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What's Going On – Over a Month of Section 219 Disclosures Under the Iran Threat Reduction and Syria Human Rights Act of 2012

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Section 219 (codified as Section 13(r) of the Securities Exchange Act) has been in effect for six weeks. During this time, more than 100 SEC-registered reporting issuers have made required disclosures regarding their Iran or SDN-related activity. Collectively, these disclosures highlight several issues confronting this new reporting requirement. More importantly, these disclosures make it clear that further guidance regarding the Section 219's disclosure procedure would be most beneficial.

Noteworthy Trends

- Activities of foreign subsidiaries of US companies have dominated the disclosures.
- Reporting issuers have taken a broad view of affiliates in their disclosures.
- Most of the activities disclosed under Section 219 to date were not sanctionable at the time the activity was conducted.
- Issuers recognize that there is no *de minimus* value threshold for reporting under Section 219.

Section 219 Recap

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 requires SEC-registered issuers to disclose in their periodic reports filed under Section 13 of the Securities Exchange Act of 1934, among other things, any "transaction or dealing" by the issuer or its affiliates with: (i) the "Government of Iran" as defined by the United States Department of the Treasury's Office of Foreign Assets Control; (ii) persons or entities designated by OFAC for supporting global terrorism; or (iii) persons or entities designated by OFAC for

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supporting weapons of mass destruction proliferation activities.[1] Moving past merely charting the disclosures to date, in this publication we take a closer look at the collective body of Section 219 disclosures as of Friday, March 15, 2013, and discuss implications going forward for the key Section 219 stakeholders, including issuers, their counsel, investors, OFAC, and the SEC.

Iran-Related Activities of Foreign Subsidiaries of US Companies Dominate the Disclosures

Thus far the majority of disclosures have concerned US companies with non-US subsidiaries or affiliates that conducted some transaction or dealing with Iran or an SDN during the reporting period.[2] Although much attention has been given to Section 219, the impact of Section 218 of the Threat Reduction Act has played a prominent role in disclosures to date. Section 218 imposes civil penalties on US parents if their foreign subsidiaries knowingly engage in any transactions with the Government of Iran, or any person subject to its jurisdiction, that would be prohibited if engaged in by a US person. Section 218 became effective on October 10, 2012. It effectively tightened the sanctions by prohibiting foreign subsidiaries of US companies from engaging in almost all transactions with (and within) Iran. SEC-registered issuers, however, could avoid liability if they divested from or terminated their business with the Iran-related entity before February 6, 2013 or disclosed that they were winding down all such activity prior to March 8, 2013. As a result, not only are reporting companies disclosing broadly, as discussed below, but the majority of these disclosures indicate that their foreign affiliates have already ceased or are in the process of ceasing their business activities in Iran. So while the effect of Section 219 in *uncovering* Iran-related activity by SEC-registered issuers remains an open question, it appears that Section 218 has already had a measurable impact on the cessation of Iran-related activities of foreign subsidiaries of US companies.

[1] For additional information on Section 219's disclosure requirements, see our Client Publications, "Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 – Additional Reporting Requirements for US Domestic and Foreign Issuers Registered with the SEC" (November 8, 2012) (which can be found here), "SEC Releases CD&Is for Iran Sanctions Disclosures Required Under Exchange Act Section 13(r)" (December 6, 2012) (which can be found here), and "Flash Report: Section 219 Disclosures Under the Iran Threat Reduction and Syria Human Rights Act of 2012" (February 14, 2013) (which can be found here).

[2] Of course this trend may be due to the timing of when non-US companies' 20-Fs are required to be filed. There will likely be more disclosures by non-US companies when more Form 20-Fs become due.

