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In this issue...

FOCUS

FEATURE COMMENT • Can The Government Go Fast Forward On Reverse Auctions? ... ¶ 263

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DEVELOPMENTS

Certification Clause Added To Controversial Contractor Responsibility Proposal ¶ 264

DOD Plan To Revamp Logistics Lacks Coordination, GAO Says ¶ 265

DOJ Releases New Defense Procurement Fraud Debarment Program Guide ¶ 266

Privatization No Answer To High DOE Cleanup Costs, Says GAO ¶ 267

Developments In Brief ¶ 268

LEGISLATION

Agencies Get Six-Month Reprieve In Implementing IT Accessibility Rules ¶ 269

REGULATIONS

NARA Dismisses DOD Concerns About New Records Storage Rule ¶ 270

Regulations In Brief ¶ 271

DECISIONS

Sample Production Requirement Not "Special" Responsibility Standard ¶ 272

AGBCA Refuses To Vacate Decision Even Though Settlement Hinged On Vacatur ¶ 273

Significant Evaluation Subfactor Must Be Clearly Identified Even If Reasonably Related To RFP's Stated Evaluation Criteria ¶ 274

Government Fails To Prove Impact From Pension Cost Accounting Change; Contractor Due \$1.8 Million Refund ¶ 275

Bid Responsive Despite Different Names For Bidder And Bid Bond Principal ¶ 276

Focus

¶ 263

FEATURE COMMENT • Can The Government Go Fast Forward On Reverse Auctions?

"Online auctions" such as those conducted by eBay or Amazon.com have been an integral and growing part of the Internet virtually since the Internet was first used to conduct commerce. In an online auction, items are placed for sale on a website and are bid on by multiple buyers who access the website through their own Internet connections. As in traditional auctions, the item ultimately sells to the highest bidder.

More recently, "reverse" online auctions have gained in popularity. In a reverse auction, the price is driven by the seller's desire to sell an item or service, rather than the buyer's desire to buy. The reverse auction is initiated when a buyer announces online its desire to purchase the item or service. Multiple sellers then compete against one another, decreasing their offer prices until the lowest bidder prevails. An increasing trend is the establishment of reverse auction networks by large-scale buyers in common industries who sometimes pool their requirements to obtain lower prices for bulk purchases. In theory, these networks will attract more suppliers, who are then pitted against one another in reverse auctions to drive down price. Such networks have been established in diverse industries, from defense and aerospace to winemaking, and substantial cost savings have been reported.

Now the Federal Government is on the verge of embracing reverse auctions to realize similar savings. Recent initiatives by several agencies to implement reverse auction infrastructure have garnered considerable attention within the Government procurement community. Many predict that these ini-

Focus continued on page 3...

tiatives will revolutionize the way the Government does business and result in substantial cost savings. Although this remains to be seen, a more immediate question is whether reverse auctions are appropriate under the existing rules of federal procurement.

This **FEATURE COMMENT** examines whether the current federal procurement regulatory regime can accommodate the use of online reverse auctions by federal agencies. The **COMMENT** does not attempt to address the many policy issues that reverse auctions present. That broader inquiry is best left for a later date, after the results of various ongoing pilot projects have been considered.

Recent Events—The past few months have seen significant and relatively fast-paced movement toward the use of online auctions in federal procurement:

In May, the U.S. Navy's Naval Supply Systems Command (NAVSUP) awarded what was hailed as the first Government contract awarded by reverse auction. NAVSUP reportedly saved about \$1 million (or almost 29%) on the procurement of aircraft ejection seat components when compared with the historical price of those items. NAVSUP indicated its auction was conducted as part of "discussions" under Federal Acquisition Regulation Part 15.

That same month, the U.S. Army's Communications-Electronics Command (CECOM) and its Tank-Automotive and Armaments Command (TACOM) each announced online auction pilot projects. CECOM conducted a few auctions in May for small value procurements, which were mostly commercial items such as laptop computers and office equipment. TACOM has indicated, however, that it intends to explore using online auctions to purchase items built to military specifications. Based on its pilot project announcement, it appears that TACOM will be using both sealed bidding (FAR Part 14) and competitive negotiation (Part 15) techniques. In a related development, the Department of Defense has established a pilot program to study online reverse auctions and to collect "lessons learned" for distribution among defense components that may be using the procurement technique.

