SEC Issues Guidance on Iran-Related Disclosures Required Under Section 13(r) of the Exchange Act

On December 4th, the Securities and Exchange Commission (SEC) updated its Compliance and Disclosure Interpretations (C&DI) to provide additional guidance on issuers' disclosure and other obligations under Section 13(r) of the Securities Exchange Act of 1934, as amended (Exchange Act), concerning certain Iran-related activities. The additional disclosures required by Section 13(r) must be included in periodic reports required to be filed on or after February 6, 2013.

Background

President Obama signed the Iran Threat Reduction and Syria Human Rights Act of 2012 (Act) on August 10, 2012, expanding sanctions against Iran and Syria and the scope of liability for U.S. companies engaging in prohibited conduct, and instituting additional disclosure requirements for companies engaged in, or affiliated with an entity engaged in, activities sanctionable under the Act.

C&DI Guidance on Disclosures Under Section 13(r) of the Exchange Act

Confirmation of Definition of "Affiliate"

- A company subject to Section 219 of the Act must make disclosures about sanctionable activities knowingly conducted by it or any of its "affiliates". For purposes of the Act, the term "knowingly" means that "with respect to conduct, a circumstance or a result, . . . a person has actual knowledge, *or should have known*, of the conduct, the circumstance, or the result".
- The SEC confirmed that "affiliate" for purposes of Section 13(r) of the Exchange Act is defined in Exchange Act Rule 12b-2, which means that it encompasses any "person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the issuer".
- This definition commonly is interpreted to include directors and executive officers, subsidiaries and entities controlled by the issuer, and controlling shareholders, such as private equity firms (and potentially their other portfolio companies), to the extent the shareholder has the power to direct or cause the direction of the management and policies of the issuer as a result of its ownership.

Interpretation of "Specific Authorization"

- A company subject to Section 219 of the Act must make disclosures only if the otherwise reportable activities were not "specifically authorized" by a Federal department or agency.
- The SEC clarified that "specific authorization" comprises both general and specific licenses issued by the U.S. Office of Foreign Assets Control (OFAC).

Guidance Relating to the Timing and Scope of Required Disclosures

The SEC advised that:

- Issuers subject to Section 219 of the Act may not avoid disclosure by filing early reports required to be filed only on or after February 6, 2013.
- Disclosures by issuers subject to Section 219 of the Act must include all activities conducted during the period covered by the relevant report, whether or not certain of the activities occurred prior to enactment of the Act.

- Issuers that have not (together with any such issuer's affiliates) engaged in Iran-related activities subject to disclosure under the Act need not include a representation affirming compliance in their filings.
- The reference in Section 13(r)(1)(D)(iii) to "specific authorization of a Federal department or agency" (relating to an exemption from disclosure of activities with the "Government of Iran") does not permit issuers to omit disclosure of dealings specifically authorized by a foreign governmental authority (but not by any U.S. Federal department or agency).

Who Is Subject to the Heightened Disclosure Requirements?

Any company that files periodic reports under Section 13(a) of the Exchange Act is subject to the additional disclosure requirements imposed by Section 219 of the Act. This includes smaller reporting companies and foreign private issuers (even if a filer's home jurisdiction does not restrict or prohibit such business dealings with Iran). Voluntary filers, and other issuers that do not have securities registered under Section 12 of the Exchange Act (such as most debt-only filers), are not subject to the additional disclosure requirements under the Act. Note, however, that voluntary filers should review the terms of their indentures to ensure compliance with any covenants that may require disclosure.

Scope of Activities Subject to Disclosure

An issuer subject to Section 219 of the Act must disclose the following activities, if knowingly conducted by it or its affiliates during the period covered by the relevant periodic report:

- Transactions with the "Government of Iran" not "specifically authorized" by a U.S. Federal department or agency.
    - "Government of Iran" captures:
        - The state and government of Iran and all political subdivisions, agencies and instrumentalities thereof, entities owned or controlled directly or indirectly by the foregoing, persons acting directly or indirectly for or on behalf of the any of the foregoing and any other person determined by OFAC to fall within the definition of "Government of Iran".
        - Thus, entities organized under the laws of Iran, individuals ordinarily resident in Iran, individuals and entities actually in Iran and non-Iranian entities owned or controlled by any of the foregoing will fall within the definition of "Government of Iran".
- Most transactions with Iranian financial institutions.
- Transactions with persons whose assets are frozen pursuant to executive orders dealing with terrorism or the proliferation of weapons of mass destruction or United Nations Security Counsel resolutions relating to Iran (which individuals may reside outside of Iran), including most transactions with Iranian financial institutions.
- Transactions relating to Iran's energy industry.
- Transactions facilitating Iran's procurement or proliferation of weapons or terrorism.
- Transfer of technology or services to Iran that are likely to be used in connection with human rights abuses in Iran, including the restriction of free flow of unbiased information and the disruption, monitoring or restriction of free speech.

Filers should note that there is no materiality threshold with respect to any of these activities.

Required Company Disclosures and Notice; Mandatory Regulatory Response

Any company subject to the disclosure requirements of Section 219 of the Act must disclose:

- The nature and extent of each activity subject to disclosure;
- The gross revenues and net profits attributable to each such activity; and
- Whether or not it intends to continue each such activity.

Companies that make disclosures required under the Act must file a concurrent notice with the SEC detailing the information included in the filing. The SEC must then post the notice on its website and send the report to the President and certain Congressional committees. The President thereafter must initiate an investigation within 180 days to determine whether and to what extent sanctions should be imposed on the company.

Additional Considerations and Recommended Actions

- Review thoroughly any global operations related to Iran to ensure compliance with the Act and newly updated OFAC regulations and other U.S. and relevant foreign laws. Note that the definition of "Government of Iran" in the Act potentially captures the distribution of nearly any product or service in Iran, with a particularly high likelihood of required disclosures in sectors where the Iranian government is more heavily involved, such as healthcare and banking.
- Consider updating codes of conduct and other relevant policies to prohibit and require prompt disclosure of sanctionable activities.
- Institute additional screening and disclosure controls aimed at surfacing reportable activities among all affiliates. Controlled companies should make inquiries of controlling shareholders in this regard.
- Expand training programs for operational and compliance employees and update compliance procedures.
- Update due diligence procedures for new acquisitions, license arrangements and joint ventures to ensure potentially sanctionable activities are uncovered and communicated.
- Companies required to make Iran-related disclosures under the Act should consider adding a risk factor related to the activity and the company's related disclosure, detailing the notification process, mandated regulatory response to follow and possible imposition of sanctions and reputational harm.

If you would like to learn more about the issues in this alert, please contact your usual Ropes & Gray attorney.