SEC Filings Under The New Iran Disclosure Obligations Have Reached A Steady Drumbeat

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In the last several weeks, over sixty issuers have disclosed activities involving Iran or certain so-called bad actors, as mandated by Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 ("ITRA"), in a quarterly or annual report filed with the Securities and Exchange Commission. Enacted last August as part of the U.S. government's increasingly expansive Iran sanctions program, the new disclosure requirement, included as a new Section 13(r) to the Exchange Act, applies to all SEC filings on Forms 10-K or 10-Q, as well as on Form 20-F, required to be made after February 6, 2013. It appears from these recent disclosures that multinational issuers with worldwide operations across multiple affiliates have undertaken significant time and expense in collecting data about potentially reportable activities that issuers have never before been required to publicly disclose — including transactions with customers, vendors, and other business partners.

BACKGROUND

In 2010, Congress passed the Comprehensive Iran Sanctions, Accountability, and Divestment Act ("CISADA"), which expanded U.S. sanctions against Iran originally implemented under the Iran Sanctions Act of 1996. CISADA primarily expanded sanctionable activities for companies transacting in or supporting Iran's petroleum and refining industries and for financial institutions that facilitated transactions linked to the Iranian Revolutionary Guard, WMD, or terrorism. Since then, Congress has enacted further legislation (such as the National Defense Authorization Act of 2012 and the National Defense Authorization Act of 2013), and the President has issued Executive Orders (such as Executive Order Nos. 13599 and 13622) that further increase the scope of U.S. economic sanctions involving Iran.

On August 10, 2012, President Obama signed ITRA into law. The Act both expanded the scope of sanctionable activities and created a broader menu of available sanctions. Section 219 of the ITRA also created a new disclosure requirement for issuers that file annual or quarterly reports with the SEC. Specifically, Section 219 of ITRA added a subsection (r) to Section 13 of the Securities and Exchange Act of 1934, which is codified at 15 U.S.C. § 78m, requiring issuers to disclose in their reports filed on Forms 10-K, 10-Q, and 20-F certain types of activities involving Iran or certain so-called bad actors during the period covered by the filing. Section 13(r) also requires that issuers concurrently file a separate type of notice with the SEC — which the SEC has designated as IRANNOTICE — identifying the issuer and indicating that it disclosed sanctionable activity in its 10-K, 10-Q, or 20-F.

SECTION 219: WHO IS COVERED?

Section 219 applies to all annual and quarterly reports required to be filed under Section 13(a) with due dates falling after February 6, 2013. Issuers must disclose all enumerated activities that occurred during the period covered by the report, even if the activities in question predated the August 10, 2012 enactment of ITRA. To date, ITRA disclosures have been found in 10-Ks, 10-Qs, and 20-Fs, reflecting that a broad range of issuers — both domestic and foreign — are required to comply with Section 13(r).

SECTION 219: WHAT TYPES OF ACTIVITIES MUST BE DISCLOSED?

Section 219 requires all domestic and foreign issuers that are required to file annual or quarterly reports under Section 13(a) to disclose whether, "during the period covered by" the issuer's report, "the issuer or any affiliate of the issuer" worldwide knowingly engaged in certain types of "transaction[s] or dealing[s]," which terms are not defined, involving Iran, the Government of Iran, or certain individuals and entities on the list of Specially Designated Nationals ("SDNs") published by the U.S. government. The activities that must be disclosed principally include transactions and dealings:

- with the government of Iran — including its political subdivisions, agencies, and instrumentalities, entities owned or controlled by the foregoing, persons acting on behalf of the government of Iran, and persons designated on the SDN list as representatives of the government of Iran;
- relating to Iran's petroleum sector;
- relating to the development of WMD;
- with persons and entities identified on the SDN list as supporters of terrorism or proliferators of WMD;
- relating to the transfer of goods, technologies, or services to Iran, any entity organized under the laws of Iran or otherwise subject to its jurisdiction, or a national of Iran, likely to be used by Iran to commit serious human rights abuses;
- between U.S. financial institutions or their affiliates and the Iranian Revolutionary Guard;
- relating to the purchase, subscription, or facilitation of the issuance of Iranian sovereign debt or the debt of any entity that the Government of Iran owns or controls;
- involving financial institutions that facilitated a transaction for any person or SDN-designated entity whose property is now blocked in connection with terrorism support provided by Iran or the proliferation of WMD; and
- involving financial communications service providers who provide or help to provide financial messaging services for the Central Bank of Iran or other Iranian financial institutions sanctioned for WMD- or terrorism-related activities.

Importantly, the list above is intended only to convey the essence of the key activities covered by Section 219, and all activities involving Iran in any way should be closely analyzed to determine whether disclosure is required.

SECTION 219: WHAT MUST BE DISCLOSED?

Any disclosure required under Section 219 must include the following:

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

When a disclosure is made under Section 219, the issuer must concurrently file a separate notice — the IRANNOTICE — with the SEC that a Section 219 disclosure has been included in its annual or quarterly report. The SEC must post on its website the relevant information contained in the report and the notice and transmit the report to the President and specified House and Senate congressional committees. The President then must initiate an investigation into the possible imposition of sanctions and, within 180 days, determine whether to impose sanctions against the issuer or the issuer's affiliate(s).

