

# PRATT'S GOVERNMENT CONTRACTING LAW REPORT

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# The Rise of SBIR Acquisitions: A Strategic Pathway for Growth and Exit

*By John Prairie and Scott Nuzum\**

*In this article, the authors discuss the rise of Small Business Innovation Research (SBIR) grants in government contracting, delving into how past SBIR funding creates a legal and strategic pathway to sole-source contracts under federal acquisition rules, acquisitions of SBIR-awarded companies and SBIR awards, the relevant legal and regulatory implications at play, and recommendations for key stakeholders.*

The current technology investment and procurement landscape is being reshaped by a confluence of macroeconomic volatility, persistent geopolitical tension, and accelerating defense modernization imperatives. These pressures are forcing both private and public actors to reevaluate how innovation is sourced, scaled, and secured. Amid this backdrop, an interesting new trend is emerging: large government contractors and defense integrators are acquiring small businesses that previously received Small Business Innovation Research (SBIR) awards, sometimes years after the original Phase I or II research and development (R&D) efforts were completed, or are just outright buying the SBIR awards themselves. They are then leveraging those SBIR awards to obtain sole-source Phase III contracts.

This strategy is not merely opportunistic. It reflects a growing recognition that past SBIR funding creates a legal and strategic pathway to sole-source contracts under federal acquisition rules. Under the right conditions, these acquisitions allow large firms to lock in non-competitive access to Phase III contracts with U.S. government agencies, a particularly valuable proposition at a time when agility, technical differentiation, and contracting speed are at a premium.

For buyers, this presents a unique opportunity to absorb innovation that has already been technically validated, partially de-risked through government funding, and legally positioned for direct contracting. For sellers, particularly deep-tech startups facing long commercialization timelines and uncertain venture-capital terrain, this trend offers a potential liquidity event that might not otherwise materialize through traditional private-market exits. The result is a rare alignment of strategic interests.

But the opportunity is not without its risks. A flawed understanding or improper execution of the legal requirements that underpin sole-source SBIR

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Phase III awards can unravel the very value proposition these transactions aim to capture. Recent protest decisions by the U.S. Government Accountability Office (GAO) reinforce that while federal agencies' SBIR Phase III authority is broad, it is not immune from scrutiny.<sup>1</sup> Contractors must properly structure acquisitions of SBIR awards, and agencies must demonstrate a clear and uninterrupted chain of R&D derivation, to justify sole-source awards, or risk successful bid protests that can reverse procurement decisions and chill the strategic intent behind such acquisitions.<sup>2</sup>

To harness this opportunity successfully and responsibly, stakeholders must understand the legal foundations, strategic drivers, and diligence requirements that define SBIR-driven M&A. This article explores each in depth.

## **OVERVIEW OF THE SBIR PROGRAM AND SOLE-SOURCE AUTHORITY**

The SBIR program was created under the Small Business Innovation Development Act of 1982 (Act) and is codified at 15 U.S.C. § 638.<sup>3</sup> The Act is significant as it represents one of the earliest articulations by a national government of a formal policy designed to invest in domestic small business “to enable them to undertake and to obtain the benefits of research and development in order to maintain and strengthen the competitive free enterprise system and the national economy.”<sup>4</sup>

In the 40-plus years since its enactment, the SBIR program has stimulated technological innovation, fostered private-sector commercialization of federal R&D, and ensured small business participation in federally funded research and development. The program, which is administered across 11 federal agencies, channels over \$3 billion annually into small business-led innovation efforts.<sup>5</sup>

The SBIR program has a three-phase structure. Phase I focuses on feasibility and proof-of-concept studies, typically with contracts or grants of \$50,000 to \$300,000.<sup>6</sup> Phase II supports further development and prototype efforts, often exceeding \$1 million in funding.<sup>7</sup> Phase III involves commercialization and

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<sup>1</sup> See, e.g., Digital Force Technologies, Inc., B-423319 (May 19, 2025).

<sup>2</sup> See *id.*

<sup>3</sup> Pub. L. No. 97-219, 96 Stat 217, July 22, 1982.

<sup>4</sup> *Id.*

<sup>5</sup> See <https://www.sbir.gov/participating-agencies>.

<sup>6</sup> See [https://www.sbir.gov/sites/default/files/SBA%20SBIR%20STTR%20-%20Change%20the%20World%202025\\_508.pdf](https://www.sbir.gov/sites/default/files/SBA%20SBIR%20STTR%20-%20Change%20the%20World%202025_508.pdf).

