

## COURSE 9, TUTORIAL 3

# THE VALUE OF PHASE III AWARDS AND HOW TO IDENTIFY THEM



**P**hase III is one of the least understood phases of the SBIR/STTR programs. Federal employees and SBIR/STTR entrepreneurs alike struggle to master the intricacies of this phase of the SBIR and STTR programs. SBIR and STTR Data Rights, and a variety of special rights unique to these programs apply to Phase III. For that reason, it is important to understand the full implications of Phase III awards. In this Tutorial on SBIR and STTR Data Rights, we will look at Phase III closely for that reason. SBIR/STTR Data Rights apply to Phase III, and therefore it is important to gain a full understanding of what a Phase III award is, how to identify it, and why it is important to insist that federal employees accord SBIR/STTR Data Rights in a Phase III award.

Before we go on, as in the prior sections, we note that SBIR and STTR Data Rights are identical. They use the same clauses, and are included in SBIR and STTR awards in an identical fashion. Therefore, we will refer to SBIR Data Rights below, for convenience, but everything said will apply to STTR Data Rights, unless we note otherwise.

### **NONDISCLOSURE GRANTS PROTECTION AGAINST COMPETITION**

The value of SBIR Data Rights cannot be overstated. As the SBIR firm moves past Phase I feasibility testing, and past extended research in Phase II, the much more difficult stage of commercializing the technology into a usable or marketable product begins. This stage, which we refer to as Phase III, involves the whole process of testing and re-testing, developing manufacturing know-how, developing a prototype, ruggedizing the prototype into a product that can withstand the rigors of the battlefield or the marketplace, and finally, marketing and selling a product. The SBIR firm that undergoes this arduous

process certainly does not want its innermost secrets, its “secret sauce” if you will, its SBIR Data, disclosed to a competitor, which can by-pass this entire rigorous process and become a competitor of the SBIR firm overnight— with little or no effort. That explains the necessity of protecting the all-important SBIR Data from disclosure.

Disclosure of SBIR Data virtually destroys the value of SBIR technologies. Potential buyers will not pay for something they can get for free from the government. So when the SBIR firm seeks to sell its technology, or ultimately its firm, disclosure of its SBIR Data significantly erodes the value of this data that the SBIR firm worked so hard to develop.

The government’s nondisclosure obligation helps maintain the market that the SBIR firm has created and worked hard to develop for its product, and fends off unwanted competitors. The “roll-over” provision set out in Section 8 of both the SBA SBIR and STTR Directives has the effect of maintaining this confi-



dentiality of SBIR Data Rights indefinitely if the SBIR/STTR firm keeps winning Phase III awards. This nearly perpetual secrecy of SBIR Data assures that the SBIR firm can keep selling the product long enough to recover the significant investment the SBIR put into creating the product in the first place. We look closer at this roll-over provision in Section Four of this course.

**WHAT IS A PHASE III?**

SBIR/STTR Data Rights clauses are routinely placed in Phase I and Phase II awards. There seems to be little dispute about according SBIR Data Rights in these awards. However, Phase III awards are very different, and it is the very different na-

that the proposed Phase III work can be for an entirely different application of the technology that was developed in a prior Phase I, Phase II, or even a prior Phase III. Thus, even if the SBIR technology is now being proposed to advance an application that is different than the prior work pursued, it does not disqualify it as a Phase III. In fact, quite the opposite: the term “extends” means that pursuit of a different application for the SBIR technology can qualify the work under consideration as a Phase III. This term “extends” is particularly important for basic technologies, like signal processing that have many applications. The term “completes” refers to the process of converting prior SBIR research and effort into a product, which is the



ture of Phase III awards that raises questions in the minds of some federal employees and some employees of large firms as to whether or not SBIR Data Rights should be accorded in Phase IIIs.

A Phase III is defined as an award that derives from, extends, or completes prior SBIR effort and is funded with non-SBIR funds. This definition contains two important components: the fact that a Phase III derives from, extends or completes prior SBIR effort or work, and the requirement that it be funded with non-SBIR funds. Identification of a Phase III, therefore, is the first step in preserving SBIR Data Rights after Phase I and II are completed. Let’s take a close look at each of these components.

The term “derives from” means that the Phase III work under consideration must trace back to prior SBIR or STTR effort. The prior work that the Phase III effort under consideration is being compared to can be SBIR work performed in a prior Phase I, Phase II, or even a prior Phase III. The term “extends” means

completion of the innovation continuum. A Phase III can result if any one of these tests apply – they are connected by the word “or.” That means that if any one of these broad terms applies, the new requirement can be a Phase III.

The second component, however, is the most troublesome for employees of the federal government or large firms alike. The Phase III requirement must be funded with “non-SBIR” funds in order to constitute a Phase III. This definition is very confusing to some federal employees. They are instructed that the funding for a requirement defines its nature. Therefore, they many times mistakenly assume that because work being considered is funded with “non-SBIR” funds, the work cannot constitute a Phase III SBIR. However, the opposite is true. The very fact that a Phase III requirement is funded with non-SBIR funds makes it a Phase III. This means that funding for the Phase III work does not come from SBIR program, that is, the set aside funds used for Phase I and II. A Phase III, therefore, looks a lot like a non agency procurement because it is funded with mission



funds of the agency. However, it is that very fact that makes the new requirement a Phase III, if it also derives from, extends, or completes prior SBIR effort.

### **IT CAN BE CONFUSING**

This requirement causes seemingly normal federal procurements that derive from, extend or complete prior SBIR work to qualify as Phase III awards. When Phase III status applies, the award must be given SBIR or STTR Data Rights, and accorded all of the other attributes of a Phase III award. The SBA SBIR Policy Directive makes that a matter of law. This can come as a surprise to unsuspecting federal employees. Up to that point, they may have thought they were running a normal federal procurement, under which the federal government would receive unlimited or unrestricted data rights. Yet, in a competition, where the award winner has offered a technology or approach that derives from, extends, or completes prior SBIR effort, and the funding is not from the SBIR set aside, the unsuspecting federal employee may suddenly realize that the contemplated award, or the award just made, is a Phase III. This may lead to some frustration on the part of the unsuspecting federal employee who intended that the competition would result in a non-SBIR procurement, complete with unlimited or unrestricted data rights. Yet, the SBA SBIR and STTR Policy Directives states clearly that a Phase III may result from a competition, so this interface will require education about the law and a professional discussion of the issues.



# “There are special attributes given to a Phase III award”

When this discussion occurs, the SBIR award winner must know how to defend its right to SBIR or STTR status and Data Rights. A clear letter describing how the work proposed in the new requirement derives from, extends or completes prior SBIR effort and of course, will be funded with non-SBIR funds, may be in order. Such a letter can be an important source of education for either the federal employee, or a large firm employee who may not be familiar with these SBIR rules.

Phase III status is important because it is the admission ticket to receiving SBIR/STTR Data Rights and other Phase III rights. Once an SBIR firm passes through Phases I and II of the SBIR program, it enters the Phase III stage, where the right to SBIR Data Rights is harder to recognize. It is important for SBIR firms to recognize that federal officials and large firm employees sometimes mistakenly believe that SBIR Data Rights do not apply because a procurement or subcontract looks like a normal procurement or a normal subcontract. It is up to the SBIR firm to recognize and defend its SBIR Phase III rights.

We hope this explanation of the importance of identifying a Phase III has been helpful.

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