The General Services Administration stepped into the online auction world in April by announcing plans to experiment with three variants of

online auctions. Reverse online auction services also were added to the list of services available through GSA's multiple-award schedules. In May, GSA initiated a six-month pilot program to test the use of reverse auctions, mainly for Government purchases of commercial computer hardware and software.

The initiatives outlined above raise several questions. For example, do the recent amendments to FAR Part 15, which omitted language flatly prohibiting auctions in federal procurement, mean that such auctions now are entirely proper? Which of the FAR's procurement procedures are best suited for reverse auctions? Are reverse auctions properly characterized as Part 15 discussions? Do the reverse auction procedures currently being used by agencies comply with Part 15's requirements for conducting discussions? Do the various dictates for sealed bidding addressed by FAR Part 14 permit online reverse auctions? These questions, and some related issues, are addressed below.

The FAR's Prohibition of "Auction Techniques"—Much of the discussion surrounding the use of reverse auctions in federal procurement has centered on an obvious question—whether "auction techniques," once prohibited by the FAR, are now permissible because of changes made by the FAR Part 15 "rewrite." The Part 15 rewrite was a two-year regulatory evolution completed in September 1997 that significantly changed the rules for conducting negotiated procurements. See 39 GC ¶ 466. Language that before had prohibited the use of auction techniques was omitted from the final version of Part 15. Thus, a first step in considering the feasibility of using reverse auctions is to consider the treatment under the FAR of auction techniques, both before and after the Part 15 rewrite.

Prior to the Part 15 rewrite, the FAR stated that the use of auction techniques could constitute prohibited conduct. Examples of prohibited auction techniques included (1) indicating to an offeror a cost or price that it must meet to obtain further consideration, (2) advising an offeror of its price standing relative to another offeror (except that it was permissible to tell the offeror that its cost or price was too high or unrealistic), and (3) otherwise furnishing information about other offerors' prices. FAR 15.610(e) (1997). Interest-

ingly, although FAR Part 15 applies only to negotiated procurements, the General Accounting Office also has applied the auction prohibition in several cases involving FAR Part 14's sealed bidding procedures. See, e.g., *Cagle Welding & Equipment, Inc.*, Comp. Gen. Dec. B-247199, 92-1 CPD ¶ 359 (resolicitation does not create auction where post-bid opening cancellation of invitation for bids was otherwise proper).

Even when the former Part 15 was in force, however, GAO had concluded that there was "nothing inherently illegal in the conduct of an auction in a negotiated procurement." *The Faxon Co.*, Comp. Gen. Dec. B-227835, 87-2 CPD ¶ 425. Nonetheless, under its existing precedent, GAO likely would not have approved the Government's use of an online reverse auction to award a contract. GAO consistently has held, for example, that an agency may reveal its own internal estimates and the like, but may *not* create a situation in which offerors were competing directly against one another with knowledge of specific and current bids. GAO's view was that the auction prohibition was meant "to preclude direct price bidding between competing offerors, not the negotiation of a price with the Government where an offeror's standing in the competition is not divulged." *Carol L. Bender*, Comp. Gen. Dec. B-196912, 80-1 CPD ¶ 243. On several occasions GAO stressed that agencies may not create a situation where offerors know their comparative standings. See, e.g., *Ikard Mfg. Co.*, Comp. Gen. Dec. B-213891, 84-1 CPD ¶ 266, 26 GC ¶ 104. Even when an agency did not reveal prices or comparative standing, GAO found that an improper auction could result if the agency conducted multiple rounds of negotiations or best-and-final offers without reasonable justification. *Action Mfg. Co.*, Comp. Gen. Dec. B-222151, 86-1 CPD ¶ 546. As discussed below, however, these early auction cases have been eclipsed by the FAR Part 15 rewrite.

The Post-Rewrite Part 15—The rewrite, applicable to solicitations issued after January 1, 1998, purged FAR Part 15 of any reference to prohibited auction techniques. Part 15, however, still contains some language that could be construed as limiting the way auctions are conducted. In particular, current regulations prohibit Government personnel involved in an acquisition from

engaging in conduct that "[r]eveals an offeror's price without that offeror's permission." FAR 15.306(e)(3). But the same FAR provision does allow the agency to (a) inform an offeror that its price is too high or too low, (b) reveal the results of the analysis supporting the conclusion that the price was too high or too low, and (c) indicate to all offerors the cost or price that government price analysis, market research, or other reviews has found reasonable. *Id.* Arguably, these provisions support rather than restrict the use of auction techniques. Nonetheless, the propriety of auction techniques under the new FAR Part 15 appears to turn on obtaining advance consent from all participants to release bid prices.

