

# FOCI Mastery: Safeguarding National Security in Foreign Investments



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Palmetier Law was founded to help small and medium-sized businesses navigate the maze of government contracting regulations. As a WOSB/SDVOSB, Karri understands the entrepreneurial spirit of a small business and appreciate the difficulties they face to enter the government contract market. With more than two decades of experience in the Air Force, major defense contractor and law firm, she brings a unique perspective as a trusted adviser to support companies.

My Primary Practice areas are:

- Small Business Requirements
- Data Rights and Patents
- Ethics Programs
- Contract Administration and Terms/Conditions
- Commercial Item Status
- Subcontract Management
- Non-FAR Contracts
- Compliance and Training

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- FOCI Overview
- Small Business Eligibility
- Socioeconomic Certification
- Small Business Innovative Research and Small Business Technology Transfer (SBIR/STTR)
- Export Controls
- Security Clearances
- Changes in Ownership
- DoD Specific Requirements
- Practical Tips

# Foreign Ownership Control and Influence (FOCI)

- While “FOCI” derives from security clearances, term now applies to many more spheres; e.g., any situation in which a foreign country gains the ability to obtain access to sensitive information
  - Ownership means having an interest in the ownership structure of the company for any class of ownership (depends on company structure)
  - Control means having the power (even if not exercised) to approve or disapprove company operations whether as an owner, member of the board, or key management position
  - Influence means having the ability (even if not exercised) to shape or transform a company’s operations whether as an owner, member of the board, or key management position
- Critical because of role of government contractors and access to sensitive information

# Small Business Eligibility

- Applies to any company seeking to qualify as a small business for government procurements
- Eligibility requirements-13 C.F.R. §121.105
  - Majority owned by individuals or other small businesses
    - Joint Ventures – no more than 49% by a foreign business *entity*
  - Organized for profit
  - Have a place of business in the U.S.
  - Operate primarily in the U.S. or significantly contributes to the U.S. economy through taxes or American products, materials, labor; and
  - Qualify as small based on size of headcount/revenue by NAICS
- Standard Affiliation rules apply 13 C.F.R. §121.103
  - Watch corporate investors carefully – trace to individual level and know who else they own
- **Ownership and control may be foreign**

## Socioeconomic Status (8(a), HUBZone, WOSB, SDVOSB)

- Applies to any company seeking to qualify for socioeconomic status for government procurements
- Eligibility requirements-13 C.F.R. §124.105, 13 C.F.R. §126.200, 13 C.F.R. §127.200, 13 C.F.R. §128.200:
  - Disadvantaged Person(s) must directly own and control
  - Must be U.S. citizen or permanent resident (foreign must be minority and within criteria)
  - Must own at least 51% (also consider proportional size)
- **Foreign ownership is allowed but foreign control and influence is prohibited:**
  - Most nuanced area because control can be direct or indirect, and exercised through a variety of means to include positions within the company, voting approvals, and reliance on resources
    - Watch board members, officers, and key management positions
    - Know their other ownerships and positions in other companies
    - Loans from other than traditional banks or if lender has role in company
  - Also consider affiliation rules. 13 C.F.R. §121.103
    - Watch corporate investors carefully – trace to individual level and know who else they own

- Applies to any company seeking to obtain SBIR/STTR prime awards
- Rationale – purpose of the SBIR/STTR program is to stimulate U.S. innovation and to build a strong U.S. economy. 15 U.S.C. §638
  - Additional requirements and controls apply

- Eligibility requirements-13 C.F.R. §121.702:
  - More than 50% directly owned and controlled by:
    - individuals who are U.S. citizens or permanent residents
    - other small business concerns that are owned by U.S. citizens or permanent residents
    - Indian tribe/ANC/NHO
  - Joint Venture – each owner must meet eligibility criteria
- **Minimal Foreign Ownership is allowed**
  - SBIR and STTR Extension Act of 2022 imposed restrictions on small businesses with any ties to a foreign country of concern (China, Russia, North Korea, Iran, and other countries as determined)
  - Must now disclose foreign ownership, control and influence and may not be allowed to receive award after due diligence review
- **Foreign Control and Influence is prohibited**

