



**Entrepreneurial  
Training & Consulting**

# **Developing the Business of Technology**



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Technology

# What New SBIR Policies Mean for Venture-Backed Businesses

## Connecticut Innovations

### May 14, 2014

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# Today's Webinar



- What's new with SBIR/STTR since reauthorization?
- Can “VC” funded companies participate?
- What are the new eligibility requirements?
- Pros and cons of SBIR participation for such businesses



# What are SBIR\* and STTR\*\*?



**\$2.5 billion of federal funding to:**

- Support small business to:
  - Stimulate technological innovation to
    - Develop products with commercial merit

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\* – Small Business Innovation Research

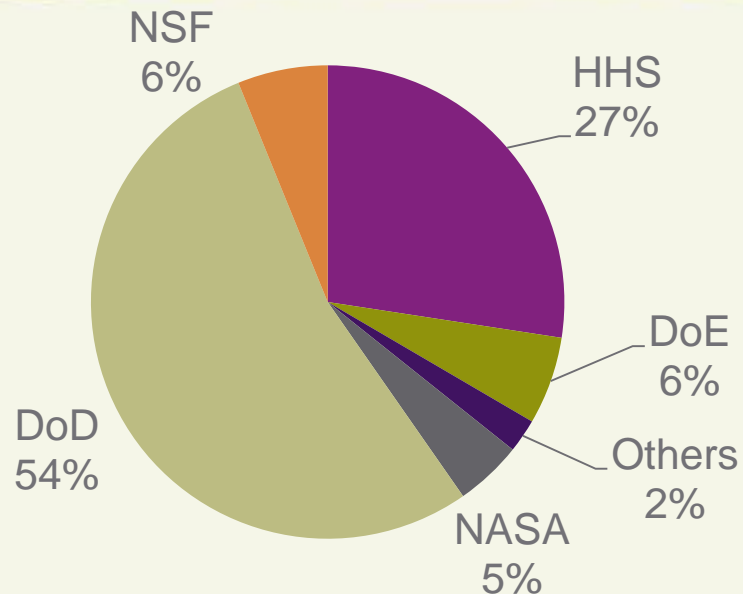
\*\* – Small Business Technology Transfer

# What is SBIR/STTR....



- Mandated by legislation (NDAA FY2012)
  - Current authorization for 6 years through 2017
  - Separate legislation for SBIR and STTR
- Applies to agencies with extramural research budgets that exceed certain thresholds
  - SBIR applicable to 11 Agencies
  - STTR applicable to 5 of the 11 SBIR agencies
  - Participation mandatory
- SBA “oversees” program implementation and compliance
  - SBIR/STTR Policy Directive
  - Small Business Size Regulations

# Participating Federal Agencies



**TOTAL: >\$2.6 B FY 2012**

SBIR & STTR (\$m)	SBIR Only (\$m)
DoD - \$1,400	<b>USDA - \$20</b>
<b>HHS - \$717</b>	DoT - \$4
<b>NSF - \$161</b>	EPA - \$4
<b>DoE - \$157</b>	DoC ( <b>NIST</b> & NOAA)- \$12
NASA - \$120	DoED - \$8
	DHS - \$22



# SBIR/STTR Reauthorization



# 2012 Reauthorization SBA Documents

## SBIR and STTR Policy Directive

- Final Policy Directive with Request for Comments
- Published Aug 6, 2012
  - <https://www.federalregister.gov/articles/2012/08/06/2012-18119/small-business-innovation-research-program-policy-directive>
  - Effective upon publication
  - Public comments due on or before Oct 5, 2012
- Updated Policy Directives published Jan 2014





# Policy Directive



- Increased set aside over 6 years
  - SBIR 2.6% FY2012 up to 3.2% FY 2017
  - STTR 0.35% FY2012 up to 0.45% FY2017
  
- Increased funding “caps”\*\*
  - Guidelines \$150k Phase I; \$1 million Phase II
  - Caps up to 150% of guidelines
    - \$225k Phase I
    - \$1.5 million Phase II

**\*\* Refer to individual agency solicitations for specific funding guidelines and limits**



# Policy Directive



- Streamline award process
  - 90 days to a decision, 180 days to funding
    - NSF and NIH up to 1 year
  
- Increased outreach
  - Goal to increase participation by minority and women owned firms
    - Women-owned ~13% of FY2011
    - Minority-owned ~7%
    - 26 states combined ~8%

# Policy Directive



- “Invitation Only” Phase II no longer allowed
  - Applies to new Phase I awardees
  - Check with agency if prior Phase I awardee
- Can switch from SBIR to STTR or vice versa between Phase I and II
  - At agency discretion
- Direct to Phase II Pilot
  - NIH launched in 2014



