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Strategic M&A and Risk Management in Government Contracts: What In-House Counsel Need to Know in 2025

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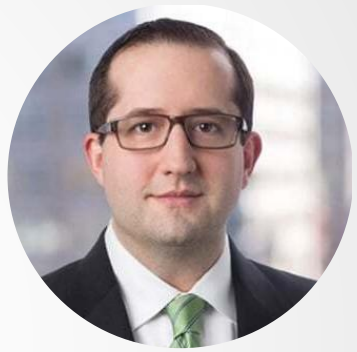

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Government Contracts M&A Industry Trends and Outlook

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Government Contracts M&A Industry Trends and Outlook

- Federal Budget Uncertainty Remains
  - Buyers and Sellers in the Government Contracts space remain cautious.
  - Adjusting to the “new normal” as clarity seems to be emerging.
- Strategic Focus on Specialization
  - Tech-driven assets, in specialized areas such as cybersecurity, AI, unmanned systems.
- Regulatory and Political Uncertainty
  - Antitrust, ESG/ESG-backlash, and other regulatory developments are adding complexity and pressure.
- Private Equity M&A Activity
  - Potential inability to exit existing investments in the current market
  - Desire to acquire hindered by valuation concerns.
- Cautionary Approaches to Dealmaking
  - Increased diligence in all areas, particularly financial and customer diligence.
  - Funding purchase price with earnouts/milestones to hedge against valuation concerns.

Government Contracts and National Security Compliance and Liability Diligence

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Information and Supply Chain Security Requirements

- FAR 52.204-21, Basic Safeguarding of Covered Contractor Information Systems
  - Applies to contracts that involved federal contract information ("FCI")
  - Mix of information system controls and facility security requirements, including limiting access to covered information systems, maintaining antivirus and similar software to protect against malicious code, periodically scanning information systems for malicious code, and implementing facility security measures (e.g., escorting and monitoring visitors; maintaining records of physical access, controlling and managing physical access devices.
- DFARS 252.204-7012, Safeguarding Covered Defense Information and Cyber Incident Reporting
  - Applies to all "covered contractor information systems" that process, store, or transmit Covered Defense information/Controlled Unclassified Information (collectively, CDI)
  - Contractors must "provide adequate security" for information systems that store, process, or transmit CDI.
    - Non-federal covered contractor information systems must comply with National Institute of Standards and Technology (NIST) Special Publication (SP) 800-171
    - Third-party cloud services must meet the Federal Risk and Authorization Management Program (FedRAMP) Moderate Baseline
  - Contractors must "rapidly" report cyber incidents within 72 hours of discovery and take other relevant steps, including submitting malicious software to the DoD Cyber Crime Center, preserve and protect images of all known affected information systems…and all relevant monitoring/packet capture data for at least 90 days after submitting a cyber incident report, and cooperate with DOD damage assessments and forensic analyses.

Information and Supply Chain Security Requirements (cont'd)

- DFARS 252.204-7020, NIST SP 800-171 DoD Assessment Requirements
  - Offerors subject to DFARS 252.204-7012 to undergo a NIST SP 800-171 assessment in accordance with DFARS 252.204-7020
  - Current assessment score (i.e., a score from an assessment conducted within the past three years) in the DOD Supplier Performance Risk System (SPRS) to be eligible for award of a prime contract.
  - Prime contractors cannot award subcontracts to prospective contractors that have not completed the required assessment.
- HSAR 3052.204-72, Safeguarding of Controlled Unclassified information
  - Contractors must provide adequate security to protect CUI and other forms of sensitive information in accordance with a variety of Department of Homeland Security (DHS) policies.
  - Contractors must report cyber incidents, with timelines ranging from one hour to eight hours depending on the information involved

Information and Supply Chain Security Requirements (cont'd)

- CMMC
  - On October 15, 2024, DoD issued a final rule creating the CMMC program and is working to finish the rulemaking process that will amend the DFARS to apply CMMC requirements to defense contractors.
  - Three Levels
    - CMMC Level 1
      - Compliance with FAR 52.204-21
      - Self-assessment
      - No POA&M
    - CMMC Level 2
      - CMMC Level 1 + NIST SP 800-171 Rev. 2
      - Self-assessment or certification assessment
      - POA&M allowed for certain controls
    - CMMC Level 3
      - CMMC Level 2 + 24 selected security requirements from NIST SP 800-172
      - Certification assessment
      - POA&M allowed for certain controls
  - Annual affirmations of continuing compliance with the appropriate level self-assessment or certification assessment from the affirming official
  - DFARS final rule is pending

Information and Supply Chain Security Requirements (cont'd)

