Bloomberg BNA

Securities Regulation & Law Report™

DISCLOSURE

Compliance Issues with the New SEC Reporting and Disclosure Requirements Under the Iran Threat Reduction and Syria Human Rights Act of 2012



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In August 2012, the Iran Threat Reduction and Syria Human Rights Act of 2012 (''ITRSHRA'') was passed to expand U.S. sanctions against Iran and Syria. ITRSHRA includes a new disclosure requirement for public companies subject to Section 13(a) of the Securities and Exchange Act of 1934, as amended (''Exchange Act'').[1] The new disclosure requirement is in ITRSHRA Section 219, which amends Section 13 of the Exchange Act by adding subsection (r). New subsection 13(r) provides that each issuer required to file an annual or quarterly report pursuant to Section 13(a) of the Exchange Act shall disclose if, during the period covered by the report, the issuer or any affiliate of the issuer knowingly engaged in any of the following:

(i) providing support for Iran's ability to develop petroleum resources or produce or export refined petroleum products, as described in Section 5, subsections (a) and (b) of the Iran Sanctions Act of 1996 (''ISA'');

(ii) facilitating a significant transaction with, or providing significant financial services for, the Iranian Revolutionary Guard Corps (''IRGC''), Iran's weapons of mass destruction activities, or Iran's support for terrorism or human rights abuses, as described in sections 104(c)(2), 104 (d)(1) and 105A(b)(2) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, as amended (''CISADA''); or

(iii) conducting any transaction or dealing (a) with any person whose property is blocked pursuant to Executive Order No. 13224 relating to blocking property and prohibiting transactions with persons who commit, threaten to commit, or support terrorism, (b) with any person whose property is blocked pursuant to Execu-

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[1] H.R. 1905, Sec. 219, Pub. Law. 112-158, 126 stat. 1214, effective August 10, 2012, and 15 U.S.C. § 78m(r).

 ISSN 0037-0665

tive Order No. 13382 relating to blocking of property of weapons of mass destruction proliferators and its supporters, or (c) with any person or entity meeting the definition of the Government of Iran under 31 C.F.R. Section 560.304 without the specific authorization of a federal department or agency.[2] The ''specific authorization'' exception appears only at the end of the last subparagraph referring to Iranian Government entities, and in guidance published on December 4, 2012 the SEC referred to this exception in a manner that suggests its purpose is limited to that subparagraph.[3] This SEC guidance also indicated, however, that although the statute uses the term ''specific authorization,'' the SEC will construe that term to cover both general and specific licenses issued by the Office of Foreign Assets Control (''OFAC''), provided that all conditions of the applicable license are strictly observed.[4]

The new disclosure requirement extends not only to wholly or majority owned subsidiaries of issuers, but also other entities that meet the rather amorphous Securities and Exchange Commission (''SEC'') concept of ''affiliates'' (see below). It also extends beyond transactions relating to the petroleum industry, conventional or nuclear weapons or human rights abuses. The significant scope of the disclosure requirement can be expected to raise difficult compliance questions for foreign entities in a variety of commercial sectors and in joint venture and investment scenarios that do not involve a majority U.S. interest.

Who Is Subject to the New Disclosure Requirements?

The requirements apply to issuers that are required to file annual or quarterly reports under Section 13(a) of the Exchange Act.[5] This includes foreign companies that file such reports by virtue of issuing securities in the United States.

In addition, any ''affiliate'' of the issuer is also covered by the new disclosure requirement. As Section 219 of ITRSHRA amends Section 13 of the Exchange Act, the applicable definition of affiliate is the definition in the Exchange Act. Rule 12b-2 of the Exchange Act applies to statements and reports filed pursuant to Section 13 of the Exchange Act and provides that an affiliate of, or a person affiliated with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with the person specified.[6] The term ''control'' (including the terms ''controlling,'' ''controlled by'' and ''under common control with'') means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.[7]