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The Requirement to Report Activities of Affiliates Permeate the Disclosures

Section 219 requires that disclosures be made of activities conducted by the issuer or any affiliate of the issuer. The SEC staff, in guidance published on December 4, 2012, suggested that the term "affiliate" in Section 219 is the same as defined in Exchange Act Rule 12b-2. Rule 12b-2 states that "[a]n '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." [3] In light of this broad interpretation, reporting issuers appear to have searched far and wide for activities that could potentially be subject to disclosure under Section 219.

Several issuers required to make disclosures under Section 219 commented on the breadth of the reporting requirement in light of the SEC's broad interpretation of "affiliate" in Section 219. For example, Fidelity National Information Services, Inc. (a US company) disclosed activities of an affiliate because, according to Fidelity, "the SEC defines the term 'affiliate' broadly, it includes any entity controlled by us as well as any person or entity that controlled us or is under common control with us." In its disclosure, Fidelity made it clear that neither it nor any of its controlled affiliates or subsidiaries engaged in any of the specified activities. Nonetheless, Fidelity disclosed the activities of Bausch & Lomb. Fidelity described its relationship to Bausch & Lomb as being quite attenuated: "During 2012, Warburg Pincus LLC, a private equity firm, was potentially an upstream affiliate of ours as so defined, as a result of the share ownership of WPM, LP (which owned 14.2% of our outstanding stock as of February 27, 2012, but only owns 6.5% as of the date of this report) and its right to designate a single director to our eight person board of directors." Warburg informed Fidelity that Bausch & Lomb, a private company controlled by Warburg, had conducted business in Iran. Fidelity noted that it had "no involvement in or connection with the activities of Bausch

[3] Under the rule, 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 direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." Exchange Act Rule 12b-2.

& Lomb or any of its subsidiaries and received no revenue from them and did not independently verify or participate in the disclosure."[4]

Warburg was not the only private equity firm to provide a "link" causing disclosures by issuers of activities wholly unrelated to the issuer's business. There were multiple others, such as LyondellBasell Industries NV and Blackstone Group LP. For example, Blackstone reported in its Form 10-K filed March 1, 2013 that TRW Automotive Holdings Corp. and Travelport Limited, which, according to Blackstone, "may be considered" Blackstone's affiliates, had made disclosures under Section 219, which Blackstone in turn reported. Blackstone expressly noted that it did not independently verify nor did it participate in the preparation of TRW's or Travelport's disclosures. Subsequently, several affiliates of Blackstone made the same disclosure, including Cheniere Energy Partners, L.P. (and its SEC-registered affiliate Cheniere Energy Inc.), DJO Finance LLC, Orbitz Worldwide, Inc., Freescale Semiconductor, Ltd., Michaels Stores Inc., and others. It seems unlikely that Congress intended for multiple issuers to report identical activity by virtue of an "affiliation" with the same private equity group, especially where the SEC-registered issuer making the disclosure expressly states that it has no control over a private affiliate of the disclosing party's private affiliate.

Disclosing Non-Sanctionable Pre-Acquisition Activities

Not only are SEC-registered reporting issuers going through great measures to apply the broad interpretation of affiliates, some of these issuers are also electing to report on non-sanctionable pre-acquisition activity engaged in by entities acquired during the reporting period. Thus, they are continuing the general theme of expansive reporting. For example, the below issuers disclosed the following:

- Terex Corp (a US company) disclosed in its Form 10-K filed on February 28, 2013, that it acquired a majority interest in Demag Cranes AG on August 16, 2011, but did not obtain management control over Demag Cranes AG and its subsidiaries until April 18, 2012. Subsequent to obtaining management control over Demag and its subsidiaries, Terex was able to implement its internal policy on sales into Iran on June 4, 2012. However, between January 1, 2012, and June 4, 2012, certain subsidiaries of Demag Cranes AG exported certain products into Iran.
- Ecolab Inc. (a US company) disclosed in its Form 10-K filed on February 26, 2013, that it acquired Nalco, which at the time of the acquisition had foreign subsidiaries that engaged in sales in Iran. Shortly following the closing of the Nalco acquisition, Ecolab instructed all Nalco subsidiaries to cease all activities in sanctioned countries by March 31, 2012, and, consistent with Ecolab's directive and policy, Nalco's sales in Iran ceased, and all in-country activity was terminated. The company, however, conducted limited activities in Iran within the context of winding down Nalco's Iranian business.