# Other Reauthorization Items



## Focus on Commercialization

- Establish commercialization benchmarks (mandated by statute)
  - Will only apply to frequent winners (e.g., >20 Phase I, >15 Phase II)
    - Phase I to II to be implemented January 2013
    - Phase II to III to be implemented October 2013
  - If don't make benchmarks may not qualify for awards for 12 months
- Increase technical assistance (e.g., 'commercialization' assistance)
  - \$5,000/award/year with potential to identify service provider
- Administrative funding to agencies to support new initiatives
- Sharing best practices between agencies

# Other Reauthorization Items



## Acquisition Preference

- Federal agencies and prime contractors, *to the greatest extent practicable*, shall issue Phase III awards to the SBIR Phase I or Phase II awardee
- Agencies may issue sole source Phase II awards to the SBIR Phase I or Phase II awardee
- Not all contracting officers are up to date on these changes to the law
  - “The law trumps the FAR”

# 2012 Reauthorization SBA Documents

## Small Business Size Regulations

- Final Rule
- Published 12/27/2012  
<https://www.federalregister.gov/articles/2012/12/27/2012-30809/small-business-size-regulations-small-business-innovation-research-sbir-program-and-small-business>
- Effective Jan 28, 2013



# SBIR & STTR Size Regulations

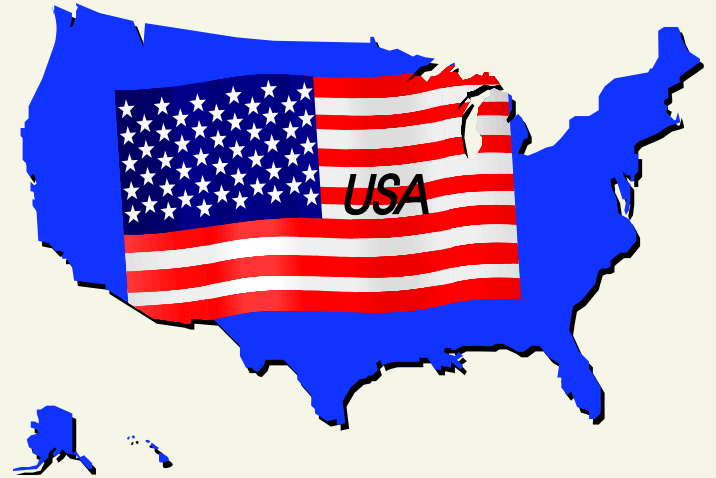


## Timing of Size Certifications

- Eligibility is self-certified
- Size and eligibility certified at the time of award
- If awardee grows to > 500 employees during the time of the award it may continue to perform activities covered by the award
- If awardee merges or is acquired it may only continue for the current funding period and then will have to recertify

# Eligibility for Funding

- Small business
  - For-profit
  - U. S. owned and controlled
  - < 500 employees
  - Located in the U.S.
  - R&D must be performed in the U.S.





# SBIR & STTR Size Regulations

## Ownership and Control

- >50% owned and controlled by:
  - i. **US citizens, permanent resident aliens** and/or one or more **domestic business concerns** which themselves are >50% owned and controlled by US Citizens or permanent resident aliens  
.....or.....



# SBIR & STTR Size Regulations

## Ownership and Control (cont.)

.....or.....

- >50% owned and controlled by:
  - ii. **Multiple** domestic VCOC\*s, HFs, or PEFs, provided that no single such investor owns more than 50%\*\* **(SBIR ONLY)**

**\*\* At agency's option!**



(\*Venture Capital Operating Company, Hedge Fund, Private Equity Fund)

# The “VC” Rule

- A participating business may now be majority owned by multiple domestic venture capital operating companies, hedge funds or private equity firms, provided that:
  - (i) no single domestic venture capital operating company, hedge fund or private equity firm owns more than 50 percent of the business; and
  - (ii) each such venture capital operating company, hedge fund or private equity firm 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 or of any state.



# Definitions

## CFR 121.701 and 121.702

- (3) **Hedge fund** has the meaning given that term in section 13(h)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)(2)). The hedge fund 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 or of any State.
- (4) *Portfolio company* means any company that is owned in whole or part by a venture capital operating company, hedge fund, or private equity firm.
- (5) **Private equity firm** has the meaning given the term “private equity fund” in section 13(h)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)(2)). The private equity firm 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 or of any State.
- (6) **Venture capital operating company** means an entity described in §121.103(b)(5)(i), (v), or (vi). The venture capital operating company 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 or of any State.



