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ARE LOCAL GOVERNMENTS REQUIRED TO COMPLY WITH COMPETITIVE BIDDING REQUIREMENTS WHEN PURCHASING COMPUTER SOFTWARE?

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Local governments in North Carolina, like many public and private entities, are becoming increasingly dependent upon computers to conduct their business. Investments in information technology, including computer software, hardware, and related services, are costly and complicated. Rapid innovation and development of new products makes it difficult for many local governments to maintain the expertise necessary to evaluate available products prior to investing in new systems. Local governments must therefore rely on independent consultants and suppliers of information technology products to help develop and evaluate computer systems that meet local governments' needs. Purchases of information technology range from simple acquisition of personal computers and prewritten software products available "off-the-shelf," to integrated systems involving custom-designed programs developed specifically to meet a particular need. Many computer software purchases fall somewhere in between these extremes, involving specialized software that has already been developed, but that will be "configured" or modified slightly to fit the specific environment of the purchaser. Local government officials have inquired whether competitive bidding requirements apply to any or all of these contracts.

No North Carolina case has addressed this question. This bulletin analyzes how a court might apply the bidding statutes to local government computer software contracts, drawing analogies to similar inquiries under the sales tax law and the Uniform Commercial Code

(UCC).[1] It concludes that based on cases from other states, a North Carolina court would probably rule that prewritten computer software delivered on a tangible medium is within the scope of North Carolina's competitive bidding statutes, but a contract to design custom software is not. The bulletin goes on to discuss several statutory exceptions to the bidding requirements that may apply to certain computer software contracts. Finally it describes some approaches to obtaining bids on computer software within the statutory framework. The bulletin concludes that while it is possible to purchase computer software using a competitive process that complies with North Carolina's legal requirements, that process may lack the flexibility required to obtain the best value at the best price to meet local governments' growing information technology needs.

Interpreting the Competitive Bidding Statutes

Local governments are required to obtain sealed, competitive bids for the purchase or lease-purchase of "apparatus, supplies, materials, or equipment" estimated to cost $30,000 or more.[2] Informal bids must be received for purchases costing from $5,000 to $30,000.[3] Before discussing the competitive bidding procedures, it is important to consider whether computer software falls within the scope of the statute.

The North Carolina courts have rarely had occasion to interpret the scope of the competitive bidding laws over the 65 years since they were first enacted. The leading case is *Mullen v. Town of Louisburg*,[4] decided in 1945, in which the court faced the question of whether the bidding requirements apply to the purchase of electricity. The court held that the bidding requirements *did not* apply. The ruling turned on the fact that, due to government regulation of electrical rates, the bidders were not able to name their price. In effect, since there was no open market for competitive pricing, a competitive bidding process would be a futile effort.[5]

Although the *Mullen* case involved a narrow set of facts, the court discussed the meaning of the statute before reaching its holding. The terms "apparatus, materials, and equipment," the court noted, denote particular types of *tangible personal property*. Though the term "supplies" is perhaps open to broader definition, the court confined the term's meaning to property of "like kind and nature" given its use in conjunction with the other three terms.[6]

A preliminary question, then, is whether computer software is tangible personal property. Certainly, most software has a tangible, physical form – from the "off-the-shelf" variety that you can buy in a box, to the more customized form that may be installed directly by a vendor as part of a larger, multi-faceted computer system. On the other hand, computer software also represents intangible forms of property, and computer software contracts often include a service component. These issues are explored below.

Computer Software as Service Contract

North Carolina's competitive bidding law applies to tangible personal property, but it *does not* apply to service contracts. There is no exception in the law for service contracts – it's just that they do not fall within any of the categories of contracts listed in the statute.[7] There are two separate situations in which a service component could be important in determining how computer software contracts are viewed under the bidding laws. The first question is whether the software itself represents a service as opposed to a tangible good. The second question is whether the bidding laws apply to contracts that involve some service component in addition to the software itself.

Is software a service?

Although no North Carolina case has addressed this issue in the bidding context, it is interesting to note that North Carolina's state sales tax law defines computer software as tangible personal property that is subject to taxation. The definition of tangible personal property includes "computer software delivered on a

[1] The Uniform Commercial Code (UCC) is a set of uniform laws that has been enacted in substantially the same form in every state. The laws are designed to modernize the law of commercial transactions, and to provide uniformity and continuity in the laws governing commercial transactions to facilitate interstate commerce. In North Carolina the UCC can be found in Chapter 25 of the General Statutes.

