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UNCITRAL Considers Electronic Reverse Auctions, as Comparative Public Procurement Comes of Age in the U.S.

Christopher R. Yukins
Don Wallace, Jr.¹

The United Nations Commission on International Trade Law (UNCITRAL) is revising the UNCITRAL Model Procurement Law, to reflect emerging practices in procurement. That effort, it is hoped, will yield real benefits for emerging nations that rely on the UNCITRAL model law to shape their procurement systems. In late January 2005, as part of that reform effort, the UNCITRAL Secretariat hosted a meeting of international experts in Vienna, Austria, to discuss how electronic auctions should be handled under the Model Law, and to assess the concomitant problem of unrealistically low pricing (known in the European system as "abnormally low bids"). In April 2005, an UNCITRAL working group of representatives from around the world met to develop proposed changes to the UNCITRAL Model Law.² These efforts will, it is hoped, lead to

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² The UNCITRAL Working Group I (Procurement) published the following materials for the group's Seventh Session (April 4-8, 2005) at the United Nations headquarters in New York, which are available through www.uncitral.org > Working Groups > Working Group I > Procurement: *Annotated Provisional Agenda for the Seventh Session of Working Group I (Procurement)*, A/CN.9/WG.I/WP.33 (Dec. 13, 2004) (review of issues before Working Group); *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services – Issues Arising from the Use of Electronic Communications in Public Procurement: Note by the Secretariat*, A/CN.9/WG.I/WP.34 (Dec. 13, 2004); *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services – Issues Arising from the Use of Electronic Communications in Public Procurement: Note by the Secretariat (Addendum 1)*, A/CN.9/WG.I/WP.34/Add.1 (Dec. 15, 2004); *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services – Issues Arising from the Use of Electronic Communications in Public Procurement: Note by the Secretariat (Addendum 2)*, A/CN.9/WG.I/WP.34/Add.2 (Dec. 15, 2004); *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services – Issues Arising from the Use of Electronic*

changes in the Model Law, to be adopted by UNCITRAL, to accommodate emerging issues in procurement worldwide.

Although the current round of UNCITRAL reforms spans a broad array of issues, this article focuses on one part of that reform effort: UNCITRAL's assessment of electronic reverse auctions.³ The article draws on UNCITRAL's extensive review of reverse auctions internationally, and uses reverse auctions as a test case for comparative public procurement. Reverse auctions raise, perhaps for the first time, an opportunity for public procurement systems across the world to share lessons – and failures – in the name of common progress. Reverse auctions mark an intersection between modern technologies and ancient issues of best value in public procurement. As a result, all public procurement systems confront reverse auctions in the same way, at the same time,

Communications in Public Procurement: Comparative Study of Practical Experience with the Use of Electronic (Reverse) Auctions in Public Procurement: Note by the Secretariat, A/CN.9/WG.I/WP.35 (Feb. 16, 2005) [hereinafter "UNCITRAL Secretariat Note on Reverse Auctions"]; *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services – Issues Arising from the Use of Electronic Communications in Public Procurement: Comparative Study of Practical Experience with the Use of Electronic (Reverse) Auctions in Public Procurement: Note by the Secretariat (Addendum 1)*, A/CN.9/WG.I/WP.35/Add. 1 (Feb. 17, 2005) [hereinafter "UNCITRAL Secretariat Note on Reverse Auctions: Addendum 1"]; *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services – Issues Arising from the Use of Electronic Communications in Public Procurement: Comparative Study of Abnormally Low Tenders: Note by the Secretariat*, A/CN.9/WG.I/WP.36 (Feb. 24, 2005) [hereinafter "UNCITRAL Secretariat Note on Abnormally Low Tenders"]. Earlier UNCITRAL meetings included an experts' meeting in March 2004, see Don Wallace, Jr. & Christopher R. Yukins, *UNCITRAL's Model Procurement Law: Changes on the Horizon*, 81 *Federal CONTRACTS REPORT* No. 11 (Mar. 23, 2004), and a working group meeting concluded in early September 2004, see Don Wallace, Jr., Christopher R. Yukins & Jason P. Matechak, *UNCITRAL Model Procurement Law: Reforming Electronic Procurement, Reverse Auctions, and Framework Agreements*, *PROCUREMENT LAWYER*, Winter 2005, at 10 (American Bar Association). For a review of the many potential areas of reform to the Model Law, see Sue Arrowsmith, "Public Procurement: An Appraisal of the UNCITRAL Model Law as a Global Standard," 53 *Int'l & Comp. L. Q.* 17 (2004). The experts' meetings provide technical support to the UNCITRAL Secretariat; the UNCITRAL Working Group meetings, which are far larger and more formal, are where the actual drafting of proposed changes to the Model Law takes place. The Working Group acts under the direction of the U.N. Commission on International Trade Law (UNCITRAL), and in time the Working Group will likely present the Commission with proposed amendments to the Model Law, for consideration and possible adoption by the Commission.

³ In electronic reverse auctions, prospective vendors "bid" against one another online, generally by offering successively lower prices to win a contract.

and so reverse auctions pose an extraordinary opportunity for sharing lessons internationally, based on common international norms in procurement.⁴

What is perhaps most interesting about international progress in reverse auctions is how the same issues have emerged, again and again, in different nations. In December 2003, for example, the Office of Government Commerce in the United Kingdom announced that it was offering reverse-auction services to other government agencies,⁵ in an announcement remarkably similar to the U.S. General Services Administration's July 2002 announcement that it was offering parallel electronic auction services to U.S. agencies.⁶ The U.K. agency's forecast that reverse auctions would save, on average, 25% for customer agencies echoed proponents' claims in the U.S. marketplace that reverse auctions will save 20%.⁷ Similarly, expert reports submitted to the UNCITRAL secretariat on experience in Europe and Asia,⁸ France,⁹ Latin America,¹⁰ and the United States,¹¹ and the UNCITRAL Secretariat's own reports on electronic reverse auctions,¹² reflect parallel efforts, in many nations, to address electronic reverse auctions.

⁴ See generally Steven L. Schooner, "Desiderata: Objectives for a System of Government Contract Law," (2002) 11 P.P.L.R. 103.

⁵ U.K. Office of Government Commerce, Press Release: "Government Launches New 'Electronic Reverse Auction' Framework" (Dec. 2, 2003), available at <http://www.ogc.gov.uk/>.

⁶ U.S. General Services Administration, "Reverse Auction Services" (Dec. 2002), available at <http://www.gsa.gov>.

⁷ See Mohanbir Sawhney, "Forward Thinking About Reverse Auctions," CIO Magazine, June 1, 2003.

⁸ Simeon A. Sahaydachny, *Electronic Reverse Auctions* (revised draft Jan. 18, 2005), available at www.law.gwu.edu/facweb/sschooner/links.html. Much of the experts' review at the January 2005 meeting focused on Mr. Sahaydachny's paper.

⁹ Olivier Moreau, of France, submitted a paper on, *inter alia*, the French experience with reverse auctions, available at www.law.gwu.edu/facweb/sschooner/links.html.

¹⁰ See Jorge Claro, "A Report on Recent Legal Developments in Government Procurement in Latin America," (Jan. 17, 2005), available at www.law.gwu.edu/facweb/sschooner/links.html.

¹¹ See Christopher R. Yukins, *Response to UNCITRAL Secretariat's Draft Questionnaire Regarding "Low-Bidding" (or "Abnormally Low Prices") and Reverse Auctions* (draft January 14, 2005), available at www.law.gwu.edu/facweb/sschooner/links.html.

¹² See UNCITRAL Secretariat Note on Reverse Auctions, *supra* note 2, and UNCITRAL Secretariat Note on Reverse Auctions: Addendum 1, *supra* note 2.

But while reverse auctions have advanced in parallel in many nations, regulatory progress to govern these auctions has been much more uneven. The regulators who oversee the U.S. federal procurement system launched a regulatory initiative several years ago, intended to set rules and parameters for when reverse auctions can and should be used. That effort has stalled. In Europe, in contrast, a similar initiative to govern reverse auctions has been adopted.

The regulatory initiative to govern reverse auctions in U.S. procurement seems to have stalled, in part, because of industry opposition¹³ and, more substantively, because there is no consensus on when, in fact, reverse auctions should be used. In an attempt to chart a path forward, the analysis below draws on emerging lessons from procurement systems around the world, in an effort to draw out a system of principles to guide the decision when – and how – reverse auctions are to be used.