- FAR 52.204-25, Prohibition on Contracting for Certain Telecommunications and Video Surveillance Services or Equipment
  - Implements § 889 of the National Defense Authorization Act for Fiscal Year 2019, Pub. L. No. 115-232
  - Prohibits federal agencies, with certain exceptions, from purchasing and contractors from using covered telecommunications services or products from Huawei Technologies Co., ZTE Corporation, and certain other Chinese companies and their subsidiaries as an essential or substantial component of any system or as critical technology of a system.
  - This prohibition can apply even if the contractor is not using the covered telecommunications services or products to perform a Government contract.
  - A company that fails to comply with these requirements is ineligible to do business with the Government absent a waiver. FAR 52.204-25 requires contractors to conduct a "reasonable inquiry" that does not require internal or third-party audits. Contractors must report noncompliances within one business day of discovery and provide additional information within ten business days.
- FAR 52.204-27, Prohibition on a ByteDance Covered Application
  - Prohibits contractors "from having or using a covered application," defined as "the social networking service TikTok or any successor application or service developed or provided by ByteDance Limited or an entity owned by ByteDance Limited," on "information technology owned or managed by the Government, or on any information technology used or provided by the Contractor under this contract."
  - This prohibition extends to information technology "equipment provided by the Contractor's employees."
- Other requirements

U.S. Export Controls Overview

Export Administration Regulations (EAR)

- Administered by BIS
- Regulates:
  - Commercial items without obvious military use
  - Commercial items with commercial & military proliferation applications
  - Less sensitive military items
- U.S. Commerce Control List (CCL) enumerates items controlled under EAR

International Traffic in Arms Regulations (ITAR)

- Administered by DDTC
- Regulates:
  - Defense articles
  - Defense services
  - Brokering activities
- U.S. Munitions List (USML) enumerates items controlled under ITAR

Nuclear-Related Export Controls

- Administered by NRC
- NRC administers export controls on nuclear equipment and materials
- DOE administers export controls on nuclear-related technology

U.S. Sanctions Overview

Agencies

- U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC)
- U.S. Department of State, Office of Economic Sanctions Policy and Implementation

Purposes of U.S. Sanctions

- Advance foreign policy goals and national security interests
- Restrict exports of goods and technology that could contribute to military potential of adversaries
- Prevent proliferation of weapons of mass destruction
- Prevent terrorism
- Fulfill international obligations
- Balance these objectives against impact on U.S. economy

Case Study - White Deer Management LLC (June 2025)

- On June 16, 2025, the U.S. Department of Justice ("DOJ") announced that it was declining to prosecute a private equity firm, White Deer Management LLC ("White Deer"), following voluntary disclosure of sanctions violations and related offenses committed by an acquired company, Texas-based Unicat Catalyst Technologies LLC ("Unicat").
- Unitcat made at least 23 unlawful sales of chemical catalyst products and related services used in oil refining and steel production by customers in Iran, Venezuela, Syria, and Cuba.
  - According DOJ, Unicat had a "hidden history" of sanctions violations.
  - Prior to the closing of the acquisition of Unicat, White Deer hired outside legal counsel to perform pre-acquisition due diligence of Unicat's international operations but did not learn of Unicat's violations.
  - White Deer was provided evidence of Unicat transactions with Iran had been provided to White Deer's outside counsel during the pre-closing due diligence process but was overlooked during the due diligence review.
- During its post-acquisition integration efforts, White Deer discovered evidence of Unicat's potential violations of U.S. sanctions law and export controls and launched an internal investigation, which resulted in a voluntary self-disclosure to the U.S. government.
- In December 2024, the DOJ entered into a non-prosecution agreement with White Deer and Unicat. Unicate agreed to forfeit over US $3 million in proceeds associated with the violations.

Key Due Diligence Considerations - Export Controls and Sanctions

- Risk Assessment
  - The relevant risk for export controls and sanctions successor liability will depend on the nature of the target's business, including any involvement of sensitive technology and/or international business activities.
- Program Overview
  - Every company should have a compliance program to address export controls and sanctions requirements. This program should be appropriately tailored to the Company's risk profile based on the nature of the company's business activities.
- Past Transactions
  - Due diligence should evaluate past transaction activities involving highly-sanctioned countries.
- Past Violations
  - Outside of limited circumstances, disclosures of past export controls and sanctions are subject to voluntary self-disclosure to applicable regulating agencies. However, self-disclosure is a key component of an effective compliance program. Due diligence should be appropriately tailored to identify any disclosed or otherwise identified potential violations.
- Customer / Transaction Screening
  - Identifying and reviewing clients and suspect transactions. Applicable policies, procedures, and processes should address how the company screens customers and identifies/reviews transactions and accounts for possible violations, whether conducted manually, through interdiction software, or a combination of both.
- Recordkeeping
  - Applicable policies, procedures, and processes should comply with applicable recordkeeping requirements for sanctions (10 years) and exports controls (5 years).
- Technology Safeguards
  - A viable compliance program should include technological controls to prevent inadvertent export controls and sanctions violations. Examples of common technology enabled protections, such as automatic customer screening, geofencing, etc.