Thus, there is no objective test to determine whether an entity is an ''affiliate,'' and practitioners must look to case law as well as historical statements and positions expressed by the SEC and commentators in interpreting the application of these concepts to specific fact patterns. Pursuant to historical ''no-action'' positions published by the SEC and in previous proposed rulemaking, the SEC has stated that it is the existence of power, rather than the exercise of the power, that is determinative, and that control can arise from a combination of factors, with the relative weight to be accorded such factors varying from case to case depending upon the particular circumstances, the persons having interest and the existence of special relationships among the relevant parties. Such factors can include, among others, greater than 10% ownership in the issuer's stock, issuer board representation and participation in management, contractual agreements where control over an issuer may be attained or relinquished, and material business relationships with the issuer. This list is not exhaustive. In sum, the determination of ''affiliate'' status under the Exchange Act is a factual question requiring an analysis of all relevant circumstances and relationships on a case-by-case basis.

Section 218 of ITRSHRA, by contrast, prohibits Iranian transactions by foreign ''subsidiaries'' of U.S. parent companies, and for this purpose the ''subsidiary'' definition requires over 50% equity ownership, a majority of the directors, or other control of the entity. Given the express majority ownership and board criteria in Section 218, that definition is unlikely to be construed to reach foreign entities with a minority U.S. investment in the absence of special U.S. control provisions. Section 219 can be expected, therefore, to reach a broader range of foreign entities, and because it applies to issuers, it will even reach foreign entities that issue securities in the United States as well as their affiliates anywhere in the world.

What Activities Require Disclosure?

If an issuer and/or affiliate ''knowingly'' engages in any of the activities listed below during the period covered by the issuer's annual or quarterly report, such activity must be disclosed in the report. For purposes of determining the application of the new disclosure requirement, Section 14 of ISA[8] provides that ''[t]he term 'knowingly' with respect to conduct, circumstance, or a result, means that a person has actual knowledge, or

[2] *Id.* The term *Government of Iran* includes: (a) The state and the Government of Iran, as well as any political subdivision, agency, or instrumentality thereof; (b) Any entity owned or controlled directly or indirectly by the foregoing; (c) Any person to the extent that such person is, or has been, or to the extent that there is reasonable cause to believe that such person is, or has been, since the applicable effective date, acting or purporting to act directly or indirectly on behalf of any of the foregoing; and (d) Any person or entity designated by the Secretary of the Treasury as included within paragraphs (a) through (c) of this section. 31 C.F.R. § 560.304.

[3] *See* Answer to Question 147.06 at http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm.

[4] *Id.*

[5] H.R. 1905, Sec. 219, Pub. Law. 112-158, 126 stat. 1214, effective August 10, 2012, and 15 U.S.C. § 78m(r).

[6] 17 C.F.R. § 240.12b-2. In guidance published on December 4, 2012, the SEC confirmed that this definition applies to disclosures under ITRSHRA Section 219. See Answer to Question 147.03 at http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm.

[7] *Id.*

[8] *See* H.R. 1905, Sec. 219, Pub. Law. 112-158, 126 stat. 1214, effective August 10, 2012, and 15 U.S.C. § 78m(r).

   ISSN 0037-0665

should have known, of the conduct, the circumstance or the result.''[9]

Activities covered by ISA:

(1) The activities covered by Section 5(a) of ISA relating to the energy sector in Iran and which include, in brief summary, the following, subject to very limited exceptions[10]:

■ Development of petroleum resources of Iran through investment by the issuer or its affiliate of $20 million or more, or a combination of investments in a 12-month period equal to at least $5 million each and $20 million or more in the aggregate;

■ Production of refined petroleum products or support for the development of petroleum resources and refined petroleum products in Iran through sale, lease or provision to Iran of goods, services, technology, information or support by the issuer or its affiliate, any of which has a fair market value of $1 million or more, or which during a 12-month period have an aggregate fair market value of $5 million or more;

■ Exportation of refined petroleum products to Iran through the sale or provision by an issuer or its affiliate of refined petroleum products that have a fair market value of $1 million or more, or which during a 12-month period have an aggregate fair market value of $5 million or more;

