
Special Reports

8.1 An Analysis of Reverse Auction Bidding

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Reverse auction bidding (RAB) is a process in which a buyer of goods and services continues to solicit bids from sellers until the buyer is satisfied it has received an acceptably low price. As used in construction, the process usually entails using a dedicated internet web site. At a scheduled time, the bidding for a project opens and all interested bidders submit their prices to the web site. The host web site then posts the prices on the site for all bidders to see. The bidders' identities usually remain anonymous. Bidders are then given a certain period in which to offer any *lower* price that they may choose to submit. Thus, the auction proceeds in the "reverse" of a typical auction in that bids are expected to go down rather than up. Once no further bids are received after a certain period following the receipt and posting of the last bid, the auction is closed. Award is then made to the lowest bidder.

Reverse auction bidding differs from traditional sealed bidding in which sealed bids are received and opened at a specified time and the project is awarded to the lowest responsible bidder. Under the traditional method, general contractors submit their bids, or pre-selected general contractors solicit bids from subcontractors, and there is no opportunity for subsequent bidding after the specified time for bid opening.

The use of RAB is increasing for the purchase of construction commodities. For example, the Minnesota Department of Administration recently obtained legislative authority to conduct RAB to procure construction goods, but not services. See Minn. Stat. § 16C.10, subd. 7. More recently, the reverse auction technique has been extended by some public bodies, e.g., Pennsylvania's Department of General Services, to procure construction services. Several private companies, especially large national "big box" retailers are using RAB to select general contractors and subcontractors.

The RAB process has many perceived costs and benefits. In this paper, the Construction Industry Cooperative Committee of Minnesota (CICC) intends to discuss the current debate over this new construction procurement method in the context of three issues: (1) savings, (2) bid shopping, and (3) best value. CICC believes that a better understanding of the perceived advantages and disadvantages of RAB will allow interested participants to decide whether using RAB would enhance or detract from their particular project.

Savings

Advantages

Advocates of RAB claim that owners or taxpayers gain significant savings through use of the process. For instance, the Minnesota Department of Administration conducted a reverse auction for the aluminum it uses in license plates. Because the prices started at \$1.555 per pound and dropped to \$1.029 in 45 minutes, the state claimed that the process saved taxpayers about \$150,000 over the course of five years. As summarized by the state, "A reverse auction gets to the absolute lowest price a vendor will offer, as opposed to a bid price [under the traditional sealed bid approach] that might not be the bottom line price." The press secretary for Pennsylvania's Department of General Services commented that in reverse auction bidding, bidders "see each other's bids and keep going down, and we get a better price. It's very exciting because the bids will drop \$10,000 at a time." According to the press secretary, the contractors prefer online bidding because they can see the other bids, as opposed to bidding blindly with sealed bids. Several large national retailers who use RAB claim similar savings successes based on historical cost data.

Disadvantages

Critics of the process argue that the claimed savings generated by RAB are illusory and that the process could actually cost owners and taxpayers more than traditional sealed bidding. Owners often point to the drop in pricing from the first bid to the last as proof of the cost savings generated by RAB. Opponents argue that bidders in the RAB process do not start at their lowest number as they have to in the traditional sealed bid method. Instead, opponents assert that it is common for bidders in an auction setting to start with a high bid, see what prices their competitors are bidding, and then reduce their bid only if forced to do so by competition. Thus, downward movement from inflated initial bids should not be viewed as savings.

Proponents attempt to show savings from the RAB process by comparing the resulting low bid to historical bids obtained under the traditional sealed bidding method. Skeptics argue that it is difficult to demonstrably prove that the same savings for that particular bid would not have been achieved by using the traditional sealed bid method. Changes in market cycles can just as easily explain savings as the particular bidding system used. As support for their arguments, proponents point to a 2004 study by the U.S. Corps of Engineers recommending that RAB should not be used to procure construction services and that the process fails to realize any additional savings over the sealed bid process. In 2005, the Acquisition Reform Working Group, which includes the U.S. Chamber of Commerce, also recommended that RAB not be used to procure construction-related services.

Critics also contend that knowledge of everyone's bids gained in the open RAB process does not necessarily extract the lowest bid. For example, in traditional sealed bidding, it is assumed that bidders will submit their lowest price at the time of bid opening exactly because they do not know what their competitors are bidding. If a bidder does not immediately bid its lowest price in traditional bidding, the bidder will forever lose its opportunity for the work. In RAB, however, the bidder does not start with its lowest bid, and only reduces its bid if forced to do so by competition. The open competition may not force a bidder to submit the lowest price it would have submitted had it been bidding blindly in a traditional sealed bidding process. Critics contend there is significant evidence that RAB does not flush out the lowest price for the owner or the public. Indeed, if RAB truly saved owners money, it would have displaced traditional sealed bidding long ago.

