October 4, 2012

SMALL BUSINESS ADMINISTRATION
409 3rd Street SW
WASHINGTON, D.C.

RE: SBA's Policy Directive Published on August 6, 2012

This letter is being submitted in response to the Small Business Administration's request for comments on its Policy Directive applicable to the SBIR program. The comments are from the Small Business Technology Council (SBTC), and are also supported by the National Small Business Association (NSBA).

Even though the SBA has stated that the Policy Directive is final and only a guidance document, SBA is nevertheless soliciting comments. Thus SBTC feels that it is imperative to highlight several concerns from the small business community regarding the proposed changes in the Policy Directive, in the expectation that SBA will make appropriate changes to the directive in response thereto.

INTRODUCTION

An overriding concern of SBTC is that the diverse provisions of the directive are tantamount to "requirement creep", imposing arguably onerous and perhaps unnecessary requirements on SBIR applicants and on the process itself.

The founder of QUALCOMM, Irwin Jacobs, has testified before the Senate and stated in a meeting at the White House that SBIR has become the victim of requirement creep. As an early recipient of an SBIR award, Mr. Jacobs speaks with some authority. At the time of his award, the SBIR program was simple, had few requirements and imposed little burden on SBIR applicants. QUALCOMM went on to grow into a 14,000 employee company, having started with a relative small amount of SBIR money. Clearly compliance with complex rules and processes is not a forecaster of success, performance is.

Now there are over a hundred pages to be digested by applicants and agencies, text that also includes complex accounting principles with which companies are to comply. Unfortunately, the new policy directive imposes even more burdens on small businesses. If the complexity of the requirements were not intimidating enough, agency Inspectors General seem to demand strict compliance with every minute detail in this complex regulatory maze.

Will new applicants be discouraged from applying? Will the 1/3 of SBIR winners be discouraged from pursuing next stage grants? If so, what innovations will be lost? This risk is not imaginary, and needs to be weighed as SBA guides the management of the SBIR program.

Given the reality of the "requirement creep" that is developing, SBA needs to make a serious attempt to reduce the burdens on SBIR firms, if not on all small firms, especially on those which have received less than 10 SBIR awards.

SBTC's general and specific comments follow.

GENERAL COMMENTS

We note with disappointment that:

- SBA did not propose guidance on Section 5122. This section requires DOD to establish goals and incentives for transitioning SBIR technology, but chose only to focus on commercialization goals for small business and did not require agencies to establish commercialization goals for the agencies themselves. Why?

- SBA did not propose procedures and processes to enforce compliance with Section 4(c).

- SBA did not provide guidance on SBIR data rights, an issue on which we have recommendations for SBA to consider.

On a positive note, we are pleased that SBA inserted provisions that clarify that agencies may exceed the minimum percentages. The ability to make additional awards to SBCs by an Agency is an important clarification.

SPECIFIC COMMENTS

<u>Section 3(j) Definitions - Essentially Equivalent Work</u>

The wording in the current Directive discriminates against small businesses in Federal R&D by setting a much broader constraint upon the SBIR awardee than is faced by large businesses in their R&D awards. Large businesses are precluded from billing twice for the same work, without any of the vagueness inherent in the rest of the SBA SBIR Policy Directive wording. However, a search of the term exclusive of the SBIR program shows that the term is used only for the SBIR program, and the SBA is asked to define what is meant. As a key purpose of the SBIR program was to correct small business underrepresentation in Federal R&D as compared to large business, the SBA should choose to define this prohibition to match at worst the prohibition against double billing that is faced by large businesses. To avoid discriminating against small business R&D vs. large business R&D, the SBA should define "essentially equivalent" in the more fair terms compared to the rules placed upon large businesses, not seek to expand the term to place a heavier burden on small businesses than is placed on large businesses.

