



## *A Contractor's Guide to Reverse Auctions*

**Reverse Auctions: What are they?** Reverse auctions (also commonly referred to as 'competitive bidding events'), are an Internet-based method of bidding for the supply of goods and services. The growing use of electronic commerce has resulted in some owners/purchasers exploring use of this procurement method, including the procurement of construction services. The intent of reverse auctions is to hold a live, on-line bidding competition, whereby the successful bidder is determined by the lowest price submitted to the tendering authority at the conclusion of the auction.

**How do they work?** When used for the procurement of construction services, the following process is typically followed (based on recently conducted events):

- The owner develops a list of pre-qualified bidders (contractors) and invites them to participate in the reverse auction. Drawings and specifications, along with instructions on how to participate in the reverse auction, are provided to the bidder in advance of the event.
- An online, Internet-based auction is scheduled and conducted on behalf of the owner by a third-party service provider, with all bidders participating simultaneously, with a specified start and closing time. A reserve price may be stipulated by the owner, usually based on a consultant's estimate.
- All bidder identities are kept confidential during the reverse auction event.
- The bidders submit initial prices once the reverse auction begins, and submitted prices are ranked (lowest dollar value bid results in highest ranking) and then communicated back to all participating bidders, with the bidder being told of their own ranking relative to others.
- Bidders can re-submit new lower prices (a minimum increment may be stipulated) as many times as they wish up to the specified closing time, with new rankings communicated back to all bidders as new bids are made.
- An extension of the auction closing time can be triggered for a pre-determined amount of time if one of the top bid rankings change (usually one of the top three ranked bids).
- The auction closes once no more new bids are placed and the original or extended closing time expires.
- All bidders are immediately notified of the final bid rankings, with only the dollar value of the winning bid disclosed.
- The owner is notified of the bidding results by the auction service provider, who then initiates the appropriate follow-up with the winning bidder to complete the formal award of the contract.

Variations of this process exist, as determined by the owner in consultation with the auction service provider and the owner's policy for the use and conduct of reverse auctions.

**Why should reverse auctions not be used for construction?** The Canadian Construction Association (CCA), in consultation with its Standard Practices Committee, General Contractors Council, Trade Contractors Council and many local construction associations across Canada, has expressed grave concerns with respect to the use of reverse auctions for the procurement of construction services.

The CCA recognizes the value and benefits of Internet-based bidding and endorses its use when intended to increase the competitiveness and efficiency of the construction tendering process. In this regard, CCA is currently working with owners, contractors and other construction industry representatives to develop appropriate guidelines for the use of electronic bidding practices. However, the concept of a bidding auction is a radical departure from the principles of recommended construction procurement practices, and as such, is strongly opposed by CCA and its constituent representatives.

The construction industry's objection to reverse auctions stems from many risks and pitfalls associated with their use. As a contractor who may be invited to bid on a project using a reverse auction, you should be aware of the following:

- Reverse auctions do not respect the prevailing industry practices for construction procurement. The industry has long-recognized practices for traditional design-bid-build construction bidding, stipulated in documents such as *CCDC 23 'A Guide to Calling Bids and Awarding Contracts'* and *CCDC 29 'A Guide on Standard Contracting and Bidding Procedures'*. Both of these guides (prepared in close consultation with the industry, contractors, public and private owners and the design community) advocate best practices which are specifically developed and used for construction procurement. Reverse auctions disregard these recommended practices.
- Owners, contractors and design professionals are familiar with the traditional bidding process and clearly know what obligations they must meet in order to fulfil their responsibilities. The reverse auction process is not designed for construction procurement, thus its use creates greater likelihood of disputes, bad faith and an increased risk of claims. By respecting prevailing industry bidding practices, owners demonstrate commitment to the project and lend greater credibility.
- Under traditional bidding practices, the owner is receiving a contractor's absolute best 'competitive' price outright for providing the services required. Internet auctions encourage contractors to initially submit artificially inflated prices, knowing that there will be an opportunity to re-submit a more competitive price. As a result, an owner runs the risk of not receiving the contractor's best competitive price. In other cases, this can also lead to 'cut-throat' pricing by contractors, inevitably forcing them to cut corners to cover the difference from their best competitive price and invites greater potential to compromise the quality of a project.
- Traditional bidding practices have mechanisms in place to deal with governing laws and regulations, bid and contract security, mistaken bids, issuance of addenda, etc. Reverse auctions may be governed by the laws of the location of the auction's service provider, which is often remote from the actual construction project's or owner's location.
- The extension of bid closing times and the ability to re-submit prices as allowed by reverse auctions can be interpreted as a form of pre-closing negotiation or bid shopping, which is discouraged within the industry as it compromises the spirit of a fair and open competitive process. Moreover, for public owners reverse auctions may contradict certain existing and proposed trade agreements.

***Are reverse auctions suitable for some procurement?*** Reverse auctions can be suitable for the procurement of supplies and materials, but not when combined with construction services. A supplier of stand-alone office products or automobiles, for example, can easily establish their absolute minimum prices and profit margins, as these products are often catalogue items, with easily predetermined unit costs for production and delivery. Construction materials and services for a project, on the other hand, are always considered as a prototype. The scope of each construction project has a different set of factors (such as program, project location, site conditions, local codes and permit fees, material changes/availability, fluctuating labour conditions, etc.) which effect the contractor's bid estimate and an acceptable minimum profit margin.

***What should contractors do when asked to participate in a reverse auction?*** Local construction associations and the CCA are eager to assist contractors in working with owners to dissuade their use of reverse auctions. CCA and its partners have already been successful in convincing a number of owners to abandon their planned use of a reverse auction event, and is willing to implement similar actions when new cases arise. **Should you become aware of or asked to participate in a reverse auction event, you are strongly encouraged to contact your local association and provide as much information as possible on the reverse auction (owner and project details, list of invited bidders, auction service provider, rules for conduct of the event).**

Both your local association and CCA will correspond with the owner to voice their objection to the use of the reverse auction, recommend the use prevailing procurement practices and offer assistance to the owner in establishing a preferred procurement solution. Part of this process may also include a strategy involving all invited bidders to collectively persuade the owner to use a traditional bidding process, without compromising the existing rapport that some contractors may have with the owner. It is important to remember that a reverse auction will not take place unless bidders agree to participate!

**Note:** *CCDC 23 'A Guide to Calling Bids and Awarding Contracts'* and *CCDC 29 'A Guide on Standard Contracting and Bidding Procedures'* are endorsed for use by the Association of Consulting Engineers of Canada, Construction Specifications Canada, the Royal Architectural Institute of Canada and the Canadian Construction Association.