A SAMPLING OF RECENT FILINGS UNDER SECTION 219

Section 219 covers transactions and dealings not only with customers and clients, but with all third parties (including vendors and other business partners) as well. For example, a transaction that is not otherwise disclosable under Section 219 may become disclosable simply by virtue of the fact that a payment was facilitated by an Iranian bank. Thus, in a Form 10-K filed by United Technologies Corporation ("UTC"), UTC reported that a payment received by a non-U.S. affiliate for elevator service performed at the Iranian embassy in Paris was drawn on a local branch of Bank Melli of Iran, which has been designated as subject to sanctions. UTC's disclosure of the payment drawn on Bank Melli raises the question of whether a payment drawn on an Iranian financial institution can, by itself, render an otherwise nondisclosable activity disclosable under Section 13(r).

Disclosures must be made regardless of materiality — that is, any and all reportable transactions or dealings must be disclosed, even if immaterial to the issuer or its affiliates. Some of the reported transactions approach *de minimis* levels. For example, Hyatt Hotels Corp. reported that it received revenues of approximately $9,300 and net profits of approximately $2,600 under a prenegotiated contract with Europaeisch-Iranische Handelsbank AG, an entity listed on OFAC's SDN list.

The term "affiliate" is defined pursuant to Exchange Act Rule 12b-2 as "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." Recent disclosures reflect a conservative interpretation of the term "affiliate," with several issuers reporting activities by a "sibling" company that appears to have an affiliate relationship solely because of indicia of common control. For example, in a Form 10-Q filed by Toyota Motor Credit Corp. ("TMCC"), the company disclosed activities performed by a commonly controlled affiliate, Toyota-Astra Motor ("TAM") — an Indonesian company in which TMCC's Japanese parent company, Toyota Motor Corporation ("TMC"), owns a 49% stake. During the relevant period, TAM sold two Toyota vehicles to the Iranian embassy in Indonesia in compliance with applicable law. These sales generated approximately $37,000 in gross revenues for TMC, and significantly less in net profits.

TMCC's disclosure is also notable in that it reported that its parent, TMC, was still conducting ongoing investigations of its affiliates. TMCC included a commitment in its Form 10-Q to update its disclosure to the extent necessary as Toyota completed its review of other affiliates.

The term "knowingly" as used in Section 219 means actual knowledge or "should have known." In a Form 10-K filed by JetBlue Airways Corp. ("JetBlue"), the company reported that Lufthansa — a 17% stockholder of JetBlue, which JetBlue noted could make it an affiliate of JetBlue's under Rule 12b-2 — provided air transportation services to Iran under existing agreements between the governments of Germany and Iran. JetBlue made this disclosure despite the fact that Lufthansa would not specify the total revenue it receives in connection with those transactions and that Lufthansa confirmed that the transactions are not prohibited under any applicable laws.

It is noteworthy that many of the transactions that now must be disclosed under Section 219 were likely lawful at the time they were undertaken, because the extension of certain Iranian sanctions to entities owned or controlled by U.S. persons did not occur until October 2012. Prior to that date, many transactions involving Iran were lawful as long as they did not involve a U.S. person or goods or services that originated in the United States.

PLANNING AHEAD

Scrutiny of corporate activities involving Iran appears greater than ever before. Issuers should consider designing and implementing standing measures that will simplify compliance with Section 219 in future reporting periods and position issuers to swiftly and persuasively respond to any SEC comment letters. Some possible measures include broadening sanctions compliance procedures to screen for and escalate activities involving customers, vendors, and other business partners on the lists of entities and individuals covered by Section 219. Existing sanctions screens used across global operations might not be broad enough to capture this information, especially because all transactions and dealings involving Iran and certain SDNs that might need to be disclosed under Section 219 are not necessarily prohibited under current U.S. law. Early identification of covered activities also enables an issuer's leadership to contemplate whether discloseable activities should be terminated for reputational or legal reasons, a topic which Section 219 requires issuers to address as part of their disclosure.

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For more information regarding this memorandum, please contact:

Joshua Bonnie
jbonnie@stblaw.com
+1 (212) 455-3986

D. Rhett Brandon
rbrandon@stblaw.com
+1 (212) 455-3615

Nicholas Goldin
ngoldin@stblaw.com
+1 (212) 455-3685

Joseph Kaufman
jkaufman@stblaw.com
+1 (212) 455-2948

A.J. Kess
akess@stblaw.com
+1 (212) 455-2711

George Wang
gwang@stblaw.com
+1 (212) 455-2228

David Caldwell
dcaldwell@stblaw.com
+1 (212) 455-2612

Abram Ellis
aellis@stblaw.com
+1 (202) 636-5579

Karen Hsu Kelley
kkelley@stblaw.com
+1 (212) 455-2408

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UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000