

INSTRUCTIONS GUIDE FOR THE IDENTIFICATION AND TREATMENT OF ABNORMALLY LOW BIDS AND PROPOSALS IN THE CONTEXT OF PROCUREMENT FINANCED WITH CABEI RESOURCES

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RISK MANAGEMENT

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I. INTRODUCTION

The Central American Bank for Economic Integration (CABEI) is an international multilateral development financial institution whose resources are invested, among others, in the non-financial public sector of the member countries.

In CABEI's procurement of goods, works, services and consultancies, it is reviewed whether the bids/proposals submitted by bidders/consultants are abnormally low.

Some examples of how a bid/proposal (hereinafter, bid) may appear abnormally low, include:

- a) When compared to the estimated cost of the Borrower/Beneficiary for the contract if there is no ability to compare with market prices;
- b) When compared to all other Substantially Responsive bids;
- c) When it does not seem to provide a profit margin; and
- d) When the low price cannot be explained by, for example:
 - i. The economics of the selected construction method, or
 - ii. The technical solution chosen.

The Bank's Standard Documents contain instructions related to Abnormally Low Bids (ALBs) for the bidders. This way, if the borrower/beneficiary uses one of the standard documents, they will need to check if the bid price is abnormally low.

In all contract award decisions, the borrower/beneficiary is expected to perform reasonable due diligence to ensure that the bidder is able to perform the contract and in the event of a suspicious ALB, enhanced due diligence on the bid is required. An ALB may appear to represent a good value; however, it can result in higher overhead costs, contract delays, or even the collapse of a contract. In other words, accepting ALBs has the potential to jeopardize the contract, as such bids are often submitted by bidders who might not be able to complete their work at the set price or may simply have made mistakes in their bids and would not be able to complete the work at that price, resulting in the borrower/beneficiary investing time and money in managing an underperforming contractor or supplier or in finding a new contractor to complete the work.

II. OBJECTIVE

This document is intended to facilitate a structured approach for the borrower/beneficiary or executing agencies to identify, clarify and deal with Abnormally Low Bids (ALBs).

III. SCOPE

This document must be used by borrowers/beneficiaries or executing agencies for the proper management of procurements where the procurement methods established in CABEL's Procurement Policy Application Norms are applied in public sector operations that are financed by the Bank.

IV. ABBREVIATIONS AND TERMS

- CABEL: Central American Bank for Economic Integration.
- ALB: Abnormally Low Bid.

V. DEFINITIONS

- **Abnormally low bid:** An abnormally low Bid/Proposal is one whose price, in combination with other constituent elements of the Bid/Proposal, appears to be so low that it raises serious doubts to the borrower/beneficiary as to the Bidder's ability to execute the Contract at the offered price.
- **Substantially responsive bid:** A Bid that is evaluated as complete and without major deviations from eligibility, technical and commercial requirements in the procurement documents.

VI. RELATED DOCUMENTATION

- Regulations for the Application of the Procedures for Procurement of Goods, Works, Non-Consulting Services and Consulting Services financed with CABEL Resources.

VII. DEVELOPMENT

1. Steps to follow for the treatment of an ALB

- 1.1. Standard Procurement documents contain clauses related to Abnormally Low Bids. The treatment of an ALB is developed in five (5) stages:
 - a. **Identify:** The Borrower/Beneficiary identifies a potential ALB based on comparison with market prices, or with cost estimation;
 - b. **Clarify:** The Borrower/Beneficiary seeks clarification from the Bidder;
 - c. **Justify:** The Bidder prepares a justification of its price based on the request of the Borrower/Beneficiary;
 - d. **Verify:** The Borrower/Beneficiary fully analyzes the bidder's justification to verify if it is an ALB; and
 - e. **Decide:** The Borrower/Beneficiary fully documents the decision to accept or reject the bid with the Bank's non-objection.

2. Identify

- 2.1. When the evaluation of the bids has been completed and the most convenient bid has been identified, the Borrower/Beneficiary shall verify whether the price of the bid is abnormally low.