<sup>7</sup> See *id.*

transition to the government or private sector; importantly, Phase III is not funded through SBIR set-aside funds and Phase III awardees do not have to meet the traditional SBIR eligibility requirements.<sup>8</sup>

Under 15 U.S.C. § 638(e)(4)(C), a Phase III award is defined as work that “derives from, extends, or completes” prior SBIR-funded efforts.<sup>9</sup> The statutory authority for awarding such contracts without competition is found at 15 U.S.C. § 638(r)(4), which directs that “Federal agencies and Federal prime contractors shall . . . issue Phase III awards relating to technology, including sole source awards, to the SBIR and STTR award recipients that developed the technology.”<sup>10</sup>

Importantly, Section 4(c)(5) of the Small Business Administration’s SBIR/STTR Policy Directive states that “there is no time limit on when a Phase III award may be made,” provided that the new work maintains continuity with the SBIR-funded R&D.<sup>11</sup> Additionally, there is no limit on the number or value of SBIR Phase III awards that can be made based on a prior Phase I or II award. The Directive emphasizes that Phase III eligibility hinges on whether the new contract work logically builds upon or extends previous SBIR efforts, regardless of the time elapsed since the earlier phases.<sup>12</sup>

### **EMERGING M&A TREND: ACQUISITIONS OF SBIR-AWARDED COMPANIES AND SBIR AWARDS**

A noticeable uptick in M&A activity has occurred in sectors where dual-use technology and government contracting converge. Defense primes, large systems integrators, and corporate venture arms have increasingly targeted SBIR-awarded companies with advanced prototypes, technical data rights, and demonstrable alignment with agency needs. While definitive datasets are difficult to assemble due to the often-private nature of early-stage M&A transactions, a growing body of anecdotal and reported evidence suggests that the value of SBIR lineage is being actively priced into acquisition strategies.<sup>13</sup>

Buyers are also acquiring just the SBIR awards themselves. This can be accomplished through an asset purchase agreement that includes all the assets

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<sup>8</sup> See *id.*

<sup>9</sup> 15 U.S.C. § 638(e)(4)(C).

<sup>10</sup> 15 U.S.C. § 638(r)(4).

<sup>11</sup> [https://www.sbir.gov/sites/default/files/2024-07/SBA%20SBIR\\_STTR\\_POLICY\\_DIRECTIVE\\_May2023.pdf](https://www.sbir.gov/sites/default/files/2024-07/SBA%20SBIR_STTR_POLICY_DIRECTIVE_May2023.pdf).

<sup>12</sup> See *id.* at 25.

<sup>13</sup> See, e.g., <https://www.sbir.gov/success/sbir-sttr-success-aerius-photonics>; <https://www.sbir.gov/success/sbir-sttr-success-bluefin-robotics-corp>; <https://www.sbir.gov/success/sbir-sttr-success-irobot>; <https://www.sbir.gov/success/sbir-sttr-success-orbital-atk-inc>.

involved in performance of the underlying SBIR award. Buyers can seek novation of the SBIR award if it is still active, but, if the award is already completed, novation is not necessary to qualify as a successor-in-interest for purposes of receiving SBIR Phase III awards.<sup>14</sup>

This transaction trend is driven by several key factors. First, acquiring a firm (or award) that retains SBIR data rights and Phase III eligibility offers immediate access to sole-source contracts. SBIR Phase III awards are not subject to the traditional competitive processes of FAR Part 6, streamlining contract execution and reducing acquisition timelines.<sup>15</sup> For companies engaged in federal R&D-heavy markets, including aerospace, energy systems, advanced manufacturing, and quantum computing, this pathway provides a compelling competitive edge.

Moreover, acquiring an SBIR-awarded company allows buyers to secure a pipeline of technical innovation that has already been de-risked. The technical merit of the R&D has been validated by federal experts, and the award history creates a paper trail of agency interest, which can help position the acquiring company as a credible and capable contractor for future development or procurement efforts. SBIR data rights enhance this advantage by offering a temporary shield against third-party competition, allowing the acquirer to mature the technology without the risk of immediate market displacement.

For the seller, these transactions represent a viable exit strategy in a funding environment that often misaligns with deep-tech commercialization cycles. Traditional venture capital models, with their 7- to 10-year fund life cycles and preference for scalable commercial models, often cannot accommodate the long development and procurement timelines associated with dual-use technologies. As a result, acquisition by a prime contractor offers a path to liquidity and continued technology maturation under a more infrastructure-rich environment.

## LEGAL AND REGULATORY CONSIDERATIONS

Transactions involving SBIR-derived technologies must navigate a complex web of eligibility, compliance, and intellectual property (IP) considerations. The core legal issue in any SBIR-related acquisition is whether the acquiring party can legitimately inherit the eligibility for a sole-source Phase III contract.

