

Outside Director and Proxy Holder Training:  
Module 3: Managing Relationships with Foreign Ownership,  
Control, or Influence (FOCI) Affiliates

Defense Security Service  
February 2014





# Training Objectives

- Business Structure
  - Affiliates
  - Organizational Chart
  - Governance Documents
  - SSA/SCA versus Proxy
  - Best Efforts
  - Senior Management Official
  - Inside Directors
  - Government Security Committee
  - Compensation Committee
- Managing the Relationship with the Affiliates
- Financial Reporting to the Affiliates
- Best Practices
- Reasons for Poor Security Ratings and Undue Influence





## Business Structure and FOCI – Affiliates

- Affiliates - The Ultimate Parent and each entity that directly or indirectly controls, is directly or indirectly controlled by (other than the FOCI Mitigated Company and its Controlled Entities), or is directly or indirectly under common control with the Ultimate Parent.
- FOCI Mitigation Agreements do not differentiate between Affiliates located in the United States versus those in foreign countries
  - FOCI Control Procedures apply equally to all Affiliates to ensure the Ultimate Foreign Interest can not directly or indirectly exert control or influence over the FOCI Company
  - DSS requires this given the FOCI Mitigation Agreements do not provide insight or control over the nature and scope of interactions between Affiliates in the U.S. and foreign Affiliates
  - Unmitigated Affiliates in the U.S. are representatives of the Ultimate Foreign Interest





## Business Structure and FOCI – Organizational Chart

- To ensure all FOCI interaction requirements are met it is critical to obtain or develop a Corporate Organizational Chart
  - The Organizational Chart can be used to identify all companies that are excluded as Affiliates and those that fall under the requirements of FOCI Mitigation Instrument
  - Developing an organizational chart, which differentiates between the FOCI Company and the Affiliates is a useful tool to educate employees on when their interactions are controlled in accordance with the FOCI Mitigation Instrument





# Business Structure and FOCI – Governance Documents

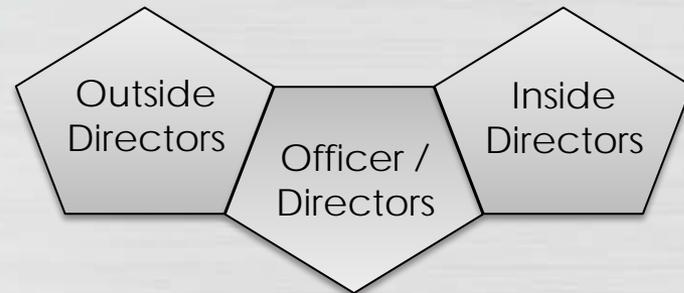
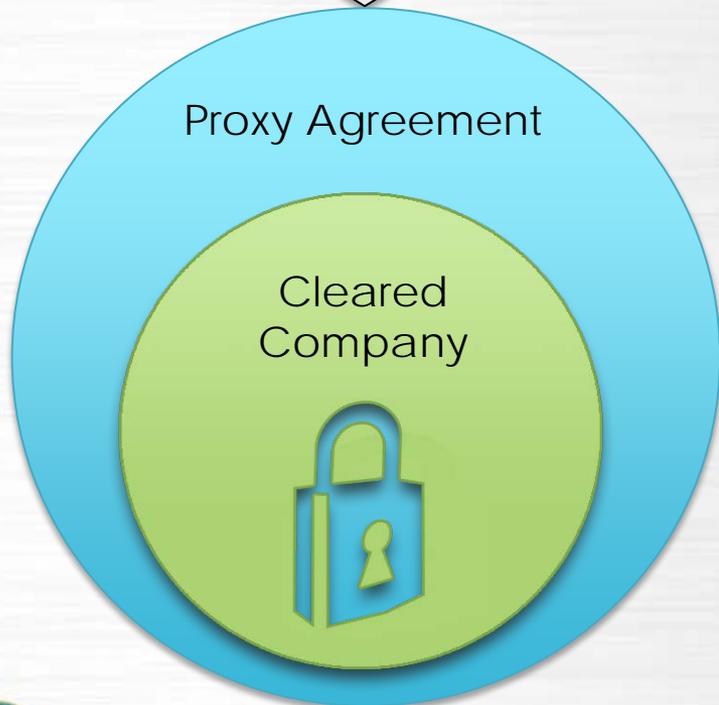
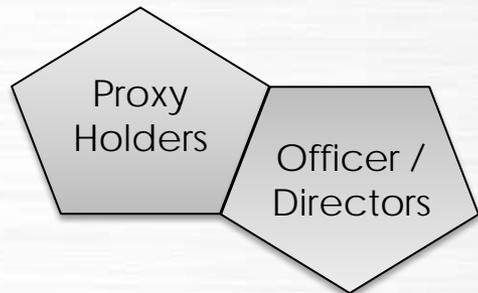
- The FOCI Mitigation Agreements set forth that the control of the FOCI Company shall be vested in the FOCI Company's Board or similar governing body
  - Outside Directors and Proxy Holders must be possessed with and capable of exercising all of the rights, powers, privileges, immunities and duties conferred or imposed upon such persons by applicable statutes and regulations, and by the FOCI Company's charter and governing documents
  - The FOCI Company's governing documents, any resolution, regulation, or bylaw shall be consistent with the requirements of the FOCI Mitigation Agreement\*
- Outside Directors and Proxy Holders should review the FOCI Company's governance documents to understand their rights and responsibilities as members of the Company's Governing Body