In all cases, the identification of an ALB must be based on the prices of the evaluated bids that were substantially responsive.

- 2.2. The two approaches that can be used to identify a potential ALB, depending on the number of bids or proposals received, are:
 - a. **Absolute Approach:** When fewer than five Bids have been received and these respond substantially, the "absolute" approach identifies an ALB based on a comparison of the price of the evaluated bid and its constituent parts, with that of the Estimated Costs of the Borrower/Beneficiary. If the price of the bid is 20% or less than the estimated cost of the Borrower/Beneficiary, then the Borrower/Beneficiary shall clarify the price of the bid with the Bidder, to determine whether the bid is abnormally low.
 - b. **Relative approach:** Uses a statistical calculation using at least five receptive prices.

- 2.3. A potential ALB will be identified when the Low Bid is greater than one standard deviation, below the average of the substantially receptive bids received. The

identification of an ALB by a mathematical calculation assumes that the prices of the bid are competitive and independent. That is, that there is no collusion in the market by keeping prices artificially grouped.

During the preparation of the strategic procurement plan, the Borrower/Beneficiary should consider whether the market sector its approaching has a history of collusion and/or a history of ALB. If there is a history of collusion or ALB in the market, then special care should be taken to identify an ALB even if the lowest bid price is not within the ALB mathematical risk zone.

Example of identifying an ALB using the relative approach

	Expressed in Millions of US\$
Bid 1	72
Bid 2	92
Bid 3	82
Bid 4	101
Bid 5	53
Average	80
Standard deviation	17
Abnormally Low Bid Threshold	63

In the example above, the average bid prices are \$80MM. The standard deviation of bid prices is \$17MM. So, the ALB risk zone is any price below \$63MM (which is calculated by subtracting the average price \$80MM minus the standard deviation amount \$17MM). In this case the most convenient bid price of \$53MM is a potential Abnormally Low Bid.

- 2.4. Whatever approach is applied to identify a potential ALB, the borrower/beneficiary should be aware that the Bank will not accept or agree to the automatic rejection of a bid that is suspected to be an ALB, without the Borrower/Beneficiary first clarifying the basis of the alleged ALB with the bidder.
- 2.5. In identifying a potential ALB, the Borrower/Beneficiary shall conduct a preliminary evaluation of the bid to find any part that may have been greatly underestimated by the bidder. Based on the findings of the preliminary assessment, the Borrower/Beneficiary should ask the bidder for clarification on the particular elements that appear abnormally low.

- 2.6. If an ALB has been identified in the assessment process, the assessment report shall contain all the details of the "absolute" value or "relative" basis on which an ALB has been identified.

3. Clarify

- 3.1. In the event that the Borrower/Beneficiary proposes to recommend the award of the contract to the bidder of a potential ALB, the Borrower/Beneficiary has a mandatory requirement to establish the Bidder's ability to execute the contract with the evaluated bid price. A borrower/beneficiary shall not automatically reject a potential ALB without first completing the five stages in this process unless, the bidder does not provide the requested clarification in a timely manner, then the bid will be rejected on that basis. The borrower/beneficiary must perform:

- a. **Preliminary assessment:** Competitive prices generally should not deviate substantially for goods, works and services. However, price variations should be expected for items designed by contractors or when offering alternative technical solutions.

The cost of materials generally has minimal divergence between bidders; however, there may be circumstances in which a bidder has an advantage due to locally available resources or reduced transportation costs due to the proximity of the contract to the proposed site.

The preliminary assessment should seek to identify problems such as:

- i. Has the bidder failed to price some items and this was intentional or accidental?
 - ii. Do some items have a significantly lower price by the bidder than estimated by the Borrower/Beneficiary? and if so, is it an arithmetic error?
 - iii. Do certain items/types of items have consistently lower prices (e.g., cost per meter of pipes in a trench) and is it clear why this is the case?
- b. **Request for clarification:** Requests to bidders to submit "detailed price analysis" must be made in accordance with the contents of the bidding document.

