

Director of Legal Services :
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BRIEFING

PROCUREMENT USING ELECTRONIC AUCTIONS

Executive Summary

1. Traditionally local authorities have undertaken procurement by requiring tenders to be submitted by a prescribed closing date in a sealed envelope, and have impressed upon tenderers the fact that their bids are confidential.
2. In practice, it is realised that even with bulk purchasing that best value is not being achieved and that tenderers' margins may be high in service areas where there is little risk or price volatility.
3. **Electronic reverse auctions** are a novel procurement mechanism which can be applied to certain supplies and a few services in order to secure a lower price than could be achieved under other forms of competitive tendering. A reverse auction is a procurement procedure that enables tenderers to adjust their tenders in the light of information on the tenders submitted by other tenderers. The use of electronic auctions is specifically endorsed in the new consolidated procurement directive.

EU Directive 2004/18/EC

4. Directive 2004/18/EC ("**the Directive**") of the European

Parliament and of the Council of 31st March 2004 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts ("**Public Contracts**") is the new consolidated directive which consolidates the existing separate procurement directives for such contracts and introduces new procurement procedures.

5. The Directive recognises that the technique of electronic auctions is likely to increase and that such auctions should be given a Community definition governed by specific rules in order to ensure that they operate in full accordance with the principles of equal treatment, non-discrimination and transparency¹.
6. An "**electronic auction**" is a repetitive process involving an electronic device for the presentation of new prices, revised downwards and / or new values concerning certain elements of tenders, which occurs after an initial full evaluation of the tenders, enabling them to be ranked

All references in the footnotes
are to the Directive

¹ Recital (14)

- using automatic evaluation methods².
7. As with any competition, the overriding consideration has to be that local authorities cannot use them in such a way as to prevent, restrict or distort competition³

Electronic communications

8. The Directive allows for all communications and information exchange for Public Contracts to be by post, fax or electronic means⁴. However the means of communication chosen must generally be available and therefore not restrict contractors' access to the tendering procedure⁵
9. **"Electronic means"** using electronic equipment for the processing (including digital compression) and storage of data which is transmitted, conveyed and received by wire, by radio, by optical means or by other electromagnetic means⁶.
10. Communication and the exchange and storage of information has to be carried out in such a way as to ensure that the integrity of data and confidentiality of tenders and requests to participate are preserved⁷.
11. The tools used for communicating by electronic means, as well as their technical characteristics, have to be non-discriminatory, generally available and interoperable with the information and

communication technology products in general use.⁸

12. The Directive also lays down rules that are applicable to devices for the electronic transmission and receipt of tenders and to devices for the electronic receipt of requests to participate.⁹

Drivers behind electronic procurement

13. The Office of Government Commerce has estimated that the average savings for the public sector from the use of electronic reverse auctions are currently estimated at approximately 25% when viewed against traditional paper-based tender processes, with the potential for far higher savings dependent upon the type of goods being tendered for.
14. Every local authority has to produce an Implementing Electronic Government (IEG) statement of what it intends to do and when it intends to deliver electronic government. The Government has set a target for all local authorities to be able to provide all services electronically by December 2005. This target relates only to those services which can be provided electronically. Birmingham City Council achieved this 21 months ahead of the deadline.

Types of Contract

15. Electronic auctions are not suitable for all types of contract. They can be used for a wide

² Article 1 (7)

³ Article 54 (8)

⁴ Article 42 (1)

⁵ Article 42 (2)

⁶ Article 1 (13)

⁷ Article 42 (3)

⁸ Article 42 (4)

⁹ Article 42 (15) and Annex 10

range of supplies which would include office supplies such as paper. They can also be used for certain services such as cleaning and security. They would be unsuitable for supplies where pricing is volatile e.g. oil. They are unsuitable for contracts for the performance of works. Essentially they are for contracts where evaluation is predominantly by price. It is therefore a requirement for such contracts that the specification can be determined with precision¹⁰.

16. Electronic auctions will most likely be used either in an open procedure (where the auction is open to all persons who respond to a public notice) and under a restricted procedure (where the auction is open to all persons who respond to a contract notice and are then selected as meeting the required standard to take part in the auction). It is essential that if a local authority wishes to hold an electronic auction it states this in the contract notice¹¹.
17. A local authority will need to decide before holding an auction as to whether its outcome is to be based: -
- solely on prices where the contract is awarded to the tenderer submitting the lowest price; or
 - on prices and / or on the new values of the features of the tender indicated in the specification when the contract is awarded to the most economically advantageous tender (This allows for non price criteria

to be converted into a price equivalent).¹²

Pre-Auction Process

18. The local authority will need to prepare a specification for the contract which will have to contain information which is relevant to the conduct of the electronic auction. This will comprise: -
- 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;
 - any limits on the values which may be submitted, as they result from the specifications relating to the subject of the contract;
 - 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;
 - the relevant information concerning the electronic auction process;
 - the conditions under which tenderers will be able to bid and, in particular, the minimum differences which will, where appropriate, be required when bidding. (Clearly the aim of the auction is to maximise price reductions and therefore 'de minimis' reductions do not count);
 - the relevant information concerning the electronic equipment used and the arrangements and technical specifications for connection. (It may be necessary to provide training to tenderers who have not participated in such an

¹⁰ Recital (14) and Article 54 (2)

¹¹ Article 54 (3) of the Directive.

