

**Congress of the United States**  
**Washington, DC 20515**

To: Members, Veterans Affairs' Committee's Subcommittee on Oversight and Investigations  
Members, Small Business Committee's Subcommittee on Contracting and Workforce

From: Committee Staff

Re: Joint Hearing: "Contracting Away Accountability – Reverse Auctions in Federal Agency Acquisitions."

Date: December 5, 2013

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On December 11, 2013, the House Veterans' Affairs Committee Subcommittee on Oversight and Investigations (O&I) and the House Small Business Committee Subcommittee on Contracting and Workforce will hold a joint oversight hearing titled "**Contracting Away Accountability – Reverse Auctions in Federal Agency Acquisitions.**" The hearing will begin at 10:00 AM in Cannon House Office Building room 334.

The purpose of this hearing will be to address serious problems with the use of reverse auctions by the Department of Veterans Affairs (VA) and other federal agencies. A reverse auction is a contracting process in which a buyer solicits bids from multiple sellers, in contrast to a standard auction where a seller solicits bids from multiple buyers. This hearing is the result of a two-year investigation conducted by O&I. Following O&I's collection of evidence, the findings were given to the Government Accountability Office (GAO) which substantiated the majority of the problems and drafted a report that will be released on Dec. 9, 2013, two days prior to the hearing.

Should you have any questions, please contact Eric Hannel, O&I Majority Staff Director, at 5-3569 or Emily Murphy, Senior Counsel, Committee on Small Business at 5-5821.

**WITNESS LIST**

**Panel 1**

**Mr. Nigel Cary**

President

Cox Construction Company

On behalf of the Association of General Contractors

**Mr. Louis J. Celli Jr.**

Director, Legislative Division

The American Legion

**Panel 2**

**Ms. Michelle Mackin**  
Director  
Acquisition and Sourcing Management  
Government Accountability Office

**Mr. Joseph Jordan**  
Administrator  
Office of Federal Procurement Policy  
Office of Management and Budget

**Mr. William Sisk**  
Deputy Commissioner  
Federal Acquisition Service  
General Services Administration

**Panel 3**

**Mr. Jan Frye**  
Deputy Assistant Secretary  
Office of Acquisitions and Logistics  
Department of Veterans Affairs

*Accompanied by:*

**Mr. Philip Matkovsky**  
Assistant Deputy Under Secretary for Health for Administrative Operations  
Veterans Health Administration

**I. Background**

Reverse auctions first gained popularity in the late 1990s, as Internet-based technologies allowed potential vendors to underbid each other in real time. Since then, they have grown to account for nearly one percent of federal prime contract dollars awarded each fiscal year.<sup>1</sup> While the Office of Federal Procurement Policy (OFPP) has been promising guidance on the use of reverse auction procurements since 2000, to date no guidance or regulations have been forthcoming, meaning that over \$828 million in procurements are awarded using a methodology never mentioned in the Federal Acquisition Regulation (FAR) or in statute.<sup>2</sup> Instead, OFPP and the

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<sup>1</sup> GAO, REVERSE AUCTIONS, GUIDANCE IS NEEDED TO MAXIMIZE COMPETITION AND ACHIEVE COST SAVINGS 2 GAO-14-108 (2013).

<sup>2</sup> Colleen O'Hara, "Reverse Auctions Move Forward," FEDERAL COMPUTER WEEK (Aug. 3, 2000) *available at* <http://fcw.com/articles/2000/08/03/reverse-auctions-move-forward.aspx>, quoting the OFPP Administrator as planning to "issue guidance to sharpen up the Federal Acquisition Regulation regarding reverse auctions."

Office of Management and Budget (OMB) have encouraged the use of reverse auctions without offering guidance on how to best use this methodology.<sup>3</sup>

Of the \$828 million in federal agency reverse auctions awarded in FY 2012, GAO reported that 99% were conducted by the same contractor, FedBid,<sup>4</sup> and VA awarded the greatest dollar value of these – over \$200 million. Due to this, for purposes of this hearing, the primary focus will be on the use of FedBid by VA, although similar issues arise when any agency chooses a nongovernmental entity to conduct reverse auctions on its behalf. This memorandum will examine the selection and compensation of FedBid, savings to VA when using FedBid, questions regarding competition, issues specific to small businesses, and whether additional guidance or legislation is necessary.

