



**STATEMENT OF
LOUIS J. CELLI, DIRECTOR,
LEGISLATIVE DIVISION OF THE AMERICAN LEGION**

BEFORE THE

**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES**

**SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
UNITED STATES HOUSE OF REPRESENTATIVES**

ON

**CONTRACTING AWAY ACCOUNTABILITY
REVERSE AUCTIONS IN FEDERAL AGENCY ACQUISITIONS**

DECEMBER 11, 2013

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To “aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns”¹ (*Original charter of the U.S. Small Business Administration*)

In 1953 the Small Business Act was signed into law, and created the Small Business Administration (SBA) we know today. The act was created to encourage and promote small business growth, and foster free market competition. In 1945 and 1946 millions of Americans took off their uniforms after WWII and came home to a job market that was shrinking because the war no longer provided economic stimuli. True to their very nature, American patriots turned to entrepreneurship. Still, large firms which grew powerful as a result of war production had a tremendous advantage over smaller, and start-up companies, so Congress created the SBA to help level the playing field.

The Small Business Act applies government wide, not just to the SBA. Government has a fiduciary responsibility and legal obligation to treat small business fairly, and to not take advantage of its buying power and become predatory, or act as a monopolistic powerbroker.

Over the past 10 years The American Legion has worked closely with hundreds of small business owners, and has established a Small Business Taskforce that is comprised of successful small and medium sized veteran owned businesses. Additionally, we have thoroughly researched numerous reports and articles both extolling the benefits of the reverse auction, and the disadvantages of them. Much of the research we reviewed was gathered from the Reverse

¹ 15 U.S.C. § 631 : US Code - Section 631: Declaration of policy - See more at: <http://codes.lp.findlaw.com/uscode/15/14A/631#sthash.y4mlz3Oa.dpuf>

Auction Research Center which is located in the Department of Management at Southeastern Louisiana University, and through senior leadership at Fed Bid, one of the major online reverse auction services used by the federal government.

The American Legion appreciates the goal of the government contracting community to lower federal exposure through competitive contracting initiatives, but is concerned that misuse of extra-governmental tools that have not suffered the scrutiny of the appropriations process, is putting veteran owned small businesses at risk and could also be serving to undermine the entire procurement process.

According to the Institute for Supply Management, reverse auctions are “a type of e-auction that is conducted online, in real-time, between a single buying organization and pre-qualified suppliers. Suppliers compete in presenting bids to the buyer for the supply of goods or services whose specifications for design, quantity, quality, delivery, and related terms and conditions have been clearly defined”; and David C. Wyld, Executive Director of the Reverse Auction Research Center reports in his 2011 report, *Reverse Auctioning: Saving Money and Increasing Transparency*, “The reverse auction acquisition tool is not appropriate for all spending categories. In fact, there are “sweet spots” for the use of reverse auctioning, namely in the areas of commodity-type buys of goods and services and in goods that are readily specifiable.”²

The American Legion also notes that all of the evidence, both for and against reverse auctions consistently use the term “when used correctly, reverse auctions can be an effective purchasing tool”. However, “when used correctly” turns out to be the default phrase that places the responsibility for proper use squarely on the customer, in this case – the federal government. Contracting officers who are not formerly trained to use these tools have ended up taking unfair advantage of small businesses, and because these tools are not government tools, the oversight for structure and use lacks proper implementation.

Wyld’s article also discusses a 2004 memo from Robert A. Burton, then the associate administrator of the Office of Federal Procurement Policy (OFPP), The OFPP urged each federal agency, in the interest of “maximizing productivity gains from technology ...to explore increasing the use of commercially available online procurement services”. One tool specifically mentioned in the Burton memo was reverse auctions, and the OFPP noted at the time that: “If used correctly, the reverse auction approach can ensure that the government receives competitive prices”.³

Reverse auctions are not necessarily bad, any more than firearms are bad, when used properly by trained professionals. But while largely unregulated and improperly utilized, reverse auctions pervert the federal procurement system and skew the economic marketplace by encouraging

² See David C. Wyld, “Reverse Auctioning: Saving Money and Increasing Transparency” (July 2012), available at www.businessofgovernment.org/report/reverse-auctioning-saving-money-andincreasing-transparency.

³ Ibid

awards made through an unnatural procurement process that ultimately preys on weak businesses, rather than promote strong businesses. This process ends up giving a false valuation of fair market product pricing, and will eventually create a disparity between more thorough procurement vehicle processes where value is made part of the decision matrix, and the reverse auction where value or added value is often omitted from bid consideration. Further, reverse auctions appear to undermine the Government Services Administration's (GSA) application process that requires the government be offered the best possible price in the first place. If that is true, then how can GSA contract holders consistently compete in the reverse auction process at offers lower than their established GSA contract?