Current OFAC Sanctions Programs

- Afghanistan-Related Sanctions (E.O. 14064)
- Balkans Sanctions (31 C.F.R. 588)
- Belarus Sanctions (31 C.F.R. 548)
- Burma Sanctions (31 C.F.R. 525)
- Central African Republic Sanctions (31 C.F.R. 553)
- Chinese Military-Industrial Complex Sanctions (31 C.F.R. 586)
- Counter Narcotics Trafficking Sanctions (31 C.F.R. 536 and 598)
- Counter Terrorism Sanctions (31 C.F.R. Parts 566 and 594-597)
- Countering America's Adversaries Through Sanctions Act of 2017 (CAATSA)
- Cuba Sanctions (31 C.F.R. 515)
- Cyber-related Sanctions (31 C.F.R. 578)
- Democratic Republic of the Congo Sanctions (31 C.F.R. 547)
- Ethiopia Sanctions (31 C.F.R. 550)
- Foreign Interference in a United States Election Sanctions (31 C.F.R. 579)
- Global Magnitsky Sanctions (31 C.F.R. 583)
- Hong Kong-Related Sanctions (E.O. 13936 and 31 C.F.R. 585)
- Hostages and Wrongfully Detained U.S. Nationals Sanctions (E.O. 14078)
- Hizballah Financial Sanctions (31 C.F.R. 566)
- ICC Sanctions*
- Iran Sanctions (31 C.F.R. 535 and 560-562)
- Iraq Sanctions (31 C.F.R. 576)
- Lebanon Sanctions (31 C.F.R. 549)
- Libya Sanctions (31 C.F.R. 570)
- Magnitsky Sanctions (31 C.F.R. 584)
- Mali-Related Sanctions (31 C.F.R. 555)
- Nicaragua-Related Sanctions (31 C.F.R. 582)
- Non-Proliferation Sanctions (31 C.F.R. 539 and 544)
- North Korea Sanctions (31 C.F.R. 510)
- Rough Diamond Control Sanctions (31 C.F.R. 592)
- Russian Harmful Foreign Activities Sanctions (31 C.F.R. 587)
- Somalia Sanctions (31 C.F.R. 551)
- South Sudan-Related Sanctions (31 C.F.R. 558)
- Sudan/Darfur Sanctions (31 C.F.R. 538 and 546)
- Syria Sanctions (31 C.F.R. 542 and 569)
- Transnational Criminal Organizations Sanctions (31 C.F.R. 590)
- Ukraine-Related Sanctions (31 C.F.R. 589)
- Venezuela Sanctions (31 C.F.R. 591)
- West Bank-Related Sanctions (E.O. 14115)
- Yemen Sanctions Regulations (31 C.F.R. 552)

Equal Employment Opportunity and "Illegal DEI"

Key, Longstanding Statutory Prohibitions

- **Title VII of the Civil Rights Act of 1964**
  - Prohibits use of protected classifications/characteristics as a factor in employment decisions (for public and private employers) – policies may violate Title VII when they result in disparate treatment or have a disparate impact
  - Title VII interpreted to allow limited "affirmative action" under E.O. 11246 - even that regime did not allow use of protected characteristics in employment decisions (customer preferences, promoting diverse workforce to reflect society/community, diversity of ideas – not an excuse)
- **42 U.S.C. § 1981**
  - Prohibits persons entering (or refusing to enter) into contracts because of race
  - Applies to contracting decisions but also has been applied in employment context
  - Only applies to race; not other protected characteristics covered by Title VII (and no disparate impact reach)

Equal Employment Opportunity and "Illegal DEI" (cont'd)

Trump Administration Policies and Enforcement Priorities

- **Executive Order 14173, *Ending Illegal Discrimination and Restoring Merit-Based Opportunity***
  - Does not change Title VII and Section 1981 – but does signal change in how Executive Branch will enforce those laws and foreshadow forthcoming regulations (including FAR clauses)
  - Rescinds EO 11246 – basis for federal contractor race and sex affirmative action program requirements dating back to Johnson Administration (90-day grace period has expired)
  - Requires certification that contractor does not operate any programs promoting DEI that violate any applicable federal anti-discrimination law
  - Not all "DEI" or "diversity" programs are necessarily illegal – but many preexisting programs may be deemed illegal by the Administration
  - E.O. also leverages federal agencies to identify and penalize violations of existing law (but Administration has indicated it will not use disparate impact theory)

