Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits (MARS)

Student Guide

September 2017

Center for Development of Security Excellence

Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits (MARS) Short

Introduction

Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits, or MARS, are becoming more and more common and more and more complex. As the number and complexity of MARS transactions increase, so does the risk of an uncleared entity acquiring control of classified contracts. An FCL cannot be bought or sold as an asset!

In this course, you will learn what the MARS types are, key questions to ask and documents for review when a MARS transaction occurs, and evaluate the potential impacts of those transactions. In MARS transaction scenarios, you will recognize reporting thresholds and procedures and analyze risk. Through these scenarios, you will appreciate the benefits of advanced reporting.

So, what does happen when a MARS transaction takes place between cleared and uncleared entities? What change conditions affect the Facility Security Clearance, or FCL?

NISPOM: National Industrial Security Program Operating Manual, *Change 2*
DoD 5220.22-M Relevant Sections: • 1-302g. Change Conditions Affecting the Facility Clearance • 2-108. Multiple Facility Organizations • 2-109 Parent-Subsidiary Relationships • 2-302 Procedures • 2-310 Foreign Mergers, Acquisitions and Takeovers and the CFIUS

Mergers

Mergers and consolidations occur when two separate entities combine to create a new business entity. One or both of the original entities may or may not be cleared. Once the merger goes through, if Entity C will have classified contracts, it requires a facility security clearance (FCL).

Acquisitions

An acquisition refers to the takeover of one entity by another. The acquired entity may become a subsidiary or undergo liquidation. If a company will be working on existing classified contracts, it must have an FCL prior to beginning that work. This is true regardless of the type of transaction. FCLs do not transfer from one entity to another in an acquisition, whether it is a subsidiary or liquidation scenario.

Acquisitions where one entity acquires another entity that, in turn, becomes a subsidiary of the acquiring entity are commonly referred to as a stock purchase. Acquisitions where one entity acquires another entity that is then dissolved are liquidations that are commonly referred to as an asset purchase. Note, not all asset purchases result in a company being dissolved.

Reorganizations

Reorganizations and restructures are transactions that affect the legal, operational, ownership, or other structures of a business entity. There are many types of reorganizations. For example, a limited liability company, or LLC, may convert to a corporation or a corporation may convert to an LLC. In a true conversion, the entity must provide the certificate of conversion from the Secretary of State. The entity would then need to provide DSS with all documentation applicable to the new structure. The FCL remains active.

Another common reorganization can occur when a wholly-owned subsidiary becomes a branch office. Entity B should report an impending legal structure change and FCL termination as early as practicable. If classified contracts issued to Entity B will be novated to Entity A, both FCLs must remain active until novation is complete.

> **NOTE:** Companies should confirm that they have converted and not actually created a new entity.

Spin-offs/Splits

The last types of transactions we will discuss are the spin-off and the split. Spin-off transactions occur when a business unit of an entity becomes independent, for example, Entity B spins-off from Entity A.

- If Entity B spins-off from cleared Entity A, both entities will require FCLs to work on classified contracts.
- If cleared Entity A spins-off its classified efforts to Entity B, Entity A will no longer require an FCL.
- If Entity B spins-off from cleared Entity A and Entity A will maintain all classified work and Entity B will not support any classified contracts, Entity A's FCL will remain active.

A split transaction occurs when a single company splits into two or more new entities.

- If Entity B spins-off from cleared Entity A, both entities will require FCLs to work on classified contracts.
- If cleared Entity A spins-off its classified efforts to Entity B, Entity A will no longer require an FCL.
- If Entity B spins-off from cleared Entity A and Entity A will maintain all classified work and Entity B will not support any classified contracts, Entity A's FCL will remain active.

Red Flags

Each MARS transaction carries risk when classified contracts are involved. MARS transactions can set off a red flag for entities working on classified information as it can create multiple change conditions. When more than one change condition is reported at the same time or in connection with the same change, it sets off a red flag for entities working on classified information. A reported CAGE code change also sets off a red flag since legitimate CAGE code changes are very rare.

Let's look at change conditions that could set off red flags.

The National Industrial Security Program Operating Manual, or NISPOM, Section 1-302(g) defines change conditions that affect the FCL. These change conditions include ownership, legal structure, operating name, address, and key management personnel (KMP). Foreign Ownership, Control, or Influence (FOCI) are also changed conditions that can raise a red flag when they occur in conjunction with another change.

Cleared contractors must notify the IS Rep of any reportable change as soon as it is identified so DSS may process the change efficiently. Failure to report a known changed condition may have an adverse impact on the FCL and could lead to invalidation.

The Change Conditions Reporting Job Aid contains detailed information and examples on what types of company changes you should report to DSS, when to report a change, and what documentation you will need to provide.

Activity 1

Check your understanding of the red flags in this evolving scenario. **SCENARIO:** Pluto, LLC, a cleared company, is a subcontractor on numerous classified contracts with the same prime contractor.

For each reported change condition, select whether it is a red flag.

Select the best response; then check your answer in the Answer Key at the end of this Student Guide.

Question 1 of 4. Reported Change Condition: Pluto, LLC doing business as (dba) Pluto reports a name change to “Pluto”. Is this a red flag?

- O Yes
- O No

Question 2 of 4. Reported Change Condition: Pluto reports an address change from 123 Main St, Anytown, CO to 432 North Ave, Alexandria, VA. Is this a red flag?

