



RISK DOCTOR BRIEFING

MANAGING CONTRACT CLAIMS RISK



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Many organisations involved in or with the construction industry want to know how to minimise the risk of contractor (or sub-contractor) claims during the execution phase of a project, after contracts have been signed and work has started on site. While this is important, it is better to focus on not getting claims in the first place. This the key answer to the question “How can we manage claims risk effectively?”

In general, claims or disputes arise where an inappropriate contract strategy has been chosen or where risks have not been clearly allocated. Unfortunately, this method of risk transfer is often not considered or implemented effectively.

All projects include a degree of risk and effective management of risk should start at the concept stage, before a contract is let, and before a contractor is chosen. A client should be clear about what they really want. They must know what is important to them and why the project is needed. They should be able to determine and articulate clear objectives against which risks can be identified and assessed.

Once real risks have been identified and prioritised, a client can decide how to manage them. Sometimes an organisation may not be able to manage all those risks effectively themselves. Where that is the case, the organisation may ask a contractor to take on some of their risks, to manage them on their behalf. However, passing risks to a contractor is not always the right thing to do. When thinking about transferring risks to a contractor, the following questions should be considered:

- Is this risk best managed by someone else, or is it better to keep it ‘in-house’?
- Is this contractor capable of managing the risk on our behalf?
- Should liability for impact of the risk be transferred to the contractor, if it were to occur?
- Has the contractor been clearly informed of the risk they are being asked to take?
- Is the contractor being paid fairly for taking the risk on our behalf?
- Will the chosen contract strategy effectively transfer the risk?
- Does the contract make clear who is responsible for management of the risk and who is liable for its impact?

Everyone likes to get work done at the cheapest possible price, however, it is not always true that the cheapest quote is best. Sometimes cheaper quotes result from a client asking a contractor to accept risks, but without being prepared to pay an appropriate amount. Sometimes the client has an unjustified belief that the contractor is better able to manage risks. This course of action is usually the start of disputes and claims, as the lowest quote usually does not include a reasonable allowance for risk.

Some clients are now choosing different contract types to better manage risk transfer, such as alliancing or partnering. These types of contract include a mechanism to share the pain from threats that occur, as well as sharing the gain from captured opportunities. Whatever contract type is used, it is important to think carefully about risk transfer to contractors, because if it is wrong, there will inevitably be an increase in claims.

The best way to reduce claims risk is to avoid claims in the first place. By addressing the questions outlined here, organisations will give themselves and their contractors the best chance of delivering successful projects without unnecessary claims.