings occurred nearly a month after the initial earnings guidance was issued and forty-two days prior to year end.

On November 20 one of the analysts who attended the meeting with the CEO and IR officer issued a report to the investment firm's subscribers stating that Flowserve had reaffirmed its earnings guidance. The report was electronically distributed to subscribers of Thomson's First Call.

On November 21, Flowserve's closing stock price was approximately 6% higher than the closing price the day before and trading volume increased by 75%. After the market close on November 21, Flowserve submitted a current report on Form 8-K to the SEC that stated that the Company had "reaffirmed its full year 2002 estimated earnings per share".

Observations

This action by the SEC is the first enforcement action related to Regulation FD involving a reaffirmation of earnings guidance by a reporting company. The action demonstrates that by confirming that a prior projection is still current, an issuer can be conveying new information as of the date of its reaffirmation of a prior statement. Whether the reaffirmation is material will depend on a number of factors, including the amount of time between the announcement of the estimate and the reconfirmation and what events may have occurred between the time of the estimate and the reconfirmation. In any event, reporting companies should be very cautious about reconfirming earnings estimates more than a few days after the initial statement unless such reaffirmations are publicly disseminated simultaneously in accordance with the requirements of Regulation FD.

According to the SEC, this is the first settled Regulation FD enforcement action against a director of investor relations. In the order, the SEC has taken the view that a company's director of investor relations must take an active role in ensuring compliance with Regulation FD. While the Flowserve director of investor relations did not make any statements confirming earnings guidance or providing other material nonpublic information, he was nevertheless found to have violated Regulation FD by failing to prevent his CEO from making such statements or to take action after the statements were made. Indeed, the SEC indicates in its

order that the IR officer was present during the CEO's statements to the analysts, but failed to reiterate the company policy as to earnings guidance and did not caution the CEO regarding his response to the question regarding the company's earnings guidance.

* * *

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as additional memoranda regarding recent corporate governance developments, can be obtained from our website, *www.simpsonthacher.com*.

SIMPSON THACHER & BARTLETT LLP