

Section 13(r) of the Securities Exchange Act of 1934: Disclosure Guidance for Public Companies

Eight Law Firm Consensus Report

Starting in February 2013, the Iran Threat Reduction and Syria Human Rights Act (the “Threat Reduction Act”) will impose new reporting requirements on U.S. domestic and foreign companies that are required to file reports with the U.S. Securities and Exchange Commission (the “SEC”) pursuant to Section 13(a) of the Securities Exchange Act of 1934 (the “Exchange Act”). In particular, Section 219 of the Threat Reduction Act added new Section 13(r) to the Exchange Act. Under Section 13(r), Annual Reports on Form 10-K, Annual Reports on Form 20-F and Quarterly Reports on Form 10-Q filed pursuant to Exchange Act Section 13(a) must include disclosure of contracts, transactions and “dealings” with Iranian and other entities. Section 13(r) is effective beginning with reports with a due date after February 6, 2013.

The Staff of the Division of Corporation Finance of the SEC (the “SEC Staff”) has provided helpful guidance on implementation of these new requirements in Exchange Act Compliance and Disclosure Interpretations Questions 147.01-147.07 (available at <http://www.sec.gov/divisions/corpfin/guidance/exchangeactsections-interps.htm>). However, many questions remain, and the following questions and answers represent the consensus views of the undersigned law firms.

None of the firms subscribing to this report intends thereby to give legal advice to any person. The undersigned firms recommend that counsel be consulted with respect to matters addressed in this report. The answers below may need to be modified based upon unique facts and circumstances.

1. **Question:** If an issuer discontinues a disclosable activity prior to February 6, 2013, or prior to the filing of its annual or quarterly report that is due after February 6, 2013 (*e.g.*, selling the affiliate or ending the dealings in question), must the activity in the reporting period be disclosed nonetheless?

Answer: Yes. We do not believe the disclosure requirement is avoided if the activity is terminated before the filing of the issuer’s annual or quarterly report so long as the activity was ongoing at some point during the reporting period.

2. **Question:** Does the definition of “affiliate” under Exchange Act Rule 12b-2 include natural persons?

Answer: Yes. Issuers should take into account possible reportable activities of all affiliates. This could mean board members and senior executive officers, which might lead issuers to include additional questions in annual D&O questionnaires or other reasonable steps appropriate to the circumstances. Issuers should also consider including appropriate questions in the checklists of disclosure committees for purposes of quarterly reports or in quarterly certifications from field personnel supporting the CEO and CFO certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act.

3. **Question:** Does the definition of “affiliate” under Exchange Act Rule 12b-2 include anyone that was an affiliate of the issuer at any time during the period covered by the report, even if that person or entity is no longer an affiliate of the company at the end of the period covered by the report or at the time the annual or quarterly report is filed with the SEC?

Answer: Yes.

4. **Question:** One of the issuer’s affiliate directors is also an affiliate of another company; must the issuer take steps to determine all activities of the other company for purposes of disclosure under Section 13(r)?

Answer: We believe that, absent unusual circumstances, it is sufficient to take reasonable steps to determine the activities of the affiliate director, as opposed to activities of other companies of which that director is an affiliate. This would be the case, for instance, where the director is an officer or director of another company, which would have its own compliance obligations. In the analogous context of related party transaction disclosure, Instruction 6 to Item 404(a) of Regulation S-K provides that disclosure of the issuer’s transactions with a company with which a related person has a relationship is not required where the relationship is solely that of a director of the company. The Commission recognized in Instruction 6 that it is unnecessary for an issuer to disclose transactions by or with another company when the only connection between the issuer and that company are that they share a common director.

5. **Question:** Where in the annual or quarterly report should the Section 13(r) disclosure appear?

Answer: There is no provision for a particular place in the annual or quarterly report under the Exchange Act. Natural places for such disclosure would include Item 1 (Description of Business) or Item 7 (MD&A) of the Form 10-K, Item 4 of Form 20-F, and Item 2 (MD&A) or Item 5 (Other Information) of Form 10-Q, as well as risk factors or inclusion in the description of legal proceedings.

6. **Question:** Is there a de minimis exception to the disclosure requirements?

Answer: Section 13(r) does not include either a de minimis exception or a materiality threshold.