Equal Employment Opportunity and "Illegal DEI" (cont'd)

Risks of Programs and Policies Deemed "Illegal DEI"

- **False Claims Act Liability**
  - E.O. 14173 expressly intended to create contractual predicate for later FCA claims – through certification and statement that compliance with applicable Federal anti-discrimination laws is material to the Government's payment decision for FCA purposes
  - Deputy AG Memo (May 2025) establishes Civil Rights Fraud Initiative targeting "any recipient of federal funds that knowingly violates federal civil rights laws"
  - Materiality will not be "slam dunk" - precedent shows that actual behavior matters (e.g., payment decisions)
- **Terminations for Convenience (or even Default)**
  - E.O. does not unilaterally modify existing contracts (or purport to do so), but Administration will take view that modifications are not necessary to allow enforcement of Administration's interpretation of existing laws
  - Certain DEI practices, policies, and programs may be subject to scrutiny even if legal under current precedent interpreting Title VII and Section 1981
  - Beyond termination for default, FCA action, and other extreme measures, termination for convenience is ever-present risk – any DEI practice, policy, or program deemed inconsistent with policy has potential to prompt adverse action

Equal Employment Opportunity and "Illegal DEI" (cont'd)

Key Diligence Considerations

- Understand the laws (including state and local laws) and prime contract and subcontract requirements applicable to contractor's existing contracts and those in pipeline
- Review DEI practices, policies and programs for employees
  - E.g., written employment policies; hiring practices; promotion requirements/criteria; training programs and materials; affinity groups; mentorship programs; fellowships and internships
- Review DEI practices, policies and programs for suppliers/service providers
  - E.g., vendor and supplier diversity programs and practices; written supplier policies
- Identify practices, policies and programs that are, or potentially could be, illegal and those that are legal but likely to draw federal scrutiny

Impact of Tariffs on Contractor Supply Chain and Costs

- Trump Administration has imposed a range of tariffs on goods imported into the U.S., with tariffs varying based on the nature of the product, the country of origin, and other factors
- Government contractors are not universally exempt from tariffs; they may be able to pass through increased costs to U.S. government customers
- Cost-Reimbursement and other Flexibly-Priced Contracts
  - Increased costs resulting from tariffs generally should be allowable unless (a) contract provision states that they are unallowable, or (b) contractor entitled to assert an exemption from the tariff
  - Funding limitations and fee schedule could be implicated (and notice of exhaustion required)
- Fixed Price Contracts
  - FAR 52.229-3 – provides equitable adjustment for an "after-imposed Federal tax" – increased costs for tariffs imposed after the effective date of a contract likely triggers clause if contractor is required to pay the tariff *directly* and contractor promptly notifies CO
  - FAR 52.216-4 and other Economic Price Adjustment clauses – may require CO to negotiate price adjustment based on the impacts of tariffs on the contractor (but adjustments likely capped)
- Contractor may be entitled to seek an exemption/duty-free entry (FAR 52.225-8, DFARS 252.225-7013) – Administration policies on exemptions are in flux

Government Contracts and National Security Pipeline Diligence

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Shifting Funding Priorities, E.O. 14222, DOGE, and DoD Memorandum on Service Contractors

- Trump Administration immediately shifted funding priorities, resulting in termination of programs and review of many others
  - Focus on specific programs (e.g., USAID overseas support) and consulting contracts and value-added resellers – thousands of contracts cancelled
  - Certain types of contracts largely insulated from termination/cancellation risks (e.g., mission critical-services, intelligence support, immigration enforcement)
- E.O. 14222 formally introduced Department of Government Efficiency "cost-efficiency initiative" intended to transform spending on federal contracts and grants
  - Mandates agency review of contracts and grants to reduce or reallocate spending
  - Requires justifications for payments to contractors
- DoD issued May 27 memorandum implementing E.O. 14222
  - Prioritizes reliance on in-house capabilities, including hiring of new staff, over external contracts for IT consulting, management, and advisory services
  - Requires review of existing contracts for IT consulting, management, and advisory services
  - Requires, with limited exceptions, approval at Deputy Sec Def level for new contracts for IT consulting, management, or advisory services supported by cost-benefit analysis considering alternatives

Recertification Rules for Mergers, Acquisitions, and other Change-of-Control Transactions – Background