- O Yes
- O No

Question 3 of 4. Reported Change Condition: Pluto reports a KMP/ownership change and provides the KMP and ownership of Saturn, Inc. doing business as (dba) Pluto. Is this a red flag?

- O Yes
- O No

Question 4 of 4. Reported Change Condition: Pluto, Inc. doing business as (dba) Pluto reports a CAGE code change. Is this a red flag?

- O Yes
- O No

Activity 2

Now try this question. **SCENARIO:** Saturn, Inc. acquired Pluto, LLC in an acquisition (liquidation) and Pluto, LLC was dissolved. Both entities used the DBA “Pluto” to “transfer” the FCL.

Can Saturn, Inc. work on the Pluto, LLC classified contract?

Select all that apply; then select Submit.

- ☐ Yes, because once Pluto, LLC was dissolved the work was taken over by Saturn, Inc.
- ☐ Yes, because Saturn, Inc. was doing business as Pluto
- ☐ No, because Saturn, Inc. does not have its own FCL
- ☐ No, because an FCL cannot be transferred and Saturn, Inc. is not cleared

MARS Categories

MARS transactions can be categorized in three levels of priority and noted risks. The highest priority is given to a transaction that results in an uncleared entity having control of, or influence over, existing classified contracts. The risks in these transactions are that the uncleared entity would have access to classified information and that work on a classified contract would have to stop until an FCL is obtained.

Medium priority transactions involve novation of existing classified contracts to a different entity, which requires FCL or changed condition processing. These transactions can be at risk because there may be a missing contractual link between the entity to which the contracts are issued and the entity actually working on the contracts. There is also a risk that the contract holder may be dissolved prior to novation completion.

A MARS transaction that results in a reportable changed condition with no new FCL required has a low priority. The risk is low for these transactions and results from the inherent risk of any changed condition.

Novation
An agreement in which a contracting party accepts a new party in place of the prior party (relieving the prior party of any further obligations). Refer to the FAR 42.12 for more information.

Merger Issue

Take a moment to read the Certificate of Merger document. What MARS scenario would this Certificate of Merger fall under?

State of Delaware
Secretary of State
Division of Corporations
Delivered 10:12 AM 12/30/2015
FILED 10:12 AM 12/30/2015
SRV 060711468 – 4197125 FILE

STATE OF DELAWARE
CERTIFICATE OF MERGER OF DOMESTIC CORPORATION INTO FOREIGN CORPORATION

Pursuant to Title 8, Section 252 of the Delaware General Corporation Law, the undersigned corporation executed the following Certificate of Merger.

FIRST: The name of each constituent corporation is Mercury, Inc. a California corporation, and Jupiter, Inc., a Delaware corporation.

SECOND: The Agreement of Merger has been approved, adopted, certified, executed and acknowledge by each of the constituent corporations pursuant to Title 8, Section 252.

THIRD: The name of the surviving corporation is Mercury, Inc. a CA corporation.

FOURTH: The Certificate of Incorporation of the surviving corporation shall be its Certificate of Incorporation.

FIFTH: The merger is to become effective on January 1, 2016

SIXTH: The agreement of Merger is on file at 123 Main Street,

What MARS scenario would this Certificate of Merger fall under?

Although Secretary of State documents describe this as a merger, there are two separate legal entities, Mercury, Inc. and Jupiter, Inc. and one of the original legal entities survives. DSS would need to focus on the surviving entity, Mercury, Inc. If this is not the legal entity DSS cleared, the company would need to work with DLA to obtain a new CAGE code and then submit a request to DSS to clear Mercury, Inc. This should be done BEFORE the transaction occurs to avoid compromising classified information.

This transaction is actually an acquisition – liquidation transaction. This example is to make the point that the word “merger” is sometimes used as a catch all for various types of transactions.

Note, not all CAGE code situations are the same.

Activity 3

Now check your understanding of the MARS prioritization.

Select the best response; then check your answer in the Answer Key at the end of this Student Guide.

Question 1 of 3. What priority is a transaction that involves novation of existing classified contracts to a different entity and does not result in an uncleared company gaining control over classified contracts?

- ○ High priority
- ○ Medium priority
- ○ Low priority

Question 2 of 3. What priority is a transaction that results in a reportable changed condition with no new FCL required?

- ○ High priority
- ○ Medium priority
- ○ Low priority

Question 3 of 3. What priority is a transaction where an uncleared company ultimately gains control over another company's classified contract?

- ○ High priority
- ○ Medium priority
- ○ Low priority

Roles and Responsibilities

Cleared contractors and DSS must work together when changed conditions are anticipated and occur. Cleared entity's must notify DSS of changed conditions before they occur even if they are just anticipated. Waiting until submission of the e-FCL package is too late to properly address the situation. With numerous stakeholders having varying interests, the cleared entity must coordinate meetings to ensure everyone is informed of key information on the changed condition. The Facility Security Officer (FSO) should always be involved for security purposes. Senior Management Officials (SMOs) will need to provide key information and points of contact for all entities involved in the upcoming change.

DSS's role in a MARS transaction is to discuss the legal documentation with the cleared contractors. This includes tracking how the original entity became the current entity and verifying the status of all entities requiring an FCL as legally organized and existing per NISPOM 2-102b. DSS will discuss the MARS type, the entities and contracts involved, and actions needed, such as a new entity needing to be cleared as soon as possible. DSS will coordinate with other field offices if multiple cleared facilities are impacted and coordinate changes in the National Industrial Security System (NISS), if a new entity needs to be cleared to minimize risk of an uncleared entity acquiring control of a classified contract(s). DSS will also define and mitigate foreign ownership, control or influence, or FOCI. FOCI will be discussed later in the course.

