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Client Alert

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US Sanctions Against Iran Continuing To Expand and Impact Non-US Companies

In recent months, the US government has dramatically expanded US sanctions laws by making it more difficult for non-US companies to engage in a growing range of trade and financial activities involving Iran. Building on longstanding sanctions, these new and emerging sanctions expand the ways in which US law can effectively restrict, penalize or expose activities with little or no nexus to the United States.

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While previous US sanctions have, since 1995, prevented US companies and US persons from engaging in or supporting virtually all trade and most other dealings relating to Iran, new measures in 2012 and 2013 focus primarily on non-US entities and non-US persons that historically have been beyond the reach of US sanctions. Coupled with radically ramped-up civil enforcement, including major criminal actions against non-US banks, this aggressive assertion of extraterritorial jurisdiction is having a growing impact on non-US companies and their ability to conduct business with Iran.

This *Client Alert* focuses on two significant Iran sanctions developments and their expected impact in 2013. They are:

- **Expansion of US Sanctions to Foreign Entities Owned or Controlled by a US Person:** In August 2012, President Obama signed into law the Iran Threat Reduction and Syria Human Rights Act (ITRA). Among other things, ITRA expands the jurisdictional reach of US sanctions to apply to entities that are owned or controlled by US persons, including non-US subsidiaries of US companies. In October 2012, the US Treasury Department's Office of Foreign Assets Control (OFAC), the agency charged with administering and enforcing the US sanctions regime, reissued in their entirety the Iranian Transactions and Sanctions Regulations (ITSR). This regulatory "rewrite" updated OFAC's sanctions on Iran and aligned them with new and evolving Iran sanctions laws. In late December 2012, OFAC amended ITSR further, incorporating a new "general license" that expires in March 2013, authorizing foreign parties that are owned or controlled by US persons to engage in limited activities that are necessary and incidental to winding down business relationships with parties in Iran.

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- **New Exchange Act Disclosure Requirement for US and Non-US Public Companies:** ITRA amended the Securities Exchange Act of 1934 (Exchange Act) to impose a new disclosure requirement for issuers required to file annual or quarterly reports with the Securities and Exchange Commission (SEC) under Section 13 of the Exchange Act. This new disclosure requirement applies to certain activities by issuers or their affiliates relating to Iran. As discussed below, the Staff of the Division of Corporation Finance of the SEC (the SEC Staff) has released guidance relating to this new reporting requirement.

Expansion of US Sanctions to Foreign Entities Owned or Controlled by US Persons

ITRA amends various existing US sanctions laws, including the Iran Sanctions Act of 1996 (ISA) and the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA). In a dramatic expansion of extraterritorial jurisdiction, Section 218 of ITRA directs the President to prohibit an "entity" owned or controlled by a US person and established or maintained outside of the United States from knowingly engaging in any transaction, directly or indirectly, with the Government of Iran or any person subject to the jurisdiction of the Government of Iran, if that transaction would be prohibited by existing OFAC sanctions (maintained under the International Emergency Economic Powers Act or IEEPA). ITRA defines the term "entity" broadly to include a "partnership, association, trust, joint venture, corporation, or other organization." It also defines the concept of ownership or control broadly — more broadly than OFAC's prior use of these terms.

For ITRA purposes, a US person "owns or controls" a foreign entity if it: (1) *holds more than 50 percent* of the equity interest by vote or value in the entity (but see below); (2) holds a majority of seats on the board of directors of the entity; *or* (3) otherwise controls the actions, policies, or personnel decisions of the entity. Section 218 also makes the US person directly liable under the IEEPA penalty scheme for activities by the foreign entity to violate or "cause" a violation of the OFAC sanctions, and it further provides that the only way the US person can extinguish any such liability is to "divest[] or terminate[] its business" with the foreign entity no later than February 6, 2013.

On October 9, 2012, the President issued Executive Order 13628 to implement Section 218. Section 4(a) provides that "[n]o entity owned or controlled by a United States person and established or maintained outside the United States may knowingly engage in any transaction, directly or indirectly, with the Government of Iran or any person subject to the jurisdiction of the Government of Iran, if that transaction would be prohibited . . . if the transaction were engaged in by a United States person or in the United States."