Bid Shopping

Advantages

Proponents of RAB contend that the process of shopping for the lowest price will not be misused because it is (or should be) based on strict, published protocols. Accordingly, the process should not be critically labeled as "bid shopping" simply because it reduces contractor profit. Owners argue that bid shopping, a process where a general contractor seeks price reductions from its subcontractors, commonly occurs after the prime contract is awarded on traditionally bid projects. Owners criticize this form of bid shopping because the savings a general contractor "shops" out of subcontractors is kept by the general contractor, not passed on to the owner. As a result, the general contractor becomes richer while the owner receives lower quality work from the general's unhappy and unqualified subcontractors. Proponents argue that, even if RAB is bid shopping, at least it is done openly and consensually and the benefits go to the owner, not the general contractor.

Disadvantages

According to its critics, RAB institutionalizes a new form of bid shopping, a practice in which repeated demands are made upon general contractors and subcontractors to lower their prices or else they will lose the work. Critics argue that this form of bid shopping encourages an adversarial project relationship among all project participants (e.g., the owner, contractor, designer and subcontractors) because the practice forces contractors to reduce necessary profit and contingency dollars from their bids. Critics fear that in order to make money in this environment, contractors will make claims for extra work at every opportunity. The result will be less cooperation and more litigation. Bid shopping also reduces quality and safety by encouraging bidders to take short cuts, because bidders have been left without adequate profit and contingency funds. The industry has long recognized that it is not in the owner's best, long-term interest to extract the last profit dollar from the construction process. This is why reputable general contractors do not bid shop and why bid shopping is bad for the owner, no matter who ends up with the purported savings.

Best Value and the Commodities and Service Distinction.

Advantages

Advocates of RAB contend that private and public owners must continue to reduce costs, especially in this demanding economy, and reverse auction bidding leverages internet technology to ensure owners reach the broadest market and obtain the lowest price. To those that argue lowest price may not result in best value to the owner, proponents respond that quality concerns can be protected by well-drafted contract documents to which bidders must agree as a condition of participating in the RAB process. Advocates argue RAB is appropriate for procuring construction services as well as commodities as evidenced by current negotiations among all types of owners and service providers regarding price. Therefore, if a construction owner can obtain the lowest price and assured value through RAB, then the method provides the owner with the best value whether purchasing services or commodities.

Disadvantages

Everyone favors expanding markets and fair competition through responsible use of internet technology. Opponents of RAB argue that the market-broadening advantages of the internet are equally applicable to traditional sealed bidding as they are to reverse auction bidding.

Reverse auction bidding may be appropriate for purchasing commodities, but construction services are not commodities. Commodities are typically produced with fixed factors of production. Therefore, a buyer can purchase commodities through a reverse auction bid with some assurance that it will receive the same quality in each unit because the amount of labor and supervision spent on each unit is the same.

In contrast, the factors of production in construction are more fluid, with the main quality and price variable being the amount of labor used to build and supervise a particular project. The amount of labor used to construct a building can vary from one location to the next, even if it is the same design, due to code variations, different labor pools, and a different team of contractors. Whereas price variations may not affect a purchaser's ability to receive identical units of a commodity, price variations may very well affect whether a purchaser can receive identical construction projects from one location to the next.

The RAB process pressures construction bidders to reduce their main price variable -- the amount of labor and supervision used to build the project. RAB critics express concern that the RAB process may induce bidders, in their efforts to be the lowest bidder, to reduce labor and supervision to levels that will endanger safety and lessen quality. Many contractors fear that when costs must be reduced, proper site safety is one of the first costs to be cut. Such a result would not be good for contractors, labor, the owner, or the public.

Owners may believe that they are protected against unsafe construction practices or poor quality by their contract documents, but a process that induces bidders to imprudently reduce the hours bid for labor and supervision will only lead to lawsuits to enforce quality and safety obligations. The adversarial relationships and loss of partnering that RAB will cause will be more costly than any purported savings garnered through the process. When it embraced "partnering" decades ago, the industry recognized that value is not solely defined by low price. Therefore, many RAB critics assert that owners' desire for the best value in terms of price *and* quality, reliability and safety is best achieved through traditional sealed bidding, not reverse auction bidding.

CONCLUSION

The use of RAB is in its incipient stages in the construction industry. Therefore, demonstrable proof of savings due to the process is, and may always be, difficult to establish. CICC does not support any procurement method that results in or induces poor quality work or unsafe working conditions. The construction industry in Minnesota has an enviable reputation for quality, value, safety, and collaboration among owners, contractors, subcontractors and designers. Whatever procurement method is used, it should be designed to further, not lessen, these values.

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8.2 Project Labor Agreements

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Project Labor Agreements (PLAs) are increasingly popular types of collective bargaining agreements in today's construction industry. They play a significant role in construction industry labor relations, and the project team should be aware of how PLAs change the dynamics of the project. The purpose of this paper is to discuss some of the basic features of PLAs and why some groups advocate for or against their use.

What is a Project Labor Agreement (PLA)?

A PLA is a collective bargaining agreement between organized labor and contractors and/or owners that applies to a specific project site. It is limited in scope to the project definition contained in the agreement. PLAs have a specified beginning date at which time they become effective. They normally expire at the completion of the project.

