

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SECURITIES AND EXCHANGE COMMISSION,
100 F Street, N.E.
Washington, D.C. 20549-4631,

Plaintiff,

v.

BAKER HUGHES INCORPORATED and
ROY FEARNLEY,

Defendants.

United States Courts
Southern District of Texas
FILED

APR 26 2007

Michael N. Milby, Clerk

COMPLAINT

H-07-1408

Plaintiff, Securities and Exchange Commission ("Commission"), alleges that:

SUMMARY

1. From at least 1998 through 2003, Baker Hughes Incorporated ("Baker Hughes" or the "Company"), paid approximately \$5.2 million to agents while knowing that some or all of the money was intended to bribe government officials in Kazakhstan. These commission payments were made to influence acts and decisions by foreign officials in Kazakhstan who were employed by the country's state-owned oil companies to obtain or retain business for Baker Hughes. Baker Hughes lacked sufficient internal controls to prevent or detect such improper payments, and improperly recorded the payments in its books and records.

2. One agent was hired in late September 2000 near the very end of a long competitive tender process for a significant oil services contract for the Karachaganak oil field in Kazakhstan. Baker Hughes retained this agent on the understanding that Kazakhoil, Kazakhstan's national oil company, had demanded that the agent be hired to influence senior-

level employees of Kazakhoil to approve the award of the closed tender to Baker Hughes. The agent was hired even though Baker Hughes did not need any legitimate services from an agent at this late juncture in the tender process as its bid had been submitted approximately seven months prior and it was just then awaiting for the business to be awarded; Baker Hughes already understood it was to be recommended the contract by the tendering group, a consortium of oil companies called Karachaganak Integrated Organization (“KIO”); agents were not legally required for such tenders in Kazakhstan; and Baker Hughes had conducted no due diligence as to the agent’s background, competence or track record. In fact, Baker Hughes failed to conduct any meaningful due diligence on the agent until more than two years after its retention, after approximately \$2.5 million had already been paid to the agent.

3. Baker Hughes retained the agent principally at the urging of Roy Fearnley, a Baker Hughes business executive located in Kazakhstan, who also was Baker Hughes’ primary coordinator for its bid on the Karachaganak tender. Fearnley told his bosses that the “agent for Kazakhoil” told him that unless the agent was retained, Baker Hughes could “say goodbye to this and future business.” Recognizing the urgency of the situation, Fearnley sought and obtained the approvals from senior executives across several operating divisions of Baker Hughes to engage the agent.

4. Baker Hughes was awarded the Karachaganak contract in October 2000, and it generated \$219.9 million in gross revenues from 2001 through 2006. From May 2001 to November 2003, Baker Hughes made twenty-seven commission payments to the agent’s London bank account totaling over \$4.1 million. Of that amount, Baker Hughes paid approximately \$2.3 million on its own behalf with the balance of \$1.8 million paid by Baker Hughes on behalf of its subcontractors. Baker Hughes received no identifiable services from the agent in exchange for such commission payments.

5. Baker Hughes retained a second agent in Kazakhstan in 1998, and made commission payments to the agent from July 1998 to April 1999. A senior official and a Country Manager of a Baker Hughes' wholly-owned operating subsidiary authorized payments to this agent to influence acts and decisions by foreign officials in Kazakhstan for the benefit of Baker Hughes. The commission payments to the agent's company were made at the direction of a high-ranking executive of KazTransOil, Kazakhstan's national oil transportation company, who was therefore in a position to influence or determine the award of a chemical contract obtained by Baker Hughes. Baker Hughes paid agent commissions of nearly \$1.1 million, reflecting a commission of approximately 30% on gross revenues on the contract of more than \$3.2 million. Baker Hughes retained the agent without having conducted any due diligence at all as to its background, competence or track record.