Executive Order 13628 does not define what it means for a foreign entity to be "owned or controlled" by a US person. In guidance issued by OFAC contemporaneously with Executive Order 13628, the agency confirmed that, at that time, there was no "wind-down or safe harbor" from the application of Section 4 of Order, and that "Subsection 4(c) of the Order provides that civil penalties shall not apply if the US person divests or terminates its business with the foreign subsidiary . . . not later than February 6, 2013."

New Iran Regulations and Subsequent Amendments

On October 22, 2012, OFAC reissued the regulations previously called the "Iranian Transactions Regulations" as the new and expanded Iranian Transactions and Sanctions Regulations (ITSR). The new regulations implement parts of Executive Order 13599 (February 5, 2012) and the National Defense Authorization Act for Fiscal Year 2012 (signed December 31, 2011), which require property and interests in property of the Government of Iran, as well as Iranian financial institutions, to be blocked when they are in the United States, come within the United States, or come within the possession or control of a US person.

At the same time, OFAC added several "general licenses," such as one that authorizes sales under certain circumstances to Iran — including to the Government of Iran and its agencies — of non-sensitive medicines and listed basic medical supplies, without needing a specific license from OFAC under the Trade Sanctions Reform and Export Enhancement Act (TSRA). However, the rewritten Iran regulations issued in October did not address the expansion of the US sanctions to reach foreign entities owned or controlled by US persons. That change came through amendments to the ITSR published in the Federal Register on December 26, 2012. OFAC did not expand the definition of "US person" in the regulations but rather included a new provision, found at 31 C.F.R. § 560.215, that tracks the language of Executive Order 13628.

Notably, OFAC in one important respect expanded the definition of "owned of controlled" to capture a US person's "50 percent *or greater* equity interest by vote or value" (emphasis added) in the foreign entity, as compared to Section 218 of the ITRA that captured only ownership of "*more* than 50 percent." OFAC's expansion of the ITRA in this respect is consistent with the agency's prior guidance. The definition of "owned or controlled" in the ITSR also includes a US person holding a majority of the seats of the board of directors of the foreign entity, *or* a US person "controlling the actions, policies, or personnel decisions of the entity." While OFAC practitioners have been familiar with ownership and control tests based on equity ownership, or board control, the expansion of the control test to reach *solely* control over "the actions, policies, or personnel decisions of the entity," is significant, and OFAC has not issued any guidance on this point.

Moreover, while guidance issued by OFAC in the form of Frequently Asked Questions about the implementation of Section 218 of ITRA often has used the shorthand "foreign subsidiaries of US companies," the expansion of the Iran regulations to reach US-owned or -controlled entities can also reach other relationships, such as joint ventures. The amended regulations also clarify that foreign entities that are owned or controlled by US persons can now take advantage of OFAC specific licensing opportunities as well as general licenses under the ITSR, or exemptions to the ITSR, provided the foreign entity complies with the terms of general licenses (*e.g.*, registering intellectual property rights in Iran) or exemptions (*e.g.*, certain travel-related transactions or the provision of informational materials to Iran).

Narrow OFAC General License for Wind-Down Activities with Iran

Significantly, the amendments to the ITSR in December 2012 include a new "wind-down" general license, found at 31 C.F.R. § 560.555. This narrow authorization, subject to certain limitations, permits foreign entities owned or controlled by a US person to engage in "all transactions ordinarily incident and necessary to the winding-down of transactions" that are prohibited under the ITSR.

- The general license is time-limited: It is available only in respect of wind-down activities taking place from October 9, 2012 through March 8, 2013.
- The activities must be "ordinarily incident and necessary" to closing out legacy relationships with parties in Iran, and these are terms that are interpreted narrowly by OFAC (*i.e.*, the activities must be *both* ordinarily incident and necessary). We also understand that the general license would not authorize "new" business by the foreign entity with Iran.
- The wind-down activities must not "involve" a US person — such as a the US parent company or a US financial institution — or occur in the United States. "Involvement" would almost certainly encompass approval, support, or facilitation by a US person of the offshore wind-down activities, but presumably should permit a narrow range of counseling to ensure the foreign entity's understanding of, and compliance with, the narrow terms of the general license.
- The general license for wind-down activities does not authorize activities prohibited by Section 560.205, which precludes reexport by non-US parties of US-regulated goods, technology or services to Iran or the Government of Iran.
- The general license does not authorize the US-owned or -controlled foreign entity to engage in transactions that involve Iranian financial institutions that are designated under terrorism- or WMD-related Executive Orders.