## **II. The Selection and Compensation of FedBid**

In choosing FedBid to conduct its reverse auctions, O&I found that VA did not solicit offers from any other contractors, contradicting the spirit of the Competition in Contracting Act of 1984, which requires that agencies fully compete contracts except in seven limited circumstances.<sup>5</sup> VA has signed three contracts with FedBid to perform these services, each contract containing an action obligation of \$1. Rather than VA paying a true contractual value for the services, FedBid is compensated by the fee (up to 3 percent) it adds onto the final award price of vendor contracts. As such, FedBid and federal agencies claim that use of FedBid is free to the government. However, when FedBid's fee is tacked onto the final award price of a contract, the seller is effectively passing on the fee to the government. Consequently, if VA is using a contract that already charges a fee for its use, it ends up paying two fees for these services: one for the use of the existing contract vehicle and another to pay FedBid its percentage.<sup>6</sup> Thus, GAO determined that in FY 2012, four agencies using FedBid paid \$1.3

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<sup>3</sup> See Robert Burton, Acting OFPP Administrator, "Utilization of Commercially Available Online Procurement Services" (May 12, 2004), *available at* [http://www.whitehouse.gov/sites/default/files/omb/assets/omb/procurement/publications/online\\_procurement\\_051204.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/omb/procurement/publications/online_procurement_051204.pdf); Paul Denett, OFPP Administrator, "Effective Practices for Enhancing Competition" (Jul. 18, 2008) *available at* [http://www.whitehouse.gov/sites/default/files/omb/procurement/memo/enhancing\\_competition\\_071808.pdf](http://www.whitehouse.gov/sites/default/files/omb/procurement/memo/enhancing_competition_071808.pdf); Jeffrey Zients, Deputy Director, OMB, "The Accountable Government Initiative" (Sept. 14, 2010) *available at* [http://www.whitehouse.gov/sites/default/files/omb/memoranda/2010/AccountableGovernmentInitiative\\_09142010.pdf](http://www.whitehouse.gov/sites/default/files/omb/memoranda/2010/AccountableGovernmentInitiative_09142010.pdf).

<sup>4</sup> FedBid is a Virginia company founded by Ali Saadat in 1999. In 2012, it secured "significant investment from Revolution Growth, a venture capital fund created by Steve Case, Ted Leonsis and Donn Davis." <http://www.fedbid.com/about/directors/> Mssrs. Case and Leonsis were the cofounders of AOL, and Mr. Leonsis is the owner of the Washington Wizards and Capitols. FedBid's Board of Directors includes General George Casey, Jr., former Army Chief of Staff, Mr. Leonsis, and Susan Bostrom, former CMO of Cisco. *Id.* Their list of advisors includes former political appointees of Presidents Clinton and George W. Bush, generals, admirals, and Members of Congress. <http://www.fedbid.com/about/advisors/>.

<sup>5</sup> Enacted as part of the Deficit Reduction Act of 1984, P.L. 98-369, §§ 2701-2753, 98 Stat. 1175 (1984), codified at 41 U.S.C. § 2304.

<sup>6</sup> The General Services Administration's (GSA's) Multiple Award Schedule (MAS) contracts carry a fee of 0.75 percent. Other Governmentwide Acquisition Contracts (GWACs), Multiple Award Contracts (MACs), Indefinite Delivery/Indefinite Quantity (ID/IQ) contracts and Multiple Award Task Order Contracts (MATOCs) may carry varying levels of fees.

million in fees to use MAS contracts, and another \$2.8 million in fees for FedBid to run the reverse auction against these same contracts.<sup>7</sup>

### **III. Savings**

The fees charged by FedBid to run reverse auctions for agencies may be acceptable if they are offset by otherwise unattainable savings, but this does not seem to be the case. Of the \$1.7 billion in federal and commercial auctions conducted by FedBid in FY 2013, FedBid claims to have saved its customers \$159 million – savings of about 8.5 percent, including fees.<sup>8</sup> In a briefing for subcommittee staff, FedBid stated that on VA construction contracts the savings rate actually exceeds 10%.

