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Final SBIR Rules Published

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On December 27, 2012, the US Small Business Administration (SBA) published a final rule to amend regulations governing eligibility for the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) Programs and to implement provisions of the SBIR/STTR Reauthorization Act of 2011. The Reauthorization was included in the FY12 National Defense Authorization Act (NDAA), which reauthorized the SBIR Program for six years and now allows small firms that are majority-owned by venture capital operating companies (VCOCs), hedge funds, or private equity firms to compete for SBIR grants.

This advisory briefly summarizes the most important changes to the SBIR eligibility rules and discusses how investments in or acquisitions of SBIR-funded companies may be affected.

Final Rules – What Will Change?

The final rule implementing the SBIR/STTR Reauthorization is effective January 28, 2013. When the final rule is effective and integrated into the federal agency grant cycle process, multiple VCOCs, hedge funds, and private equity firms will be able to take majority positions in SBIR applicants, provided that no single firm owns a majority interest in the SBIR applicant. As described below, so long as each investment firm owns and controls only a minority share of voting stock under the minority ownership rule, the investor will be able to include the SBIR applicant in its portfolio without aggregating the employees of its other portfolio companies with the SBIR applicant's employees for purposes of the SBIR affiliation determination.

Summary of Final Changes to SBIR Ownership and Control Requirements

The SBA's final rule expands the current ownership requirements to permit SBIR applicants to be more than 50% owned and controlled by (i) US citizens, permanent resident aliens, or one or more domestic business concerns which are themselves more than 50% owned and controlled by US citizens or resident aliens, or (ii) majority-owned by multiple domestic VCOCs, hedge funds, or private equity funds, provided that no single such investor owns more than 50% of the SBIR applicant.

- The SBA has included in its final rule language stating that all ownership, control, and affiliation determinations will be made using fully diluted shares on a converted basis.
- The SBA retained provisions requiring SBIR applicants to have a place of business in the US and to be organized as for-profit businesses under US law.
- VCOCs, hedge funds, and private equity funds investing in the SBIR applicant also must be organized under US law and have a place of business in the US.

Summary of Final Changes to SBIR Affiliation Requirements

The final rule also makes changes to proposed affiliation rules determining the number of employees of the SBIR applicant and its affiliates.

- The SBA will retain the current 500 employee size standard, subject to further review under the Small Business Jobs Act of 2010.
- The SBA's final rule amends the affiliation rules for SBIR and STTR applicants by providing that the SBIR applicant will be deemed an affiliate of an entity that (i) owns or controls more than 50% of the applicants voting stock, (ii) owns and controls more than 40% of the applicant's voting stock if there are other circumstances that demonstrate the minority shareholder has the power to control the applicant, or (iii) owns or controls more than 40% of the applicant's total equity if there are other circumstances that demonstrate the minority owner's power to control the applicant.
- The SBA has retained provisions in the proposed rule dealing with the affiliation based on common management and on ostensible subcontractors and license agreements.
- Affiliation based on the newly organized concern rule has been modified to limit the time that a concern is considered "newly organized" to one year.
- The SBA modified provisions in the proposed rule in regards to affiliation based on identity of interest to state that affiliation will be found if the awardee relies upon another entity for 70% or more of its receipts.

Timing of Size Certifications

The SBA has made a key change in regards to when it will determine eligibility for Phase I and Phase II SBIR grants. Under the proposed rule, eligibility was determined both on the date the SBIR solicitation is announced and on the date of award. In response to comments that certification at the time of submission or offer would be burdensome, the SBA has decided to retain the current rule, requiring that size and eligibility are certified at the time of award only. If a SBIR awardee grows to an excess of 500 employees during the term of the award, it may continue to perform activities covered by the grant. However, if the awardee merges or is acquired it may only perform the grant for the current funding period and will have to recertify its size before the agency may exercise an option to extend the SBIR grant.

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