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**BEFORE THE HOUSE SMALL BUSINESS COMMITTEE
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE**

March 19, 2015

Chairman Hanna, Ranking Member Velázquez, Chairman Chabot, Members of the Committee, good morning. I am grateful for the honor of being invited to testify before you today about electronic reverse auctions and other important procurement issues. I am the Senior Advisor to the Government Procurement Law Program at the George Washington University Law School, which has, for more than 50 years, been the premier venue for the studying and teaching of procurement law in this country.

Let me begin by commending you for focusing on the important topic of electronic reverse auctions, which are essentially auctions run through the Internet in which bidders offer successively lower prices. I have seen the importance of these reverse auctions in both the U.S. acquisition system and in procurement systems around the world in recent years, including in countries as diverse as Bangladesh, Macedonia, Brazil, and Russia.

In the U.S., perhaps the best report on the subject is the Government Accountability Office's December 2013 report, *Reverse Auctions: Guidance Is Needed to Maximize Competition and Achieve Cost Savings*, GAO-14-108. In that report, GAO looked at the use of reverse auctions in fiscal year 2012, and found that more than \$1 billion had been awarded in contracts through use of reverse auctions during that year. GAO focused on the five federal agencies that together used about 70 percent of the auctions in 2012: the Departments of the Army, Homeland Security, Interior, and Veterans Affairs, and the Defense Logistics Agency (DLA). Of those five, the first four all used the same vendor to run the auctions, and GAO was able to obtain detailed information on their use of auctions from that vendor; the fifth agency, DLA, bought a license to run its auctions without reliance on a vendor, but it lacked detailed data for GAO to review.

Both from my review of the GAO report and from what I have seen and heard, in the U.S. and abroad, I would suggest that use of electronic reverse auctions has brought benefits in three areas: savings, speed, and small businesses.

Savings: While GAO expressed concern that the exact amount of savings obtained is uncertain, there is no doubt that reverse auctions have led to a reduction in the amount of taxpayer funds spent on the commodity goods and services for which auctions were used. I have seen estimates of savings on the order of 10 to 20 percent, and sometimes higher, though GAO is right to point out that the way savings are measured can be problematic.

Speed: Reverse auctions can be conducted quickly, and they have contributed to a substantial improvement in efficiency in government procurement systems over the past 10 years, both in the U.S. and abroad.

Small businesses: GAO reported that 86% of the procurements in which reverse auctions were conducted were won by U.S. small businesses, which translated to 80% of the dollar value of the procurements. In its report, GAO notes this is consistent with the presumptive set-aside for U.S. small businesses under federal law for procurements under \$150,000. While it is thus not clear that use of reverse auctions increased the percentage of these procurements that would have otherwise been won by small businesses, the fact is that the great majority of the procurements went to U.S. small businesses.

In its report, GAO identified some challenges associated with use of electronic reverse auctions, and my experience, both in the U.S. and overseas, confirms that many users, or potential users, of auctions have wrestled with these issues. While I do not think that amending the Federal Acquisition Regulation is needed (in part because technology moves faster than the regulatory process), I very much concur with GAO's recommendation that the Office of Management and Budget issue guidance related to the issues discussed below (and in the GAO report).

Identifying procurements suitable for use of reverse auctions: Some users are tempted to conduct reverse auctions in almost every procurement; most recognize, however, that some procurements are suitable for auctions, while others are not. In terms of *what* is being bought, most people agree that auctions make the most sense when the government is buying commodities. Thus, GAO found that reverse auctions were used largely for commodity goods, in particular, information technology (IT) and medical equipment and supplies. Use of reverse auctions for the purchase of services is more controversial. While GAO was told that their use for buying services was increasing, in my view, auctions may not be a sensible way to conduct a procurement for services unless the services being bought are commodities, such as overnight delivery of packages.