- A firm's size status is usually determined as of the date of its initial offer including price—a firm considered small at that point is generally considered small throughout the life of the contract.
- A firm that is involved in a merger, acquisition, or transaction resulting in a change of control has been required to recertify its size status within 30 calendar days.
  - Lack of clarity on whether an agreement in principle (e.g., letter of intent) triggers a recertification obligation prior to the closing of the change-of-control transaction.
- A firm's recertification as other than small (i.e., a large business) due to an M&A event generally has not prohibited an agency from awarding new orders under or exercising options on the firm's existing set-aside MACs.
  - Exception: If a contracting officer required recertifications at the order level under a set-aside MAC (a discretionary decision), the firm would be ineligible for that order unless it qualified as small following the M&A event.
- SBA's prior rules addressed the impact of a firm's recertification as other than small due to an M&A event on pending offers, but the application of those rules was often less than clear. For instance, was an agency *required* to consider a firm eligible if the event occurred more than 180 days after offer submission or merely *allowed* to consider the firm eligible?

Recertification Rules for Mergers, Acquisitions, and other Change-of-Control Transactions – SBA's Final Rule

- SBA, Final Rule, HUBZONE Program Updates and Clarifications, and Clarifications to Other Small Business Programs, 89 Fed. Reg. 102,448, SBA-2024-0007 (Dec. 17, 2024) changes rules related to the recertification of size and SBA program status in connection with M&A activity
- SBA acknowledged that "how SBA always intended recertification to operate . . . may be unclear from the existing regulatory text." SBA intended to simply and clarify its recertification rules.
- All recertification rules are now codified in one place: 13 C.F.R. § 125.12 (which is cross-referenced in the regulations for and applies to SBA's separate programs).
- Recertification requirement is largely unchanged: recertification is due within 30 calendar days of the triggering M&A event (i.e., "a merger, acquisition, or sale of or by a concern or an affiliate of the concern, which results in a change in controlling interest"), applies to both sides of an M&A transaction if both have received an award as a small business, and is based on the current size standard applicable to the NAICS Code assigned to the award.
- SBA has clarified that a firm is not obligated to recertify based solely on an "agreement in principle."
  - Practice Pointer: Do not conflate the timing for when recertification is required with the timing for when affiliation arises following an agreement in principle.
- SBA has introduced a new name for an existing concept: the "disqualifying recertification," a recertification where the contractor is "other than small or other than a qualified small business program participant that is required" to be eligible for a set-aside or reserved award.

Recertification Rules for Mergers, Acquisitions, and other Change-of-Control Transactions – SBA's Final Rule (cont'd)

- If a firm submits a disqualifying recertification following a triggering M&A event *involving a large business* (a firm that was large *before* the transaction):

1. **Existing Set-Aside Single-Award Contracts** – The firm remains *eligible* to receive future orders and agreements and have options exercised, but the purchasing agency cannot count them for small business goaling purposes.
2. **Existing Unrestricted MACs** – The firm is *ineligible* to receive future set-aside orders and agreements; the firm remains *eligible* to receive future unrestricted orders and agreements and to have options exercised, but the agency cannot count them for small business goaling purposes.
   - The restriction on future set-aside orders and agreements applies to GSA Multiple Award Schedule contracts.
3. **Existing Set-Aside MACs** – The firm is *ineligible* to receive future orders and agreements and to have options exercised.
4. **Pending Offers**
   - **For Set-Aside Single-Award Contracts** – The firm remains *eligible* if offer submitted at least 180 days before triggering M&A event *and* the purchasing agency can count the award for small business goaling purposes for up to 5 years (unless there is a separate disqualifying recertification); the firm is *ineligible* if offer submitted less than 180 days before triggering M&A event.
   - **For Set-Aside Multiple-Award Contracts** – The firm is *ineligible* because it would be ineligible for all orders under the MAC.

Recertification Rules for Mergers, Acquisitions, and other Change-of-Control Transactions – SBA's Final Rule (cont'd)

- **Exception for Small-on-Small M&A Activity**
  - Despite a disqualifying certification, a firm remains eligible to receive future set-aside orders under unrestricted and set-aside MACs and to have options exercised on set-aside MACs if both the firm and the other party to the M&A transaction qualify as small under the size standard for the applicable NAICS Code.
  - The purchasing agency cannot count the orders and options for small business goaling purposes.
- **Delayed Phase-In of Ineligibility for Orders under Set-Side MACs**
  - If a disqualifying recertification is based on a triggering M&A event that occurs before January 17, 2026, a firm remains eligible for future orders under a set-aside MAC—this special eligibility will extend to order-level procurements under MACs conducted after the delayed effective date, assuming the firm has not otherwise lost its size or SBA program status (e.g., through a subsequent disqualifying recertification or order-specific recertification).
  - The purchasing agency cannot count the orders for small business goaling purposes.
  - SBA says final rule "should not be retroactively applied" but will apply to existing MACs.