[2] G.S 143-129.

[3] G.S. 143-131.

[4] 225 N.C. 53, 33 S.E.2d 484 (1945).

[5] In light of the impending deregulation of the electrical supply industry, this case may no longer be a reliable statement of the application of the bidding requirements to the purchase of electricity.

[6] *Mullen*, 225 N.C. at 58, 33 S.E.2d at 487.

[7] Construction or repair services are covered by the bidding laws, and contracts for architectural, engineering, or surveying work are subject to the procedures in G.S. 143-64.31 – 64.32.

storage medium, such as a cd rom, a disk, or a tape." [8] The statute contains an exemption, however, for "custom computer software," which is "written in accordance with the specifications of a specific customer."[9] The statute further qualifies the definition by specifying that custom computer software does not include "prewritten software that can be installed and executed with no changes to the software's source code other than changes made to configure the hardware or software."[10]

These definitions appear to be aimed at distinguishing computer software transactions in which the service of designing a custom program predominates, from those in which the product has already been developed and is commercially available. Although significant personal effort goes into the development of many computer software products, once a product is available in a tangible form its purchase is no longer characterized as a service. In the case of prewritten software involving "configuration" work, the tax code seems to imply that the amount of personal service involved is incidental.[11]

The same distinction can be seen in cases addressing the question of whether computer contracts are subject to Article 2 of the Uniform Commercial Code (UCC), which applies only to transactions in "goods."[12] One court, concluding that computer software should be characterized as goods under the UCC, analyzed the issue this way:

> Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser-readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.[13]

A majority of courts considering the issue have held that transactions involving prewritten computer software constitute sales of goods and are within the scope of the UCC.[14] The next section of this article discusses a proposal to revise the UCC prompted by concerns about treating computer software contracts and licenses like sales of other goods. Despite many questions about what rights are obtained in software licenses, however, courts have generally held that prewritten software represents a tangible product.

Although the tax law and the UCC are separate from the competitive bidding law and exist for different purposes, all three sets of laws apply to tangible personal property. A court might draw from the definitions in the tax law and rulings under the UCC to conclude that previously developed computer software is tangible personal property and is subject to the bidding requirements, while a contract to develop custom computer software is a service and is not within the scope of the bidding statute.

Mixed Service/Tangible Property Contracts

Many local government contracts involve the purchase of both tangible personal property and a service. For example, the purchase of equipment may include installation or maintenance. Computer software contracts often involve similar combinations of service and tangible product. In each of these situations, it is necessary to determine which aspect of the contract is predominant or most significant, in order to determine whether bidding is required.

North Carolina courts have recognized in contexts other than computer software, that the predominance of a service component is significant in determining whether competitive bidding is required.[15] Courts have

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[8] G.S. 105-164.3(20).

[9] G.S. 105-164.13(43).

[10] *Id.*

[11] *See* International Business Machines Corporation v. Director of Revenue, State of Missouri, 765 S.W. 2d 611, 612 (1989) (computer software was subject to sales tax and was neither a service nor customized since modifications from the product available in the catalogue were minimal).

[12] G.S. 25-2-102, 2-105.

[13] Advent Systems Ltd. v. Unisys Corp., 925 F.2d 670 (3d Cir 1991) (holding that a computer software contract involves a sale of "goods" and is covered by the Uniform Commercial Code). *See also* Architectronics v. Control Systems, Inc., 935 F. Supp. 425, 431 n. 5 (S.D.N.Y. 1996) (agreement to write the software is not subject to the UCC).

[14] *See* Andrew Rodau, Computer Software: Does Article 2 of the Uniform Commercial Code Apply?, 35 Emory L.J. 853 (1986); NMP Corp. v. Parametric Technology, 958 F. Supp. 1536, 1542 (N.D. Okla. 1997).

[15] *See* Plant Food Co. v. Charlotte, 214 N.C. 518, 522, 199 S.E. 712, 715 (1938), holding that a contract for removal

also used this analysis in determining whether contracts involving both goods and services are subject to the UCC.[16] To determine what aspect of a contract is predominant, a court may consider whether the bulk of the cost is for the service, or for the tangible goods. An alternative approach is to consider whether the primary benefit to the contracting unit derives from the knowledge and expertise of individuals, or whether their contribution is incidental.

