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## A Case Study in Comparative Procurement Law: Assessing UNCITRAL's Lessons for U.S. Procurement

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## PREFACE

I am pleased and deeply honored to introduce this, the *Public Contract Law Journal's* first international special-subject issue.

First, of course, we need to turn to the obvious question: Why an international issue, for a journal (and an ABA section, for that matter) that has traditionally focused on federal, state, and local procurement? The answer, of course, is that the broader world of procurement is rapidly changing, as the world seems to grow smaller by the day.

The gathering changes in international law will impact U.S. public procurement on a day-to-day basis, as the United States enters into more bilateral and plurilateral treaties that govern procurement practices, and as those treaties' norms become more tightly bound to the U.S. regulatory regime. In a few short years, none of us should be surprised if foreign vendors are bringing protests in U.S. forums, grounded not in the Federal Acquisition Regulation but rather in international commitments to open U.S. procurement markets (including, in some instances, state and local markets) to competition from the United States' trusted trading partners. This volume, with essays on new treaties and harmonization initiatives around the world, points the way forward to that future.

At the same time, U.S. exporters, for their part, are looking abroad for emerging opportunities in global markets. These new initiatives present U.S. lawyers with a stark choice: U.S. procurement attorneys can either broaden their practices with their clients' global ambitions or remain rooted here in the United States. My guess is that they'll choose the more challenging path; Americans always have. This issue of the *Public Contract Law Journal*, which includes essays on many different foreign procurement systems, is a first step towards an expanded span of inquiry for the *Journal*, as we anticipate and accommodate our readers' needs for a wider window on procurement systems around the world.

Beyond issues of international and foreign law, we have tried in this issue to open the way to serious comparative assessments of public procurement law. One vital aspect of comparative law is to look abroad to better understand one's own laws. At a time when U.S. procurement law seems to be in a funk, caught between waves of reform, looking abroad to other systems for lessons for our own may be the best medicine. Our hope, then, is that this issue of the *Journal* will help show the way forward for improvements in the procurement system here in the United States.

Finally comes the praise for assembling this special issue, much of which goes to Rebecca Pearson, who steered this volume for over a year, and to our soon-departing student editor-in-chief Adelicia Cliffe Taylor, who has worked so hard on this issue with the GWU Law student staff. Were it not for them, this volume would not exist, and the procurement community owes them a great debt.

In this same vein, I would like to close on a personal note. In the coming months, Carl Vacketta, who has headed the *Journal* through many years of extraordinary growth, will be passing the reins to Karen Manos. All of us in the procurement bar owe Carl a great deal for those years of hard work. Through his

cheerful leadership and thoughtful appreciation for scholarship, he has helped make the *Journal* what we all hope it will be for a very long time: one of the world's leading forums for exchanging ideas about public procurement law. From all of us, a very heartfelt thank you, Carl.

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A CASE STUDY IN COMPARATIVE PROCUREMENT LAW:  
ASSESSING UNCITRAL’S LESSONS FOR U.S.  
PROCUREMENT

*Christopher R. Yukins*

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SYNOPSIS

The United Nations Commission on International Trade Law (UNCITRAL) has commissioned a working group, with delegations from many industrialized and developing nations, to reform and update the UNCITRAL Model Law on Procurement of Goods, Construction and Services. The working group is currently reviewing reforms on a number of fronts. This essay focuses on three areas of reform in particular—electronic communications, electronic reverse auctions, and unrealistically low bidding—to gauge whether lessons from the UNCITRAL debate may be useful for reform in the U.S. procurement system. As the essay reflects, the international debate surrounding UNCITRAL reform does in fact yield many lessons for U.S. policymakers. Indeed, the analysis suggests that the U.S. system may be at a point where it would be irresponsible not to consider comparative lessons from reforms abroad, to ensure that U.S. procurement policy draws thoughtfully upon lessons learned from other procurement systems around the world.

I. INTRODUCTION

Since 2004, the United Nations Commission on International Trade Law (UNCITRAL) has been working to update the 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services (the “Model Pro-

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curement Law”).<sup>1</sup> UNCITRAL has entrusted that reform effort to a working group, which began its work in Vienna in August–September 2004,<sup>2</sup> continued in New York in April 2005,<sup>3</sup> and reconvened in Vienna in November 2005.<sup>4</sup> The next scheduled meeting of the working group is to be in New York in April 2006. What is striking about the UNCITRAL reform effort is not that U.S. procurement law has much to contribute to the working group (that is hardly surprising, given many decades of experience in the U.S. procurement system<sup>5</sup>), but instead that the UNCITRAL debate has so much to offer U.S. procurement reform. To show why, this essay reviews three areas of focus in the current UNCITRAL effort: electronic communications, electronic reverse auctions, and abnormally low (or “unrealistically low”) bidding. In each case, as the discussion below reflects, the international reform effort yields important lessons for the United States. What this suggests, then, is that as procurement grows more international, it may prove irresponsible *not* to consider lessons from abroad if we are to build sensible reforms in the U.S. procurement system.

1. For background on the 1994 model law, U.N. Doc. No. A/49/17 and Corr. 1 annex I, see James J. Myers, *The New UNCITRAL Model Law on Procurement*, 23 PUB. CONT. L.J. 267 (1994). References to the United Nations documents throughout this article (the “A/-series” documents) are to the working papers and reports of UNCITRAL Working Group I, available at <http://www.uncitral.org> (specifically [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html)). For previous discussions of the UNCITRAL developments, see Don Wallace’s essay on UNCITRAL: in this issue, and Christopher R. Yukins & Don Wallace Jr., *UNCITRAL Considers Electronic Reverse Auctions, as Comparative Public Procurement Comes of Age in the United States*, 4 PUB. PROCUREMENT L. REV. 183 (2005); Christopher R. Yukins et al., *UNCITRAL Model Procurement Law: Reforming Electronic Procurement, Reverse Auctions, and Framework Agreements*, 40 PROCUREMENT LAW. 12 (Winter 2005) (Am. Bar Ass’n); Don Wallace Jr. & Christopher R. Yukins, *UNCITRAL’s Model Procurement Law: Changes on the Horizon*, 81 FED. CONT. REP. (BNA) No. 11, Mar. 23, 2004. Drafts of those earlier pieces are generally available on the Social Science Research Network website, <http://www.ssrn.com>. This essay is based in part on earlier technical reports on the November 2005 meeting of the UNCITRAL working group, prepared with Don Wallace Jr. and Jason Matechak for the American Bar Association’s Section of International Law (for an upcoming issue of the *International Lawyer*), and with Professor Laurence Folliot-Lalliot, *Révision de la Loi Type sur les Marchés Publics de la CNUDCI*, CONT. PUB., No. 51, Jan. 2006. The author gratefully acknowledges Daniel Gordon for his assistance with the latter report, and Adelia Cliffe Taylor, of the *Public Contract Law Journal*, for her patient help with this essay. Any errors herein are, of course, the author’s own.

2. See UNCITRAL, *Report of Working Group I (Procurement) on the Work of Its Sixth Session (Vienna, 30 August–3 September 2004)*, U.N. Doc. No. A/CN.9/568 (Sept. 17, 2004), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html).

3. See UNCITRAL, *Report of Working Group I (Procurement) on the Work of Its Seventh Session (New York, 4–8 April 2005)*, U.N. Doc. No. A/CN.9/575 (Apr. 12, 2005), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html).

4. See UNCITRAL, *Report of Working Group I (Procurement) on the Work of Its Eighth Session (Vienna, 7–11 November 2005)*, U.N. Doc. No. A/CN.9/590 (Nov. 18, 2005) (draft, on file with author), to be available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html).

5. See, e.g., Anne Janet DeAses, Note, *Developing Countries: Increasing Transparency and Other Methods of Eliminating Corruption in the Public Procurement Process*, 34 PUB. CONT. L.J. 553 (2005) (discussing U.S. lessons for anticorruption efforts worldwide).

## II. ELECTRONIC COMMUNICATIONS IN PUBLIC PROCUREMENT: FUNCTIONAL EQUIVALENCE AND "ACCESSIBILITY"

The first topic taken up by the Working Group was electronic communications in public procurement. This is not a controversial issue, as many procurement processes, especially in the developed world, have shifted to electronic media, most often the Internet. The purposes of this initiative under the Model Procurement Law are to bring the model law up to date and, even if only indirectly, to encourage nations that rely on the Model Procurement Law to use electronic communications for procurement.

In undertaking this initiative, the Working Group has deferred to the work being done under the UNCITRAL Model Law on Electronic Commerce.<sup>6</sup> In keeping with the Model Law on Electronic Commerce, the proposed changes to the Model Law are to reflect the principles of *functional equivalence* between electronic communications and traditional paper-based transactions and *technological neutrality* between different types of technology solutions.<sup>7</sup>

Because the UNCITRAL procurement law will largely defer to the UNCITRAL initiatives in electronic commerce, most of the proposed changes regarding electronic communications are not to be in the UNCITRAL Model Law itself,<sup>8</sup> but instead are to go to the accompanying *Guide to Enactment* for the UNCITRAL Model Law. The *Guide to Enactment* would note that, at the time the Model Law was adopted in 1994, electronic communications were still not broadly used in procurement.<sup>9</sup> That has changed, and the *Guide to Enactment* would be updated to ensure that electronic communications are adopted smoothly, without causing discrimination among vendors due to lack of access; without threatening basic principles of security, confidentiality, and authenticity in electronic communications; and without undermining existing socioeconomic goals in procurement.<sup>10</sup> And the proposed changes to the Model Procurement Law itself would mean that "any requirement for writing, for a record or for a meeting" under the Model Procurement Law could be met using electronic communications.<sup>11</sup>

To update the Model Procurement Law to accommodate electronic commerce, the Working Group was presented with three possible amendments

6. Available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/1996\\_Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/1996_Model.html).

7. See UNCITRAL, *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services—Drafting Materials Addressing the Use of Electronic Communications in Public Procurement—Note by the Secretariat*, U.N. Doc. No. A/CN.9/GW.I/WP.38, ¶¶ 14–17 (July 19, 2005), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1/Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1/Procurement.html); U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 19 (citing U.N. Doc. No. A/CN.9/575, *supra* note 3, ¶ 12).

8. Available at <http://www.uncitral.org/pdf/english/texts/procurem/ml-procurement/ml-procure.pdf>.

9. See U.N. Doc. No. A/CN.9/WG.I/WP.38, *supra* note 7, ¶ 23.

10. *Id.*, ¶¶ 1–4.