[4] Interestingly, Bausch & Lomb's disclosure related to the provision of "sightsaving products to surgeons and patients in Iran, and to improve the eye healthcare of the Iranian people." Bausch & Lomb then stated that it and its affiliates "plan to continue their existing activities and operations in Iran." This disclosure concluded by noting that "all of this business (including business conducted by non-US companies) is conducted pursuant to licenses issued by OFAC."

In fact, some SEC-registered issuers are even disclosing activity that happened *prior to* the reporting period, such as:

- CH2M Hill Companies LTD (a US company) disclosed in its Form 10-K filed on March 1, 2013, that back in November 2011, it acquired Halcrow, a UK engineering consulting company that provides services to clients worldwide and had a small presence in Iran. As a condition of the acquisition, the UK affiliate was required to terminate all activities in Iran, and the company undertook expedient steps to withdraw all operational activities in Iran, *including abandoning certain assets*. In doing so, it was able to complete the wind down within the context of US and EU sanctions governing restrictions on activities in Iran. It also stated that the acquired company has no intentions to resume its activities in Iran. Interestingly, although CHEM Hill Companies LTD did file an Iran Notice with the SEC, its disclosure makes no reference to the Iran Threat Reduction Act, Section 219, or 13(r) of the Exchange Act. Indeed, the disclosure itself does not conform to the basic reporting requirements of the Section 219 but rather appears to be a general disclosure of the company's activities in Iran.
- Santander Holdings USA (a US company) disclosed in its Form 10-K filed on March 15, 2013, that it did not have any activities, transactions, or dealings with Iran requiring disclosure but that it has certain legacy export credits and performance guarantees with Bank Sepah (entered into in May 1996) and Bank Mellat (entered into in February 2000) both of which are listed on OFAC's list of specially designated persons. Santander also noted that both banks have been in default under their respective agreements for the last few years.

Transactions Involving Humanitarian Trade with the Iranian Ministry of Health or Its Affiliates

The most notable exception to the great exodus of SEC-registered reporting issuers from Iran relates to businesses involved in humanitarian trade with Iran. Companies engaged in humanitarian trade routinely expressly stated their intentions to continue their business dealings with Iran. For example, Sanofi, Novartis, and Novo Nordisk A/S clearly and expressly state their strong intentions to continue their business with Iran. Indeed, Novo Nordisk states that: "The purpose of Novo Nordisk's Iran-related activities is to provide access to important and life-saving pharmaceutical products such as insulin and haemophilia products to patients in Iran, and to improve the healthcare of the Iranian people in accordance with a key component of Novo Nordisk's access to care strategy. For that purpose, Novo Nordisk intends to continue these activities." Novartis and Sanofi had similar positions regarding their continued business in Iran.

- Novartis (a non-US company) disclosed that during 2012, non-US affiliates within its Vaccines and Diagnostics Division sold influenza vaccines and rabies vaccines to Medical Equipment and Pharmaceutical Holding Co. of Iran, which it understands is an affiliate of the Iranian Ministry of Health. Gross sales of these influenza and rabies vaccines during 2012 were €185,000 and €1,362,500, respectively, with net profits from such sales being €43,300 and €397,501, respectively. Novartis also stated that it expects to continue to make sales of vaccines to this customer during 2013.
- Sanofi (a non-US company) disclosed that it conducts limited business relating to human and animal health products with Iran contributing well under 1% of the Group's consolidated net profit. It further disclosed that these sales consisted of bulk and branded pharmaceuticals, vaccines, and animal health supplies and that its US affiliates, or foreign affiliates controlled by US affiliates, were either not involved in these activities or operate under humanitarian licenses issued by OFAC. It continued that limited business not exceeding €10.2 million in gross revenues has been conducted by foreign subsidiaries not requiring an OFAC license with entities such as public hospitals or distributors tied to the Ministry of Health or Ministry of Agriculture. Sanofi does not believe that any of its activities are

sanctionable under the Act, and, in light of the nature of the products concerned, Sanofi does not intend to cease its commercial operations in Iran.

