



## *An Owner's Guide to Reverse Auctions*

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

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

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

The construction industry's objection to reverse auctions stems from many risks and pitfalls associated with their use. As an owner and purchaser of construction services, you should be aware of the following:

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

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

***How can owners determine the best method of construction procurement?*** As a purchaser of construction services, you are encouraged to follow the prevailing, recommended practices of construction procurement in Canada. Your local or regional construction association is always willing to provide assistance in determining the best solution for your upcoming construction procurement needs, including alternatives to the use of reverse auctions.

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