SHEARMAN & STERLING LLP

LITIGATION

CLIENT PUBLICATION

November 8, 2012

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

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 mandates additional disclosure requirements for US-registered issuers concerning certain Iran-related activities and, under a plain reading of the statute, certain activities with non-Iran-related persons or entities listed on the US Department of the Treasury's Office of Foreign Assets Control's Specially Designated Nationals and Blocked Persons List (SDNs). In light of these new requirements, US-registered issuers should carefully review their business activities to determine whether such activities are reportable under Section 219 and consider implementing screening procedures to ensure that they are not engaged in reportable activities with SDNs.

Introduction

In the last several years, the US Government has implemented a number of mechanisms to collect information on the business activities of companies – both US and non-US companies – that might be sanctionable under various US sanctions programs. Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 (the "Threat Reduction Act") provides the US Government with another such mechanism, requiring SEC-registered issuers to report to the SEC business activities in several categories – generally relating to Iran's energy and financial sectors and Iran's suppression of human rights, but also relating to transactions with the Government of Iran, global terrorists and weapons proliferators – for further investigation by the US Government. Although most SEC-registered issuers likely already report Iran-related activities in their periodic reports filed with the SEC or have provided detailed information about such activities to the SEC's Office of Global Security Risk (OGSR), Section 219 requires additional information (e.g., gross revenues and net profits attributable to such activity) and covers some activities (e.g., activities with certain SDNs) that might not otherwise be reported under current SEC rules and guidance or through inquiries from OGSR. Accordingly, issuers should conduct a careful review of their business activities to ensure that the reports they file with the SEC meet the requirements of Section 219 of the Threat Reduction Act.

Section 219 is effective 180 days after the enactment of the Threat Reduction Act, or February 6, 2013. Accordingly, annual or quarterly reports filed before February 6, 2013 are not impacted by the reporting requirements of Section 219.

A Broad Range of Activities Are Reportable Under Section 219 of the Threat Reduction Act

Under Section 219, which amends Section 13 of the Securities Exchange Act of 1934 (the Exchange Act), issuers required to file an annual or quarterly report under Section 13 of the Exchange Act must disclose in that report if the issuer or an affiliate of the issuer, during the period covered by the report, engaged in the following:

- *Knowingly engaged in an activity described in Section 5 of the Iran Sanctions of 1996 (as amended) (ISA):*
  - The activities described in Section 5(a) of the ISA generally relate to Iran's energy sector, such as certain investments or the provision of goods, services, technology, or support that could contribute to the development of petroleum and petrochemical resources or the production refined petroleum products in Iran, exportation of refined petroleum products to Iran, or transportation of crude oil from Iran.
  - The activities described in Section 5(b) of the ISA generally relate to Iran's development of weapons of mass destruction or other military capabilities, such as investment in a joint venture with the Government of Iran or an Iranian entity relating to the mining, production, or transportation of uranium, or transactions relating to goods, services, or technology that could enhance Iran's ability to acquire weapons of mass destruction or advanced conventional weapons.
- *Knowingly engaged in an activity described in Section 104(c)(2) or 104(d)(1) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA):* The US Department of the Treasury promulgated the Iranian Financial Sanctions Regulations (31 C.F.R. 561) (IFSR) pursuant CISADA Section 104(c)(2). The IFSR prohibits financial institutions from engaging in activities (including money-laundering) that facilitate the efforts of the Government of Iran to acquire or develop weapons of mass destruction or to support designated global terrorists, or facilitates the activities of a UN-designated person or entity, including the efforts of the Central Bank of Iran or any other Iranian financial institution in support thereof. The facilitation of a significant transaction for or the provision of significant financial services to Iran's Revolutionary Guard Corps or a financial institution designated by the Department of the Treasury's Office of Foreign Assets Control (OFAC) under the IFSR is also prohibited and thus reportable under Section 219.
- *Knowingly engaged in an activity described in Section 105A(b)(2) of CISADA:* CISADA Section 105A(b)(2) generally mandates sanctions against persons or entities who assist the Government of Iran in the suppression of human rights in Iran. Under Section 105A(b)(2), the transfer of goods or technology, or the provision of services, that are likely to be used by the Government of Iran to commit serious human rights abuses against the people of Iran, such as the provision of items to the Government of Iran such as rubber bullets, police batons, pepper or chemical sprays, or surveillance technology, or technology that could be used by the Government of Iran to restrict the free flow of unbiased information in Iran or disrupt, monitor, or otherwise restrict speech of the people of Iran is sanctionable and therefore reportable under Section 219.
- *Knowingly conducted or engaged in a transaction or dealing with:*
  - A person or entity designated as a global terrorist on OFAC's Specially Designated National and Blocked Persons List (the SDN List) pursuant to Executive Order 13224;
  - A person or entity designated as a weapons of mass destruction proliferator on the SDN List pursuant to Executive Order 13382; or
  - The Government of Iran, any political subdivision, agency, or instrumentality thereof, or any person or entity controlled directly or indirectly by the Government of Iran. Only transactions with the Government of Iran that are

conducted "without specific authorization" from a US federal department or agency are reportable under this sub-section.

Section 219 of the Threat Reduction Act Requires Reporting of Specific Information Relating to the Activity

If an issuer engaged in any of the activities described above, Section 219 requires that the following information be reported with respect to such activity in the periodic report filed by the issuer pursuant to Section 13 of the Exchange Act:

- the nature and extent of the activity;
- gross revenues and net profits, if any, attributable to the activity; and
- whether the issuer, or its affiliate, intends to continue the activity.