Compliance with the Procurement Integrity Act: The FAR's current treatment of price disclosure is in line with the direction set forth in what is popularly referred to as the Procurement Integrity Act. See 41 USC § 423; FAR 15.306(e). The PIA prohibits Government personnel or those acting on behalf of the Government from knowingly disclosing "contractor bid or proposal information or source selection information" before contract award. 41 USC § 423(a)(1). The PIA does, however, allow disclosure by the contractor of bid or proposal information to any person or class of persons authorized, in accordance with applicable agency regulations or procedures, to receive that information. 41 USC § 423(h). The first PIA provision appears to contemplate the release of information only to those persons who traditionally see such information—for example, Government evaluators or technical services contractors that are retained as advisors to the source selection team. As for the latter provision, one could interpret it to permit a contracting agency to disclose bid or proposal information to a third party (i.e., other bidders) *with the contractor's consent*, which in fact is the rule now set forth in the FAR.

A potential issue is whether an agency that requires offerors to reveal their bid prices—as a condition of participating in a procurement—truly has obtained the "contractor's consent." To the extent that the PIA, or for that matter, the Trade Secrets Act, 18 USC § 1905, gives a contractor legal rights to protect proprietary information, it is unclear whether a contractor's "consent" to waive confidentiality in an online auction setting would be enforceable if challenged.

Post-Rewrite Case Law Addressing Auctions under FAR Part 15: The rewrite and the omission of the auction prohibition language has been interpreted by some to allow auctions. Allegedly improper auctions have been protested in three cases since the rewrite took effect, one at the Court of Federal Claims and two at GAO. All three decisions state that the prior prohibition on auction techniques no longer applies. In fact, the COFC actually expressed in dicta an interpretation of the rewrite language that is favorable to the creation of a reverse auction arrangement.

In *DGS Contract Serv., Inc.*, 43 Fed. Cl. 227, 239–240 (1999), 18 FPD ¶ 28, 41 GC ¶ 229, the agency reopened negotiations, disclosed to each offeror its respective position in the price range, and allowed submission of new price proposals. The protester alleged that this amounted to an improper auction and that such conduct was still impermissible notwithstanding the elimination of the auction prohibition from FAR Part 15. The Court, interpreting the language of the rewrite, rejected the protester’s argument:

Nothing in the plain language of section 15.306(e) explicitly prohibits the use of auction techniques.... Construing section 15.306(e), an agency theoretically could conduct an auction and disclose prices of each offeror in the competitive range provided it obtained their consent. *Id.* at 239.

In GAO’s first post-rewrite decision on auctioning, the protester alleged an improper auction where the eventual awardee had been notified during negotiations that its price was too high. See *Nick Chorak Mowing*, Comp. Gen. Dec. B-280011.2, 98-2 CPD ¶ 82, 41 GC ¶ 229 (Note):

While the predecessor Part 15 included constraints on the government’s use of ‘auction techniques,’...the rewrite does not contain such a provision. Section 15.306(e) now sets forth specific limitations on exchanges with offerors by Government personnel involved in an acquisition.... Here the record establishes that the agency conducted discussions consistent with the legal requirements outlined [in FAR 15.306(e)(3)]. The contracting officer did not reveal either offeror’s quote to the other. Instead the contracting officer notified [the eventual awardee] that she considered its price too high, which is permissible under the revised regulations.

The second GAO post-rewrite decision also suggests in dicta that auctions are now permissible. See *Rel-Tek Sys. & Design, Inc.*, Comp. Gen. Dec. B-280463.7, 99-2 CPD ¶ 1. In *Rel-Tek*, GAO noted that even though the former version of FAR Part 15 (prohibiting auctions) governed the subject contract, “the recently revised FAR provisions regarding limitations on the disclosure of offerors’ prices during discussions does not include language regarding the prevention of auctions.” *Id.* at n.7.

Although these three cases fall short of unequivocal disavowal of all pre-rewrite auctioning precedent, they nonetheless signal a major departure from that prior case law.