This article proceeds in several parts. Part I reviews the experience with reverse electronic auctions in the U.S. system, and describes the stalled regulatory initiative. Part II cites lessons from other nations' use of electronic reverse auctions, including, most significantly, the European Union's extensive direction on the use of reverse auctions. Part III reviews a traditional question in reverse auctions: when is it appropriate to use reverse auctions? Part IV then turns to a more difficult question, one that is too often overlooked in the literature: when is it *inappropriate* to use reverse auctions or, more specifically, when should procurement officials curb what may well be an *overuse* of reverse auctions? Part V deals separately with the disruptive threat of below-cost pricing, and describes different nations' approaches to the risks posed by unrealistically low

¹³ See Major Susan L. Turley, "Wielding the Virtual Gavel – DOD Moves Forward with Reverse Auctions," (2002) 173 Mil. L. Rev. 1, 25-31 (discussing sources of industry opposition to reverse auctions).

pricing. Finally, Part VI draws on lessons from the U.S. experience on how to deal with the inevitable, occasional failures in the reverse auction process.

I. Experience in the U.S. Procurement System

In 2000, the U.S. administrative councils that publish the Federal Acquisition Regulation (FAR) published a special notice, asking for comments on proposed rules to govern reverse auctions:

Recently, several agencies have taken advantage of technological advances in various commodity procurements by conducting pricing competitions on-line where competing vendors lowered their prices to obtain the contract. Use of this so-called "reverse auction technique" appears to be gaining interest in certain segments of the commercial marketplace. Additional agencies are now considering potential applications for this technique. A variety of considerations will likely shape these decisions and guidance may be beneficial.

The Councils understand that interested parties have varied opinions on the need for guidance on the Government's use of reverse auction techniques. The opinions include:

- There is insufficient agency experience upon which to develop meaningful guidance at this time.
- Explicit coverage in the FAR is not needed because FAR 1.102(d) [48 C.F.R. § 1.102(d)] permits any technique that is not expressly prohibited.
- Reverse auction policy should be included in the FAR.
- Other guidance is needed, such as best practices guides, agency instructions, or training.

Therefore, the Councils are seeking input that will help them determine the best approach to help inform thinking regarding the use of reverse auction techniques.¹⁴

The FAR Councils' request engendered enormous debate in the U.S. procurement community, but no solid resolution. No FAR rule on reverse auctions has been issued,¹⁵

¹⁴ 65 Fed. Reg. 65,232 (Oct. 31, 2000).

¹⁵ The U.S. Army Materiel Command reported on the outcome of that abortive regulatory effort:

In February 2001, the DAR [Defense Acquisition Regulation] Council tasked the Contract Placement Committee (CPC) with considering the more than 40 public comments received in

but the request for comments helped focus the issues in the debate surrounding reverse auctions.¹⁶

One significant obstacle to reverse auctions in the U.S. system has been the lack of clear legal authority, under U.S. procurement law, for these types of auction techniques.¹⁷ As the U.S. Army Materiel Command (AMC) has noted, “until the rewrite of Part 15 of the Federal Acquisition Regulation (FAR) in 1997, the FAR prohibited the use of auction techniques in negotiated procurements.” When FAR Part 15 (which governs negotiated procurements) was rewritten, “it encouraged a more open dialogue between the Government and offerors, and no longer included the prohibition against the use of auction techniques.”¹⁸

Although the Army Materiel Command, among others, has pointed out that now “there is not any direct prohibition against the use of on-line auctions,” the Army Materiel Command readily conceded that “neither the FAR nor the GAO [had]

response to the request on reverse auctioning which had been issued in the Federal Register. They were to prepare a proposed FAR rule on reverse auctions. Although FAR Case 2001-010 was never formally published, the CPC suggested some changes to the FAR which would have recognized the reverse auction technique as an “innovative approach” to conduct simplified acquisitions and, more importantly, as an approved method of submitting “price proposals and conducting price discussions” in negotiated acquisitions. Unfortunately, these suggested changes were never adopted.

U.S. Army Materiel Command, *Reverse Auction Contracting Technique*, at 2, available at http://www.amc.army.mil/amc/command_counsel/resources/documents/newsletter02-4/encl06.pdf.

¹⁶ In the U.S. procurement system, the Government Accountability Office (GAO), an arm of Congress, is the lead agency in hearing challenges to other agencies' procurement decisions.

¹⁷ See, e.g., Thomas F. Burke, "Online Reverse Auctions," 00-11 *Briefing Papers* 1 (West/Thomson Oct. 2000).

¹⁸ U.S. Army Materiel Command, *Reverse Auction Contracting Technique*, *supra* note 15, at 1; American Bar Association, Public Contract Law Section, *Comments on Reverse Auction Notice* (Jan. 5, 2001), available at http://www.abanet.org/contract/federal/regscomm/ecommm_003.html. (“Until the FAR Part 15 re-write three years ago, the FAR generally prohibited auctioning. In particular, the use of “auction techniques” such as “[i]ndicating to an offeror a cost or price that it must meet to obtain further consideration; . . . [a]dvising an offeror of its price standing relative to another offeror; . . . [and] [o]therwise furnishing information about another offeror’s price,” was forbidden. See, e.g., FAR 15.610(e)(2) (1996). The revised Part 15 removed this language, suggesting that use of these auction techniques is no longer prohibited.”).

specifically approved of [the] use” of reverse auctions.¹⁹ Private sector commentators have argued, though, that prohibitions which might otherwise bar reverse auctions – specifically, prohibitions on disclosing competitors’ pricing and technical information – may be waived with the consent of the participating vendors.²⁰ Indeed, the Government Accountability Office (GAO) has held that agencies may legally stage reverse auctions in which vendors are forced to disclose their prices to one another.²¹

The debate over electronic reverse auctions has centred, in important part, on the disclosure of competitive information during the course of an online auction.²² United States procurement law generally strictly prohibits any disclosure of an offeror’s commercially sensitive information during a procurement.²³ The American Bar

¹⁹ U.S. Army Materiel Command, *Reverse Auction Contracting Technique*, *supra* note 15, at 1. The GAO, which hears the vast majority of U.S. procurement protests, in 2001 decided a case involving a reverse auction, but specifically reserved the issue of whether reverse auctions are legal. *Royal Hawaiian Movers, Inc.*, Comp. Gen. No. B-288,653, 2001 CPD ¶ 182, at note 4 (Oct. 31, 2001), *available at* <http://www.gao.gov>. In 2003, the GAO said that electronic reverse auctions could indeed be used under U.S. procurement rules. *MTB Group, Inc.*, Comp. Gen. Dec. B-295,463, 2005 CPD ¶ 40 (Feb. 25, 2003). In 2005, the GAO decided a protest that stemmed from a procurement which used a reverse auction. Although the GAO did not address the propriety of that reverse auction, the GAO did note that offers in the auction dropped from the agency's opening requirement of roughly \$23 million to a low of approximately \$16 million. *USA Fabrics, Inc.*, Comp. Gen. Dec. B-295737 (Apr. 19, 2005).

²⁰ Timothy D. Palmer, Agnes P. Dover & Thomas L. McGovern, "Can the Government Go Fast Forward on Reverse Auctions?," *Gov. Contractor*, Vol. 42, No. 26, ¶ 263 (West/Thomson 2000); *see also* David A. Whiteford, "Negotiated Procurements: Squandering the Benefit of the Bargain," (2003) 32 *Pub. Cont. L.J.* 509, 543-44.

²¹ *MTB Group, Inc.*, Comp. Gen. Dec. B-295,463, 2005 CPD ¶ 40 (Feb. 25, 2003).

²² Another private commentator concluded that certain reverse auctions are not, in fact, legal under current U.S. procurement law. See Robert Antonio, *Do Reverse Auctions Violate FAR 15.307 (b)?* (July 24, 2000), *available at* <http://www.wifcon.com/anallegal.htm>.

²³ Indeed, a recent scandal involving the U.S. Air Force and Boeing stemmed, initially, from allegations that an Air Force official had disclosed sensitive Airbus commercial information to Boeing, a competitor. *See, e.g.*, Jason Nissé, "The \$27bn Turbulence Caused by Boeing’s Ability to Court Scandal," *The Independent*, Nov. 30, 2003 (“It is alleged [Mrs. Darlene Druyun, the former Air Force official] gave Boeing financial information about a rival bid from a consortium led by European defense giant EADS, the majority shareholder in Airbus.”). Mrs. Druyun subsequently confessed to having provided that confidential information to Boeing. *See* Supplemental Statement of Facts, *United States v. Druyun*, Cr. No. 04-150-A, at pages 2-3 (E.D. Va. Oct. 2004), *available at* <http://www.pogo.org/m/cp/cp-druyun-postpleaadmission-2004.pdf>.