6. Between 1998 and 2005, Baker Hughes also made payments in Kazakhstan and other countries either to agents or to other individuals, including public officials, in circumstances that reflected a failure to implement sufficient internal controls to determine whether the payments were for legitimate services, whether the payments would be shared with government officials, or whether these payments would be accurately recorded in Baker Hughes' books and records. Examples include, but are not limited to, the following: (1) in Angola, from 1998 to 2003, Baker Hughes paid an agent more than \$10.3 million in commissions under circumstances in which the company failed to adequately assure itself that such payments were not being passed on to employees of Sonangol, Angola's state-owned oil company, to obtain or retain business in Angola; Baker Hughes also failed to conduct any meaningful due diligence into the background of this agent; (2) in Nigeria, a Baker Hughes operating subsidiary made a payment to a tax consultant in 2001 under circumstances in which it failed to make an adequate inquiry to determine whether all or a part of such payment was to be funneled to a Nigerian

government official (the payment was also inaccurately recorded in the company's books and records); (3) in Indonesia, between 2000 and 2003, Baker Hughes paid certain freight forwarders to import equipment into Indonesia using a "door-to-door" process under circumstances in which the company failed to adequately assure itself that such payments were not being passed on, in part, to Indonesian customs officials; (4) Baker Hughes authorized payments to a company in Kazakhstan for an option to lease a parcel of land in connection with another oil services contract bid while knowing that a high-ranking executive of the Kazakhstan national oil company had a direct or indirect interest in the company; moreover, the payee company was controlled, directly or indirectly, by the principal of the same agent to which Baker Hughes improperly agreed to make payments back in 2000 for the Karachaganak project; (5) in Nigeria, between at least 2001 and 2005, Baker Hughes authorized payments to certain customs brokers to facilitate the resolution of alleged customs deficiencies under circumstances in which the company failed to adequately assure itself that such payments were not being passed on, in part, to Nigerian customs officials; and (6) from 1998 to 2004, Baker Hughes authorized commission payments of nearly \$5.3 million to another agent (who worked in Kazakhstan, Russia and Uzbekistan) under circumstances in which the company failed to determine whether such payments were, in part, to be funneled to government officials in violation of the FCPA.

7. By making these payments, Baker Hughes violated the Foreign Corrupt Practices Act of 1977 (the "Foreign Corrupt Practices Act" or "FCPA") as incorporated into the federal securities laws as Sections 30A, 13(b)(2)(A), 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act"), and also violated Section 13(b)(5) of the Exchange Act.

8. In addition, by authorizing and directing these payments, Roy Fearnley violated the FCPA as incorporated into the federal securities laws as Sections 30A, and aided and abetted

Baker Hughes' violations of Sections 30A, 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and also violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder,

9. In addition to violating the federal securities laws, certain of this conduct violated a cease-and-desist order against Baker Hughes issued by the Commission on September 12, 2001. The Commission issued the cease-and-desist order after finding that Baker Hughes violated the FCPA's books and records and internal controls provisions in connection with improper payments it made in Indonesia, Brazil and India.

10. Baker Hughes and Roy Fearnley may, unless restrained and enjoined, continue to engage in the acts and practices set forth in this complaint and in acts and practices of similar purport and object.

JURISDICTION AND VENUE

11. This Court has jurisdiction over this action pursuant to Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa].

12. Venue in the Houston Division of the Southern District of Texas is proper pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa].

13. In connection with the conduct described herein, Baker Hughes and Roy Fearnley made use of the mails or the means or instrumentalities of interstate commerce.

DEFENDANTS

14. **Baker Hughes** is a Delaware corporation headquartered in Houston, Texas. Baker Hughes is a global provider of oilfield services and products both in the United States and, during the relevant period, through various operating subsidiaries outside the United States. Baker Hughes' common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

15. **Roy Fearnley** is a British national residing in Kazakhstan. From 1999 to 2003, Fearnley was employed by Baker Hughes as a Business Development Manager in Kazakhstan and later in Russia. As of September 2005, Fearnley was employed as Vice President of Business Development for an oilfield service company based in Kazakhstan with offices in Kazakhstan and the United States.

FACTS

A. Payments with respect to Karachaganak Oil Field, Kazakhstan

Background to the Karachaganak Oil Field Project

16. In November 1997, the Government of the Republic of Kazakhstan and Kazakhstan's then national oil company, Kazakhoil, signed a 40-year Final Production Sharing Agreement with the partners of the Karachaganak Integrated Organization ("KIO"), consisting of Eni-AGIP S.p.A. of Italy, British Gas Exploration and Production Ltd. of the United Kingdom, ChevronTexaco Inc. of the United States and Lukoil Oil Co. of Russia, to develop and operate for world production the Karachaganak oil field near Aksai, Kazakhstan. To assist it in implementing this Production Sharing Agreement, the KIO consortium set out to tender a substantial oil drilling services contract for the Karachaganak oil field to outside vendors. The tender, which offered the potential for hundreds of millions of dollars of revenues to the winning bidder, would be for a variety of bundled services, including project management, oil drilling operations logistics and engineering support, among other services.