An example of added value would be a printer and copier vendor that, through their negotiated license agreement with the manufacturer, is required to provide training and technical support on the products they sell. This added value increases the market price of the product, but may not be reflected in the sterile environment of the reverse auction bid process. Reverse auctions create a disproportionate disparity in the federal procurement industry while American Legion resolution 321⁴ specifically calls for equal parity in federal procurement, and according to the Federal Acquisition Regulation (FAR); ““Fair market price” means a price based on reasonable costs under normal competitive conditions and not on lowest possible cost”.⁵ Further, Fair Market Price is mentioned in nearly every part of the FAR and that exact term can be found more than 30 times.

In the FAR we also find FAR part 19 §807 giving a definition of Estimating Fair Market Price;

“(c) In estimating a fair market price for a repeat purchase, the contracting officer shall consider recent award prices for the same items or work if there is comparability in quantities, conditions, terms, and performance times. The estimated price should be adjusted to reflect differences in specifications, plans, transportation costs, packaging and packing costs, and other circumstances. Price indices may be used as guides to determine the changes in labor and material costs. Comparison of commercial prices for similar items may also be used.”

And FAR part 15 §404-1 discusses proper Proposal Analysis Techniques;

“(a) General. The objective of proposal analysis is to ensure that the final agreed-to price is fair and reasonable.”⁶

And finally FAR part 19.1405 outlines Service-Disabled Veteran-Owned Small Business Set-Aside Procedures;

“(b)(2) Award will be made at a fair market price.”⁷

⁴ Resolution No. 321: Support reasonable set-aside of federal procurements and contracts for business owned and operated by veterans, American Legion. National Convention August 2012

<http://archive.legion.org/handle/123456789/2190>

⁵ Federal Acquisition Regulation, March 2005, <http://www.acquisition.gov/far/current/pdf/FAR.pdf>

⁶ Ibid

While reverse auctions may have a place in federal procurement, in a limited capacity, The American Legion believes that the federal contracting office has the primary responsibility to ensure that every product that the government spends tax payer dollars on, is purchased at fair market value. This assurance protects the tax payer, the small business, and the market.

Generally, reverse auctions are not popular in the commercial marketplace because the buyer doesn't always know what they are getting. Another example of reverse auctions is the online travel auction site Priceline. In these auctions the buyer knowingly understands that they are probably going to sacrifice comfort, convenience and quality for a lower price. Our federal government is not authorized to and should not be willing to forfeit those necessities, and congress does not fund government with the understanding that they must purchase marginally acceptable equipment and services, just as there is no pending legislation requiring federal travelers to use Priceline for their travel needs in an effort to save money. Also, Congress appropriates funds through an analytical process based on funding projections. If the government under spends the appropriated amount because they are thwarting the procurement process, then they should be mandated to immediately return the unobligated funds to the treasury, not obligate them for another purpose.

The American Legion is extremely concerned that reverse auctions will lead to decreased quality and decreased employment opportunities for veterans, which is in direct violation of American Legion resolution number 50⁸ that supports more hiring opportunities for veterans. Reverse actions will encourage vendors to learn how to provide the cheapest product and service in order to maintain profit margins, and government will be stuck purchasing poor quality because they will have no ability to shop for best value, only best price. These types of business models favor home-based business that primarily operate online and have no other employees than the owner, and no customer support. Businesses of this type end up relying solely on federal procurement as their only source of income, and this type of business model severely disadvantages businesses that hire veterans because businesses that hire employees have increased overhead expenses.

Businesses that have used reverse auctions successfully include very large businesses like Wal-Mart, Target, and Home Depot, who are in business for the sole purpose of making a profit. Purchasing at the lowest possible price is a core tenet for businesses like this as they have no legal, civic responsibility to protect small business like the federal government does, which is probably one reason our military isn't outfitted with products from Wal-Mart.

An article in Contract Management magazine points out a case study, conducted on The Department of State, reveals reverse auctions are already losing market share and have dropped

⁷ Ibid

⁸ Resolution No. 50: Support legislation that bolsters the hiring of veterans in the public and private sectors, American Legion. National Convention, August 2012
<http://archive.legion.org/bitstream/handle/123456789/2212/2012N050.pdf?sequence=1>

30 percent between 2007 and 2010, despite an increase in bid notifications of more than 225 percent.⁹

There will be plenty of testimony presented today that will offer evidence of billions of dollars in savings – but at what cost? The American Legion has been able to find no evidence that this process contributes to business innovation, economic growth, or positive partner relationships between government and industry. The American Legion has found reverse auctions fosters resentment between sellers and buyers and leaves the seller with the attitude of not wanting to provide anything more than exactly what was paid for, thus obliterating any harmonious relationship that should be developed between buyer and seller.