11. *Id.*, ¶ 13.

to the Model Procurement Law. All three variants would confirm that electronic means of communication are sufficient for public procurement, and all three would caution that electronic means will not, in practice, work to discriminate against certain vendors.<sup>12</sup> Of the three, the version that gained the most support at the Vienna meeting<sup>13</sup> read as follows:

Article 4 bis. Functional equivalence of all methods of communicating, publishing, exchanging or storing information or documents

(1) Any provision of this Law related to writing, to a record or to a meeting shall be interpreted to include electronic, optical or comparable means, [including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy] [*provided that the enacting State or procuring entity is satisfied that such use:*

(a) [Does not represent an obstacle to the procurement process] [uses means of communication generally available];

(b) Promotes economy and efficiency in the procurement process; and

(c) Will not result in discrimination among or against potential suppliers or contractors or otherwise substantially limit competition] [*provided that the enacting State or procuring entity is satisfied that such use complies with the accessibility standards contained in article [article 4 bis or 5 bis].*] . . .<sup>14</sup>

Controversy arose on this proposed provision at the November 2005 meeting. Because the italicized language seems to leave it to the procuring agency to assess the discriminatory impact that electronic communications might have (against new or foreign bidders, for example), the proposed language was criticized by some in the Working Group. The proposed language might be read to vest agencies with subjective authority to determine whether a proposed means of electronic communication will not raise a barrier to entry, will promote efficiency and economy, and will not have a discriminatory impact on prospective vendors. This discretionary authority might be read too broadly in a subsequent bid challenge (protest); this could, in practice, insulate (for example) a state's discriminatory efforts to use electronic communications to exclude vendors.<sup>15</sup>

At the earlier April 2005 meeting in New York, the Working Group concluded that the procuring entity (i.e., agency) should have the right to select the form of communication to be used (electronic or nonelectronic), and that the procuring entity should not have to justify its choice.<sup>16</sup> Those points were, at the time, relatively uncontroversial. By adding the proposed text outlined above, which would vest additional, subjective discretion in the procuring entity to determine whether the electronic means chosen were truly "acces-

12. See *id.*, ¶ 26.

13. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 22.

14. See U.N. Doc. No. A/CN.9/WG.I/WP.38, *supra* note 7, ¶¶ 25, 28 (emphasis added). The version quoted above was presented as "Variant B."

15. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 24.

16. See U.N. Doc. No. A/CN.9/575, *supra* note 3, ¶¶ 32–33.

sible,” the proposed language may go too far: it could allow the procuring entity to choose the means of communication, without justification, and would allow the procuring entity to reach a subjective (and presumably undocumented) conclusion as to whether those communications were truly “accessible.” As a result of discussions held at the November 2005 meeting, the Working Group concluded that it may be better to delete the language italicized above, so that an *objective* test (rather than the procuring agency’s subjective belief) would govern.<sup>17</sup> Final language will be addressed at the Working Group’s meeting in April 2006, in New York.

What does the UNCITRAL debate have to teach the U.S. procurement system? It shows that there was a gap in the reforms of the 1990s, when, to accommodate the ill-fated Federal Acquisition Computer Network (FACNET) launched by the Federal Acquisition Streamlining Act of 1994,<sup>18</sup> the Federal Acquisition Regulation (FAR) was amended to allow for electronic communications in procurement.<sup>19</sup> While subsequent decisions from the Government Accountability Office (GAO) have confirmed agencies’ reasonable discretion to choose electronic methods of procurement,<sup>20</sup> and the GAO has generally protected agencies from liability for failures in electronic procurement,<sup>21</sup> the statutes, regulations, and subsequent decisions have never truly resolved the issue addressed by the UNCITRAL working group: that the choice of electronic means in procurement may well discriminate against some potential offerors in a deeply anticompetitive way.

That discriminatory issue—the anticompetitive impact of using new modes of electronic procurement—may well come to a head with encryption technologies, an issue that the GAO and the U.S. Court of Federal Claims (the main U.S. bid challenge forums) have not yet had to address.<sup>22</sup> Here, the

17. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 24.

18. 41 U.S.C. § 426(a) (2000) (“The head of each executive agency, after consulting with the Administrator, shall establish, maintain, and use, to the maximum extent that is practicable and cost-effective, procedures and processes that employ electronic commerce in the conduct and administration of its procurement system.”); see Christopher R. Yukins, *FACNET: Has Congress Struck a Mortal Blow?* WASH. TECH., Jan. 12, 1998; Christopher R. Yukins, *Managing Electronic Commerce on the Federal Acquisition Computer Network (FACNET)*, 27:1 NAT. CONT. MGT. J. (1996).

19. See, e.g., 61 Fed. Reg. 64,916 (1997) (final rule liberalizing regulations regarding electronic commerce in federal procurement).

20. See, e.g., Commonwealth Indus. Specialties, Inc., Comp. Gen. B-277833, Nov. 25, 1997, 97-2 CPD ¶ 151 (“agencies generally . . . have found that, with advances in information technology, the use of an electronic format can be more efficient than the use of a paper format and does not unduly restrict competition”); NuWestern USA Constructors, Inc., Comp. Gen. B-275514, Feb. 27, 1997, 97-1 CPD ¶ 90 (same); Nat’l Inst. of Standards & Tech.—Use of Elec. Data Interchange Tech. to Create Valid Obligations, Comp. Gen. B-245714, Dec. 13, 1991, 96-2 CPD ¶ 225 (agencies may use electronic data interchange and other electronic means to “sign” binding contracts).

21. See, e.g., Am. Material Handling, Inc., Comp. Gen. B-281556, Feb. 24, 1999, 99-1 CPD ¶ 46. *But cf.* Jack Faucett Assocs., Inc., Comp. Gen. B-279347, June 3, 1998, 98-1 CPD ¶ 155 (protest sustained because not adequate notice of electronic procurement).

22. *Cf.* Kenwood USA Corp., Comp. Gen. B-294638, B-294638.2, B-294638.3, Nov. 29, 2004, 2004 CPD ¶ 239 (deferred to agency, finding encryption card requirements in radio equipment not unduly restrictive).



UNCITRAL working group's discussion was instructive, for the working group focused on the practical problems in assuring that vendors have access to new electronic procurement systems, which is precisely the problem likely to arise as U.S. agencies secure their procurement systems with sophisticated encryption technologies.

A working paper from the UNCITRAL Secretariat had suggested<sup>23</sup> that, if a procuring entity uses a particular technology for procurement, the "procuring entity should provide it openly and without charge," and the procuring entity "should ensure that any electronic systems are fully compatible (or interoperable) with those in general use." The members of the UNCITRAL working group noted that, while laudable, these goals may be overly ambitious. It is probably inappropriate to suggest that any software or tools used be available "without charge,"<sup>24</sup> and it may prove impossible, from a drafting standpoint, to define what "fully compatible" (or "interoperable") means. While no language was fixed at the November 2005 UNCITRAL working group meeting,<sup>25</sup> the consensus seemed to be that it may be more prudent simply to suggest in the *Guide to Enactment* caution that proprietary, incompatible software systems may pose unreasonable barriers to competition.

The UNCITRAL deliberations suggest a future pathway for U.S. procurement, when U.S. policymakers come to grapple—as they almost certainly will—with the anticompetitive ramifications of encryption. Much of the information transferred electronically in U.S. procurement today is unencrypted and is exchanged through open websites (such as [www.fedbizopps.gov](http://www.fedbizopps.gov), the central point of entry for business opportunities) or through simple electronic mail messages. Agencies across the Federal Government are seeking out solutions to secure their electronic procurement systems. In doing so, U.S. policymakers favor *technology neutrality*, so that U.S. systems are not bound to any particular technical solution that may sink into obsolescence. The U.S. policymakers' cautious approach, founded on technology neutrality, is consistent with the UNCITRAL Model Law on Electronic Commerce,<sup>26</sup> and with U.S. practice under the E-SIGN Act,<sup>27</sup> the Uniform Electronic Transactions Act (UETA),<sup>28</sup> and federal procurement law under the Federal Acquisition Regulation.<sup>29</sup>

At some point, however, U.S. policymakers probably will have to surrender a measure of technology neutrality, and to embrace some common form of

23. UNCITRAL, *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services—Drafting Materials Addressing the Use of Electronic Communications in Public Procurement*, U.N. Doc. No. A/CN.9/WG.I/WP.38/Add. 1, ¶ 5 (July 19, 2005), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1/Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1/Procurement.html).

24. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 41.

25. See *id.*, ¶ 33.

26. U.N. Doc. No. A/CN.9/WG.I/WP.38/Add. 1, *supra* note 23, ¶¶ 13–15.

27. Pub. L. No. 106-229, 114 Stat. 464 (2000) (codified at 15 U.S.C. § 7001 *et seq.* (2000)).

28. Available at <http://www.law.upenn.edu/bill/ulc/fnact99/1990s/ueta99.htm>.

29. See, e.g., Richard Vacura & Christopher R. Yukins, *Emerging Legal Issues in DOD's Shift to E-Business*, 43:3 GOV'T CONTRACTOR (2001).

electronic encryption, to secure procurement processes. The United States,<sup>30</sup> like other countries,<sup>31</sup> may well adopt digital signatures, using a technology known as “public key infrastructure” or PKI, as the encryption method of choice for federal procurement.<sup>32</sup> In doing so, however, U.S. policymakers will have to grapple with the discriminatory, anticompetitive impact that their choice of PKI technology—a complex technology, with significant attendant costs and burdens<sup>33</sup>—may have on the procurement process. Encryption using PKI is expensive and difficult, and the PKI initiative, in practice, may damage competition by driving potential commercial vendors away from the federal market. In assessing that question, U.S. policymakers will be able to draw on the UNCITRAL working group’s preliminary assessment that, while it may well be impractical to provide all vendors with free access to the chosen encryption technology, it is imperative to recognize the barriers to competition that a new technology may raise, and to weigh the benefits of that technology against the anticompetitive impacts.

The lessons learned from UNCITRAL thus will open a new aspect of the U.S. policy debate over securing electronic procurement, a debate that to date has focused much more narrowly on agencies’ direct costs of implementing electronic security<sup>34</sup> and has tended to ignore the broader costs of electronic barriers to competition. The UNCITRAL lessons also point to practical lessons from other nations that have grappled with these same issues of electronic procurement; those comparative lessons from abroad will make it easier for U.S. policymakers to weigh the benefits, and competitive costs, of secure electronic procurement.<sup>35</sup> The UNCITRAL effort thus opens the door to a

30. See generally Regina Marie Jennings, *The Challenges Facing E-Government Contracting: Are They Insurmountable?* at 57–67 (Jan. 2006) (thesis on file with the library at The George Washington University Law School, Washington, D.C.).