17. As Kazakhstan's national oil company, Kazakhoil was responsible for overseeing various oil and gas activities in the country, including the Karachaganak oil field project. KIO sought Kazakhoil's approval at various stages of the tender process, including its approval of KIO's recommendation for the ultimate award. As a reflection of this influence, Baker Hughes

perceived that its fortunes with respect to the KIO tender relied, in large part, on Kazakhoil's favorable recommendation.

18. Prior to the Karachaganak contract, Baker Hughes' Kazakhstan-related revenue was modest, with only approximately \$10 million in revenues from its Baker Atlas, INTEQ and Baker Oil Tools divisions in 1999. By late 1999, Baker Hughes expected revenue for the Karachaganak project alone was approximately \$100 million over three years. By October 2000, when the Karachaganak tender was ultimately awarded to Baker Hughes, expected revenue from the contract was nearly \$200 million. Given the amount of revenue Baker Hughes expected to receive in Kazakhstan at that time, an individual who later became Baker Hughes' Vice President of Marketing and Technology (the "VP of Marketing") stated in November 1999 that winning the Karachaganak project was "crucial for the future health of [Baker Hughes] in Kazakhstan."

The KIO Tender Process

19. In October 1998, Baker Hughes learned about the specifics of KIO's impending tender for the Karachaganak oil drilling services contract, and began coordinating its preparation for the bid. Among other items, Baker Hughes learned that the KIO tender required a company to submit a single integrated bid for all of the requested bundled services. Integrated bids were comparatively rare at Baker Hughes – frequently the Baker Hughes operating divisions prepared their own separate bids for a given contract; in fact, culturally and operationally the divisions frequently acted like stand-alone companies. An early internal Baker Hughes estimate suggested that 85% of the potential revenues and costs of the Karachaganak contract would be shared by three of Baker Hughes' operating divisions — Baker Atlas, Baker Oil Tools and INTEQ. A single integrated bid also had the added complication of requiring Baker Hughes to coordinate

with third-party subcontractors to provide those “gap” services that Baker Hughes could not provide itself.

20. In December 1998, Roy Fearnley, then Baker Hughes’ Business Development Manager for Kazakhstan, was designated “Team Leader” to coordinate Baker Hughes’ Karachaganak tender submission. Fearnley’s strategy from the outset was to garner support from Kazakhoil and its senior-level employees. As part of this strategy, Fearnley and the VP of Marketing met with senior-level employees of Kazakhoil. Later, Fearnley reported to his supervisor that he had made contact with a particular high-ranking executive of Kazakhoil and had discussed a strategy for Baker Hughes’ pre-qualification and tender submission. Baker Hughes and Fearnley understood that this individual, in particular, wielded significant responsibility and decision-making authority over the Karachaganak tender.

21. The KIO consortium’s tendering process began in earnest in late 1999, when Baker Hughes was informed that its pre-qualification was successful, and it received the official tender documents (along with other competing bidders). Baker Hughes then sent a tender team consisting of Fearnley and representatives from the various operating divisions to Holland to concentrate on putting together the draft tender submission.

22. On or around February of 2000, the tender team presented the draft tender at a meeting in London that was attended by hemisphere vice presidents of three of Baker Hughes’ operating divisions. Among the topics discussed was the fact that Baker Hughes’ draft bid had very thin expected profit margins — around 5-6% — relative to the double digit margins typically expected of such projects. By the end of February 2000, more than a year after it began coordinating the effort, Baker Hughes submitted its integrated bid to the KIO for the Karachaganak oil field drilling services contract. Baker Hughes’ bid, when submitted, did not

contain a provision for the retention of an agent and an agent was not foreseen as necessary to obtain the work.

23. Because it was a “closed” tender, meaning the competing parties submitted blind bids for the tender, after Baker Hughes submitted its bid to the KIO consortium pricing negotiations on the submitted bids generally came to a halt. By late August 2000, other than providing “clarifications” to the KIO about its tender bid, or technical or legal responses to the terms of its bid, and discussions of whether to extend the terms of its bid for three additional years, Baker Hughes essentially had finished substantive negotiating with the KIO over its bid to win the Karachaganak contract. On September 12, 2000, Fearnley told his senior supervisor residing in Houston, Texas, the VP of Marketing, that though they had no “official” news, he had heard unofficially that Baker Hughes had won the Karachaganak tender and that they should know definitively within the week.