7. **Question:** Each of Section 13(r)(1)(A), (B), (C) and (D) begins with “knowingly engaged” or “knowingly conducted.” However, the “knowledge” standard applies to the activity, not to the requirement to report the activity. Nevertheless, may one imply a “knowledge” requirement into the reporting obligation, such that a sanctionable activity would be disclosable only if the issuer knows of the activity after satisfying a reasonable inquiry standard?

Answer: We believe that for reporting on an issuer’s own activities, the “knowledge” standard applies to the conduct and not the reporting obligation. However, in reporting on activities by affiliates, we do believe a reasonable knowledge standard is appropriate. The manner by which such reasonable knowledge is developed will necessarily vary based upon an issuer’s facts and circumstances.

8. **Question:** Are the following considered to be “specific authorization” by a federal agency for purposes of Section 13(r)(1)(D)(iii), exempting the related activities from the disclosure requirement?

Exemptions that authorize certain activities – OFAC regulations specifically include certain exemptions in 31 C.F.R. sec. 560.210 (e.g., travel, humanitarian donations, informational materials).

Interpretations (interpretive provisions in OFAC’s regulations) that authorize certain activities – e.g., 31 C.F.R. sec. 560.405 contains an interpretative provision that authorizes transactions ordinarily incident to a licensed transaction while 31 C.F.R. sec. 560.407 contains a specific interpretive provision that clarifies which Iranian origin goods are not considered to be prohibited (i.e., those that were substantially transformed outside of Iran or incorporated in a third product). If a company is relying on these express provisions in the regulations to facilitate a licensed transaction or purchase substantially transformed goods, shouldn’t that activity also be covered by the “specific authorization” language in Section 13(r)(1)(D)(iii) and thus be exempt from reporting?

Answer: We believe that any activity undertaken pursuant to explicit provision in OFAC’s regulations (including activity pursuant to an exemption or interpretation that authorizes specific conduct), or any other relevant federal agency should be excluded from disclosure.

9. **Question:** Are issuers or their affiliates required to diligence their counterparties such as its customers to confirm that the goods purchased from issuers or their affiliates by counterparties are not resold to the Government of Iran or any sanctioned person specified under Section 13(r)(1)(D)?

Answer: As a general matter, no, unless issuers or their affiliates had the requisite knowledge that these counterparties were mere conduits for the issuer or affiliate to the Government of Iran or a sanctioned person specified under Section 13(r)(1)(D).

10. **Question:** A U.S. issuer has a foreign affiliate that sold medical devices to a private-sector customer in Iran during the period covered by a periodic report. The Iranian customer paid for the devices directly or indirectly through an Iranian bank covered by Section 13(r)(1)(D)(i), (ii), and/or (iii). Has the issuer’s affiliate knowingly conducted a transaction or dealing with the Iranian bank, requiring disclosure under Section 13(r)?

Answer: No. If the affiliate's bank received funds from a bank covered by Section 13(r)(1)(D), we do not believe the issuer or the affiliate conducted a “transaction or dealing” subject to disclosure. The “transaction or dealing” instead was with the customer, and is not disclosable unless the customer itself is an entity covered by Section 13(r)(1)(D)(i) or (ii), or an entity covered by Section 13(r)(D)(iii) and the sale was not pursuant to specific Federal authorization.

The answer might be different, however, if the issuer or its affiliate had an active role in structuring payments or other transactions with the bank, such as by directing the customer to route funds through the bank, or by presenting documents to draw funds under a letter of credit the customer obtained from the bank.

11. **Question:** The Commission has created a new EDGAR form to satisfy the notice requirement of Section 13(r)(3). What should be included in such notice?

Answer: A simple statement to the effect that the accompanying periodic report contains Section 13(r) disclosure should be sufficient.

12. **Question:** To the extent that an activity has been disclosed in a prior periodic report, need it be repeated in a more current report?

Answer: No, unless the activity continues into the period covered by the more current report.

13. **Question:** An issuer acquires another company that had disclosable activities under Section 13(r), but these activities were terminated prior to closing of the acquisition. Must the issuer report the activities of the company it acquired?

Answer: No. A transaction by an acquired entity that occurred prior to the acquisition is not a transaction by the issuer or an affiliate.

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