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# A Strategic Investor

Federal equity investing approaches to advance national security

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When should DoD buy equity in private companies?  
How can it control the risks?

## ABOUT NDIA-ETI

# Emerging Technologies Institute (ETI)

ETI is an affiliate of NDIA focused on the future of national defense. We produce policy-focused analysis, convene industry and government, and develop recommendations to strengthen the defense industrial base.

- Policy Studies & Reports

- Technical Webinars & Short Courses

- Workshops with NDIA Chapters

- Annual Emerging Tech Conference

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- Partnerships with Industry Experts

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NEWSLETTER

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## Equity: A narrow tool

Useful only when capital markets fail or governance needs exceed normal tools.

## Thesis: Equity can advance national security under *very specific* conditions

01

### Patient Capital

Equity can tolerate the high default risk that blocks debt markets, providing funding for projects where loans and loan guarantees fall short.

02

### Governance Rights

Equity provides a wide range of negotiable control mechanisms — voting rights, information rights, covenants — more comprehensive than CFIUS protections alone.

03

### Budget Neutrality

Unlike grants or contracts, equity can generate financial ROI, making it potentially balance-sheet neutral — a critical advantage when financing large industrial investments.

### But: Equity also creates risk and requires thoughtful controls

The acquisition workforce will need to implement training, governance structures, compliance systems, portfolio risk management techniques, and oversight mechanisms.

*"Equity refers to a family of investment securities that share the ability to receive a share of future profits from a firm."*

## WHAT IS EQUITY?

# A Negotiable Bundle of Rights and Obligations

Each equity transaction is a legal contract between an investor and a firm. This "bundle of rights" is negotiable.

### **Economic Rights**

Residual claimant rights (profit share), dividends, and liquidation preferences / seniority in financial payouts.

### **Control Rights**

Board seats or votes, veto rights over M&A and IP disposition, and ability to amend the corporate charter.

### **Information Rights**

Access to financial and operational data — typically provided to support corporate governance and oversight decisions.

### **Transfer Restrictions**

Limitations on who can purchase shares later; anti-dilution or "ratchet" clauses protecting the investor's economic upside over time.

### **Enforcement Rights**

Clawbacks, step-in rights, and affirmative/negative covenants covering compensation, accounting, cybersecurity standards, and leadership requirements.

*Each Type of Equity Provides a Different Bundle of Rights to the Shareholder*

## DEFINITION OF EQUITY INSTRUMENTS

# Common Types of Equity Securities

### 01 Preferred Stock

Priority claim over common stock in repayment. Often carries board seats and veto rights over M&A and IP disposition. A high-control investment security.

### 02 Common Stock

Lower payback priority than preferred shareholders. Carries voting rights for board elections.

### 03 Warrants

Option to purchase shares at a set price at a future date. Provides financial upside with no control or other rights.

### 04 Convertible Notes & SAFEs

Securities that convert to equity under future conditions. Provide optionality on economic rights

### 05 Golden Shares

A class of equity providing an override for key board decisions, without economic rights.

## 5+ *Firms*

DoD equity positions as of Spring 2026, appear to be funded primarily through Title III, using Defense Production Act purchase authority.

### DOD'S CURRENT APPROACH

## The Pentagon Is Piloting Equity Investing

As of 2026, the U.S. federal government has acquired equity in at least eight firms. The Pentagon itself holds positions in at least five.

■ <b>MP Materials</b>	Rare earth mining, refining, and permanent magnet production
■ <b>Korea Zinc</b>	Critical minerals processing
■ <b>ReElement Technologies</b>	Rare earth separation and refining
■ <b>Trilogy Metals</b>	Copper and cobalt mining
■ <b>L3Harris (subsidiary)</b>	Defense electronics

Sources: Shivakumar et al. (CSIS, 2026)

# *\$400M in Convertible Preferred Stock*

Equity acquired by DoD in MP Materials, July 2025, plus a warrant to purchase additional shares.

