LAW360

Portfolio Media. Inc. | 230 Park Avenue, 7th Floor | New York, NY 10169 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Open Questions After Defense Contractor Executive Order

By **Alexander Hastings, Celia Soehner and Christian Kozlowski** (February 11, 2026, 6:27 PM EST)


Alexander Hastings


Celia Soehner


Christian Kozlowski

President Donald Trump issued an executive order on Jan. 7 imposing new obligations on the U.S. defense industrial base, including immediately prohibiting any so-called major defense contractor from conducting future stock buybacks or issuing dividends at the "expense of accelerated procurement and increased production capacity."

Within 60 days of the order, the secretary of defense must ensure that future contracts both prohibit stock buybacks and the issuance of dividends under specified circumstances and include certain provisions and limitations on executive compensation.

Executive Order No. 14372 also directs the U.S. Department of Defense to conduct an ongoing review of defense contractor performance and capital allocation practices, including whether identified underperformance coincided with stock buybacks or corporate distributions. It also provides for a short remediation period in the event underperformance is identified. The executive order noted that some defense contractors had already received this notice.

The consequences for inadequate remediation may be significant. If the DOD determines that a remediation plan is insufficient, or if a defense contractor and the DOD are unable to resolve disputes regarding an alleged underperformance within a 15-day negotiation period, then the DOD may take immediate action to expedite production, prioritize the U.S. military, and return the contractor to sufficient performance, investment, prioritization and production.

Three listed solutions include:

- A voluntary agreement with the defense contractor;
- Enforcement under the Defense Production Act; and
- Any available contract enforcement mechanisms within the Federal Acquisition Regulation.

The executive order directs the DOD to consider the financial condition of the defense contractor, the economic viability of relevant programs, and the potential mutual benefits offered by robust and

sustained growth opportunities from the U.S. government coupled with capital investments by the contractor.

The executive order further provides that the secretary shall develop and implement additional contractual provisions related to the following:

- Prohibiting both stock buybacks and corporate distributions during a period of underperformance, noncompliance, or insufficient prioritization, investment or production speed;

- Prohibiting tying executive compensation to short-term financial metrics like "free cash flow or earnings per share"; and

- Authorizing the government to cap executive base salaries to allow the secretary to "scrutinize the incentive portion of executive compensation" to the identified metrics.

The order also instructs the secretaries of the U.S. Department of State and the U.S. Department of Commerce to cease advocacy for any identified contractors' participation in foreign military or direct commercial sales.

Finally, the chair of the U.S. Securities and Exchange Commission is instructed to consider whether to amend Rule 10b-18 to prohibit use of the relevant safe harbor by companies identified by the DOD.

Government Contractor Implications

The order leaves much of the implementation to future development, including new contract clauses governing or prohibiting the exercise of dividend payments and stock buybacks. Such restrictions, if implemented, may have a detrimental effect on a contractor's ability to attract and retain key executive talent.

However, the immediate impact is significant. The executive order directs the DOD to issue new cure-type notices to underperforming contractors. If a defense contractor does not implement satisfactory remedial action, the order directs the DOD to return the contractor to satisfactory performance.

This directive is noteworthy because instead of terminating underperforming contractors, the executive order appears to direct the DOD to take a more active role in the affairs of the contractor — including through Defense Production Act authority.

Recognizing that the U.S. administration is willing to use or cite to the Defense Production Act in a variety of situations, including during the COVID-19 pandemic, the use of this authority in this context is likely to raise significant questions — and perhaps legal challenges — regarding the scope of the DOD's authority under the Defense Production Act and the need to protect the intellectual property and other assets held by defense contractors.

The executive order leaves open significant questions regarding its scope and effect that may be the subject of further guidance or rulemaking.

Are nondefense government contractors within the scope of the executive order?

The text focuses on those defense contractors that support warfighters. It is not clear whether the changes prompted by the executive order will address government contractors that support both military and commercial functions.

What is the scope of the executive order's reference to "major defense contractors"?

Although it also references "any defense contractors" without the "major" qualifier, it remains unclear whether the executive order is intended to apply to all contractors that conduct business with the DOD or only those that are major.

If the latter, it is unclear what defense contractors the government might consider major for purposes of the executive order. It is also unclear how broadly the DOD will interpret the executive order's reference to "critical weapons, supplies and equipment" that are covered by this action.

What criteria will be used to assess when a defense contractor's remediation plan is insufficient?

The executive order introduces a new level of uncertainty to assessing what type of remediation may be acceptable to the DOD.

For instance, it remains unclear whether addressing the underlying performance issues will be sufficient or if remediation will require that a contractor provide the DOD with a more direct role in addressing the underlying purported issues.

Does the executive order direct the DOD to adjust production speeds under existing contracts?

The executive order instructs the DOD to consider whether "production speed is insufficient as determined by the Secretary," but does not account for when production speed may still be in line with contract requirements.

In such instances, it is not clear whether the DOD is expected to modify performance metrics under existing contracts to align with its current production expectations, as opposed to those that exist under current contracts.

What is the result of any finding that executive compensation is too high or tied to inappropriate metrics?

