



THOUGHT LEADERSHIP

Navigating board requirements of the U.S. national industrial security program

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In a world increasingly characterized by global business relationships, foreign investment in the U.S industrial base is inevitably on the rise. And when that foreign influence is present in companies with Department of Defense or other U.S. government contracts of a classified nature, a host of mandatory security requirements must be met by those companies.

Among those requirements is the creation of a specialized, government-sanctioned board of directors that will serve to monitor and control the flow of information to the company's foreign owners and their affiliates. The goal is to mitigate the risk of unauthorized access to classified and export-controlled information and, in some cases, highly sensitive intellectual property. These directors shoulder a critical responsibility.

And for the companies with a foreign ownership interest that seek to win classified U.S. government contracts, identifying the senior and experienced talent capable of obtaining the requisite government clearance and performing effectively as a board member is a key business priority. Yet, understanding and navigating the government regulations, clearance standards and process for board members, and other specific requirements can be challenging to say the least, especially for the uninitiated.

This piece focuses on the in-depth knowledge of, and experience with, government-regulated proxy and special security agreement (SSA) boards. The firm's unparalleled expertise and resources in this area include DHR International's Vice Chairman who is currently a director on a government-regulated proxy board (see section, "Firsthand"). This perspective makes DHR International uniquely qualified among executive search firms to partner with clients to identify the senior leaders who possess the integrity, business acumen, and dedication to fulfill this vital role.

The Process

Companies under foreign ownership, control or influence (FOCI) that seek to provide classified services to the U.S. government must be sponsored for a U.S. government facility security clearance by a cleared company or U.S. government entity that intends to award a classified contract to the company. These sponsorship requests are generally submitted to the Defense Security Service (DSS) of the U.S. Department of Defense. The Department of Energy also issues facility security clearances for classified contracts. Legal counsel can be a useful early step to help determine the appropriate FOCI mitigation arrangement and prevent delays in obtaining approvals. DSS will conduct an evaluation of the company's foreign influence factors and dictate the arrangement to be established prior to the company engaging in classified business with the U.S. government.

A U.S. company is considered to be under FOCI when a foreign interest has the power, whether direct or indirect, to make decisions affecting the management or operations of a company in a manner that may result in unauthorized access to classified information or may adversely affect the performance of classified contracts. Considerations for a FOCI determination include the country of the foreign owner's record of economic and government espionage against U.S. targets, the type and sensitivity of information requiring protection, the country of the foreign owner's record of compliance with pertinent U.S. laws, and other matters. DSS generally requires one of three security agreements, each including a special board structure, for companies deemed to be under majority foreign control or influence.

Proxy agreements and voting trust agreements require the appointment of three proxy holders or voting trustees who are cleared U.S. citizens, and who also must be elected to the company's board of directors. Representatives of the parent companies (including U.S. parents) and their affiliates are not eligible to serve on a proxy or voting trust board.

The third arrangement, the SSA, allows for a board that includes three cleared independent U.S. citizens (Outside Directors), any cleared U.S. citizen management team members who also serve as directors (Officer/Directors), and the representatives of the parent companies (Inside Directors, who may or may not be U.S. citizens). Under an SSA, the number of Outside Directors must exceed the number of Inside Directors.

In any of these board structures, generally only the U.S. citizen directors with personnel security clearances (PCLs) may participate in board discussions that involve national security matters, such as those pertaining to classified contracts. Within the SSA structure, however, foreign owners retain a direct board voice and representation for financial and other business management issues through the presence of Inside Directors on the company's board and board committees.

When operating under the proxy agreement, the cleared proxy holders, who also serve as directors, are vested with the voting rights of the foreign owners for most business matters, with specified exceptions (see section, "Brass Tacks").

Unique Responsibilities

The cleared directors of proxy and SSA boards serve as the ultimate gatekeepers of the information flow between the U.S. business and its parent companies, investors or affiliates. The CEO of the U.S. company or business division, as well as all senior executives, must report to the foreign owners through the proxy or SSA board.

In other ways, SSA and proxy boards function like, and bear many of the same responsibilities of, any other board of directors, providing business oversight and strategic input. The board typically has a Chairman as well as a Compensation Committee, which is required by the SSA, and the required Government Security Committee.

Nominating Committees and Audit Committees are normally not part of the board committee structure. In addition to attending board and committee meetings, proxy holders and Outside Directors also should expect to attend meetings convened by DSS for all U.S. directors in such roles, as well as annual meetings with DSS in connection with their company's FOCl mitigation arrangement.