Although no North Carolina court has addressed this issue in a case involving bidding of computer software, cases from other states have. A series of cases from New York illustrates how the courts analyzed the issue of whether a computer software purchase involves primarily services or products. New York bidding law contains an exception for purchasing services "which require scientific knowledge, skill, expertise and experience."[17] This exception was held to apply in a case where

> [b]oth the RFP [request for proposals] and the undisputed facts contained in the record establish that, rather than a group of physical articles of electronic hardware, [the governmental agency] primarily was seeking the design of a computer system which would provide prompt, efficient, cost-effective computer services to satisfy its growing and increasingly complex needs for the next five years. Such a design required the employment of the highest skills in the field of computer science. Vendors were allowed considerable discretion in the RFP in proposing the hardware and software components of the system, and they were also encouraged by [agency] officials to be innovative and flexible in meeting the required specifications in their design proposals.[18]

The court held that the service exception applied because it was clear that the agency was seeking the *design* of a computer system to meet its specific needs. Similar results were reached in two earlier cases, one involving a computer data control system for off-track betting,[19] and one involving a security system and service.[20] The service exception applied because the contract was viewed as involving "inextricable integration of scientific and technical skills used in conjunction with electronic hardware and software."[21]

In another New York case, however, the court found that a computer system contract did not involve a substantial service component, and did not fall within the "services" exception to bidding. The court based its decision on these facts:

> [T]he City *knew* the specific type of computer equipment it needed to meet its needs...had conducted its own study of its computer needs and hired an independent consultant to perform a capacity study...The proposers had little discretion under the RFP in selecting the hardware or software. The RFP did not invite innovative design proposals for a computer system. The only services which the RFP called for were installation and maintenance, services which accompany many machine purchases.[22]

These cases illustrate the type of analysis courts might use in determining whether particular contracts involve predominantly services, or services that are inextricably involved in the total system being purchased, or whether the services involved are incidental to the purchase. In the New York cases the court seemed influenced by the amount of discretion the bidders had in preparing their proposals. In addition, the court weighed heavily the extent to which the city would need to exercise discretion in choosing among the proposals since the New York bidding statute, if it was found to apply, allowed consideration of price only. As noted below, North Carolina's bidding laws allow consideration of factors in addition to price, so that issue might be less important if a case arose in this state. Furthermore, a court might conclude that the bidding laws apply even when the

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of sludge from a waste treatment system was a service contract rather than a sale of city property.

[16] Batiste v. American Home Prod. Corp., 32 N.C. App. 1,6, 231 S.E.2d 269, 272, *disc. rev. denied*, 292 N.C. 466, 233 S.E.2d 921 (1977).

[17] Pacificorp Capital, Inc. v New York City, 741 F. Supp. 481, 485 (S.D.N.Y. 1990).

[18] Burroughs Corp. v. New York State Higher Education Services Corp., 458 N.Y.S. 2d 702 (1983).

[19] American Totalisator Co., Inc. v. Western Regional Off-Track Betting Corp., 396 N.Y.S. 2d 301 (1974). *See also* Autotote Ltd. v. New Jersey Sports and Exposition Authority, 427 A.2d 55 (N. J. 1981) (service exception applies to contract for computer system for a racetrack involving a complex computer network designed to tabulate and categorize bets, and to calculate payoffs for each race, including a staff of technicians and operators and on-call engineers).

[20] Doyle Alarm Co. v. Reville, 410 N.Y.S.2d 466 (1978).

[21] *American Totalisator*, 396 N.Y.S.2d at 302.

[22] *Pacificorp*, 741 F. Supp. at 485.

bidders have significant discretion in developing their bids on the theory that the bulk of the expense consists of the hardware and software itself.[23]

Local governments might urge the North Carolina courts to adopt the reasoning in the first New York case described earlier, that when the local government relies on the vendor to design a computer system to meet the local government's needs the design services provided by the vendor predominate. In such a case, the argument runs, the transaction should be treated as a service despite the fact that the cost of the hardware and software may represent the bulk of the cost. This argument has practical significance since the designer/vendor of an integrated computer system may not guarantee that the desired performance will be achieved if the computer hardware and software are purchased from and installed by different suppliers. Without further interpretation or clarification from the North Carolina courts, however, local governments run the risk of a challenge if they fail to use competitive bidding in these situations.

