SMI INSIGHT

FROM CONCEPT TO CAPABILITY

SENATE ARMED SERVICES COMMITTEE PROPOSES LEGAL FRAMEWORK FOR PENTAGON EQUITY INVESTMENTS

By Mark Gillman, Senior Vice President and Defense Industrial Base Practice Area Lead

KEY POINTS

- The Senate Armed Services Committee's FY2027 National Defense Authorization Act (NDAA) would create a formal statutory framework for Pentagon equity investments through the Office of Strategic Capital (OSC).
- OSC would receive exclusive authority for ten years to make qualifying equity investments, supported by a new Treasury-held Equity Investment Account.
- The proposed authority would be limited to investments tied to critical minerals, materials, chemicals, and batteries.
- The bill would impose significant limits on Pentagon equity stakes, including prohibitions on majority ownership, board representation, and investments above specified thresholds.
- Before making an equity investment, OSC would need to conduct ownership reviews and certify to Congress that the investment in necessary, cost-effective, and in the national security interest.
- The legislation would require advance notification to congressional defense committees and would prohibit the Industrial Base Fund from making equity investments.

The Senate Armed Services Committee's FY2027 National Defense Authorization Act (NDAA) would establish a formal statutory framework governing the Department of War's use of equity investments to strengthen critical segments of the defense industrial base.

The bill would grant the Office of Strategic Capital (OSC) exclusive authority for the next ten years to make equity investments – "any direct or indirect purchase, acquisition, or commitment of funds by the [Department] in exchange for an ownership interest, convertible interest, warrant, revenue-sharing instrument, or other similar financial instrument in a non-Federal entity" – in limited circumstances based upon the investment amount, its purpose(s), and a set of qualifying criteria that must be certified to Congress.

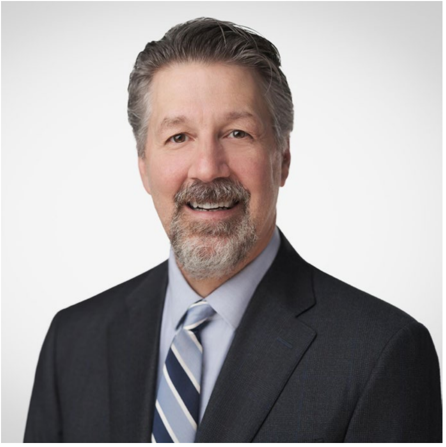
To support these activities, OSC would have authority to draw resources from a newly created Equity Investment Account at the Treasury Department, which would consist of congressionally appropriated funds. Funding from the account would be limited to making equity investments for critical minerals, materials, and chemicals as well as batteries.

OSC's Equity Investment Limitations

The legislation places several limitations on OSC's equity investment activities. The Department could not hold a majority stake in an entity; the aggregate equity investments in an entity could not exceed $500 million; and an equity investment could be no more than 40 percent of the total amount of equity investments in the entity at the time of OSC's equity investment. Additionally, the bill would prohibit OSC's Director from serving on the board of directors or having any form of voting representation within any entity that receives an equity investment. Taken together, these provisions aim to ensure that the Department remains a minority investor and is not directly involved in corporate governance.

Ownership Review

Before making an investment, the bill requires OSC to conduct a comprehensive review of the recipient company's ownership structure. This review would include an assessment of any direct or indirect foreign ownership interests in the entity; the identification of all owners with at least a five percent stake as well as the members of the board of directors, advisory boards, and executive leadership team; and a determination of whether any mitigation measures are needed to protect U.S. national security or prevent conflicts of interest.



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Certifications to Congress

Moreover, the bill requires OSC to make several certifications to Congress prior to taking an equity interest. First, OSC would need to certify that, absent the investment, "sufficient commercial credit is not available to the entity under reasonable terms or conditions… or the entity would be unable to expand operations to support the defense industrial base in the time frame necessary to address a shortfall of such operations." (Notably, the House Financial Services Committee's Defense Production Act reauthorization, which was described in a recent SMI Insight, contains similar language.) Second, the certification must include a statement that "the investment is the most cost effective, expedient, and practical alternative available to meet the needs of the Federal Government." And third, the certification must include a determination that the investment is in the United States' national security interest. Within 15 days of the review's conclusion, the bill requires OSC to submit a report on its findings to Congress.

Prior Notification to Congress

Apart from requiring those certifications to Congress, the bill also mandates that OSC give prior notification to the defense committees before making equity or debt investments. (The bill defines a debt investment as a "loan, note, bond… or other instrument representing an obligation of an entity to repay funds advanced" by the Department.) The bill would require OSC to provide the committees with copies of the term sheet, "a description of why the investment is necessary and determined to be in the long-term defense interests of the United States," and "clear criteria for the Federal Government to sell, liquidate, or otherwise exit the investment."

The deadline for notification would be determined by the size of the proposed equity investment. For investments below $50 million, OSC would have five days from signing the term sheet to notify and brief the congressional defense committees; and the bill would prohibit OSC from signing a legally binding agreement until 15 business days had passed following the briefing. For investments of $50 million or more, the congressional notification and briefing requirements would remain the same. However, OSC could not enter into a legally binding agreement before *30 days* had passed after the congressional briefing.

The legislation also includes a retrospective transparency provision. For equity investments made prior to the bill's enactment, the Department would have 30 days to "transmit to the congressional defense committees all unredacted term sheets for each equity investment or debt investment."

IBAS Prohibited from Making Equity Investments

Finally, the bill would prohibit the Industrial Base Fund from being used to make equity investments. Authority for such purchases would rest solely with OSC.

What's next

The proposal represents Congress's most comprehensive effort to date to establish a formal legal framework for Pentagon equity investing. While the bill would provide OSC with explicit authority to take ownership stakes in strategically important companies, it simultaneously imposes significant limitations on investment size, governance involvement, ownership reviews, congressional reporting, and notification requirements.

The Senate Armed Service Committee completed its mark-up of the bill in June. The bill now awaits consideration by the full Senate.

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