31. See, e.g., HILDE VAN EYLEN ET AL., *TRANSBORDER EPROCUREMENT STUDY: PUBLIC EPROCUREMENT INITIATIVES AND EXPERIENCES—BORDERS AND ENABLERS 17* (2002) (study report for the European Commission’s Interoperable Delivery of European eGovernment Services to Public Administrations, Businesses and Citizens (IDABC), which reviews security initiatives in electronic procurement systems around the world), available at <http://europa.eu.int/idabc/servlets/Doc?id=22188>; Richard Bray, *IT Security Becomes Imperative*, SUMMIT, Dec. 2001 (discussing Canada’s decision to use public key infrastructure technology), available at [http://www.summitconnects.com/Articles\\_Columns/Summit\\_Columns/2001/1201/1201\\_wiredotgov.htm](http://www.summitconnects.com/Articles_Columns/Summit_Columns/2001/1201/1201_wiredotgov.htm).

32. See Statement of Linda D. Koontz, U.S. Gov’t Accountability Office, GAO No. 05-84T, *Smart Card Usage Is Advancing Among Federal Agencies, Including the Department of Veterans Affairs* (Oct. 6, 2004), available at <http://www.gao.gov/new.items/d0584t.pdf>.

33. See, e.g., U.S. Gov’t Accountability Office, GAO No. 04-1023R, letter to Hon. Tom Davis, Chairman, Comm. on Gov’t Reform, House of Representatives, *Public Key Infrastructure: Examples of Risks and Internal Control Objectives Associated with Certification Authorities* (Aug. 10, 2004) (discussing costs and benefits of using internal government infrastructure rather than sourcing PKI services from private sector), available at <http://www.gao.gov/new.items/d041023r.pdf>.

34. See, e.g., U.S. DEP’T OF DEF., *DoD PKI ROAD MAP* (2000) (outlining strategy for Defense Department’s PKI implementation), available at [http://www.dod.mil/nii/org/sio/ia/pki/PKI\\_Roadmap.pdf](http://www.dod.mil/nii/org/sio/ia/pki/PKI_Roadmap.pdf); OFFICE OF MGMT. & BUDGET, *FEDERAL INFORMATION SECURITY MANAGEMENT ACT (FISMA)—2004 REPORT TO CONGRESS* (2005), available at [http://www.whitehouse.gov/omb/infomag/2004\\_fisma\\_report.pdf](http://www.whitehouse.gov/omb/infomag/2004_fisma_report.pdf).

35. For case studies in electronic procurement by member states of the European Union, see the website of the IDABC, at <http://europa.eu.int/idabc/en/chapter/197>.

much more holistic policy analysis for U.S. procurement, one that draws on lessons learned from around the world.

### III. ELECTRONIC REVERSE AUCTIONS

Probably the most controversial issue taken up at the UNCITRAL working group meeting of November 2005 was “electronic reverse auctions,” on-line auctions through which vendors compete to provide lower prices to buyers.<sup>36</sup> This issue, which has been pending before UNCITRAL for some time,<sup>37</sup> raises serious issues related to competition, transparency, and the collateral impacts of reverse auctions. As with electronic procurement more generally, discussed above, and “unrealistic” bidding, discussed below, though the UNCITRAL debate over reverse auctions certainly does not provide all the answers for U.S. procurement policy, the UNCITRAL debate does point the way forward by suggesting the right questions.

The European Union has promulgated directives that address electronic reverse auctions, and the UNCITRAL initiative is very much an outgrowth of the European regulation.<sup>38</sup> The United States, however, remains in a regulatory limbo regarding reverse auctions. Although U.S. regulators published a request for comments on electronic reverse auctions in 2000,<sup>39</sup> and the U.S. Office of Management and Budget has issued guidance encouraging the use of reverse auctions, no governmentwide regulations for reverse auctions have ever been published in the U.S. system. The impasse is likely due, at least in part, to intense industry criticism of reverse auctions,<sup>40</sup> and to a real uncertainty among government officials as to how to regulate reverse auctions. This uncertainty has left a regulatory gap and has allowed hundreds of reverse

36. See, e.g., Sue Arrowsmith, *Electronic Reverse Auctions Under the EC Public Procurement Rules: Current Possibilities and Future Prospects*, 6 PUB. PROCUREMENT L. REV. 299 (2002).

37. See, e.g., Christopher R. Yukins & Don Wallace Jr., *UNCITRAL Considers Electronic Reverse Auctions, as Comparative Public Procurement Comes of Age in the U.S.*, 4 PUB. PROCUREMENT L. REV. 183 (2005) (draft available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=711847](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=711847)); UNCITRAL, *Comparative Study of Practical Experience with the Use of Electronic (Reverse) Auctions in Public Procurement*, U.N. Docs. Nos. A/CN.9/WG.I/WP.35 & Add. 1 (Feb. 2005), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html).

38. One open question is whether reverse auctions will become part of the upcoming renegotiation of the Government Procurement Agreement in the World Trade Organization. See UNCITRAL, *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services—Drafting Materials for the Use of Electronic Reverse Auctions in Public Procurement—Note by the Secretariat*, U.N. Doc. No. A/CN.9/WG.I/WP.40, at 18 n.2 (Aug. 5, 2005) (“The Secretariat has been advised in consultations with the World Trade Organization that there is as yet no decision as to whether electronic reverse auctions will be included in the revised text of the GPA.”), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html).

39. See 65 Fed. Reg. 65,232 (Oct. 31, 2000) (request for comments on whether regulation of electronic reverse auctions is necessary or appropriate).

40. See, e.g., Press Release, Associated Gen. Contractors, AGC Raises Serious Questions About Reverse Auctions (Sept. 16, 2003), available at [http://www.agc.org/content/public/PDF/Press\\_Releases/2003/09-16-03b.pdf](http://www.agc.org/content/public/PDF/Press_Releases/2003/09-16-03b.pdf).

auctions to proliferate across the U.S. procurement system,<sup>41</sup> unguided and unregulated. Left unregulated, reverse auctions in the U.S. federal system have spawned a number of practices that raise concerns under fundamental principles of U.S. procurement law.

Congress recently stepped into this regulatory void, if only to sound a cautionary bell. The U.S. House Armed Services Committee, in its version of the defense authorization act for fiscal year 2006, H.R. 1815, originally incorporated a provision from a bill sponsored by Representative Tom Davis (R-Virginia), the proposed Acquisition System Improvement Act (ASIA), H.R. 2067, which would have specifically required agencies to use commercial online procurement services, including reverse auctions, “to the maximum extent practicable.”<sup>42</sup> That provision, which had strong support from certain

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41. Recently the U.S. General Services Administration, the primary centralized purchasing agency in the U.S. procurement system, has announced that it will work with a third-party reverse auction services provider to allow agencies to make broader use of electronic reverse auctions. See, e.g., Michael Hardy, *GSA Taps FedBid for Reverse Auctions*, FED. COMP. WEEK, Jan. 11, 2006, available at <http://www.fcw.com>.

42. The House reported the following language in the version of H.R. 1815 that was sent to the Senate in May 2005:

SEC. 812. USE OF COMMERCIALLY AVAILABLE ONLINE SERVICES FOR FEDERAL PROCUREMENT OF COMMERCIAL ITEMS.

(a) Amendment to the Federal Acquisition Regulation—Not later than 180 days after the date of the enactment of this Act, the Federal Acquisition Regulation shall be revised to include provisions that require the head of an executive agency, to the maximum extent practicable, to use commercially available online procurement services to purchase commercial items, including those procurement services that allow the agency to conduct reverse auctions.

(b) Report—Not later than one year after the revisions to the Federal Acquisition Regulation are issued pursuant to subsection (a), the Administrator for Federal Procurement Policy shall submit to the Committees on Governmental Affairs and Homeland Security and on Armed Services of the Senate and the Committees on Government Reform and on Armed Services of the House of Representatives a report on the use of commercially available online procurement services. The report shall include—

(1) a list of the executive agencies that have used commercially available online procurement services, and the number of times each has so used such services;

(2) a list of the types of commercially available online procurement services used by each executive agency and the dollar value of the procurements conducted through each type of commercially available online procurement service; and

(3) the Administrator's recommendations for further encouraging the use of commercially available online procurement services, particularly those that afford the Federal Government the opportunity to conduct reverse auctions.

(c) Definitions—In this section:

(1) The term “commercially available online procurement services,” with respect to procurement by executive agencies, includes reverse auctions and other services accessible on the Internet that allow executive agencies to purchase commercial items from electronic catalogs and offerors to bid for delivery orders of such items.

(2) The term “reverse auction,” with respect to procurement by executive agencies, means a method of soliciting offers on the Internet for commercial items, not including construction-related services, in which—

(A) firms compete against each other on the Internet in real time and in an open and interactive environment; and

(B) each firm's identity and pricing are safeguarded.

(3) The term “Federal Acquisition Regulation” means the single Government-wide pro-

providers of reverse auction services, was ultimately diluted in the conference between House and Senate negotiators (the Senate's version of the defense authorization bill had included no similar provision). The final conference report took a much more cautious approach, and merely called for a study of online procurement services, including reverse auctions:

*Use of commercially available online services for federal procurement of commercial items*

The House bill contained a provision (sec. 812) that would require the use of commercially available online procurement services, including reverse auction services, to purchase commercial items to the maximum extent practicable.

The Senate amendment contained no similar provision.

The House recesses.

The conferees note that online procurement services, such as reverse auction services, are appropriate for the acquisition of some types of commercial items, but may not be suitable for others. For example, items that call for technical solutions, require modification, or will be acquired on a basis other than low-cost are unlikely to be suited to acquisition through reverse auction methods. There may be cases in which the use of commercially available online procurement services could limit access to federal agency contracts.

The 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>43</sup>

To respond to Congress's demand for direction in this area—and to break out of the current regulatory limbo—U.S. policymakers will be able to draw on the work of the UNCITRAL working group, and on many nations' ongoing experience with reverse auctions.

As the UNCITRAL working group began its discussion of reverse auctions in November 2005,<sup>44</sup> there were several points of concern. The first issue was structural: should reverse auctions be erected as a separate "method" of procurement, or should electronic reverse auctions simply serve as a tool to improve pricing under *existing* procurement methods, such as sealed bidding and negotiations. Those who favored the working group's consensus approach—

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urement regulation issued in accordance with sections 6 and 25 of the Office of Federal Procurement Policy Act (41 U.S.C. 405 and 421).

(4) The terms "executive agency," "commercial item," and "procurement" have the meanings provided those terms in section 4 of the Office of Federal Procurement Policy Act (41 U.S.C. 403 et seq.).

43. H.R. REP. NO. 109-360, at 769-70 (2005) (Conf. Rep.), reprinted in 164 CONG. REC. H12739, H13100. The conference report accompanied the National Defense Authorization Act for Fiscal Year 2006, which was signed into law by President Bush on January 6, 2006, as Public Law No. 109-163.

