INNOVATE Act of 2025

Investing in National Next-Generation Opportunities for Venture Acceleration and Technological Excellence

SECTION-BY-SECTION ANALYSIS

Sec. 1. Short Title.

This section provides that the Act may be cited as the "Investing in National Next-Generation Opportunities for Venture Acceleration and Technological Excellence" or the "INNOVATE Act".

Sec. 2. Table of Contents.
This section provides the table of contents for the bill.

TITLE 1 – PROMOTING TRANSITION FOR BATTLE READY TECHNOLOGIES

Sec. 101: Enhancing Small Business Success in the STTR Program

This section focuses the Small Business Technology Transfer (STTR) program, which awards grants to joint partnerships between research institutions and small businesses, on types of research most likely to benefit from a research institution partnership such as basic or fundamental research. It does this by limiting the (STTR) grants to Phase I awards. After Phase I, STTR awardees must transition into the Small Business Innovation Research (SBIR) program to access Phase II and Phase III, which is available to small businesses that may or may not have partnerships with research institutions. It also raises the minimum small business work requirement to 50 percent (from 40 percent) and lowers the minimum research institution work requirement to 20 percent (from 30 percent).

This section continues the existing 3.65 percent topline allocation of an agency's extramural research budget to fund the SBIR-STTR programs but with important adjustments. It raises the SBIR allotment by 0.25% (from 3.20 to 3.45 percent) and lowers the STTR allotment by 0.25 percent (from 0.45 percent to 0.20 percent).

Reason:
Some agencies find it challenging to effectively utilize STTR funding because of its partnership requirements, as acknowledged by the Department of Defense (DoD).[1] Many small businesses find it difficult to navigate partnerships with research institutions, and those partnerships often have limited utility beyond the earliest stages of research. Accordingly, this section requires small businesses who successfully complete an STTR Phase I award to transition into the SBIR program for any Phase II awards, where partnerships with research institutions are allowed but no longer required.

Further, while research institutions can provide critical collaboration for basic research and development, commercialization should be the focus of the STTR program. Requiring a small business to carry out at least 50 percent of the work on a STTR award will ensure that the small business is sufficiently committed to the commercialization potential of the funded project.

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[1] Aprille Ericsson, Assistant Secretary of Defense for Science & Technology, Keynote Address at Defense TechConnect Conference (Dec. 4, 2024).

Sec. 102: Phase II Strategic Breakthrough Funding

This section replaces the Department of Defense (DoD) Commercialization Readiness Program with a new Phase II "Strategic Breakthrough Award" program. It reserves a minimum of 0.25 percent of its expanded SBIR budget to provide these new awards.

As defined in this section, Strategic Breakthrough Awards are larger, Phase II awards of up to $30 million for a small business to spend on design for establishing manufacturing facilities, tooling, and supply chain capacity; buying raw materials or inventory; the integration of products with open interoperability standards; testing, evaluation, and certification of low-rate production units; and the purchase and maintenance of production units.

To become eligible, small businesses must demonstrate clear commercial potential and be responsive to DoD's needs. They cannot have accumulated more than $50 million in DoD funding cumulatively. They must also have 100 percent matching funds from non-SBIR government sources or private capital. Finally, they must have a commitment for purchase contracts from a relevant acquisition official.

This section also directs DoD to establish a mechanism to provide these small businesses direct access to program and requirements offices that may purchase technologies under SBIR Phase III.

<u>Reason:</u>
DoD has struggled to acquire many of the promising technologies it funds though the SBIR-STTR programs, even when it is clear that they are deployable, economical, would benefit the warfighter, or provide other capabilities. Last year's Commission on Planning Programming, Budgeting, and Execution Reform (PPBE Reform Commission) report underscored the structural impediments that exist in the budget process for the integration of these new technologies.[2] This section responds to these calls for reform by establishing greater synergy between the SBIR-STTR programs and DoD's acquisition processes to enable easier transition of battle-ready SBIR-STTR funded technologies into the hands of the agency's end-users.[3]

To that end, 0.25 percent of the SBIR budget is set aside for Phase II Strategic Breakthrough Awards. Modeled after the Air Force's successful Strategic Funding Increase (STRATFI) program, this Strategic Breakthrough allocation will allow DoD to grant large dollar awards to the most promising SBIR-funded technologies to scale up production to a level ready for a DoD formally approved acquisition.[4]