The executive order instructs the DOD to develop contract clauses that tie incentive-based compensation for executives to identified defense contract performance metrics, e.g., on-time delivery or increased production, rather than "short-term financial metrics," e.g., free cash flow.

The executive order also allows the DOD to effectively freeze base salaries of executives during the pendency of any review of whether the company has appropriate incentive compensation metrics in place.

The order does not clarify what actions the DOD may take upon a finding that compensation is not sufficiently tied to such metrics or is otherwise misaligned with the government's goals.

Capital Allocation and Securities Law Implications for Public Defense Contractors

The executive order has significant implications for U.S. public companies considered to be major defense contractors, particularly with respect to capital allocation practices and securities law compliance.

Most notably, the order directs the DOD to include provisions in future defense contracts prohibiting stock buybacks and corporate distributions during periods of underperformance, noncompliance, or insufficient prioritization, investment or production speed, as determined by the secretary.

As a result, defense contractors may face explicit contractual limitations on dividends and share repurchases tied to operational performance under their government contracts.

The executive order also instructs the chair of the SEC to consider amendments to Rule 10b-18, the nonexclusive safe harbor under the federal securities laws for issuer share repurchases.

Any restriction or removal of Rule 10b-18 protection for defense contractors could materially increase legal uncertainty and potential liability risk for repurchases that fall outside newly defined parameters.

While reliance on Rule 10b-18 is not required to conduct share repurchases, the breadth of the Exchange Act's market manipulation provisions may make it difficult for issuers to structure repurchases with certainty absent the safe harbor.

In addition, brokers, which often play a critical role in facilitating issuer repurchase programs, may be reluctant to participate in buybacks without the comfort of an available safe harbor.

Taken together, these developments could further constrain capital return strategies for publicly traded defense contractors and heighten the need for careful coordination among legal, finance and compliance teams.

Executive Compensation Considerations

The executive order provides that contracts must stipulate that incentive-based compensation for executives (1) be tied to "on-time delivery, increased production, and all necessary facilitation of investments and operating improvements required to rapidly expand [U.S.] stockpiles and capabilities," and (2) not be based on short-term financial metrics.

The executive order provides free cash flow and "earnings per share driven by stock buybacks" as nonexhaustive examples of prohibited financial metrics.

Further, the order provides that all new contracts impose a cap on the base salaries of executive officers of defense contractors if the secretary finds that a contractor has engaged in underperformance, noncompliance, or insufficient prioritization, investment or production speed.

The order appears to give the secretary broad discretion in determining compliance with these limitations on executive compensation for defense contractors.[1]

Next Steps

The executive order does not explicitly prohibit future share repurchases or dividend issuance, but it

does impose additional burdens that include analyzing contractual performance before approving and effecting repurchases and dividends.

Defense contractors will need to assess provisions in applicable agreements and develop a process for determining how to evaluate and determine whether and when there is underperformance, insufficient prioritization, or lack of adequate production speed.

Defense contractors, particularly those publicly traded in the U.S., should consider the following:

- Determining whether additional risk factor disclosure is needed in upcoming periodic reports, including upcoming annual reports on Form 10-K, and whether the potential impacts of the executive order warrant discussion in cautionary, forward-looking statement language;

- Developing talking points with shareholders and the investment community, keeping parameters such as Regulation FD in mind;

- Working with the compensation committee or board of directors to determine whether changes to executive compensation philosophy or metrics are needed in light of potential restrictions tied to performance metrics and capital allocation;

- Educating boards of directors on prospective changes to share repurchase and dividend requirements, and updating policies and procedures relating to repurchases and dividends; and

- Updating other applicable board governance documents to address the impacts of the executive order.

Employers should anticipate additional reviews, requests for information and increased scrutiny of employment agreements by the DOD. While current employment agreements seem protected, for now, employers should consider potential impacts to the terms and conditions of any future employment agreements, including any agreements currently in negotiation, in order to retain eligibility for defense contracts.

Of course, the talent pool for skilled executives already is limited. Time will tell whether, in light of this executive order, defense industry employers will face an even shallower pool of qualified candidates.

Such employers should consider taking a fresh look at their restrictive covenant agreements and other retention mechanisms. They might also revisit well-worn metrics for evaluating executive performance and possible advancement to align with the executive order's priorities.

Alexander B. Hastings is a partner at Morgan Lewis & Bockius LLP.

Celia A. Soehner is a partner and co-leader of the capital markets and public companies practice at the firm.

Christian Kozlowski is an associate at the firm.

Morgan Lewis partners David C. Dziengowski and Erin E. Martin contributed to this article.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] "Further, the Secretary shall ensure such future contracts allow the Secretary, upon a finding by the Secretary that a contractor has engaged in underperformance, non-compliance with the contractor's contract, insufficient prioritization of the contract, insufficient investment, or insufficient production speed, to require that executive base salaries of the contractor be capped at current levels, with increases allowed for inflation, consistent with applicable law, for a time period sufficient to allow the Secretary to scrutinize the incentive portion of executive compensation to ensure it is directly, fairly, and tightly tied to the above metrics."