

# Fiscal and Regulatory Impact Analysis

Purchase and Contract  
01 NCAC 05B

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## A. General Information

### Agency:

NC Department of Administration

### Title and Citation of Rule:

01 NCAC 05B .0503 Negotiation

### Statutory Authority:

N.C.G.S. § 143-52, -53, and -60

### Impact Summary:

State Government:	Yes
Local Government:	Yes
Substantial Impact:	Yes

### Statement of Impact:

The proposed rule would clarify the conditions under which the Division of Purchase and Contract may enter into negotiations with potential vendors. Due to ambiguity in the current rule, the state rejects potentially strong vendors on procedural grounds rather than the substantive merits of the vendors' proposals.

Negotiations can clarify price, terms and conditions, quality, performance of the contract or any other aspect of the procurement. Specifically allowing negotiations to correct flaws in promising proposals will expand the pool of proposals available to state evaluation teams and enable more consideration of quality-based factors. In addition to helping the state obtain the best value in its procurement contracts, a negotiated approach will allow for situations where the "ideal solution" is not clear at the outset of the solicitation process. As such, it facilitates competition and potentially mitigates no bid and one bid outcomes.

Through a negotiation process there may be greater opportunity to anticipate contract management issues and identify solutions that would mitigate the possible future need for contract amendments, additional funding or lengthy delays. Finally, negotiation provides a format --*real conversation*--for realizing greater value to the agency through contractor concessions or no-cost extras that would not be considered using a Best and Final Offer.

The amount of any procurement contract cost savings cannot be quantified as numerous factors affect each unique procurement, including whether or not the term to be negotiated is tied to a fiscal outcome. The overall magnitude on statewide procurement, however, is potentially great if even a tenth of 1% of costs are avoided as a result of the ability to negotiate terms more favorable to the State. More than \$9B in statewide procurements occur annually.

Copy of Proposed Rule:

**01 NCAC 05B .0503 NEGOTIATION**

(a) ~~If the Purchasing Agency does not receive a Responsive Offer to a Solicitation and determines that soliciting Offers again would not yield a different result, the~~ The Purchasing Agency may negotiate with one or more Responsive Vendors, Vendors in the Competitive Range or reject all Offers under the provisions of Rule .0501 of this Subchapter and negotiate with one or more sources of supply that may be capable of satisfying the requirement. Negotiations may also be conducted under conditions that merit a waiver of Competition pursuant to Rule .1401 of this Section.

(b) Negotiations shall be conducted by the Purchasing Agency if the Solicitation is under its Bid Value Benchmark or General Delegation. A Purchasing Agency may request the participation of the Division in any Negotiation.

(c) Negotiations shall be memorialized by a written agreement executed by the parties and issued by the Division.

(d) All Negotiation results shall be documented in writing for public record.

*History Note: Authority G.S. 143-52; 143-53; 143-60;*

*Eff. February 1, 1996;*

*Amended Eff. April 1, 1999;*

*Readopted Eff. October 1, 2019.*

*Amended Eff. \_\_\_\_\_*

## **B. Summary of the Proposed Regulation**

### Necessity:

Pursuant to N.C.G.S. 143-53.1, the State, through the Department of Administration, Division of Purchase and Contract, is required to use a competitive solicitation model in procurement. N.C.G.S. 143-53.1(a) states "...competitive bidding shall promote compliance with the principles of procurement efficiency, transparency, and fair competition to obtain the State's business."

The intent of State procurement evaluations is to reach an equal comparison of vendor proposals responding to a solicitation. Negotiation is often the only way to remove contractual flaws and reach such a fair comparison of offers without impermissibly varying a solicitation from its original scope and purpose.

However, as the rule is written currently, there is ambiguity around when and how a negotiation may ensue. This lack of clarity results in the state rejecting potentially strong vendors on procedural grounds, rather than the substantive merits of the vendors' proposals. Specifically allowing negotiations to correct procedural flaws in promising proposals will expand the pool of proposals available to state evaluation teams and enable more consideration of quality-based factors. These changes are expected to help the state obtain the best value in its procurement contracts.