\*Which is accomplished through the execution of the FOCI Mitigation Agreement's authorizing resolutions





# Business Structure and FOCI: Governing Body





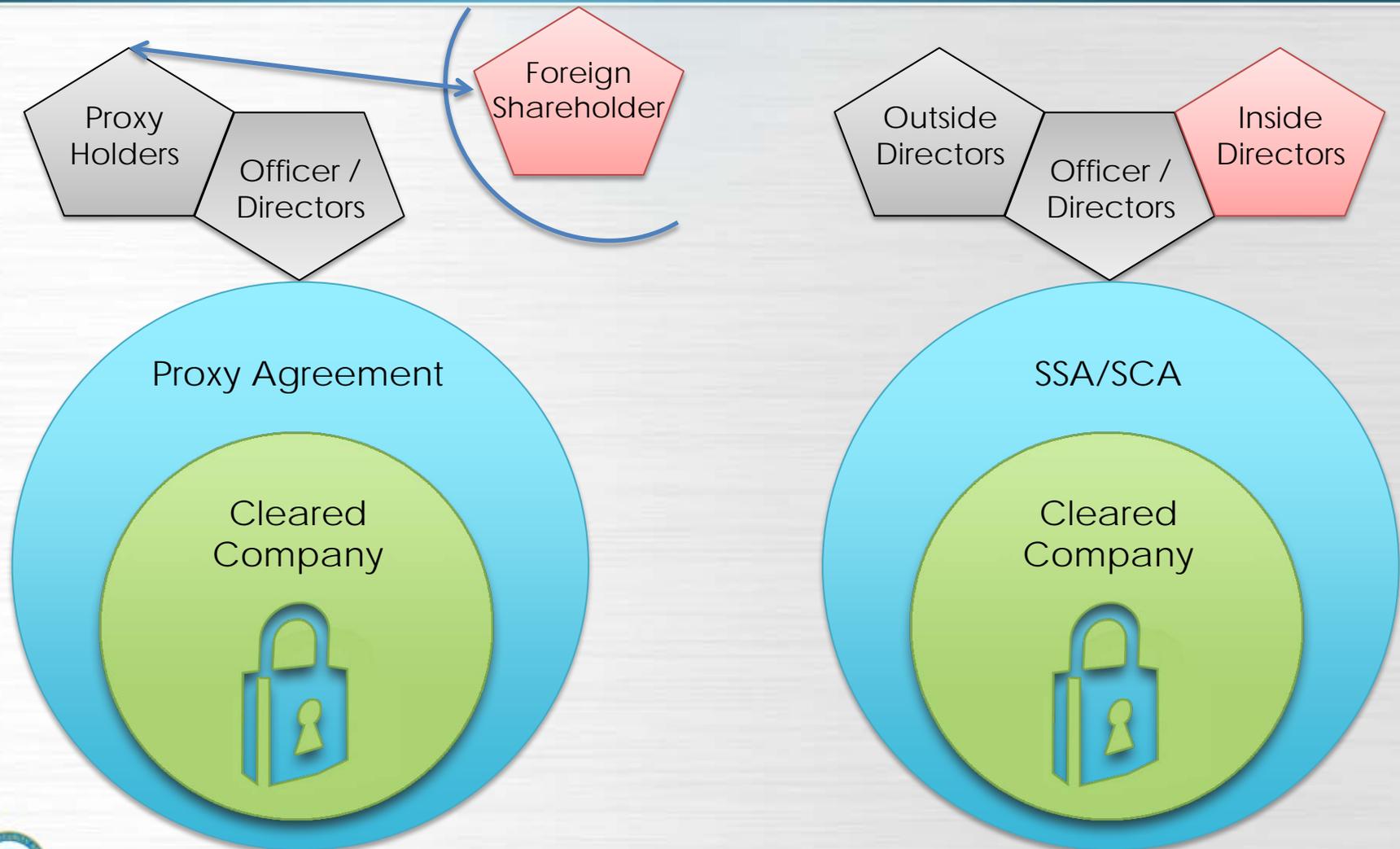
## Business Structure and FOCI – SSA/SCA versus Proxy