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[2] PPBE REFORM COMMISSION, FINAL REPORT: DEFENSE RESOURCING FOR THE FUTURE SECTION V – FOSTER INNOVATION AND ADAPTABILITY 67-94 (Mar. 2024), *available at* https://ppbereform.senate.gov/wp-content/uploads/2024/03/Commission-on-PPBE-Reform_Full-Report_6-March-2024_FINAL.pdf.
[3] *Id*. at 203-205.
[4] WHITNEY M. MCNAMARA, PETER MODIGLIANI, MATTHEW MACGREGOR, AND ERIC LOFGREN, COMMISSION ON DEFENSE INNOVATION ADOPTION FINAL REPORT 19-20, ATLANTIC COUNCIL, (Jan. 16, 2024), *available at* https://www.atlanticcouncil.org/wp-content/uploads/2024/01/Commission-on-Defense-Innovation-Adoption-Final-Report.pdf.

This section also adopts recommendations from the Defense Innovation Board to help SBIR companies bridge the Valley of Death— the phase between final prototype and production—for the most promising technologies.[5] It creates a consistent funding source for transitioning SBIR companies into acquisition programs if they meet specific DoD end user needs. From FY 2012–FY 2021, only 16 percent of DoD SBIR companies won Phase III awards, and only 6 percent of SBIR companies received more Phase III dollars than Phase I / II dollars. This Strategic Breakthrough award will address this challenge.[6]

Sec. 103: Implementation Briefings

No later than 60 days after the passage of this legislation, DoD will begin recurring briefings with Congress on Sec. 103 until implementation is complete.

Reason:
These regular briefings will allow congressional oversight over the implementation of the Strategic Breakthrough award program.

Sec. 104: Fixed Price Contracts

To incentivize cost efficiency, this section requires all SBIR and STTR contracts to utilize firm-fixed-price contracts as defined in section 16.202 of the Federal Acquisition Regulation (FAR) unless, on a case-by-case basis, the head of an awarding agency makes a determination to use a different contract structure.

Reason:
Many SBIR programs use cost-reimbursement contracts, which means the more a grantee spends, the more they get paid with no reason to be efficient. Such contracts can balloon costs to taxpayers and impose burdensome paperwork to detail and justify expenses. Fixed-price contracts, on the other hand, encourage efficiency and streamline accounting.

TITLE II – ENCOURAGING SMALL BUSINESS INNOVATION IN ALL OF AMERICA

Sec. 201: Encouraging New SBIR and STTR Entrants

This section prohibits any small business that has received over $75 million cumulatively from the SBIR or STTR programs from applying for any additional grants. It also prohibits a primary investigator from simultaneously serving as the primary investigator on more than one SBIR or

[5] DEFENSE INNOVATION BOARD, TERRAFORMING THE VALLEY OF DEATH: MAKING THE DEFENSE MARKET NAVIGABLE FOR STARTUPS 3 (July 2023) *available at* https://innovation.defense.gov/Portals/63/DIB_Terraforming%20the%20Valley%20of%20Death_230717_1.pdf.

[6] AMANDA BRESLER & ALEX BRESLER, ASSESSING THE EFFECTIVENESS OF DEFENSE-SPONSORED INNOVATION PROGRAMS AS A MEANS OF ACCELERATING THE ADOPTION OF INNOVATION FORCE WIDE, (Apr. 2023), https://dair.nps.edu/bitstream/123456789/4868/1/SYM-AM-23-101.pdf.

STTR proposal per solicitation and establishes a $40 million maximum revenue-based size standard for any small business seeking to participate in Phase I of the SBIR and STTR programs.

This section also requires an agency to set aside at least 2.5 percent of its SBIR budget to fund new Phase 1A awards. These will be smaller one-time $40K awards for new entrants to submit their ideas through a shorter, more streamlined application, under an open topic solicitation where the focus will be describing the commercialization potential of their proposal.