Stakeholders
Stakeholders include: • Legal representatives of buyer and seller • Senior Management Officials (SMOs) of all involved companies of buyer and seller • Facility Security Officer (FSO) • Corporate Administrative Contracting Officer / Administrative Contracting Officer (CACO/ACO) • Defense Security Service

NISS - National Industrial Security System
As of October 30, 2017, NISS is the system of record for facility clearance information, including submission of Initial FCL and Change Condition Packages.

Key Information

Key information FSOs and SMOs provide DSS on a MARS transaction includes:

- How ownership will change and legal documents related to the change

- When the change did/will occur and whether it will occur in phases
- The legal name and any fictitious or doing business as (dba) name
- Whether the legal entity DSS originally cleared will survive
- If novation of contracts to the new business that will be responsible for performance of the classified contracts is necessary, then identify:
    - The novation plan/timeline
    - Who will work on the classified contract(s)
    - Supporting contract documents
- Assurance that the government customer has been made aware of the novation and has agreed to the novation

Key Documents for Review

New business entity business documents are listed in the FCL Orientation Handbook. Take a moment to examine the list of key MARS transaction documents for review. Note, however, that not all of these documents will necessarily apply to your transaction.

Key MARS transaction documents* for review, include:

- Purchase Agreement/Merger Plan/MOU
- Commitment Letter (FOCI)
- Documentation for Trade Name, DBA, or Fictitious Name (certified by the Secretary of State)
- Novation Agreement (see FAR 42.12 for template)
- Authenticated copy of the instrument effecting asset transfer (Documentation submitted to or received from Secretary of State—Bill of Sale/Certificate of Merger/Contract Deed/Court Decree, etc.)
- Certified copy of each resolution of each corporate party's stockholder meeting necessary to approve transfer of assets
- List of Classified Contracts affected
    - Location of classified information

The FCL Orientation Handbook can be accessed at: http://www.dss.mil/documents/facility-clearances/FCL_Orientation_Handbook_18FEB15.pdf

Novation Agreement
A legal instrument executed by the contractor (transferor); successor in interest (transferee); and government; and by which among other things, the transferor guarantees performance of the contract, the transferee assumes all obligations under the contract, and the Government recognizes the transfer of the contract and related assets.

Activity 4

Now try this activity. **Scenario:** Neptune Inc. acquired all of the assets of Venus, LLC, which had a SECRET FCL and 4 classified contracts. This was reported to DSS after the transaction as a legal name, ownership, KMP, and address change. The new information provided was actually Neptune Incorporated's information, not Venus, LLC's. Venus, LLC no longer existed.

Select the best response; then check your answer in the Answer Key at the end of this Student Guide.

Question 1 of 4. Is this MARS transaction a merger?

- Yes
- No

Question 2 of 4. Does this MARS transaction send up a red flag?

- Yes
- No

Question 3 of 4. Could the Venus, LLC FCL be invalidated?

- Yes
- No

Question 4 of 4. Does the FCL transfer to Neptune, Inc. now that Venus, LLC is dissolved?

- Yes
- No

Reporting Thresholds and Procedures

As soon as possible, and ideally before it is finalized, a MARS transaction should be reported to DSS. Facilities should provide a MARS plan, even informally, that outlines the pre- and post-transaction legal structure, impact on classified contracts, novation plan and timeline and then provide updates along the way.

There are several reporting thresholds to keep in mind for a successful transition when classified contracts are involved in the MARS transaction.

DSS Seal

If a new entity needs to be cleared as a result of a MARS transaction, the FSO and SMOs should notify DSS as soon as possible and forward the MARS Plan and any contractual documentation. When a Corporation converts to an LLC or vice versa, it is often legitimately the same legal entity and the FCL remains with the entity. You must, however, provide DSS with all new legal documentation for the new business structure. If a new entity was actually created, a complete FCL package meeting the requirements outlined in the FCL Orientation Handbook for a company new to the NISP must be received in the National Industrial Security System (NISS) in a timely manner.

Changed Conditions Affecting FCL

Often, one change within a company may have rippling effects leading to several reportable change conditions. Typical documentation for each business structure that should be provided for DSS review and validation of the reported change can be found in the Change Conditions Reporting Job Aid at http://www.cdse.edu/documents/toolkits-fsos/change-conditions-job-aid.pdf .

Remember, failure to report a known changed condition as soon as it is identified may have an adverse impact on the FCL. When a reportable change has been identified, cleared contractors must submit a changed condition package in NISS.

Novation Agreement

Novation agreement and change-of-name-agreement processes go hand-in-hand.

- Some business sales, such as those accomplished as an asset sale, may require novation of contracts to the new business that will be responsible for performance of the classified contracts.
- FAR 42.12 prescribes policies and procedures for
  - Recognition of a successor in interest to Government contracts when contractor assets are transferred
  - Recognition of a change in a contractor’s name

- Execution of novation agreements and change-of-name agreements by the responsible contracting officer
- Note that novation is a contractual decision and is the responsibility of the contracting officer at the Government Contracting Activity (GCA).
  - DSS has no say in the novation process.