- SSA and SCA
  - The Affiliate’s participation in the management at the Company is limited to the position of an Inside Director(s) for those companies operating under Special Security Agreements and Security Control Agreements
- Proxy Agreements
  - Proxy Holders are expected to exercise all management prerogatives to ensure the FOCI Company is organized, structured, and financed to be capable of operating as a viable business entity independent from its parent companies and their Affiliates
- All FOCI Mitigation Agreements include limitations on the Company’s governing body to ensure certain “Investor Protections.”
  - These actions are defined in each FOCI Mitigation Agreement and require shareholder approval prior to the FOCI Company’s implementation





# Business Structure and FOCI: Proxy versus SSA/SCA





## Business Structure and FOCI – Best Efforts

- Each Outside Director and Proxy Holder is expected to perform his or her duties, including fiduciary duties, in good faith and in a manner believed to be:
  - (i) in the U.S. national interest;
  - (ii) where not inconsistent with the U.S. national interest, in the best interests of the FOCI Company and the FOCI Company's shareholders in accordance with the laws of the State of Incorporation to the extent that any such state law is not preempted by this Agreement; and
  - (iii) with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances





## Business Structure and FOCl – Senior Management Official

- Day-to-day operations of the FOCl Company will reside with the Senior Management Official (SMO)
  - The SMO shall be subordinate to the FOCl Company's governing body and shall not report directly to the Affiliates
  - DSS expects the FOCl Company's governing body to manage the reporting requirements to the Shareholder
    - This may be done through establishing the formatting and processes for the FOCl Company to report to the Shareholder
    - The FOCl Company's governing body should ensure reporting requirements to the Shareholder are met, but do not circumvent the governing body's responsibilities as the controlling entity for the FOCl Company
- The FOCl Company's governing body manages the performance reviews of the SMO and other company Senior Executives (as determined by the Compensation Committee) not the Affiliates





## Business Structure and FOCI – Inside Directors

- Companies operating under an SSA or SCA authorize the Affiliates to have representation on the governing body of the Company through the position of an Inside Director(s)
- An Inside Director shall **NOT**:
  - be the Chairman of the Board;
  - have access to classified or export controlled information held by the FOCI Company except as permissible under applicable U.S. law;
  - take any action to direct or decide matters affecting the management or operations of the FOCI Company in a manner that may result in unauthorized access to classified information, adversely affect the performance of contracts pursuant to which access to classified information may be required, or otherwise undermine the U.S. national interest due to unauthorized access to critical U.S. technology; and
  - seek and obtain classified information and Export Controlled Information in the possession of the FOCI Company except as permissible under applicable U.S. law