The Director Profile

Clearly, identifying the right individuals for a proxy or SSA board is of the utmost importance. That's true because of the critical nature of the role for these directors, as well as the extensive process companies must engage in to establish and maintain the government required board. Squandering time and resources with poorly selected candidates or directors who are ill-suited to the role is counterproductive, costly, and in some cases difficult to rectify. For instance, specific criteria must be satisfied in order to remove a proxy holder.

When assembling a board that will operate under a proxy agreement or an SSA, director nominees must possess, or be eligible to attain, the same level of clearance as is required for the facility. So, a Top Secret facility would require directors with Top Secret clearance. Individuals may not personally request a clearance; rather, the sponsoring company must request the clearance if a candidate does not already possess a current PCL through DSS, and the process can be time-consuming. Director nominees will submit a resume to DSS, complete a questionnaire, and be the subject of an exhaustive investigation. Clearance requests can be denied for a variety of reasons, including personal, financial, and other matters.

Identifying Candidates

While business knowledge and acumen are musts for this role, there is, understandably, less emphasis placed on acquiring extensive business credentials through the selection of such a director. Instead, greater emphasis is placed on identifying a leader with relevant insight into governmental processes and concerns, as well as the related contact network. Obviously, these leaders will be individuals who will bring the highest level of integrity, dedication, and soundness of judgment to the board position.

Often, the best candidates for proxy or SSA board roles are leaders from the defense and intelligence establishment, either from a uniformed or a corporate background. For that reason, many of these leaders will be found outside the ready-contact list of most executive search firms.

For companies seeking to establish a government sanctioned board operating under a proxy agreement or SSA, tapping DHR's executive and board search expertise to identify and attract the best qualified director candidates can bring a disciplined approach to this critical endeavor, not to mention superior results. DHR possesses a unique understanding of, and access to, this population of leaders. The firm combines decades of search experience with the important insights gained from its singular position among proxy and SSA board leaders.

Companies under foreign ownership or influence that aspire to contract with the U.S. government for classified services should view board formation as a vital first step.

DHR is well-prepared to serve as an ally in this process.

Brass Tacks

Getting down to brass tacks, here is a thumbnail comparison of some key requirements for boards operating under proxy or voting trust agreements versus the special security agreements (SSA). The Defense Security Service of the U.S. Department of Defense will determine which agreement applies on a case-by-case basis.

Similarities: Under all three structures, the board will include three U.S. citizens who have obtained clearance appropriate to the level of the facility security clearance. These three directors (and any company officers with personnel security clearances who also serve as directors) will be the only board members to participate in discussions related to classified information and national security matters.

Differences: A proxy or voting trust board is composed solely of the three U.S. directors and any cleared U.S. company officers who are also elected as directors. An SSA board includes three independent cleared U.S. citizen directors (Outside Directors), the cleared company officers who have been elected as directors (Officer/Directors), as well as U.S. citizen or non-U.S. citizen directors who represent the parent companies (the Inside Directors).

Under a proxy or voting trust agreement, the prerogatives of ownership are surrendered by the ultimate foreign investor to the U.S. proxy holders or trustees. Exceptions to this surrender of rights include for the sale of assets, reorganization, bankruptcy filing, dissolution of the U.S. company, and other specified matters. Under an SSA, the prerogatives of ownership are generally retained by the ultimate foreign investor through the investor's representation on the board with the Outside Directors serving as stewards to ensure that the U.S. business is managed and directed by the SSA Chief Executive Officer (CEO), the CEO's management group, and the SSA board.

This arrangement permits the ultimate foreign investor a direct voice in business matters not related to national security through the company's board and board committees.

Firsthand

What better way to be guided through the intricacies of the U.S. National Industrial Security Program than by someone with firsthand experience? Pete Metzger, a Vice Chairman at DHR, currently is also a proxy board director for a business that is a prime classified contractor to the intelligence community and other U.S. government customers. The company is a government IT solutions subsidiary of a large, foreign-owned company, whose largest shareholder is a foreign government. Therefore, a proxy board is required by the U.S. Department of Defense.

Pete Metzger has the distinction of being the only consultant in the search industry who is serving as a proxy holder and director for a company operating under a Department of Defense proxy agreement. Prior to his executive search career, Pete served as a U.S. Marine officer, worked in the CIA, and served as Marine Military Assistant to President Ronald Reagan. Pete is a graduate of the U.S. Department of State's Foreign Service Institute and the Inter-American Defense College of the Organization of American States.

As a proxy holder, Pete chairs the Compensation Committee, which leads all U.S. division executive compensation decisions; he also serves as Secretary of the Government Security Committee. While the board functions much like any other company board in many respects, the overriding responsibility of a proxy holder is to protect and insulate classified information and export-controlled information not authorized for release to a company's parent companies and their affiliates. In Pete's words, "You become the trusted holder of the intellectual property of the business, and that is a serious matter."



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