

Why Acquirers Should Reevaluate Federal Contract Risk

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Based on a predictable and stable revenue stream, investors have historically viewed businesses that have contracts with the U.S. government as a stable investment.

Rich Weber, a partner at the accounting firm Moss Adams, noted in 2023 that “[g]iven their reliability, government contracts often make businesses more appealing to lenders and investors, facilitating easier access to loans and financing under favorable terms.”^[1]

Government contractors have been targeted specifically by private equity firms because they are considered to be reliable revenue streams immune from the volatility of the financial markets.^[2]

However, because of the evolving political climate — notably, the Trump administration’s executive orders and the actions taken by the new Department of Government Efficiency, or DOGE — investors considering acquiring or making an investment in federal contractors may have questions about the reliability of a target’s federal government contracts pipeline and associated revenue risks.

Through these executive orders and other agency memoranda designed to carry out President Donald Trump’s policy initiatives, a number of federal agencies have now paused federal funding — putting a lock on issuing new contracts and, in some cases, issuing stop-work orders and termination notices on existing contracts.

For example, the General Services Administration’s acquisition pause,^[3] and the U.S. Department of State’s pause on U.S. foreign assistance,^[4] have halted the government’s procurement cycle, which previously ran like clockwork. The freezes are not limited to certain agencies but are happening across the federal government in virtually every executive agency.

The freezes are also not limited to the executive orders on diversity, equity and inclusion, or DEI;^[5] unleashing American energy;^[6] or U.S. foreign aid.^[7] On top of this, contractors at some agencies are being asked by DOGE to justify their existence.

These actions have resulted in many contractors receiving stop-work orders and contract terminations — indeed, on March 3, the U.S. Department of Veterans Affairs said it was to terminate 585 consulting contracts.^[8] Some contractors may face False Claims Act exposure resulting from the DEI executive order.^[9]

To be clear, the federal government's ability to terminate contracts without finding a breach or default by the contractor is not new and is not specific to the current administration. Unlike commercial contracts, the federal acquisition regulations provide the government with the unilateral right to terminate all or a portion of a federal contract for its own convenience without any finding of a breach or default thereof by the contractor.

However, while terminations for the government's convenience are not new, potential acquirers should understand that the scale and breadth with which the Trump administration, and particularly DOGE, are attempting to eliminate federal contracts and other forms of financial assistance is unprecedented.

Contracts that were not typically seen as controversial are now being reviewed and, in some cases, terminated based on DOGE's unilateral determination that they are unnecessary, frivolous, contrary to policy agendas or wasteful.

While several courts have issued temporary orders to block these funding freezes,^[10] it is not immediately clear that such temporary orders will ultimately be successful in slowing down or stopping the administration's efforts.

INCREMENTAL DUE DILIGENCE REGARDING PIPELINES FOR PROSPECTIVE ACQUIRERS

So, how should a private equity fund or strategic buyer that is considering the acquisition of a federal contractor evaluate the fluctuating risk associated with government contracts in light of this political upheaval?

First, prospective acquirers should consider the size and scope of all active and pending government contracts of the target company, especially in light of the published administration priorities that are available at the relevant time.

Acquirers should closely review the scope of such contracts to determine whether the subject activities fit within any of the at-issue areas the administration is targeting.

For example, any government contracts involving cultural programming — whether or not expressly relating to DEI — should likely be viewed as high risk, as all agencies have been instructed by the administration to terminate such contracts in whole or in part. Similarly, any contracts, grants or other forms of financial assistance related to any form of renewable energy or climate change should also be viewed as at least moderate risk.

Second, in addition to the widely covered executive orders, agencies are issuing public guidance, as well as private notices, to contractors that provide instructions on how to comply with the executive orders.

Therefore, due diligence should include a review of not only all relevant executive orders, but also related agency guidance, including publicly available guidance and any direct nonpublic guidance or correspondence received by the target company.

Prospective acquirers should also conduct due diligence to consider the impact of any related court orders, such as temporary restraining orders or injunctions that may have an effect on the administration's actions related to suspending or terminating federal funding.

Diligence should also include reviews of all correspondence, written or oral, from DOGE, along with the target company's responses thereto.

It would also be prudent for acquirers to speak directly with the target company's personnel most familiar with its active and pending federal government contracts, in order to gain an understanding of the climate within the particular agencies the personnel are working with, and to evaluate intangible risks related to the performance and administration of their active contractors.

Third, there is a growing concern that the Trump administration, or certain agencies, may attempt to do away with, or at least limit, the use of preferences for socioeconomic categories of businesses, such as woman-owned small

businesses or disadvantaged business enterprises.

Thus, to the extent a target company has contracts that were awarded on a set-aside basis for these types of contracts, the prospective acquirer's due diligence exercise should also include an analysis of the business impact if the target company — or joint ventures in which it participates — are no longer able to utilize this status as a benefit to receiving contracts.

Finally, in light of the executive order^[11] requiring government contractors to certify that they do not have any DEI policies that would violate federal civil rights laws, and notwithstanding the temporary restraining order issued by a federal court enjoining enforcement of the executive order, acquirers should review all relevant target company policies that involve employment practices, as well as other activities of the organization, to evaluate whether they put the company at risk of any False Claims Act liability.

PROTECTION OF TARGET FIRM PAYMENT RIGHTS EVEN IF CONTRACTS ARE SUSPENDED OR TERMINATED

Notwithstanding the foregoing, it is important for investors to understand that federal contractors that receive stop-work orders, suspension notices or termination notices are not completely without recourse.^[12]

For terminations for convenience, depending on the contract type, contractors are entitled to payment for work performed, including a reasonable profit, or costs they have incurred under the contract, as well as reasonable costs associated with the contract termination.