Baker Hughes Approached by “Kazakhoil . . . [T]hrough an [A]gent”

The Request for a Commission

24. By September 14, 2000, the VP of Marketing had received a phone call from a senior level employee of Baker Hughes’ Western Geophysical division who informed him that Kazakhoil requested that Baker Hughes hire an agent in connection with the Karachaganak tender. On September 14, 2000, the VP of Marketing e-mailed Fearnley about his call from the Western Geophysical employee, stating that “I have heard rumours (from [Western] Geo[physical]) that the Kazakhs are looking for an agency agreement. I hope not at this late stage.” Fearnley confirmed the rumor in a reply e-mail that day, later telling the VP of Marketing and Baker Hughes’ Vice President of Sales (“VP of Sales”) in a follow-up e-mail that “[a]s you know from W[estern]G[eophysical] Kazakhoil approached me through an agent in London stating that to get Kazakhoil approval a 3% commission is required.” Fearnley went on

to explain that the commission had been demanded despite his understanding that the KIO tender representatives already had recommended that Baker Hughes win the tender and were awaiting approval from their respective companies and Kazakhoil. Fearnley then added, “if one our (sic) competitors comes in with a pot of gold, it is not going to be our contract.”

25. Fearnley, with approval from the VP of Marketing, determined that the best course of action was to respond by refusing the demand to hire the agent on the Karachaganak project, but offering to retain the same agent for future work in the region. This approach was consistent with the fact that the agent had performed no identifiable services for Baker Hughes with respect to Karachaganak to deserve a commission, and also, as Fearnley stated by e-mail, would “keep[] [Baker Hughes] clear of any criticism (sic) for this KIO contract.” After soliciting and receiving support from the eastern hemisphere vice presidents for the three divisions involved in the tender — Baker Atlas, Baker Oil Tools and INTEQ — Fearnley met with the agent to discuss the counteroffer.

26. By Sunday, September 24, 2000, the agent had not only rejected Baker Hughes’ counterproposal for commissions based only on future business acquired, but had increased the pressure on Baker Hughes to pay a commission for Karachaganak. Fearnley explained to the VP of Sales, who was his immediate supervisor residing in Houston, Texas, and to the VP of Marketing that the “agent for Kazakhoil” was demanding that “unless we pay a commission relative to the KIO contract we can say goodbye to this and future business.” Fearnley also indicated that a decision was needed quickly, noting that Kazakhoil was expected to make a recommendation to the KIO tender team as to Baker Hughes’ bid the coming Tuesday, September 26, 2000, at a meeting in Kazakhstan and “unless we do this the recommendation for BH will be fought hard by Kazakhoil.” Fearnley went on to explain to the VP of Sales and to the

VP for Marketing that he now understood that a discounted 2% commission would “seal this support” for Baker Hughes’ bid.

Baker Hughes Hires the Agent

27. Almost immediately, Fearnley and the VP of Sales began to canvass the division Vice Presidents for their support for the 2% commission. By the following morning, Monday, September 25, 2000, Fearnley and the VP of Sales had secured approvals from senior officials of Baker Atlas and Baker Oil Tools, and soon thereafter had approval from INTEQ as well. Because any agent commission payments would also have a financial impact on expected revenues to the subcontractors who were associated with Baker Hughes’ bid (because the commission payments would be deducted from revenue due to the subcontractors), Fearnley also scrambled to get their approvals to the commission payments. One of the subcontractors gently pushed back on the necessity for the commission before agreeing to go forward: “As I am sure you will agree being held to ransom at this late date is not palatable. . . . Our response to the question is do we have any option?” Fearnley responded to the subcontractor that even though it was “distasteful,” it was necessary.

28. In the meantime, Fearnley was also attempting to formalize the agency relationship with the agent, a company based in the Isle of Man led by an individual citizen and resident in the United Kingdom. On that Sunday and Monday, September 24 and 25, 2000, Fearnley sent drafts to the agent’s principal of a one-page side letter reflecting Baker Hughes’ agreement to pay a 2% commission for the Karachaganak project based on the project’s revenues and a separate sales representation agreement that would appoint it as Baker Hughes’ agent for future services in Kazakhstan (excluding Karachaganak and certain other projects) at a commission of 3% of such services awarded. Fearnley’s cover e-mail to the agent’s principal attaching the side letter also referred to the link between the commission payment and approval