

**Frequently Asked Questions (FAQs)
on the Pilot Program to Incentivize Contracting with Employee-Owned Businesses
DFARS Subpart 270.1**

What is the Pilot Program to Incentivize Contracting with Employee-Owned Businesses?

Congress recognized the unique value proposition of 100% ESOPs to national security in that employee ownership provides financial security as well as avoids further consolidation of the defense industrial base. Congress authorized a Pilot Program to Incentivize Contracting with Employee-Owned Businesses in Section 874 of the National Defense Authorization Act (NDAA) for Fiscal Year 2022, which was subsequently updated and expanded as part of Sec. 872 of the FY24 NDAA. With improvements in Sec. 872 of the FY24 NDAA, the updated language provides authority for the Department of Defense (DoD) to establish a pilot program authorizing contracting officers to award a sole source follow-on contract to 100% S Corp ESOPs. To qualify, the ESOP must be the incumbent and received a “satisfactory” rating or above in the applicable past performance database.

When will I be able to use the authority granted in Sec. 874 / Sec. 872?

Now. The authority granted by Sec. 874 / Sec. 872, **now DFARS Subpart 270.1**, can be found here:

<https://www.acquisition.gov/dfars/part-270-defense-contracting-programs>

What is an Employee Stock Ownership Plan (ESOPs)?

An ESOP is a qualified defined contribution plan that provides a company’s workers with retirement savings through their investments in their employer’s stock, *at no cost to the worker*. ESOPs are regulated by the Department of Labor under the Employee Retirement Income Security Act just like pension funds, 401(k) plans, and other qualified retirement plans. Congress authorized the S corporation ESOP structure over two decades ago to encourage and expand retirement savings by workers providing the opportunity to have equity in the companies where they work.

What is a business wholly-owned through an S Corp ESOP?

A business wholly-owned through an S Corp ESOP means that the employees own 100% of the business. Technically, the S Corp ESOP owns 100% of the business and the employees are the shareholders of the S Corp ESOP.

How does America benefit from supporting employee-owned businesses?

As employee ownership in America has grown, employee-owned businesses have consistently provided the economy, their workers, and their customers with unique and tangible benefits. When a company is owned by its employees, important socioeconomic dynamics arise that benefit workers, the company, the community, and the national economy. Because ESOPs are regulated by a strict legal code that requires ownership to be broadly held across employees, from the mailroom to the boardroom, companies that are ESOP-owned – and particularly those that are majority or wholly ESOP-owned – consistently report higher performance metrics, better job growth, fewer job reductions during economic downturns, boosted employee savings, and strong protections against foreign acquisitions. Among the data points that underscore the specific value of ESOPs:

- Despite the financial strain caused by the 2008/09 economic downturn and the resulting great recession, **ESOP-owned companies kept far more jobs than other private companies**. According to a 2012 study by Alex Brill, **employment among employee-owned firms increased more than 60% from 2001-2011, while the private sector had flat or negative growth in the same period**.
- **ESOPs reduce wealth inequality and promote financial security in the American workforce**. A 2016 study by Jared Bernstein shows that by increasing wage-earning employees’ share of their business capital, **ESOPs reduced the wealth concentration among the top 10 percent of employees by 2.5%**.

How does the DoD benefit from Employee Ownership?

A first-of-its-kind research report leveraging Contractor Performance Assessment Rating System (CPARS) data was published in May 2024. *Outperform and Outlast – 100% Employee-Owned Contractors Top the Charts* confirms that

100% ESOP federal contractors receive higher CPARS scores than other companies and are also more resilient to acquisition avoiding consolidation of the defense industrial base.

How does the sole source follow-on authority of the pilot program encourage competition?

100% ESOPs are more resistant to acquisition and avoid consolidation of the defense industrial base. Because of this, supporting policies that incentivize the creation of more employee-owned companies will help to grow the defense industrial base and result in more competition over time. Congress authorized the sole source follow-on authority in the pilot program because Congress believes the benefits 100% ESOPs provide to DoD will result in better performance for DoD and help to reverse the trend of an ever-shrinking defense industrial base, thus increasing competition.

Why is the pilot program important now?

With the recent reductions in DoD contracting personnel, the ability to expedite contracting actions is vital. The ability for a contracting officer to leverage sole source follow-on contracts with high-performing employee-owned businesses will allow contracting officers more time to spend on more complex contracting actions and ensures that DoD's needs are met in a timely and cost-effective manner.

Where can I find the authority in DFARS?

DFARS Subpart 270.1 can be found here: <https://www.acquisition.gov/dfars/part-270-defense-contracting-programs>

How can I use the authority in DFARS Subpart 270.1?

A document called Procedures, Guidance, and Information (PGI) is published as a companion to DFARS Subpart 270.1 and contains instructions for how DoD customers can apply for use of the authority in DFARS Subpart 270.1. A sample application format at the end of this FAQ Sheet contains the requirements of the PGI. The PGI can be found here: <https://www.acquisition.gov/dfarspgi/pgi-part-270-defense-contracting-programs>

Has DoD issued a Policy Memo on using the Pilot Program to Incentivize Contracting with Employee-Owned Businesses?

A DoD Policy Memo on the Pilot Program to Incentivize Contracting with Employee-Owned Businesses – dated December 5, 2024 – provides more guidance on using the authority in DFARS Subpart 270.1 and answers frequently asked questions. Attachments to the policy memo include a sample application for contracting officers to leverage as well as a template for the required data collection. The Policy Memo is accessible in DPC's Policy Vault here: <https://www.acq.osd.mil/dpap/policy/policyvault/USA002576-24-DPCAP.pdf>

What is a Qualified Business?

A qualified business means an S corporation as defined in 26 U.S.C. 1361(a)(1) for which 100 percent of the outstanding stock is held through an employee stock ownership plan as defined in 26 U.S.C. 4975(e)(7).

How do I prepare to use the authority in DFARS Subpart 270.1?

DoD customers can work with their 100% ESOP contractors to collect the information required by the DFARS clause and complete an application.

Is there a sample application format to request approval to use the authority granted in DFARS Subpart 270.1?

Yes. The DoD Policy Memo on Pilot Program to Incentivize Contracting with Employee-Owned Businesses dated December 5, 2024, includes a sample application.

Who is the DoD POC?

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