# Policy Directive



## VC/PEF/HF “Quotas”

- Multiple VCOC/PEF/HF owned companies eligible to compete (Size Rules)
- Funding limited by “quota”
  - < 25% NIH, NSF, DoE
  - <15% all other agencies
- Agencies “opt in”
- Agencies can refuse to accept proposals

# SBIR & STTR Size Regulations



## Size and Affiliation

- Under 500 employees for SBIR applicant and its affiliates including:
  - Full-time, part-time or other basis
  - Employees obtained from a temporary employee agency, professional employer organization (PEO) or leasing concern
- Based on average of number of employees for each pay period in the preceding 12 months

# SBIR & STTR Size Regulations

## Size and Affiliation



- Affiliation exists 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. It does not matter whether control is exercised, so long as the power to control exists. For the purposes of the SBIR and STTR programs, the following bases of affiliation apply:

# Affiliation

## ***(1) Affiliation based on ownership.***

- For determining affiliation based on equity ownership, a concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50 percent of the concern's voting equity. However, SBA may find a concern an affiliate of an individual, concern, or entity that owns or has the power to control 40% or more of the voting equity based upon the totality of circumstances. If no individual, concern, or entity is found to control, SBA will deem the Board of Directors to be in control of the concern.





# Affiliation

## ***(2) Affiliation arising under stock options, convertible securities, and agreements to merge.***

- In determining size, SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.
  - (i) Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered “agreements in principle” and are thus not given present effect.
  - (ii) Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.
  - (iii) An individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so. SBA will not give present effect to individuals', concerns' or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.



# Affiliation

## ***(3) Affiliation based on common management.***

- Affiliation arises where the CEO or President of a concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. Affiliation also arises where a single individual, concern, or entity that controls the board of directors of one concern also controls the board of directors or management of one or more other concerns.

# Affiliation

## ***(4) Affiliation based on identity of interest.***

- Affiliation may arise among two or more persons (including any individual, concern or other entity) with an identity of interest. An individual, concern or entity may rebut a determination of identity of interest with evidence showing that the interests deemed to be one are in fact separate.
  - (i) SBA may presume an identity of interest between family members with identical or substantially identical business or economic interests (such as where the family members operate concerns in the same or similar industry in the same geographic area).
  - (ii) SBA may presume an identity of interest based upon economic dependence if the SBIR/STTR awardee relies upon another concern or entity for 70% or more of its receipts.
  - (iii) An SBIR or STTR awardee is not affiliated with a portfolio company of a venture capital operating company, hedge fund, or private equity firm, solely on the basis of one or more shared investors, though affiliation may be found for other reasons.



# Affiliation

## ***(5) Affiliation based on the newly organized concern rule.***

- Affiliation may arise where former or current officers, directors, principal stockholders, managing members, general partners, or key employees of one concern organize a new concern in the same or related industry or field of operation, and serve as the new concern's officers, directors, principal stockholders, managing members, general partners, or key employees, and the one concern is furnishing or will furnish the new concern with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise. A concern may rebut such an affiliation determination by demonstrating a clear line of fracture between the two concerns. A “key employee” is an employee who, because of his/her position in the concern, has a critical influence in or substantive control over the operations or management of the concern. A concern will be considered “new” for the purpose of this rule if it has been actively operating continuously for less than one year.

# Affiliation

## ***(6) Affiliation based on joint ventures.***

- Concerns submitting an application as a joint venture are affiliated with each other with regard to the application. SBA will apply the joint venture affiliation exception at §121.103(h)(3)(iii) for two firms approved to be a mentor and protégé under SBA's 8(a) program.



# Affiliation

## ***(7) Affiliation based on the ostensible subcontractor rule.***

- A concern and its ostensible subcontractor are treated as joint venturers, and therefore affiliates, for size determination purposes. An ostensible subcontractor is a subcontractor or subgrantee that performs primary and vital requirements of a funding agreement (*i.e.*, those requirements associated with the principal purpose of the funding agreement), or a subcontractor or subgrantee upon which the concern is unusually reliant. All aspects of the relationship between the concern and subcontractor are considered, including, but not limited to, the terms of the proposal (such as management, technical responsibilities, and the percentage of subcontracted work) and agreements between the concern and subcontractor or subgrantee (such as bonding assistance or the teaming agreement). To determine whether a subcontractor performs primary and vital requirements of a funding agreement, SBA will consider whether the concern's proposal complies with the performance requirements of the SBIR or STTR program.