It is important to note that due to long novation timelines, a contractual relationship between the entity awarded the contract and the new entity doing the work must be established in the interim.

Novation
Novation: An agreement in which a contracting party accepts a new party in place of the prior party (relieving the prior party of any further obligations). Refer to the FAR 42.12 for more information.

FCL Noncompliance & Invalidation

A MARS transaction that is noncompliant with the NISPOM can result in the FCL invalidation. Take a moment to examine the circumstances in which this may occur.

Transaction is not reported to DSS prior to completion	➡	Transaction results in an uncleared company taking control of classified contracts
Transaction is reported to DSS prior to completion, but the FCL for the new entity is not in place prior to the closing of the transaction	➡	An uncleared company gains control of classified contracts
A cleared entity is dissolved	➡	Classified contracts have not been novated to another cleared entity

MARS transactions can result in numerous situations that would negate the integrity of the contractor's security program.

Uncleared Company Taking Control of Classified Contracts
If the MARS transaction has already occurred or, if at any point, an uncleared entity takes control of an existing FCL, DSS will invalidate the FCL as an interim measure to allow the contractor to correct circumstances that: • Negate the integrity of the contractor's security program OR • Result in the potential for compromise of classified information

Mars Transactions Involving FOCI

A final change condition affecting the FCL is a MARS transaction involving FOCI.

A company is required to complete the SF 328, Certificate Pertaining to Foreign Interests, when applying for an FCL or when significant changes occur to information previously submitted. This applies to the processing of all new companies, not just ones under FOCI.

NOTE: In the case of a corporate family, the SF 328 form shall be a consolidated response rather than separate submissions from individual members of the corporate family.

When a contractor with an FCL enters into negotiations for the proposed merger or acquisition by a foreign interest, the contractor submits notification to the Cognizant Security Agency (CSA) at the commencement of such negotiations.

The Committee for Foreign Investments in the United States (CFIUS) is an interagency committee chaired by the Treasury Department that conducts reviews of proposed mergers or acquisitions of U.S. persons by foreign interests. The CFIUS review and the CSA industrial security FOCI review are carried out in two parallel but separate processes with different time constraints and considerations. CFIUS timelines are aggressive and must be strictly adhered to. Please note, that the CFIUS process is a voluntary process entered into by the contractor.

If a MARS is filed in CFIUS, the FCL becomes an immediate priority for DSS and the MARS transaction category becomes an immediate Level 1, high priority. If a MARS transaction results in a substantive change to FOCI, additional coordination with DSS may be necessary to ensure appropriate steps are taken to manage risk related to existing and future FOCI. If unmanaged FOCI exists, or an entity does not provide information necessary to evaluate the transaction in a timely manner, invalidation procedures ensue.

Activity 5

Given an asset purchase with the transfer of classified contracts, where entity A is not cleared and Entity B is cleared, if Entity A cannot be cleared before Entity B is dissolved, what level of criticality is this transaction and what steps will happen next?

Select the best response; then check your answer in the Answer Key at the end of this Student Guide.

- ○ Low priority – Entity A will take over Entity B's classified work while DSS processes its FCL and validates reported change conditions.
- ○ Medium priority – Entity A and Entity B will report change conditions and Entity B's FCL will transfer to Entity A.
- ○ High priority – Entity B's FCL may be invalidated until Entity A obtains the required FCL and novation commences.

Course Conclusion

Summary

Congratulations! You have completed the *Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits* Short.

In this Short, you learned about the various MARS transactions in the NISP and how to categorize their criticality levels and associated risks. You examined the roles and responsibilities of cleared contractors and DSS when embarking on these types of transactions and the changed conditions that must be reported in order to safeguard classified information. Key point: Failure to report a known changed condition may have an adverse impact on the FCL and could lead to invalidation.

You also evaluated various scenarios to determine the impact of a transaction, the risks, and next steps when negotiating a transaction. Red Flags occur when:

- More than one changed condition reported at the same time or in connection with the same change
- CAGE Code change

Most importantly, you discovered that by apprising DSS of an upcoming transaction and working together, you can seamlessly transition a classified contract to a new entity with the appropriate FCL without loss of time and invalidation proceedings.

For more detailed information, refer to the accompanying *Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits (MARS) Job Aid*.

You should now be able to perform all of the listed activities.

- Evaluate the impacts of MARS transactions
    - o Analyze the risk in the given MARS scenarios

Appendix A: Answer Key

Review Activities

Activity 1

Check your understanding of the red flags in this evolving scenario. **SCENARIO:** Pluto, LLC, a cleared company, is a subcontractor on numerous classified contracts with the same prime contractor. Over several weeks, the entity reports multiple name changes, a KMP and ownership change, an address change, and a CAGE code change.

For each reported change condition, select whether it is a red flag.

Question 1 of 4. Reported Change Condition: Pluto, LLC doing business as (dba) Pluto reports a name change to “Pluto”. Is this a red flag?

- ⦿ Yes
- ○ No

Feedback: *Yes. A legal business name must include a designation identifying the type of business (e.g. LLC, Corp, Inc., or G.P.) and must match exactly the information on file with the jurisdiction whose laws the company is organized and existing under. In most cases, this will be reflected on a Certificate of Incorporation or Organization or a Certificate of Name Change or Amendment or similar document filed with the Secretary of State’s office in the applicable state. “Pluto” is not the company’s legal name and should not be reported as such. It is a name the company can legally use in doing business, which has many names that vary depending on the jurisdiction and include doing business as name (DBA), fictitious name, trade name, or also known as (AKA) name. In this case, this company should report any officially registered DBA names to DSS but the legal name of the company remains “Pluto, LLC”.*

Question 2 of 4. Reported Change Condition: Pluto reports an address change from 123 Main St, Anytown, CO to 432 North Ave, Alexandria, VA. Is this a red flag?