■ Joint ventures with Iran relating to developing petroleum resources if the joint venture is established on or after January 1, 2002 and the Government of Iran is a substantial partner or investor in the joint venture, or Iran could, through direct operational control in the joint venture or by other means, receive technological knowledge or equipment not previously available to Iran that could directly and significantly contribute to the enhancement of Iran's ability to develop petroleum resources in Iran;

■ Sale, lease or provision to Iran of goods, services, technology, information or support by the issuer or its affiliate, any of which has a fair market value of $250,000 or more, or which during a 12-month period have an aggregate fair market value of $1 million or more that could directly and significantly contribute to the maintenance or enhancement of Iran's ability to develop or refine petroleum resources;

■ Ownership, operation, control or insurance of a vessel used after November 8, 2012 to transport crude oil from Iran to another country; or

■ Ownership, operation or control of a vessel that after November 8, 2012 suspends satellite tracking or conceals its ownership, operation or control by the Government of Iran, the National Iranian Tanker Company, the Islamic Republic of Iran Shipping Lines or an entity owned or controlled by one of the foregoing.[11]

(2) The activities covered by Section 5(b) of ISA relate to the development of weapons of mass destruction or other military capabilities, including, in brief summary, the following, subject again to very limited exceptions[12]:

■ Exporting or transferring to Iran, or permitting or facilitating a transfer to a person with knowledge or reason to know that an export, transfer or transshipment to Iran will likely result, of any goods, services, technology or other items that would contribute materially to the ability of Iran to acquire or develop chemical, biological, or nuclear weapons or related technologies, or acquire or develop destabilizing numbers and types of advanced conventional weapons;[13]

■ Joint ventures relating to the mining, production or transportation of uranium if the joint venture was established on or after February 2, 2012 with (i) the Government of Iran, (ii) an entity incorporated in Iran or subject to the jurisdiction of the Government of Iran, or (iii) a person acting on behalf of or at the direction of, or owned or controlled by, the Government of Iran, an entity incorporated in Iran or an entity subject to the jurisdiction of the Government of Iran;[14] or

■ Transfers of uranium or nuclear technology to Iran.[15]

Activities governed by CISADA:

(3) The activities covered by Section 104(c)(2) of CISADA, including, in brief summary, the following activities by foreign financial institutions:

■ Facilitating the efforts of the Government of Iran (including the IRGC or any of its agents or affiliates) (i) to acquire or develop weapons of mass destruction or delivery systems for weapons of mass destruction or (ii) to provide support for designated foreign terrorist organizations or acts of international terrorism;

■ Facilitating the activities of a person subject to financial sanctions pursuant to certain United Nations Security Council Resolutions relating to sanctions on Iran;

■ Engaging in money laundering or facilitating efforts by the Central Bank of Iran or any other Iranian financial institutions to carry out any of the activities in the foregoing two bullet points; or

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[9] Pub. Law. 104-172, as amended through Pub. Law. 112-158, enacted August 10, 2012.

[10] For example, underwriters and insurance providers are excepted if the President determines that the person has exercised due diligence in establishing and enforcing official policies, procedures, and controls to ensure that the person does not underwrite or enter into a contract to provide insurance or reinsurance for the sale, lease, or provision of goods, services, technology, information or support that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. *See* Pub. Law. 104-172, as amended through Pub. Law. 112-158, enacted August 10, 2012.

[11] Pub. Law. 104-172, as amended through Pub. Law. 112-158, enacted August 10, 2012.

[12] Note that sanctions shall not apply if participation in the joint venture was before date of the enactment of ITRSHRA on August 10, 2012 and such participation is terminated no later than 180 days after the enactment of ITRSHRA, which is February 6, 2013. Pub. Law 104-172, as amended through Pub. Law 112-158, § 5(b)(2)(B), enacted August 10, 2012.

[13] Pub. Law 104-172, as amended through Pub. Law 112-158, § 5(b)(1), enacted August 10, 2012.

[14] Pub. Law 104-172, as amended through Pub. Law 112-158, § 5(b)(2), enacted August 10, 2012. For this purpose, an entity ''subject to the jurisdiction of the Government of Iran'' includes entities in third countries that are owned or controlled by Iranian entities or individuals.