Additional Small Business Developments on Horizon?

- ***Expansion of the "Rule of Two" to FAR Part 16 Task-and-Delivery-Order Competitions?***
  - Rule of Two requires agencies to set aside contracts for small businesses when the agency, based on market research, reasonably expects to receive offers from at least two qualified small business concerns at fair prices. For procurements above the simplified acquisition threshold, corollary requires agencies to first consider set-asides for socioeconomic small business programs (8(a), SDVOSB, and WOSB).
  - GAO has held that Rule of Two does not apply to FAR Part 16 orders.
  - In October, SBA proposed to mandate the Rule of Two for FAR Part 16 order procurements over micro-purchase threshold; Federal Supply Schedule orders would be excluded. Agencies would retain discretion to choose which vehicle to use (although there would be new documentation requirements). Agency-specific exceptions would be allowed.
- ***Or Elimination of the Rule of Two with FAR Rewrite?***
  - Rule of Two is only statutorily mandated for Department of Veterans Affairs (with respect to SDVOSBs and VOSBs).
  - Government-wide application of Rule of Two could be revisited through FAR rewrite effort; there already is proposed legislation to preserve it.
- ***Crackdown on Mentor-Protégé Joint Ventures?***
  - Last year, SBA sought comments on eliminating MPJV exception to affiliation for MACs or contracts of more than 5 years.
  - This year, SBA sought comments on ability of proteges to "direct and manage" their mentors when performing MPJV contracts.

Organizational Conflicts of Interest

- Government-wide rules codified in FAR subpart 9.5 - FAR rules have stagnated – rules date back to 1980s even though government contracting has evolved substantially since that time
- FAR Council issued proposed rule on January 15 to implement Preventing OCIs in Federal Acquisition Act
  - Move rules from FAR subpart 9.5 to new subpart 3.12
  - Adopts case law on need for “hard facts” to establish OCI and acceptability of “incumbent advantage” (or “natural advantage”)
  - Exempts acquisitions of commercial products (but not commercial services)
  - Requires offerors to affirmatively identify unequal access to information OCIs
  - Authorizes COs to accept risk of impaired objectivity OCIs in some circumstances; imposes additional administrative requirements for OCI waivers
  - Introduces five new FAR clauses to standardize solicitation and contract terms, including clause requiring disclosure of post-award OCIs
- OCI review is critical element of diligence, especially for service contractors
  - Analyze potential OCIs related to impaired objectivity and access to non-public information
  - May require clean team to facilitate sharing of detailed information on current work and pipeline opportunities

Foreign Investment Considerations

Updated DOD SF-328 Related to Foreign Interests

- DCSA considers foreign interests of and in current and prospective cleared contractors
- DCSA released new Standard Form 328, Certificate Pertaining to Foreign Interest (SF-328) on May 9
- New SF-328 applies to new FOCI packages submitted on or after May 12 (e.g., initial FCL request, reporting change of ownership) – DCSA not requiring resubmission for pending packages (or from existing cleared contractors without pending packages)
- Changes to SF-328 clarify and broaden the scope of questions and require more detailed disclosures (potentially reducing need for follow-up based on DCSA requests)
  - Requires identification of beneficial ownership and control structure if foreign entity holds 5% or more interest in contractor and details of governance documents describing powers and rights of foreign interests
  - Requires reporting of foreign ownership of 5% or more in aggregate by multiple foreign persons in same country or within affiliated entities
  - Requires reporting of foreign outsourcing contractual relationships (manufacturing, R&D, admin support)
  - Lowers reporting threshold for aggregate foreign proceeds from 30% to 15% of total revenue or net income (Question #7(b)).
  - Introduces standard Foreign Affiliations Statement (required for individual who holds a management position within organization and also holds position with or serves as consultant to or representative for any foreign person)

DCSA FOCI Review of Uncleared Contractors

- DCSA historically limited formal disclosures and review to contractors with contracts requiring access to classified information
- Congress increasing concerned with foreign investment impacting supply chain and defense industrial base
- Section 847 of FY 2020 National Defense Authorization Act (as amended by Section 819 of FY2021 NDAA)
  - Requires “covered contractors” to disclose FOCI-related information to DCSA in advance of award
  - DoD Instruction 5205.87: Mitigating Risks Related to Foreign Ownership, Control, or Influence for Covered DoD Contractors and Subcontractors
  - DoD rulemaking pending (DFARS Case 2021-D011)