Section 3(o) Definitions - Funding Agreement

The current wording incorrectly assumes an SBIR award must be between a Federal agency and the SBC. The definition is also used throughout the Directive to refer to Phase III awards, as well as awards under Phases I and II. As the PD and law are clear that "A subcontract to a Federally-funded prime contract may be a Phase III award" (p46821: 4-(c) (7)), the key Policy Directive definition therefore of a funding agreement should make it clear that the funding agreement rules apply also to subcontracts to Federal prime contracts that meet the Phase III definition at 4-(c)(2) (p 46819). Using the current definition, small businesses have often been initially denied Phase III status by both Federal contractors and by Federal contract officers because our effort would be under a federal subcontract (or purchase order), thereby delaying contract action while putting firms under strong pressure to waive our SBIR Phase III status. The resulting threatened denial of a contract unless the SBIR awardee gives up its SBIR designation and resulting data rights is coercion, prohibited by the Policy Directive under section 8(4).

Section 4(c)(4) states that "Phase III work may be for products, production, services, R/R&D, or any such combination". As a result, the phrase "funding agreement" should be modified to refer not just to R&D that may include products or services (as is implied by the current wording) but clearly to products and services that meet the definition of Phase III work (i.e. deriving from, extending or completing prior SBIR work). The definition should also encompass the case of the funding agreement covering a government purchase of goods or services by the Federal government.

We therefore recommend the definition of Funding Agreements in Section 3(o) to be modified (in *italics*):

- "Funding Agreement. Any contract, grant, or cooperative agreement entered into between any Federal agency, *or any Federal agency contractor,* and any SBC for the performance of experimental, developmental, or research work, *and/or* products or services, funded in whole or in part by the Federal Government."

Section 4(a) Phase I

This section should be modified to read:

- "Phase I shall be treated consistently by all agencies as feasibility studies conducted by small business. Phase I shall be early stage efforts directed to proof-of-concept work supporting the relative merit of potentially follow-on Phase II work. The research aspects of Phase I efforts shall remain paramount and shall not be discounted in favor of later state development and commercialization, which is expected during Phase II and Phase III."

This change will balance the thrust for commercialization in Phase II and Phase III with the need for early stage research.

Section 4(b) Phase II

Section 4(b) provides that an agency my not use an invitation, pre-screening or pre-selection process for determining eligibility for a phase II award. The rationale for this is unclear and could be detrimental to the program.

For example, by eliminating the pre-selection process completely, the Directive is reintroducing a funding gap between Phase I and Phase II. Some agencies (Navy, MDA) have tried to address this gap by dividing the Phase I money into Base and Option. Typically when the Phase II invitation is issued at the end of Phase I, the agency would also award the Phase I awardee money to help fund the 6 month funding gap between Phase I and Phase II.

This new section would recreate a funding gap. Agencies will have to wait until all Phase II proposals have been submitted and evaluated. Is this the intention of Congress or the SBA, namely to create or increase funding gaps between Phase I and Phase II? If agencies were allowed to issue letters of encouragement and award Phase I Option funds before making a Phase II decision, the funding gap and time wasted in writing Phase II proposals would be avoided particularly when the government is interested in moving forward with the known technology.

SBTC believes that agencies should be able to send letters of encouragement to awardees whose projects are extremely meritorious and in which an agency has an interests. This would allow programs such as Phase II bridge grants to continue. Without some way for an agency to highlight Phase I proposals of special interest to the agency, the successful bridge funding program will not work. Possible language should be added that states:

- "Phase II proposals may be submitted by any Phase I recipient. However, communications between the program officials and the small business is encouraged to ensure the greatest success from Phase II proposals and to save both the agencies and small businesses from pursuing efforts that show little promise of receiving continued support."

It is important to preserve successful bridge funding between Phase I and Phase II projects that are meritorious. This language is similar to the language used in BAAs.

Section 4(c) Phase III

The law is clear; SBIR phase III awards should be used "to the greatest extent practicable."

The SBTC is disappointed that SBA did not provide a procedure that would require an agency to justify when it chooses not to award a phase III awards. Agencies should be required to submit to SBA a statement explaining why they did not choose to award a SBIR Phase III. Without such a requirement, it will be difficult to evaluate an agency's compliance with the legal provision "to the greatest extent practicable".