# Affiliation

## ***(8) Affiliation based on license agreements.***

- SBA will consider whether there is a license agreement concerning a product or trademark which is critical to operation of the licensee. The license agreement will not cause the licensor to be affiliated with the licensee if the licensee has the right to profit from its efforts and bears the risk of loss. Affiliation may arise, however, through other means, such as common ownership or common management.



# Affiliation

## ***(9) Exception to affiliation for portfolio companies.***

- If a venture capital operating company, hedge fund, or private equity firm that is determined to be affiliated with an awardee is a minority investor in the awardee, the awardee is not affiliated with a portfolio company of the venture capital operating company, hedge fund, or private equity firm, unless:
  - (i) The venture capital operating company, hedge fund, or private equity firm owns a majority of the portfolio company; or
  - (ii) The venture capital operating company, hedge fund, or private equity firms holds a majority of the seats of the board of directors of the portfolio company.





# Affiliation

## **(10) *Totality of the circumstances.***

- In determining whether affiliation exists, SBA may consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation.
- (d) *Calculating ownership and control.* SBA will review the small business' equity ownership on a fully diluted basis for purposes of determining ownership, control and affiliation in the SBIR and STTR programs. This means that SBA will consider the total number of shares or equity that would be outstanding if all possible sources of conversion were exercised, including, but not limited to: Outstanding common stock or equity, outstanding preferred stock (on a converted to common basis) or equity, outstanding warrants (on an as exercised and converted to common basis), outstanding options and options reserved for future grants, and any other convertible securities on an as converted to common basis.





National Institutes of Health  
Office of Extramural Research

## Venture Capital Companies

- Small business concerns that are majority-owned by multiple venture capital operating companies (VCOCs), hedge funds and/or private equity firms **ARE NOW ELIGIBLE** to apply (**NIH SBIR only**).
- See NOT-OD-13-071:  
<http://grants.nih.gov/grants/guide/notice-files/NOT-OD-13-071.html>
- SBIR and STTR VCOC forms available at:  
<http://grants.nih.gov/grants/forms.htm#sbir>

\*Note: SBIR VCOC form also used for SBIR contracts





### VC Case Study:

- A small business is 54% owned by a single VC and 12% owned by another VC. In the coming months, the small business expects to lower their 54% ownership to below 50%.

**Are they eligible to apply for the upcoming deadline?**





### VC Case Study:

- Yes, as long as the small business meets the eligibility requirements of being less than 50% owned by a single VC firm **by the time of award (not submission)**
- Currently, the small business **IS NOT eligible** since the SBC is majority owned by a single VC firm
- Link to eligibility criteria for SBIR:  
[http://grants.nih.gov/grants/guide/pa-files/PA-14-071.html#\\_Section\\_II.\\_Award\\_1](http://grants.nih.gov/grants/guide/pa-files/PA-14-071.html#_Section_II._Award_1)

**Would they need to fill out a VOCC form?**





### VC Case Study:

- No, not with the application since the company is **not** majority multiple VC-firm owned.
- Only fill out a VOCC form if the company is **majority owned by more than one** VC firm, hedge fund and/or private equity firm.
- However, if the SBC goes under 50% owned by the VC, the SBC would need to reevaluate after their equity distribution to see if they are now majority VC owned.



# Facilities Requirement

- The research work to be performed by the awardee is to be conducted in:
  - **Company** controlled
  - **Research** space
  - Suitable to do the work proposed



# SBIR for “VC” Companies



## Pros

- Non-dilutive
- External technical due diligence
- Funds technical risk... Therefore increases value
- The pie gets bigger without sharing a piece

## Cons

- IF... you use it as a strategic component of a funding strategy then...
  - None that I can see....



# BBC Team



- **Lisa M. Kurek**, MS – Managing Partner
- **Michael P. Kurek**, PhD, MBA – Partner
- **Andrea Johanson**, PhD – Principal Consultant
- **Becky Aistrup**, – Principal Consultant
- **Kris Bergman** – Consultant, Grants and Contract Management
- **Kristin Burgard**, Principal Consultant
- **Jayne Berkaw** – Director, Marketing and Outreach





# What We Do

BBC works with technology-based entrepreneurs and companies on strategies to advance R&D efforts to commercialization. Through training courses and one-on-one counseling, the BBC team coaches clients in:

- Technology Assessment
- Commercialization Planning
- SBIR/STTR/Other Research Grant Assistance
- Entrepreneurial Training
- Grant/Contract Management
- Tech-Based Economic Development Programs

The BBC team is nationally recognized for its success in helping clients win federal funding through the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs, and use it tactically to propel growth.





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