

## **THE NATIONAL INDUSTRIAL SECURITY PROGRAM OPERATING MANUAL**

### **An Overview of Foreign Ownership, Control, or Influence Regulations**

**January 2007**

U.S. Government contracts requiring Facility Security Clearances (“FCL”) will not be awarded to firms under foreign ownership, control, or influence (“FOCI”) unless adequate safeguards are in place to protect the national security. The National Industrial Security Program Operating Manual (“NISPOM”) provides government-wide guidance for determining whether U.S. companies are under FOCI, and implements U.S. Government policy for granting or continuing security clearances for U.S. companies found to be operating under FOCI.

In keeping with longstanding U.S. Government policies, the NISPOM recognizes that it is in the national interest of the United States to allow foreign investment in the defense industrial base where it is consistent with U.S. national security interests. One of the purposes of the National Industrial Security Program is to protect the defense industrial base against *improper* foreign influence or control.

The determination whether a U.S. company is under FOCI involves a comprehensive review of the company’s relationship with foreign persons, including (but not limited to) investors, directors, management, lenders, and customers. Foreign influence is considered in the aggregate, and the fact that one or more FOCI factors is present will not necessarily work to bar a company from receiving an FCL.

The determination that a company is under FOCI will, however, render the company ineligible for an FCL unless and until steps have been taken to mitigate FOCI to the satisfaction of the U.S. Government.

*It is particularly important for U.S. companies to consult with counsel when they are contemplating merger or acquisition with or by a foreign investor, or when they are planning to undertake significant relationships (including strategic alliances) with a foreign partner. Similarly, foreign investors contemplating the acquisition of a security-cleared U.S. contractor should review the impact of the acquisition on the target company's U.S. Government contracts, including an*

*assessment of whether the government is likely to require mitigation of FOCI and, if so, whether a FOCI mitigation plan can be structured to the mutual satisfaction of the U.S. Government and the foreign investor.*

The NISPOM includes procedures for industrial security investigations concerning mergers or acquisitions under review by the U.S. Government's Committee on Foreign Investment in the United States ("CFIUS"). The Exon-Florio provision of the Defense Production Act authorizes the President to investigate and, if necessary, block mergers, acquisitions, and takeovers of U.S. companies by foreign persons if the President determines that the transaction threatens the national security. CFIUS and industrial security reviews move on two parallel, but separate, tracks with differing time constraints and considerations. A satisfactory security arrangement, while a significant factor, is only one of the factors considered in a Department of Defense or other U.S. agency recommendation to CFIUS. (Technically, a security agreement cannot be signed until the transaction is closed. Therefore, the parties negotiate a shadow agreement, to be signed at the time of closing. In cases where the remaining issue is the industrial security arrangement, the Department of Defense may recommend a suspension if significant issues remain unresolved, or recommend blocking the transaction if there is indication that further negotiations are not likely to be successful.)

**The NISPOM recognizes four FOCI mitigation plans that permit foreign-owned companies to hold facility security clearances:**

(1) **Board Resolution** -- Where foreign investment in a company is sufficient enough to raise national security concerns, *but not enough to allow representation on the Board of Directors*, it will generally suffice for the Board to adopt a resolution certifying, among other things, that the foreign investor will be precluded from access to classified information, and will not be permitted to influence the performance of classified contracts. If foreign ownership is sufficient to elect a member to the Board, a Board resolution may not be used to mitigate FOCI, even if the foreign owner is not, in fact, represented on the Board.