The Phase III preference language in the PD needs to go further. A SBC should be able to request SBA involvement in the early stage of decision making and SBA should require that agencies make written determinations each time that a decision is made not to award a Phase III. Moreover, senior

programs officials should be required to review these decisions at the time they are made. Some of the 3% administrative funds should be used by SBA and the agency to fund efforts to make sure that "to the greatest extent practicable" phase III are awarded to Phase I and Phase II technology.

What follows are some suggestions to help promote Phase III transitioning "to the extent practicable" (whether inserted into the Policy Directive or elsewhere):

1. Agencies should be required to do market research on the SBIR topics of interest to them and identify qualified companies (or company) that could reasonably be expected to perform the specified work. [Note that agencies are currently using FAR 19.502(b)(2) to avoid making any SB R&D awards – see file below] When SBIR companies are identified that could perform the effort, this contract should be set aside for small business competition or as a sole source award

2. Require that a clause be added to all BAA solicitations that preference should be given in evaluation of proposals for efforts that are identified as SBIR Phase IIIs

3. Add to all solicitations a proposal evaluation factor for prime contractors to include SBIR Phase III subcontracts in their subcontracting plan. [If SB companies are identified as named subcontractors, under new legislation no "bait and switch" can occur without COs approval]

4. Assign responsibility to each Agency's SBIR Program Manager to act as an SBIR Ombudsman to handle protests from Small Businesses when awards are improperly made that should have been awarded as a Phase III

Sec. 4(c)(8)(iii) gives SBA only 5 business days to appeal an Agency's decision to pursue Phase III work with a business concern other than the SBIR awardee that developed the technology. The SBTC believes that this response period is way too short. It should be long enough to enable a practical SBA response and also to provide proper notice to the SBIR company, so that it has time to notice and react. We recommend a 60 day period, with notice to both SBA and the SBIR company. In addition, the SBIR company who developed the technology should also be able to make an appeal in this situation. The Agency should also be required to consult with both the SBA and the SBIR company during the review period by the head of contracting activity. No serious protection of the SBIR preference right could be made without involvement with the SBIR awardee.

Section 6 Eligibility and Application (Proposal) Requirements

Though it was not included in the full text of the Policy Directive, SBA has requested comments on a proposed new definition requiring the principal investigator must perform at least 51% of his/her work based on a 40 hour week. We object to the use of a 40 hour work week as a standard to measure all principle investigators, and we do not believe that this requirement should be included. There are many weeks over the course of a project where a PI will not be required to spend 40 hours on a specific job. It is extremely difficult to make sure that the PI spends 40 hours every week on the SBIR project.

Also, there are times that a PI may have to work on a non-SBIR project or for a different employer. This is another example of requirement with no justification.

Section 7(h)(1) Periods of Performance and Extensions

The rationale for the requirement that "no cost extensions, NCEs, of time should be kept to a minimum" is unclear and even desirable. There are numerous reasons and justifications to request and receive an extension of time. Often experiments take longer than anticipated. Flexibility is needed and desirable to accommodate delayed R&D progress, staffing delays and overall company management. Common sense and the interest of the SBIR program should govern decisions regarding cost extensions. Program officers and contracting officers already have strong incentives to make good decisions here; there is no need to create further restrictions for them.

As such, we view this language as unnecessary and could be interpreted in an unduly restrictive way. We recommend revising the language in this section to delete these restrictions:

- "In keeping with the legislative intent to make a large number of relatively small awards, modification of funding agreements ~~to extend periods of performance, to increase the scope of work, or~~ to increase the dollar amount should be kept to a minimum."