Association (ABA) Public Contract Law Section addressed this issue in its comments on reverse auctions:

The Procurement Integrity Act provides that procurement officials, as defined in the Act, “shall not, other than as provided by law, knowingly disclose contractor bid or proposal information or source selection information before award of a contract to which the information relates.” 41 U.S.C. § 423(a)(1) - (2) (2000). *See also* FAR 3.104-4(a). The Act also includes various “savings provisions,” including a provision permitting disclosure pursuant to applicable agency regulations or procedures and a provision permitting disclosure by the offeror. 41 U.S.C. § 423(h)(1) - (2) (2000). The FAR reflects these “savings provisions” in FAR 15.306(e)(3), which allows a Contracting Officers to disclose an offeror’s price with the offeror’s permission (i.e., where the disclosure is voluntary).

In reverse auctions conducted to date, potential offerors have expressly agreed to disclosure of their pricing in order to participate in the procurement. It appears, however, that they would have been precluded from participating if they had refused, so that the effectiveness and "voluntariness" of their consent may be open to question (i.e., the savings provisions of the Procurement Integrity Act may not provide a statutory safe harbor). . . .

* * * * *

FAR guidance in this area -- or perhaps even amendments to the Procurement Integrity Act -- would eliminate these ambiguities and provide both contractors and the Government with more predictability as the use of reverse-auction techniques is expanded.²⁴

Notwithstanding the ABA Public Contract Law Section’s cautious warnings on the disclosure of prices, as noted many other commentators have pointed out that the current regulatory structure, as liberalized through the 1990s,²⁵ seems to have opened the

²⁴ American Bar Association, Public Contract Law Section, *Comments on Reverse Auction Notice*, *supra* note 18.

²⁵ For a discussion of reverse auctions’ emergence in the broader context of procurement reform during the Clinton administration, see Professor Steven Kelman’s review of the reform initiatives undertaken during his tenure as Administrator of the U.S. Office of Federal Procurement Policy, at Steven Kelman, "Remaking Federal Procurement," (2002) 31 Pub. Cont. L.J. 581, 606. For a response to Professor Kelman’s piece by Professors Nash and Cibinic, see Ralph C. Nash & John Cibinic, "Acquisition Reform: A Progress Report," Nash & Cibinic Rep., Vol. 16, No. 10, ¶ 48 (West/Thomson Oct. 2002).

door to reverse auctions, for now contracting officials may reveal bidders' prices when the bidders have acquiesced.²⁶

The way forward on reverse auctions has not, however, been clearly marked in U.S. procurement. A May 2004 memorandum from the office tasked with U.S. procurement policy, the Office of Federal Procurement Policy, only deepened questions regarding the use of electronic auctions. The memorandum noted that electronic techniques, including reverse auctions, are extremely useful procurement tools when “used correctly.”²⁷ The one-page memorandum did not, however, explain when reverse auctions are, in fact, “used correctly.”²⁸

²⁶ As one commentator has noted:

[Federal Acquisition Regulation (FAR)] § 15.306(e)(3) no longer expressly incorporates the former auction prohibitions of FAR § 15.610(e)(2). Now the regulation targets only one activity: the agency may not reveal an offeror's price without that offeror's permission. Otherwise, except for any unfair practices during negotiations, the agency has practically full leeway to bargain with an offeror about price as permitted by FAR 15.306(d). Further, FAR 15.306(e)(3) must be construed against the back drop of FAR § 1.102(d), which permits any procurement practice consistent with sound business judgment, provided that the practice is consistent with law, regulation, and case law, and is not addressed in the FAR.

Steven W. Feldman, *Government Contract Awards: Negotiation and Sealed Bidding* § 16:18.10, “Revealing Prices Without Permission” (Mar. 2004) (available on Westlaw); see Whiteford, *supra* note 20, at 543 (“Agencies celebrated the auction prohibition's demise, as demonstrated by their use of the reverse online auction technique.”).

²⁷ Robert A. Burton, Associate Administrator, Office of Federal Procurement Policy, U.S. Office of Management & Budget, Memorandum for Federal Acquisition Council & Senior Procurement Executives, “Utilization of Commercially Available Online Procurement Services” (May 12, 2004), available at <http://www.acqnet.gov/Notes/commercialtechniques.pdf>. The memorandum notes:

Numerous commercial entities offer federal agencies a variety of online procurement services. For example, one electronic tool affords government buyers the opportunity to conduct reverse auctions on the web, allowing suppliers to submit multiple bids. If used correctly, the reverse auction approach can ensure that the government receives competitive prices. Other online procurement services allow government buyers to purchase from electronic catalogues and allow online bidding for delivery orders.

Id. The memorandum concluded that, “in order to meet the government’s objective of maximizing productivity gains from technology,” the Office of Management and Budget asked “each agency to explore increasing the use of commercially available online procurement services.” *Id.*

²⁸ See Ralph C. Nash & John Cibinic, “Online Procurement Services: Reverse Auctions Too,” Nash & Cibinic Rep., Vol. 18, No. 7, ¶ 29 (West/Thomson July 2004) (“While the OFPP memorandum indicates that the reverse auction can be advantageous ‘if used correctly,’ it does not specify what constitutes the

Even without regulatory guidance, it appears that U.S. agencies have begun to make broad use of electronic reverse auctions. Although no rule was ever finalized with regard to reverse auctions, agencies regularly publish notices of procurements that involve reverse auctions on the central government registry for procurement opportunities,²⁹ and some U.S. agencies offer reverse auction services to others.³⁰ Procedures in these U.S. agency auctions appear, in the absence of regulation, to vary widely,³¹ and seem to be set on an almost *ad hoc* basis.

Although no central regulation guides U.S. reverse auctions, an example from a recent procurement may help to illuminate how, it appears, many of these procurements are actually run. The procurement at issue was to be run by a third-party vendor named “FedBid, Inc.,” which reported that it had completed 10,000 online reverse auctions by May 2004.³² For sheer scope, we should note that a database search of the central site for federal procurement opportunities, www.fedbizopps.gov, in January 2005 for the term “reverse auction” yielded 1576 “hits” (in both active and archived procurements), and a

correct use. Nor is there any indication of what constitutes correct use in the FAR or its agency implementations.”).

²⁹ See www.fedbizopps.gov. For a discussion group on successes and failures in the use of reverse auctions in U.S. procurement, see <http://www.wifcon.com/arc/forum62.htm>. For a collection of news stories on the experience in the United States and elsewhere in governments’ use of electronic reverse auctions, see www.egov.vic.gov.au/Research/OnlineAuctions/auctions.htm.

³⁰ A U.S. centralized purchasing agency, the U.S. General Services Administration, has, through its Rocky Mountain Regional Office (Region 8) of the Federal Technology Service, offered reverse auction services (for a fee) to other U.S. agencies. For a review of the procedures used in launching such a reverse auction, see www.r8.gsa.gov/FTSWeb.nsf/0/def311033320029b87256c07004811b0?OpenDocument. For the perspective of a buying agency which has endorsed the use of reverse auctions but also has not provided detailed guidance on when reverse auctions may be appropriate (or inappropriate), see the June 2003 letter from the U.S. Department of Veterans Affairs letter to its contracting offices, available at <http://www1.va.gov/oamm/info/il03-11.pdf>.

³¹ See, for example, an auction checklist used by the U.S. Department of the Navy, at www.auctions.navy.mil/support/checklist-govreverse.html, and the qualification requirements used by the U.S. Department of Homeland Security (DHS) at <http://www2.eps.gov/spg/DHS-BT/INS/COW/NFU050093/Combine%20Synopsis%5FSolicitation.html>. In the case of the DHS procurement, the only prequalification requirement was registration in the Central Contractor Registration system, which is a prerequisite for *all* U.S. contracting.

³² <http://www.fedbid.com/news>.

search in the same database for “FedBid” yielded 757 “hits.” This crude search suggested that FedBid coordinated a substantial share of the reverse auctions in the U.S. government.³³

In this sample procurement, the U.S. Department of Homeland Security was using the services of FedBid, Inc. to host an online auction for spray in canisters in a solicitation posted on FedBizOpps.gov. Parsing that procurement’s notice illustrates how reverse auctions are, in practice, being used by some in the U.S. procurement system. The solicitation discussed here³⁴ follows what appears to be a common format for procurements that will use reverse auctions hosted by FedBid, Inc.:

Posting of Opportunity: The opportunity was posted on the standard, centralized federal website for business opportunities, www.fedbizopps.gov; generally speaking, all opportunities above \$25,000 are supposed to be posted there.³⁵ To participate in the online auction, companies had to be registered in the U.S. government's online Central Contractor Registration (CCR) system.³⁶

Solicitation Form: Using simplified procedures which are permitted for commercial-item purchases, the solicitation was compressed into the posted synopsis (the abbreviated notice of the procurement), per FAR Subpart 12.6.