Reason:
This section reorients the SBIR-STTR programs towards its original objective of encouraging new entrants across the country to test their concepts for commercialization potential, by significantly lowering the bar of entry for innovators and by capping the ability of a certain number of veteran firms to take an outsized portion of the programs funds.[7] Within the past decade, the top 25 companies in DoD's SBIR program (0.53 percent of all companies) have received 18 percent of all Phase I and II funding, with an average of $92 million in awards per company, demonstrating how a small number of companies crowd out new entrants and promising startups.[8] Although the vast majority of SBIR companies will never reach the $75 million SBIR-STTR funding threshold,[9] the lifetime limit ensures that small startup companies use these programs for their intended purpose as early-stage seed support to produce innovations that meet the needs of agencies, not as a perpetual revenue source.

The provision restricting multiple proposals from a principal investigator in a single solicitation prevents a principal investigator from receiving duplicative funds for a single work product.[10] It also encourages a small business innovator to focus their efforts on their highest-potential proposal.

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[7] The intent of the SBIR program at its inception was to provide small businesses with early-stage seed funding to commercialize their technology and attract private capital. The Senate Small Business Committee report issued during passage of the *Small Business Innovation Research Act of 1981* details how the program was created to stimulate lagging American innovation and to focus on "younger, innovative companies" that outperform larger firms on key metrics such as patent activity and job creation. These public "preventure" investments were intended to "encourage additional private investment in these firms." Further, the National Academies 2022 Study on the National Institutes of Health (NIH) SBIR-STTR programs states its branding as "'America's Seed Fund' reflects the core program objective of helping competitive but capital constrained small businesses weather the so-called 'valley of death.'"

[8] DEFENSE INNOVATION BOARD, TERRAFORMING THE VALLEY OF DEATH: MAKING THE DEFENSE MARKET NAVIGABLE FOR STARTUPS 3 (July 2023) *available at* https://innovation.defense.gov/Portals/63/DIB_Terraforming%20the%20Valley%20of%20Death_230717_1.pdf.

[9] From SBA's SBIR.gov award database (2010 to 2022 period), 95 percent of SBIR awardee companies received less than $10 million in SBIR awards. Just 0.3 percent of SBIR awardee companies received more than $50 million in SBIR awards and 0.17 percent of SBIR awardee companies received more than $75 million in SBIR awards.

[10] From SBA SBIR.gov award database, among companies with a Phase I award for all years data was collected, about 1 percent had an award where the same Principal Investigator applied and received SBIR funding for the same SBIR award. For Phase II awards, 3 percent of awards with the same title have the same Principal Investigator as well.

According to the 2023 Federal Reserve Small Business Credit Survey, 95 percent of small businesses have under $10 million in annual revenue, which makes the legislation's $40 million revenue-based SBIR-STTR size standard a more accurate metric of what constitutes a small business in Phase I.[11] This proposal is paired with a new Phase 1A award to new SBIR applicants with a streamlined, two-page application submitted via open topic solicitation to encourage new, truly-small, and high-potential entrants. Under this proposal, at least 2.5 percent of each agency's SBIR budget would provide awards of up to $40,000 through a streamlined proposal process, identifying innovations in an estimated 2,700 new small businesses per year across participating agencies. This Phase 1A award seeks to extend the impact of early-stage funding to help thousands of new small businesses test out their ideas each year. In doing so, participating agencies will gain an insight into a larger range of novel solutions that nontraditional innovators bring to the table to identify the best technology for more investment in Phase II and beyond.

Sec. 202: Combatting Discriminatory Practices in the SBIR and STTR Programs

This section provides new statutory definitions for "emerging State" and rural area. An "emerging State" is one of 25 states that, over the past decade, have seen the fewest SBIR and STTR award recipients earn their <u>first</u> award. A "rural area" is a county or other political subdivision of a State that is defined as mostly or completely rural at the last decennial census. This section replaces reporting requirements for small businesses owned by women or socially and economically disadvantaged individuals with reporting on SBIR or STTR awards to companies in emerging states and rural areas.

This section also conditions agency use of SBIR and STTR administrative funding on the following: (1) Eliminating any consideration of the race, gender, or ethnicity of the principal investigator, founder, or key personnel in an SBIR-STTR award decision; (2) Eliminating any requirement of a statement or plan to promote diversity or equity in an award application; or (3) Eliminating any supplemental funding based on the race, gender, or ethnicity of the principal investigator, founder, or key personnel of the award winner.

This section ends the pilot status of the administrative funds pilot program.