- Applies to everyone (individuals, companies)
- Applies regardless of government contract status
- Overview
  - Rationale is to protect critical technologies from adversaries on the bases of national security or vital economic interests.
  - Legal Regimes
    - International Traffic in Arms Regulations (ITAR) at 22 C.F.R. Parts 120-130 which are administered by the Department of State – Directorate of Defense Trade Controls (DDTC)
    - Export Administration Regulations (EAR) at 15 C.F.R. Part 774 which are administered by Department of Commerce’s Bureau of Industry and Security
    - DFARS 252.225-7048, Export-Controlled Items, requires compliance with export control laws

# Export Control Laws

- What constitutes an export:
  - Foreign Person means someone who is not a US citizen, Permanent Resident, or certain asylum seekers and refugees
    - Watch owners, board members, key personnel, employees
    - Visitors to your company facilities
  - Foreign Country – even to US Persons including company personnel located in a foreign country.
    - Hardware, Software, and even Discussions can be exported and even returning a foreign country's technology
- Licenses
  - Must assess if your hardware, software and discussions are subject to an export regimes
  - Obtain appropriate licenses from DDTC or BIS *before* exporting
    - EAR 99 is general authorization and no license is generally required unless you are exporting to certain countries
  - Certain countries may not be approved for export depending on technology: China, Iran, North Korea, Sudan, Syria
- Obtain help for export control advisors
- **Does not prohibit foreign ownership or control but does restrict what information may be provided**

- All companies must notify the contracting officer(s) per paragraph (d) of FAR 52.204-13, System for Award Management Maintenance
- Small Businesses must notify the SBA and/or the contracting officer(s) per paragraph (b) of FAR 52.219-28, Post-Award Small Business Program Rerepresentation
- SBIR/STTR Phase I and Phase II contracts include requirements to notify the contracting officer of any changes in ownership.
- What if potential owner is a foreign person? Before allowing foreign investments, companies must determine if a CFIUS review is required...

# Committee on Foreign Investment in the United States (CFIUS)

- Applies to any company in the United States that seeks to sell ownership interests to foreign persons
- Section 721 of the Defense Production Act of 1950, as amended (section 721), and as implemented by Executive Order 11858, as amended, and the regulations at chapter VIII of title 31 of the Code of Federal Regulations
- Purpose is interagency committee authorized to review certain transactions involving foreign investment in the United States and certain real estate transactions by foreign persons, in order to determine the effect of such transactions on the national security of the United States

# CFIUS Review Required

- A foreign person acquires a substantial interest in a U.S. business
  - 25% or more voting interests
  - Foreign government owns 49% or more voting interest in foreign person
- Produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies for which a U.S. export authorization would be required
  - Critical Technology, critical infrastructure, sensitive personal data; or
  - Export controlled
- **Foreign persons may acquire US companies but Government approval may be required**

- Applies to all companies seeking to obtain a facility clearance to receive access to classified information
- Overview
  - Operated by Defense Cooperation and Security Agency (DCSA)
  - National Industrial Security Program Operations Manual (NISPOM), 32 C.F.R. Part 117 sets forth requirements for how companies and its personnel may obtain a facility clearance
- Eligibility for a facility clearance requires the company
  - Be organized in the United States
  - Have a reputation for integrity and lawful business dealings
  - Have a sponsor
  - Have a legitimate need to access materials
  - Either not have any FOCI or have approved mitigation
- **Companies with Foreign Ownership, Control or Influence may be able to obtain a facility clearance if DCSA approves but will require additional protections**

- Application Process
  - Must include a SF-328, Certificate Pertaining to Foreign Interest, in the application and disclose any foreign ownership, control, or influence (FOCI) to include owners, directors, key management personnel, trusts, proxy holders, etc
  - List of Key Management Personnel
  - Organizational Chart
  - Contract Security Classification Specifications (DD Form 254)
  - Corporate Documents
  - Other documents as requested by DCSA

# Security Clearance – Identification of FOCI

- A company is considered to be operating under FOCI whenever a foreign interest has the power, direct or indirect, whether or not exercised, and whether or not exercisable, 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.
- It is U.S. government policy to allow foreign investment consistent with the national security interest of the United States. A company that is operating under FOCI is ineligible for an FCL until security measures have been put in place to mitigate or negate foreign ownership, control or influence.
- DCSA will review the SF-328 for any FOCI to include:
  - 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
  - Ownership or control, in whole or in part, by a foreign government