### *History and Rule Interpretation*

This rule was recently readopted under the Periodic Review schedule. During the course of revisions and in an effort to tie the language of this rule with the revised defined terms in 01 NCAC 05A .0112, the term "Responsive Offer" was used to describe, in effect, a condition precedent to the use of negotiation by an agency. A "Responsive Offer" is defined to mean "...an Offer that conforms to the Requirements of the Solicitation in all material respects to be considered by the State for award." In procurement usage for the Division, this means that a vendor offer has to meet the procedural requirements of the solicitation "...before any further evaluation of the Offer is conducted by the State" (including negotiation) to determine how well the offer meets the "specifications" or physical characteristics of the goods or services to be procured in the solicitation. Failure to meet requirements could include the offer being late or not in proper form or simply grossly missing the target: offering to provide an automobile when the State wanted a truck. "Requirements" are thus contrasted with "specifications" in a solicitation, the former being basically procedural and the latter reflecting the heart of content of what the State is procuring.

As this plays out in practice, the intent of this new rule was to provide, through any needed negotiation with bidding vendors, a simple way to produce apples-to-apples offers for comparison in the evaluation and award process. This negotiation rule has always assumed that negotiation initially will be with Responsive Bidders. For instance, if all bids are nonresponsive, they cannot be considered further, so there is no "competitive range" of bidders/vendors as now provided in this rule and no bids are read for award consideration. This rule apparently still provides for "rejection of all offers" and negotiation. However, some construe the rules with its use of "or" to

meant that the “reject all bids negotiation” process is conditioned upon no “responsive” bid being received - a relatively rare situation in State procurement. This construction would render the rule useless and this subsidiary issue of statutory construction should be addressed.

The change in the rule was instead meant to broaden the negotiation process consistent with the background and explanation first above. The prior version of this rule only provided for use of negotiation if all offers were not “satisfactory” and all such offers were formally rejected. Even in the context of “rejection” in accordance with 01 NCAC 05B .0501, “satisfactory” was intended to reflect non-responsiveness and “inconsistency with specifications,” not just failure to comply with procedural requirements or “responsiveness.”

“Satisfactory” has always referred in this context to a responsive bid “meeting specifications,” not a bid that could be rejected under 01 NCAC 05B .0501(1). Note the usage of “requirements” in that rule refers to what is proper practice are referred to as “specifications,” as defined and quoted above.

However, negotiation under the current rule is initially tied to a very strict condition that the State not receive any “responsive” bid. If all offers have to be formally rejected to negotiate - even very promising ones that with “tweaking” could very well meet the needs of the State - the State has potentially missed out on an opportunity for receiving “best value” as required by statute. Rejecting all offers as in the previous rule also potentially ignored fairness to vendors who has taken the time and absorbed the sometimes high cost of responding to the solicitation with an offer was close to complying to the solicitation specifications. Rejection of all bids opens the possibility that a “close” bid of a vendor may not receive the award in that procurement and that another vendor - perhaps not among the initial bidders -- who responds well to negotiation may be the awarded party. It is, of course, also possible that negotiating with “known sources or supply” may well provide the State with a solution not provided by the original bidders in their negotiations.

#### Economic Analysis:

Under the proposed rule, the Purchase and Contract Division and State agencies would first explore negotiations to correct the procedural errors in the proposals with only existing responsive bidders/vendors. An apples-to-apples comparison among existing responsive bidders would then be available for State evaluation teams to obtain the best value for the state as mandated in N.C.G.S. 143-135.9. The “reject all bids” process could be used as an alternative, which many agencies are already familiar with.

#### *State Government Benefit Estimates*

The proposed rule changes would apply statewide to enable State agencies and institutions subject to N.C.G.S. 143, Article 3 to negotiate vendor offers and identify potential cost savings or value improvements. In Fiscal Year 2019, there were 1,382 contract awards which totaled \$1,349,384,237. There is no immediately accessible data to determine the number of awards that were achieved through negotiation processes compared to any other means. One could presume that if the State achieved at least a 1% cost reduction through negotiation, the savings would have exceeded \$1.3 million.

There is no way to estimate the number of contracts that will be executed in any given fiscal year. In 2019, the State awarded 1,382 distinct contracts across all contract categories, while in 2018, the State awarded 1,469 contracts. State agency needs and access to funds are the primary drivers for acquisition. Because of budget issues, any extrapolation based on historical data would be unreliable.