Computer Software as Intangible Property or License

In addition to its tangible form, computer software also consists of intangible property interests. The unique design of each computer software program (including everything from the source code to the graphic display that appears on the screen) is recognized as "intellectual property" – a form of intangible property that is protected by copyright and trade secret laws. In order to maintain this protection, computer software companies sell their products under a *license,* which usually limits the use of the products to the actual purchaser(s), and restricts its resale, reproduction, or alteration.

Some have argued that the interest obtained under a computer software license is sufficiently limited, that it is more like a lease than a purchase, and as such, should not be considered to be within the scope of the bidding statute. (Since the explicit language of the bidding law refers to *purchases*, the law is generally understood not to apply to lease contracts. [24] As such, a lease, as opposed to a purchase of computer software is not subject to the bidding laws.)

In cases arising under the UCC, courts have struggled to develop a consistent body of law on the threshold question of whether a software license is a contract for the sale of goods. While some cases argue that a license is simply not a sale,[25] other courts have concluded that computer software licenses can represent the conveyance of a tangible product, despite the restrictions on the use of the product imposed under the license and the copyright laws. As one court noted, "We treat licenses as ordinary contracts accompanying the sale of products, and therefore as governed by the common law of contracts and the Uniform Commercial Code." [26]

To make matters even more complicated, courts are not bound by the parties' characterization of the transactions as either a lease, sale, or license. Instead, courts will evaluate the actual character of the transaction. Thus, a court may conclude that a contract involves a sale, even when it is called a lease or a license, if the transaction appears to give the buyer ownership of a copy.[27] "If a transaction involves a single payment giving the buyer an unlimited period in which it has a right to possession, the transaction is a sale. In this situation, the buyer owns the copy regardless of the label the parties use for the contract."[28] The nature of many computer software contracts then, is that they may involve the sale of an object that embodies work that is protected by copyright, or they may involve a license for limited use of protected material but no ownership of any tangible product.

Concerns about inconsistent court rulings on the characterization of computer software contracts, and about the consequence of applying the provisions of the UCC to these unique transactions have prompted a proposed revision to the UCC. A new Article 2B would establish separate rules for software contracts

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[23] *See* Neilson Business Equipment Center, Inc. v. Monteleone, 524 A.2d 1172, 1174 (Del. 1987) (turnkey purchase of computer system in which the hardware and software are combined prior to sale and then installed is predominantly a sale of goods and the UCC applies).

[24] *See* G.S. 160A-19 (lease with option to purchase is subject to competitive bidding).

[25] *See* Microsoft Corp. v. Harmony Computers & Electronics, 846 F. Supp. 208, 212 (E.D.N.Y. 1994).

[26] *See* ProCD, Inc. v. Zeidenberg, 86 F.3d 1447, 1450 (7th Cir. 1996)(enforcing the terms of a "shrinkwrap" license under the UCC).

[27] *See* Applied Information Management, Inc. v. Icart, 976 F. Supp. 149, 154 (E.D.N.Y. 1997)(citing Raymond Nimmer, The Law of Computer Technology, (1992), § 1.18(1), p. 1-103).

[28] *Id.* Determining whether the buyer owns a copy is significant for application of the "first sale" doctrine of copyright law, and determining the uses the buyer can make of the product without infringing on the intellectual property rights of the seller or licensor. *See* 17 U.S.C. 117, 109(a).

(whether or not they are characterized as licenses) and licenses of information. As noted in the commentary to a recent draft of the new article,

> [These] transactions whether licenses or sales are subject to either express or implied limitations on the use, distribution, modification and copying of the software. These limitations are commercially important because (unlike...newspapers and books) the technology makes copying, modification and other uses easy to achieve and essential to even permitted uses of the software...[A]s a relatively new form of information transaction involving products with distinctive and unique characteristics, no common law exists on many of the important questions with reference to publisher and end user contracts regardless of whether a transaction constitutes a license or sale of a copy.[29]

It is unclear whether the unique aspects of computer software contracts that evoked the proposed revision to the UCC would influence a court's analysis of whether computer software is subject to bidding. The UCC addresses issues of contract formation, and rights of the parties under the contract once formed. The competitive bidding laws are designed to promote fairness and competition in public contracting, and to conserve public funds.[30] The limitations that a seller places on the use of computer software may not bear upon the policies promoted by bidding. As noted in the conclusion to this article, however, the unique aspects of computer software transactions may suggest a need for a more flexible competitive process.