DCSA FOCI Review of Uncleared Contractors (cont'd)

- Covered Entities under Section 847 and DoD Instruction
  - Holds a prime contract, subcontract or research agreement with DoD with value of more than $5M
  - Commercial products and commercial services excluded, but there are exceptions if risk to national security
- Contractors provide DCSA information about beneficial foreign owners
  - DoD will use SF-328 to solicit information on foreign interests
  - Additional documents and follow-up requests possible
- DCSA provides risk indicator report / FOCI assessment (within 25 working days)
  - Analysis of risk to national security, potential for compromise of sensitive data, systems or processes or other perceived threat to covered contractor's ability to perform contract
  - Statement concerning mitigation if needed
- FOCI mitigation measures
  - Negotiated between the DoD component and covered contractor, implemented and overseen by DCSA
  - Generally implemented within 90 days
  - Examples include exclusion resolutions, outside directors, proxy agreement, voting trust agreement
- DCSA will perform annual review and report non-compliance to DoD components

Trends in CFIUS Filings and Enforcement (FY 2023)

- In 2023, number of CFIUS filings significantly decreased
  - 109 declarations and 233 notices in 2023 (compared to 154 declarations and 286 notices in 2022)
- Percentage of notices going to investigation remained relatively stable
  - Out of 233 notices in 2023, CFIUS investigated 128 transactions (55%) (48% in 2021, 57% in 2022)
- CFIUS appears to have ramped up review of non-notified transactions, resulting in increased filing requests
  - In 2023, 60 non-notified transactions were reviewed, 13 of which resulted in a filing request (22%) (6% in 2021, 13% in 2022)
- CFIUS continued to require mitigation at higher rates
  - CFIUS adopted mitigation measures and conditions in 43 instances (18% of notices)
  - Rate of mitigation requirement increased significantly in 2022 (18% of notices in 2022, 10% of notices in 2021)
- CFIUS is also increasingly bringing enforcement actions
  - CFIUS imposed penalties in 3 cases in 2024

“America First Investment Policy” Memo (Feb. 21, 2025)

China

- Calls for various measures intended to reduce or restrict Chinese investments in the United States and U.S. investments into China
- Also calls for considering new or expanded restrictions on U.S. outbound investment in China in the following sectors: semiconductors, artificial intelligence, quantum, biotechnology, hypersonics, aerospace, advanced manufacturing, directed energy, and other areas implicated by the China’s national Military-Civil Fusion strategy

Allies and Partners

- Announces plans to create “fast-track” process to facilitate greater investment from specified allied and partner countries in U.S. businesses involved with U.S “advanced technology and other important areas,” subject to security provisions (e.g., avoid partnering with U.S. foreign adversaries)
- Seeks to reduce administrative burden of CFIUS process by avoiding “open-ended” mitigation agreements and instead direct more administrative resources to facilitate investments from key partner countries

Expansion of CFIUS Enforcement Powers

- Under Final Rule that took effect on December 26, 2024, CFIUS now has
  - Enhanced power to request and receive information pertaining to non-notified transactions, including from third parties such as banks, underwriters, and service providers and through subpoenas
  - Enhanced power to request and receive information for other reasons, e.g., to monitor compliance with mitigation agreements; to determine whether a party made material misstatement or omitted information
  - Discretionary power to impose a timeframe for responding to CFIUS's proposed mitigation terms
- Final Rule also increases maximum penalties
  - Material misstatements, omissions, or false statements: 20-fold increase to $5 million per violation
  - Failure to submit mandatory declaration: 20-fold increase to $5 million per violation
  - Violation of material provision of mitigation agreement (entered into on or after December 26, 2024): $5 million, value of violator's interest in business, or value of transaction, whichever is greater

Structuring Transactions to Address Compliance/Liability and Pipeline Risks

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Structuring Transactions to Address Liability and Pipeline Risks

- Diligence
  - Increased focus on Quality of Earnings and financial diligence; customer diligence, financial projections (non-binding but good faith).
  - Exhaustive diligence on FCA exposure, CAS, cybersecurity risks, security clearances, etc.
- Structure
  - Asset-based purchases if narrow target areas of interest, to help avoid hidden regulatory liabilities.
  - Understanding CFIUS-FOCI issues and current and future ownership.
- Purchase Price
  - Partial funding with earnouts/milestones to hedge against valuation concerns and potential future/renewed awards in the pipeline.
  - Use of escrows and holdbacks to cover liability exposures for unclear risks.
- Representations and Warranties
  - Buyers to expand to target regulatory compliance (FAR, CAS, cybersecurity, data privacy).
  - Use of R&W Insurance (and exclusions) and special indemnities for areas of risk.
- Post-Closing Planning
  - Novation and transitional provisions (including deferred purchase price tied to novation milestones).
  - Immediate remediation and compliance updates for any regulatory concerns.