<u>Reason:</u>
Several agencies including the Department of Energy (DOE) and NIH have created SBIR-STTR diversity supplement awards based on the identity of the researchers or key personnel of small businesses receiving an award or required a diversity statement as part of the application.[12] Further, 10 percent of DOE's SBIR-STTR application review is based on an applicant's ability to

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[11] FEDERAL RESERVE BANK,2024 REPORT ON EMPLOYER FIRMS: FINDINGS FROM THE 2023 SMALL BUSINESS CREDIT SURVEY, (Mar. 7, 2024), *available at* https://www.fedsmallbusiness.org/reports/survey/2024/2024-report-on-employer-firms.

[12] DEPARTMENT OF ENERGY, OFFICE OF SCIENCE, *Department of Energy Phase II Diversity Supplements, available at* https://web.archive.org/web/20241023113923/https://science.osti.gov/sbir/Awardee-Resources; NATIONAL INSTITUTES OF HEALTH, NIH SEED, *NIH SEED Small Business Diversity Supplement Application Guidance, available at* https://web.archive.org/web/20241129105126/https://seed.nih.gov/small-business-funding/find-funding/supplemental-funding-to-diversify-the-entrepreneurial-workforce/application-components

"Promote Inclusive & Equitable Research."[13] These requirements detract from the merit based nature of these programs, where awards would should be aligned with quality of the proposal rather than identity of the proposer. The award process will be based on the technological, scientific, and commercial potential of what a small business brings to the table.

TITLE III – STREAMLINING PARTICIPATION IN THE SBIR AND STTR PROGRAM

Sec. 301: Definition of Open Topics

This section defines the term "open topic announcement" as a solicitation with a generalized problem statement or broad technology area that does not contain any language requiring that the solutions that a small business proposes adhere to specific technological specifications. The solicitation is structured for agencies to evaluate the ability of the solution proposed by the small business concern to meet the stated innovation need of the agency or government end user. A clear definition will provide consistency across agency components in carrying out the program on innovation topics [15 U.S.C 638(ww)] and help realize the benefits of open topics in attracting new innovations, including from the commercial sector.

Reason:
DoD solicitations sometimes artificially excluded applicants by requiring technical specifications or limiting topics to very narrow issue areas.[14] The Government Accountability Office (GAO) found that many DoD components' open topics, in practice, were very similar to conventional topics, but that truly open topics promote competition and innovative thinking.[15] This proposal creates a more concrete definition of an open topic announcement to ensure the benefits of a broad inquiry are realized. It also helps to ensure there is a true merit-based competition and the awards aren't geared towards a certain company through the solicitation process.

Sec. 302: Reducing Administrative Burden

This section prohibits a small business from submitting more than three proposals to a single Phase I or direct-to-Phase II solicitation. It also prohibits a small business from submitting more than 25 proposals to the Phase I or direct-to-Phase II solicitations published by a single agency in a single fiscal year.

Reason:
The rise of generative artificial intelligence has increased the volume of applications to federal grant programs, and instances of AI services producing SBIR proposals are increasing.[16] These

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[13] DOE Briefing to S. Comm. on Small Business and Entrepreneurship Staff, (Sept. 6, 2024).
[14] For examples, please see Army SBIR Canine Readiness and Performance Open Topic (Oct. 2, 2024), SOCOM Open Topic for Autonomous Precision Timing in Contested/Congested RF Environments (Sept. 26, 2024).
[15] GAO, GAO-24-107036, AGENCIES BROADLY SOLICIT IDEAS, BUT CLEARER GUIDANCE COULD IMPROVE DOD EFFORTS (Sept. 30, 2024), *available at* https://www.gao.gov/assets/gao-24-107036.pdf.
[16] NATIONAL SCIENCE FOUNDATION, *Notice to Research Community: Use of Generative Artificial Intelligence in the NSF Merit Review Process*, (Dec. 14, 2023), *available at* https://new.nsf.gov/news/notice-to-the-research-community-on-ai

trends have the potential to place incredible burdens on SBIR program staff in the proposal review and award selection process. These reasonable limits ensure that SBIR program staff are well resourced to select the best companies and technologies for a given solicitation.