44. See U.N. Doc. No. A/CN.9/WG.I/WP.40, *supra* note 38, ¶ 6; U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 64.

who favored making electronic reverse auctions a distinct “method” of procurement—argued that insinuating reverse auctions into other methods of procurement could undermine the careful protections (for competition and transparency) built into those other methods.<sup>45</sup> It is worth noting, though, that the U.S. Army Corps of Engineers has addressed this issue in its own pilot study of reverse auctions and has concluded that reverse auctions should *not* be considered a distinct type of procurement, but instead should be used as a complementary part of other procurement methods.<sup>46</sup>

Discussion at the November 2005 working group meeting, based on proposals from the UNCITRAL Secretariat,<sup>47</sup> centered on the following points, all of which are directly relevant to U.S. policy regarding reverse auctions:

- *Limiting reverse auctions to procurements where “precise” specifications can be achieved:* The UNCITRAL Secretariat’s proposed text suggested that electronic reverse auctions should be used only where “precise [and accurate] specifications” can be generated.<sup>48</sup> This followed the language of the European directives, for example Article 54 of Directive 2004/18/EC, which says that electronic auctions may be used “when the contract specifications can be established with precision.”<sup>49</sup> In fact, however, this requirement for “precision” in specifications is the same prerequisite that should apply to any procurement using sealed bids: unless the specifications are well-defined, competition will be badly impaired. The important lesson for U.S. policymakers, however, is that the converse is

45. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 65.

46. See U.S. ARMY CORPS OF ENGINEERS, FINAL REPORT REGARDING THE U.S. ARMY CORPS OF ENGINEERS PILOT PROGRAM ON REVERSE AUCTIONING, § 1, at 1 (2004), *available at* <http://www.agc.org/page.wv?section=Reverse+Auctions+Resource+Center&name=Reverse+Auctions+Resource+Center>.

47. The central proposed text would have provided:

Article 19 *bis*. Conditions for use of electronic reverse auctions

(1) (Subject to approval by . . . (the enacting State designates an organ to issue the approval),) a procuring entity may engage in procurement by means of an electronic reverse auction in accordance with article 47 *bis* and *ter*,\* in the following circumstances:

- a. Where it is feasible for the procuring entity to formulate detailed [, and] precise [and accurate] specifications for the goods [construction or services] such that homogeneity in the procurement can be achieved {;
- b. Where there is a competitive market of at least [ten] suppliers or contractors [that are anticipated to be qualified to participate in the electronic reverse auction]; and]
- c. The goods [, construction or services] to be procured are [standardized] [standard products] [commodities], [[such that] [and] the price [and other quantifiable criteria expressed in figures or percentages] thereof [is] [are] the only [criterion] [criteria] to be used in determining the successful bid] [[such that] [and] all criteria that are to be submitted and evaluated in the auction can be evaluated automatically].

U.N. Doc. No. A/CN.9/WG.I/WP.40, *supra* note 38, ¶ 10 (brackets in original).

48. The proposed UNCITRAL language, *see supra* note 47, also would have limited electronic reverse auctions to those situations where there are “standard” or “standardized” products.

49. Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts, art. 54, 134 O.J. 114, 148 (Apr. 30, 2004), *available at* [http://www.minefi.gouv.fr/daj/marches\\_publics/ppn/ppn-anglais/07\\_2004-18e.pdf](http://www.minefi.gouv.fr/daj/marches_publics/ppn/ppn-anglais/07_2004-18e.pdf).

also true: as Congress suggested in the recent conference report, where there are alternative technical solutions for a given problem (and thus not “homogeneity” in the technical specifications), a reverse auction that binds the procuring entity to only one technical solution may not be the optimal choice, however beguiling that auction may be because of its promise of reduced prices.<sup>50</sup>

- *Ensuring adequate competition in reverse auctions:* In a break with the European directives, which include no such minimum benchmark for competition, the proposed UNCITRAL text would have limited reverse auctions to those situations where there is a “competitive market of at least [ten] suppliers or contractors [that are anticipated to be qualified to participate in the electronic reverse auction].” Several working group participants endorsed this approach, for a more robust market suggests that more cost information will be available to both suppliers and government officials, which will reduce the risks of unreasonably high pricing and below-cost (or “unrealistic”) bidding (which poses a performance risk for the Government<sup>51</sup>). A more robust market also reduces the risk of price signaling through the auction. Finally, the proposed approach, which would have turned on contracting officials’ reasonable expectations of the number of prospective bidders in the market, was viewed as preferable to relying on contracting officials’ subjective assessment of whether there is a “standing” competitive market of ten or more suppliers. Others in the working group, however, were unhappy with the proposed approach, which would have limited electronic reverse auctions to those markets with ten or more participants. The UNCITRAL working group ultimately concluded, therefore, that there should be no fixed minimum number of bidders, but that instead there should simply be a sufficient number of bidders to ensure effective competition.<sup>52</sup> At the same time, though, the working group rejected imposing any artificial upper limits on the number of bidders in a reverse auction, in part because of the relatively low marginal costs of including additional bidders in an electronic auction. The working group’s debate, which highlighted the need for a competitive market analysis *before* embarking on a reverse auction, highlights a gap in current U.S. practice.<sup>53</sup>

50. See H.R. REP. NO. 109-360, *supra* note 43, at 770 (“For example, items that call for technical solutions, require modification, or will be acquired on a basis other than low-cost are unlikely to be suited to acquisition through reverse auction methods.”).

51. See Thomas F. Burke, *Online Reverse Auctions*, 00-11 BRIEFING PAPERS 1 (Oct. 2000) (discussing risk of collusion in electronic auctions). For a more detailed discussion of below-cost pricing, see *infra* notes 69-97 and accompanying text.

52. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 75.

53. A recent reverse auction sponsored by the U.S. National Institute of Standards & Technology (NIST), for example, called for a reverse auction of a device with the following specifications, in a procurement specially set aside for small business, per Solicitation No. SBI341-06-Q-0223:

LI 001, High Resolution Quartz Crystal Microbalance (QCM) Instrument Background: NIST Polymers Division is assembling a new quartz crystal microbalance instrument suitable for AT-

- *Prequalification of bidders*: The UNCITRAL Secretariat also proposed new text for the UNCITRAL model law, to govern purchasing agencies' conduct in the pre-auction period.<sup>54</sup> The first issue raised by the proposed language went to *prequalification*. Under the Secretariat's proposed language, procuring entities would be left the option of *not* reviewing prospective tenderers in prequalification procedures, per the Brazilian model, which may defer a review of supplier qualifications until *after* a reverse auction.<sup>55</sup> In the Brazilian system, however, reverse auctions are generally used only for certain limited categories of commodities.<sup>56</sup> Should the United States not similarly limit the universe of items subject to reverse auction, procuring agencies may wish to "screen" prospective vendors through prequalification proceedings.
- *"Models" for structuring reverse auctions*: Much more controversial at the UNCITRAL meeting, however, were the different "models" of electronic reverse auctions that the Secretariat's working paper put forward. Those models, developed by Professor Sue Arrowsmith<sup>57</sup> and drawn from international practice, had been outlined in an earlier working paper:

33. Depending on which evaluation criteria are assessed and when, three models conducting ERAs [electronic reverse auctions] are used in practice by procuring entities:

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cut quartz crystal analysis by phase-lock oscillation with high speed data readout. The application area is the direct measure of change in quartz substrate frequency versus time for the analysis of photoresist thin films dissolution. The suitable QCM shall meet the following specifications: 1. Quartz crystal substrates and cells 1.1. 5 MHz resonance frequency AT-cut QCM substrates with 1 inch diameter coated with 300 nm of chromium optimized for 25 degrees C measurements (50 required) 1.2. 5 MHz resonance frequency AT-cut QCM substrates with 1 inch diameter coated with 300 nm of gold optimized for 25 degrees C measurements (50 required) 1.3. Temperature control 1.4. QCM flow cell made of organic solvent resistant material. Preferably Teflon housing with Viton O-rings. 2. Microbalance 2.1. Mass sensitivity range using 5 MHz crystals 2.2. Ability to measure resistance and frequency change 2.3. Capability to measure at least two simultaneous running QCM experiments for cross-correlation of changes in frequency from sample to reference, thereby eliminating noise, confirming true frequency changes from artifact. 2.4. Frequency resolution 0.1 Hz 2.5. High speed data acquisition ms resolution 3. Data acquisition and software 3.1. I/O card for TTL data acquisition trigger externally controlled by software 3.2. Software for QCM data analysis and reduction 3.3. Libraries for LabView operation, 1, EA;

<http://www.fbo.gov/spg/DOC/NTIS/NTIS/SB1341%2D06%2DQ%2D0223/Combine%20Synopsis%5FSolicitation.html>. There was no indication in this solicitation (or in many other reverse auctions' solicitations reviewed on <http://www.fedbizopps.gov>) that the purchasing agency had ensured that there was, in fact, a robust competitive market for the listed item, which in turn raised the risk that the reverse auction could result in *higher* prices than might normally be the case.

54. U.N. Doc. No. A/CN.9/WG.I/WP.40, *supra* note 38, ¶ 20.

55. *Id.*, ¶ 22. For a further study of the Brazilian reverse auction system, see Luiz Antonio Joia & Fuad Zamot, *Internet-Based Reverse Auctions by the Brazilian Government*, 9:6 ELEC. J. INFO. SYS. DEVEL. COUNTRIES (2002), available at <http://www.is.cityu.edu.hk/research/ejisdc/vol9/v9r6.pdf>.

56. See, e.g., Yukins & Wallace, *supra* note 37, at n.56.

57. See Arrowsmith, *supra* note 36, at 307 (developing models); Sue Arrowsmith, *Electronic Reverse Auctions Under the New EC Procurement Directives*, 4 PUB. PROCUREMENT L. REV. 203 (2005) (applying models).



Model 1, in which all aspects of tenders that are to be compared in selecting the winning supplier are submitted through the ERA itself. Often lowest price is the sole award criterion in competitions conducted entirely through an ERA. Tenderers know their position both during the ERA phase and its close;

Model 2, with prior assessment of all tender aspects or only those not subject to the ERA phase. Before the ERA phase, suppliers are provided with information on their ranking based on the outcome of an evaluation of the relevant tenderer prior to the ERA. All evaluation criteria are factored in a mathematical formula, which re-ranks the tenderers on the submission of each bid. Thus, during the ERA phase and at its close, suppliers know their overall standing;

Model 3, in which there is no prior assessment of any aspects of the tender. During the ERA phase, suppliers have information only on how they compare with their competitors in respect of those criteria that are subject to the ERA phase (usually, but not always, just the price). Thus, in contrast with models 1 and 2, when the ERA phase closes, the suppliers do not know whose tender is the best; this is established once the “non-auction” aspects of the tender have been factored in.<sup>58</sup>

Discussion at the Working Group reflected a consensus that “Model 3”—in which, for example, bidders will compete on price in a reverse auction but award will be made based upon criteria applied *after* the reverse auction—is sharply disfavored, for bidders under Model 3 are bidding “blindly” in the initial auction, without knowing how their bids may affect their ultimate chances of award. Model 3 was therefore not under serious consideration by the Working Group.