Speaker Biographies

Bill King

General Counsel & Chief Compliance Officer
QinetiQ US

Bill King serves as General Counsel & Chief Compliance Officer for QinetiQ US, where he is responsible for managing all legal affairs of the organization, as well as overseeing the company's ethics and regulatory compliance efforts.

Bill has worked as in-house counsel at both large and small organizations and at both public and private-equity-sponsored companies, including IBM, Acuity International, and NISC Holdings.

Prior to his business career, Bill served as an officer in the U.S. Air Force. He is a graduate of Virginia Tech (B.A., English) and the Seattle University School of Law.

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Naomi M. Hartman advises clients in highly regulated industries on a broad range of corporate matters, including corporate formation and governance, mergers and acquisitions, public and private offerings, and SEC reporting and compliance. Ms. Hartman also has experience in intellectual property matters, focusing on the protection, development and commercialization of intellectual property.

Ms. Hartman earned her JD from American University Washington College of Law, summa cum laude, where she was a Myers Society Distinguished Fellow, staff on the Administrative Law Review and member of the Moot Court Honor Society. During law school, Ms. Hartman served as a judicial intern in the chambers of the Honorable Kathleen M. O'Malley in the United States Court of Appeals for the Federal Circuit and a legal intern in the Office of the General Counsel for the United States Department of Transportation.

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Michael McGill represents clients across virtually all industry sectors that do business with government customers (including aerospace and defense, technology, healthcare, pharmaceuticals, energy, and professional consulting) and in nearly all aspects of procurement and contracting law. He has experience handling some of the most complex litigation and transactional matters in this area.

Michael regularly litigates high-stakes bid protests, contract claims against government agencies, prime-subcontractor and teaming disputes, and other contentious matters related to government contracting at the federal and state levels. He has litigated before the Government Accountability Office (GAO), U.S. Court of Federal Claims (COFC), Armed Services and Civil Boards of Contract Appeals, and the Federal Aviation Administration Office of Dispute Resolution for Acquisition (ODRA), among other forums, achieving favorable results for clients through various forms of alternative dispute resolution (ADR) in addition to litigation.

Speaker Biographies

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Tom Pettit represents government contractors in litigation, mergers and acquisitions, and investigations. He advises on a variety of regulatory compliance issues. Tom is a U.S. Marine Corps veteran of Operation Iraqi Freedom whose prior employment before joining Arnold & Porter included a top 20 federal contractor and the general counsel's office of a federally-funded research and development center. He is well-versed in the needs and concerns of the defense, aerospace, intelligence, and national security communities.

Tom litigates bid protests, contract claims, and prime-subcontractor disputes before the U.S. Government Accountability Office, U.S. Court of Federal Claims, U.S. Court of Appeals for the Federal Circuit, Boards of Contract Appeals, Small Business Administration Office of Hearings and Appeals, and other forums.

He also represents strategic and private equity buyers and sellers in complex corporate transactions involving government contractors, including mergers, acquisitions, bankruptcies, teaming arrangements, joint ventures, and subcontracting partnerships. Tom also regularly advises on small business issues, including mentor-protégé and joint venture agreements, size and status compliance, and size and status protests, as well as labor and employment issues unique to government contractors, including compliance with the Service Contract Act and the Davis-Bacon Act.

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Trevor Schmitt's practice focuses on national security law, complex internal investigations, and government contracts with a particular focus on working with individuals and companies in government and internal investigations related export and sanctions enforcement, including with respect to the International Traffic in Arms Regulations (ITAR), the Export Administration Regulations (EAR), and Office of Foreign Assets Control (OFAC) sanctions. He also provides both U.S. and non-U.S. companies with guidance on compliance with U.S. trade sanctions and export controls. In addition to advising clients on strategic planning, compliance and enforcement, Trevor regularly deals with various government agencies responsible for the administration of these laws and appears before panels, courts, and other forums hearing disputes involving international trade and investment matters.

Trevor also advises both private and public sector clients on the application of regulations governing foreign investment and international trade in goods, services, and technology across industries, including the financial services, information technology, microelectronics and defense and aerospace sectors.

His experience includes advocating for companies that do business with the U.S. Government, either directly or as a subcontractor.

Questions?

Thank You!