TITLE IV: PROTECTING AMERICAN INNOVATION FROM ADVERSARIAL INFLUENCE

Sec. 401: Definition of Foreign Risk

This section establishes a new definition of "foreign risk" that federal agencies must follow. It requires agencies to look back at least 10 years for any applicant's foreign affiliation, technology licensing agreements, joint ventures, contractual or financial obligations (pending or otherwise), investment agreement, research relationship (including co-authorship), or business relationship between a small business submitting a SBIR or STTR proposal, its owner, or other key personnel and individuals or entities in a foreign country of concern. This comprehensive definition of "foreign risk" leaves no discretion with the agencies and provides a consistent baseline for evaluation.

Reason:
Since 2022, the 11 agencies with an SBIR program, including five with an STTR program, have implemented the foreign ties due diligence program established in the *SBIR and STTR Extension Act of 2022*. This program was instituted after reports found that China and other adversaries exploited the programs to acquire key federally funded emerging technologies.[17] Since 2022, the agencies have held 11 implementation briefings with congressional staff allowing Congress to conduct oversight on existing due diligence evaluation processes. Unfortunately, the agencies maintained diverging approaches to identifying certain types of foreign risks and deciding on interventions when a foreign risk was identified. A November 2024 GAO report also identified this inconsistency as a significant problem, noting that several agencies lack clear procedures in their due diligence programs.[18] This new definition of "foreign risk" provides clarification to all the participating agencies about what constitutes a potential foreign risk from a foreign country of concern and provide a consistent baseline for evaluation in their foreign ties due diligence programs.

Sec. 402: Bolstering Research Security of SBIR and STTR Awards

This section amends what constitutes a required denial under the foreign ties due diligence program, to create clear standards and ensure consistency in evaluation of small businesses. It requires a denial if an SBIR or STTR applicant has ties to an entity or individual on a number of

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[17] PROTECTING THE NATIONAL SECURITY INNOVATION BASE STUDY GROUP AND OSE/FACTOR 8 PROGRAM, SURVEY OF PRC STATE-SPONSORED TECHNOLOGY TRANSFERS AFFECTING SBIR PROGRAMS: A DOD CASE STUDY, (Apr. 2021), *available at* https://cdn01.dailycaller.com/wp-content/uploads/2023/10/%E2%80%8Esbtc.orgwp-contentuploads202205PNSIBStudy-DODSBIR-China-Study-FINAL.pdf.

[18] GAO, GAO-25-107402, SMALL BUSINESS RESEARCH PROGRAMS: AGENCIES IDENTIFIED FOREIGN RISKS, BUT SOME DUE DILIGENCE PROGRAMS LACK CLEAR PROCEDURES (Nov. 21, 2024), *available at* https://www.gao.gov/assets/gao-25-107402.pdf.

lists of entities in adversarial nations that are sanctioned or restricted by the U.S. government.[19] This section requires denial if the primary source of a foreign risk is classified and provides discretion to agencies to deny an applicant for any foreign risk or national security risk they determine warrants denial.

This section also prohibits an agency and its personnel from communicating prior to formal notification that an application was denied due to a foreign risk and explicitly permits agencies to work with the intelligence community and inspectors general to conduct due diligence.

Reason:
These changes make clear that an agency must deny an SBIR-STTR applicant if it has an owner or covered individual that is party to a malign foreign talent recruitment program, a business entity, parent company, or subsidiary located in a foreign country of concern, or has an owner or covered individual with a foreign affiliation with a foreign country of concern.

These provisions also link the SBIR-STTR due diligence program to established lists maintained by federal agencies to track adversarial entities and individuals. If an SBIR-STTR applicant is affiliated with such an entity, the company will be deemed ineligible for program participation. The U.S. House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party (Select Comm. on CCP) issued a report in 2023 recommending the restriction of U.S. taxpayer investment to all lists of entities with government sanctions or red flag lists and these required denial provisions parallel those recommendations.[20] Another addition to the list of required denials is if a primary source of a foreign risk is classified.

This section corrects the ambiguity in current law of an agency's denial authority by making clear that agencies have a duty to deny an applicant if they meet the definition of specific foreign risks, and they have broad authority to deny any applicant for any such concerns even if they don't meet the legal definition of foreign risk. Further, agencies are prohibited from letting a company know, prior to an official award decision, if they were denied based on a foreign risk given the sensitivity of information.