This narrow general license may provide some relief to non-US parties that are owned or controlled by a US person, and the general license is far broader than the limited safe harbor in Section 218 of ITRA. The latter requires the US person to divest or terminate its business with the foreign entity no later than February 6, 2013, to avoid liability for the foreign entity's offshore activities with Iran. It is, however, important for US persons impacted by the recent expansion of the US sanctions against Iran to recognize that this narrow wind-down general license is available to the foreign entity only through March 8, 2013. After that date, US persons that own or control foreign entities knowingly engaged in virtually all trade or other business dealings with Iran will be exposed to IEEPA civil penalties.

New Exchange Act Disclosure Requirement for Public Companies

Section 219 of ITRA amends the Exchange Act to impose a new disclosure requirement for issuers required to file annual or quarterly reports with the SEC under Section 13(a) of the Exchange Act after February 6, 2013. This provision is effectively a "sunshine" measure, intended to bring to light — and possibly sanction — parties in and outside the United States that knowingly engaged in certain dealings with Iran or specially designated parties during the relevant reporting period. This new disclosure obligation applies broadly to all companies whose stock is listed on US national securities exchanges, including listed ADRs of non-US issuers.

Disclosure is required if during the period covered by the annual or quarterly report, the issuer or any affiliate of the issuer knowingly:

- Engaged in an activity sanctionable under Section 5(a) and (b) of ISA, which relate to investments and other activities connected to Iran's energy sector.
- Engaged in an activity relating to financial institutions that facilitate weapons of mass destruction (WMD), terrorism, money laundering, and other activities sanctionable under Section 104(c)(2) or (d)(1) of CISADA.

- Engaged in an activity relating to the transfer of weapons and technology used by the Government of Iran to commit serious human rights abuses against the people of Iran, as described in CISADA Section 105A(b)(2).
- Conducted any transaction or dealing with a person designated under Executive Order 13224 (relating to persons who commit, threaten to commit, or support terrorism) or Executive Order 13382 (relating to WMD proliferators and their supporters). These so-called specially designated nationals or SDNs are identified on OFAC's List of Specially Designated Nationals with the program designators "[SDGT]" and "[NPWMD]." While SDNs may relate to Iran, such as Islamic Republic of Iran Shipping Lines (IRISL), there are designated parties under each of these Executive Orders that are not Iran-related, such as the Revolutionary Armed Forces of Colombia (FARC).
- "[W]ithout the specific authorization of a Federal department or agency," conducted any transaction or dealing with the Government of Iran, its political subdivisions, agencies, instrumentalities, the Central Bank of Iran, and any person owned or controlled by the foregoing or acting on its behalf (collectively defined as the Government of Iran).

The term "knowingly" in ITRA has the same meaning given to that term in ISA, namely is that "a person has actual knowledge, or should have known, of the conduct, the circumstance, or the result." The phrase "transaction or dealing" is not defined in ITRA. In the OFAC context, ITSR provides in Section 560.206 that for purposes of a section prohibiting trade-related transactions by US persons with Iran, "the term transaction or dealing includes but is not limited to purchasing, selling, transporting, swapping, brokering, approving, financing, facilitating, or guaranteeing."