- ○ Yes
- ⦿ No

Feedback: *No. An address change is not necessarily a red flag. However, when combined with several other change conditions, it may indicate a need for a closer look.*

Question 3 of 4. Reported Change Condition: MARS reports a KMP/ownership change and provides the KMP and ownership of Saturn, Inc. doing business as (dba) Pluto. Is this a red flag?

- ⦿ Yes
- ○ No

Feedback: *Yes. While Saturn, Inc. has registered for the exact same DBA name in its own jurisdiction of formation that Pluto, LLC reported, the two companies are separate legal entities formed under separate jurisdictions with different business structures and governance documents.*

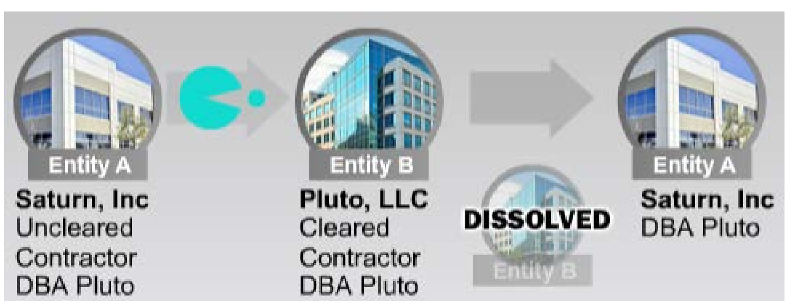
Question 4 of 4. Reported Change Condition: Pluto, Inc. doing business as (dba) MARS reports a CAGE code change. Is this a red flag?

- ⦿ Yes
- ○ No

Feedback*: Yes. A CAGE code change is almost always a red flag. In most cases, CAGE codes cannot simply be transferred among legal entities. If two separate legal entities exist, typically, they each must obtain separate CAGE codes. It is extremely rare that a company with an existing FCL would be in a position that would enable them to change their CAGE code to a different legal entity without also being in a position that would adversely impact the FCL.*

Activity 2

Now try this question. **SCENARIO:** Saturn, Inc. acquired Pluto, LLC in an acquisition (liquidation) and Pluto, LLC was dissolved. Both entities used the DBA “Pluto” to “transfer” the FCL.



Can Saturn, Inc. work on the Pluto, LLC classified contract?

- ☐ Yes, because once Pluto, LLC was dissolved the work was taken over by Saturn, Inc.
- ☐ Yes, because Saturn, Inc. was doing business as Pluto

- ☑ No, because Saturn, Inc. does not have its own FCL
- ☑ No, because an FCL cannot be transferred and Saturn, Inc. is not cleared

Feedback: *No, Saturn, Inc. cannot work on the dissolved entity's classified contract because it does not have an FCL and the FCL cannot be transferred. Though both entities used the DBA "Pluto" this did not demonstrate any actual connection between the two companies.*

Activity 3

Now check your understanding of the MARS levels of criticality.

Question 1 of 3. What priority is a transaction that involves novation of existing classified contracts to a different entity?

- ○ High priority
- ⦿ Medium priority
- ○ Low priority

Feedback: *A transaction that involves a novation agreement is a medium priority that may have a risk of a missing contractual link between the companies.*

Question 2 of 3. What priority is a transaction that results in a reportable changed condition with no new FCL required?

- ○ High priority
- ○ Medium priority
- ⦿ Low priority

Feedback: *This is a low risk transaction, assuming the transaction is properly categorized.*

Question 3 of 3. What priority is a transaction where an uncleared company ultimately gains control over another company's classified contract?

- ⦿ High priority
- ○ Medium priority
- ○ Low priority

Feedback: *This is a high priority transaction that could lead to access to classified information and cause work stoppage until an FCL is obtained.*

Activity 4

Now try this activity. **Scenario:** Neptune Inc. acquired all of the assets of Venus, LLC, which had a SECRET FCL and 4 classified contracts. This was reported to DSS after the transaction as a legal name, ownership, KMP, and address change. The new information provided was actually Neptune Incorporated's information, not Venus, LLC's. Venus, LLC no longer existed.

Question 1 of 4. Is this MARS transaction a merger?

- ○ Yes
- ⦿ No

Feedback: *This transaction is commonly known as an asset purchase, which is a type of Acquisition Liquidation.*

Question 2 of 4. Does this MARS transaction send up a red flag?

- ⦿ Yes
- ○ No

Feedback: *This transaction sends up a red flag because there are multiple changed conditions, the cleared entity was dissolved, and incorrect information was provided to DSS.*

Question 3 of 4. Could the Venus, LLC FCL be invalidated?

- ⦿ Yes
- ○ No

Feedback: *The FCL for Venus, LLC could be adversely impacted based on not meeting NISPOM requirements.*

Question 4 of 4. Does the FCL transfer to Neptune, Inc. now that Venus, LLC is dissolved?

