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**Mitigation of Foreign Ownership,
Control, & Influence
The Experience Under the
NISPOM**

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U.S. Defense Policy Encourages Foreign Investment in the Defense Industrial Base

“Foreign investment can play an important role in maintaining the vitality of the U.S. industrial base. **Therefore, it is the policy of the U.S. Government to allow foreign investment consistent with the national security interests of the United States.** The following FOCI policy for U.S. companies subject to an FCL [facility security clearance] *is intended to facilitate foreign investment* by ensuring that foreign firms cannot undermine U.S. security and export controls to gain unauthorized access to critical technology, classified information, and special classes of classified information.

National Industrial Security Program Operating Manual (“NISPOM”) Section 2-300.
(DoD 5220.22-M, 2/28/2006) [Emphasis added.]

The Regulatory Framework

Protecting Classified Information

- A U.S. company is considered under Foreign Ownership, Control, or Influence (“FOCI”) “whenever a foreign interest has the power, direct or indirect, whether or not exercised, and whether or not exercisable through the ownership of the U.S. company's securities, by contractual arrangements or other means, to direct or decide matters affecting the management or operations of that company in a manner *which may result in unauthorized access to classified information or may adversely affect the performance of classified contracts.*”
- “Whenever a company has been determined to be under FOCI, *the primary consideration shall be the safeguarding of classified information.*”
- “A U.S. company determined to be under FOCI is ineligible for an FCL unless and until security measures have been put in place to negate **or** mitigate FOCI. When a contractor determined to be under FOCI is negotiating an acceptable FOCI mitigation/negation measure, an existing FCL shall continue **so long as there is no indication that classified information is at risk of compromise**....An existing FCL shall be revoked if security measures cannot be taken to remove the possibility of unauthorized access or adverse affect on classified contracts.”
- “If the company does not have possession of classified material, and does not have a current or impending requirement for access to classified information, **the FCL shall be administratively terminated.**”

NISPOM 2-300 [Emphasis added.]

A Risk-Based System

- Under the NISPOM, FOCI negation or mitigation is triggered by the requirement for a Facility Security Clearance (“FCL”). No mitigation is required unless a foreign owned contractor requires an FCL. FOCI reviews and mitigation determinations are risk-based.
- The FOCI assessment reaches all manner of foreign ownership and control – but the key concern is the ability of the foreign owner “**to direct or decide matters affecting the management or operations of that company in a manner which may result in unauthorized access to classified information or *may adversely affect the performance of classified contracts.***”
- The primary consideration is the safeguarding of classified information.
- If the company does not possess classified material, and “does not have a current or impending requirement for access to classified information, **the FCL shall be administratively terminated.**”

A Risk-Based System

FOCI reviews are managed for the DOD and many other agencies (e.g., FBI) by the Defense Security Service (“DSS”). The Department of Energy and the National Nuclear Security Administration do their own FOCI assessments, but it is fair to say that DOE/NNSA policies are informed by DSS guidance. The DSS website and the NISPOM (2-301) note that the following factors are to be considered “in the aggregate” in determining whether a company is under FOCI, whether it should receive an FCL, and what protective measures should be required:

- Record of economic and government espionage against U.S. targets;
- Record of enforcement and/or engagement in unauthorized technology transfer;
- The type and sensitivity of the information that shall be accessed;
- The source, nature and extent of FOCI;
- Record of compliance with pertinent U.S. laws, regulations and contracts;
- The nature of any bilateral and multilateral security and information exchange agreements that may pertain; [and]
- Ownership or control, in whole or in part, by a foreign government.

Reviews are considered on a case-by-case basis. There is no entitlement to an FCL or a mitigation plan.

Forms of FOCI Mitigation/Negation

In majority control cases:

- Voting Trust -- Ownership is vested in an independent Trustee
- Proxy Agreement -- Voting rights are exercised by independent Proxy Holders
 - Limited reservation of rights
 - Consultation permitted with foreign owner per terms of agreement.
- Special Security Agreement – Foreign owner permitted direct representation on the Board of cleared company, provided that Board includes independent, cleared U.S. citizen Outside Directors (Outside Directors must outnumber directors representing foreign owner). Board will also include U.S. citizen Officer-Directors.
- Trustees, Proxy Holders, Outside Directors are chosen by foreign owner with approval of US Government. Removal requires notice to USG (permitted unless USG objects).