Until changes in the law are actually enacted the fact remains that most courts recognize that a transfer of tangible property can occur even when accompanied by or characterized as a license. **Except in cases of custom computer design or development contracts, local governments should assume that computer software contracts are subject to the competitive bidding requirements.** Before submitting a computer software contract to bid, however, it is important to examine whether any of the statutory exceptions to bidding apply.

Exceptions to Bidding: Sole Sources and "Piggybacking"

Two relatively new exceptions in the competitive bidding laws may apply to certain computer software purchases. The "sole source" exception contained in G.S. 143-129(f) applies to purchases when "performance or price competition is not available; when a needed product is available from only one source of supply; or when standardization or compatibility is the overriding consideration." Purchases made under this exception must be approved by the governing board. The sole source exception is fairly broad and may apply to several common computer software purchasing situations.

Purchase of upgrades to existing computer programs will often be within the scope of the sole source exception. Usually, the upgrade will only be available from the company that produced the original system. It is important to note, however, that even if a particular make or brand is needed, there may be more than one supplier, and in such a case, the sole source exception does not apply. For example, upgrades to products produced by Microsoft are available from numerous retail sources. Many software programs commonly used by local governments, however, are designed for specific functions unique to local government (tax collection, financial accounting, geographic information systems). Once a local government chooses to purchase and install a particular system, upgrades and modifications to that system are generally available only from the original provider, or its successor. In these cases, the sole source exception applies.

The sole source exception may also apply to the initial purchase of computer software. There may be some computer software needs that can only be met by one supplier. Applying the sole source exception to the purchase of a new computer program is more troublesome than applying it to an upgrade. Suppose, for example, that a local government wants to purchase a new software system to handle finance department and purchasing operations, including accounts payable, encumbrance accounting, purchase order issuance and related functions. There are numerous computer programs that can complete these tasks, but they vary in the way they do it, the types of equipment they require – indeed, they vary in hundreds of ways, depending upon how detailed a comparison is made. On some level, each one of these systems is unique, and each of them may be available from only one source. If a local government decides that one particular system best meets its needs, does the sole

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[29] Henry Beck, Uniform Commercial Code Article 2B – Licenses, National Conference of Commissioners on Uniform State Laws, January 20, 1997 Draft, p 54-55, in Practicing Law Institute, Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series, PLI Order No. G4-4010.

[30] Mullen v. Town of Louisburg, 225 N.C. 53, 58-59, 33 S.E.2d 484, 487 (1941).

source exception eliminate the need to receive competitive bids?

It is probably not appropriate to use the sole source exception in the situation described above. As a general rule, if there are multiple products available in the market that address a particular need, competitive bids should be sought. Many local government officials would prefer not to conduct a competitive process once they have identified a product that best meets their needs. They may be concerned that once bids are received, they will be required to purchase the lowest priced product, or they may prefer to negotiate with a single provider, an option not available under the bidding law. As discussed later, however, while the competitive bidding process lacks flexibility and does not allow negotiation, it does allow local governments to purchase the best, as opposed to the lowest priced, computer software for their particular needs.

A difficult issue in using the sole source exception to purchase computer software arises when the contract includes both hardware and software. In most cases, even if the software is available from only one source, the hardware is available from multiple sources. The software vendor may require, or the local government may desire, that the software be delivered installed on the hardware. In some cases, a vendor may refuse to warranty the software if it is installed on hardware that is purchased separately. Application of the "predominant aspect" rule described above would suggest that if the hardware represents a substantial proportion of the total cost, the contract should be divided and the hardware bid separately, or the entire contract should be bid, even though the software is available from only one source. This common problem simply does not have a clear or practical solution under the competitive bidding laws as currently written.

Another exception to the bidding requirements allows local governments to purchase from a contractor who has previously contracted with another public agency. Often referred to as the "piggybacking" exception, G.S. 143-129(g) provides that if another public agency (any local government or state in the country, and any federal agency) has contracted to purchase the item within the previous 12 months, and the contractor is willing to sell the same product at the same price, a local government can purchase without bidding. The original contract must have been entered into following a public bidding procedure similar to the one required for local governments in North Carolina. The statute also requires that the contract be approved by the governing body at a regular meeting upon 10 days public notice. No action is required of the agency that originally contracted.[31]

Under this exception, a local government can purchase computer software that has been purchased by another public agency without repeating the competitive bidding process as long as the prior contract is fewer than 12 months old. This time limitation may reflect a concern that after 12 months, the prices or competition available in the market may be sufficiently different that a new bidding process should be conducted.

