

Reverse Auctions

Written by Nick Sanders
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In a reverse auction, the traditional roles of buyer and seller are reversed. The sellers compete to obtain business by offering progressively lower prices. Wikipedia notes:

A reverse auction is different in that a single buyer offers a contract out for bidding (by either using specialized software or through an online marketplace). Multiple sellers are then able to offer bids on the contract. As the auction progresses, the price decreases as sellers compete to offer lower bids than their competitors whilst still meeting all of the specifications of the original contract. As the buyer is able to see all of the sellers' offers, and to choose any of them, a reverse auction is not a true auction.

Wikipedia also offers this synopsis of the Government's use of reverse auctions to acquire goods and services—

In 2004, the White House Office of Federal Procurement Policy (OFPP) issued a memorandum encouraging increased use of commercially available online procurement tools, including reverse auctions. In 2005, both the Government Accountability Office and Court of Federal Claims upheld the legality of Federal agency use of online reverse auctions. In 2008, OFPP issued a governmentwide memorandum encouraging agencies to improve and increase competitive procurement and included specific examples of competition best practices, including reverse auctions. In 2010, The White House Office of Management and Budget cited 'continued implementation of innovative procurement methods, such as the use of web-based electronic reverse auctions' as one of the contracting reforms helping agencies meet acquisition savings goals

More recently, the Defense Logistics Agency [announced](#) that reverse auctions would henceforth become *mandatory* for

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all negotiated, competitive, procurements valued in excess of \$150,000. The DLA announcement reported—

The agency has saved more than \$34 million through reverse auctions since fiscal 2010, when contracting officers began tracking savings from reverse auctions. Most of the savings stems from about 400 auctions held so far in fiscal 2012, said Charles Howerton, a procurement and systems analyst for the DLA Acquisition Programs and Industrial Capabilities Division. ...

Reverse auctions were designed specifically to increase competition and reduce government costs, Howerton said, adding that contractors who say the tool diminishes profits are wrong. Rather, it forces contractors to be more efficient and offer items and services at the best possible price.

‘Reverse auctions provide incentive for suppliers who are able to restructure their internal operating procedures and costs,’ he said. It can help them make their operations more efficient and cost effective. It’s a win-win.’

Enabling contractors to see the amount others are bidding often leads to tough decisions on the contractor’s end, Howerton continued. For example, a contractor that’s been doing business with DLA for several years and sees another contractor bidding for the same business at a lower cost will have to reconsider everything from production processes to prices.

‘That contractor will have to ask, ‘Can I make money selling my product at the same price as the lowest bidder or not?’ If they’re thinking long-term and strategically, they’ll make the best choice to get their internal operations as efficient as possible if it means keeping their business,’ he said.

The problem with reverse auctions is that they lack full transparency. The sellers know that *so*

mebody is underbidding their proposed price, but not necessarily who is doing so. This situation creates the opportunity for “phantom bids” —

i.e.

, bids submitted by Federal buyers whose sole intent it to generate “savings” for their agency by forcing the prices lower and lower.

How likely is the possibility of Government-submitted phantom bids? It’s difficult to determine because the goal of such behavior is not to be the winning bidder but, instead, to be the *next*

higher bidder. That way their name won’t be disclosed and nobody will know that the price was driven down by fraudulent bids. (The bids are fraudulent, of course, because the Government bidder has no intention of fulfilling the order. Indeed, the Government bidder

cannot

fulfill the order.)

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We are relatively confident that this situation has happened at least once. Writing on the [WIF CON blog](#), “Don Acquisition” reported—

... Although [a contractor] submitted several bids, he ultimately lost the reverse auction. When he checked to see who had won, he was surprised to see that the federal agency that was in need of the required items was the low bidder. In other words, the federal agency was submitting bogus bids in an effort to get the contractor to reduce his bid price. The federal agency then contacted him and offered to purchase the items from the contractor at his lowest bid price. Feeling that he had been duped, he told them to get lost.

The tactic employed by the federal agency, called phantom bidding, is not new. Many view the practice as unethical while others see it as a legitimate tactic. In regular auctions, the legality of seller participation in bidding varies from state to state. For those states that allow it, sellers typically must disclose that they reserve the right to participate in the bidding.

“Don Acquisition” also quoted the defrauded contractor as follows—

In this particular case, whenever we resubmitted the bid, we were shown to be in the lead for a short period of time, then lagged again, so ‘Someone’ was entering a bid in response to our reduction. At the conclusion of bidding, we found out there were no other (genuine) bidders.

This is a good time to remind readers of the Executive Branch requirement that the Federal Acquisition System will “conduct business with integrity, fairness, and openness.”

To conclude, we have a couple of thoughts about DLA’s decision to mandate use of on-line reverse auctions for competitive, negotiated, procurements valued at \$150,000 or more. First, since the rationale for that decision is to continue to generate reported savings from use of that approach, we hope that the DLA has made sure the reported savings amounts weren’t increased by use of fraudulent bids. Second, we are concerned about use of reverse auctions for more complex items and services (*i.e.*, those valued in excess of \$150,000) because using price as the sole criterion skips over such key evaluation criteria as past performance and technical quality. Third, as DLA moves out on this initiative we sincerely hope agency leadership issues policy guidance to buyers, prohibiting them from employing such nefarious tactics as submitting fraudulent “phantom bids” with the sole purpose of driving down the price, and generating savings that will look nice on monthly and quarterly reports.