Commercial Items and Simplified Acquisitions—Reverse auction procedures would appear to work well when the Government procures commercial items. Indeed, DOD has advised the Senate Armed Services Committee that online auctioning “may be well suited for competitive, high volume, commodity type purchases.” See Senate Fiscal Year 2001 National Defense Authorization Bill, S. 2459 (S. Rept. 106-292, May 12, 2000). Although such purchases are not necessarily limited to commercial item acquisitions, streamlined procedures make their purchase well-suited to online reverse auctions, as such auctions work best for competitions based on price alone. Obviously, even when price is the determining factor, complications may arise as a result of, for example, evaluation “preferences” for U.S. products or for those of small disadvantaged businesses. See FAR 25.105(b); FAR Subpart 19.11. Some thought will have to be given as to how to account for these preferences in a fair manner, such as by “real time” disclosure of how they affect the relative standing of the bidders.

FAR Part 12 commercial item acquisitions also lend themselves to reverse auctions because in such acquisitions, technical information need not be obtained unless the Contracting Officer deems it necessary and, even in those instances, existing product literature may suffice. See FAR 12.205(a). Thus, aside from conducting the reverse auction, COs using Part 12 procedures may only be required to ensure that an offeror’s product is generally suitable for agency needs and that the offeror’s past performance information indicates that the offeror is a responsible source. See FAR Subpart 12.2.

Similarly, procurements conducted in accordance with FAR Part 13's simplified acquisition procedures appear to be ideally suited to the use of reverse auctions. Those procedures allow the CO broad discretion in formulating evaluation procedures, allowing for the use of "one or more, but not necessarily all," of the procedures set out in Parts 14 and 15. Indeed, such procurements could be limited to consideration of only the winning bid from the reverse auction and the CO's own knowledge of the winning bidder's past performance. See FAR 13.106-2. Although the procedures generally apply only to procurements that do not exceed \$100,000, they can also be used under a Subpart 13.5 test program expanding simplified acquisition techniques to procurements valued between \$100,000 and \$5 million if the CO expects that only commercial items will be offered. Finally, under simplified acquisition procedures, offerors need not execute the "Certificate of Independent Price Determination," FAR 52.203-2, required in most fixed-price contracts, which certifies that the offeror did not and will not knowingly disclose its prices to any other competitor before bid opening or contract award. See FAR 3.103-1(a). This certificate, intended to eliminate collusion among offerors, may pose problems for other procurements using auction techniques, if read literally.

Even when procuring a commercial item using Part 15's more complicated negotiated procurement procedures, an agency would seem to be acting appropriately by treating the auction as an aspect of "discussions" under FAR Part 15. Agencies may now address practically all areas of a proposal during discussions, including "bargaining" on price. See FAR 15.306(d). (See also 42 GC ¶¶ 143, 243 examining new FAR rule on discussions.) Importantly, because the technical evaluations normally required by Part 15 are not needed for commercial item acquisitions, the corresponding full-blown evaluations and discussions normally called for by Part 15 would not pose an obstacle to reverse auctions for commercial items.

However, the use of reverse auctions on more complicated procurements requiring greater emphasis on non-price factors may present difficulties. Such procurements, using either the sealed bidding procedures of Part 14 or the negotiation procedures of Part 15, are subject to stricter regulation involving procurement goals potentially in-

consistent with the characteristics of reverse auctions.

Sealed Bid Procurements under FAR Part 14—The FAR procedures for sealed bidding appear to be adaptable to the use of reverse auctions, but will have to be liberally construed. Although Part 14 has been updated to reflect recent innovations such as electronic solicitations and electronic bids, its provisions are still largely written with traditional (i.e., paper-based) procedures in mind. Thus, whether reverse auctions may be accomplished under Part 14 depends upon whether those called upon to interpret the regulations choose to adhere to a literal reading. Interpreted that way, several provisions in Part 14 may present obstacles to reverse auctions.

For example, Part 14 contemplates that an "exact time" will be set by the agency for both receipt and opening of bids. See FAR 14.302(a), 14.304(b)(1). An online auction obviously does not lend itself to a situation where a precise time is set for the receipt and opening of bids (in fact, in an online auction receipt and opening are practically simultaneous), unless one views the time set for receipt and opening of bids as being a "window" of time associated with the auction.

A somewhat related issue concerns the safeguarding of bids. The FAR requires that "[a]ll bids...received before the time set for the opening of bids shall be kept secure....[T]he bids shall not be opened or viewed, and shall remain in a locked bid box, a safe, or in a secured, restricted-access electronic bid box." FAR 14.401(a). Similar to the previous example, the underlying assumption here, which does not fit the online auction model, is that sealed bids are to be submitted at an exact time, opened at an exact time, and safeguarded in the interim. But so long as the "time set for opening of bids" is interpreted as the time the reverse auction is set to begin, the safeguarding requirement should present no obstacle. Concerns about the security and validity of incoming bids can be adequately addressed by available technologies involving encryption and electronic or digital signatures.