A subtle limitation on the use of this exception arises if the local government wishes to make modifications in the product that was purchased under the prior contract. For example, if a computer system was purchased by one public agency, but the vendor must adapt or modify it to suit the needs of the local government that desires to purchase it under the piggybacking exception, the purchase may violate the requirement under the exception that it be the same item that was purchased by the other agency. It is impossible to identify what specific types of changes would be deemed so significant that the purchase no longer represents the same product that was previously purchased. Certainly if necessary adaptations result in more than a nominal price increase it may not be safe to assume that use of the exception would be upheld if challenged.[32]

Bidding Computer Software

Computer software purchases that do not fall within an exception and do not constitute service contracts must be competitively bid. This means that if the contract is estimated to cost $30,000 or more, an advertisement must be placed in a newspaper of general circulation in the area. The ad must identify the time and place of the bid opening, describe when and where interested bidders can obtain specifications, and state that the governing board reserves the right to reject any and all bids. Bid bonds and performance bonds are required, but may be waived by the governing board or by the manager or purchasing officer to whom this authority has been delegated.[33] A

[31] For a sample notice and answers to commonly asked questions about the piggybacking exception *see* Frayda S. Bluestein, *Interpretations of the "Piggybacking" Exception to North Carolina's Formal Bidding Requirements*, LOCAL GOVERNMENT LAW BULLETIN, No. 85 (June 1998).

[32] The statute does allow the contractor to provide the product at a more favorable price or at more favorable terms.

[33] G.S. 143-129(c), (a).

waiver of bonds should occur before bids are received and the specifications should clearly indicate whether or not bonds are required. The statute also requires that bids be awarded to the "lowest responsible bidder, taking into consideration quality, performance, and the time specified in the proposals for the performance of the contract."[34] No minimum number of bids is required unless a local policy requires it.[35]

For contracts in the informal range ($5,000 - $30,000) the statute simply requires that the local unit obtain bids.[36] No advertisement is required and again, no minimum number of bids must be obtained unless a local policy requires it. Nonetheless, the local government should contact at least two potential suppliers to obtain quotes, since it would be difficult to argue that "bids" have been sought if only one supplier is solicited. As noted above, if only one supplier is available, the sole source exception may apply.[37] The standard for awarding informal contracts is the same as for contracts in the formal range.

Using "RFPs" in Computer Software Bids

Despite the fact that most computer software contracts involve tangible personal property, bidding computer software is not like bidding vehicles or office supplies. The main difference is that in many cases it is difficult, if not impossible, to prepare detailed specifications of the product that is to be purchased. This difficulty is not unique to computer software, however, and there are approaches to specification writing that can be used to invite competition, even when the details of the product are not known or when various types of products will meet the unit's need.

A commonly used approach to purchasing computer software or computer systems is a request for proposals or "RFP." Although RFP is not a term that is used in North Carolina bidding laws, it is a competitive procedure commonly used in other jurisdictions, and by North Carolina local governments for procuring services, which are not subject to competitive bidding requirements. An RFP usually contains a "performance" specification that describes the desired function or outcome without specifying in detail how it is to be accomplished. This process relies on the vendor's expertise, and the vendor's proposal sets out the method and supplies necessary to perform the desired function or service. A request or invitation for bids ("RFB" or "IFB"), on the other hand, is generally understood to be the solicitation document used in a sealed bid procedure. An IFB typically contains detailed specifications of the item to be purchased, and bids that do not offer the item as specified must be rejected as nonresponsive. This is the type of specification that North Carolina local governments usually use in a formal bidding procedure.

Can local governments use an RFP format with a performance specification and still comply with state bidding requirements? Although no North Carolina case has addressed this question, cases from other states, discussed below, suggest that they can. First, it is important to note that the formal bidding statute does not limit the local unit's discretion in preparing specifications, nor does it specify what type of solicitation must be used. The local government must advertise and receive sealed bids at a public bid opening, but the sealed bids can be in any format designed by the local unit, as long as the specifications do not unjustifiably restrict competition.[38]

The main concern with using an RFP in a formal bidding process stems from the difficulty in comparing and evaluating the proposals. Unlike most formal bids, proposals for computer systems can be quite voluminous and often contain a wide range of options. When bidders submit proposals with varying approaches, it may be difficult to evaluate whether the bids are responsive (that is, whether they meet specifications),[39] and to determine which is the "lowest responsible bidder." In one case, a Massachusetts court held that the use of "problem-oriented specifications" instead of definite specifications did not satisfy the applicable bidding statute.[40] On the other hand, several cases from other

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[34] G.S. 143-129(b).