Moreover, these non-US companies have generally taken a stronger position regarding their intentions to continue their humanitarian trade in the face of US economic sanctions, whereas US companies appear less certain in their conviction (and ability) to continue providing potentially life-saving drugs to Iranian citizens.[5] For example, a couple of US SEC-registered issuers have suggested in their disclosures that they would continue their sales of medicine in Iran only to the extent that doing so was authorized under economic sanctions laws:

- Jazz Pharmaceuticals (a US company) concluded its Form 10-K filed on February 27, 2013, that its mission is to improve patients' lives by identifying, developing, and commercializing products that address unmet medical needs. As part of fulfilling its mission, Jazz intends to provide access to important and life-saving pharmaceutical products to patients wherever they may be located, including in Iran, to the extent permitted by applicable US and non-US laws and regulations.
- Gilead Sciences Inc. (a US company) noted in its Form 10-K filed on February 27, 2013 that in January 2012, a non-US subsidiary of Gilead based in Greece sponsored an HIV conference in Abu Dhabi, UAE, during which strategies for the treatment and prevention of HIV were discussed. A third-party distributor for Gilead in North Africa and the Middle East, including Iran, invited doctors throughout the region, including four Iranian doctors, at least two of whom appear to have been officials for the Iranian National AIDS Program. Gilead Sciences Europe Limited reimbursed the distributor for the travel-related expenses of the four Iranian doctors to attend the HIV conference. The expenses for all four Iranian doctors totaled $3,330 and covered the cost of visa fees, airline tickets, and transportation. Gilead also noted that it has no current intention to engage in the activities described above in the future, directly or pursuant to any of its non-US subsidiaries. Gilead concluded its disclosure by noting that if at a future time it were to engage in such activities, it would first obtain a license from OFAC or rely on an applicable exemption.

As the legislative record indicates, a notable concern for at least one Senator, Tim Johnson of South Dakota, was the possible chilling effect that these sanctions would have on companies' willingness to engage in humanitarian trade with Iran in the current sanctions environment. Senator Johnson notes that the Iran Threat Reduction Act was not intended to interfere with "humanitarian trade, including agricultural commodities, food, medicine and medical products" as they have "long been specifically exempted by Congress from successive rounds of Iran sanctions." Accordingly, Senator Johnson concluded that: "It is not and has not been the intent of US policy to harm the Iranian people by prohibiting humanitarian trade that is licensed by the US Treasury Department." Although some reporting US-issuers seem uncertain, such activity is permissible under a general license issued by OFAC.

[5] In addition, at least one non-US company, with current activities in Iran and intent to continue those activities appears to have made a disclosure based solely on the payment of Iranian taxes. Unilever disclosed on its 20-F filed on March 8, 2013, that it operates in Iran through a non-US subsidiary and that sales in 2012 were not material; and that it did not sell any products directly to the Government of Iran or any parties affiliated with the Government of Iran. Still, Unilever disclosed that income, payroll and other taxes, duties, and fees (including utilities) were paid to the Government of Iran and affiliated entities in connection with its operations.