Section 8(a) Proprietary Information Contained in Proposals

The purpose of the SBIR program is to find and support innovative new technologies, which are by their nature confidential. This clause has no basis in the law. It is inherently inconsistent with a program that seeks to draw out the most innovative new technologies. The SBIR program is asking for proposals whose essence is to describe brand-new, often embryonic technologies, discuss of how they are superior to current technologies and how they resolve unmet problems, what is yet unproven and uncertain, how the company plans to develop the technology (especially noting intellectual property) and what may its business plan and business model, and finally who are the specific team members who will be critical to the new technology's success. For the SBIR program to also ask that this proposal avoid proprietary information is impossible. What sensible new technology business would describe its technology, its plans and its people for release to all of its potential competitors? The second sentence asking to segregate the proprietary information to a separate section is almost laughably designed to be cumbersome and add work for the small business, while clearly tempting the business to waive its intellectual property rights and choose which of its confidential information is especially proprietary, and to release the rest for competitive analysis.

The policy is also discriminatory against small businesses. It is not generally required of large companies in their regular R&D requests to the Federal Government. NIH does have a similar clause, with its objective of public disclosure of health care information, but this does not mean other agencies have to follow their lead. Even NSF has a much more cautious statement: "Patentable ideas, trade secrets, privileged or confidential commercial or financial information, disclosure of which may harm the proposer, should be included in proposals only when such information is necessary to convey an understanding of the proposed project" (http://www.nsf.gov/pubs/gpg/nsf04_23/1.jsp). Other agencies have no such restraint, notably DoD, NASA and DOE.

For the SBIR program to add yet more restriction on top of regular Agency treatments of proprietary information in proposals is discriminatory and burdensome against the small businesses. It induces them to give up their legitimate proprietary information rights in order to make a proposal to a government solicitation that overtly seeks new and presumably innovative technology and business plans. A common reason proposals are turned down is that there was inadequate description of the proposed technology and its effectiveness. Such information is inherently confidential, and to have an overt policy discouraging the submission of such information leads the proposer to either waive their legitimate rights or to risk being unresponsive and unpersuasive. This wording was in past PDs, and is largely ignored for good reason – it leads to inadequate disclosure in proposals and/or unnecessarily unclear proposals such as where an attempt is made to keep the confidential on separate pages from the non-confidential or where the proposing business simply provides inadequate informational support in order to protect its ownership rights. It does not serve any SBIR interests.

We recommend the following sentence in Section 8(a) should be stricken from the PD:

- "Agencies will discourage SBCs from submitting information considered proprietary unless the information is deemed essential for proper evaluation of the proposal."

Section 8(b) Rights in Data Developed Under SBIR Funding Agreement

We believe that Section 8(b) should also apply to prime contractors - not just federal agencies. For example Section 8(b)(4) should also require that Prime Contractors should not be able to pressure or coerce a company to relinquish, transfer or modify in any way its SBIR data rights. What follows are changes SBTC believes should be made to Section 8(Modifications indicated with *Italics*):

- (b) Rights in Data Developed Under SBIR Funding Agreement. The Act provides for "retention by an SBC of the rights to data *(including full title and ownership)* generated by the concern in the performance of an SBIR award."

Section 8(b)(4)

- (4) Agencies must insert the provisions of (b)(1), (2), and (3) immediately above as SBIR data rights clauses into all SBIR Phase I, Phase II, and Phase III awards. *In Phase III programs where SBC is subcontractor to a prime, the prime needs to insert "SBIR Data Rights clause" into SBC subcontract.*

Section 8(b)(4)

- *Agencies or primes* must not, in any way, make issuance of an SBIR Phase III award conditional on data rights.

Section 8(d) Continued Use of Government Equipment

- The Act directs that an agency allow an SBIR awardee participating in the third phase of the SBIR Program continued use, as a directed bailment, of any property transferred by the agency to the Phase II awardee *or acquired by the awardee for the purpose of fulfilling the contract*. The Phase II awardee may use the property for a period of not less than 2 years, beginning on the initial date of the concern's participation in the third phase of the SBIR Program.