In addition to reporting such information in an annual or quarterly report, Section 219 mandates that issuers file a separate concurrent notice with the SEC explaining that a disclosure under Section 219 has been included in the annual or quarterly report and including the information described above. Upon receipt of such notice, the SEC is required to alert the US Congress and President of the disclosure. The President shall then initiate an investigation into the activity disclosed in the notice and make a determination as to whether sanctions should be imposed with respect to the issuer (or the issuer's affiliate). The SEC is also required to make the information contained in the notice available to public on its website. To date, the SEC has not issued guidance or rules governing the additional notice requirement.

Considerations for Issuers Reporting Business Activities Under Section 219 of the Threat Reduction Act

Section 219 of the Threat Reduction Act raises several issues that SEC registrants will need to consider before filing periodic reports required under Section 13 of the Exchange Act:

- *Activities of "any affiliate of the issuer" must be reported.* The reporting requirements under Section 219 cover activities of an issuer's affiliates. Although the SEC has not provided guidance on what constitutes an "affiliate of the issuer" in the context of Section 219, it is likely that the definition of "affiliate" in Exchange Act Rule 12b-2 will apply since that rule governs reports filed pursuant to Section 13 of the Exchange Act. 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." Accordingly, issuers will need to evaluate the business activities of affiliates, as broadly defined in Rule 12b-2, and make a determination as to whether such activities are required to be disclosed under Section 219.
- *There is no materiality threshold for reporting under Section 219.* The requirement to report gross revenues and net profits, "if any," suggests that there is no materiality threshold for reporting business activities that meet the criteria of the four categories described above. Therefore, under a plain reading of the statute and absent further guidance from the SEC, any activities that fall within one of the categories described, regardless of scope and breadth, must be reported under Section 219.
- *Activities that have no relation to Iran could be reportable under Section 219.* The requirement to disclose *any* "transaction or dealing" with OFAC-designated global terrorists or weapons proliferators (i.e., SDNs designated under the US Counter Terrorism and Non-proliferation sanctions programs) reaches activities that might be unrelated to Iran. This is because such individuals or entities designated as such could be located anywhere in the world and may have no

connection at all to Iran. Issuers, in particular foreign issuers who may not have previously considered whether they conduct business with SDNs (but rather focused sanction-related disclosures on the countries in which they do business), should consider conducting a more thorough evaluation of business activities to confirm that they do not do business with SDNs designated as global terrorists ([SDGT] designation on the SDN List) or weapons proliferators ([NPWMD designation on the SDN List). To this end, issuers might consider implementing OFAC compliance software to screen counterparties and business partners to ensure that such persons or entities are not on the SDN List.

- *The "Government of Iran" is broadly defined in Section 219.* Section 219 requires disclosure of all transactions or dealings with the Government of Iran as that term is defined in OFAC's Iranian Transactions Regulations, (31 C.F.R. 560) (ITR). As discussed, the definition of "Government of Iran" in the ITR 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 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." In light of this broad definition and the Iranian Government's involvement in many sectors of the Iranian economy, issuers should carefully review business activities in Iran to ensure that Iranian counterparties are not, in fact, controlled by the Government of Iran. If such counterparties are controlled by the Government of Iran, business dealings with those entities are reportable under Section 219.
- *Not all business activities required to be disclosed under Section 219 are sanctionable under current US sanctions programs.* Under a plain reading of Section 219, certain business activities that are reportable under the statute are not necessarily sanctionable under current US sanctions programs, particularly certain activities engaged in by non-US persons, e.g., foreign issuers. Although the US Government has significantly increased extraterritorial sanctions measures with respect to Iran, not all business activities conducted by non-US persons relating to Iran are sanctionable. The extraterritorial sanctions currently in place generally deal with activities relating to Iran's energy and financial sectors. However, under Section 219, a foreign issuer is required to disclose, for example, a contract that it may have with the Government of Iran for the sale of wheat into Iran. Such activity – a contract for the sale of wheat – is not sanctionable under current US programs.
- *SEC-registered issuers should pay attention to "red flags" suggesting that they, or their affiliates, are engaged in reportable activity.* Generally, a person or entity "knowingly" engages in the activities described above if the person or entity knows (i.e., had actual knowledge), or should know, that they are engaged in such conduct. Accordingly, in considering whether certain activities fall within one of the categories described above – e.g., whether a counterparty is controlled by the Government of Iran – SEC-registered issuers should pay attention to red flags or other indicia suggesting that such activities could fall within one of the categories. If red flags are ignored, the US Government would likely take the position that the person or entity should have known the nature of its conduct. We are happy to provide advice in this regard should questions arise concerning specific business activities.
- *Non-registered issuers are not obligated to comply with the disclosure requirements of Section 219.* The disclosure requirements under Section 219 of the Threat Reduction Act are not applicable to non-registered issuers, such as issuers of securities under Securities Act of 1933 Rule 144a. This is because Section 219 amends Section 13 of the Exchange Act and non-registered issuers are not bound by the reporting requirements of Section 13.

Conclusion

In light of the requirements of Section 219, SEC-registered issuers should implement policies and procedures to ensure that business activities worldwide are evaluated for a determination as to whether such activity is reportable. Certain business activities that might not have been reported previously on the basis of materiality or otherwise might now need to be reported under Section 219. Furthermore, activities with SDNs that may not have previously been reported should be carefully evaluated and reported pursuant to Section 219 where appropriate.

As always, you should continue to monitor US foreign policy and follow developments in this area closely. We are happy to advise on any specific questions that you might have in regards to the new reporting requirements discussed herein, or any other sanctions-related issue.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Stephen Fishbein
New York
+1.212.848.4424
sfishbein@shearman.com

Philip Urofsky
Washington, DC
+1.202.508.8060
philip.urofsky@shearman.com

Richard J.B. Price
London
+44.20.7655.5097
rprice@shearman.com

Danforth Newcomb
New York
+1.212.848.4184
dnewcomb@shearman.com

Copyright © 2012 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.