The request for clarification of detailed price analysis should focus on the issues that have been identified during the preliminary assessment and should clearly indicate the basis on which the Borrower/Beneficiary determined that the bidder's price may be excessively low.

The borrower/beneficiary must ensure that the bidder is given sufficient period to provide the requested clarifications and/or detailed price analyses. Under normal circumstances and depending on the volume/complexity of the information to be provided by a bidder, a period of not less than 5 to 10 business days will generally be considered a reasonable period.

The Borrower/Beneficiary must also inform the bidder that any misrepresentation by the bidder in the information provided will be subject to the Bank's anti-fraud and corruption guidelines and may be subject to sanction. The information that is typically requested in a price analysis may comprise the following basic components of costs:

i. Clarification of resource inputs and prices

If the Borrower/Beneficiary determines that the bidder's estimate of a resource input associated with a particular part of the bid may be unrealistic or substantially below the respective estimate of the Borrower/Beneficiary, the Borrower/Beneficiary shall request the bidder to clarify to the satisfaction of the Borrower/Beneficiary the basis on which the bidder has:

- Estimated the respective contribution of resources; or
- Determined that the underlying agreements may be modified or substituted within their total bid price.

If the Borrower/Beneficiary determines that the bidder's estimate of the cost of a resource input may be unrealistic or is substantially below the respective assumption of the Borrower/Beneficiary, the Borrower/Beneficiary shall request the bidder to provide appropriate evidence corroborating its price of the respective resource input, including, as necessary, more detailed price analysis with respect to the resource input questioned by the Borrower/Beneficiary.

ii. Clarification provided by the bidder's subcontractors

A contractor shall be liable for the acts or breaches of any subcontractor, its agents or employees, as if they were acts or breaches of the contractor. Therefore, the bidder shall ensure that its proposed subcontractor will be fully capable of performing the part of the contract that the bidder chooses to subcontract.

Therefore, if a bidder proposes a designated subcontractor for the performance of any part of the contract, the Borrower/Beneficiary will require the bidder to demonstrate its subcontractor's ability to perform the contract as if it were to be performed by the bidder.

Similarly, if the bidder's clarification response contains a justification related to a subcontractor's price, the Borrower/Beneficiary may request details of that price if it is materially low.

iii. Clarification of the General Expenses of the bidder.

The general components of a bid are usually a source of variation in prices and depend on, for example:

- Organization arrangements and project management (on and off-site);
- Machinery and labor costs; and
- Profit margin allowed by the bidder for the contract.

The basis on which overheads are included in a bid price may be substantially different between bidders and may therefore fluctuate substantially. Therefore, if necessary, during the evaluation of the bid, the borrower/beneficiary may require bidders to provide detailed information about their overheads.

4. Justification

- 4.1. The time allowed for the preparation and presentation of the justification by the bidder must be determined with due consideration of the particular circumstances of the processes and the magnitude and complexity of the contract. Normally, borrowers/beneficiaries must ensure that bidders have a period of no less than 5 to 10 business days.
- 4.2. The bidder's justification must include all information requested by the Borrower/Beneficiary and any documentary evidence that the bidder used to determine the price of its bid.
- 4.3. If the bidder does not provide the requested information within the time period indicated in the procurement documents, or does not provide all the requested information, the Borrower/Beneficiary may reject the bid at this time. Likewise, no bidder may be authorized by a client to withdraw its bid or add any cost element when

providing a clarification (without the loss of its bid guarantee), during the period of validity.

4.4. The explanation provided by the bidder may relate to:

- a. The economics of the manufacturing process, the services provided or the method of construction;
- b. The technical solutions chosen or the exceptionally favorable conditions available to the bidder for the supply of the Goods, Works or Non-consulting Services;
- c. The originality of the work, supplies or services proposed by the bidder;
- d. Compliance with the applicable rules and obligations mentioned in the selection documents; and
- e. The above points, where goods, works or non-consulting services will be provided by a subcontractor.

