Capability Guidance

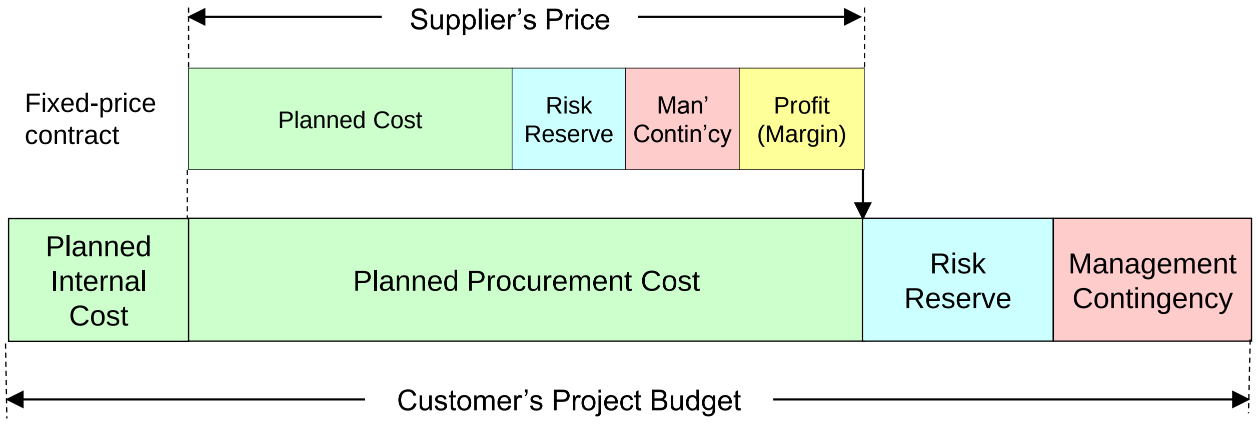
Linking Risk to Contract Management

Purposes

1. Align contractual incentives with the ability of the parties to manage risk.
2. Avoid accepting liability for risk that another party controls and can exploit.
3. Share risk when there is a mutual benefit in doing so.

Fixed price Contracts

Fixed price contracts are a common approach to clarifying contractual liabilities for risk. Each party has contractual obligations to be met at its own cost. A well written contract (including its referenced documents) will clarify contractual obligations such that any risk is implicitly owned by one party or the other.



Risk-bearing organisation

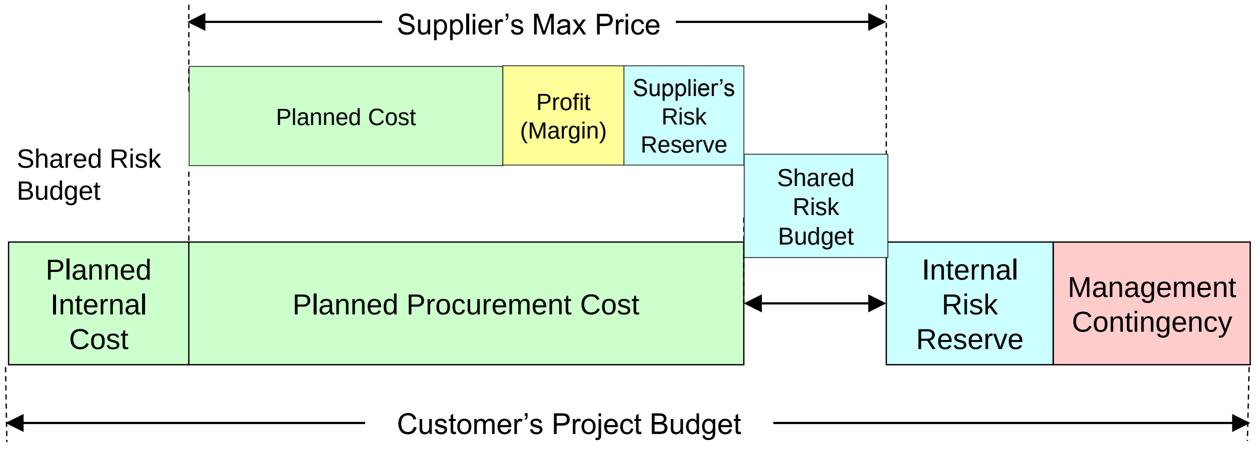
The risk-bearing organisation is the one that would bear the financial impact of the risk involved. It is good practice to understand a proposal or contract in order to identity the risk bearing organisation for each risk.

1. If it is unclear which party owns a risk, the contract may need clarification.
2. Your organisation should avoid owning risk that can be better managed by the other party.
3. Understanding the source(s) of uncertainty that influence risks helps make risk transfer decisions.

Risk Sharing approaches

Sometimes there is a mutual benefit to be gained from sharing risk. Risk sharing strategies include:

1. **Shared project ownership** with a vehicle that shares risk, whilst aligning work share with expertise.
2. **Sharing benefits** where there can be mutual interest (e.g. revenue from post-project operations).
3. **Through life cost optimisation incentives** e.g. supplier commitments to post delivery service prices.
4. **Variable Price** contracts in which overall savings or cost overruns relative to a target cost are shared.
5. **Shared risk budget** for risks explicitly identified in the contract.



Maxims to remember

1. One party's risk may be another party's opportunity.
2. You can transfer cost-related risk. But time is immutable.
3. Risk management should start before submitting a proposal or signing a contract.