- ○ Yes
- ⦿ No

Feedback: *Neptune, Inc. must be processed for an FCL. Had this been reported to DSS prior to the MARS transaction, DSS may have been able to work with the companies to process Neptune Inc. for an FCL in advance of the MARS transaction to facilitate a smooth transition of the work on the classified contracts.*

Activity 5

Given an asset purchase with the transfer of classified contracts, where Entity A is not cleared and Entity B is cleared, if Entity A cannot be cleared before Entity B is dissolved, what level of criticality is this transaction and what steps will happen next?.

- ○ Low priority – Entity A will take over Entity B's classified work while DSS processes its FCL and validates reported change conditions.

- ○ Medium priority – Entity A and Entity B will report change conditions and Entity B’s FCL will transfer to Entity A.
- ⦿ High priority – Entity B’s FCL may be invalidated until Entity A obtains the required FCL and novation commences.

Feedback: *This is a red flag transaction at High priority. If Entity A is not cleared prior to the dissolution of Entity B, the FCL for Entity B may be invalidated to ensure GCAs are aware that an uncleared company controls the classified contracts. The invalidation will remain in place until Entity A obtains an FCL at the required level and novation commences. Only after novation is complete will the FCL for Entity B be terminated (may not occur concurrently with the dissolution of Entity B).*

Job Aid: Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits (MARS)

Contents

Part 1: MARS Basics

MARS Transaction Types

Merger/consolidation: A merger occurs when two separate entities combine forces to create a new business entity.

Acquisition: An acquisition refers to the takeover of one entity by another. The acquired entity may become a subsidiary or liquidation.

- Subsidiary - Entity A acquires Entity B, which becomes a subsidiary of Entity A. Commonly referred to as a stock purchase.
- Liquidation - Entity A acquires Entity B and Entity B is dissolved. Commonly referred to as an asset purchase.

Reorganization/restructure: The act of reorganizing the legal, operational, ownership, or other structures of a business entity. For example:

- LLC converts to a corporation or vice versa.
- Wholly-owned subsidiary becomes a branch office.

Spin-off: In a spin-off, a business area of an entity becomes an independent entity with assets, employees, intellectual property, technology, or existing products that are taken from the original entity.

Split: A single entity splits into two or more new entities.

Red Flags

More than one changed condition reported at the same time or in connection with the same change.

Change Conditions Affecting the Facility Clearance include:

- Ownership
- Legal Structure
- Operating Name
- Address
- Key Management Personnel (KMP)
- Foreign Ownership, Control, or Influence (FOCI)

Report of a CAGE code change. Legitimate CAGE code changes are very rare.

MARS Categories

Priority	Description	Risk
HIGH	Any MARS transaction in which an uncleared entity will ultimately have control of or influence over existing classified contracts	• Uncleared entity controlling classified contracts • Uncleared entity accessing classified • Work stoppage/interruption
Medium	Any MARS transaction that involves novation of existing classified contracts to a different entity; FCL action(s) or changed condition(s) need to be processed with consideration to novation process	• Missing contractual link between the entity classified contracts are issued to and the entity working on the contracts • Contract holder dissolving prior to novation completion *Note: If the transaction is filed in CFIUS, it becomes an immediate* MARS *Level 1.*
Low	A MARS transaction that results in a reportable changed condition with no new FCL required.	• Assuming MARS is properly categorized, risk is low and results from the inherent risk from any changed condition

Part 2: Roles and Responsibilities

Cleared Entity's Role

- With numerous stakeholders having varying interests, coordinate meetings to ensure everyone is speaking the same language. Stakeholders include:
  - Legal representatives of buyer and seller
  - Senior Management Officials (SMOs) of all involved companies of buyer and seller
  - FSO (should always be involved for security purposes)
  - Corporate Administrative Contracting Officer / Administrative Contracting Officer (CACO/ACO)
  - Defense Security Service
- Provide information/documentation/timelines on the upcoming change
- Provide POCs representing all involved entities to whom DSS may reach out
- Key information FSOs and SMOs provide DSS on a MARS transaction:
  - How ownership will change and legal documents related to the change
  - When the change did/will occur and whether it will occur in phases
  - The legal name and any fictitious or doing business as (dba) name(s)
  - Whether the legal entity DSS originally cleared will survive
  - If novation of contracts to the new business that will be responsible for performance of the classified contracts is necessary, then identify the novation plan/timeline; who will work on the classified contract(s); and supporting contract documents

Key Tips

If an anticipated MARS transaction will result in a new entity needing to be cleared, inform DSS for streamlined processing as soon as possible to minimize the risk of an uncleared entity acquiring control of a classified contract(s).

Due to long novation timelines, a contractual relationship between the entity awarded the contract and the new entity doing the work must be established in the interim. FAR 42.12 outlines novation and change-of-name-agreement processes. Note that novation is a contractual decision and is the responsibility of the contracting officer at the Government Contracting Activity (GCA).

MARS Transactions Involving FOCI

- Committee for Foreign Investments in the United States (CFIUS) timelines are aggressive and must be strictly followed. If a MARS is filed in CFIUS, the FCL becomes an immediate high priority.
- If a MARS transaction results in a substantive change to FOCI, DSS takes steps to mitigate risk. However, if unmitigated FOCI exists or an entity does not provide information necessary to evaluate the transaction in a timely manner, invalidation procedures may ensue.