SEC Staff Guidance on the Disclosure Requirement

In December 2012, the SEC Staff added seven new Exchange Act Compliance and Disclosure Interpretations (C&DIs) on the new Iran-related disclosure requirements. These Frequently Asked Questions explain that:

- The "reports required to be filed" language in Section 219 requires that all periodic reports filed with a due date after February 6, 2013 must include any responsive Iran-related disclosures, even if the issuer elects to file its report on or before February 6.
- A public company is required to disclose responsive Iran-related activities that occurred during the period covered by the report, even if the responsive activities took place prior to the enactment of ITRA in August 2012. "For example, an issuer that files an annual report for the fiscal year ending December 31, 2012 is required to disclose any" responsive Iran-related activities "that took place between January 1, 2012 and December 31, 2012."
- The term "affiliate" in Section 219 of the ITRA has the same meaning as the term affiliate in Exchange Act Rule 12b-2. Rule 12b-2 captures a "person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with," the issuer.
- An issuer with no responsive Iran-related activities during the reporting period does not have to include a statement in its report to that effect.

- A transaction or dealing during the reporting period with the Government of Iran (based on the expansive definition above of the Government of Iran) must be disclosed unless it was authorized by a US federal department or agency. If a foreign government approved the transaction or dealing, then the activity must be disclosed. However, the issuer can disclose the fact of the foreign government authorization "to provide appropriate context for the disclosure."
- The phrase "specific authorization of a Federal department or agency" in Section 219 includes both OFAC specific licenses as well as general licenses in ITSR. However, the SEC Staff emphasized that "all conditions of the applicable" general OFAC license must have been "strictly observed." This response from the SEC Staff suggests that foreign entities owned or controlled by a US persons may be able to avoid a disclosure requirement for wind-down activities involving the Government of Iran, or its agencies, provided they observe the limits of the wind-down general license discussed above, which again is available only for such activities between October 9, 2012 and March 8, 2013.
- All periodic reports filed with the SEC, including disclosures of responsive Iran-related activities in such reports, will automatically become publicly available upon filing through the EDGAR system.

Content of Disclosure and Subsequent Actions

For a company with responsive Iran-related activities, Section 219 of ITRA requires that that the company provide "a detailed description" of each reportable Iran-related activity by the company or its affiliates, including (1) the nature and extent of the activity, (2) the gross revenues and net profits, if any, attributable to the activity and (3) whether the company or the affiliate of the company intends to continue the activity.

Separate and apart from the Iran-related disclosure in its quarterly or annual report, the company is required to file concurrently with the SEC a notice that identifies the company and alerts the SEC that the report includes a disclosure of responsive Iran-related activities that contains the information described above. On December 19, 2012, the SEC Staff issued an Announcement explaining that it was in the process of "modifying EDGAR to accommodate the filing of these notices." The SEC Staff explained that "issuers required to file the notice should prepare a separate document that includes the information required by the statute, convert it to ASCII or HTML . . . and submit it using a new EDGAR form type called IRANNOTICE." These separate notices will appear with the issuer's filing history on EDGAR the SEC Staff rolled out the IRANNOTICE on January 14, 2013.

Section 219 requires the SEC to transmit disclosures with responsive Iran-related activities to (1) the President of the United States; (2) the House of Representative Committee on Foreign Affairs and the Committee on Financial Services; and (3) the Senate Committee on Foreign Relations as well as the Committee on Banking, Housing, and Urban Affairs. Notably, Section 219 requires the President in all cases except transactions or dealing with the Government of Iran to initiate an investigation into the possible imposition of sanctions pursuant to ISA, CISADA, Executive Order 13224, Executive Order 13382, "or any other provision of law relating to the imposition of sanctions with respect to Iran." Within 180 days of initiating an investigation, the President is required to make a determination with respect to whether sanctions should be imposed on the issuer or the affiliate of the issuer (as the case may be). Bear in mind that while activities of foreign subsidiaries of US companies with Iran may not trigger an SEC disclosure requirement, those activities can create significant penalties for the US parent now that the expanded US sanctions reach such offshore dealings.

Conclusion

The changes to the US sanctions regime and the related new Exchange Act disclosure requirements underscore the importance of asking the right questions about sanctions compliance. There are no one-size-fits-all solutions in this area, but a prudent starting point should include the following considerations:

- How should operations be diligenced?
- How should transactions, including customer and other relationships, be screened against OFAC's List of Specially Designated Nationals?
- What Iran-related disclosure may be needed and what should it say?
- How should policies, procedures, and training be updated to ensure continued compliance with the expanding US sanctions against Iran?

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