Section 9(d)(2) Interagency Actions – Phase II Awards

This change reduces agency flexibility and increases delay. This section requires that both agencies issue a written determination that the topics are the same, then both agencies have to submit a report to the SBA. This makes it more difficult for an agency to make a phase II award to a technology that won a phase I award at a different agency. This is a wasteful time consuming paperwork burden that decreases the likelihood that an agency will make a phase II award to a technology that was funded by a phase I at a different agency. The law and existing SBIR policy has been to encourage agencies to make awards for technology that a different agency has funded. Agencies should be free and encouraged to fund phase II research from another agency's Phase I award. Requiring that the topics be the same makes it difficult for an agency to fund research that started at another agency. This is the opposite of what the law states. Continuation of research advances the objectives of the SBIR program.

We recommend that the language that increases the paperwork burden and time delay for interagency awards be removed from the Policy Directive.

Section 9(e) Limitation on Use of Funds

It is clear that to accomplish some of the primary goals of the law and of Section 9(e) that the agencies will have to pool money and provide the support and assistance that the law directs. For example, outreach efforts to underserved areas of the country and to underserved populations such as minority owned businesses and women owned businesses will need to be provided to state level organizations. These efforts will be better performed by a program coordinated at a national level, probably by SBA. Likewise, national conferences will need to be funded by all agencies. Another area may be to fund the data collection and funding of National Academy studies.

In order to accomplish these tasks effectively, all agencies will have some of their 3% funds assessed to underwrite these common efforts. SBA and the agencies should also consider common funding for SBA to assist in overseeing the transitioning SBIR technology into Phase III programs of record. SBA currently does not have sufficient personnel to handle complaints by SBIR companies that agency and prime contractors are not using their technology as required by the law.

One possible area of agency use of these funds is to create an agency ombudsman to support transitioning of SBIR technology into Phase III. There needs to be someone in the agency whose job is to assist in making sure that SBIR technology is considered for insertion into programs of record. If such a person were to exist in the agency, then some of the funds should be used to hire additional personnel make sure that SBIR technology is transitioned "to the greatest extent possible".

Additional uses of 3% Administrative funds:

- Education and Training. The Agencies, with assistance with small business groups, shall develop education and training programs for contracting officers and contract/grant specialist, on the SBIR program. Training programs shall include SBIR rules and emphasis on transitioning contracts/grants to Phase III, including standard contract/grant language for Phase IIIs. The 3% agency funds may be used for this purpose.

- Phase III Awards. Each Agency, with consultation with small business groups, shall develop standardized Phase III contracts and grants. Contracting Officers shall be encouraged to use these standardized documents to help increase commercialization, technology transition, and job growth in small companies.

Section 9(b) Discretionary technical assistance to SBIR awardees.

We recommend that SBA include language similar to that found in the current DoE SBIR/STTR Solicitation 2013-1 to further clarify proposal budget details, which says:

- "You may include up to $5,000 for assistance. Please note that this commercialization assistance does not count toward the maximum award size listed in Part II. C. For example, seeking commercialization assistance from your provider could result in an increase of $5,000 over the maximum award limit. That is, for a topic with a maximum award limit of $150,000, the actual award may increase to $155,000. Reimbursement is limited to services received that comply with 15 U.S.C. ' 638(q). In the event some or the entire amount listed is not expended on a commercialization assistance services as proposed, the remaining funds cannot be budgeted to other project costs. Re-budgeting of these funds is not allowable."

Section 9(f) Preventing Fraud, Waste, and Abuse

The provisions involving waste, fraud and abuse are too onerous. The SBA guidelines at section 9(f) do not take into consideration that 1/3 of all recipients of SBIR awards are first time winners who have never had a government contract before. These provisions impose strict liability on innocent mistakes by categorizing them as "fraud".

For example, Sec. 9(f)(1)(v) defines "Failure to comply with applicable federal costs principles governing an award" as falling within the definition of "fraud, waste and abuse." Even CPA's often disagree about federal cost principles. To say that a company that fails to comply with the current interpretation of all of the various cost principles is guilty of waste, fraud or abuse is just wrong. Federal cost principles are one of the most complicated and difficult accounting principles. Honest mistakes should not be considered fraud. This requirement places a huge burden on SBIR companies and subjects them to possible criminal penalties for not complying with principles that are changing and extremely difficult to understand.