Another metric, in terms of which procurements are suitable for auctions, is the dollar value of the procurement, but here the picture is somewhat complicated. GAO found that the four agencies for which it obtained detailed data were using auctions primarily for procurements valued below \$150,000 – while the guidance of the fifth agency, DLA, was to use auctions for purchases above that level. My sense is, in terms of whether a reverse auction is appropriate, that the question of what is being bought is more important than the value of the procurement.

Another metric, though, also needs to be considered. Some people believe that electronic reverse auctions can be used regardless of whether the government is focused on buying the lowest-price acceptable good or service, or whether, instead, the government wants to be able to conduct a tradeoff between multiple award criteria, including price and another factor, such as the bidder's past performance or the quality of its product. In my experience, auctions make the most sense when the government is focused on obtaining the lowest price – that is why commodities are the best candidates. As soon as the government is considering doing a tradeoff with a non-price factors, such as quality or past performance, I believe that the auction risks causing mischief. Where the government is concerned about quality, rather than simply buying a commodity, the

auction's focus on price may run counter to the government's goals. Especially when the government is buying professional services, the auction's focus on low price may be inconsistent with the government's interest. Moreover, if the company that wins the price auction may lose the competition for the contract, one needs to ask what the point of an auction is.

Addressing limited competition in the auctions: In the auctions that GAO reviewed for its report, and in procurement systems that I have looked at overseas, concerns have arisen due to limited competition in the auctions, which can call into question the value of the auctions. GAO found that in more than a third of the auctions it studied no competitive bidding took place at all: in 27 percent of the auctions, there was only one bidder, and in another 8 percent, while there was more than one bidder, none of them submitted more than one bid. In all of those cases, use of the Internet-based auction technique seems to have provided no benefit beyond that of the "sealed bidding" competition that the federal government has used for more than 100 years. Similarly, I learned that in one European country that I visited recently to discuss its procurement system, a high percentage of reverse auctions obtain only one bid. In my opinion, any competition for a government contract, whether run electronically or "the old fashioned way," that gets only one bid should be considered a failure. If the government is paying a fee to use an electronic reverse auction and only one bid is received, the government is paying a fee for that failed procurement. In that regard, GAO found that agencies had paid \$3.9 million in fees for reverse auctions in which there was no competitive bidding.

Considering the costs and benefits of using a private firm to run the auctions: Many U.S. agencies rely on a single private firm to conduct electronic reverse auctions for them. While in theory more than one company could provide that service, my experience is consistent with what GAO found, which is that one firm – FedBid, Inc. – conducted more than 99 percent of the reverse auctions listed in the government-wide database, FedBizOpps. FedBid has clearly brought benefits to the federal government: not only does it provide a good, ready-to-use platform for reverse auctions, but, as GAO notes, FedBid also relieves agencies of various administrative duties and it offers training and technical support. Overall, FedBid has played a key role in helping agencies obtain the cost and efficiency savings that reverse auctions can bring. Moreover, the fee that FedBid charges for its services may be viewed as quite reasonable: they are capped at three percent of the contract value, and the company waives its fee entirely in various situations.

The benefits that FedBid brings, however, need to be compared to the risks of use of a private-sector company playing a central role in a function that is closely associated with an inherently governmental function, the award of federal contracts. *See* Office of Federal Procurement Policy, *Performance of Inherently Governmental and Critical Functions*, Policy Letter 11-01 (Oct. 2011). As is often the case in situations where contractors perform functions closely associated with inherently governmental ones, the risks do not arise because of any defect or flaw in the company. On the contrary, the contractor – FedBid, in this case – may perform so well that agencies tend to defer to it even when they should not. Thus, FedBid correctly makes clear that the contracting agencies make all key acquisition decisions, from whether to use a reverse auction at all to what the award criteria are to which company actually wins the contract. Yet that deference, which is completely appropriate, is eroded when the company is plainly the expert in this area, and agency personnel are inclined to defer to the company – indeed, I suspect

that many federal contracting officials consider that letting FedBid take the lead is the whole point of using the company's services. Put another way, FedBid does its job so well that federal officials allow its role to expand into areas that should be the federal officials' responsibility.