Ironically, however, Model 3 appears still to be used by U.S. agencies, which continue to launch reverse auctions without any regulatory guidance. One recent U.S. agency solicitation (which followed a common pattern in such solicitations) clearly stated, for example, that the purchasing agency might well apply nonprice evaluation criteria only *after* the results of the price auction had been delivered:

This is a combined synopsis/solicitation for commercial items prepared in accordance with the format in FAR Subpart 12.6, in conjunction with FAR 13.5, and as supplemented with additional information included in this notice. This announcement constitutes the only solicitation . . .

The GSA [General Services Administration] FTS [Federal Technology Service] Region 6 requires the following items, EXACT MATCH ONLY, to the following:

LI 001, P2-P7U-L2L, ATL P4000/P7000 HP LTO-2 200GB, LVD SCSI, hot-swap tape drive, field upgrade, Brand Name Quantum, 8, EA; . . .

For this solicitation, GSA FTS Region 6 intends to conduct an online competitive reverse auction to be facilitated by the third-party reverse auction provider, . . . [The third-party reverse auction provider] has developed an online, anonymous, browser based application to conduct the reverse auc-

58. See U.N. Doc. No. A/CN.9/WG.I/WP.35, *supra* note 37, ¶ 33.

tion. An Offeror may submit a series of pricing quotes, which descend in price during the specified period of time for the aforementioned reverse auction. GSA FTS Region 6 is taking this action in an effort to improve vendor access and awareness of requests while expediting its ability to gather multiple, completed, real-time offers. All responsible Offerors that respond to this solicitation MUST submit the pricing portion of their offer using the online exchange . . . Offerors may not artificially manipulate the price of a transaction . . . by any means. . .

Buyers and Sellers agree to conduct this transaction through [the third-party auction service] in compliance with the . . . Terms of Use. *Buyers and Sellers understand that [the third-party auction service provider] ranks all bids by price, regardless of the evaluation criteria used by the Buyer; however, pursuant to applicable acquisition regulations and/or departmental guidelines, Buyers may use criteria other than price to evaluate the offer.* Please note that any such evaluation criteria must be articulated in the solicitation to the extent required by such regulations and/or guidelines. . .<sup>59</sup>

59. <http://www.fbo.gov/spg/GSA/FTS/6TS-A-SMTP/DKTS06NS000H/Combine%20Synopsis%5FSolicitation.html> (emphasis added).

Another recent solicitation, this one from the U.S. Patent & Trademark Office, took the same approach, signaling to vendors that their technical proposals would be considered *separately from*—and presumably *after*—the price auction, in a format replicated across many reverse auction solicitations posted at [www.fedbizopps.gov](http://www.fedbizopps.gov):

The US Patent & Trademark Office requires the following items, BRAND NAME OR EQUAL, to the following: LI [Line Item] 001, Oxford green pressboard folders, item #H1502F13. Pressboard end tab expansion file folder. Extra-durable, 25 pt.2” expansion green pressboard. Tyvek gussets. Each box must be marked with PTO-2154 IFW Retention Folders, 100000, EA;

. . . All responsible Offerors that respond to this solicitation MUST submit the pricing portion of their offer using the online exchange located at [third-party auction services vendor's website] . . .

In addition to providing pricing at [the online reverse auction site] for this solicitation, each Offeror must provide any required, NON-PRICING responses (e.g. technical proposal, representations and certifications, etc.) directly to [shirlena.morgan@uspto.gov](mailto:shirlena.morgan@uspto.gov) (NOT THROUGH [THE REVERSE AUCTION SERVICES VENDOR]) so that they are received at that email address no later than the closing date and time for this solicitation. . . Buyers and Sellers understand that [the reverse auction third-party vendor] ranks all bids by price, regardless of the evaluation criteria used by the Buyer; however, pursuant to applicable acquisition regulations and/or departmental guidelines, Buyers may use criteria other than price to evaluate the offer. Please note that any such evaluation criteria must be articulated in the solicitation to the extent required by such regulations and/or guidelines. Award will be made based on Best Value to the government. . .

<http://www.fbo.gov/spg/DOC/PTO/OPDC20220/150D0600305/Combine%20Synopsis%5FSolicitation.html>.

A third solicitation, again posted on <http://www.fedbizopps.gov>, but offering support from a different third-party reverse auction vendor, also indicated that the purchasing agency (UNICOR) would weigh nonprice factors *after* the reverse auction was over—which again meant, in essence, that the vendors in the reverse auctions would be bidding “blindly,” without knowing how the agency would weigh price and quality:

During the auction, Offerors will provide pricing through submission of electronic offers via the [third-party vendor] website. The primary pricing competition for this solicitation will be through the online reverse auction. [The third-party reverse auction vendor] will explain this process in detail and train each qualified offeror prior to the reverse auction through a simulated reverse auction. Qualified Offerors will have the ability to submit revised pricing during the auction in response to prices submitted by other offerors. The identity of offerors

The solicitation for this reverse auction, written in a regulatory void, thus described a reverse auction in which the buying agency *could* evaluate nonprice factors after the price auction was concluded—but, contrary to basic principles of public procurement, the bidders in the reverse auction would have no idea what relative weight price and nonprice factors would have in the evaluation. The lesson from the UNCITRAL working group, therefore, is that U.S. regulators should, at the very least, make it clear that U.S. agencies should not engage in “Model 3” reverse auctions.

- *Regulating “Model 1” and “Model 2” auctions:* Because the UNCITRAL working group largely rejected Model 3 out of hand, Model 1 (all criteria for award included in auction) and Model 2 (preranking reflected in “handicapped” bidding) thus were the only models under serious consideration.<sup>60</sup> Several members of the working group argued that it is not clear that Model 2 (ranking and handicapping bidders before the price auction) is a sound approach. Opponents of Model 2 noted that it is an approach typically favored by proponents of reverse auctions, who would like to argue that all criteria for award can ultimately be “factored into” a reverse auction. Model 2 raises transparency and competition concerns, however, for it is not clear whether vendors will fully understand how the pre-auction “ranking” will impact their bids in the reverse auction, i.e., how their bids will be “handicapped.”<sup>61</sup> Several members of the Working Group—including, especially, those from member states of the European Union, which allows Model 2<sup>62</sup>—nevertheless argued in favor of including Model 2 in the UNCITRAL Model Law.<sup>63</sup> As

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will not be revealed to each other during the auction. The final such revision during the auction will be considered the Offerors’ final proposal. The Contracting Officer reserves the right to conduct verbal or written discussions with respect to factors other than price with the Offerors at anytime prior to award. Only offerors that have been determined qualified will be permitted to participate in the auction. Offerors who are deemed qualified will be notified by the Contracting Officer.

<http://fs1.fbo.gov/EPData/DOJ/Synopses/4786/CT1758-06/CT1758.PDF>. This example shows, again, that U.S. agencies at least appear to be conducting “Model 3” auctions, despite a strong international consensus against these sorts of auctions in which the price competition *precedes* the agency’s consideration of the vendors’ technical worth.

60. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶¶ 84–85.

61. Model 2 also raises logical concerns: for example, an attribute that leads to a high ranking *before* the bidding begins (a particularly robust transmission in an automobile, for example) should, in theory, *hurt* the bidder as prices descend in the reverse auction, for that robust attribute *increases performance risk* (raises the risk of default) as the reverse auction “ratchets down” the prices offered. Thus, a prebid “ranking” under Model 2 seems to offer a good deal of opportunity for missteps, and (several argued) Model 1 is the safer, simpler course. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 85.

62. See, e.g., European Union Directive 2004/18/EC, 49, art. 54.

63. The working group did not address the technical challenges that Model 2 can raise: if offers are “ranked” before the electronic reverse auction begins, Model 2 assumes that ranking will “handicap” the price-based bids in the electronic auction (i.e., higher-ranked bids will not have to offer the same price concessions). This “handicapping” system logically requires, however, a relatively sophisticated electronic auction, for bidders need to know where they stand in the

noted, U.S. regulators have *not* distinguished between the various “models” for electronic reverse auctions, and until they do, it will be impossible to determine which, if any, approaches should be allowed in U.S. procurement.

- *Elements of solicitation*: The UNCITRAL Secretariat’s proposed language for the Model Law would spell out the required elements of a solicitation. For comparison purposes, Table 1 compares those proposed elements with the elements taken from Article 54 of European Union Directive 2004/18/EC.<sup>64</sup>

For U.S. regulators, the proposed UNCITRAL language obviously offers much more detail to prospective bidders on how the reverse auction will be conducted. The required elements outlined in the proposed UNCITRAL approach are not onerous, and they offer a useful checklist, should U.S. regulation proceed in this area.

- *Ranking information broadcast to bidders*: The European directive, which contemplates prebid “ranking” and “handicapping,” requires that bidders be told of their relative rankings throughout the auction. This raises risks of gamesmanship throughout the auction, and raises risks of price signaling as bidders can recognize how the market is organizing itself.<sup>65</sup> From the procuring entity’s standpoint, another (and perhaps less risky) alternative is to post only the “best” bid, which was one of the solutions suggested at the recent UNCITRAL working group meeting. In U.S. reverse auctions, one firm that provides substantial reverse-auction services to federal agencies uses a “lead/lag” method, which tells each bidder only whether its is the “lead” bid or “lags” behind that lead.<sup>66</sup> In principle, this should reduce firms’ ability to reinforce an incipient cartel through the reverse auction.<sup>67</sup>
- *Failure of “winning” bidder*: The UNCITRAL Secretariat also addressed the situation where the winning bidder “collapses” after the auction is over. Instead of simply awarding to the next-best bid, the UNCITRAL Secretariat proposed to the working group that the bidding should be reopened, or another form of procurement should be considered, if the

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auction, even accounting for their handicaps. On this point alone—technical complexity—it seems, again, that Model 2 raises potential obstacles to implementation.

64. The UNCITRAL secretariat also proposed language for the model law, outlining how electronic reverse auctions should be conducted. See U.N. Doc. No. A/CN.9/WG.I/WP.40, *supra* note 38, ¶¶ 26–27.

65. See U.S. FED. TRADE COMM’N, STAFF REPORT, ENTERING THE 21ST CENTURY: COMPETITION POLICY IN THE WORLD OF B2B ELECTRONIC MARKETPLACES 10–11 (2000), available at <http://www.ftc.gov/os/2000/10/b2breprot.pdf>.

66. See FedBid, Terms of Use, <http://docs.fedbid.com/fedbid/termsview.html#bidprocess> (last visited Mar. 14, 2006).

67. See generally Robert C. Marshall & Michael J. Meurer, *Bidder Collusion and Antitrust Law: Refining the Analysis of Price Fixing to Account for the Special Features of Auction Markets*, 72 ANTI-TRUST L.J. 83 (2004) (discussing collusive behavior in auctions); Susan L. Turley, *Wielding the Virtual Gavel—DOD Moves Forward with Reverse Auctions*, 173 MIL. L. REV. 1 (2002) (discussing literature on potential anticompetitive collusion in government reverse auctions).