While anticipatory profits are not recoverable, contractors can recover reasonable costs incurred in the settlement process — including accounting, legal and clerical expenses associated with preparing a settlement proposal — as well as the termination and settlement of subcontracts.

Contractors can also recover hard costs such as storage, transportation and other costs needed for the preservation, protection or disposition of inventory.

Alternately, if a contractor receives a suspension of work or stop-work order, and work is later resumed, contractors have the right to repayment.^[13]

Depending on the type of notice received that halts the work, contractors may be able to file a request for equitable adjustment or claim with the contracting officer, requesting repayment for costs incurred by the suspension of work or for increases in cost for the remaining performance of the contract that are the result of the suspension of work.

Additionally, to the extent that freezes, suspensions, or terminations delay a contractor's receipt of payment from the government, under the Prompt Payment Act, the contractor can assess and recoup a monthly compounding interest penalty — currently set at 4.625% — for payments that are more than 30 days late.

NEXT STEPS

Despite all of this new uncertainty, the government will inevitably continue to rely on contractors to perform many important functions, ranging from information technology to healthcare to security and defense, as it lacks the resources to provide these services itself.

In the short term, for example, the administration has signaled that there may be significant funding opportunities in the defense and homeland security contracting space, as evidenced by Trump's executive orders on the iron dome^[14] and securing borders.^[15]

A number of large government contractors have also voiced their support for the manner in which DOGE is operating, hoping that its aggressive cost-cutting measures will result in a streamlined acquisition process; both DOGE and the GSA have indicated that regulatory changes are ahead for contractors.

After the dust settles following DOGE's significant reductions in the federal government workforce,^[16] and further expected reductions based on Trump's workforce optimization initiative,^[17] it seems likely that the government will

need contractors to fill the gaps left by these large-scale cuts.

As this is a dynamic area, private equity funds and strategic buyers should continue to monitor the evolving government actions^[18] and evaluate how the changes may affect proposed or ongoing transactions.

[1] Rich Weber, How Government Contracts Can Unlock Business Opportunity and Stability, Moss Adams (Oct. 25, 2023), <https://www.mossadams.com/articles/2023/10/benefits-of-government-contracts>.

[2] Martin O'Neill, Why Private Equity Investors Find Government Contractors Attractive, Chesapeake Corporate Advisors (Aug. 9, 2024), <https://ccabalt.com/why-private-equity-investors-find-government-contractors-attractive/>.

[3] Memorandum from GSA Acting Administrator Stephen Ehikian on federal acquisition pause, General Services Administration (Jan. 24, 2025), <https://www.gsa.gov/system/files/GSA%20Directive%20to%20Pause%20Acquisition%20and%20Lease%20Actions.pdf>.

[4] Press Statement, U.S. Department of State, Implementing the President's Executive Order on Reevaluating and Realigning United States Foreign Aid (Jan. 26, 2025), <https://www.state.gov/implementing-the-presidents-executive-order-on-reevaluating-and-realigning-united-states-foreign-aid/>.

[5] Exec. Order No. 14173, 90 Fed. Reg. 8633 (Jan. 21, 2025).

[6] Exec. Order No. 14154, 90 Fed. Reg. 8353 (Jan. 29, 2025).

[7] Exec. Order No. 14169, 90 Fed. Reg. 8619 (Jan. 30, 2025).

[8] <https://news.va.gov/press-room/va-to-terminate-585-non-mission-critical-or-duplicative-contracts/>.

[9] Suzanne Jaffe Bloom et al., Understanding and Addressing Increased FCA Exposure Risks Resulting from DEI-Focused Executive Order, Winston & Strawn LLP (Jan. 31, 2025), <https://www.winston.com/en/blogs-and-podcasts/investigations-enforcement-and-compliance-alerts/understanding-and-addressing-increased-fca-exposure-risks-resulting-from-dei-focused-executive-order>.

[10] Alex Lemonides et al., Tracking the Lawsuits Against Trump's Agenda, N.Y. Times (Feb. 26, 2025 – continually updating), <https://www.nytimes.com/interactive/2025/us/trump-administration-lawsuits.html>.

[11] Exec. Order No. 14173, 90 Fed. Reg. 8633 (Jan. 21, 2025).

[12] Elizabeth Leavy et al., What to do After Receiving a Stop-Work Order or Termination of Your Federal Contract or Grant: A Practice Guide for Government Contractors and Recipients, Winston & Strawn LLP (Feb. 7, 2024), <https://www.winston.com/en/blogs-and-podcasts/investigations-enforcement-and-compliance-alerts/what-to-do-after-receiving-a-stop-work-order-or-termination-of-your-federal-contract-or-grant-a-practice-guide-for-government-contractors-and-recipients>.

[13] See id.

[14] Exec. Order No. 14186, 90 Fed. Reg. 8767 (Feb. 3, 2025).

[15] Exec. Order No. 14165, 90 Fed. Reg. 8467 (Jan. 30, 2025).

[16] Joey Garrison, Firings Across Federal Government Begin After Trump, Musk Order Sweeping Cuts, USA Today (Feb. 13, 2025), <https://www.usatoday.com/story/news/politics/2025/02/13/trump-musk-federal-workforce-mass-firings/78524273007/>.

[17] Exec. Order No. 14210, 90 Fed. Reg. 9669 (Feb. 14, 2025).

[18] Winston & Strawn LLP, New Administration: The First 100 Days, <https://www.winston.com/en/new-administration-the-first-100-days>.

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