Negotiation is more prevalent on larger contracts, as the stakes for vendors and the State are higher. Additionally, there is more potential for cost savings on contracts for general and professional services. Broadening the use of negotiation should impact even more procurements thereby generating cost savings among all contract types and commodities.

Negotiations in the public sector are not uncommon; in fact, negotiations are an effective means of achieving a best-value outcome as defined by the General Assembly. They have defined best value as “(t)he selection of a contractor based on a determination of which proposal offers the best trade-off between price and performance, where quality is considered an integral performance factor. The award decision is made based on multiple factors...” Although this statement refers to another commodity/service category, the precept is the same. Quality and price are always the critical component of a value equation whether the reference is to a technology procurement or construction or goods and services.

#### *State Government Costs Estimates*

Utilizing negotiation as a tool to obtain the best value for the State presents its own unique constraints - namely professional development to train proper negotiation techniques; development of tools, guidance and other resources to reinforce negotiation techniques; practice of identifying and including the correct subject matter experts in negotiation meetings, engaging vendors properly to show good faith, among others. The Division of Purchase and Contract estimates the number of staff to include approximated 300 participants at \$65.00 per hour for 12 hours of negotiation training in the first year and 6 hours for each subsequent year. Staff time opportunity costs total approximately \$234,000 in year one and \$117,000 each year thereafter. All of these constraints have inherent costs; however, the overall net benefit to the State far outweighs the stated costs - primarily training and change management - which are addressed through existing programs.

No additional funding is required for this proposed rule change. The duties and responsibilities associated with negotiations are inherent in the procurement role and are incorporated in required training for employees performing procurement functions.

#### *Local Government Impact*

This rule change would minimally impact local governments. Local government agencies buy from Statewide Term Contracts so the lower prices received through negotiation would benefit them directly. However, local government procurements are authorized through Article 8 of G.S. 143. This rule is supported by Article 3 of that same Chapter.

### *Impact on Vendors*

Successful contract negotiations mean that both sides look for positives that benefit both parties in every area while still achieving a fair and equitable deal. The negotiation process may drive prices down and reduce revenues for Vendors. As noted above, the impact of price reductions cannot be estimated precisely but are likely to be significant in aggregate across all procurement contracts. However, negotiations also establish a process for collaboration with Vendors. A signed contract that benefits both parties will provide a firm foundation to build a long-lasting relationship with Vendors.

### Alternatives:

Three alternatives were considered to address the stated problem:

1. **Do Nothing:** The State could leave the rule as it is written. The rule's current ambiguity and undue restrictions would encourage Agencies to avoid negotiations for fear of applying the rule incorrectly and potentially suffering the challenge of a recommended award. If the challenge is upheld, the Agency must comply with the directions of the State Purchasing Officer, which may require immediate contract cancellation and redoing the procurement—leaving the Agency with no services until the procurement redo is completed. The requirement to reject all offers is another reason the Do Nothing alternative is unacceptable. The State should not be required to reject all offers in order to negotiate with the bidder appearing to offer the best value. Negotiations drive prices down, while establishing a foundation for collaboration with the successful vendor. Improved procurement outcomes are based on lower prices and improved vendor relationships.

2. **Provide extensive work arounds:** The State could provide guidance on extensive workarounds to afford Agencies a path to negotiations. For example: If an Agency desired to negotiate with a vendor, the Agency could reject all offers on one of the bases listed in 01 NCAC 05B .0501, then request a waiver of competition using one of the conditions described in 01 NCAC 05B .1401, then negotiate with the vendor as if the vendor is the sole source of supply. This approach is problematic for several reasons: first, the motives are artful and serve to circumvent the rule, which potentially has negative effects on other Responsive competitors; second, the workaround lays the groundwork for successful protests from unawarded vendors; third, the workaround creates unnecessary work and delays for the Agency; and finally, the workaround violates the open, fair and transparent tenets of public procurement.

3. **Change the rule:** The State could change the rule to provide clarity on the conditions under which negotiations could ensue. This is the State's preferred option as it offers the clearest path to yielding the most fiscally responsible outcome based on open and fair negotiations with Vendors. Additionally, it maintains the integrity of the procurement process, and it affirms the State as a collaborative partner that is transparent and honest in its dealings with Vendors.