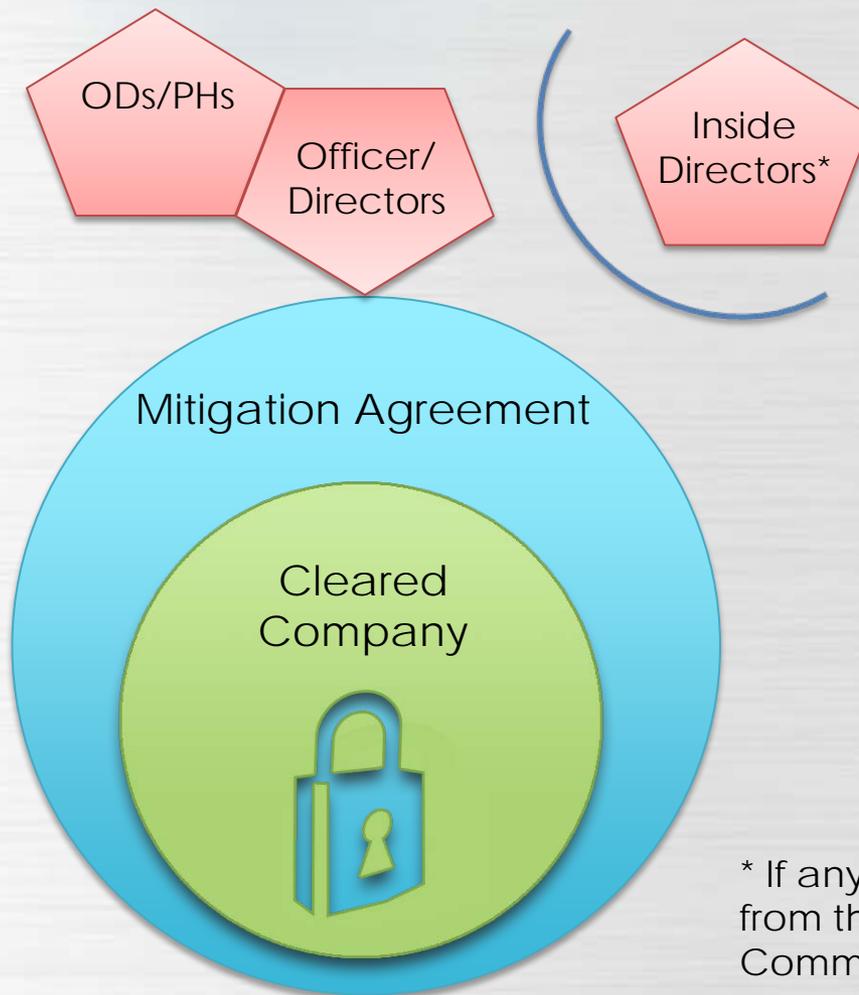
## Business Structure and FOCI – Government Security Committee

- All FOCI Mitigation Agreements require the establishment of a Government Security Committee (GSC) as a permanent committee of the FOCI Company's governing body
- The GSC is responsible for ensuring the FOCI Company establishes the requisite security policies and procedures
- The GSC consists of all Outside Directors/Proxy Holders and all cleared Officer Directors (if any)
- The Chairman of the GSC must be an Outside Director or Proxy Holder
- The Secretary of the GSC must be a member of the GSC





# Business Structure and FOCI – Government Security Committee



\* If any, they are excluded from the Government Security Committee





## Business Structure and FOCI – Compensation Committee

- All FOCI Mitigation Agreements require the establishment of a Compensation Committee as a permanent committee of the Company's governing body
- Responsible for reviewing the annual compensation of the Company's Key Management Personnel
- For an SSA or SCA the Compensation Committee must consist of at least one Outside Director and one Inside Director