**TABLE 1:**  
Comparison of European Union Directive and UNCITRAL Proposed  
Language on Specifications for Reverse Auction

European Directive	Proposed UNCITRAL Model Law
<p>The specifications shall include, inter alia, the following details:</p> <p>(a) the features, the values for which will be the subject of electronic auction, provided that such features are quantifiable and can be expressed in figures or percentages;</p> <p>(b) any limits on the values which may be submitted, as they result from the specifications relating to the subject of the contract;</p> <p>(c) the information which will be made available to tenderers in the course of the electronic auction and, where appropriate, when it will be made available to them;</p> <p>(d) the relevant information concerning the electronic auction process;</p> <p>(e) the conditions under which the tenderers will be able to bid and, in particular, the minimum differences which will, where appropriate, be required when bidding;</p> <p>(f) the relevant information concerning the electronic equipment used and the arrangements and technical specifications for connection.</p>	<p>(4) (e) Unless already provided to suppliers or contractors, the invitation to participate in the electronic reverse auction shall include [the following information] . . . :</p> <p>(i) If features of tenders other than price have been used in the initial evaluation, the results of the initial evaluation of the invitee's own tender;</p> <p>[(ii) The date and time of the opening of the electronic reverse auction;</p> <p>(iii) The website address at which the electronic reverse auction will be held, and at which the auction rules, the tender and other relevant documents will be accessible;</p> <p>(iv) The requirements for registration and identification of bidders at the opening of the auction;</p> <p>(v) The features of the tender that are to be presented at the auction;</p> <p>(vi) If the award is to be based on the lowest evaluated tender, the formula to be used to quantify the non-price features to be presented [any such feature is to be quantifiable and capable of expression as a figure or percentage]. The formula shall incorporate the weighting of all the criteria established to determine the lowest evaluated tender;</p> <p>(vii) The information that will be made available to bidders in the course of the auction and, where appropriate, how and when it will be made available;</p> <p>(viii) All relevant information concerning the auction process itself, including any identification data for the procurement, technical requirements as to information technology equipment to be utilized, whether there will be only a single stage of the auction, or multiple stages (in which case, the number of stages and the duration of each stage);</p> <p>(ix) The conditions under which the bidders will be able to bid and, in particular, any minimum differences in price or other features that will [be required when bidding] [must be improved in any individual new submission during the auction] [and the time which the procuring entity will allow to elapse after receiving the last submission before closing the auction];</p> <p>(x) All relevant information concerning the electronic equipment used and the arrangements and technical specifications for connection;</p> <p>(xi) The criteria that shall determine the closure of the auction;] and</p> <p>(xii) All [other] information necessary to enable the supplier or contractor to participate in the auction. [The procurement regulations may prescribe the information that is to be so provided.]</p>

procuring agency finds that the winning bidder cannot perform. The Secretariat's approach was supported by several observers, for the Secretariat's approach, which would not simply default to the second-best bidder, would make it less likely that "straw" leading bidders could be used by "second-best" bidders to manipulate auctions (for the "second-best" bidders could otherwise reserve significant pricing margins, knowing that the "winning" bidder would ultimately collapse).<sup>68</sup>

The UNCITRAL working group's discussion of electronic reverse auctions thus yielded important lessons for U.S. regulators. The international discussion suggests that U.S. reverse auctions *should* be regulated—practical experience from around the world suggests that leaving reverse auctions unregulated leaves far too much risk—and the ongoing international dialogue suggests *how* that regulation could be structured. Should U.S. policymakers move to regulate reverse auctions (which seems the sensible course at this point), the regulatory path forward is already well-marked by experience from around the world.

#### IV. ABNORMALLY LOW TENDERS

The final substantive issue taken up by the November 2005 Working Group meeting was the lingering issue of below-cost ("abnormally low") bidding.<sup>69</sup> In the U.S. procurement system, abnormally low pricing is generally referred to as pricing that is too low to be "realistic." In the wake of bidding, but before award, the contracting officer may be called upon to determine whether the price offered is indeed "realistic." In principle,<sup>70</sup> "low-ball" (or below-cost) pricing could occur for a number of reasons,<sup>71</sup> including:

- Predatory pricing, to drive out competitors.
- At-loss pricing to maintain market share.
- Indifference to cost constraints because of, e.g., imminent bankruptcy.
- Mistakes as to true internal costs of production.

As the U.S. Government Accountability Office noted in *Star Mountain, Inc.*,<sup>72</sup> the Federal Acquisition Regulation (FAR) "provides a number of price analysis

68. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 92.

69. These issues were addressed in a working paper, UNCITRAL, *Possible Revisions to the UNCITRAL Model Law on Procurement of Goods, Construction and Services—Drafting Materials for the Use of Electronic Reverse Auctions in Public Procurement*, U.N. Doc. No. A/CN.9/WG.I/WP.40/Add.1 (Aug. 5, 2005), available at [http://www.uncitral.org/uncitral/en/commission/working\\_groups/1Procurement.html](http://www.uncitral.org/uncitral/en/commission/working_groups/1Procurement.html).

70. For an excellent theoretical assessment of auction pricing theory in the context of reverse auctions in public procurement, see Ohad Soudry, *Promoting Economy: Electronic Reverse Auctions Under the EC Directives on Public Procurement*, 4 J. PUB. PROCUREMENT 340 (2004).

71. As Professors Ralph Nash and John Cibinic stressed, however, low pricing intended to drive a new contractor into a market or project—"buy-in" pricing—is not necessarily a malicious business practice. Ralph C. Nash & John Cibinic, *Buying-In: An Improper Business Practice?* 18 NASH & CIBINIC REP. ¶ 14 (Apr. 2004).

72. Comp. Gen. B-285883, Oct. 25, 2000, 2000 CPD ¶ 189.

techniques that may be used [by agencies] to determine whether prices are reasonable [not too high] and realistic [not too low], including comparison of the prices received with each other; comparison of previously proposed prices for the same or similar items; comparison with independent government estimates; and analysis of pricing information provided by the offeror.”<sup>73</sup> Because U.S. agencies are often barred from demanding cost information from vendors,<sup>74</sup> agencies typically cannot determine directly whether the vendor’s pricing is below cost (something that is not transparent to the agency).<sup>75</sup>

Because contractors bear the risk that they will be able to complete the work at the price paid on a firm-fixed-price project, agencies logically focus instead on whether a low price poses *performance* risk. The Government’s position is that if the contractor has bid below cost, that is the contractor’s

73. *Id.* (citing FAR 15.404-1(b)(2)).

74. *See, e.g.*, FAR 15.403-1. The bar against demanding cost data does not mean, however, that agencies cannot perform effective price-realism analyses, by using negotiating strategies such as that outlined by Professors Nash and Cibinic, in a strategy suggested for negotiating a services contract:

To enable the agency to conduct such negotiation, the [solicitation] has to call for the submission of sufficient data to permit analysis of the price. FAR 15.403-1(b)(1) prohibits requiring the submission of cost or pricing data when the [contracting officer] determines that prices agreed upon are based on adequate price competition but this should not keep the agency from obtaining sufficient data to do a good price analysis. In most cases, the most important data is labor hours of effort to accomplish the major tasks called for by the contract. The competitors should be required to submit the labor hours, by labor category, for their own workers and their major subcontractors that will perform the task. Analysis and comparison of these labor hours should identify disparities where an offeror has proposed to do the work for significantly more or fewer hours than other offerors or the Government estimate. This is the subject of a good price negotiation that will reveal cases where the offeror does not have the same understanding of the work as the Government or where the offeror is “buying in” to win the award. Offerors should, of course, be given the opportunity to submit a final proposal revision to adjust their price as a result of such negotiation. *See* FAR 15.307(b). To deal with the possibility that the offeror may stick with a “buy in” price, the [solicitation] should contain a provision calling for a price realism analysis to determine the risk of such a low price. . . . This does not mean refusing to award the contract to an offer with an unrealistically low price but evaluating the risk of such an award in terms of its effect on successful performance of the contract.

Ralph C. Nash & John Cibinic, *Price Negotiation: The Lost Art?* 17 NASH & CIBINIC REP. ¶ 62 (Dec. 2003); *see also* Ralph C. Nash & John Cibinic, *Price-Based Acquisition: “Just Do It!”* 14 NASH & CIBINIC REP. ¶ 17 (Mar. 2000) (noting that effective price negotiation to mitigate performance risk requires skill and sophistication); Ralph C. Nash & John Cibinic, *Price Realism Analysis: A Tricky Issue*, 12 NASH & CIBINIC REP. ¶ 40 (July 1998) (step-by-step strategy for bringing price realism analysis to bear in procurement).

75. Perhaps because of the natural contradictions and tensions here—agencies must try to assess contractors’ prices to gauge whether they are below cost, usually without direct access to data on contractors’ actual costs—the regulatory scheme is, perhaps predictably, somewhat murky. *See, e.g.*, Ralph C. Nash & John Cibinic, *Price Realism in Fixed-Price Incentive Contracts: A Tricky Evaluation*, 17 NASH & CIBINIC REP. ¶ 51 (Oct. 2003) (“FAR 15.404-1(d) [which provides guidance in this area] is a sorry excuse for a regulation when it comes to price realism analysis and we hope this decision will induce Contracting Officers to ignore it and do the job right. Of course, the [Federal Acquisition Regulation] Council should also rewrite the regulation but we are not holding our breath.”); Jerome S. Gabig, *FAR Part 15 Rewrite—A Lost Opportunity to Reduce the Confusion Involving Cost Realism*, 12 NASH & CIBINIC REP. ¶ 16 (Mar. 1998) (noting that FAR does not deal clearly with issues of price realism).

risk,<sup>76</sup> though the Government recognizes that there is a lingering risk that the contractor, having bid too low and so without adequate resources, will abandon or short-change performance. In resolving questions of “low-ball” bids, therefore, agencies have focused on whether the bid in effect poses performance risk; in doing so, as noted, agencies have focused primarily on whether the bidder seemed to understand the requirements of the contract. See, for example, *Mindleaf Technologies, Inc.*,<sup>77</sup> where the Government Accountability Office held:

Mindleaf [the protester] also contends that because [the awardee] KMR’s price proposal is unrealistically low, it reflects KMR’s lack of understanding of the solicitation, which, in turn, represents a significant performance risk to the government. The Air Force responds that it determined that performance risk was low by virtue of KMR’s understanding of the solicitation’s requirements as reflected in KMR’s proposal. Specifically, in addition to responding to each of the evaluation criteria, KMR’s proposal identified an approach for realizing efficiency in staff training. Furthermore, KMR’s experience as incumbent gave credence to KMR’s understanding of the solicitation. We find no basis to disagree with the Air Force’s conclusion. In any event, as discussed above, we find reasonable the Air Force’s determination that KMR’s price is not unrealistically low.<sup>78</sup>

In the U.S. system, therefore, agencies typically will assess price realism by asking whether “the proposed cost or price provides an adequate reflection of [the contractor’s] understanding of the requirements of the solicitation.”<sup>79</sup> As the GAO explained in *J.A. Farrington Janitorial Services*,<sup>80</sup> this question of price realism often becomes part of the purchasing agency’s broader assessment of the offeror’s “responsibility,” or ability to perform.<sup>81</sup>

76. See, e.g., Gen. Dynamics-Ordnance & Tactical Sys., Comp. Gen. B-295987, B-295987.2, May 20, 2005, 2005 CPD ¶ 114 (“Generally, where, as here, a solicitation contemplates the award of a fixed-price contract, the agency is not required to conduct a realism analysis. This is because a fixed-price (as opposed to a cost-type) contract places the risk and responsibility for loss on the contractor.”).