¹² Article 54 (2)

auction previously and to have a mock auction).¹³

19. Before the electronic auction starts, tenderers would first have to have submitted their initial prices and those would have to have been evaluated by the authority in accordance with the award criterion / criteria set and with a weighting fixed for them.¹⁴

Invitation to Participate in Auction

20. All tenderers who have submitted admissible tenders are then invited to participate in the auction. The key components of this process are:¹⁵

- the invitation is submitted simultaneously by electronic means by the local authority to all such tenderers;
- the invitation is for participants to submit new prices and / or new values;
- the invitation has to contain all relevant information concerning individual connection to the electronic equipment being used;
- the invitation has to state the date and time of the start of the electronic auction;
- the auction may take place in a number of successive phases;
- the auction may not start sooner than two working days after the date on which invitations are sent out;
- if the contract is to be awarded on the basis of the most economically advantageous tender (i.e. not on the basis of price alone) the invitation has to be accompanied by the

outcome of the full evaluation of the relevant tenderer;

- the invitation also has to state the mathematical formula to be used in the electronic auction to determine automatic reranking on the basis of the new prices and / or the new values submitted. This formula has to incorporate the weightings of all the criteria fixed to determine the most economically advantageous tender, as indicated in the contract notice or in the specifications. Where variants are authorised, a separate formula has to be provided for each variant.

Conduct of Auction¹⁶

21. An auction can be conducted over a relatively short period of a matter of hours.
22. Local authorities have to instantaneously communicate to all tenderers throughout each phase of an auction at least sufficient information in order to enable them to ascertain their relative rankings at any moment. Therefore, when a tenderer submits a revised tender it is essential for that tenderer to know whether it puts that tenderer into the lead.
23. Local authorities can also communicate other information concerning other prices or values submitted, provided that this is stated in the specifications. Therefore, they can communicate what is the leading price at any given stage or the reduction necessary to convert a tenderer's last submission into a leading tender this is provided in the specification.

¹³ Article 54 (3)

¹⁴ Article 54 (4)

¹⁵ Articles 54 (4) and (5)

¹⁶ Article 54 (6)

24. Local authorities may also at any time announce the number of participants in that phase of the auction. However, it is fundamental that local authorities do not disclose the identities of the tenderers during any phase of an electronic auction as this will breach confidentiality.
25. Local authorities may quite properly seek to encourage tenderers at various stages in the auction to put in revised prices.
26. A typical pattern which may be seen during an electronic auction is that at the outset the price reductions are relatively insignificant. However after a while one tenderer breaks from the pack and submits a tender which is significantly lower than the others. The effect of this is then to galvanise other tenderers into effective competition and prices in turn may then subsequently plummet. The local authority may in turn seek to encourage those who have not participated in this effective stage of the process in submitting a better bid. In addition where the time fixed for the close of the auction is approaching and it appears that the competition is being led by two or three tenderers then the authority may encourage those participants to submit a final winning tender.
- advance. The auction can be brought to an end in one or more of the following ways:-¹⁷
- an authority can indicate the date and time fixed in advance in the invitation to take part in the auction;
 - when an authority receives no more new prices or new values which meet the requirements concerning minimum differences. In that event the authority has to state in the invitation to take part in the auction the time which they will allow to elapse after receiving the last submission before they close the auction;
 - when the number of phases in the auction fixed in the invitation to take part in the auction has been completed.
28. After closing an electronic auction the local authority has to award the contract on the basis of the results of the electronic auction.¹⁸
29. An electronic auction could result in an extraordinary low tender being submitted. If a local authority is satisfied that a tender appears to be abnormally low, it may before rejecting that tender, request in writing details of the constituent elements of the tender that it considers relevant.¹⁹ The local authority is then obliged to verify the constituent elements by consulting the tenderer, taking account of the evidence supplied. If the leading tender is rejected it does not automatically mean that the second best tenderer wins, as the other tenderers have not been provided with an

Closure of an electronic auction

27. Where there is effective competition running right up to the end of an electronic auction it is crucial that the process by which it is brought to an end has been clearly determined in

¹⁷ Article 54 (7)

¹⁸ Article 54 (8)

¹⁹ Article 55 (1)

opportunity to improve upon it. Unless the invitation to participate in the auction provided for this eventuality, it may be necessary to re-open the auction procedure.

For advice on Electronic Auctions:

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Conclusion

30. Birmingham City Council undertook a reverse price auction in 2003 for photocopying paper and card, and estimated it achieved a saving of 28% on its previous arrangement.
31. The scope for price reductions in an auction below those tendered by tenderers at the initial stage is substantial and can quite easily exceed the substantial costs in setting up the technology required to conduct an electronic auction.
32. Clearly time has to be invested with participants in the market to encourage them to take part in the auction. Whilst it may be questioned why suppliers would be keen to submit what would otherwise be very low prices for their supplies and services, it needs to be understood commercially that suppliers have clear business reasons for participating in order to retain/increase their share of the market, to maintain their volumes, and to avoid losing a client.
33. If a local authority sets up a new contract following an electronic auction it is unlikely to procure the same service/supplies in a new electronic auction following the expiry of the new contract since it is unlikely that prices will be able to reduce further in the short term.