Commercialization Achievement Index

As to the commercialization goals or index, SBTC recommends that the SBA and agencies use the DOD Commercialization Achievement Index, CAI, to collect commercialization information.

The CAI is a program that is already in place and understood by many of the SBIR companies, and with minor adjustments it could be adapted to all agencies. Rather than start a whole new program, expanded used of CAI can be put into place quickly with a minimum of burden on the agencies and the SBC.

Regardless of the course pursued, there are a number of principles that should be clear.

Small business firms should:

1) only be required to submit standardized data to a requesting agency;
2) be assured that the data will be shared with all SBIR and STTR awarding agencies, and be incorporated into one government information source; and
3) not be required to respond to different data requests from agencies. There should be no duplication of reporting. The company should never have to report the same data to second agency.
4) be assured that the SBC data is confidential. Commercialization data is a firm's most valuable trade secret and must not be disclosed. Since much of the information and data to be collected are confidential, steps must be taken to insure that the confidential and trade secret information are keep confidential and access to the data is limited. Most of the data can be aggregated to prevent disclosure of individual company information.

It needs also to be made clear that the commercialization index should be used to document a company's success in the particular agency. Agencies such as DOD that often purchase the results of the SBIR research will have a far different commercialization rate than agencies that do not. Firms that focus on agencies such as NSF where early stage research is emphasized may have a lower commercialization rate, especially since early stage research takes much longer to reach the marketplace. It is unfair to rely on the commercialization rate at a different agency without considering such caveats. Moreover, five years is much too short a period on which to make a fair comparison. In many instances it takes more than five years to develop technology. It is also important to clearly state that the one year ban clears the record for the company.

In the interest of the SBIR program, SBTC believes that there should be an appeal process for a company to pursue when it is determined that the company does not meet the commercialization test. Some companies may be working in areas of research where commercialization is unlikely. These companies should be able to justify staying in the Agencies' SBIR program even if their commercialization rate is low. Sometimes a SBC will be competing in areas that result in technology that has no commercial value but still provides the government with important research. In addition, a SBC may be competing in an area that the government decides that it does not wish to pursue. For example: when NASA decided to focus on space and not on aeronautics, many SBCs were left with SBIR research that NASA no longer wanted. An appeal or exception process is critical to prevent a firm from being excluded unfairly from the SBIR program.

We also believe that 20 phase Is in a 5 year period is sufficient cut off. A company that hasn't won more than 20 awards in 5 years is not a problem and shouldn't be subject to the burdens of the index.

Revising Federal Acquisitions Regulations Language

An additional area for SBA to consider that was not included in the Policy Directive is the proposed new language for Federal Acquisitions Regulations (FAR). As pointed out by SBA, the existing last sentence in FAR 19.502(b)(2) has been interpreted as an additional and unique condition that must be met before a contracting officer can proceed with a small business set-aside for research and development. The proposed language to amend the FAR to clarify that contracting officers shall set aside acquisitions for research and development, "when there is also a reasonable expectation, as a result of market research, that there are small businesses capable of providing the best scientific and technological approaches", also places an additional and unique condition in requiring that there is a reasonable expectation that small businesses would provide the "best" approach. Previously contracting officers have argued that, even when market research has shown that there are two or more small businesses capable of performing the proposed S&T work, they cannot know that the small business can provide the "best" technical solution since they are not privy to all of the internal technology development efforts being conducted by large businesses.

With the proposed FAR language requiring a reasonable expectation that there are small businesses capable of providing the "best" scientific and technological approach, this will again introduce an additional and unique condition for making small business set-asides. To avoid this, the proposed FAR language should state "there is also a reasonable expectation, as a result of market research, that there are small businesses capable of providing acceptable scientific and technological approaches" rather than requiring evidence that small businesses would provide the best approach.

We thank the SBA for this opportunity to provide our input on the proposed changes to the Policy Directive, and we would be happy to meet with SBA to discuss these comments further, and any other issues that may arise during the process of implementing the new changes to the SBIR and STTR rules and regulations.

Jere W. Glover
Executive Director
Small Business Technology Council