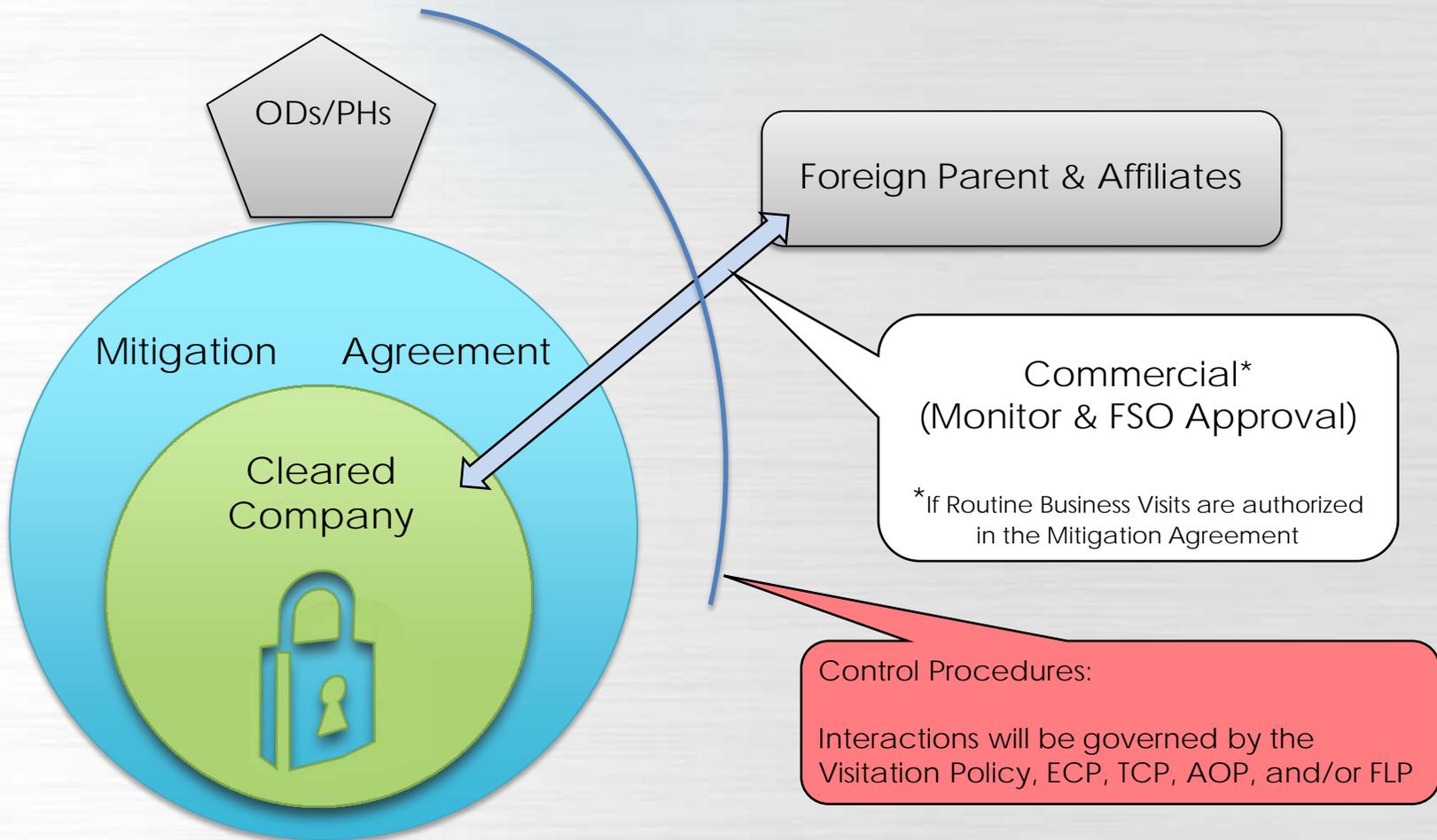
## Managing Relationships with the Affiliates