(2) **Voting Trust Agreement and Proxy Agreement** -- Voting Trust Agreements and Proxy Agreements are devices employed in circumstances where a foreign investor is in a position to control a U.S. company. Under such agreements, typically three trustees (or proxy holders) are vested with control of the company, except for specifically identified matters, such as mergers or dissolution, for which the consent of the foreign stockholder may properly be required. All of the proxy holders/trustees must be clearable U.S. resident citizens with no prior involvement with either company. In practice, while the foreign stockholder may not influence the U.S. company under a Proxy Agreement, the U.S. Government generally permits the foreign stockholder to consult with the proxy holders on matters of importance to the company, and the NISPOM expressly permits such consultation "where otherwise consistent with U.S. laws, regulations, and the terms of the Voting Trust or Proxy Agreement." Under either arrangement, no restrictions are placed on the company's eligibility to have access to classified information or to compete for classified contracts. Although

the U.S. Government generally views Voting Trusts and Proxy Agreements alike for purposes of FOCI mitigation, both impose significant, and different, legal constraints on the foreign owner. For these reasons and others, consultation with U.S. counsel is advisable in structuring Proxy and Voting Trust Agreements.

(3) **Special Security Agreements/Security Control Agreements** -- The Special Security Agreement (“SSA”) may be used in cases where a foreign person owns or controls a U.S. company. Although a company under an SSA may have access to classified information for the performance of classified contracts, it may only have access to proscribed information<sup>1</sup> with special authorization following a National Interest Determination (“NID”). The standard for an NID is that the release of the proscribed information to the SSA company “shall not harm the national security interests of the United States.”<sup>2</sup> Under an SSA, the foreign investor may have minority representation on the Board of Directors if, among other restrictions, the directors representing the foreign investor are excluded from classified and export control matters.

If a company is not effectively owned or controlled by a foreign shareholder, but the foreign shareholder is represented on the Board of Directors, the company may be cleared under a Security Control Agreement (“SCA”). The SCA is similar to an SSA, except that limitations on access to classified information are not normally required by an SCA.

(4) **Limited FCL** -- A Limited FCL may be available to a foreign-owned U.S. company if the United States has entered into an Industrial Security Agreement with the government from which the foreign ownership is derived, and release of classified information is in conformity with the U.S. National Disclosure Policy. In extraordinary circumstances, a Limited FCL may also be available based on a compelling need statement provided by the U.S. Government contracting activity to the Cognizant Security Agency justifying the FCL and verifying that access to classified information is essential for contract performance. Access limitations are inherent with the granting of a Limited FCL and are imposed upon all of the cleared company’s employees, regardless of citizenship.

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<sup>1</sup> Proscribed information is defined in the NISPOM to include Top Secret information; Communication Security (COMSEC) information, except classified keys used for data transfer; Restricted Data as defined in the U.S. Atomic Energy Act of 1954, as amended; Special Access Program (SAP) information; and Sensitive Compartmented Information (SCI).

<sup>2</sup> Absent a secretarial waiver, the U.S. Department of Defense and the Department of Energy are prohibited, by statute, from entering into contracts with certain foreign government-owned or -controlled corporations if the contract requires access to proscribed information.

The NISPOM will require any company operating under a Voting Trust, Proxy Agreement, SSA, or SCA to establish a permanent committee of its Board of Directors known as a Government Security Committee (“GSC”). The GSC is to be composed of voting trustees, proxy holders, and outside directors, as applicable, and officer/directors who hold personnel security clearances. The purpose of the GSC is to ensure that the company maintains policies and procedures to safeguard classified information, and to ensure that the company complies with U.S. export-control laws.

Under the NISPOM, all companies cleared under a Voting Trust, Proxy Agreement, SSA, or SCA must also establish a Technology Control Plan “to reasonably foreclose the possibility of inadvertent access by non-U.S. citizen employees and visitors to export-controlled information for which they are not authorized.”

The NISPOM provides the outline for agreements that allow foreign investors to invest in U.S. defense and national security contractors without jeopardizing the security clearances that enable the companies to do the very work that makes them valuable investments. It provides a broad array of options, with varying degrees of control on the foreign investor, depending on the relationship between the U.S. company and the foreign investor. Careful attention to these requirements can enable the foreign investor to secure meaningful protection of its investment while, at the same time, addressing the national security interests of the United States.

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