

**THE OFFICE OF THE UNDER SECRETARY OF DEFENSE FOR
RESEARCH AND ENGINEERING
RESPONSE TO
SENATE SMALL BUSINESS COMMITTEE
REQUEST FOR INFORMAL VIEW
2 JUNE 2022**

REQUEST: The Senate Small Business Committee requested an informal view of draft language associated with security risk, waivers for larger Phase II, and limits on Phase I awardees within the Small Business Innovation Research and Small Business Technology Transfer programs.

RESPONSE: The Office of the Under Secretary of Defense for Research and Engineering non-concurs with the draft language as written and offers the following rationale:

DUE DILIGENCE PROGRAM TO ASSESS SECURITY RISKS

Issue of non-concurrence:

- The DoD treats foreign ownership, control, and influence (FOCI) and associated national security risks seriously and efforts to address these risks are not limited to SBIR/STTR. The Department is moving out on FOCI mitigation measures aligned with the National Security Technology Council (NSTC) interagency implementation of the National Security Presidential Memorandum 33 (NSPM33) and FY21 NDAA Sec 223. The rulemaking process to implement any due diligence process requires Paperwork Reduction Act (PRA) approval, which is estimated to be completed in 2023.
- The language is broadly worded such that any due diligence would have to occur on any and all proposals that are submitted vice performing said due diligence contingent on award.
- Given the reporting requests listed in the draft language, it would require additional efforts that would be substantial and require additional resources. A phased approach to implementation would be necessary to ramp up the staff required to perform such due diligence/assessments for the volume of proposals awarded by the Department for the SBIR/STTR programs. This would both substantially slow down any awards and greatly diminish the number of awards made in a given year.
- The language puts undue burden on unclassified research and addresses non-specific concerns over general national security risks which are not called out and not clear to any individual small company.
- The language creates an inordinate amount of analysis up front – even for a Phase 1 award – that would include full up assessments on cyber security, patent analysis, amongst others and places huge burdens and barriers that are both over and above normal unclassified, open awards.
- The language also creates a significant barrier to entry for innovative small businesses at a time when the Department is trying to make it easier for them to work with us.
- The Department does not have the authority nor the resources to carry out this function for the Federal government. This statement also applies to section “Report on Adversarial

Military and Foreign Influence in the SBIR and STTR Programs” subparagraphs (a) and (c).

Recommendation:

- This language should be deleted in its entirety, short of that, there should be more emphasis placed NSPM33 and FY21 NDAA Sec 223 implementation. To perhaps even include language that would waive PRA requirements.
- The language should direct the U.S. Small Business Administration (SBA), as the Federal-wide administrator of the SBIR/STTR programs, to require participating Federal agencies to assess and implement due diligence processes for their individual programs. The SBA in coordination with the other Federal agencies should also establish guidelines/standards for this process to ensure consistency across government.

REQUIREMENTS FOR WAIVERS OF SIZE FOR PHASE II AWARDS

Issue of non-concurrence:

- When the Department seeks a waiver from SBA, there is typically a transition sponsor identified, this would not involve venture capital or other private sector investment. In many cases, additional R&D is needed before the transition sponsor/prime will pull the technology into a Program of Record or fielded system.
- In FY21, out of 1,328 new Phase II awards, totaling \$1,424,987,222, SBA granted a total of 42 waivers totaling \$200,855,972. This represents 14% of the total Phase II award amount. However, of the \$200M for the waivers, one award at ~\$100M, accounts for half of the total award amount of the waivers. Removing that one award, brings the total waiver amount to 7% of the total Phase II awards. Further, within the 42 waivers, only 5, totaling ~\$12M, went to companies with over 50 awards (over a three-year period).
- Most programs cannot get over the valley of death for \$5 million or less, therefore, the proposed language would likely increase the valley of death and place the company in a position to seek external capital. An even bigger concern: No other acquisition program within DoD is required to go to the Service Secretary level for a waiver before they execute their program.

Recommendation:

- The Department steadfastly believes that imposing increasing stipulations or limitations on Phase II would only hasten the rate at which these small businesses look for capital elsewhere to include opening themselves up to foreign capital, which is counter to growing a vibrant domestic small business ecosystem and growing the Nation’s industrial base. Small businesses need access to capital to accomplish the technology development for innovation and rapid adoption of the technology that is key to national and economic security. The waiver process has been an effective path forward for these companies that have nascent technology.
- Given the importance that the Department places on small businesses, recommend that instead of limitations on waivers for Phase II, that Congress consider the legislative proposals LP448 and LP450 from the Department as a means to ensure that the

Department has the agility to ensure that small businesses can cross the valley of death and remain a contributing member of the defense industrial base.

ANNUAL LIMIT ON NUMBER OF PHASE I AWARDS

Issue of non-concurrence:

- The proposed caps will reduce competition and inhibit innovation. The small business industrial base is already shrinking and instituting a cap on the largest source of R&D funding for small businesses will only serve to make matters worse. The SBIR/STTR programs are competitive, technical, merit-based programs that allow the DoD to select proposals with the highest technical merit, regardless of how many awards a firm may have won. Instituting a cap will prevent the DoD from being able to select the most innovative proposals. Caps also result in DoD missing out on a critical technology if the small business that had proposed the best solution was prevented/prohibited from submitting a proposal because of the cap.
- Phase I award winners require sustained investment in order to cross the valley of death and be integrated into programs of record or fielded systems. Most successful Phase III companies received multiple Phase I and II awards. These multiple awardees were chosen because they deliver innovative solutions to the Department's needs. Firms are applying to multiple topics across all Federal agencies and a limit of three awards would potentially constitute 3 Phase I awards and limited opportunity to move on to Phase II.

Recommendation:

- OUSD(R&E) recommends the use of a tiered benchmark process as an alternate approach to caps, and has been working with SBA to draft language to implement stricter benchmarks for firms with more than 50/75/100 awards. Since the benchmarks are already implemented by previous legislation, they would be easier to modify than trying to create and implement a new process.