



INDUSTRIAL SECURITY

LETTER

Industrial Security letters are issued periodically to inform cleared Contractors, User Agencies and DoD Activities of developments relating to industrial security. The contents of these letters are for information and clarification of existing policy and requirements. Suggestions for Industrial Security Letters are appreciated and should be submitted to the local Defense Security Service cognizant industrial security office. Articles and ideas contributed will become the property of DSS. Inquiries concerning specific information in Industrial Security Letters should be addressed to the cognizant DSS industrial security office.

ISL 2009-03

November 17, 2009

Q: What constitutes a reportable material change under the National Industrial Security Program Operating Manual (NISPOM) paragraph 1-302g (5) or a reportable significant change under NISPOM paragraph 2-302?

A: While nothing in this ISL modifies the current reporting obligations, including but not limited to those under NISPOM paragraph 1-302g (1) through (4) or the rights of DoD to determine significance for purpose of NISPOM paragraph 2-300e, the following matrix describes circumstances that business organizations are required to report on the Standard Form 328, Certificate Pertaining to Foreign Interests, to the Defense Security Service (DSS). When submitting information, it is not necessary to repeat answers that have not changed.

Please note that this matrix is not an exhaustive list of circumstances. It may be revised based on factors such as emerging financial instruments and the experiences of government activities responsible for the oversight of Foreign Ownership, Control or Influence (FOCI) affecting the protection of classified information in industry.

SF 328 Question		Changed Conditions Requiring Report (Note: In addition to the situations described below, <u>all</u> circumstances that would change any answer on the SF 328 from “No” to “Yes” must be reported by submitting a changed condition SF 328.)
1.a.	Where a foreign interest owns five percent (5%) or more of a U.S. business organization	Five percent (5%) or greater increase in the beneficial ownership of a class of equity securities of the business organization, as determined by voting or investment rights, by one or more foreign interests as defined in NISPOM Appendix C and any U.S. person effectively controlled by a foreign interest.

1.b.	Where a foreign interest owns five percent (5%) or more of a U.S. business organization that does not issue stock	Five percent (5%) or greater increase in the beneficial ownership of the business organization, as determined by voting or investment rights, by one or more foreign interests as defined in NISPOM Appendix C and any U.S. person effectively controlled by a foreign interest.
2.	Where a U.S. business organization owns ten percent (10%) or more of a foreign interest	Any increase equivalent to 10% or more of the tangible net worth of the business organization.
3.	Where a U.S. business organization has non-U.S. citizen Key Management Personnel (KMP)	Appointment of any additional non-U.S. citizen to a position required to be cleared in connection with the facility clearance or to any position identified in the articles of incorporation, by-laws, articles of organization, or equivalent governance documentation or charter for the business organization.
4.	Where a Foreign Person has the power to control selection or tenure of KMPs/other decisions	Any change in such power/authority except amendments or waivers to governance documentation either to correct manifest error or which are of a formal, minor, or technical nature and do not change materially any person's rights or obligations.
5.	Where there are contracts, agreements, understandings, arrangement with foreign person(s)	Any change expected to result in annual payments to or from an entity where the payments exceed twenty percent (20%) of the U.S. business organization's annual gross revenues.
6.	Where there is indebtedness, liabilities or obligations to foreign persons	<p>There is a changed condition reportable on SF 328 whenever there is:</p> <p>(i) any new indebtedness to foreign persons which results in a liability exceeding ten percent (10%) of the tangible net worth of the business organization or includes an instrument creating a mortgage, deed of trust, pledge, lien, security interest or other charge or encumbrance against (A) any of its property, assets or leasehold interests exceeding ten percent (10%) of the business organization's tangible net worth or (B) pledges five percent (5%) or more of the voting securities of the business organization as collateral or</p> <p>(ii) any other new foreign indebtedness where the business organization permits to exist a leverage ratio exceeding two to one (2:1) based on the business organization's indebtedness to its tangible net worth and calculated on the basis of information set forth in its financial statements.</p>
7.a.	Where the business organization derives five percent (5%) or more of total revenues/net income from a single foreign person	With respect to the business organization and that single foreign person, any change expected to result in annual payments to or from the business organization where the payments exceed an additional ten percent (10%) of the business organization's annual gross revenues.
7.b.	Where the business organization derives thirty percent (30%) or more of total revenues/net income from	With respect to the business organization and any foreign persons, any change expected to result in annual payments to or from the business organization where the payments exceed an additional