Another complication may arise from the requirement that bids be publicly opened. FAR 14.402-1(a). Logically, the ability of auction participants to view bids as they come in during an online auction should be considered the regula-

tory equivalent of a “public opening,” however, that has yet to be decided. If participant viewing is deemed inadequate, a “public opening” could be achieved by allowing the public to view reverse auctions in progress either in agency viewing rooms or through view-only access to a website available to non-participants. Likewise, the requirement that agencies allow, when practical, post-opening examination of bids could be accomplished by storing the results of the auctions electronically and re-running them for interested parties. See FAR 14.402-1(c). These data are already typically stored by auction service providers for review at a later time.

Part 14 also includes provisions that may adapt well to online auction procedures. For example, one contingency that must be planned for is the possibility that a bidder may unexpectedly lose its connection to the online auction site. When such disruptions occur, the auction service provider can usually verify that a disconnection did in fact take place and notify the CO of the fact, who then decides whether to extend bidding to allow the disconnected bidder to rejoin. Part 14 already contains provisions addressing the situation in which an unreadable electronic bid is received by the Government. See FAR 14.406. In such circumstances, the CO must immediately notify the bidder that its bid will be rejected unless clear and convincing evidence is provided of the original content of the bid and that the bid’s unreadable condition was caused by Government error. This process would appear to be readily adaptable for use in online auctions where an offeror’s Internet connection is lost because of error attributable to the Government or its auction service provider.

FAR Part 15 Considerations—Although the more flexible requirements of Parts 12 and 13 lend themselves more readily to reverse auctions, several of the initiatives now underway appear to be using such auctions in the context of more complicated negotiated acquisitions.

For example, NAVSUP’s \$2.4 million procurement of aircraft ejection seat components, noted above, was conducted under FAR Part 15. NAVSUP solicited and evaluated technical proposals in accordance with Part 15 requirements, as it would have for any negotiated procurement. Three proposals were found technically acceptable and those offerors were invited to participate in the online

reverse auction phase of the procurement. This phase, characterized as Part 15 “discussions” by NAVSUP, lasted 51 minutes. During the auction, bidders could see real-time bids, although the bidders were not identified by name. Contract award was made to the low bidder approximately one hour after close of bidding, presumably on the basis of “best value.” In that regard, although NAVSUP did not reveal whether it used the feature, several online auction service providers have indicated that a built-in feature to assist in making “best value” determinations may be included with their software. The Army’s overall approach to reverse auctions appears to be substantially similar to the one used by NAVSUP. See *Commerce Business Daily*, No. PSA-2596, May 12, 2000.

Reverse Auctions as “Discussions”: Several reverse auctions have been characterized as “discussions” under FAR Part 15. It seems clear that if agencies intend to conduct procurements involving reverse auctions in accordance with Part 15, they must also conduct technical evaluations of offerors’ proposals. This is because agencies are required to address the quality of the supplies or services in every source selection, through consideration of one or more non-cost evaluation factors (e.g., past performance, technical excellence, management capability, etc.). See 10 USC § 2305(a)(3)(A); 41 USC § 253a(c)(1)(A); FAR 15.304(c)(2). Not only must non-cost factors be evaluated for each proposal, but if discussions are to be held, they must comply with the guidelines set out in Part 15. COs must discuss with each offeror still being considered for award the “significant weaknesses, deficiencies, and other aspects of its proposal.” FAR 15.306(d)(3).

It is hard to conceive how these types of discussions could be conducted during an online reverse auction, so it would appear that some period for conducting traditional discussions would have to be set aside. But if time for discussions is built into an auction model, the substantial time (and cost) savings from the use of online auction techniques may be diminished. Moreover, as long as technical proposals must be prepared and evaluated as before, neither the Government nor industry will realize the full time savings possible through the use of online auctions.