## Security Clearance – Mitigation of FOCI

- If FOCI is identified, then DCSA **may** elect at **its sole discretion** whether to work to mitigate
- Methods include:
  - Board Resolution
  - Special Security Agreement (SSA)
  - Security Control Agreement (SCA)
  - Voting Trust Agreement (VTA)
  - Proxy Agreement (PA)
  - Affiliated Operations Plan (AOP)
- Company must have an approved Technology Control Plan (TCP), Electronic Communications Plan (ECP), Visitation Plan, Facilities Location Plan (FLP)
- FOCI Mitigation is complicated process that will require significant time and resources

- DoD Instruction 5205.87, Mitigating Risks Related to Foreign Ownership, Control or Influence for Covered DoD Contractors and Subcontractors, May 13, 2024
  - Implements Section 847 of the FY2020 NDAA to extend FOCI requirements for classified to unclassified work
  - Requires comprehensive assessment by DCSA of ownership and control if value of funding agreement (contract, OTAs, SBIRs, CRADAs, etc) exceeds \$5M (not unique to small business)
  - DCSA may establish FOCI mitigation measures
  - If FOCI exists and DCSA does not recommend mitigation, the company will not receive award and there is no explicit appeal
  - While commercial products and services are exempt, DoD may elect to apply FOCI requirements
  - Final Rule with new contract clauses anticipated

# DoD Specific Requirements

- DoD Memorandum, Defense Small Business Innovation Research and Small Business Technical Transfer Due Diligence, dated May 13, 2024
  - Implements SBIR and STTR Extension Act of 2022 which required identifying and mitigating security risks for SBCs with ties to a foreign country of concern (China, North Korea, Russia and Iran)
  - Applies to SBIR/STTRs less than \$5M
  - Complete form with proposal disclosing all ownership and ownership with foreign countries of concern
  - Establishes formal process to determine if and degree of review to assess security risks is required. Factors include:
    - Foreign Talent Recruitment Program
    - Foreign Ownership/Control
    - Foreign Patents, Intellectual Property and Technology Transfers
    - Financial Obligation
    - Foreign Affiliations
  - Each agency will have own supplement

- Know who owns your company and sits on the board of directors
  - For individuals, require proof of citizenship
  - For publicly traded corporations, require proof of country of registration
  - For privately held companies, require proof of citizenship of each individual owner
- Watch seed rounds and other investors because they will usually want voting rights and/or board positions
- If engaged in Socioeconomic, SBIR/STTR, Export Controlled or Security Clearance – foreign ownership, control or influence may be obstacle or even a prohibition
- Read solicitations carefully. In addition to areas discussed in this presentation, the government can impose additional limitations in specific solicitations



# Comparison

Program	Ownership	Control/Influence	Specific to Foreign
<b>Small Business</b>	Individuals or other small businesses (watch affiliation rules)	Individuals or other small businesses (watch affiliation rules)	Foreign ownership may be a minority as long as still small May be owned or controlled by foreign as long as has a US registered company located in the US.
<b>Socioeconomic Small Business</b>	Disadvantaged Person must be a US citizen or permanent resident and own at least 51% (watch affiliation rules)	Disadvantaged Person must have full control of operations (watch affiliation rules)	Foreign ownership may be a minority as long as still small No foreign control allowed (only Disadvantaged Person may control)
<b>SBIR/STTR</b>	US citizen or permanent resident or US small business must own at least 50% (watch affiliation rules).	US citizen or permanent resident or US small business must control (watch affiliation rules)	Foreign ownership allowed if minority interest with cautions on covered countries  No foreign control or influence allowed
<b>Export Controls</b>	Foreign owners are allowed but license required for them to access export-controlled information	Foreign control is allowed but license required for them to access export-controlled information	License may be required to export to any foreign person or US person in a foreign country
<b>CFIUS</b>			More than 25% foreign ownership if have export-controlled information requires CFIUS review and approval
<b>Security Clearance</b>	Foreign owners are allowed with approvals	Foreign control is allowed with approvals	Any foreign ownership, control, or influence requires DCSA approved mitigation plan
<b>DoD &gt;\$5M</b>	Foreign owners may be allowed after review	Foreign control or influence may be allowed after review	DCSA will determine if mitigation measures required if there is foreign ownership, control, or influence

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