

OD/PH Module 2: Administering the FOCI Agreement and Compliance Student Guide

Table of Contents:

Module 2 Introduction	2
Objectives	2
Basic Business Structure	2
Organizational Chart.....	3
Corporate Governance Document	3
Corporation Documents	3
General Partnership Documents	4
Limited Partnership Documents.....	4
Governing Body	4
Senior Management Officials	5
Inside Director	5
Government Security Committee	6
Compensation Committee	6
ODs, PHs & VTs	6
Adding, Replacing, or Removing.....	7
Operations of the FOCI Agreement	8
Best Efforts	8
Module 2 Conclusion.....	9

Module 2 Introduction

Welcome to Module 2, Administering the Foreign Ownership, Control, or Influence (FOCI) Agreement and Compliance.

This module supports the Outside Directors, Proxy Holders, and the Voting Trustees to identify the types of business structures, their corporate governance documents, and their role as a board member.

Now that the FOCI Mitigation Agreement is in place and the company's governing Board of Directors has been established, each party of the FOCI Agreement is entrusted to abide by the provisions in that Agreement. They also agree to ensure that there will be no unauthorized access of any classified and export-controlled information to the Affiliates.

Let's take a look at the objectives for this module.

Objectives

The objectives include an overview of the basic business structure which includes the organizational chart, governance documents, and governance body. We will familiarize you with the role of the Senior Management Official (SMO) and the Inside Director.

We will briefly go over the two committees known as the Government Security Committee (GSC) and the Compensation Committee. We will discuss the qualification, appointment, and removal of the Outside Directors, Proxy Holders, and the Voting Trustees. We'll explain the operation of the FOCI Agreement, best efforts and the board relationship with the Affiliates.

Let's start with the business structure and why it is important.

Please note that throughout this Module, the term "Affiliate" refers to both the foreign parent (foreign shareholder) and other companies owned by the foreign parent, including those located in the U.S.

Basic Business Structure

Understanding the basic business structure of your company and its corporate governance documents is critical to your position as a board member. Whether your company is a Privately or Publicly Held Corporation, Limited Liability Company (LLC), Limited or General Partnership you should review the governance documents to understand your role on the board.

Typically, the business structure includes an organizational chart, the governance documents such as Articles of Incorporation or Certificate of Formation, By-laws, Operating Agreements, Shareholders Agreement and Business License.

Once the FOCI Agreement is put in place, the Articles of Incorporation and the By-Laws should be changed or a meeting minute executed to establish the new corporate board to include the Outside Directors, Proxy Holders, or Voting Trustees as members. If applicable, the Senior Management Official and the Inside Director should be identified as well.

Refer to Course Resources link, Module 2 for more information.

We covered this basic business structure; now, let's talk about the organizational chart.

Organizational Chart

Business structures can be complex and may even involve more than one foreign entity in the chain of ownership or investments. It is important that you understand your Corporate Organizational Chart. The chart identifies all Affiliates (foreign parent-owned companies) in the chain of ownership and any companies that fall under the requirements of the FOCI Mitigation Agreement, such as any cleared subsidiaries.

Remember, the FOCI Agreement applies to the entire corporation, not just the cleared employees.

The Organizational Chart should also identify the associations between the cleared facilities and the ultimate parents to include percentages of ownership, Facility Security Clearance (FCL) status, Commercial and Government Entity (CAGE) codes and other helpful information explaining the relationship among the companies in the chain of ownership. It is also useful to educate employees of the company under FOCI and their interactions with the Affiliates.

Refer to Course Resources link, Module 2 for more information.

Now let's take a look at Corporate Governance Documents.

Corporate Governance Document

As a board member, it is important to recognize the company's business strategies and how to integrate the security measures of the FOCI Mitigation Agreement. This involves becoming familiar with the company's day-to-day operation.

Corporation Documents

Let's talk about corporate documents. The basic governance documents for a corporation include:

- Articles of Incorporation
- Corporate By-Laws
- Loan Agreements
- Shareholder Agreements (if applicable)
- Purchase Agreements
- Corporate Stock Ledger indicating stockholder's name(s)
- Overall percentage(s) of ownership, and
- Most recent copy of board meeting minutes
- Other governance documents that may require reviewing are: Letters of Intent, Partnership or Joint Venture Agreements, licensing and/or patent agreements, the company's financial reports, and Operating Agreements.

General Partnership Documents

In the case of an LLC and General Partnership the governance documents could include:

- Articles of Organization
- Operating Agreement
- Membership list with member/manager name(s)
- Overall percentage of capital commitment

Limited Partnership Documents

When the company is a Limited Partnership the Corporate Governance documents would include:

- Certificate of Limited Partnership,
- Partnership Agreement,
- Partnership list with limited/general partner name(s), and
- Overall percentage of capital commitment

Special attention should be placed on any foreign indebtedness or company's purchases of foreign subsidiaries, and how dependent the company is on the foreign entities or shareholders. These documents should be consistent with the FOCI Agreement.

Good corporate governance includes transparency for corporations and investors, sound disclosure policies, and communication beyond disclosure through dialogue and engagement as necessary and appropriate.