The answer depends on several interrelated factors, starting with R&D continuity. As noted above, a Phase III award must be based on a requirement that derives from, extends, or completes efforts made under the original SBIR

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<sup>14</sup> See 85 Fed. Reg. 50062, 60063 (Aug. 17, 2020).

<sup>15</sup> See generally, 48 CFR Part 6.



contract.<sup>16</sup> This lineage must be documentable, logical, and consistent with the agency's acquisition justification. A break in that chain—or a failure to demonstrate how the new requirement flows from the SBIR-funded work—can defeat sole-source eligibility.

Further, the acquiring entity must scrutinize SBIR clause compliance in the original contract. If the target company failed to assert its data rights properly, delivered work without appropriate markings, or otherwise failed to comply with contractual requirements, those rights may have lapsed or become unenforceable. In some cases, deliverables under non-SBIR subcontracts or collaborative R&D arrangements may not carry the same protections, exposing the IP to wider disclosure or competition.

IP ownership and chain of title are also paramount. Because many SBIR awardees emerge from university tech transfer offices or involve joint development with federal labs or other companies, ownership of background IP, SBIR-generated data, and commercialization rights can be fragmented or unclear. Acquirers must validate that the IP supporting the Phase III opportunity is unencumbered, assignable, and protected.

A recent GAO decision addressed eligibility for SBIR Phase III awards in a protest against a Phase III solicitation issued by the U.S. Air Force for a Tactical Security System (TSS).<sup>17</sup> The solicitation contemplated a sole-source award to Clear Align, LLC, based on two SBIR Phase II efforts previously performed not by Clear Align, but by another company, Computer Optics, Inc. Clear Align had since acquired the assets of Computer Optics and sought to qualify for the award as a successor-in-interest.

The protester, Digital Force Technologies, advanced two primary arguments.

First, it asserted that the Air Force's proposed procurement was not a lawful use of SBIR Phase III authority because the government's requirement (procurement of the TSS) did not itself "derive from, extend, or complete" the earlier SBIR-funded work.<sup>18</sup>

Second, it challenged Clear Align's status as a qualified successor-in-interest, arguing that eligibility for a Phase III award must be confined to the original SBIR performer.<sup>19</sup>

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<sup>16</sup> 15 U.S.C. § 638(e)(4)(C).

<sup>17</sup> See Digital Force Technologies, Inc., B-423319 (May 19, 2025).

<sup>18</sup> See *id.* at 4.

<sup>19</sup> See *id.*

GAO rejected both arguments and denied the protest in full,<sup>20</sup> offering several important holdings for contractors navigating the SBIR Phase III framework. Most notably, GAO reaffirmed that the statutory derivation requirement under 15 U.S.C. § 638(e)(4)(C) focuses not on whether *the government's requirements* are traceable to prior SBIR efforts, but whether “*the work to be performed under the award*” derives from, extends, or completes earlier SBIR-funded research.<sup>21</sup> In this case, the Air Force’s Determination and Findings (D&F) demonstrated that Clear Align’s proposed TSS solution incorporated a mid-wave infrared camera—the Z 320 MWIR—that had been developed under Computer Optics’ Phase II SBIR contracts.<sup>22</sup> GAO held that this was sufficient to satisfy the statutory derivation requirement, even though other elements of the TSS were commercial off-the-shelf components.<sup>23</sup>

Importantly, GAO also confirmed that a contractor may lawfully receive a Phase III award as a successor-in-interest, so long as it has acquired the SBIR-developed assets and can demonstrate a direct connection to the prior work. Clear Align’s proposal explained that it had acquired all of Computer Optics’ relevant assets, including its intellectual property, patents, technical data, and proprietary designs.<sup>24</sup> It included a copy of the asset purchase agreement memorializing the transaction.<sup>25</sup> The Air Force reviewed these materials and concluded in its D&F that Clear Align had lawfully stepped into Computer Optics’ shoes for purposes of Phase III eligibility.<sup>26</sup> GAO affirmed this reasoning, noting that SBA regulations recognize the concept of a successor-in-interest and that no statutory provision prohibits such a transition in the context of Phase III.<sup>27</sup>

GAO was also persuaded by the Air Force’s efforts to document and validate the SBIR connection throughout the acquisition process. The solicitation explicitly required offerors to demonstrate the inclusion of SBIR-derived technology, and Clear Align’s proposal included a separate volume detailing the relevant SBIR awards, the components at issue, and the connection to its

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<sup>20</sup> See *id.* at 5.

