PP007 – Reverse Auction

Introduction

A Reverse Auction is a method of construction procurement arranged by the Obligee that involves a live online bidding competition which allows interested bidders to review the most recent accepted bid and submit a lower bid until either a desired price is obtained, or a fixed time limit expires.

Background

In the late 1990s, reverse auctions were introduced in Canada as an alternative method of construction procurement and as a substitute to the open tender process. The reverse auction practice originated from large manufacturing industrial firms in the United States and was originally used for the purchase of goods and supplies before being expanded into the construction procurement area.

SAC Position

Construction groups across Canada, including the Canadian Construction Association (CCA - http://www.cca-acc.com/), have strongly discouraged the use of reverse auctions as a method of construction procurement. The Surety Association of Canada (SAC) supports the construction community and believes that while reverse auctions may be suitable for the purchase of certain types of supplies and services, it is inappropriate for construction procurement. Similar to the construction community's position, SAC believes that this approach to construction procurement does a disservice to both the Obligee and Principal for a number of reasons, primarily:

1. Best Price

Under traditional bidding practices, a Principal has one opportunity to submit its best compliant bid price for the tendered project to the Obligee. Internet auctions allow Principals to submit multiple bid prices, knowing that there will be opportunities to re-submit lower bid prices prior to the expiry of the fixed time limit, as determined by the Obligee.

In instances where the Obligee selection method is based on target bid price, the bidding period may end before bidders have submitted their lowest prices.

Under both scenarios, the Obligee could end up paying more for the tendered project than if the traditional bidding methods had been used.

There is also a risk that the Principal may end up pricing the project too low to fend off competing bidders which could compromise the quality of workmanship to ensure a profitable return.

2. Traditional Bidding Practices Work

Traditional bidding practices have mechanisms in place to deal with governing laws and regulations, bid and contract security, mistaken bids, issuance of addenda, etc. These precedents do not apply to reverse auctions. The lack of these precedents could cause legal and other related problems for both the Obligee and the Principal.

3. Not Designed for Construction Contracts

Obligees, Principals and professional consultants are familiar with traditional bidding processes and standards, and clearly know the contractual obligations and responsibilities. Because reverse auctions were originally structured for the purchase of goods and/or services, the contract documents and processes may not address specific construction issues such as disputes and accusations of bad faith which can lead to an increased risk of claims. By respecting the prevailing industry bidding practices, Obligees should have confidence that the bidding process and contract terms are standardized and provide more security to them.

4. Lowest Cost May Not Be the Best Value

The nature of the reverse auction process implies a commitment by the Obligee to award based on the lowest bid price in lieu of "best value" or "best qualified" Principal. There may be no consideration of the lifecycle costs of the project which could lead to an increase in overall costs for the owner during the life of the project.

5. Bid Shopping

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 Obligees, reverse auctions may contradict the provisions of certain existing and/or proposed trade agreements.

6. Best Practices

The construction industry has long-recognized best practices for traditional design-build construction tenders which are disregarded in a reverse auction procurement method. These best practices are outlined stipulated in CCDC 23 "A Guide to Calling Bids and Awarding Contracts" (see www.ccdc.org for more information). This guide was prepared in close consultation with industry stakeholders (Principals, public/private Obligees, and professional consultants)

Summary

While the use of reverse auctions as a construction procurement method has declined in recent years, they are still used occasionally by Obligees. The Surety Association of Canada encourages Obligees, Principals and professional consultants to favour the traditional construction industry bidding practices.

Glossary of Terms

Obligee

An individual or organization in whose favour an obligation is created and to whom a bond is given.

Principal

The individual or organization that bears the primary responsibility for fulfilling the obligation under the written contract referenced in the bond and that has the duty to perform for the Obligee’s benefit.

Surety

The party to a surety bond who answers to the Obligee for the Principal's default or failure to perform as required by the underlying contract, permit or law.

This paper is intended to serve as a general guideline to assist members and other readers in responding to the issues discussed. Nothing contained herein should be construed as legal advice and readers are cautioned to consult with legal counsel for such advice.

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