

ALERT

# GAO: SBIR Phase III Awardees Must Have Performed Or Been Novated the Preceding SBIR Phase I Or II Awards To Be Eligible for Award



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**WHAT:** The Government Accountability Office (GAO) recently sustained a protest challenging the award of a sole-source Small Business Innovative Research (SBIR) phase III award because the awardee was not the legal entity that performed the phase I and II awards. In *ASRC Federal Data Network Technologies, LLC*, B-418028, the awardee, American Systems Corporation, had acquired the phase I and II awardee, DDL Omni Engineering, after performance of those awards was complete. The government subsequently executed a novation agreement based on an assignment and assumption agreement between DDL Omni and American Systems which included a prior DDL Omni phase III award, but not DDL Omni's phase I or II awards that led to the phase III award in question. Based on GAO's reading of the SBIR Policy Directive, it found that American Systems must have either performed or been novated a phase I or phase II award to be eligible for the new phase III award based on DDL Omni's technology. Because it did not, GAO found that the phase III award to American System did not "derive from, extend, or complete a prior SBIR contract," as required by the Policy Directive.

**WHAT DOES IT MEAN FOR INDUSTRY:** This decision is a cautionary tale for companies looking to acquire a SBIR awardee whose phase I or phase II SBIR awards have already been completed. Under GAO's interpretation of the current SBIR Policy Directive, unless a phase I or phase II award is novated following the transaction, a buyer will not be eligible for new phase III awards based on the target's SBIR-

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developed technology. The government is often reluctant to approve novation of a completed contract, and thus the transaction and SBIR-award timing may be a critical factor in determining the future value of the acquired SBIR-developed technology.

In *ASRC*, GAO relied on the plain language of the SBIR Policy Directive, after noting that the SBIR statute merely provides that Phase III awards must go to award recipients that developed the technology. The Policy Directive, issued by the Small Business Administration (SBA), provides that a SBIR awardee may include “those identified via a ‘novated’ or ‘successor in interest’ or similarly-revised Funding Agreement. However, the Policy Directive also states that “to receive a Phase III award, the [a]wardee must have either received a prior Phase I or Phase II award or been novated a Phase I or Phase II award.” GAO focused on the word “must,” and held that “the Policy Directive is clear on the eligibility requirements for a phase III awardee, and it does not provide that a company should be considered a successor in interest for purposes of SBIR phase III eligibility simply by acquiring another company that previously had performed an SBIR phase I or II award.”

Notably, GAO solicited and ultimately rejected the SBA’s view, including at a hearing, that American Systems was eligible as a successor in interest to DDL Omni. SBA, like the agency, argued that by acquiring DDL Omni, American Systems had purchased DDL Omni’s rights and interests and therefore was a successor-in-interest in the phase I and II technology. As a result, SBA asserted that, assuming other eligibility criteria were met, American Systems had the same phase III rights as if it had performed the phase I or II awards itself, regardless of the lack of novation. GAO disagreed.

Ultimately, whether this decision will have long-term impacts will depend on the SBA’s next steps. GAO’s recommendation explicitly charged the contracting agency to work with SBA to determine if changes were needed to the SBIR Policy Directive to accomplish the intent SBA espoused in this case. In the interim, buyers should novate all active SBIR awards acquired, attempt to persuade the Government to novate the target’s completed phase I and phase II awards, and factor in the Government’s reluctance to novate completed contracts into the transaction.