³³ For a more recent survey, see Christopher W. Rauen, *It's Time to Embrace Reverse Auctions*, at 34 (Feb. 2005) (draft note, on file with authors).

³⁴ Posted at <http://www1.eps.gov/spg/DHS-BT/INS/COW/NFU050093/Combine%20Synopsis%5FSolicitation.html>.

³⁵ FAR 5.201, 48 C.F.R. § 5.201.

³⁶ <http://www.ccr.gov>.

Offer/Quote: Vendors were allowed to submit *quotations* rather than actual bids in the reverse auctions. This helped to mitigate bidding risk for vendors, but may have opened the door to manipulation because bidders could know that the prices they proposed (the "quotes") were not, in fact, binding offers. The solicitation did warn, though, that “offerors may not artificially manipulate the price of a transaction on www.FedBid.com by any means. It is unacceptable to place bad faith offers, to use decoys in the www.FedBid.com process or to collude with the intent or effect of hampering the competitive www.FedBid.com process.”

Location of Auction: The auction was to be hosted not on a government site, but at www.FedBid.com.

Structure of Auction: As the auction notice pointed out, a vendor could "submit a series of pricing quotes, which descend in price during the specified period of time for the aforementioned reverse auction." To submit this pricing information, vendors had to register with FedBid.

Ranking of Bidders/Nonprice Factors: The solicitation specifically stated that “FedBid ranks all bids by price, regardless of the evaluation criteria used by the buyer [the customer agency]. Buyers and Sellers [vendors] understand that a Buyer always maintains all rights assigned under their contracting authority and/or applicable acquisition regulations, and may select the most advantageous bid for the government’s purpose while considering offline factors such as delivery, past performance, socio-economic classifications, and source rotation.” Although the

solicitation warned bidders to deliver non-price information to the customer agency directly, the solicitation did not appear to require any such non-price information. What use a government buyer would make of nonprice factors was not explained; thus, for prospective bidders, it would be unclear what weight, if any, quality was to have in a price-quality trade-off. This raised serious questions under U.S. procurement practices, which require a clear statement of the factors for award, and how those factors will be weighted.³⁷

As this example shows, the relatively lax regulation of U.S. reverse auctions has opened a series of potential issues. First, contrary to what some opponents of reverse auctions may have hoped, simply leaving reverse auctions unregulated has *not* stemmed their spread; reverse auctions appear to be spreading across the U.S. system on their own. Without the structure of regulatory requirements, reverse auctions may stumble in critical ways. The auction cited here, for example, has divorced price bidding from quality terms, which disrupts an economically efficient auction (and violates basic principles of procurement law). On balance, therefore, the U.S. experience suggests that regulating reverse auctions is the sounder course. Although regulation may add transaction costs, *not* regulating reverse auctions may be even more costly and disruptive.

II. Lessons from the International Experience with Reverse Auctions

For comparative scholars, therefore, the question is whether U.S. procurement regulators, stalled in their own progress on electronic reverse auctions, can draw lessons from other countries' implementations of reverse auctions. The answer is mixed. While

³⁷ See, e.g., FAR 15.203(a) (Requests for Proposals).

a number of states and international organizations have made real progress in drafting a regulatory framework for reverse auctions,³⁸ in many cases those frameworks have launched reverse auctions without considering the harder question: when, in fact, are reverse auctions *inappropriate*?³⁹

As noted, UNCITRAL is currently considering whether, and how, to address electronic reverse auctions in UNCITRAL's Model Procurement Law on Procurement of Goods, Construction and Services.⁴⁰ As the UNCITRAL secretariat's note in support of the August – September 2004 working group meeting pointed out, both France and Brazil have used electronic reverse auctions, the United Kingdom has endorsed the use of reverse auctions, and draft proposed revisions to the World Trade Organization's Government Procurement Agreement (GPA) contemplate the use of reverse auctions.⁴¹ Furthermore, the papers submitted to the UNCITRAL secretariat by Jorge Claro,⁴² Olivier Moreau,⁴³ and Simeon Sahaydachny⁴⁴ reported progress in reverse auctions in procurement systems across Latin America, France, and Central and Eastern Europe.

³⁸ See, e.g., UNCITRAL Secretariat Note on Reverse Auctions: Addendum 1, *supra* note 2, ¶¶ 2-55 (discussing various nations' regulations governing reverse auction procedures).

³⁹ The European initiative in reverse auctions is discussed below. Although the European Union's directives in early 2004 endorsed the use of reverse auctions, notably the European Union in late 2004 also launched a survey, available at http://europa.eu.int/comm/internal_market/publicprocurement/e-procurement_en.htm, directed at the private sector, to explore the private sector's assessment of electronic public procurement.

⁴⁰ The UNCITRAL Model Law is available, with its Guide to Enactment, at <http://www.uncitral.org/english/texts/procurem/procurementindex.htm>. See generally Sue Arrowsmith, "New Developments in UNCITRAL: Future Work on Public Procurement and New Model Provisions on Privately Financed Infrastructure Projects," (2003) 6 P.P.L.R. NA131.

⁴¹ See United Nations Commission on International Trade Law, Working Group I (Procurement), Sixth Session, Vienna (30 August-3 September 2004), *Recent Developments in the Area of Public Procurement – Issues Arising from the Increased Use of Electronic Communications in Public Procurement: Note by the Secretariat* ¶ 85 (June 7, 2004) (A/CN.9/WG.I/WP.31) [hereinafter "UNCITRAL Secretariat's Note (June 2004)"], available at http://www.uncitral.org/english/workinggroups/wg_1/wg1-procurement-index-e.htm.

⁴² See *supra* note 10.

⁴³ See *supra* note 9.

⁴⁴ See *supra* note 8.

Probably the most important international endorsement of reverse auctions in procurement has come from the European Union, which in March 2004 adopted new directives on public procurement⁴⁵ which include provisions to regulate member states' use of reverse auctions.⁴⁶ Because of the leading role the EU provisions have taken in the international debate over reverse auctions, it is worthwhile reviewing the EU guidance regarding reverse auctions in some detail.

Article 54 of Directive 2004/18/EC (the "public sector" directive), for example, makes it clear that contracting authorities in the EU "may" – but need not – use electronic auctions in public contracting, in open, restricted and negotiated procedures. (Article 54 is set forth as an appendix, below.) The Directive provides that contracting authorities may decide to use an electronic auction "when the contract specifications can be established with precision."⁴⁷ Article 54 further provides that electronic auctions may be

⁴⁵ Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, [2004] O.J. L134/1 (Apr. 30, 2004); Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, [2004] O.J. L134/114 (Apr. 30, 2004) [hereinafter "EU Public Sector Directive"], *both available at*

http://europa.eu.int/comm/internal_market/publicprocurement/legislation_en.htm. For more detailed analysis of the provisions on auctions in these directives see Arrowsmith, "Electronic auctions under the new EC procurement directives" in the same issue of this review.

⁴⁶ As in the U.S. system, doubts in the European Union regarding the legality of reverse auctions had apparently slowed their implementation. *See* Sue Arrowsmith, "Electronic Reverse Auctions Under the EC Public Procurement Rules: Current Possibilities and Future Prospects," (2003) 6 P.P.L.R. 299 (arguing that electronic reverse auctions were allowable under prior European directives, and reviewing early history of reform eventually manifested in the 2004 directives).

⁴⁷ The Directive does not, however, specify how award under an electronic reverse auction should be decided. While there are several formats for auctions – the classic being award to the lowest bidder after open, successive rounds of bidding, through an "English" auction – on average, at least as a theoretical matter, the different formats yield similar outcomes and benefits for the sponsoring agency. *See* Ohad Soudry, "Promoting Economy: Electronic Reverse Auctions Under the EC Directives on Public Procurement" (2004) 4 J. Pub. Proc. 340, 353 ("The equivalence among all auction formats . . . does not mean that the outcome in a first-price sealed-bid auction will be exactly the same as that in the English auction . . . for instance, but only that on average all auction formats lead to the same equilibrium result.").

used for follow-on competitions among contractors under a framework agreement,⁴⁸ or under the dynamic purchasing systems permitted under Article 33 of the Directive.⁴⁹

Notably, the Directive does *not* limit auctions to price-only procurements; instead, the Directive also allows contracting authorities to use electronic auctions that are based "on prices and/or on the new values of the features of the tender indicated in the specification when the contract is awarded to the most economically advantageous tender." By contemplating auctions involving non-price terms, the European Directive thus raises fundamental questions about whether contracting authorities will be able to *quantify* non-price terms with sufficient precision to throw those terms open to an auction. Notably, the Directive limits the risks and uncertainties raised by non-price auctions by requiring that a procurement's specifications set forth "the features, the values for which will be the subject of electronic auction, provided that such features are quantifiable and can be expressed in figures or percentages." Where award is to be based upon technical and price factors taken together, the auction is to be used as a *second phase*, after an initial thorough evaluation and disclosure of the offers' technical merits.