A second issue arises from Part 15 provisions dictating the order of negotiated procurement pro-

cedures, which may conflict with reverse auction methods. Specifically, agencies are required first to evaluate all proposals, and “if discussions are to be conducted, establish the competitive range.” FAR 15.306(c)(1), 15.306(d); see also *Kathpal Tech., Inc.*, Comp. Gen. Dec. B-283137.3 et al., 99-2 CPD ¶ 120, 42 GC ¶ 25. Thus, agencies would be required to evaluate proposals before conducting the auction. More importantly, however, when setting the competitive range, agencies must evaluate proposals “against all evaluation criteria,” which include price or cost to the Government. FAR 15.306(c)(1), 15.304(c)(1). This procedural hurdle could be cleared simply by requesting offerors to submit their “starting price” with their proposal, perhaps then eliminating those clearly out of range (e.g., based on an excessive or unreasonable price that indicates either that the offeror misapprehends the procurement requirements or is unlikely to prevail in the auction). Offerors could then begin their bidding at their respective starting prices. Indeed, such a procedural requirement may prove useful to agencies as a rough calculator of the savings to be gained from using an online auction, and as an insight into the degree to which particular contractors may reduce their prices because of the auction.

Finally, it should be noted that the procedural difficulties associated with competitive negotiation regulations could be minimized by instead employing, when appropriate, the two-step sealed bidding process set forth in Part 14. See FAR Subpart 14.5. The two-step process calls first for submission of technical proposals, and then for submission of sealed bids only from those offerors submitting technically acceptable proposals. FAR Part 15 gives the CO much more discretion with respect to the technical evaluation step than Part 14. The sealed bidding step, however, would generally raise the same issues as discussed above regarding auctions conducted under the standard FAR Part 14 procedures.

“Best Value” Considerations: Under FAR Part 15 procedures, the mere fact that an offeror is the low bidder in a reverse auction does not mean that the offeror will be the awardee. The FAR recognizes that an award to the lowest-priced offeror may not always be in the Government’s interest:

The award of a contract to a supplier based on lowest evaluated price alone can be false

economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this does not require an award to a supplier solely because that supplier submits the lowest offer. FAR 9.103(c).

Thus, regardless of who “wins” the reverse auction by being the lowest-priced offeror, the question of which offer represents the “best value to the Government”—price and other evaluation factors considered—still governs the ultimate award decision. When contracting by negotiation, agencies must still choose the offeror that “provides the greatest overall benefit in response to the requirement.” FAR 2.101.

At least with respect to Part 15 reverse auctions conducted thus far, it appears that agencies are still evaluating proposals against all the evaluation factors and subfactors set out in the solicitation, setting the competitive range, conducting discussions (which now include the reverse auction), and making final award decisions based on the results of these activities. In fact, because the other aspects of the procurement process have remained essentially intact, some may view the reverse auction process as little more than a price-reduction mechanism with only minimal impact on the best value determination.

As noted, some online auction service providers offer agencies the capacity to conduct automated “best value” determinations as part of a reverse auction. This, however, raises potential problems. For example, the “best value” capability supposedly analyzes the sellers, their prices, their performance, and their compliance with previous contracts to determine the offer that represents the best value to the Government; in effect, the auctioneer conducts the “best value” tradeoff process for the agency. But the FAR clearly requires that the source selection decision be made by the source selection authority and not by a software package. See FAR 15.308. Although the SSA may rely upon analyses and the like in making its determination, GAO may understandably reject an award in which the SSA relies too heavily on a predetermined, routinized “best value” formula to reach an award decision. Indeed, GAO has ruled on a number of occasions that a math-

emational tradeoff formula may be used as one source selection tool, but it has insisted that qualitative assessment is still required. See, e.g., *Opti-Lite Optical*, Comp. Gen. Dec. B-281693, 99-1 CPD ¶ 61, 41 GC ¶ 242; *Moran Assocs.*, Comp. Gen. Dec. B-240564.2, 91-2 CPD ¶ 495. Furthermore, the “best value” software would have to be customized for each procurement in order to comply with the evaluation factors of each solicitation. See FAR 15.101-1.

Conclusion—Parts of the current regulations have the potential to limit the extent to which traditional procurements can be automated using Internet reverse auction techniques. Nevertheless, federal procurement regulations, particularly those governing commercial item acquisitions, generally lend themselves to such streamlined acquisition practices.

As one moves from simple commodity purchases toward more complicated negotiated procurements, however, the FAR’s evaluation and award procedures may present more obstacles, particularly for those online auctions attempting to incorporate the concept of award based on “best value.”

This FEATURE COMMENT was written for THE GOVERNMENT CONTRACTOR by Timothy D. Palmer, Agnes P. Dover, and Thomas L. McGovern. Mr. Palmer is an associate and Ms. Dover and Mr. McGovern are partners at the Washington, DC law office of Hogan & Hartson LLP.