[15] Pub. Law 104-172, as amended through Pub. Law 112-158, § 5(b)(3), enacted August 10, 2012.

■ Facilitating a significant transaction or transactions with, or providing significant financial services to, the IRGC or any of its agents or affiliates whose property or interests in property are blocked pursuant to the International Emergency Economic Powers Act, 50 U.S.C. Sections 1701-1706 (''IEEPA''), or a financial institution whose property or interests in property are blocked in connection with Iran's proliferation of weapons of mass destruction or delivery systems for weapons of mass destruction or Iran's support for international terrorism.[16]

(4) The activities covered by Section 104(d)(1) of CISADA, which are transactions by any person owned or controlled by a U.S. financial institution that are with, or that benefit, the IRGC or any of its agents or affiliates whose property or interests are blocked pursuant to the IEEPA.[17]

(5) The activities covered by Section 105A(b)(2) of CISADA, which include, in brief summary, the following:

■ Transferring or facilitating the transfer to Iran, or any entity organized under the laws of Iran or otherwise subject to the jurisdiction of the Government of Iran, or any national of Iran, for use in or with respect to Iran, of

—firearms, ammunition, rubber bullets, police batons, pepper or chemical sprays, stun grenades, electroshock weapons, tear gas, water cannons, surveillance technology, or other goods and technologies that the President determines are likely to be used to commit serious human rights abuses against the people of Iran; or

—''sensitive technology,'' defined as hardware, software, telecommunications equipment, or any other technology that the President determines is to be used specifically to restrict the free flow of unbiased information in Iran; or to disrupt, monitor, or otherwise restrict speech of the people of Iran; or

■ Providing services with respect to the above items.

Activities covered by certain Executive Orders

(6) Any transaction or dealing with any person the property and interests in property of which are blocked pursuant to Executive Order No. 13224, relating to blocking property and prohibiting transactions with persons who commit, threaten to commit, or support terrorism.[18]

(7) Any transaction or dealing with any person the property and interests in property of which are blocked pursuant to Executive Order No. 13382, relating to blocking of property of weapons of mass destruction proliferators and their supporters.[19]

Activities with the Iranian Government and its agents and entities

(8) In the absence of ''specific authorization'' by a federal agency, any transaction or dealing with a party covered by the definition in Section 560.304 of Title 31, Code of Federal Regulations, which includes the Government of Iran, any political subdivision, agency, or instrumentality thereof, any entity owned or controlled directly or indirectly by the foregoing, and any person that one has reasonable cause to believe acts or purports to act directly or indirectly on behalf of any of the foregoing, including any parties listed as such by the OFAC on its list of Specially Designated Nationals (''SDNs'').[20]

What Information Is Required to Be Disclosed?

If an issuer or an affiliate of the issuer has engaged in any activity described above, a detailed description of each such activity shall be included in the applicable annual or quarterly report, including:

■ the nature and extent of the activity;

■ the gross revenues and net profits, if any, attributable to the activity; and

■ whether the issuer or the affiliate of the issuer (as the case may be) intends to continue the activity.[21]

Where Is the Information to Be Disclosed?

If the issuer or its affiliates engaged in any of the activities required to be disclosed, the issuer shall report the information required relating to the subject activity in its annual or quarterly reports covering the period when the activity took place.[22] In addition, concurrently with the filing of the applicable annual or quarterly report, the issuer shall separately file with the SEC a notice that the disclosure of the activity has been included in its annual or quarterly report.[23]

When Is the Issuer Required to Comply With ITRSHRA's New Disclosure Requirements?

Issuers must comply commencing with quarterly and annual reports required to be filed after February 6, 2013.[24] In its guidance published on December 4, 2012, the SEC has confirmed that the disclosure requirement applies to a report filed on or before February 6, 2013, as long as the due date for the report under SEC rules is after February 6, 2013.[25] Issuers, therefore, cannot avoid the disclosure requirement for the 2012 reporting year by filing early. In the same guidance, the SEC confirmed that disclosure is required for activities that occurred anytime during the period covered by the report, even if those activities occurred prior to the effective date of ITRSHRA.[26]

What Happens After the Issuer Discloses to the SEC?