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## A Blended Transaction for Domestic Rare Earth Supply Chains

# Case Study: MP Materials

### Deal Structure

Offtake and price floor agreements, \$1B+ in syndicated debt, \$400M convertible preferred stock, warrant to purchase additional shares.

### What DoD Did Not Receive

No voting rights or board seats. Control is exercised exclusively through covenants.

### Why It Matters

Rare earth magnets are critical inputs for precision munitions, radar, communications, and electric motors across the defense industrial base.

### Key Covenants

Binding requirements to construct and expand mining, refining, chemical processing, and magnet manufacturing facilities at targeted activity levels.

### National Security Protections

Prohibitions on business with foreign adversaries or non-US persons; controls over M&A, asset sales, equity transactions, and magnet sales.

### Enforcement Mechanisms

Covenant violations trigger immediate loan repayment demands, damages, or termination of DoD offtake and purchase agreements.

## KEY RISKS

# Equity Presents Novel Risks

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**01 Soft-Budget Constraints**

When a government-owned firm faces stress, political incentives may compel continued support to avoid losses or national security gaps. Chronic loss-makers may never be allowed to fail. (Kornai, 2003)

**02 Reduced Innovation**

Subsidizing one firm can suppress competitors who might generate cheaper or better alternatives.

**03 Crowding Out Effects**

Government capital and skilled labor drawn into subsidized firms may displace higher-value private investment.

**04 Workforce & Education Gaps**

Absent expert deal teams, the government risks overpaying, negotiating weak control rights, or failing to enforce conditions, as well as potentially competing unfairly with private investors.

**05 Politicized Decisionmaking**

When government representatives hold board seats or voting rights, decisions driven by political rather than strategic logic can undermine firm performance.

**06 Mandate Creep**

Without explicit, durable investment mandates, government programs can shift purpose after elections or perceived market changes, making accountability and success metrics challenging.

**07 Misappropriation of Public Resources**

Novelty, complexity, and weak metrics create vulnerability to misappropriation.

*"The Department of Commerce recruited experienced investment professionals from Goldman Sachs, KKR, and Blackstone for the CHIPS program."*

## RECOMMENDED BEST PRACTICES

# Reducing Risk with Institutional Capacity

### 01 Workforce & Institutional Capability

Staff execution offices like commercial investment firms with expertise in deal underwriting, portfolio monitoring, covenant enforcement, and risk management.

### 02 Minimally Intrusive Control Rights

Reserve golden shares and board seats for exceptional circumstances. Default to covenants targeting narrow, high-consequence decisions (IP transfer offshore, M&A). The MP Materials deal may offer a template.

### 03 Oversight Mechanisms

Provide Congress with regular reporting: fair-value balance sheet, accounting methodology, fund performance metrics (ROI, default rates, private capital mobilized), and DIB impact data. Consider pre-notification requirements for large transactions (e.g., DFC's \$20M threshold).

### 04 Internal Governance

Establish an official Investment Committee to ensure adherence to mandate and create auditable records. Designate dedicated Chief Compliance Officer or Ombuds.

### 05 Portfolio Risk Management & Exit Policy

Apply proven private-sector methodologies: stress testing and scenario analysis, liquidity risk modeling, and exposure concentration limits with rebalancing requirements.

*"Where traditional acquisition tools struggle, equity instruments may have a unique role — but only with the right institutional structure."*

## CONCLUSION

# With Guardrails, Equity Investing Can Advance National Security

### **A Legitimate and Sometimes Necessary Tool**

Government equity investing can be useful where capital markets fail and existing control mechanisms are insufficient.

### **New Risks Demand New Capabilities**

Equity's complexity and power create acute vulnerabilities: soft-budget dynamics, political governance, mandate drift, and misappropriation risk.

### **The Department Must Invest in Itself**

Responsible equity investing requires the Pentagon to build expert deal teams, robust internal governance, congressional oversight frameworks, and portfolio risk management capabilities.

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