VENABLE LLP

Government Contracts Update

May 2012

Changes to the SBIR Program Offer More Opportunities and Challenges for Small Business Contractors

AUTHORS

William L. Walsh, Jr.

George W. Wyatt

RELATED PRACTICES

Government Contracts

ARCHIVES

2012 2008 2004
2011 2007 2003
2010 2006 2002
2009 2005

On May 24, 2012, the Department of Defense (DoD) began accepting Small Business Innovative Research (SBIR) proposals for SBIR Solicitation 2012.2. This is the second of three solicitations for the SBIR program the DoD will offer this year, which in total will award over a billion dollars in SBIR-funded projects. Small businesses considering submitting proposals for that 2012.2 Solicitation need to consider the changes recently made to the SBIR and Small Business Technology Transfer (STTR) programs as part of the National Defense Authorization Act (NDAA) of 2012.

Among other things, the NDAA of 2012 reauthorized the SBIR/STTR programs until September 30, 2017. That reauthorization included many significant positive changes to the SBIR/STTR programs that increase the award sizes, allow greater flexibility in making Phase II awards, and make the programs available to more small businesses. These changes include:

- **Increased Award Sizes.** The maximum standard award sizes for the SBIR/STTR programs increased, with the size of Phase I awards rising from $100,000 to $150,000, and the size of Phase II awards rising from $750,000 to $1,000,000. Along with these increases in the maximum standard award sizes, agencies may now make "super awards," that are 50% greater than the maximum standard award size. These "super awards" allow agencies to make Phase I awards of up to $225,000 and Phase II awards of up to $1,500,000. Additionally, adjustments will now be made to these award amounts each year to account for inflation. These increased awards will provide small businesses with the additional funds needed to develop their proposed products.
- **More Opportunities for Phase II Awards.** The changes to the SBIR/STTR programs also provide for greater flexibility in making Phase II awards. One change addresses Phase I awardees who are not selected for a Phase II award. These small businesses may now receive a Phase II award from a different agency than the one that made the Phase I award. This allows small businesses to continue in the SBIR/STTR programs if a different agency is interested in the proposed work. Given that traditionally only 1 in 2 Phase I awards are selected for Phase II awards with the same agency, this change gives small business Phase I awardees more avenues to obtain a Phase II award and to continue the development of their product.

Another change is direct Phase II awards. The DoD, Department of Education, and the National Institutes of Health may now skip the Phase I award stage and make direct Phase II awards to small businesses that have not previously received a Phase I award. Under the SBIR/STTR programs, Phase I awards are limited to "determining, insofar as possible, the scientific and technical merit and feasibility of ideas that have commercial potential." 15 U.S.C. § 638(c)(4)(A). By this definition, ideas that have already shown merit and feasibility are not eligible for Phase I. Allowing direct Phase II awards opens the SBIR/STTR programs to a new set of small businesses who either originally were not selected for Phase I, but continued to pursue an idea, or who developed an idea to such an extent that they did not meet the criteria for Phase I.

Agencies are also now allowed to make a second follow-on Phase II award to a Phase II small business. Previously, small businesses were limited to receiving one Phase II award per Phase I award. Allowing agencies to award a second follow-on Phase II award creates an additional source of funding for small businesses while they move toward commercialization in Phase III.

- **Small Business Size Requirements.** Perhaps the biggest change to the SBIR program is a change in the participation requirements for small businesses. Currently, to participate in the SBIR program, a small business must: (1) be at least 51% owned and controlled by one or more individuals who are U.S. citizens; and (2) together with its affiliates not have more than 500 employees. 13 C.F.R. § 121.702 These size requirements will be changed to allow small businesses that are majority owned by multiple venture capital operating companies, hedge funds, or private equity firms to participate in the SBIR program. The Small Business Administration just

issued proposed rules for this change on May 15, 2012, and comments on these proposed rules are due by July 16, 2012. Once the proposed regulations are finalized, small businesses that are majority owned by multiple private equity firms will be eligible to compete for SBIR awards.

- **GAO Report on Data Rights.** Finally, the United States Comptroller General is to conduct a study to assess whether agencies are complying with data rights protections afforded under the SBIR/STTR programs. Under the SBIR program small businesses retain the rights to data generated in the performance of a SBIR award for four years. 15 U.S.C. § 638(1)(2)(A). These data rights are small businesses' most valuable assets, and, as the U.S. Court of Federal Claims decision in *Night Vision Corp.* shows, they must be carefully protected. *Night Vision Corp. v. United States*, 68 Fed. Cl. 368 (2005). This report should provide Congress and the small business community a better understanding of the risks to small businesses' data rights.

In addition to these positive changes, there are others that will make the SBIR program more onerous to small businesses, such as:

- **Administration Costs.** Agencies may now use three percent (3%) of SBIR allocated funds for administration costs. While seemingly a small percentage, the direct impact is fewer dollars for Phase I and Phase II awards. When this change is combined with the overall increase in award sizes (but no percentage increase in the total SBIR program funds), it is clear there will be fewer total awards given – making the SBIR program much more competitive.
- **Certification Requirement.** Small businesses receiving SBIR funds will now need to certify that they are "in compliance with the laws relating to the SBIR program and the STTR program and the conduct guidelines established under the SBIR Policy Directive and the STTR Policy Directive." This new certification requirement creates the risk of suspension and debarment, as well as the risk of liability under the False Claims Act for false certifications. Small businesses will need to carefully review the regulations and policy directives to ensure they are in compliance with all of the SBIR/STTR programs' requirements.
- **Minimum Performance Standards.** There are also new performance standards for continued participation in the program. Agencies are to "establish a minimum performance standard" with respect to receipt of Phase II and Phase III awards for small businesses that receive Phase I awards. The performance standards will evaluate the success of a small business's progression from Phase I to a Phase II and finally to commercialization in Phase III. If a small business that receives a Phase I award is determined not to meet the minimum performance standards for receipt of Phase II and Phase III awards, that small business will be excluded from the SBIR/STTR program for one year. While the intent of this change is to prevent small businesses from receiving multiple Phase I and never progressing further toward commercialization, the risk of being excluded for not meeting the minimum performance standards is a factor small businesses will now need to factor in when considering whether to submit a Phase I proposal.

The changes to the SBIR/STTR programs create new opportunities for small businesses to participate in the program. The changes also provide larger award sizes and greater flexibility to agencies to award Phase II. With these changes, however, come new certification and performance standard requirements that small business contractors will need to carefully comply with when participating in the SBIR/STTR programs.

For more information on the new changes to the SBIR/STTR programs, please contact Bill Walsh at **wlwalsh@Venable.com**, George Wyatt at **gwwyatt@Venable.com** or any of the other attorneys in Venable's **Government Contracts Practice Group**.