The Directive also requires each contracting authority to provide substantial detail, set forth in the specifications, on how the electronic auction will unfold. This reduces the discriminatory risk that those new to this type of procurement, or strangers to the contracting authority, will be caught off guard by the auction's special procedures. For transparency's sake, and to maximize competition, the Directive requires that contracting authorities disclose ahead of time any formula that will be used to balance

⁴⁸See, e.g., Rhodri Williams, "The New Procurement Directives of the European Union," (2004) 4 P.P.L.R. 153, 157-58.

⁴⁹*Id.* at 158.

price and non-price terms, and that contracting authorities notify bidders, throughout the auction, of where they stand relative to other bidders.

Useful though the Directives are in providing a regulatory framework for electronic auctions, the Directives leave open many issues – and possible risks. While the terms⁵⁰ of the European directives do provide a good deal of guidance on when reverse auctions are appropriate, the Directives are, by definition, simply a broad framework for contracting authorities in member nations, designed to open up procurement to competition within the EU. The Directives therefore do not provide detailed explanations on when reverse auctions are appropriate – or, worse yet, when electronic reverse auctions could, in fact, be inappropriate or dangerous.

⁵⁰ The introductory section to the 2004 EU Public Sector Directive, *supra* note 45, for example, states as follows:

Since use of the technique of electronic auctions is likely to increase, such auctions should be given a Community definition and governed by specific rules in order to ensure that they operate in full accordance with the principles of equal treatment, non-discrimination and transparency. To that end, provision should be made for such electronic auctions to deal only with contracts for works, supplies or services for which the specifications can be determined with precision. . . . With the same objective, it must also be possible to establish the respective ranking of the tenderers at any stage of the electronic auction. . . . In order to guarantee compliance with the principle of transparency, only the elements suitable for automatic evaluation by electronic means, without any intervention and/or appreciation by the contracting authority, may be the object of electronic auctions, that is, only the elements which are quantifiable so that they can be expressed in figures or percentages. On the other hand, those aspects of the tenders which imply an appreciation of non-quantifiable elements should not be the object of electronic auctions. Consequently, certain works contracts and certain service contracts having as their subject-matter intellectual performances, such as the design of works, should not be the object of electronic auctions.

Id. para. (14).

III. When Are Reverse Auctions Appropriate?

An obvious issue that needs to be resolved with reverse auctions is when they may appropriately be used. Electronic reverse auctions generally work best for commodities or standardized items, in competitions which will turn on price, not quality.⁵¹ The American Bar Association's Public Contract Law Section,⁵² in comments submitted in response to U.S. regulators' request, argued that U.S. procurement regulations should suggest specifically that reverse auctions be used only for commodity-type procurements:

⁵¹ See UNCITRAL Secretariat Note on Reverse Auctions, *supra* note 2, ¶ 20 ("There has been a general tendency in international practice to confine the use of this procurement technique to standardized goods and some simple types of services.").

⁵² Beyond the substantive issues stemming from *when* and *where* reverse auctions should be used, the ABA Public Contract Law Section's comments also recommended certain technical changes to procurement regulations which would ease the use of reverse auctions. Those proposed changes were summarized as follows:

The Section pointed out that the FAR Part 15 rewrite completed three years ago removed longstanding prohibitions on the use of auctioning in award of federal contracts. However, because that rewrite was completed before the prominence of the Internet made use of reverse auctions possible, the FAR should be amended to specifically endorse the use of reverse auctions. This use should expressly be limited, the Section said, to procurements where the items sought have few distinguishing characteristics so that Contracting Officers are assured that their selection of a reverse auction fully complies with the law. Solicitations should be written to provide offerors with notice of the "precise procedures" that will be used in connection with the reverse auction, according to the Section.

Additionally, the Section suggested that FAR guidance was necessary to deal with a Procurement Integrity Act prohibition on disclosure of contractor prices before contract award. Even if contractors waive PIA price disclosure provisions when they participate in a reverse auction, the Section pointed out, the "voluntariness" of this waiver could be called into question where contractors are precluded from participating in a procurement absent such a waiver.

Use of reverse auction techniques also poses a potential problem with respect to other procurement scenarios. First, guidance is necessary to deal with contractor mistakes during reverse auctions, the Section said. Second, FAR 52.203, "Certificate of Independent Price Determination," must be amended to provide contractors with an alternate certification where reverse auctions are used. Third, amendment to the FAR is necessary to clarify how socio-economic pricing differentials should be handled in reverse auctions. Fourth, the Section suggested that the FAR be amended to regulate underbidding in reverse auctions reflecting the requirement that the Government obtain goods at fair and reasonable prices.

"ABA PCL Section Weighs in on E-Commerce-Related FAR Changes," Vol. 43, No. 2 Gov. Contractor ¶ 20 (West/Thomson Jan. 17, 2001).

The Section believes that reverse auctions can be used effectively for easily identifiable, commodity-type items or simple services, where the items being procured have few if any distinguishing characteristics and where price is the determining factor. Adding a statement to that effect to the FAR will provide Contracting Officers and contractors with assurance that, in these circumstances, their use of this procurement technique is fully compliant with the law.

Nevertheless, because reverse auctions are new and evolving, there are justifiable concerns about their potential impact on the integrity of the procurement process. Use of reverse-auction techniques in procurements involving goods or services other than simple commodities, where requirements or specifications are unique or more complex, and where Contracting Officers must exercise judgment in the selection process through price/technical tradeoffs or best-value analysis, may require more detailed, specific guidance.⁵³

Anecdotal evidence from around the world seems to confirm that reverse auctions are best used for relatively simple procurements, where price is the chief (if not only) criterion for award.⁵⁴ The European Union,⁵⁵ for example, pointed out that reverse auctions typically involve just such simple procurements.⁵⁶ Some of the examples of

⁵³ American Bar Association, Public Contract Law Section, *supra* note 18.

⁵⁴ *See, e.g.*, UNCITRAL Secretariat's Note (June 2004), *supra* note 41, ¶ 80 ("Reverse auctions are most commonly used for standardized products and services for which price is the only, or at least a key, award criterion, since it is generally price alone that features in the 'auction' process."); Major Susan L. Turley, *supra* note 13, at 39-51 (discussion of situations where reverse auctions used for price and non-price factors). Commentators on U.S. Postal Service procurements noted, however, that, even when reverse auctions are used, the Postal Service ultimately may look to non-price factors (and the other-than-lowest bidder) in making a "best value" award. David P. Hendel & Stephen B. Hurlbut, "Contracting with the U.S. Postal Service/Edition II," 02-09 Briefing Papers 1, 9 (West/Thomson Aug. 2002). Moreover, the U.S. Coast Guard reported that it was using a reverse auction in what was, ultimately, a "best value" procurement that would weigh both price and technical factors in making an award. "Coast Guard Uses Online Reverse Auction for Best-Value Procurement," Vol. 42, No. 44 Gov. Contractor ¶ 466 (West/Thomson Nov. 22, 2000).

⁵⁵ *See, e.g.*, EU Public Sector Directive, *supra* note 45, ¶ 14 ("those aspects of the tenders which imply an appreciation of non-quantifiable elements should not be the object of electronic auctions").

