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New Reporting Requirements Under the Iran Threat Reduction and Syria Human Rights Act of 2012

On August 10, 2012, the United States delivered its latest economic blow to Iran by enacting the Iran Threat Reduction and Syria Human Rights Act of 2012. U.S. companies have long been forbidden from engaging in most transactions with the Persian nation under sanctions administered by the Office of Foreign Assets Control. The purpose of the latest law, however, is to apply restrictions against *non*-U.S. entities that conduct business with Iran, particularly in the petroleum (including petrochemical) and uranium sectors or areas potentially related to the proliferation of weapons of mass destruction ("WMD") or terrorism-related activities.

The Act imposes complex and sweeping regulations and sanctions. We do not intend to provide a complete overview of the Act in this alert. Instead, we highlight certain new provisions that should not be overlooked by public reporting companies.

Periodic Reporting Requirements; Expanded Liability. The Act mandates new disclosure requirements in annual and quarterly reports for reporting companies and expands the potential scope of liability for U.S. entities that own or control foreign entities that engage in sanctionable activities.

Section 219 of the Act creates new reporting requirements for all companies required to file annual and quarterly reports under Section 13(a) of the Securities Exchange Act of 1934 (the "Exchange Act"). (This includes smaller reporting companies and foreign private issuers, but does not include voluntary filers or other reporting companies that do not have securities registered under Section 12 of the Exchange Act.) New Section 13(r) of the Exchange Act requires all such reporting companies to disclose in quarterly and annual reports whether they, or their "affiliates," have knowingly engaged in certain sanctionable transactions involving Iran during the reporting period. These transactions have no materiality threshold and generally relate to:

- The Iranian petroleum industry
- The development of WMD or other military capabilities
- Financial institutions that facilitate WMD, terrorism, or money laundering
- The transfer of weapons and technology used in human rights abuses
- "Blocked persons" who engage in activities related to terrorism or WMD
- The government of Iran, or any entity owned or controlled by Iran

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If a reporting company—or its affiliate—engages in any of these activities, the reporting company must disclose (1) the nature and extent of the activity, (2) any gross revenues and net profits derived from the activity, and (3) whether the company, or its affiliate, intends to continue the activity. Any disclosure made pursuant to Section 13(r) will automatically become public upon filing through EDGAR, the SEC's online database. The reporting company is also required to provide notice to the SEC on a form type titled "IRANNOTICE". Once the company discloses sanctionable activities to the SEC, the agency will then alert the office of the U.S. President and various other governmental authorities. This process could ultimately lead to an investigation and the imposition of sanctions, including penalties established under new Section 218 of the Act.

Section 218 of the Act prohibits any U.S.-owned or -controlled foreign entity from knowingly engaging in any transaction with Iran that would be illegal if it were engaged in by the U.S. entity or in the United States. Violations of new Section 218 could result in the imposition of civil penalties (the greater of $250,000 or twice the gross value of the violating transaction) against the U.S. parent or controlling entity for actions undertaken by the foreign entity. Section 218 provides a safe harbor for U.S. entities that divest, or terminate business with, foreign entities engaged in unlawful transactions by February 6, 2013. (It remains uncertain whether causing the foreign subsidiary to cease all business with Iran by that deadline would also satisfy this safe harbor.)

On December 4, 2012, the SEC provided guidance relating to Section 219's reporting requirements in a Compliance and Disclosure Interpretation ("C&DI"). Highlights from this C&DI include:

- *Timing*. Reporting companies must comply with Section 13(r) in any periodic report with a due date after February 6, 2013. This requirement applies even if the issuer files the report with the SEC before February 6.

- *Disclosure period*. Issuers must disclose all sanctionable activities that occurred during the period covered by the report, even if the activities occurred before August 10, 2012, the effective date of the Act.

- *Meaning of "affiliate"*. For purposes of Section 219, "affiliate" is defined in Exchange Act Rule 12b-2 and 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 includes directors, officers, and subsidiaries controlled by the issuer, as well as controlling shareholders, such as private equity firms.

- *Scope of disclosure. S*ection 13(r) does not require disclosure if the reporting company and its affiliates did not engage in any sanctionable activities during the reporting period. (It remains to be seen whether reporting companies will nevertheless provide an affirmative statement that there were no sanctionable activities.) In addition, a company does not need to disclose otherwise sanctionable activities if such activity was specifically authorized by a U.S. federal department or agency. However, if a company received authorization from a foreign governmental entity, it must make the required disclosures but may also describe the authorization provided by the foreign government in order to provide context to the transaction.

Next Steps. The Act imposes new and significant obligations on reporting companies and U.S. entities generally. U.S. companies will need to engage in due diligence procedures and expanded employee training programs to ensure compliance.

For disclosure purposes, reporting companies should consider whether any of their businesses, or the business or foreign entities they own or control, involves sanctionable activities that require disclosure under Section 219. This will require updates to periodic disclosure controls and procedures to ensure quarterly and annual reporting requirements can be met. Specifically, companies could consider adding a risk factor related to the new disclosure requirements, particularly if it becomes necessary to make any affirmative disclosure under the Section 13(r) reporting requirements. Furthermore, U.S. companies could implement OFAC compliance software into their systems to confirm they do not engage in transactions with “blocked persons.” In addition to updating internal procedures, U.S. companies should also consider expanding compliance and training programs to cover foreign subsidiaries and other affiliates to ensure they understand the scope of the prohibitions that now apply to them.

For the purposes of Section 218, reporting companies should take prompt action to divest or terminate businesses that engage in sanctionable activities by the early February deadline. Moving forward, U.S. companies and nationals should also consider this section when acquiring a controlling interest in foreign entities.

Consideration of these issues will involve careful planning and a high degree of familiarity with newly updated OFAC regulations, the Act and other U.S. and relevant foreign laws. Please contact us if you have any questions or would like to learn more about the issues covered in this alert.