[35] The three-bid requirement in state law (G.S. 143-132) only applies to construction or repair contracts. Some local governments may have local policies requiring three bids for purchase contracts.

[36] G.S. 143-131.

[37] Public officials have observed that applying the sole source exception to an informal bid may be more cumbersome than bidding, since the exception requires approval by the governing board which is not otherwise necessary for contracts in the informal range. For informal contracts, it may be sufficient to seek competition, and if none is available, simply document the efforts made with the explanation for the lack of competition, rather than proceeding under the sole source exception.

[38] Sperry Corp. v. Patterson, 73 N.C. App. 123, 124, 135 S.E.2d 642, 644 (1985).

[39] For a case discussing the legal standard for evaluating "responsiveness," *see* Professional Food Serv. Management v. North Carolina Dep't of Admin., 109 N.C. App. 265, 426 S.E.2d 447 (1993).

[40] Datatrol, Inc. v. State Purchase Agent et al., 400 N.E.2d 1218 (Mass. 1980).

jurisdictions have upheld this approach, as well as the local government's discretion in selecting the best overall proposal even if it is not the lowest priced offer.[41]

In a case arising in Georgia, which has a legal standard for awarding contracts that is similar to North Carolina's, the court upheld the use of an RFP process to purchase a computer system under the bidding statute. The court affirmed that the law allows the local government to compare proposals that vary in approach and to select the approach that best meets its needs. The court noted,

> No Georgia case has held against the proposition that the lowest responsible bidder may be passed over if it is determined that a higher bidder has a decidedly better product given the specifications...The county retains some discretion to consider its needs in evaluating the bids.[42]

This case is consistent with North Carolina case law holding that the statute does not always require that the contract be awarded to the low dollar bidder.[43]

Bid Process Lacks Flexibility

The previous discussion demonstrates that it is technically possible and legally permissible to insert some flexibility into the formal bidding process using performance specifications and allowing a wide range of proposals as bids. A typical RFP process, however, contains elements that are *not permitted* under the formal bidding statutes. In these respects, the bidding law lacks flexibility, and may hinder the local government's ability to obtain the best computer systems at the best price.[44]

After receiving RFPs it is not uncommon for the parties to negotiate and make modifications in the proposal so that it more completely meets the needs of the unit. In some cases, these modifications result in changes in price. Although not specifically prohibited in the bidding statute, this type of negotiation is inconsistent with the basic tenets of competitive, sealed bidding. Under a sealed bid process, the bidders are required to submit a complete proposal, and material modifications to bids (including especially to bid prices) or deviations from specifications could be challenged as being unfair to other competitors.

The legal concern with fairness under competitive bidding laws makes sense and can readily be applied when the invitation to bid contains detailed specifications and products offered by the bidders are similar to each other. In cases, however, where products offered vary significantly from each other (for example, where different approaches are taken in response to a performance specification), it is more difficult to apply a legal standard designed to establish a level playing field among vendors of similar products. In these situations, after the local government has determined through competition which proposal offers the most desirable approach, tailoring of the preferred product may not do injustice to the competitive process. Nonetheless, current law does not allow the local government to make any material modification to a proposal after it is submitted and prior to the award of a contract.

The need for flexibility in contracting for the purchase of computer software is reflected in a recent recommendation by a state legislative study committee. The Legislative Research Commission's Committee on Information Technology has recommended legislation that would allow state agencies to use a "best value" procurement method for contracts involving the purchase of information technology.[45] The proposed legislation as currently embodied in identical bills (House Bill 1357 and Senate Bill 1188) does not apply to local governments.

Information technology is defined in the proposed legislation to include "electronic data processing and telecommunications goods and services, microelectronics, software, information processing, office systems," and related consulting and design services.[46] The best value procurement method specifically authorizes consideration of multiple factors in awarding information technology contracts, including the total cost of acquiring, operating, maintaining, and supporting the product over its projected lifetime, the technical merit or the vendor's

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[41] Burroughs Corp. v. Division of Purchase and Property, 446 A.2d 533 (N.J. Super.1981); Municipal Leasing Corp. v. Fulton County, Georgia, 835 F.2d 786, affirmed, 849 F.2d 516 (11th Cir. 1988).