Upon receipt of the notice of disclosure from the issuer, the SEC shall promptly transmit the report to the President, the Committee on Foreign Affairs and the

[16] Pub. Law 111-195, July 1, 2010.
[17] *Id.*
[18] *See* H.R. 1905, Sec. 219, Pub. Law 112-158, 126 stat. 1214, effective August 10, 2012, and 15 U.S.C. § 78m(r).
[19] *Id.*
[20] *See* note 2.
[21] *See* H.R. 1905, Sec. 219, Pub. Law 112-158, 126 stat. 1214, effective August 10, 2012, and 15 U.S.C. § 78m(r).
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *See* Answer to Question 147.01 at http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm.
[26] *Id.* Answer to Question 147.02.

  SRLR ISSN 0037-0665

Committee on Financial Services of the House of Representatives, and the Committee on Foreign Relations and the Committee on Banking, Housing, and Urban Affairs of the Senate.[27] The SEC shall also make the information disclosed by the issuer and the notice received from the issuer publicly available by posting the information on the SEC's website.[28]

Upon receipt of the report from the SEC (other than a disclosure of an activity with the Government of Iran), the President shall initiate an investigation into the possible imposition of sanctions under ISA, Sections 104 or 105A of CISADA, under the two aforementioned Executive Orders, or any other provision of law relating to the imposition of sanctions with respect to Iran.[29] The President shall, not later than 180 days after initiating such investigation, make a determination with respect to whether sanctions should be imposed on the issuer or the issuer's affiliate.[30]

Compliance Considerations

Given the range of industries and entities covered by the various statutory and regulatory provisions summarized above, reporting issues under new Section 219 are likely to arise for the following:

■ *Foreign issuers* that to date have continued conducting foreign business with Iran because OFAC's prohibitions to date have been based upon *incorporation* in the United States (extended only recently by ITRSHRA Section 218 to U.S. parents' foreign subsidiaries) not status as an *issuer*;

■ Issuers (U.S. or foreign) whose foreign subsidiaries have *previously* conducted business with Iran and continued to do so during 2012 prior to the effective date of the Section 218 prohibitions (those historical activities may be during a fiscal period covered by an annual or quarterly report required to be filed after February 6, 2013); and

■ Issuers and their affiliates in one of the above categories whose business with Iran has involved a person or entity that is owned or controlled by the Iranian government, *even if* it is in a third country and has *no* involvement in the petroleum industry, is *not* connected to the IRGC and is *not* listed as an SDN (these could be commercial entities in such areas as transportation, health care or communications).

It is important, therefore, to recognize that the impact of Section 219 is not limited to the very few issuers whose affiliates may have engaged in activities relating to the Iranian petroleum sector, conventional or nuclear weapons, uranium mining or human rights abuses. Its impact extends to a much broader range of industries because of the breadth of the definition of Government of Iran found in 31 C.F.R. Section 560.304.

Issuers should, of course, approach compliance with the new disclosure requirement not only from an SEC disclosure perspective but with the understanding that such disclosure requires thorough investigation of all the activities of an issuer and its affiliates under the ITRSHRA, ISA, CISADA, OFAC regulations and the applicable Executive Orders.

A further area of interpretation raised by Section 219 is the concept of ''specific authorization.'' Although the SEC guidance published on December 4, 2012 confirms that this includes both general and specific OFAC licenses, it still leaves open the question whether the exemptions set forth in 31 C.F.R. section 560.210 constitute ''specific authorization.'' Although these exemptions are quite limited in scope, they are important to the specific industries they affect. There is no reason in principle to treat such exempt transactions differently than transactions authorized by a general OFAC license, and one hopes that the SEC will confirm this in subsequent guidance.

[27] *Id.*
[28] *Id.*
[29] *Id.*
[30] *Id.*