⁵⁶ *See, e.g.*, Ricardo Pagliari Levy & Marcelo S. Barradas Correia, "Electronic Procurement of Goods and Services in Brazil Under the Procurement Auction Procedure," (2003) 1 P.P.L.R. 21-22 (under Brazilian law, reverse auctions are "restricted to the purchasing of goods and services referred to as 'common', which are defined as those whose quality and performance standards can be objectively and concisely defined in the invitation to tender, according to standard specifications practised in the market"). Professors Nash and Cibinic recently noted some of the appropriate – and inappropriate – uses of reverse auctions:

successful reverse auctions include purchases of yarn for federal prison workers,⁵⁷ a motorized security fence,⁵⁸ aircraft ejection seat components,⁵⁹ and lightweight modular berthing.⁶⁰ There have, however, been larger reverse auctions of information technology equipment,⁶¹ and the U.S. General Services Administration has offered reverse auctions as a suite of business services to be provided, for a fee, to other agencies.⁶²

While at least one vendor of reverse-auction services has suggested that reverse auctions are appropriate across a broad spectrum of procurements,⁶³ and a U.S. Army procuring activity has similarly urged that reverse auctions are appropriate for a very

In general, the least risky use of reverse auctions would be for purchasing commercial off-the-shelf supplies. Most of the price-only reverse auctions we have noted recently are for such items. However, we have also noted some price-only reverse auctions for what appear to be specially manufactured items. Also some solicitations have called for performance of commercial services. In procurements such as those where the bidder's obligations call for performance over a period of time, the Government's risks are much greater. The increased possibilities of delayed or poor performance suggest that the user be made aware of these possibilities before a reverse auction is undertaken. We noted one instance where the commercial services contracted for by reverse auction consisted of dental hygienist services. We wonder whether the Contracting Officer who put out that requirement would acquire such services for himself or herself based on a reverse auction. In any event, in that procurement, there did not appear to be too much concern that inferior services might be obtained. Apparently, the services were to be performed on federal prisoners.

Ralph C. Nash & John Cibinic, *supra* note 28.

⁵⁷ <http://www.eps.gov/spg/DOJ/FPI-UNICOR/MMB/CT1637/SynopsisP.html>. A search for "reverse auction" in the government wide procurement access point, www.fedbizopps.gov, regularly yields a number of open competitions that will use reverse auctions.

⁵⁸ "Developments in Brief: AFCEE's Internet 'Reverse Auction' Receives High Marks," *Gov. Contractor*, Vol. 44, No. 29, ¶ 301 (West/Thomson Aug. 7, 2002) (Air Force Center for Environmental Excellence conducted "reverse auction" for motorized security gate, will continue pilot efforts).

⁵⁹ <http://www.auctions.navy.mil/about/history.html>.

⁶⁰ <http://www.navicp.navy.mil/news/reverseauction2.htm>.

⁶¹ U.S. General Services Administration, *DFAS Gets "Best Buy" Through Federal Government's Largest Ever On-Line Reverse Auction -- General Services Administration Officials Estimate Cost Avoidance in Excess of \$2.2 Million*, available at

http://www.gsa.gov/Portal/gsa/ep/contentView.do?contentId=9469&contentType=GSA_BASIC; see "DFAS Finds Significant Savings with Online Reverse Auction," Vol. 42, No. 37 *Gov. Contractor* ¶ 390 (West/Thomson Oct. 4, 2000).

⁶² http://www.gsa.gov/Portal/gsa/ep/contentView.do?contentId=10655&contentType=GSA_OVERVIEW; see U.S. General Services Administration, *Reverse Auctions User's Guide* (2002), available at http://www.orbisonline.com/reverse_auction_guide8-29-02.pdf.

⁶³ <http://www.fedbid.com/faq.jsp>.

wide variety of procurements,⁶⁴ a U.S. Navy activity that sponsors reverse auctions took a much more careful approach. The Navy activity suggested that reverse auctions are appropriate under the following more limited circumstances, and provided detailed checklists for using auctions under those circumstances:

Reverse auctions are most efficient for high dollar, large quantity, clearly defined purchases. Item to be acquired must be fully and accurately specified. It is expected that two or more suppliers will agree to participate in the event; however, an item for which there [are] only two approved sources of supply may not be a good candidate because the anonymity factor may not be present during the reverse auction.

Sufficient time is available to conduct the acquisition using the reverse auction. Ample time for the training of suppliers and the configuration of the dynamic pricing event is required. . . .

* * * *

Normal solicitation procedures applicable for a competitive negotiation should be used. The reverse auction technique is *not* suited for Sealed Bidding. Since the tool is currently designed for using FAR Part 15 procedures, the use of this tool is not typically appropriate for acquisitions that can be processed using simplified acquisition procedures described in FAR Part 13 unless projected savings will be substantial enough to offset the cost of conducting the procurement using FAR Part 15 procedures.⁶⁵

In one of the few thorough case studies published on U.S. government reverse auctions, the author concluded that a Coast Guard reverse auction for aircraft parts succeeded, not purely because of the price savings, but because the third party that facilitated the auction was able to help the Coast Guard “reach past” U.S. suppliers to

⁶⁴ In an internal report, however, a U.S. Army contracting activity suggested that any items on common schedules of goods and services (under FAR Part 8), any “commercial items” (under FAR Part 12), and any simplified acquisitions (under FAR Part 13), would be good candidates for commercial items. See DASA(P), Headquarters, Department of the Army, “Reverse Auctions,” at slide 8 (PowerPoint presentation, dated June 14, 2001), *available at* <http://www.hq.usace.army.mil/cepr/RoundTable/ReverseAuctionBrief.ppt>.

⁶⁵ U.S. Navy Supply Systems Command, Navy Auction Site, “Getting Started,” *available at* <http://www.auctions.navy.mil/about/gettingstarted.html>.

gain lower prices from the European original equipment manufacturers.⁶⁶ Thus, in some cases the reverse auction may serve as a catalyst for a more competitive contracting process.⁶⁷

IV. Will Reverse Auctions Be Overused?

There is a danger, though, that if safeguards – mechanical or not – are not put in place, governments will tend to overuse reverse auctions. Assuming, *arguendo*, that there is an optimal level of use of reverse auctions for any given level of procurement complexity – assuming, in other words, that for any given type of procurement, we can discern an objectively optimal degree to which reverse auctions would be used – for a number of reasons, including the following,⁶⁸ it is very possible that governments would *overuse* electronic reverse auctions:

- **Novelty beguiles – the siren's song:** As a matter of human nature, agencies, attracted by the novelty and excitement of reverse auctions, may tend to overuse the reverse-auction techniques, on procurements that are either too complicated or too "simple"⁶⁹ for electronic reverse auctions. More broadly, having a reverse-

⁶⁶ Phillip M. Gillihan, "Reverse Auctions: A Case Study," Nash & Cibinic Rep., Vol. 15, No. 7 ¶ 35 (West/Thomson July 2001).

⁶⁷ In the referenced case study, as noted those staging the reverse auction served as the catalyst, and facilitated contact between the government buyer and the original equipment manufacturers. More broadly, reverse auctions can serve as catalysts themselves: an electronic auction can serve as the bridge or broker between buyers and manufacturers, and can eliminate the need for a "middleman." Andrew Stein & Paul Hawking, "Reverse Auction E-Procurement: A Suppliers Viewpoint," *available at* <http://ausweb.scu.edu.au/aw02/papers/refereed/stein/paper.html> ("The other pitfall of the online auction is the ability of the auction to connect buyers and sellers and therefore destroy the role of the traditional intermediary.").

⁶⁸ See UNCITRAL Secretariat Note on Reverse Auctions, *supra* note 2, ¶ 10 (reviewing concerns from procurement systems around the world).

⁶⁹ See, e.g., Ralph C. Nash & John Cibinic, "Reverse Auctions: Some Thoughts," Vol. 14, No. 7, Nash & Cibinic Rep. ¶ 33 (West/Thomson July 2000) ("Was an elephant gun needed? We advocate using fancy electronic tools where their use makes sense. However, in this procurement, it seems that the Navy used an elephant gun to shoot a flea. With only three competitors, it would seem that the auction could have been conducted with a conference call.").

auction mechanism at hand, even if it carries significant transaction costs, may lull an agency buyer into ignoring established, commercial markets for the same commodities.

- **Entrepreneurial agencies press for reverse auctions:** In the United States, the move to reverse auctions has been propelled, at least in part, by "entrepreneurial" federal agencies that offer other agencies reverse-auction services on a fee-for-service basis.⁷⁰ While "cutting edge" agencies in other nations may not have the same fee-based incentive to spread reverse auctions to their sister agencies, we should still remain cautious of agencies that use – and trumpet – reverse auctions as a means of advancing their own relative prestige.
- **Software manufacturers press for reverse auctions:** As Professors Nash and Cibinic noted with regard to the U.S. procurement market, the launch of reverse auctions was accompanied by a stampede of interest from software developers that sell reverse auction solutions.⁷¹ Any nation seriously considering reverse auctions should recognize the inherent conflict of interest that software firms have in touting the benefits of electronic auctions.

⁷⁰ See, e.g., "GSA to Test Reverse Auction Technique in Six-Month Pilot," Vol. 42, No. 33 Gov. Contractor ¶ 229 (West/Thomson June 14, 2000) (General Services Administration launched six-month pilot of now-defunct www.buyers.gov, online reverse auction services).