Companies must achieve the right balance between the appointment of independent and non-independent directors to ensure boards have an appropriate range and mix of expertise, diversity, and knowledge.

Governing Body

The FOCI company's governing body should ensure that reporting requirements to the shareholder(s) are met. These reports should not circumvent the governing body's responsibilities as the controlling entity for the FOCI company.

The governing body manages the performance reviews of the SMO and other company senior executives (as determined by the Compensation Committee). The Affiliate is not allowed to manage performance reviews.

It is important to familiarize yourself with the management of the company's business and the composition of the governing body or Board of Directors for both your company and all the Affiliates in the chain of ownership. This should include the Chief Financial Officer (CFO), Inside Counsel, and the President of the company.

As Outside Directors, Proxy Holders, and the Voting Trustees, you share all the same rights, powers, privileges, immunities, and duties as members of the board in decision-making of the company business and security matters.

When a company(s) is operating under a Special Security Agreement (also known as an SSA) or Security Control Agreement (SCA), the Affiliate's participations are limited to the position of the Inside Director(s).

Companies operating under Proxy or Voting Trust Agreements are expected to exercise all management prerogatives to ensure the FOCI company is organized, structured, and financed. The FOCI company should be capable of operating as a viable business entity independent from its Affiliates.

Senior Management Officials

The Senior Management Official (SMO) is one of the corporate Key Management Personnel (KMP). Examples of a SMO include such positions as the Chief Executive Officer (CEO) or the President.

The SMO shall be subordinate to the FOCI company's governing body and ***shall not report directly to the Affiliates***. The day-to-day operation of the FOCI company resides with the SMO.

The Defense Counterintelligence and Security Agency (DCSA) expects the FOCI company's governing body to manage the reporting requirements to the shareholder(s). This may be achieved by establishing the format and process for the FOCI company to report to the shareholder(s).

Inside Director

The Inside Director is a representative of the foreign parent company.

The Inside Director serves as one of the Board of Directors and is also a permanent committee board member on the Compensation Committee only for the SSA or the SCA.

Companies operating under an SSA or SCA authorize the foreign parent 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 operations of the FOCI company that may result in unauthorized access to classified information
- Adversely affect the performance of contracts which have access to classified information, or
- Undermine the U.S. national interest due to unauthorized access to critical U.S. technology

Please note that the Proxy Agreements and the Voting Trust Agreements do not have Inside Directors.

We just discussed the Inside Director's role. Now, we will discuss the two different committees starting with the GSC.

Government Security Committee

The GSC is a permanent committee of the corporation board, consisting of the Outside Directors, Proxy Holders, or Voting Trustees and other directors who are also officers of the corporation and who have personnel security clearances.

Members of the GSC shall exercise their “**Best Efforts**” to ensure the compliance measures are implemented pertaining to security and safeguarding of classified and export-controlled information.

Compensation Committee

The Compensation Committee is established and required in the SSA, SCA, and VTA. It is a permanent committee consisting of at least one Outside Director and one Inside Director (for SSA and SCA only).

The Committee is responsible for recommending the annual compensation of the corporation's company principals, who are the management personnel spelled out in the company's charter documents, to the corporation's board for approval.

In the Voting Trust Agreement, the Compensation Committee consists of three Trustee Directors elected by the Board of Directors. They decide which officers or other visitors to invite to the committee.

The committee has the authority to determine compensation for the Chief Executive Officers and other Executives.

The committee will have the sole authority to set, amend, or terminate corporate goals and objectives of the CEO.

ODs, PHs & VTs

On the Board of Directors, the number of Outside Directors should equal or exceed the number of Inside Directors for an SCA and must exceed the number of Inside Directors for an SSA. (Inside Directors are not allowed in a Proxy Agreement or Voting Trust Agreement.) As an Outside Director (Proxy Holder/Voting Trustee), you are expected to represent the national security interests of the United States and exercise all the rights, powers, and responsibilities as a board member, imposed by applicable statutes, regulations, and the corporation's charter and by-laws.

When you were nominated by your company to serve as an Outside Director (Proxy Holder/Voting Trustee), the following criteria applies as long as you hold that position. You:

- Must be a resident U.S. citizen
- Must be capable of exercising management prerogatives which ensure that the foreign owner/entity can be effectively insulated from the company.
- Must be a totally disinterested individual capable of exercising judgment independent of any influence(s) that might prejudice your decision-making capability.
- Must ensure that you have no potential conflicts of interest or business relationships with any other positions/boards that you may hold or serve.

- Must/continue to be eligible for a personnel security clearance at the level of the facility's clearance level.

Next, we will discuss the procedures for adding, replacing, or removing the Outside Directors, Proxy Holders and the Voting Trustees.

The Outside Directors, Proxy Holders, and Voting Trustees are responsible for the effective implementation of the FOCI Mitigation Agreement.