Guy Frankling, e-sourcing and implementation manager at Royal Dutch Shell, argues that specificity is key across all procurement methods. “If you are not clear on your specification, you won’t be successful doing it (procuring the good or service) either manually or electronically”.¹⁰

The American Legion also learned that businesses answering solicitations for services find that customers rarely, if ever, include all necessary requirements in the original solicitation. What is wanted versus what was asked for continues to be a source of frustration between contractors and vendors. The American Legion has received numerous complaints from veteran business owners who routinely argue that their customer is dissatisfied based not on the work that was performed, but more importantly, based on the work that wasn’t preformed because it wasn’t specified in the original solicitation.

The American Legion has worked with businesses that have gotten into trouble with reverse auction wins. In some cases they fail to realize the true expense required to deliver on a bid and have sold at such slim margins that they weren’t able to sustain a viable business model – In other cases they bid based on agreements from other manufacturers or vendors, who, after the bid was won, chose not to perform on the agreement because the profit margins were too low and they subsequently diverted their manufacturing efforts to more profitable projects.

A survey of our members found that opinions regarding reverse auctions were overwhelmingly negative. Some of the more common complaints included;

- Lack of trust in the system – not knowing who they are bidding against, no idea if automated systems are in place of live bidders.
- Lack of federal compliance oversight
- Federal government’s use of a commercial service that has not been properly competed through the procurement process, or gone through the federal design build process.

⁹ Contract management Magazine, Reverse Auctions: Turning Winners into Losers, October 2012
http://www.nxtbook.com/nxtbooks/ncma/cm_201210/index.php#/4

¹⁰ Reverse Auctioning: Saving Money and Increasing Transparency, 2011,
<http://www.businessofgovernment.org/sites/default/files/Reverse%20Auctioning.pdf>

- Buyer funded fees that are charged to the buyer, but paid by the seller. This creates a false sense of inflated receipts and places unnecessary burdens and expenses on the seller.
- Fear of grey market products being sold illegally
- Promotes direct competition between manufacturer and authorized reseller
- Creates unreasonable pressure on small businesses to engage in loss leader pricing strategies
- Quality is unsustainable as this process subverts a healthy and profitable industrial base
- Ultimately, higher quality and more successful businesses are going to walk away from the reverse auction vehicle, leaving only bottom feeders

If the government is to continue to use reverse auctions, The American Legion recommends;

1. More outreach training for small veteran owned businesses.
2. Eliminate the LEAD or LAG indicators. This creates an unrealistic stressor for the seller and can be extremely detrimental for the nascent business.
3. Collect fees directly from customer (buyer).
4. Build a fair market price list into the process for commonly purchased items, and prevent sellers from going below the established fair market price.
5. Make buyers attest that they have conducted proper and adequate market research to determine fair market price.
6. Eliminate the ability of the buyer to set a minimally acceptable price, or clearly state to the seller what the starting price is.
7. Requests for debrief, protests, and any other dispute resulting between the seller and the federal government needs to be handled directly by the federal government, not handled through a civilian commercial company who has no authority to represent the federal government.
8. Exact Match Bids need to be more interactive. Government has unique needs and requirements, and even items issued under the same National Stock Numbers provide variation that can cause end user difficulties.

Louis John Celli Jr.

Following his 22 year career in the United States Army, Master Sergeant Celli founded the company Leaders Advantage, Inc. that sold sales and leadership training material out of its 3 Boston area retail locations. In 2005 Louis Celli transformed the enterprise into a nonprofit organization called the Northeast Veterans Business Resource Center, Inc. (NEVBRC), which is dedicated to assisting veteran entrepreneurs start and grow small businesses.



Mr. Celli retired from NEVBRC in 2012 to become the Legislative Director for the American Legion – the largest veteran service organization in the United States.

As a published columnist, professional speaker, and nationally recognized small business development expert, Louis Celli has been quoted in national and local media such as the Boston Business Journal, USA Today, Forbes, MSNBC, Fortune Small Business, National Public Radio, and the Christian Science Monitor.

Louis is a graduate of Harvard University, a native of Boston Massachusetts, and together with his wife Elise has 6 children ranging in age from 11 to 22 years old.

The Honorable Mike Coffman, Chairman
Subcommittee on Oversight and Investigations
House Veterans Affairs Committee
335 Cannon House Office Building
Washington, D.C. 20510

The Honorable Richard Hanna, Chairman
Subcommittee on Contracting and Workforce
House Committee on Small Business
2361 Rayburn House Office Building (RHOB)
Washington, D.C. 20515

December 9, 2013

Dear, Chairman Coffman, and Chairman Hanna;

Neither The American Legion nor I have received any federal grants or contracts, during this year or in the last two years, from any agency or program relevant to the December 11, 2013, Subcommittee on Oversight and Investigations House Veterans Affairs Committee and the Subcommittee on Contracting and Workforce House Committee on Small Business hearing on the Contracting Away Accountability Reverse Auctions In Federal Agency Acquisitions.

Sincerely.



Louis J. Celli Jr.