⁷¹ See, e.g., Ralph C. Nash & John Cibinic, "Reverse Auctions: More Thoughts," Vol. 14, No. 12 Nash & Cibinic Rep. ¶ 67 (West/Thomson Dec. 2000) ("It seems that the computer software marketing people are launching a full-force attack on Government procurement offices pushing the 'reverse auction' online bidding software programs that they developed for use in the commercial world.").

- **Unseen Organizational Conflicts of Interest:** As a result of private contractors' direct involvement in hosting reverse auctions solutions for federal agencies, those contractors may gain access to competitors' information that will give the hosting contractors an unfair advantage in future competitions; alternatively, the hosting contractor may be bound by hidden obligations, obvious or unspoken, to certain potential competitors, which may bias the hosting contractors' advice to their customer agencies.⁷² In either case, the agency purchasing the reverse auction services should address these "organizational conflict of interest" issues.⁷³ The European experience has borne out the serious threat these potential organizational conflicts may pose.⁷⁴ Because many nations have not yet evolved sufficient rules or procedures for addressing such conflicts of interest, however, this is a risk that will likely remain less than fully mitigated.
- **Agencies tend to oversimplify procurements:** Another danger is that agencies will too often term supplies "commodities," and thus appropriate for reverse auctions, when in fact the supplies should be chosen based on more complex nonprice factors. There has been little published on electronic auctions' proven ability to

⁷² See Thomas F. Burke, *supra* note 17.

⁷³ See FAR Subpart 9.5, 48 C.F.R. Subpart 9.5.

⁷⁴ Ciara Kennedy-Loest & Ruth Kelly, "The EC Competition Law Rules and Electronic Reverse Auctions: A Case for Concern," (2003) 1 P.P.L.R. 27, 31 (citing examples of organizational conflicts of interest under European investigation, and noting that at a "broader level, the marketplaces through which these reverse auctions are run can, themselves, give rise to competition issues, particularly if the shareholders in the marketplace are competitors").

accommodate nonprice factors, such as socioeconomic initiatives that are built into the U.S. procurement process. Even where nonprice factors such as socioeconomic goals can be converted directly to price factors – through a pricing preference, for example, to be afforded to disadvantaged firms – those factors can raise complications in the rush of a reverse auction.⁷⁵ As the discussion above reflects, reverse auctions are far less when appropriate buying decisions turn more on quality than on price; the published reports suggest that electronic auctions are still too clumsy to deal reliably with nonprice factors. Agencies should, therefore, screen potential reverse auctions, to ensure that the acquisitions are, in fact, well suited to reverse auctions.

- **Agencies underestimate anti-competitive behaviour:**

Internationally, procurement reformers have given little attention to the potential anti-competitive effects of reverse auctions. In fact, however, highly structured auctions in limited markets can have significant anti-competitive effects, for they can allow potential competitors to price-signal, the complexity of the

⁷⁵The American Bar Association's Public Contract Law Section noted in its comments on reverse auctions:

Certain socio-economic programs require application of a pricing differential to some proposals. Current technology permits these mandatory pricing differentials to be factored into prices in "real time" during a reverse auction through instantaneous application of an algorithm, so that all offerors see the "true" prices in real time. This may or may not be regarded as a distortion of the competitive pricing process, but the manner in which this issue is to be handled should be addressed in the FAR to avoid lack of uniformity among the agencies and possible confusion among offerors.

American Bar Association, Public Contract Law Section, *supra* note 18.

auctions may themselves serve as a market barrier to entry, and the auctions may allow otherwise aggressive competitors to undertake joint market actions.⁷⁶ The problem is partly one of "split" bureaucracies: while one set of officials (those in procurement) may rave in favour of the savings from reverse auctions, another set of officials – those charged with safeguarding competition – may worry, quite credibly, about the anti-competitive effects of those auctions.⁷⁷

V. Below-Cost Pricing: The Hidden Threat

In assessing potential reverse auctions, regulators have noted a common problem: below-cost pricing.⁷⁸ Below-cost pricing may arise due to simple error on the part of the bidding firm, or through a conscious effort by a bidder to seize market share through

⁷⁶ Ciara Kennedy-Loest and Ruth Kelly explained these concerns, as outlined by the European Commission:

The main concerns identified by the European Commission (the body primarily charged with the enforcement of the EU competition rules) in relation to the compatibility of electronic marketplaces (and, by analogy, reverse auctions) with these rules, have focussed on three main areas:

- information exchange: in particular because the auction marketplace provides a forum for competitors to exchange commercially sensitive information;
- access and foreclosure issues: has a marketplace or auction been set up to exclude certain competitors or to require them to participate on an exclusive basis?; and
- the aggregation of purchasing power: does the auction or marketplace facilitate joint purchasing or joint selling by participants in an auction?

Ciara Kennedy-Loest & Ruth Kelly, *supra* note 74, at 28. *See generally* Peter Trepte, "Electronic Procurement Market Places: The Competition Law Implications," (2001) 5 P.P.L.R. 260 (discussing anti-competitive concerns in the context of an electronic government procurement market).

⁷⁷ *See* Ciara Kennedy-Loest & Ruth Kelly, *supra* note 74, at 28 ("it has to be recognised that competition authorities start from the perspective that these auctions inherently give rise to competition concerns").

⁷⁸ *See* Thomas F. Burke, *supra* note 17, at note 60 and accompanying text.

"predatory" pricing.⁷⁹ In either event, below-cost pricing raises performance risks, and risks of supply-chain disruption, for agencies sponsoring reverse auctions.

The first phenomenon – below-cost pricing due to a simple mistake – is often known as "winner's curse," when inadvertent below-cost bidding occurs during the frenzy of the auction process.⁸⁰ The American Bar Association's Public Contract Law Section commented on this phenomenon:

The Section is aware of trade literature describing the potential for the so-called "winner's curse" to become an issue in electronic auctions and reverse auctions. The winner's curse occurs when winning bidders find that, in the heat of a competitive auction being conducted in real time, they have gone too far in attempting to secure or retain the buyer's business.⁸¹

Logically, experience over time should mitigate this risk of "accidental" below-cost bidding, as suppliers, through the rigors of repeated auctions, become increasingly familiar with their own cost structures. From a systemic standpoint, a more serious issue arises when a bidder bids below cost *on purpose*, in an effort to secure market share.⁸²

The ABA's Public Contract Law Section also addressed this phenomenon:

The FAR clearly discourages "buying-in" to a contract -- that is, underbidding with the intent of raising the contract price later or securing a follow-on contract at an artificially higher price. *See* FAR 3.501. Nevertheless, simply underbidding a contract is not prohibited and, in fact, many contractors routinely reduce their margins or bid at a loss for sound business reasons. The Section does not believe that this practice should be limited or discouraged. Contracting Officers are nevertheless required to obtain goods and services at "fair and reasonable prices." FAR 15.402(a). In light of the potential for the "winner's curse" and the unintended

⁷⁹ See UNCITRAL Secretariat Note on Abnormally Low Tenders, *supra* note 2, ¶ 12.

⁸⁰ David C. Wald, *The Auction Model: How the Public Sector Can Leverage the Power of E-Commerce Through Dynamic Pricing*, at 18 (The PricewaterhouseCoopers Endowment for The Business of Government (Oct. 2000)) (discussing auction strategies to reduce risk of "winner's curse"), available at <http://www.businessofgovernment.org/pdfs/WyldReport.pdf>; Soudry, *supra* note 47, at 356-57.

⁸¹ American Bar Association, Public Contract Law Section, *supra* note 24 (citing David C. Wald, *supra* note 80, at 15-18).

⁸² At the UNCITRAL working group meeting in New York in April 2005, several observers argued that *purposeful* below-cost pricing, with malicious intent, should best be addressed by criminal and competition authorities outside the procurement system.

difficulties that it may engender for both contractors and the Government, especially the potential impact on the industrial base, it may be appropriate for the FAR to address the concept of fair and reasonable prices in the context of reverse auctions.⁸³

The European Union's recent Procurement Directives address underbidding, although separately from any discussion of reverse auctions. Article 55 of the Directive governing public works contracts,⁸⁴ for example, explains how European contracting authorities must address "abnormally low bids." The Directive establishes a process for careful review of bids that seem abnormally low before they may be rejected.⁸⁵ However, we understand that these provisions are directed solely at ensuring that entities do not reject tenders from other member states simply because these tenders reflect the cost advantages, such as low wages, of other states that are reflected in the tender. They do not require any review of apparently low bids or deal in any general way with the problem of low tenders.