77. Comp. Gen. B-294242, B-294242.2, Aug. 24, 2004, 2004 CPD ¶ 157.

78. *Id.*

79. E.g., E. Huttenbauer & Son, Inc., Comp. Gen. B-257778, B-257779, Nov. 8, 1994, 94-2 CPD ¶ 206.

80. Comp. Gen. B-296875, Oct. 18, 2005, 2005 CPD ¶ 187.

81. See, e.g., CSE Constr., Comp. Gen. B-291268.2, Dec. 16, 2002, 2002 CPD ¶ 207 (“Where there is no relevant evaluation criterion pertaining to realism or understanding [in the solicitation], a determination that an offeror’s price on a fixed-price contract is too low generally concerns the offeror’s responsibility, i.e., the offeror’s ability and capacity to successfully perform the contract at its offered price.”). As noted, the FAR recommends the following methods for assessing prices; although the FAR states that these are methods for assessing price reasonableness (for ensuring that the price is not too high), the methods are also recommended for assessing price realism (in an effort to gauge whether the price offered poses a performance risk to the government):

(b) *Price analysis.*

(1) Price analysis is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.

(2) The Government may use various price analysis techniques and procedures to ensure a fair and reasonable price. Examples of such techniques include, but are not limited to, the following:



Before awarding a fixed-priced contract, an agency is required to determine that the price offered is fair and reasonable. Federal Acquisition Regulation (FAR) § 15.402(a). An agency's concern in making a price reasonableness determination focuses primarily on whether the offered prices are higher than warranted, and the results of the analysis may be used in negotiating reasonable prices. . . . Although agencies are required to perform some sort of price or cost analysis on negotiated contracts to ensure that proposed prices are fair and reasonable, where, as here, the award of a fixed-price contract is contemplated, a proposal's price realism is not ordinarily considered, since a fixed-price contract places the risk and responsibility for contract costs and resulting profit or loss on the contractor. *An agency may, but is not required to, provide in the solicitation for a price realism analysis for such purposes as measuring an offeror's understanding of the solicitation requirements, or to avoid the risk of poor performance* from a contractor who is forced to provide goods or services at little or no profit. . . . However, *where there is no relevant evaluation criterion pertaining to realism or understanding, a determination that an offeror's price on a fixed-price contract is too low generally concerns the offeror's responsibility*, i.e., the offeror's ability and capacity to successfully perform the contract at its offered price.<sup>82</sup>

The approach taken in the U.S. procurement system—where the legal presumptions tip away from probing unrealistically low offers on fixed-price contracts—contrasts with the UNCITRAL reform effort, which would take a more cautious approach to unrealistically low bidding. When the UNCITRAL working group convened in November 2005, the working group members had before them the UNCITRAL Secretariat's working paper, which suggested amendments to the Model Procurement Law to address abnormally

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(i) Comparison of proposed prices received in response to the solicitation. Normally, adequate price competition establishes price reasonableness (see 15.403-1(c)(1)).

(ii) Comparison of previously proposed prices and previous Government and commercial contract prices with current proposed prices for the same or similar items, if both the validity of the comparison and the reasonableness of the previous price(s) can be established.

(iii) Use of parametric estimating methods/application of rough yardsticks (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.

(iv) Comparison with competitive published price lists, published market prices of commodities, similar indexes, and discount or rebate arrangements.

(v) Comparison of proposed prices with independent Government cost estimates.

(vi) Comparison of proposed prices with prices obtained through market research for the same or similar items.

(vii) Analysis of pricing information provided by the offeror.

FAR 15.404-1(b).

82. *Id.* (emphasis added). Professors Ralph Nash and John Cibinic summarized the U.S. case law in this area as follows:

[W]e can paraphrase it more clearly by stating that a price realism analysis indicating that an offeror's price is very low can be used in three ways:

- (1) To assess an offeror's understanding of the work.
- (2) To assess the degree of performance risk posed by the low price.
- (3) To determine whether the offeror is a responsible contractor.

What needs to be said in the [Federal Acquisition Regulation]—but isn't—is that the first two uses of a price realism analysis can only be made if there is an evaluation factor in the request for proposals calling for this type of assessment.

Ralph C. Nash & John Cibinic, *Price Realism: It's Different from Price Reasonableness*, 17 NASH & CIBINIC REP. ¶ 14 (Mar. 2003).

low bids.<sup>83</sup> In a nutshell, the proposed changes to the model law would have allowed a contracting official to probe any offer that seemed unrealistically low and, if the contracting officer remained unsatisfied that the contract could be performed at the offered price, to reject the offer. The working group took up the proposed changes, and noted the following policy concerns:

- *Possible discrimination*: The proposed changes would vest contracting officials with substantial discretion to exclude bids that seemed unrealistically low. These provisions could be used in a discriminatory manner, to exclude, for example, new entrants to a procurement market that consistently offer lower prices.<sup>84</sup> Because of this potentially discriminatory impact, the UNCITRAL working group members noted that it is important to stress that the “price realism” review process must be transparent and meant to enhance, not reduce, competition.
- *Price-based assessment*: The members of the working group stressed that any assessment of an offeror’s price should *not* rely on cost information, i.e., when assessing prices that seem low, contracting officials should not demand or rely upon contractors’ *cost* data. This is an important distinction to draw, because the European directives,<sup>85</sup> which allow contracting officials to demand information on the “constituent elements” of a suspect bid, veer disturbingly towards a cost-based assessment of price

83. See U.N. Doc. No. A/CN.9/WG.I/WP.40/Add. 1, *supra* note 69, ¶¶ 27–29.

84. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 107. For a criticism of a U.S. procurement in which the agency assessed price realism *only* by comparing the offeror’s prices to previous contractors’ prices—and, probably unsurprisingly, found “risk” in the offeror’s lower prices—see Ralph C. Nash & John Cibinic, *Postscript II: Price Realism Analysis*, 19 NASH & CIBINIC REP. ¶ 37 (July 2005) (reviewing Systems, Studies & Simulation, Inc., Comp. Gen. B-295579, Mar. 28, 2005, 2005 CPD ¶ 78). Professor Nash termed this narrow analysis simply “weird.”

85. Article 57 of Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 Coordinating the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Postal Services Sectors, 2004 O.J. (L 134) 1, provides as follows:

**Abnormally low tenders**

1. If, for a given contract, tenders appear to be abnormally low in relation to the goods, works or services, the contracting entity shall, before it may reject those tenders, request in writing details of the constituent elements of the tender which it considers relevant.

Those details may relate in particular to:

- (a) the economics of the manufacturing process, of the services provided and of the construction method;
- (b) the technical solutions chosen and/or any exceptionally favourable conditions available to the tenderer for the supply of the goods or services or for the execution of the work;
- (c) the originality of the supplies, services or work proposed by the tenderer;
- (d) compliance with the provisions relating to employment protection and working conditions in force at the place where the work, service or supply is to be performed;
- (e) the possibility of the tenderer obtaining State aid.

2. The contracting entity shall verify those constituent elements by consulting the tenderer, taking account of the evidence supplied.

3. Where a contracting entity establishes that a tender is abnormally low because the tenderer has obtained State aid, the tender can be rejected on that ground alone only after consultation with the tenderer where the latter is unable to prove, within a sufficient time limit fixed by the contracting entity, that the aid in question was granted legally. Where the contracting entity rejects a tender in these circumstances, it shall inform the Commission of that fact.

realism. The experience in the United States shows that a system for reviewing vendors' *costs* (as opposed to prices) is extremely cumbersome and difficult. It means, ultimately, erecting a system of rules and audits for determining which costs are allowable. Several observers stressed, therefore, that it is important that the Model Procurement Law remain rooted in *price* analysis.

Despite these concerns, the members of the working group did concur that contracting officials should be given the authority—and should be encouraged—to probe bids that seem suspiciously low.<sup>86</sup> The challenge is to ensure that the price realism review not be used to discriminate, for example, against new market entrants that hope to penetrate a market precisely *because* their prices are so low.

These concerns, as they play out in the UNCITRAL and European rules, shed light on the U.S. rules regarding price realism—and the U.S. rules, correspondingly, suggest a way forward for other nations. As was noted above, those crafting U.S. procurement law generally have taken a dim view of bid protests challenging price realism, and have held that typically price realism will not be independently assessed *unless* the solicitation previously alerted bidders that price realism would be a point of review.<sup>87</sup> Notably, the UNCITRAL working group favored the same approach: to ensure transparency and non-discrimination, contracting agencies should have to notify bidders in the solicitation that prices will be assessed for realism.<sup>88</sup> This would give bidders at least some opportunity to raise objections, if it appeared that the price realism review would really be used only to exclude bidders unfairly, on discriminatory grounds.

The UNCITRAL debate also suggested, though, that the U.S. approach to price realism may need to be liberalized.<sup>89</sup> The U.S. approach to price

86. See U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 109.

87. See, e.g., AllWorld Language Consultants, Inc., Comp. Gen. B-291409, B-291509.2, Dec. 16, 2002, 2003 CPD ¶ 13 (no price realism analysis required where none was provided for in solicitation). As the U.S. Court of Federal Claims explained in *Labat-Anderson Inc. v. United States*, 50 Fed. Cl. 99 (2001), the “realism of offerors’ proposed prices is not ordinarily considered in the context of a fixed-price [agreement] because the contractor bears the risk of unreasonable cost estimates under such a vehicle.” The court in *Labat-Anderson* cited, however, FAR 15.404-1(d)(3), which permits cost realism analyses, to probe underlying costs, in exceptional cases for fixed-price-type contracts, and *Hydraulics Int’l Inc.*, Comp. Gen. B-284684, B-284684.2, May 24, 2000, 2000 CPD ¶ 149, which noted that the nature and extent of an agency’s price realism analysis are matters within the agency’s discretion. The U.S. Environmental Protection Agency (EPA), it should be noted, routinely provides in its form solicitations that price realism *will* be evaluated. See EPA Acquisition Regulation 1515.209, 1552.215-70 (“[T]he Government will also evaluate proposals to determine contract cost or price realism.”). In essence, in accordance with the framework erected by the GAO decisions, the EPA has opened the door to a price realism analysis in any of the negotiated procurements covered by these standard terms. Cf. Ralph C. Nash & John Cibinic, *Price Reasonableness: A Much Misunderstood Term*, 17 NASH & CIBINIC REP. ¶ 22 (Apr. 2003) (arguing that a prudent contracting official should *always* make price realism part of a solicitation’s stated basis for evaluation, so that the door is always open to price realism analysis, to protect the government’s interest).