Their responsibilities include:

- Abide by and enforce the FOCI Agreement in place.
- Ensure the Facility Security Officer, directors, and employees comply with the provisions of the facility's Mitigation Agreement.
- Attend the quarterly Board and GSC meetings.
- Emplace a Technology Control Plan (TCP), Electronic Communications Plan (ECP), and Visitation Procedures.
- Ensure there are no Affiliated Services being provided between the FOCI company and the Affiliates that have not been approved in advance by the GSC and DCSA. Affiliated Services may also be called Affiliated Operations.
- For instances with potential FOCI Collocation, develop and submit a Facilities Location Plan for DCSA review and approval.
- Maintain oversight to ensure all Affiliated Services, FLPs, TCPs, ECPs, and Visitation Procedures are fully implemented and effectively mitigate the FOCI.
- Ensure that DCSA is advised of any known attempts to violate any provision of the facility's Mitigation Agreement or relevant U.S. government contract provisions related to security, U.S. export control laws, or the NISP.
- Communicate any material changes to DCSA.
- Serve on the GSC.

The GSC's responsibilities will be covered in detail in Module 3. In addition to these responsibilities, the Proxy Holders and Voting Trustees have other requirements outlined in their Proxy Agreement and Voting Trust Agreement that are unique. These requirements will be covered in detail in Module 4.

Adding, Replacing, or Removing

There are situations when Outside Directors, Proxy Holders, and Voting Trustees are removed or resign from their position. Other times a company may add additional Outside Directors, Proxy Holders, and Voting Trustees due to a possible change in the business structure. In the event of the death, resignation, removal or inability to act of any Outside Directors, Proxy Holders, and Voting Trustees the company should give prompt written notice to DCSA and the foreign parent.

The Outside Directors, Proxy Holders, and Voting Trustees may not be removed without a written notice stating no objection from DCSA. For special cases, the corporation can *immediately* remove an Outside Director, Proxy Holder, and Voting Trustee to prevent possible damage to the corporation or violations to statutes and regulations. DCSA can be notified prior to or concurrently

of this type of removal.

Here are some other common reasons for removal:

- Any reason permitted by the provisions of applicable state laws or the company's Certificate of Incorporation or By-laws
- Violations of the FOCI Agreement, or inability to protect the legitimate economic interest of the foreign parent.

Appointments of new and/or a replacement of Outside Directors, Proxy Holders, and Voting Trustees, should not become final without the approval by DCSA.

In the case of an SCA/SSA, if the company's shareholders removed the Outside Director, the successor is nominated by the company. In the event of a vacancy, the parent corporation fills the vacancy.

In the case of the Proxy Agreement or Voting Trust Agreement, the remaining Proxy Holder or Voting Trustee shall nominate a successor and notify the shareholders and DCSA of the nominee. As the sole stockholder, the parent corporation may remove an Outside Director, Proxy Holder, and Voting Trustee.

In the case of an SCA/SSA, the shareholder(s) can remove the Outside Director.

The Outside Director, Proxy Holder, or Voting Trustee positions must not be vacant for more than 90 days.

Operations of the FOCI Agreement

The key to the success of the FOCI company is the result of collaboration between management and the Outside Directors, Proxy Holders and Voting Trustees. Together they implement policies and practices through the GSC to ensure the safeguarding of classified and controlled unclassified information, to include the performance of the classified contracts or programs.

This is accomplished by putting security measures in place at the company such as:

- Technology Control Plan (TCP)
- Electronic Communications Plan (ECP)
- Affiliated Operations Plan (AOP)
- Facility Location Plan (FLP)

The GSC should also establish policies and procedures for the Visitation Policy and work closely with the FSO to ensure that all of these plans and policies are effective.

Best Efforts

Best Efforts is defined as:

Performing your duties, including fiduciary duties, in good faith and in a manner believed to be: (i) in the U.S. national interest; (ii) where not consistent with the national interest, in the best interest of the company and the company's shareholders in accordance with the applicable state law 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.

What should Best Efforts mean to you as a board member?

Your actions should reflect:

- honesty in belief or purpose,
- faithfulness to one's duty or obligation,
- observance of reasonable standards of fair dealing.

To achieve "Best Efforts" means "Performing your duties reasonably and in a manner believed to be in the best interests of the corporation but consistent with the national security concerns of the United States."

The FOCI company should be structured in such a way that it is not dependent upon the Affiliates to meet performance requirements on classified contracts.

The Affiliates should not circumvent the FOCI company's governing body with regards to the operations of the FOCI company.

As a member of the board you should establish your relationship with the Affiliates in the areas of:

- Commercial & Non-commercial;
- Financial Reporting to the Affiliates; and
- Role of the Inside Director, Outside Directors, Proxy Holders & Voting Trustees in relationship to the Affiliates.

Module 2 Conclusion

You have completed Module 2, on Administering the FOCI Agreement and Compliance, which covered the:

- Business Structure
- Senior Management Official
- Inside Director
- Government Security Committee and Compensation Committee
- Qualification, appointment, or removal of Outside Directors, Proxy Holders, and the Voting Trustees
- Operations of the Provisions of the FOCI Agreement
- "Best Efforts"
- Relationship with the Affiliates