- All FOCI Mitigation Agreements expect the control of the FOCI Company to be vested in the FOCI Company Board or similar governing body
  - The FOCI Company to be structured in a manner to not be dependent upon the Affiliates to meet the performance requirements on classified contracts
  - The Affiliates shall not circumvent the FOCI Company's governing body with regards to the operations of the FOCI Company
- Through the FOCI Mitigation Control Procedures, the Government Security Committee shall maintain an understanding of the operational relationships between the FOCI Company and Affiliates
- DSS encourages the Government Security Committee to use metrics regarding the frequency and nature of interactions (i.e. visits, electronic communications) to focus on the areas with greatest risk

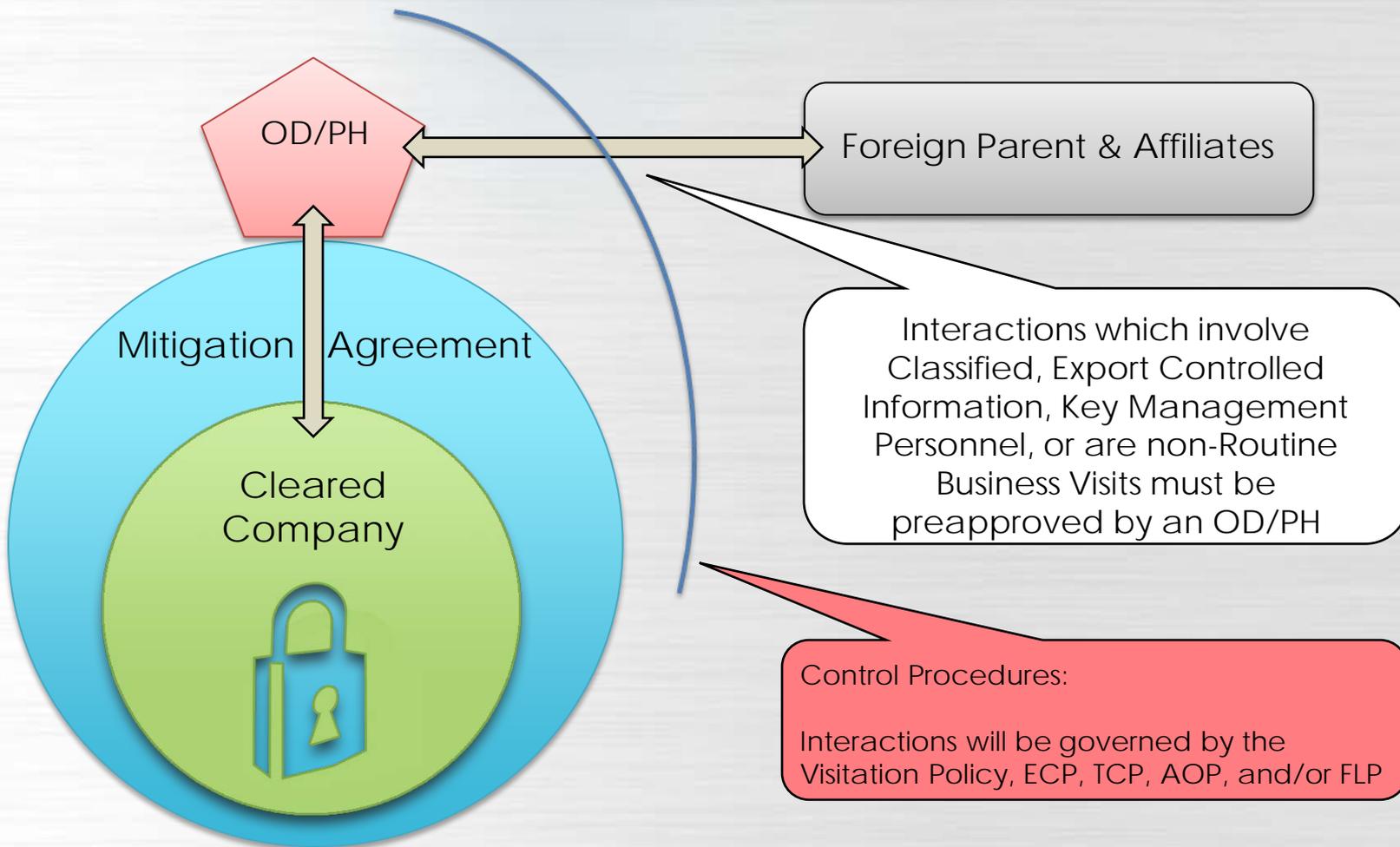




# Managing Relationships with the Affiliates: Commercial



# Managing Relationships with Affiliates: Non-Commercial





# Financial Reporting to the Affiliates

- All FOCI Mitigation Agreements allow for the flow of financial information from the FOCI Company to the foreign parent in a manner that does not compromise classified information or may adversely affect the performance of classified contracts
- The FOCI Company should coordinate with the Affiliates on the format for financial reporting
  - Proxy Agreements require DSS approval of the format
- FOCI Companies are required to provide the Affiliates with the following financial information:
  - financial statements;
  - budget forecasts;
  - independent financial audit reports;
  - financial information necessary to file consolidated tax returns;
  - information related to material investment or financing decisions; and
  - other financial documents in accordance with the FOCI Mitigation Agreement
- The format of the financial reporting is subject to approval by the Government Security Committee and should be reviewed at the quarterly Government Security Committee meetings





# Best Practices

- The Government Security Committee (GSC) and FOCl Company management are fully engaged regarding the requirements of the FOCl Mitigation Agreement & supportive of the security staff
- Automated approach to auditing FOCl requirements