88. U.N. Doc. No. A/CN.9/590, *supra* note 4, ¶ 108.

89. Notably, Professors Cibinic and Nash long argued, in their writing and in their teaching,

realism, as developed in the GAO and court decisions, focuses first—and almost exclusively—upon the allocation of *legal* risk in a fixed-price contract.<sup>90</sup> As the U.S. bid challenge forums have emphasized, a fixed-price bidder bears the legal risk that its bid will prove unrealistically low. As a result, the GAO<sup>91</sup> and the U.S. Court of Federal Claims have been reluctant to open the door to protests alleging unrealistically low bids, although they will consider a bid protest challenging a price realism analysis if the solicitation signaled that the reviewing agency would assess price realism, say, for example, to assess the offeror's understanding of the solicitation's technical requirements.<sup>92</sup>

What the U.S. decisions do *not* fully address, however, is the *practical* risk of failed performance, when the winning contractor's bid was below cost and performance is not secured by some sort of bond. Indeed, in U.S. procurement, outside the construction realm (where performance bonds are the norm),<sup>93</sup> very few contracts require security to ensure that performance is completed. Arguably, this leaves a significant risk that performance will fail. In U.S. procurement, the risk of that failure is mitigated by a series of checks on improvident contractors, including sophisticated systems that allow government officials to assess prospective contractors' ability to perform, a mature bankruptcy system that allows contractors to perform even if financially crippled, and the onerous long-term injuries (to reputation and otherwise) that contractors know they will suffer if they default on a federal contract. Those risk-mitigation measures are not perfect, however, and where a contractor's prices may, in fact, be unrealistically below cost, the Government

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that the Federal Acquisition Regulation should be amended so that price realism would be assessed in *every* fixed-price procurement. *E.g.*, Ralph C. Nash & John Cibinic, *The Federal Acquisition Regulation: Can It Be Made a Quality Document?* 16 NASH & CIBINIC REP. ¶ 22 (May 2002); Ralph C. Nash & John C. Cibinic, *Contract Prices: What Is a "Fair and Reasonable Price"?* 15 NASH & CIBINIC REP. ¶ 22 (Apr. 2001); Ralph C. Nash & John Cibinic, *An Excellent Procurement*, 14 NASH & CIBINIC REP. ¶ 42 (Aug. 2000).

90. *See, e.g.*, *First Enter. v. United States*, 61 Fed. Cl. 109, 124 (2004) (a "contracting officer will normally not perform realism analysis on an offeror's *price*—that is, determine whether an offeror's price is too *low*—because the contractor bears the risk of unreasonable estimates in fixed price contracts" (citing *Labat-Anderson, Inc. v. United States*, 50 Fed. Cl. 99, 106 (2001)); *Grove Res. Solutions, Inc., Comp. Gen. B-296228*, July 1, 2005, 2005 CPD ¶ 133.

91. The conservative approach may reflect, in part, a reluctance to open another line of protest that would be so easy to raise against almost any low-priced award; it is very easy, after all, for a bidder to argue that it lost because the winning bidder's price was unrealistically low.

92. *E.g.*, *Grove Res. Solutions, Inc.*, 2005 CPD ¶ 133, at 3 ("Although agencies are required to perform some sort of price or cost analysis on negotiated contracts to ensure that proposed prices are fair and reasonable, where, as here, the award of a fixed-price contract is contemplated, a proposal's price realism is not ordinarily considered, since a fixed-price contract places the risk and responsibility for contract costs and resulting profit or loss on the contractor. However, an agency may, as it did here, provide in the solicitation for a price realism analysis for such purposes as measuring an offeror's understanding of the solicitation requirements, or to avoid the risk of poor performance from a contractor who is forced to provide goods or services at little or no profit."); *Puglia Eng'g of Calif., Inc., Comp. Gen. B-297413, B-297413.2, B-297413.3*, Jan. 20, 2006, 2006 CPD ¶ 33 ("Where . . . an RFP contemplates the award of a fixed-price contract, an agency may provide for the use of a price realism analysis for the limited purpose of measuring an offeror's understanding of the requirements or to assess the risk inherent in an offeror's proposal.")

93. *See* FAR 28.102-1.

retains a significant risk that performance will fail when the Government does not demand a performance bond. It is that residual, unmitigated risk—one not addressed by the systemic checks in U.S. procurement—that remains unresolved in the U.S. law regarding price realism.<sup>94</sup>

The UNCITRAL and European models suggest, therefore, that U.S. policymakers ultimately may need to open the door more broadly to price realism assessments. The U.S. rules should, of course, guard against agencies' use of price realism analysis as a discriminatory "weapon" against low-price entrants to the federal market. Those concerns regarding potential discrimination could be addressed, however, by structuring highly transparent procedures for price realism assessments, including, for example, requiring that solicitations signal a possible price realism analysis.<sup>95</sup> With discrimination checked, and a broader recognition of the reasons to probe for below-cost pricing, U.S. contracting officials could better address the residual risks that unrealistically low/below-cost pricing may pose.

To extend our comparative analysis a step farther, by understanding when procuring officials in developing nations may want to make a more probing price realism analysis, we may be in a better position to predict when U.S. procurement officials, for their part, might need to probe price realism more closely. Procuring agencies in developing nations may require broader discretion to assess price realism because the systemic elements that protect U.S. agencies against unrealistically low prices—*e.g.*, vendors' fear of default termination, sophisticated systems for assessing vendors' financial strength, performance security provided by a third party, or a bankruptcy system that fosters project completion—simply do not exist in many developing nations. In those developing nations, which are much more likely than industrialized nations to adopt the UNCITRAL Model Law, the UNCITRAL Model Law should, logically, leave procuring officials more flexibility to assess the true risk posed by strikingly low bids. By the same token, where those systemic protections are not available to U.S. agencies—when, for example, U.S. agencies engage in fixed-price contracts in unruly markets, without independent systems to help assure performance—the U.S. rules should, in principle, point procuring officials toward a more probing assessment of price realism,<sup>96</sup> to

94. *Cf.* Cherry Road Techs., Comp. Gen. B-296915, B-296915.2, B-296915.3, B-296915.4, B-296915.5, Oct. 24, 2005, 2005 CPD ¶ 197 (agency not obligated to conduct realism analysis); YORK Bldg. Servs., Inc., Comp. Gen. B-296948.2, B-296948.2, B-296948.3, B-296948.4, Nov. 3, 2005, 2005 CPD ¶ 202, at n.3 (price realism assessment not required of agency even if agency had concluded that price bid was below cost).

95. Current case law in the United States already contemplates such a signal of an impending price realism analysis, and that signal gives prospective offerors an opportunity to protest if it appears price realism might be used to discriminate against low-price offerors.

96. As the GAO has noted, the Federal Acquisition Regulation already affords agencies a variety of means to assess price realism:

The Federal Acquisition Regulation (FAR) provides a number of price analysis techniques that may be used to determine whether prices are reasonable and realistic, including comparison of the prices received with each other; comparison of previously proposed prices for the same or similar items; comparison with the independent government estimate; and analysis of pricing

control the performance risk left unmitigated by the normal systemic protections. At the same time, of course, in balancing contracting officials' authority to probe prices, we must be mindful of the transaction costs caused by a pricing review,<sup>97</sup> and of the risk, discussed above, that contracting officials could use price realism to discriminate against genuinely low-cost suppliers.

## V. CONCLUSION

In this first decade of the twenty-first century, U.S. procurement law is turning a corner: probably for the first time in the modern era, comparative international assessments are becoming a profoundly useful tool in developing U.S. procurement rules. As the analysis above reflects, three issues being studied by UNCITRAL—electronic communications, reverse auctions, and abnormally low bidding—offer lessons that are directly relevant to the U.S. experience:

- With regard to electronic communications, the UNCITRAL deliberations suggest that, while federal procurement has shifted relatively easily into the electronic age, in the future that smooth progress may stumble should specialized technologies used in electronic procurement, such as security tools, prove discriminatory against certain vendors.
- With regard to reverse auctions, the research that has grown out of the UNCITRAL initiative has shown that the U.S. approach—to forego regulation, and to let the market guide reverse auctions—is probably unworkable. Without the direction that regulation provides, it is too easy for agencies to misuse reverse auctions so that, ironically, reverse auctions become anticompetitive, or result in purchases that do not reflect the best value for the Government. Around the world, other procurement regimes have regulated reverse auctions, if only to ensure that the right goods and services are bought in the best way, for the best value; the comparative review suggests quite powerfully that the United States should do the same.
- Finally, the UNCITRAL initiative, which is probing anew the curious phenomenon of “unrealistically” low bidding, suggests that U.S. law may have approached this problem too narrowly. Perhaps because they fear opening the floodgates to a new form of protest, the bid protest forums in the United States have been reluctant to encourage challenges based on unrealistically low bids, absent notice in a solicitation that price realism would be weighed in the agency's evaluation. The U.S. protest decisions have generally noted that the legal risk of completing perfor-

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information provided by the offeror. FAR sect. 15.404-1(b)(2). The nature and extent of an agency's price realism analysis ultimately are matters within the sound exercise of the agency's discretion, unless the agency commits itself to a particular methodology in a solicitation.

Burns & Roe Servs. Corp., Comp. Gen. B-296355, July 27, 2005, 2005 CPD ¶ 150, at 5.

97. See, e.g., FAR 15.402(a) (contracting officer should not seek out more cost or pricing information than is necessary).

mance rests with the low offeror, and have left it at that, although the Government in fact retains a real risk that a below-cost bid will result in failed performance. The UNCITRAL deliberations highlight this residual performance risk—the risk that the unrealistically low bidder will be unable to perform—which U.S. law may simply overlook.

As these examples show, although the United Nations' primary goal in reforming the UNCITRAL Model Procurement Law is to benefit developing nations, ironically that effort is yielding many comparative lessons for U.S. procurement reform. But beyond yielding specific lessons for reform, the UNCITRAL reform initiative confirms that procurement systems around the world face remarkably similar problems, and that procurement, like almost all other disciplines, is "globalizing" at a stunningly rapid pace.