Part 3: Key Documents in MARS Transactions

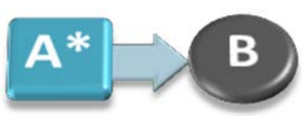
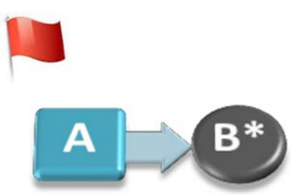
SMOs and FSOs must ensure the MARS transaction documents are available for DSS review. Examples are:

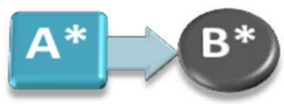
- ☑ Purchase Agreement/Merger Plan/MOU
- ☑ Commitment Letter (FOCI)
- ☑ Documentation for Trade Name, DBA, or Fictitious Name (certified by the Secretary of State)
- ☑ Novation Agreement (see FAR 42.12 for template)
- ☑ Authenticated copy of instrument effecting asset transfer (Documentation submitted to or received from Secretary of State—Bill of Sale/Certificate of Merger/Contract Deed/Court Decree, etc.)
- ☑ Certified copy of each resolution of each corporate party's stockholder meeting necessary to approve transfer of assets
- ☑ List of Classified Contracts affected
- ☑ New business entity business documents (see *FCL Orientation Handbook* pages 8 and 9)

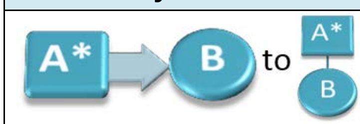
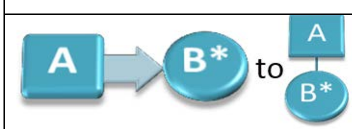
NOTE: Not all of these documents will apply.

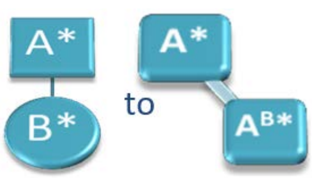
Part 4: MARS Scenarios

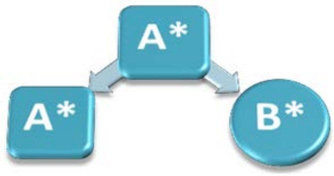
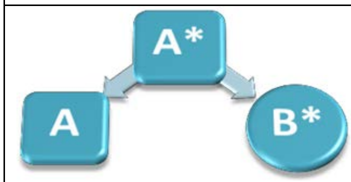
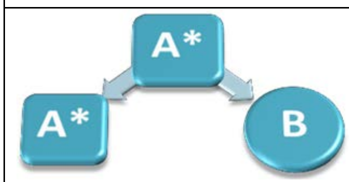
Asterisk (*) denotes a cleared entity.		***Gray indicates the entity does not survive the MARS transaction.***	
MERGER	**Description**	**Priority**	**Action**
	Entity C will have classified contracts. Entity A and Entity B may or may not be cleared.	**Medium**	Entity C must be processed for an FCL. In this scenario, Entity A and/or Entity B is cleared and has classified contracts that will require novation to Entity C.

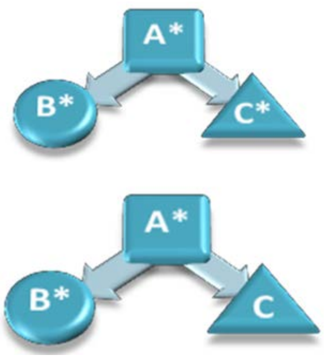
ACQUISITION **Liquidation**	**Description**	**Priority**	**Action**
 Scenario 1	Entity A is cleared and acquires Entity B, which is not cleared.	**Low**	Entity A reports changed condition(s) resulting from acquisition, if applicable (e.g. KMP change, address change, SF-328 change, etc.)
 Scenario 2	Entity A (the acquired Entity) is not cleared. Entity B (the acquired Entity that is ultimately dissolved) is cleared. *Legally speaking, companies involved in scenario 2 often think they have acquired the FCL as an asset.*	**HIGH**	*This scenario is possibly the most critical MARS type.* Entity B should provide DSS with their formal or informal acquisition plan as early and often as possible. Entity A will need to be cleared prior to the dissolution of Entity B. If this cannot be accomplished or Entity A does not meet FCL process deadlines, the FCL for Entity B may be affected

ACQUISITION **Liquidation**	**Description**	**Priority**	**Action**
 Scenario 3	Both Entity A (the acquiring entity) and Entity B (the acquired entity that is ultimately dissolved) are cleared at the appropriate level.	**Medium**	Entity A reports changed condition(s) resulting from acquisition, if applicable (e.g. KMP change, address change, SF-328 change, etc.) Entity B should report the impending legal structure change and FCL termination as early as practicable. If classified contracts issued to Entity B will be novated to Entity A, both FCLs must remain active until novation is complete. Both entities should keep DSS updated on the novation process.

ACQUISITION **Subsidiary**	**Description**	**Priority**	**Action**
 Scenario 1	Entity A is cleared and acquires an uncleared entity, Entity B.	**Low**	Entity A reports changed condition(s) resulting from acquisition, if applicable (e.g. KMP change, address change, SF-328 change, etc.)
 Scenario 2	Entity A is not cleared and acquires Entity B, which is cleared and has classified contracts.	**Medium**	Entity B reports the legal structure change and any other resulting changed conditions. Entity A is processed for an FCL or exclusion (standard priority) per the ISR's evaluation of control and influence.
 Scenario 3	Entity A is cleared and acquires Entity B, which is also cleared.	**Low**	Entity A reports changed condition(s) resulting from acquisition, if applicable. (e.g. KMP change, address change, SF-328 change, etc.)