	foreign persons	twenty percent (20%) of the business organization's annual gross revenues.
8.	Where there are ten percent (10%) or more of voting securities held in a method which does not identify beneficial owner	Any change of five percent (5%) or more in the total number of shares held in "nominee" shares, in "street names" or in some other method which does not identify the beneficial owner or any amendment to the bylaws of the business organization or its parent related specifically to voting rights of such nominee holders and any requirements regarding notice of any matter to be presented by a nominee stockholder at a shareholders meeting including any amendment affecting the voting and notice rights and obligations of nominee holders and associated persons who fail to make timely disclosures required by the U.S. Securities and Exchange Commission such as Schedule 13D.
9.	Where there are KMP(s) holding positions or serving as consultants for foreign person(s)	Any new positions held by persons required to be cleared in connection with the facility clearance. Excludes positions where the KMP is appointed by the U.S. parent business organization to a seat on the board or similar governing body of a foreign subsidiary, provided that the business organization promptly gives DSS notice of such appointment.
10.	Where there are any other factors of foreign person control or influence	Each change qualifying as an affirmative answer to this question and each change having a material effect on the ownership, control or influence of the business, operations, prospects, condition (financial or otherwise), or property of the business organization such that the security measures contemplated by an agreement with DoD to mitigate FOCI would not reasonably be expected to remove the possibility of unauthorized access to or adverse affect on the performance of classified contracts.

MATERIAL/SIGNIFICANT CHANGE GLOSSARY

Beneficial Ownership

Beneficial ownership of securities means that a person has or shares the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the securities, and includes the power to vote, direct the vote, dispose or direct to dispose such security.

Business Organization

As used herein, "business organization" means the entity submitting the Material/Significant Change SF 328.

Indebtedness

As used herein, "indebtedness" means its total liabilities, obligations and reserves, contingent or otherwise, which, in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), would be reflected as a liability on its balance sheet, including without limitation (i) any obligation for borrowed money or arising out of any credit facility, (ii) any obligation evidenced by bonds, debentures, notes or other similar instruments, (iii) any obligation to pay the deferred purchase price of property or services, (iv) any obligation under conditional sales or other title retention agreements, (v) the net

aggregate rentals under any lease as lessee that under U.S. GAAP would be capitalized on the books of the lessee or is the substantial equivalent of the financing of the property so leased, (vi) any obligation to purchase securities or other property which arises out of or in connection with the sale of the same or substantially similar securities or property or (vii) any instrument creating a mortgage, deed of trust, pledge, lien, security interest or other charge or encumbrance against any of its property, assets or leasehold interests.

Financial Statement

As used herein, "financial statements" means the business organization's most recent quarterly or annual balance sheet and statements of income, retained earnings, and sources and application of funds for such fiscal period, together with all notes thereto and with comparable figures for the corresponding period of its previous fiscal year, each prepared in U.S. dollars in accordance with U.S. GAAP.

Tangible Net Worth

As used herein, "tangible net worth" means, as of a stated date, (i) the total stockholders' equity (including capital stock, paid-in capital and retained earnings, after deducting treasury stock and reserves) that would appear on the business organization's financial statements prepared as of that date, less (ii) the aggregate book value of all intangible assets shown on the business organization's financial statements as of that date (including, without limitation, goodwill, patents, trademarks, trade names, copyrights, franchises, and unrealized appreciation of assets).