Sec. 403: Strengthening the Due Diligence Program to Assess Security Risks

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[19] DHS's UFLPA Entity List, OFAC's Non-SDN Chinese Military-Industrial Complex Companies List, Section 889 Prohibition List of the 2019 NDAA, 1260H List of 2021 NDAA, the Bureau of Industry and Security's Military End User List, the Bureau of Industry and Security's Entity list, FCC's Equipment and Services list, and USCBP's Withold Release Orders and Findings List.

[20] H. SELECT COMM. ON CCP, REPORT ON RESET, PREVENT, BUILD: A STRATEGY TO WIN AMERICA'S ECONOMIC COMPETITION WITH THE CHINESE COMMUNIST PARTY 118th Cong. 27 (Dec. 12, 2023), *available at* https://selectcommitteeontheccp.house.gov/sites/evo-subsites/selectcommitteeontheccp.house.gov/files/evo-media-document/reset-prevent-build-scc-report.pdf.

This section directs the due diligence program at each agency to analyze an applicant's relationship to entities and individuals on the lists in Sec. 402 that require a denial.[21]

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Reason:
The due diligence program will also be directed to analyze affiliations with the entities on the lists in section 402 that necessitate denial of participation in the SBIR-STTR programs to ensure that prohibited foreign risks are properly vetted for each potential awardee.

Sec. 404: Strengthening Agency Recovery Authority

This section establishes a minimum 10-year period for agencies' existing authorities to clawback an SBIR or STTR award if there are material misstatements or if there is a change in ownership or operations detrimental to national security.

This section also creates a new minimum 5-year clawback authority if an awardee sells SBIR or STTR-related intellectual property to a non-allied country (any country outside of NATO and major non-NATO allies) and creates a new minimum 10-year clawback authority for joint research or licensing of SBIR or STTR related technology with a foreign country of concern.

This section clarifies that all clawback amounts will be adjusted to inflation according to the CPI measure.

Reason:
Indexing the clawback amounts to inflation will ensure disincentives to exposing SBIR or STTR-funded technology and intellectual property to adversarial influence and ensure that the clawback doesn't become the cost of doing business. These changes to the Agency Recovery Authority ensure a more robust set of outbound investment controls for companies receiving SBIR-STTR awards to prevent U.S. government funded technology from benefiting adversarial interests. The language for creating a minimum specified time period for the agency recovery authority mirrors similar language in other outbound investment restrictions in law.[22] Joint research, technological licensing, and intellectual property sales post-award are primary methods by which China and other adversaries gain access to cutting-edge American technologies, including those funded by SBIR-STTR.[23]

Sec. 405: Best Practices on Informational Rights

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[21] DHS's UFLPA Entity List, OFAC's Non-SDN Chinese Military-Industrial Complex Companies List, Section 889 Prohibition List of the 2019 NDAA, 1260H List of 2021 NDAA, the Bureau of Industry and Security's Military End User List, the Bureau of Industry and Security's Entity list, FCC's Equipment and Services list, and USCBP's Withold Release Orders and Findings List.

[22] CHIPS Act of 2022, Pub. L. No. 117-167, §103 (2022).

[23] SEAN O'CONNOR, U.S. – CHINA ECONOMIC AND SECURITY REVIEW COMMISSION, HOW CHINESE COMPANIES FACILITATE TECHNOLOGY TRANSFER FROM THE UNITED STATES (May 6, 2019), *available at* https://www.uscc.gov/sites/default/files/Research/How%20Chinese%20Companies%20Facilitate%20Tech%20Transfer%20from%20the%20US.pdf.

This section requires the U.S. Small Business Administration (SBA), in coordination with all the agencies with an SBIR program, White House Office of Science and Technology Policy (OSTP), and the Committee on Foreign Investment in the United States (CFIUS) to develop best practices for SBIR-STTR companies to protect intellectual property (IP) from informational rights that can be unknowingly granted to adversarial actors through investments from venture capital, private equity, and hedge funds.

Reason:
Small businesses stand on the frontlines of efforts to prevent investors in venture capital, private equity, and hedge fund firms linked to America's adversaries from gaining access to SBIR-funded companies' cutting-edge technology. The Foundation for the Defense of Democracies has documented the scope of this problem and the risk adversarial limited partner interests in American funds pose to America's innovation ecosystem.[24] Best practices will inform small businesses of how to evaluate and mitigate risk from any investment sources.