Examples of this pattern are identified in GAO's report. For example, GAO found that agencies rely on FedBid to maintain data related to their reverse auctions, so that even GAO had to turn to FedBid to obtain the data that it needed for its report. Similarly, while FedBid clearly knows how much it is charging and who pays its fees, GAO found that agencies using FedBid's services often did not know how much they were paying, nor did they know, in some cases, that the agencies were paying FedBid at all. GAO also identified situations where agencies are paying two fees (one to FedBid, another to the agency that awarded the overarching contract being used), but the agencies were unaware of this.

These matters are not simply questions of confusion. Instead, they raise concern that any private-sector vendor fulfilling a function so closely associated with an inherently governmental one may have an organizational conflict of interest. FedBid, for example, has no corporate interest in clarifying confusion about whether agencies or vendors are paying its fees. Similarly, FedBid has a corporate interest in claiming that its services lead to large savings – but GAO questioned the accuracy of those claims. With regard to the important questions, explained above, of deciding whether a particular procurement is a good candidate for a reverse auction, a company that obtains a fee only if a reverse auction is conducted obviously has an interest in encouraging the use of auctions. Moreover, while an auction that obtains only one bid may be a failure for the competitive procurement system, it may not be a failure for a private-sector auction provider that obtains its fee, even in that flawed competition.

Regarding the reasonableness of FedBid's fee, agency personnel's misunderstanding of the fee and fee structure impedes their ability to judge whether the fee is reasonable. In the language of GAO's report, agencies "are not able to independently assess the cost effectiveness of reverse auctions." In this regard, I would point out that, while a fee capped at 3 percent may seem very reasonable for an auction that can lead to savings of 20 percent, those large savings are for the first time the auction is conducted. Obviously, the second time an auction is conducted for a particular item, it is unlikely that the price paid will drop an additional 20 percent, so that the savings will drop – but FedBid's fee will not, and paying 3 percent to obtain a much smaller amount of savings may seem less reasonable.

GAO also found that other companies had concerns related to FedBid's role in the federal acquisition process. Specifically, GAO heard complaints from vendors that FedBid "creates an additional layer between the vendor and the end user that can inhibit [vendors'] efforts to clarify details in the solicitation." Moreover, FedBid requires vendors that want to participate in a reverse auction to register with FedBid, and GAO heard that some vendors did not want to register with another vendor. GAO noted that this issue could reduce competition for federal contracts.

In my judgment, we would be well advised to re-visit the role that a private-sector company should play in the conduct of federal reverse auctions. I say that with full appreciation for the excellent work that FedBid has performed for the federal government for many years. The

Committee may be interested to know that in many other countries, large and small, electronic reverse auctions for government contracts are successfully conducted without reliance on a private-sector company to run them. For example, I learned recently that the small nation of Macedonia routinely conducts a large number of reverse auctions each year, run solely by government staff. Closer to home, I am pleased to see that GSA has now launched its own reverse auction program, within the context of the Federal Supply Schedule. Notably, GSA has announced that user agencies will not pay any additional fee for use of the reverse auction platform.

If a private-sector company continues to conduct reverse auctions for federal agencies, I believe that it is critical that agencies ensure that their staff are properly trained and equipped to supervise the private-sector provider. That training must ensure that agency personnel do not abdicate their responsibility for key decisions, such as deciding which procurements are appropriate candidates for reverse auctions and what the award criteria should be, as well as for collecting and maintaining data. Agency personnel must also ensure that they have the information needed to make informed decisions about the cost and benefits of conducting reverse auctions.

In conclusion, I would again commend the Committee for your work in this important, but challenging, area, and thank you for the opportunity to appear before you today. I would be pleased to respond to any questions you may have.