However, GAO rightly cautioned that all information related to fees and savings is provided by FedBid itself.<sup>9</sup> According to FedBid, it calculates its savings against the government's estimated target price.<sup>10</sup> Unfortunately, this calculation assumes the government is thoroughly researching its cost estimates, when for commercial items, the government frequently just reviews list prices.<sup>11</sup> As such, for commercial items, simply relying on published list prices is unlikely to result in the best price since volume discounts are frequently available.<sup>12</sup> Further, until April 2012, VA did not attempt any independent assessment of those savings, although guidance issued by VA now requires independent confirmation.<sup>13</sup>

### **IV. Competition of Reverse Auction Awards**

While competition itself would reasonably be expected to reduce the price paid by the government – this is the foundation of our procurement system – competition is frequently absent or not meaningful in some reverse auctions conducted by FedBid. In FY 2012, over one-third of reverse auctions conducted by FedBid for federal agencies had no interactive bidding, defined by GAO as “where vendors engage in multiple rounds of bidding against each other to drive prices lower.”<sup>14</sup> In 27 percent of auctions, there was only one bidder.<sup>15</sup> Further, in eight percent there were multiple bidders but only one round of offers – essentially, this was a sealed bid procurement.<sup>16</sup> However, agencies paid \$3.9 million in fees for these procurement services.<sup>17</sup> Perhaps even more problematic is the fact that for over 3,600 reverse auctions, \$1.7 million in fees was paid even though only one offer was received from one bidder – thus the government paid extra to award a sole source contract.

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<sup>7</sup> *Supra* note 1 at 20.

<sup>8</sup> <http://www.fedbid.com/about/resources/fact/>.

<sup>9</sup> *Supra* note 1 at 18-19.

<sup>10</sup> *Id.*

<sup>11</sup> DISA, INDEPENDENT GOVERNMENT COST ESTIMATES 2 (2009). “Commercial item cost estimates often come directly from published price lists obtained during the acquisition manager's market research.” *Id.*

<sup>12</sup> FAR § 8.405.

<sup>13</sup> Jan Frye, “Updated Policy and Procedures for Using Reverse Auctions (VAIQ 722015)” (April 3, 2012) *available at* <http://www.va.gov/oal/docs/business/pps/flash12-14attachment1.pdf>.

<sup>14</sup> *Supra* note 1 at 16.

<sup>15</sup> *Id.* at 16-17.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

## V. Inherently Governmental Functions

Another issue raised by the use of third party reverse auction providers deals with inherently governmental functions. According to the FAR, an action should only be undertaken by a federal employee if it could “[b]ind the United States to take or not to take some action by contract,” “[d]etermine, protect, and advance United States . . . interests by contract management,” or “[e]xert ultimate control over the acquisition, use, or disposition” of property or funds.<sup>18</sup> While FedBid does not itself award contracts, it is in a position of exercising functions closely associated with inherently governmental activities. For example, according to discussions with FedBid, any questions a vendor may wish to pose to a contracting officer must be submitted through FedBid. Likewise, FedBid states that it keeps independent past performance records on vendors which it shares with the government, including information regarding the creditworthiness of vendors, but does not share this information with the vendors.<sup>19</sup> Given the close hold a private company has over the award of a contract or task order, the fact that the actual award is signed by a contracting officer may not mitigate all of the inherently governmental aspects of the process.

## VI. Small Business Concerns

According to the Small Business Act, all contracts between \$3,000 and \$150,000 are exclusively reserved for small businesses, provided that there are two or more small businesses able to provide the good or service at a fair and reasonable price.<sup>20</sup> Further, in cases where the contract exceeds \$150,000, if two or more small businesses are able to compete for the contract, it is to be set aside for small business. Likewise, if there are two or more service-disabled veteran-owned small businesses (SDVOSBs), competition should be further restricted.<sup>21</sup> Approximately 80 percent of the dollars awarded using FedBid-administered reverse auctions were under \$150,000, and 86 percent of the contracts were awarded to small businesses.<sup>22</sup> However, given that items purchased using reverse auctions are supposed to be commercially available and not complex, one question is, why are all of these procurements not reserved for small businesses? Indeed, the Chief Counsel for Advocacy of the Small Business Administration (SBA Advocacy) sent a letter to OFPP stating that “some Federal agencies using reverse auctions may not be complying with the simplified acquisition threshold requirements for contracts to be reserved for small businesses.”<sup>23</sup> One of the issues may be that FedBid – as a commercial entity – does not have the authority to recommend that a contract be restricted to small businesses, and that small business advocates do not have the same level of oversight on third-party-facilitated contracts. In any case, given that these contracts are of a type and kind normally reserved for small business, additional care may be warranted.

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<sup>18</sup> FAR § 2.101; *see also* FAR § 7.5.

<sup>19</sup> FAR § 15.306. Further, if a contracting officer determines that a small business’s past performance make it unsuitable for award, it should refer that business to the Small Business Administration for review. FAR § 19.6.

<sup>20</sup> Section 15(j)(1).