Most industry officials believe PLAs are the evolution of the many years of national agreements used in different industry segments. National agreements typically apply to industrial or maintenance work and are not as prevalent in commercial building or highway construction. They have been used both on public and private projects in Minnesota and are most common on commercial building projects.

PLA Features

Most PLAs have a no-strike/no-lockout provision that prohibits work stoppages at the site for any reason and allows work at the project site to continue during a strike over local contract negotiations. They either require an all-union project (private project PLA) or that local area union wages, benefits, and working conditions be employed at the site (public project PLA). They usually contain a procedure for the processing of jurisdictional disputes and other grievances. Most PLAs incorporate the provisions of the applicable local area union agreements. In addition, they usually require retroactive payment of wages/fringes back to the expiration of the local area contract(s), if the PLA was in effect during contract negotiations and a new agreement was reached.

Promoting PLAs

The most significant benefit is the certainty created by the no-strike provision. Because the potential for strikes and other work stoppages in the union sector creates risk, some owners and contractors believe PLAs are a risk management tool, giving protection against costly work stoppages and labor disputes. PLAs have been used by organized labor to extol the benefits of building all union - citing a history of quality, safety and efficiency as reasons to build projects under a PLA.

Opposing PLAs

Critics believe that PLAs create a cost environment that favors union contractors, restricting competition and driving up costs. Also, if union contractors are bargaining as part of an association, PLAs can make labor negotiations more difficult. If there is a significant amount of work being performed under PLAs during labor negotiations, labor can use PLAs to leverage their position in bargaining, thereby driving up the cost of the settlement(s). These costs are then passed on to owners. Others believe that PLAs can diminish the importance and integrity of labor/management relationships. PLAs do change the bargaining landscape and many times pit union members, contractors and owners who are working under PLAs against those who are not. This can divide the stakeholders and do damage to important relationships that takes years to repair. Also, PLAs do not cover off site activities that may relate directly to a PLA covered project. The result could be that a strike or work stoppage at an off site location, such as a fabrication or material yard, impedes progress at a PLA project.

PLAs compared to local collective bargaining agreements

PLAs usually involve one project and many contractors/unions. Local agreements typically involve one contractor or association with one union. There may be other differences such as 8(f) or 9(a) agreement status, subcontracting, grievance procedure, personal liability, general contractor liability for subcontractor fringe benefits, etc. Whatever agreement(s) is in effect, the project team should be knowledgeable and should seek competent legal counsel if there are questions.

Private versus public PLAs

There are differences between the two and they are the result of legal issues that have been determined in court and by executive order. In the U.S. Supreme Court's 1993 decision in Boston Harbor, project agreements were deemed lawful where the public entity involved is acting as an "owner" and not attempting otherwise to regulate labor relations policies of private sector employers. Nonunion contractors are not precluded from working on Boston Harbor-type public projects, and do so only on a "this project only" basis. Most of these legal arguments are the result of PLA opponents persisting in claiming that PLAs give preference to union contractors, placing nonunion contractors at a competitive disadvantage, in violation of public competitive bidding laws.

Governor Pawlenty Signs Executive Order

Governor Tim Pawlenty signed Executive Order 05-17 on November 21, 2005. The executive order prohibits state departments (Department of Administration, Mn/DOT, etc.) from discriminating against state contractors on the basis of union or nonunion status. Although not specifically stated in the order, the most obvious issue addressed by the order is Project Labor Agreements.

Under this order, State of Minnesota departments may not require or prohibit bidders, contractors or vendors from signing agreements with labor organizations for state construction. The stated goal of the executive order is to promote and ensure open competition in state construction contracts. Further, the order states the promotion of competition and equal access to government construction contracts will reduce construction costs to the State and to taxpayers while expanding job opportunities for small and disadvantaged businesses.

The order does not prohibit contractors from voluntarily entering into PLAs for state construction projects.

Deciding to use a PLA on a project

It is the owner's decision to utilize a PLA on a project. Some of these decisions can be politically charged. The design professional, design builder or general contractor may offer assistance to help determine if the PLA adds value to the project. Expect pro/anti-PLA groups to lobby owners and contractors for/against PLAs because they believe (1) it advances their competitive position and (2) it is the best, most effective way to build the project. The ultimate decision has to be based on a cost/benefit analysis and the threat of strikes or work stoppages usually enters into the equation. Sometimes organized labor refuses to consider a PLA, citing different reasons such as the type of project, political considerations, past experience with the owner or contractor, or the timing of the proposed project.

The future of PLAs

Most industry observers see the use of PLAs increasing in Minnesota, on both public and private construction, because unions believe PLAs are a value added enhancement to a project. The long-term impact of PLAs on labor-management relations and prevailing wages has yet to be determined. Whether or not any value added can be quantified and at what cost is a subject for open debate. PLAs do not guarantee a successful project but can be a tool to manage risk. Each project must be considered individually to determine if a PLA serves the best interest of the owner.