Sec. 406: GAO Report

This section expands the due diligence GAO report to focus on the effectiveness of the due diligence programs in identifying certain risks such as cybersecurity, patent and other intellectual property theft, employee, and foreign ownership, including the number of concerning adversarial ties identified by agencies and corresponding award decisions.

Reason:
This provision reorients the current SBIR due diligence report required of GAO to analyze the effectiveness of the due diligence program in analyzing each type of risk specified in statute, including new areas of analysis proposed in this legislation. This new focus will enable improved congressional oversight of the program going forward.

TITLE V – SIMPLIFYING SBIR-STTR COMMERCIALIZATION STANDARDS

Sec. 501 Streamlining Transition and Commercialization Rate Benchmarks
This section establishes performance standard ratios for Phase I and II award recipients. For a small business with 10 or more Phase I awards, awardees shall maintain a ratio of at least 0.25 for the number of Phase II awards received compared to the number of Phase I awards received. For those with 25 or more Phase I awards, the ratio shall be at least 0.5 for the number of Phase II awards received compared to the number of Phase I awards received. There is a one-year time out for failure to achieve these benchmarks and that small business may only obtain a maximum of 5 Phase I awards in the year following until the awardee surpasses the minimum performance standard.

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[24] EMILY LA BRUYÈRE AND NATHAN PICARSIC, FOUNDATION FOR DEFENSE OF DEMOCRACIES, THE WEAPONIZATION OF CAPITAL: STRATEGIC IMPLICATIONS OF CHINA'S PRIVATE EQUITY/VENTURE CAPITAL PLAYBOOK, (Sept. 15, 2022), *available at* https://www.fdd.org/wp-content/uploads/2022/09/fdd-memo-the-weaponization-of-capital.pdf.

For companies with more than 25 Phase II awards over the company's lifetime, the commercialization benchmark is amended to require a minimum 1:1 ratio of lifetime non-SBIR-STTR revenue (including government contracts with non-SBIR-STTR dollars) to lifetime SBIR and STTR award total. Further, for companies with more than 25 Phase II awards over the company's lifetime, 65 percent of their revenue received in the three most recent years must come from non-SBIR-STTR dollars. The consequence of failure to meet a commercialization rate benchmark is a prohibition on applying for additional Phase I or Phase II awards until non-SBIR-STTR revenue is sufficient to ensure the benchmark is met.

<u>Reason:</u>
To combat exploitation of the SBIR-STTR programs by unproductive firms, SBA set benchmarks for SBIR-STTR participants to motivate awardees to progress their projects from Phase I to Phase II and to commercialization.[25] But in 2024, both the GAO and the SBA's Invention, Innovation, and Entrepreneurship Advisory Committee found these benchmarks needed improvement. This section addresses their recommendations by setting clear, streamlined commercialization expectations and deadlines for SBIR-STTR companies to achieve in order to continue participating in the program.[26] Strong commercialization standards ensure better stewardship of taxpayer dollars by incentivizing firms to deploy taxpayer investments for productive purposes.[27]

Sec. 502: Improving Direct to Phase II Authorities

This section removes pilot status and expands the pilot program that gave agencies a new but limited authority to award certain small businesses who meet established criteria with a direct to Phase II award, even if they didn't participate in Phase I. The direct to Phase II awards cannot exceed 10 percent of an agency's SBIR budget, except for DoD and NIH, where they may not exceed 30 percent of their SBIR budget. Agencies may not make any direct to Phase II awards to any small business that already has 25 or more Phase II awards. Similarly, no agency may make more than 25 direct to Phase II awards to any small business.

<u>Reason:</u>
Agencies have found that in some circumstances it is in the strategic interest of the United States to accelerate innovations in capital-intensive industries to enhance national competitiveness, especially in defense and biotechnology. For these circumstances, agencies need the flexibility to go directly to Phase II so long as a small business has progressed sufficiently in their work.

