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Executive Order Limits Underperforming Defense Contractors' Ability to Conduct Stock Buybacks, Issue Dividends and Award Certain Executive Compensation

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On January 7, 2026, President Donald Trump issued Executive Order No. 14372, "Prioritizing the Warfighter in Defense Contracting" (EO), which targets underperforming federal contractors who, in the administration's view, "pursue newer, more lucrative contracts, stock buy-backs, and excessive dividends to shareholders at the cost of production capacity, innovation, and on-time delivery." The EO sets forth the federal government's policy to "accelerate defense procurement and revitalize the defense industrial base." To that end, effective immediately, the EO prohibits underperforming contractors from paying dividends or buying back stock "until such time as they are able to produce a superior product, on time and on budget." The EO also seeks to limit future contracts, including renewals, by stipulating that executive incentive compensation for contractors be linked to "on-time delivery, increased production, and all necessary facilitation of investments and operating improvements."

We summarize key provisions of the EO and outline key implications below.

Identification and notice to underperforming contractors; remediation

Section 3 of the EO sets forth a process to identify and provide notice to underperforming defense contractors who meet certain criteria established by the EO. Specifically, by February 6, 2026, the defense secretary must identify defense contractors for "critical weapons, supplies, and equipment" that are underperforming. Notably, the phrase "critical weapons, supplies, and equipment" is not defined in the EO. In addition, while the EO refers to "large" or "major" defense contractors in Sections 1 and 2 (which set forth the policy and purpose of the EO), those terms are not defined, and no such limitation is found in Section 3, which leaves ambiguity as to the universe of contractors to which the identification, notice and remediation procedures described herein apply.

The criteria for identification by the defense secretary include:

- Noncompliance with their contracts.
- Insufficient investment of their own capital into necessary production capacity.
- Not sufficiently prioritizing US government contracts.
- Insufficient production speed.

Defense contractors meeting at least one of the criteria above must also have engaged in stock buyback or other corporate distribution during the period of underperformance to be subject to the scrutiny of the EO. Once identified, the defense secretary must provide the contractor with notice, describing the nature of the underperformance or insufficient prioritization, investment or production speed, and work with the contractor through a 15-day period to resolve the issues through a remediation plan. Contractors must submit this remediation plan approved by the contractor's board of directors for review by the defense secretary.

Enforcement options

If the defense secretary determines that a contractor's remediation plan is insufficient, or where the defense secretary and the contractor are unable to resolve the dispute as to the underperformance within the 15-day period noted above, the defense secretary may take immediate enforcement action by way of the following:

- Voluntary agreement with the contractor.

- Any available enforcement actions under the Defense Production Act (50 USC 4501 et seq.).
- Any available contract enforcement mechanisms within the Federal Acquisition Regulation and Defense Federal Acquisition Regulation Supplement.

In addition, the defense secretary must consider whether to cease or deny advocacy efforts for underperforming contractors competing for an international foreign military or direct commercial sale, in consultation with the secretary of state and the secretary of commerce. In considering whether to initiate any available enforcement action, the defense secretary may take into account factors, such as the financial condition of the contractor, economic viability of relevant programs and "potential mutual benefits offered by robust and sustained growth opportunities from the United States Government coupled with capital investments by the contractor."

Future contract terms with new or existing contractors

By March 8, 2026, the defense secretary is also directed to ensure that any future contracts with new or existing contractors (including renewals) contain the following provisions:

- Prohibiting stock buybacks and corporate distributions during a period of contractor underperformance, noncompliance, insufficient prioritization, investment or production speed.
- Stipulating that executive incentive compensation for contractors will not be tied to short-term financial metrics such as "free cash flow or earnings per share driven by stock buy-backs," and instead linked to metrics such as "on-time delivery, increased production, and all necessary facilitation of investments and operating improvements required to rapidly expand" US stockpiles and capabilities.
- Requiring executive base salaries be capped at current levels for underperforming contractors to allow the defense secretary to "scrutinize the incentive portion of executive compensation."

SEC directive

Finally, the EO also directs the chair of the Securities and Exchange Commission (SEC) to consider whether to adopt amended regulations under Rule 10b-18 to prohibit underperforming defense contractors from using the rule's safe harbor provisions for stock buybacks.

Key implications

The EO outlines significant new expectations for defense contractors, and they should expect increased scrutiny and oversight from the federal government in new areas in the immediate future, such as executive compensation, contract performance and corporate decision-making. Meeting the compliance obligations of this EO is made more challenging by the unclear application of the EO in many respects, including if the identification, notice and remediation processes apply only to "major" defense contractors – and, if so, what threshold limitations apply, what "critical weapons, supplies, and equipment" manufacturers are covered by the EO, and what other forms of "corporate distributions" are captured. Notably, the EO does not distinguish between public or private companies, or prime and subcontractor status.

Given this ambiguity and the short time frames in which to respond to a notice of underperformance, all defense contractors (including subcontractors and nonpublic entities) should take steps to review and assess current programs and contracts for weapons, supplies and equipment, and review whether such programs could be viewed as underperforming, such as whether they are behind schedule or over budget. If so, affected contractors should proactively review applicable processes authorizing stock buybacks and dividends, executive compensation plans and agreements, as well as any applicable metrics used to evaluate executive performance, for terms deemed problematic under the EO. Contractors should also proactively outline any steps necessary to address areas of underperformance in a remediation plan, such as whether to reallocate resources, and ensure their boards of directors are informed about the EO's requirements and can quickly review and approve a remediation plan. Finally, public companies should stay tuned for potential regulation from the SEC to Rule 10b-18 and be mindful regarding statements in public filings regarding existing and planned defense projects, as contractors should expect increased investor scrutiny.

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