Transactions of Small Value Are Being Reported Under Section 219

As we have discussed in our prior publications, Section 219 does not contain a materiality threshold. Accordingly, Section 219 requires that activities be disclosed even if they did not result in any revenues or profits. As such, SEC-registered issuers are reporting activities involving relatively little or no value. Examples of *de minimus* value disclosures include:

- VeriFone Systems Inc. (a US company) disclosed in its Form 10-Q that non-US VeriFone subsidiaries provided technical support services to a third-party distributor based in Dubai, UAE with knowledge that it would be assisting in the reselling of certain VeriFone point of sale terminals in Iran. No fees were charged for the technical support provided nor was any net revenue or profit recognized within the reporting period as the sale was recorded in the previous year.
- Citigroup Inc (a US company) disclosed in its Form 10-K filed on March 1, 2013, that Citibank Venezuela, who lawfully participated in the local government-run clearing and settlement exchange network in Venezuela for transactions involving, among other things, the clearing and settlement of domestic checks, processed a total of four domestic check transactions (approximately $1,000 in the aggregate) involving Bank Internacional de Desarollo, an OFAC SDN Bank. The transactions resulted in no revenues or net income to Citigroup.
- Ingram Micro (a US company) disclosed in its Form 10-K filed on February 27, 2013, that Aptec, a wholly-owned non-US subsidiary, made six sales (consisting of technology products that resulted in $81 revenue and net profits substantially less than that) to a reseller which identified its intended customer as Iranian Hospital located in Dubai.
- Dell Inc. (a US company) disclosed in its Form 10-K filed on March 15, 2013 that an affiliate of Qwest Software, Inc. (an entity Dell acquired on September 27, 2012) conducted maintenance services software renewal transactions with Melli Bank PLC, a wholly-owned subsidiary of an SDN, valued at approximately $169.90 and marketing activity.
- Hyatt Hotels Corp. (a US company) disclosed in its Form 10-K filed on February 13, 2013, that certain individuals stayed at the Park Hyatt Hamburg pursuant to a pre-negotiated standard preferred rate agreement with Europaisch-Iranische Handelsbank AG, an entity included on the SDN List. The aggregate revenue attributed to this activity was approximately $9,000.

What Does It All Mean?

Meaningful guidance is still needed. SEC-registered issuers reporting on their Iran-related or SDN activity have looked far and wide in an effort to meet their obligations under Section 219 and the Exchange Act Section 13(r). They have conducted detailed analysis to: (i) identify their “affiliates” and (ii) search for activities – *any activities* – that might conceivably fall within the requirements of Section 219. As currently drafted and implemented, Section 219’s disclosure requirements can be quite onerous for SEC-registered issuers and require them to pull manpower, finances, resources, and in some cases restructure their entire business model to unearth any Iran-related business dealings, without distinction between whether it is non-sanctionable, licensed, or sanctionable activity.

As concerning is the likely escalating burden that these disclosures are soon to be placing, if not already, on the US government. Section 219 requires that upon receipt of notice, the SEC promptly submit a report to, among others, the President. The President (*i.e.*, OFAC or the State Department via delegation) is then required to initiate an investigation and within 180 days make a determination whether the activity is sanctionable. It is, however, highly doubtful that Congress intended that the limited resources of either OFAC or the State Department be expended to investigate $81 of

sales in the UAE to an Iranian Hospital, $170 of software maintenance services or $9,000 worth of hotel stays in Germany by employees of a designated bank, or the processing of four Venezuelan checks in Venezuela for approximately $1,000 that resulted in zero revenue and net profits.

As such, the SEC, OFAC, or Congress should consider taking measures to address these more problematic trends. It remains to be seen what, if any, guidance *can or will* in fact be given to alleviate the burdens for all parties associated with Section 219 disclosures. It also remains to be seen how these trends will be impacted, if at all, by the filing of Form 20-Fs when they become due. It seems abundantly clear, however, that additional guidance would be useful to assist *all* companies to determine whether they are doing the right kind of diligence on their affiliates and the extent of the diligence needed. Otherwise reporting issuers will likely continue to inundate the SEC with notices and disclosures of non-sanctionable activity that nevertheless require some governmental agency to conduct an investigation. In doing so, the current process may cause the US government to lose sight of clearly sanctionable transactions that the legislation sought to target.

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