4.5. The bidder's justification may include its estimation of work requirements; sources and volume of materials, plant and construction equipment, transport distances, etc. required for the fulfillment of the part of the requirements for which the Borrower/Beneficiary requires clarification.

4.6. The bidder's clarification may also include a description of the nature of the bidder's access to the proposed construction equipment, e.g. rental, lease, sales contract, etc. and any documentary evidence that the bidder has used to determine its bid price during the bidding period.

5. Verify

5.1. Upon receipt of the bidder's justification, it is essential that the Borrower/Beneficiary's personnel who is duly qualified, fully analyze the information provided by the bidder and take into account all evidence presented in response to the request for clarification.

5.2. The Evaluation of the Borrower/Beneficiary related to the ability of a bidder to carry out the contract at the price quoted in its bid, should focus on the price analysis of any or all of the items of the goods or works to be carried out by the bidder or its subcontractors, in combination with other elements of the Bid/Proposal and their consistency with the bidder's estimate. The Borrower/Beneficiary may also evaluate a Bidder's past satisfactory performance and implementation of similar price contracts.

5.3. For several reasons, a bid price that is below the estimated cost of the Borrower/Beneficiary cannot be considered abnormally low, for example:

- a. A bidder's mobilization costs could be significantly lower if the bidder already has a construction contract in progress near the proposed project site and could also benefit from economies of scale (e.g., when procuring materials).
 - b. A bidder may be interested in entering a new market (e.g. in terms of country of operation and/or type of work) and takes a conscious strategic position of bidding with low prices, using a project as a "loss leader" (this is generally more applicable to contracts for goods and non-consulting services contracts than to works contracts).
 - c. A bidder could have proposed a much more efficient or innovative working method than other bidders.
 - d. A bidder may be attempting to enter a collusive market. In such cases, "market" prices may be artificially inflated and thus the Borrower/Beneficiary's estimate could make a competitive bid appear abnormally low in comparison.
 - e. A bidder may have received a state grant.
- 5.4. Upon verification of the bidder's price analysis and the detailed justifications provided by the bidder, the Borrower/Beneficiary will determine whether the price of the Bid/Proposal, in combination with other elements of the Bid/Proposal, is unreasonably low, to the extent that the bidder has not demonstrated the ability to successfully execute the contract for the price presented. If the Borrower/Beneficiary is not satisfied, and upon non-objection from the Bank, the bid must be rejected.

6. Decide

- 6.1. The borrower/beneficiary shall include in the evaluation report of the bid all the details based on the decision taken and shall include the following information:
- a. The value of the bidder's estimates of the resources and the respective price that the Borrower/Beneficiary determined is unrealistic or substantially below the level required for satisfactory execution of the contract;
 - b. The value of the Borrower/Beneficiary's estimates and assumptions in relation to the resources and the respective price required for the satisfactory performance of the contract, or an explanation of why the Borrower/Beneficiary's cost estimate, as applicable, was not taken into account;
 - c. The value of the deficit identified in the Bidder's bid;

- d. The recommended decision to accept or reject the bid based on the "Detailed Evaluation of the Bidder's Price Analysis"; and copies of all exchanges of clarification between the borrower/beneficiary and bidder, including details of any objections that the bidder has highlighted during the clarification process and the basis on which the Borrower/Beneficiary rejected the bidder's objections.
- 6.2. The bid evaluation report shall also include details of any objections that the bidder may have raised with respect to the Borrower/Beneficiary's estimates and assumptions regarding the elements of the remedy and their respective prices and the appropriate justification of why the Borrower/Beneficiary has rejected the Bidder's objections. The Borrower/Beneficiary's recommendation will be included in the bid evaluation report.
- 6.3. Due diligence on the potential price of an ALB will be performed prior to submitting the bid evaluation report to the Bank for non-objection of contracts subject to prior review.
- 6.4. Borrowers/Beneficiaries should be aware that, for contracts subject to prior review procedures, the recommendation to accept or reject the bid will be subject to the Bank's non-objection.