<sup>21</sup> FAR § 19. For a more complete explanation, please see Committee on Small Business, “Small Business Act Programs for Small Federal Contractors (2013) *available at* [http://smallbusiness.house.gov/uploadedfiles/small\\_business\\_act\\_programs\\_for\\_small\\_federal\\_contractors.pdf](http://smallbusiness.house.gov/uploadedfiles/small_business_act_programs_for_small_federal_contractors.pdf)

<sup>22</sup> *Supra* note 1 at 9.

<sup>23</sup> Winslow Sargeant, Impact of Reverse Auctions on Small Businesses (2012), *available at* <http://www.sba.gov/advocacy/816/42071>.

## VII. Guidance and Legislation

In March 2012, Jan Frye, VA Deputy Assistant Secretary for the Office of Acquisitions and Logistics, suspended all use of FedBid due to a “‘ground swell’ of complaints from VA suppliers, . . . at least one protest, potential increased costs, small-business program anomalies, and ‘violations of our VA contract hierarchy.’”<sup>24</sup> Mr. Frye is quoted as saying that once the memorandum was released, there were “‘lobbying groups after me, . . . congressmen calling me, senators calling – it was unbelievable.”<sup>25</sup> VA reversed this decision one month later, issuing new guidance on the use of reverse auctions.<sup>26</sup> While the new guidance is an improvement, it may not be sufficient.

For example, the revised memorandum states that reverse auctions may be used only if price is the sole factor for award.<sup>27</sup> However, in recent staff briefings, FedBid stated that it conducted best value reverse auctions, which by definition consider factors other than price. Likewise, the new guidance does not take into account the comments of SBA Advocacy, nor its recommendations that all guidance must comply with the Small Business Act, and that reverse auctions should only be used for commodity – not service – contracts.<sup>28</sup> Further, it did not account for best practices, such as those establishing that reverse auctions should not be used for construction-related services.<sup>29</sup> Indeed, there is legislation pending before the Committee on Small Business that would restrict the use of reverse auctions for construction services contracts.<sup>30</sup>

Given that this is not simply a VA problem, the question then becomes why government wide guidance has not been provided. Congress directed OFPP to provide such guidance in 2005, stating that, “[t]he conferees direct the Administrator for Federal Procurement Policy, in consultation with the Federal Acquisition Regulatory Council established pursuant to section 25 of the Office of Federal Procurement Policy Act (41 U.S.C. 421), to review the use of online procurement services, such as reverse auction services, and identify: (1) types of commercial item procurements that are suitable for the use of such services; and (2) features that should be provided by online procurement services that are used by federal agencies.”<sup>31</sup> No guidance has been provided.

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<sup>24</sup> Mathew Weigelt, “VA Halts Reverse Auctions, Citing ‘Violations’ of Contract Hierarchy,” FEDERAL COMPUTER WEEK (Mar. 7, 2012) available at <http://fcw.com/articles/2012/03/07/va-halt-reverse-auctions.aspx>.

<sup>25</sup> Camille Tuutti, “VA Official Explains Decision to Halt Reverse Auctions,” FEDERAL COMPUTER WEEK (Apr. 26, 2012) available at <http://fcw.com/articles/2012/04/26/va-jan-frye-reverse-auctions.aspx>.

<sup>26</sup> *Supra* note 13.

<sup>27</sup> *Id.*

<sup>28</sup> *Supra* note 23.

<sup>29</sup> Army Corps of Engineers, FINAL REPORT ON THE USACE PILOT PROGRAM ON REVERSE AUCTIONING 11 (2004).

<sup>30</sup> H.R. 2751, the Commonsense Construction Contracting Act of 2013, introduced by Chairman Richard Hanna.

<sup>31</sup> H.R. Rep. 109-360 at 770 (2005).

### **VIII. Issues Before the Subcommittees**

In the course of the Joint Subcommittee hearing, the Subcommittees wish to obtain testimony regarding the following:

- Whether reverse auctions save money, and in what circumstances;
- Whether VA's use of reverse auctions violates the principle of an inherently governmental function, and if there are more appropriate ways to achieve the same benefits;
- Whether VA properly competed its use of reverse auction service providers;
- Whether VA maximized competition for awards of contracts and task orders under reverse auctions;
- How to prevent the misuse and abuse of reverse auctions as identified by the O&I/GAO investigation; and
- Whether additional guidance or legislation are necessary.

*Recommended reading (available upon request)*

- Draft GAO Report