[42] *Municipal Leasing Corp.*, 835 F.2d at 789-790.

[43] Kinsey Contracting Co. v. City of Fayetteville, 106 N.C. App. 383, 416 S.E.2d 607, *disc. rev. denied*, 332 N.C. 345, 421 S.E.2d 149 (1992).

[44] *See generally* Margaret E. McConnell, The Process of Procuring Information Technology, 25 Pub. Cont. L.J. 379 (1996).

[45] Legislative Research Commission Information Technology Committee interim report to the 1998 Session of the 1997 General Assembly [hereinafter IT Report], May 11, 1998, p.14.

[46] IT Report, Appendix D, p.D-1; proposed G.S. 143-135.9(a).

proposal, the vendor's past performance and the likelihood that the vendor can perform the requirements stated in the solicitation on time, with high quality, and in a manner that accomplishes the stated business objectives.[47]

The proposed legislation also authorizes a "solution-based solicitation" method for highly complex information technology procurements. This is similar to the performance specification approach discussed earlier.

In support of its recommendation the Information Technology Committee observed,

> [I]nformation technology is more complex, more volatile, and often considerably more expensive than most commodities purchased by the State, and therefore should be acquired differently. In many cases State agencies seek a technology solution to a business problem, but are unsure of exactly what that technology solution might be. In such cases it is not appropriate to use the traditional means of selecting contractors, whereby the requirement is expressed in terms of detailed technical specifications and the lowest bid which meets specifications receives the award. It is more appropriate to evaluate vendors' proposals and select a contractor on the basis of "best value," meaning the best tradeoff between price and performance, where quality is considered an integral performance factor.[48]

The report notes that consideration of multiple factors in addition to price is not prohibited under the existing competitive bidding laws that apply to state agencies. (As noted earlier, the legal standard that applies to local governments similarly allows consideration of factors in addition to price.) The Committee found, however, that the technique is not often used in situations where it could be. The need for expertise in employing the best value procurement method prompted the committee to call for training in addition to specific legislative authority.[49]

Other public agencies have already established more flexible competitive procedures for procurement of information technology.[50] The City of Charlotte obtained local legislation in 1993 to exempt the city from competitive bidding for the purchase of telecommunications, data processing and data communications equipment, supplies and services. The local act created a new provision in the city's charter authorizing the city to use a flexible competitive process for these purchases that includes the option to negotiate.[51] The state of Tennessee has enacted a statute authorizing the use of a multi-step sealed bidding procedure.[52] The two-step procedure calls for submission and evaluation of technical information separate from prices. The Tennessee statute allows the state to obtain additional information from bidders to facilitate evaluation of technical proposals, and appears to allow adjustment of both technical and price bids if necessary to meet performance requirements.

A similar type of flexibility is provided in the Model Procurement Code (MPC), a set of model provisions for state and local government procurement developed by the American Bar Association. Although the MPC has not been adopted in North Carolina, it allows for a procedure called "competitive sealed proposals" combining a sealed, competitive process with the flexibility of an RFP process.[53] The competitive sealed proposal process allows discussions for clarification after proposals have been opened and allows changes in proposals. Precautions must be taken under this procedure to treat the offerors fairly and to ensure that information gleaned from competing proposals is not disclosed to the other offerors.[54]

These modified competitive procedures provide more flexibility to develop a contract that is both cost-effective and responsive to the specific needs of the governmental agency. Although the North Carolina bidding statute allows - indeed requires - consideration of quality, performance, and time, the lack of flexibility to tailor proposals after bids are received may limit local governments' ability to obtain the best proposal and may tempt units to avoid seeking competition altogether, even when avoidance is not clearly authorized.

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[47] *Id.*

[48] IT Report at p 14.

[49] IT Report at p 14-15.

[50] *See*, McConnell, *Procuring Information Technology*, at 385-389.

[51] *See* Charter of the City of Charlotte, Subchapter E; Section 9.85 (Chapter 196 of the 1993 Session Laws).

[52] Tennessee Code Annotated, §12-3-203(a).

[53] MODEL PROCUREMENT CODE FOR STATE AND LOCAL GOVERNMENTS (MPC), (ABA 1979), § 3-203.

[54] MPC, Commentary to §3-203, p.22.

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