Reorganization / Restructure	Description	Priority	Action
 Scenario 1	An LLC converts to a corporation or a corporation converts to an LLC.	**Low**	In a true conversion, the entity must provide the Certificate of Conversion from the Secretary of State. The entity would then need to provide DSS with all documentation applicable to the new structure (see the *FCL Orientation Handbook* for documentation and timelines).
 Scenario 2	Companies state that they have converted when they have actually created a new entity.	**HIGH**	If there is no conversion documentation and both entities are registered with the appropriate Secretary of State, a new entity has been formed. If the goal is to have the new entity work on classified contracts, the new entity will need to be sponsored for an FCL. The contracts will then have to be novated to the new entity, which must be completed prior to termination of the existing FCL.
 Scenario 3	A wholly owned subsidiary becomes a branch office. This is similar to Acquisition Liquidation Scenario 3.	**Medium**	Entity A reports changed condition(s) resulting from acquisition, if applicable (e.g. KMP change, address change, SF-328 change, etc.) Entity B should report the impending legal structure change and FCL termination as early as practicable. If classified contracts issued to Entity B will be novated to Entity A, both FCLs must remain active until novation is complete. Both entities should keep DSS updated on the novation process.

SPIN-OFF	Description	Priority	Action
 Scenario 1	Entity B spins-off from Entity A, which is cleared. Both entities will require FCLs and have classified contracts.	**Medium**	Entity B will need to be processed for a FCL This could be initiated by DSS, Entity A, or GCA. Contracts following Entity B will need to be novated. While novation occurs, Entity A may subcontract to Entity B.
 Scenario 2	Entity A, which is cleared, spins-off its classified efforts to Entity B. Entity A will no longer require an FCL.	**Medium**	Entity B will need to be processed for a FCL. This could be initiated by DSS, Entity A, or GCA. Contracts following Entity B will need to be novated. While novation occurs, Entity A may subcontract to Entity B. Only after novation is confirmed, will the FCL for Entity A be terminated.
 Scenario 3	Entity B spins-off from Entity A, which is cleared. Entity A will maintain all classified work. Classified B will not support any classified contracts.	**None**	Report this transaction to DSS in a timely manner.

Split	**Description**	**Priority**	**Action**
	Entity A splits into Entity B and C. One or both of these new companies will be working on the classified contract(s).	**Medium**	Entity A should provide DSS with their formal or informal MARS plan as early and often as possible. Entity B and/or C will need to be cleared. This may be initiated by DSS, Entity A, or GCA. Entity A should not be dissolved/terminated until Entity B/C is cleared and contract novation is complete. **If a cleared entity reports this after the fact and Entity A has already been dissolved OR Entity B/C is already performing on the classified contracts, this becomes a MARS Level 1/high priority and the existing FCL may be affected.*

Part 5: Glossary

ACRONYM	DEFINITION
ACO	The Administrative Contracting Officer (ACO) administers the performance of a contract.
CACO	The Corporate Administrative Contracting Officer (CACO) is assigned to a corporation that has more than one location with resident ACOs to perform contract administrative functions on a corporate-wide basis.
CFIUS	The Committee for Foreign Investments in the United States (CFIUS) is an interagency committee chaired by the Treasury Department that conducts reviews of proposed mergers or acquisitions of U.S. persons by foreign interests.
DBA	Doing Business As (DBA) refers to a name a company can legally use in doing business.
FCB	The Facility Clearance Branch (FCB) administers and oversees the approval or rejection process of a Sponsored Facility's FCL.
FCL	Issued by Defense Security Service (DSS), a Facility Security Clearance (FCL) allows a company to perform cleared government contract work on behalf of a Government Contracting Activity (GCA) or another contractor.
FOCI	An agency is considered under Foreign Ownership, Control, or Influence (FOCI) if a foreign entity has control, direct or indirect and whether or not exercised, over decisions that affect the management or operation of the organization.
FSO	A Facility Security Officer (FSO) is a U.S. citizen employee appointed by a contractor who supervises and directs security measures necessary for implementing the National Industrial Security Operating Manual (NISPOM) and other federal requirements for classified information.
ISFD	Industrial Security Facilities Database (ISFD) is maintained by Defense Security Service (DSS) and is a repository of information about Department of Defense (DoD) cleared contractor facilities.
KMP	Key Management Personnel (KMP) are company personnel who make key management decisions (generally personnel listed within corporate documents); includes but not limited to board of directors, officers, executive personnel, partners, regents, trustees, senior management officials, and other officials as

	determined by Defense Security Service (DSS).
MARS	Mergers, Acquisitions, Reorganizations, and Spin-offs/Splits (MARS) describes corporate finance, management, and strategy associated with the purchase and/or joining of companies.
Novation	Novation is an agreement in which a contracting party accepts a new party in place of the prior party (relieving the prior party of any further obligations).
Novation Agreement	A legal instrument (1) Executed by the- (i) Contractor (transferor); (ii) Successor in interest (transferee); and (iii) Government; and (2) By which among other things, the transferor guarantees performance of a contract, the transferee assumes all obligations under the contract, and the Government recognizes the transfer of the contract and related assets.
SMO	The Senior Management Official (SMO) is a contractor's senior most official at the facility.