<sup>21</sup> See *id.*

<sup>22</sup> See *id.* at 13.

<sup>23</sup> See *id.* at 13–14.

<sup>24</sup> See *id.* at 16.

<sup>25</sup> See *id.* at 16–17.

<sup>26</sup> See *id.*

<sup>27</sup> See *id.* at 18.

current TSS solution.<sup>28</sup> Clear Align further explained how it had continued investing in the camera technology post-SBIR, incorporating refinements and key design principles into its current generation of cameras.<sup>29</sup> GAO concluded that these facts supported the agency's finding that the work to be performed under the award "derived from" earlier SBIR efforts.

*Digital Force* offers a roadmap for companies seeking to pursue Phase III awards following an acquisition. GAO emphasized that eligibility must be thoroughly documented by both the agency and the awardee. That includes clear derivation in the proposal, a comprehensive solicitation record, and robust support in the agency's award justification. Agencies and contractors alike should ensure that SBIR pedigree is not only preserved but also demonstrably connected to the proposed work.

One unresolved issue may warrant future scrutiny, however. *Digital Force* raised, belatedly, a challenge to the SBA's policy of recognizing successors-in-interest under Phase III authority, arguing that it conflicts with the statutory language in 15 U.S.C. § 638(r)(1), which refers to the agency's authority to enter into Phase III agreements "with that business concern" that received a Phase II award.<sup>30</sup> GAO dismissed this challenge as untimely because it was not raised in the initial protest filing.<sup>31</sup> However, the question remains whether SBA's guidance permitting successor eligibility is fully consistent with statutory text—a potential avenue for future protests or litigation. While SBA and GAO both recognize successor-in-interest status as valid, this area may invite further judicial interpretation under evolving administrative law standards, especially in light of the U.S. Supreme Court's June 2024 decision in *Loper Bright* and related challenges to agency deference.

Ultimately, *Digital Force* offers critical affirmation that sole-source Phase III awards may be made to corporate successors who can establish continuity with prior SBIR-funded efforts, even where only one component of the proposed system traces back to the SBIR lineage. For acquirers of SBIR companies, the case confirms that eligibility for Phase III awards can travel with the technology, but only if that transfer is clearly documented and legally supported.

## RECOMMENDATIONS FOR STAKEHOLDERS

For buyers, comprehensive diligence is essential. Buyers should assess the full chain of SBIR funding, confirm proper assertion and protection of data rights,

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<sup>28</sup> See *id.* at 9.

<sup>29</sup> See *id.*

<sup>30</sup> See *id.* at 15 fn 10.

<sup>31</sup> See *id.*

and evaluate the legal eligibility of the anticipated Phase III effort. This includes understanding the specific technology objectives, deliverables, and funding mechanisms of prior awards. Counsel should be retained early to validate sole-source eligibility and ensure proper acquisition planning documentation is maintained. Deal structures that include earnouts or milestone payments tied to contract awards may help align incentives and mitigate risk.

Buyers must also develop a compelling narrative showing how their future offerings derive from, extend, or complete the acquired SBIR work. This is not only relevant for internal planning, but, as *Digital Force* demonstrates, may be essential to support a contracting officer's justification for a sole-source Phase III award.

On the sell-side, SBIR awardees should proactively organize and document their SBIR award history, including all deliverables, agency communications, and data rights assertions. They should consider developing a commercialization roadmap that explicitly connects past SBIR efforts to future agency needs. This roadmap can be a powerful asset during negotiations. Target companies should also seek valuation support that reflects the latent contracting value of SBIR Phase III eligibility, and they should preserve optionality by exploring licensing or phased acquisition structures that maximize future upside.

## **LOOKING AHEAD: THE GROWING ROLE OF SBIR IN M&A STRATEGY**

As the federal government continues to prioritize dual-use innovation and accelerate modernization initiatives, SBIR-funded technologies will become increasingly central to both acquisition and M&A strategies. The unique protections and contracting flexibilities embedded in the SBIR framework offer a rare combination of technical validation, legal exclusivity, and acquisition agility.

In an environment where venture capital timelines often clash with the slow, deliberate path of government procurement, SBIR-driven acquisitions provide a powerful alternative route to scale and liquidity. For companies navigating the intersection of government missions and commercial viability, SBIR awards may be more than just a funding milestone; they are emerging as catalysts for strategic transformation.

Stakeholders who both understand how to navigate this landscape and can align the regulatory, contractual, and commercial dimensions of SBIR strategy will be best positioned to unlock its full potential.