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Effective January 28, 2013, the Small Business Administration ("SBA") significantly expanded the eligibility rules for Small Business Innovation Research ("SBIR") and Small Business Technology Transfer ("STTR") grants. Under new SBA regulations, firms that are majority-owned by Venture Capital Operating Companies ("VCOCs"), private equity firms, or hedge funds will be eligible to receive SBIR and STTR funding, provided they meet certain qualifying criteria. While there are many similarities between the SBIR and STTR programs and regulations, this note focuses on the SBIR program.

Background

The SBIR program provides federal funding to domestic small businesses engaged in Federal Research/Research and Development with the potential for commercialization. Each year, Federal agencies with extramural research and development budgets in excess of $100 million are required to allocate 2.5 percent of their R&D budget to these programs. Eleven Federal agencies currently participate in the program.[1]

The SBIR Program is structured in three phases:

Phase I: The objectives of Phase I are to establish the technical merit, feasibility, and commercial potential of the proposed R/R&D efforts, and to determine the quality of performance of the small business awardee prior to providing further Federal support in Phase II. SBIR Phase I awards normally do not exceed $150,000 total costs for 6 months.

Phase II: In Phase II, the small business awardee continues the R/R&D efforts initiated in Phase I. Funding is based on the results achieved in Phase I and the scientific and technical merit and commercial potential of the project proposed in Phase II. SBIR Phase II awards normally do not exceed $1,000,000 total costs for 2 years.

Phase III: In Phase III, the small business pursues commercialization objectives resulting from the Phase I/II R/R&D activities. The SBIR program does not fund Phase III, although some Federal agencies may award non-SBIR R&D funds, or production contracts for products, processes, or services intended for use by the U.S. Government.

Historically, the SBIR regulations limited eligibility for funding to small businesses that were at least 51% owned and controlled by (1) U.S. citizens or permanent resident aliens, or (2) by a *single* business that itself was at least 51% owned and controlled by U.S. citizens or permanent resident aliens. In response to complaints from industry—and particularly from the venture capital and private equity communities—Congress in 2012 directed the SBA to expand SBIR funding to small businesses owned by multiple business concerns.[2]

The new SBIR regulations

Expanded eligibility provisions

Under the new regulations, businesses that are majority-owned by *multiple* VCOCs, hedge funds, or private equity firms may participate in the SBIR Program if they meet all qualifying criteria. Specifically, under the new rules, a small business may be eligible to compete for SBIR funding if:

- It is more than 50% directly owned and controlled by one or more U.S. citizens, permanent resident aliens, or by other domestic business concerns, each of which is more than 50% directly owned and controlled by U.S. citizens or permanent resident aliens; *or*
- It is more than 50% owned by multiple domestic VCOCs, hedge funds or private equity firms; *and*
- No *single* domestic business concern that is a VCOC, hedge fund, or private equity firm owns more than 50% of the small business.

Domestic business concern

The new regulations require that VCOCs, private equity firms, and hedge funds must have a place of business located in the United States and be created or organized in the United States or under the law of the United States of any State. Significantly, the new regulations do *not* require a domestic business concern to be majority owned by U.S. citizens or permanent resident aliens.

SBIR size standard

The new regulations retain the SBA's 500 employee size standard for small business concerns. Thus, a business qualifies as "small" for purposes of SBIR funding if it has fewer than 500 employees. When determining how many employees a concern has, SBA counts not only those individuals that are directly employed by the concern in question, but also the individuals employed by the concern's "affiliates." SBA makes "affiliation" determinations using the principles at 13 C.F.R. § 121.103.

Affiliation

With some minor modifications, the new regulations continue to apply SBA's traditional affiliation principles, which provide that affiliation exists between two businesses when one business controls or has the power to control another, or when a third party controls or has the power to control both businesses. Because affiliation analyses are highly fact-dependent, it is prudent to analyze each SBIR applicant's circumstances on an individual basis.

Registration requirement

Firms that are newly-eligible under the SBIR regulations (*i.e.,* small businesses that are majority-owned by multiple VCOCs, hedge funds, or private equity firms) must register[3] with the SBA as of the date they submit an initial proposal in response to an SBIR solicitation for a Phase I or Phase II award.

For additional information please contact one of the attorneys listed above.

NOTES

1. The participating agencies are: the Department of Agriculture; the Department of Commerce - National Institute of Standards and Technology; the Department of Commerce - National Oceanic and Atmospheric Administration; the Department of Defense; the Department of Education; the Department of Energy; the Department of Health and Human Services; the Department of Homeland Security; the Department of Transportation; the Environmental Protection Agency; the National Aeronautics and Space Administration; and the National Science Foundation.

2. *See* the National Defense Authorization Act for Fiscal Year 2012 (Public Law 112–81) (the "NDAA"). Section 5001, Division E of the NDAA contains the SBIR/STTR Reauthorization Act of 2011 (the "SBIR/STTR Reauthorization Act"). The SBA published its proposed rule in the Federal Register on Tuesday, May 15 (*see* 77 Fed. Reg. 28520). The final rule appeared in the Federal Register on Thursday, December 27, 2012 (*see* 77 Fed. Reg. 76215).
3. *See* the SBA's Company Registry Database at www.SBIR.gov.

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