  - 100% Capture of electronic communications
- Conducting FOCl compliance trend analysis and tailoring compliance policies & education to the recent trends
- Outstanding security education programs which foster a culture of understanding & compliance with the agreement and FOCl Control Procedures
- Conduct frequent self-inspections across the company to ensure compliance with the FOCl agreement and FOCl Control Procedures, as well as National Industrial Security Program Operating Manual (NISPOM) requirements
- Security staff involved in industry groups focused on compliance with FOCl & other NISPOM requirements
- Regular communication with DSS to ensure transparency on matters pertaining to FOCl and the NISPOM





# Reasons for Poor Security Ratings and Undue Influence

- Affiliates influencing or involved in the hiring, firing, and performance appraisals of FOCI Company employees
- Affiliates attempting to shift delivery timelines on classified contracts
- Affiliates using shared payroll services to withhold payment to personnel employed by the FOCI Company
- Establishment of reporting structures that circumvent the FOCI Company's governing body and feed directly to the Affiliates
- Lack of Separation Between Affiliates and the FOCI Company
  - Receipt of unapproved affiliated services
  - Unauthorized collocation
  - Integrated business operations and back office functions





# References

- *FOCI Information*
- [http://www.dss.mil/isp/foci/foci\\_info.html](http://www.dss.mil/isp/foci/foci_info.html)
- *FOCI Mitigation Instruments*
- [http://www.dss.mil/isp/foci/foci\\_mitigation.html](http://www.dss.mil/isp/foci/foci_mitigation.html)
- *FOCI Process In-process Companies*
- <http://www.dss.mil/isp/foci/in-process.html>
- *FOCI Process Acquisitions*
- <http://www.dss.mil/isp/foci/foreign-acquisitions.html>
- *FOCI Implementation Documents*
- <http://www.dss.mil/isp/foci/implementation-procedures.html>
- *NID Process*
- [http://www.dss.mil/isp/foci/nat\\_interest\\_deter.html](http://www.dss.mil/isp/foci/nat_interest_deter.html)
- *Regulations*
- [http://www.dss.mil/isp/fac\\_clear/download\\_nispom.html](http://www.dss.mil/isp/fac_clear/download_nispom.html)