VI. When Reverse Auctions Fail

Although much of the leading regulatory guidance on reverse auctions comes from Europe, ironically the U.S. system – which still lacks a regulation governing when reverse auctions should be *used* – already offers guidance on what to do when a reverse auction *fails*.⁸⁶ When reverse auction procedures fail, U.S. agencies retain broad flexibility to suspend reverse auction procedures. In a 2001 decision in *Royal Hawaiian*

⁸³ *Id.*

⁸⁴ European Commission Public Sector Directive, *supra* note 45, art. 55.

⁸⁵ For a general economic discussion of the strategies and pitfalls of abnormally low bids, *see* Aleix Calveras, Juan-Jose Ganuza & Esther Hauk, "Wild Bids: Gambling for Resurrection in Procurement Contracts," (2004) 26 J. Reg. Econs. 41.

⁸⁶ *See, e.g.*, Major Susan L. Turley, *supra* note 13, at 35-36 (practical responses to auction system failures).

Movers, Inc.,⁸⁷ for example, the Government Accountability Office (GAO) held that the purchasing agency could properly reopen a competition, *after* a reverse auction had closed, to accept revised price proposals in order to correct an ambiguity in the solicitation that one of the offerors had protested to the agency.⁸⁸ The GAO summarized its decision as follows:

Notwithstanding a provision in a request for proposals that price revisions could only be made during a reverse auction, the agency reasonably determined to request revised price proposals after the end of the auction, in response to an agency-level protest, where the solicitation was ambiguous concerning when the auction would end and the agency reasonably believed that offerors may have been misled.⁸⁹

Thus, though the U.S. system still lacks basic rules on how to conduct a reverse auction, the U.S. system is already evolving rules on how to deal with reverse auctions when they fail.

⁸⁷ Comp. Gen. No. B-288,653, 2001 CPD ¶ 182 (Oct. 31, 2001).

⁸⁸ For a sharp criticism of the *Royal Hawaiian* decision, see Ralph C. Nash & John Cibinic, “Oversight of Procurements: Delayed Addendum,” Vol. 16, No. 1 Nash & Cibinic Rep. ¶ 1 (West/Thomson Jan. 2002).

⁸⁹ *Id.*; see also *Pacific Island Movers*, Comp. Gen. No. B- 287643.2, 2001 CPD ¶ 126 (July 19, 2001) (“In a negotiated procurement which provided for a reverse auction, an agency reasonably determined to request revised price proposals after the end of the auction, in response to a protest which raised reasonable concerns that there were errors in the conduct of the reverse auction.”); “Comptroller General Upholds Mid-Competition Switch from Reverse Auction to Negotiated Procurement,” Vol. 43, No. 29 Gov. Contractor ¶ 310 (West/Thomson Aug. 8, 2001). For a broader discussion of when it is appropriate for agencies to take corrective action in the wake of procurement failures, see Michael A. Hordell & Laura L. Hoffman, “Reopening Competition After Award Due to Procurement Error: What’s an Agency To Do?,” Proc. Lawyer, Winter 2003, at 1 (American Bar Ass’n, Public Contract Law Section).

VII. Conclusion

Although the regulatory tapestry for reverse auctions remains far from complete on both sides of the Atlantic, reverse auctions provide a startlingly useful example of how comparative dialogue between regulators internationally can help to fill gaps in a regulatory scheme. The ongoing success of the European regulatory effort regarding reverse auctions has highlighted the gaps in the U.S. regulatory initiative, and the European directives, though they do not answer all the open questions, may provide a useful starting point for U.S. regulators. Around the world, however, regulators should be sensitive to the question that generally has been overlooked – when reverse auctions may be *overused*, despite their dangers – as procurement systems continue to experiment with reverse auctions.

Nor should we overlook the special impact that these developments may have on U.S. procurement reform. The UNCITRAL effort to craft model provisions on electronic reverse auctions, an effort which draws upon experiences from around the world, may in fact mark a turning point for the U.S. procurement system. Perhaps for the first time in the history of U.S. procurement reform, U.S. regulators drafting rules for reverse auctions will, if they choose, be able to build upon experiences from literally dozens of nations. Whereas traditionally U.S. procurement policy has been largely self-referential, through initiatives such as UNCITRAL's, U.S. policymakers will be able to look abroad, not to be bound by foreign law, but rather more practically to learn from successes and failures in foreign procurement systems. As the debate on reverse auctions shows, public procurement policy in the United States is, in other words, entering a new phase, one in which comparative public procurement may well play a pivotal role.

APPENDIX

Excerpt from Directive 2004/18/EC of the European Parliament and of the Council Of 31 March 2004 on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts And Public Service Contracts, O.J. 2004 L134/114

Article 54: Use of electronic auctions

1. Member States may provide that contracting authorities may use electronic auctions.
2. In open, restricted or negotiated procedures in the case referred to in Article 30(1)(a), the contracting authorities may decide that the award of a public contract shall be preceded by an electronic auction when the contract specifications can be established with precision.

In the same circumstances, an electronic auction may be held on the reopening of competition among the parties to a framework agreement as provided for in the second indent of the second subparagraph of Article 32(4) and on the opening for competition of contracts to be awarded under the dynamic purchasing system referred to in Article 33.

The electronic auction shall be based:

- either solely on prices when the contract is awarded to the lowest price,
- or on prices and/or on the new values of the features of the tenders indicated in the specification when the contract is awarded to the most economically advantageous tender.

3. Contracting authorities which decide to hold an electronic auction shall state that fact in the contract notice.

The specifications shall include, inter alia, the following details:

- (a) the features, the values for which will be the subject of electronic auction, provided that such features are quantifiable and can be expressed in figures or percentages;
- (b) any limits on the values which may be submitted, as they result from the specifications relating to the subject of the contract;
- (c) the information which will be made available to tenderers in the course of the electronic auction and, where appropriate, when it will be made available to them;
- (d) the relevant information concerning the electronic auction process;
- (e) the conditions under which the tenderers will be able to bid and, in particular, the minimum differences which will, where appropriate, be required when bidding;
- (f) the relevant information concerning the electronic equipment used and the arrangements and technical specifications for connection.

4. Before proceeding with an electronic auction, contracting authorities shall make a full initial evaluation of the tenders in accordance with the award criterion/criteria set and with the weighting fixed for them.

All tenderers who have submitted admissible tenders shall be invited simultaneously by electronic means to submit new prices and/or new values; the invitation shall contain all relevant information concerning individual connection to the electronic equipment being used and shall state the date and time of the start of the electronic auction. The electronic auction may take place in a number of successive phases. The electronic auction may not start sooner than two working days after the date on which invitations are sent out.

5. When the contract is to be awarded on the basis of the most economically advantageous tender, the invitation shall be accompanied by the outcome of a full evaluation of the relevant tenderer, carried out in accordance with the weighting provided for in the first subparagraph of Article 53(2).

The invitation shall also state the mathematical formula to be used in the electronic auction to determine automatic rerankings on the basis of the new prices and/or new values submitted. That formula shall incorporate the weighting of all the criteria fixed to determine the most economically advantageous tender, as indicated in the contract notice or in the specifications; for that purpose, any ranges shall, however, be reduced beforehand to a specified value.

Where variants are authorised, a separate formula shall be provided for each variant.

6. Throughout each phase of an electronic auction the contracting authorities shall instantaneously communicate to all tenderers at least sufficient information to enable them to ascertain their relative rankings at any moment. They may also communicate other information concerning other prices or values submitted, provided that that is stated in the specifications. They may also at any time announce the number of participants in that phase of the auction. In no case, however, may they disclose the identities of the tenderers during any phase of an electronic auction.

7. Contracting authorities shall close an electronic auction in one or more of the following manners:

(a) in the invitation to take part in the auction they shall indicate the date and time fixed in advance;

(b) when they receive no more new prices or new values which meet the requirements concerning minimum differences. In that event, the contracting authorities shall state in the invitation to take part in the auction the time which they will allow to elapse after receiving the last submission before they close the electronic auction;

(c) when the number of phases in the auction, fixed in the invitation to take part in the auction, has been completed.

When the contracting authorities have decided to close an electronic auction in accordance with subparagraph (c), possibly in combination with the arrangements laid down in subparagraph (b), the invitation to take part in the auction shall indicate the timetable for each phase of the auction.

8. After closing an electronic auction contracting authorities shall award the contract in

accordance with Article 53 on the basis of the results of the electronic auction.

Contracting authorities may not have improper recourse to electronic auctions nor may they use them in such a way as to prevent, restrict or distort competition or to change the subject-matter of the contract, as put up for tender in the published contract notice and defined in the specification.