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[25] SBA, Performance Benchmark Requirements*, available at* https://www.sbir.gov/performance-benchmarks.
[26] GAO, GAO-24-106398, SMALL BUSINESS RESEARCH PROGRAMS: INCREASED PERFORMANCE STANDARDS LIKELY AFFECT FEW BUSINESSES RECEIVING MULTIPLE AWARDS (Mar. 29, 2024), *available at* https://www.gao.gov/products/gao-24-106398.
[27] SBA, FISCAL YEAR 2024 REPORT FROM THE INVENTION, INNOVATION, AND ENTREPRENEURSHIP ADVISORY COMMITTEE, ENHANCING U.S. ECONOMIC COMPETITIVENESS THROUGH SUPPORT FOR SMALL BUSINESSES AND INNOVATORS, (Jan. 8, 2025), *available at* https://www.sba.gov/sites/default/files/2025-02/Invention%2C%20Innovation%2C%20and%20Entrepreneurship%20Advisory%20Committee%20Report_0.pdf.

Direct to Phase II authority was tested through a pilot program at DoD, NIH, and Department of Education and found to be an effective way to fund small businesses that have completed Phase I milestones outside of the SBIR program. This section expands the direct to Phase II authority to all agencies but places a reasonable cap on how much of the SBIR budget is eligible for direct to Phase II awards to preserve resources for the traditional path in the program. This new authority enables agencies to fund prototypes or more advanced technological development when the small businesses have already developed their technologies beyond the basic research level.

Sec. 503: Improving SBIR-STTR Data Collection

This section requires the tracking of additional data fields in the SBIR database on whether an SBIR or STTR awardee has a Phase 1A award, Direct to Phase II, Subsequent Phase II, Strategic Breakthrough Award, Phase III prime contract award, or a Phase III subcontract award. This section also requires the Federal Procurement Data System (FPDS) to track these fields and requires reporting on whether a contract is designated as a Phase III award and allows contracting officers to reference contract numbers for prior Phase I and Phase II work when recording a Phase III award.

<u>Reason:</u>
This section improves data collection practices to better inform congressional and agency oversight over the SBIR-STTR programs. Among other things, these measures will allow for a more accurate understanding of transition rates of SBIR or STTR funded technologies into non-SBIR-STTR government contracts. The changes to FPDS will also help contracting officers track projects in Phase III contracts and be able to ascertain their history with the SBIR-STTR programs.

Sec. 504: Streamlining Program Administration

Three pilot programs are sunset: the Pilot Program to Accelerate DoD SBIR and STTR Awards, NIH Proof of Concept partnership Pilot Program (pilot is removed in section 201), and the Commercialization Assistance Pilot Program. This section also removes pilot status on three pilot programs: the civilian agency commercialization readiness program, the provision allowing military institutions to participate in the STTR program, and the provision streamlining the DoD SBIR budget calculation. The section removes pilot expiration language from the transition and commercialization benchmarks and the due diligence program.

<u>Reason:</u>
This section eliminates several unnecessary and underperforming pilot programs in the SBIR-STTR programs. The DoD never formally implemented the Pilot Program to Accelerate DoD SBIR and STTR Awards, the NIH Phase 0 Proof of Concept Partnership Pilot Program complicates program administration for a $5 million pilot program out of an over $1 billion NIH SBIR-STTR budget, and most agencies never implemented the Commercialization Assistance

Pilot Program.[28] Meanwhile this section strengthens and removes pilot status for the successful pilot programs that helped establish the foreign ties due diligence program and increased commercialization standards within SBIR-STTR so they can protect federally-funded technology from malign actors and incentivize commercialization among awardees

Sec. 505: *Extending SBIR and STTR Authorization*

This section extends SBIR and STTR authorization until 2028.

Reason:
The SBIR and STTR programs expire at the end of Fiscal Year 2025, and this section extends the program until 2028 to provide certainty to small businesses that are working to develop innovative technologies to secure and promote our national interests.

[28] Under Secretary of Defense for Research and Engineering Response to S. Comm. on Small Business Request for Information, (Nov. 14, 2024), (on file with Comm.); *see also* GAO, GAO-24-107155, SMALL BUSINESS INNOVATION RESEARCH: MOST AGENCIES DID NOT IMPLEMENT REQUIRED COMMERCIALIZATION PILOT (Sept. 25, 2024), available at https://www.gao.gov/assets/gao-24-107155.pdf.