Forms of FOCI Mitigation/Negation

- Voting Trust – Exceedingly rare
- Proxy Agreement – Uncommon
- Special Security Agreement
 - SSA is Most Common Mitigation in Majority Control Cases
- SSAs require National Interest Determinations (NID) for access to Proscribed Information (e.g. TS, RD)
 - NIDs require agency finding that award is consistent with U.S. national security.
- Voting Trusts/Proxy Agreements have no access limitations and do not require NIDs.

Forms of FOCI Negation/Mitigation

- Minority Interest + Board Representation
 - Security Control Agreement
 - Outside Director Required
 - No access limitations
- Significant Minority Interest but *no* Board Representation
 - Board Resolution
 - No access limitations

Limited FCL

- Although rarely used, the NISPOM allows Limited FCLs without additional FOCI mitigation if:
 - There is an Industrial Security Agreement with foreign government of country where foreign owner is domiciled;
 - Release of classified information is consistent with US National Disclosure Policy; *or (even without these factors)*
 - There is a compelling need, consistent with U.S. national security interests.
- Limited FCLs carry access restrictions

Government Security Committee

- Common to Voting Trust, Proxy, SSA, and SCA
- Board-level committee comprised of cleared U.S. citizen directors (Officer-Directors and Outside Directors)
- Oversight of compliance with
 - Security agreement and its implementing procedures
 - Rules governing protection of classified information
 - ITAR/EAR rules governing exports

As directors, the members of the GSC have a fiduciary obligation to the Shareholder – but also have an obligation to the USG to ensure compliance with the agreement and US law.

Other FOCI Protections

- Visitation plans – OD or FSO approval required for visits with Parent (and with Affiliates outside the FOCI agreement -- including U.S. affiliates (“Affiliates”).
- Communications plans – Correspondence by the cleared company with Affiliates is monitored by Facility Security Officer and GSC.
- Shared administrative services with Affiliates (e.g., payroll processing, HR) require USG approval and may be restricted.
- Technology Control Plan must be in place to protect classified and export-controlled information.
- USG Approval required for co-location of facilities and secondment of personnel between companies.

Foreign-Owned US Government Contractors

- Some of the largest U.S. Government contractors are parties to FOCI mitigation agreements:
 - BAE Systems plc
 - Finmeccanica SpA
 - Accenture plc
 - Rolls-Royce Group plc
 - European Aeronautic Defence and Space Company
EADS NV

Foreign Investment and DoD

- DoD's Foreign Ownership, Control or Influence (FOCI) program includes more than 300 companies.
 - ~30 Proxy Agreements
 - ~100 Special Security Agreements
 - ~25 Security Control Agreements
 - Over 150 Board Resolutions

Core Values to FOCI Negation/Mitigation Plans as Implemented by DSS

- Facilitating foreign investment in the US defense industrial base, consistent with US national security.
- Protecting classified and export-controlled information against unauthorized disclosure.
- Protecting performance of classified contracts against “undue influence.”
- Ensuring that programs and policies are in place to promote compliance and allow for effective oversight.
- Ensuring transparency – Visits, communications, and shared services are disclosed and subject to review. USG can block or impose restrictions as it deems necessary.

Lessons from the NISPOM Experience

- The NISPOM is designed and intended to protect classified contracts and programs, and in this sense is not a perfect model for the NRC. Nevertheless, the DSS experience may inform the NRC's review of its foreign ownership policies.
- Case-by-case review allows FOCI mitigation to be tailored to the company and its risk profile.
- Decades of experience under the NISPOM demonstrate that FOCI can be effectively mitigated.
- The controls in place at companies operating under FOCI mitigation plans serve to enhance compliance *across the board*.

Value to the U.S. Defense Program

“[Foreign domiciled firms with US subsidiaries] are adding value to the US defense program by bringing investment and advanced technology to the defense market that expands and strengthens the defense industrial base resident in the US.”

Testimony of William Schneider, Jr., Chairman, Defense Science Board, US Department of Defense, Washington, D.C. before the Committee on the Armed Services, US House of Representatives, 2008.

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