Contracting - Additional Definitions to Know

This list of contracting terms to know supplements what you learned in your Rita Mulcahy’s™ PMP® Exam Prep book, 11th edition (Prep book), in the “Procurement” chapter (page 332). Knowing these terms can help project managers navigate procurements, and can help you get more questions right on the exam.

- **Price** This is the amount the seller charges the buyer.
- **Profit (fee)** The amount of money the seller has after costs are paid. In a fixed-price or time and materials contract, a seller builds a profit margin into the amount they charge the buyer. In cost-plus contracts, the “plus” represents the profit, and that amount is typically negotiated by the buyer and seller.
- **Cost** This is how much an item costs the seller to create, develop, or purchase. A buyer’s costs (or price) include a seller’s costs and profits.
- **Target price** This term is often used to compare the end result (final price) with what was expected (the target price). Target price is a measure of success. Watch for similar terms. Target cost plus target fee equals target price. (Remember, we are thinking about procurements from the buyer’s point of view!)
- **Ceiling price** This is the highest price the buyer will pay; setting a ceiling price is a way for the buyer to encourage the seller to control costs. The ceiling price is a condition of the contract that must be agreed to by both parties before signing. Keep in mind that answers to calculations on the exam can change when a ceiling price is mentioned.
- **Point of total assumption (PTA)** This only relates to fixed price incentive fee contracts, and it refers to the amount above which the seller bears all the loss of a cost overrun. Costs over the PTA are assumed to be due to mismanagement: a design statement of work should have been created to allow for fair and reasonable contract negotiations for the required work, suggesting the seller either did not estimate correctly or did not manage the work well. Sellers will sometimes monitor their actual costs against the PTA to make sure they are still receiving a profit for completing the project.

Formula: Point of Total Assumption
PTA = (Ceiling price − Target price) / (Buyer’s share ratio + Target cost)

- **Nondisclosure Agreement** For many procurements, there is a great need for confidentiality. Such a written agreement between the buyer and prospective sellers identifies the information or documents they will control and hold confidential; it also details who in the organization will have access to the confidential information. With a nondisclosure agreement in place, the buyer can talk more openly about their needs without fear that the public or one of the buyer’s competitors will gain access to the information.
- **Standard Contract** Commonly created by the buyer, standard contracts are usually drafted—or at least reviewed—by lawyers and generally do not require additional review if used for the purpose for which they were intended. You should understand standard contracts, but also realize the project manager’s role in special provisions (described next).
- **Special Provisions (Special Conditions)** The project manager must understand standard terms and conditions but also determine when additions, changes, or deletions from the standard provisions are required. By facilitating necessary adjustments, the project manager can make sure the resulting contract addresses the needs of the project. The project manager (remember when taking the exam that you are the buyer’s project manager, unless a question states otherwise) meets with the

procurement manager (if there is one) to discuss the needs of the project and to determine the final contract terms and conditions.

Additions, changes, or deletions are sometimes called special provisions and can simply pertain to the type of project and project requirements, risk analysis and administrative, legal, or business needs.

- **Letter of Intent** In some instances, the seller may need to start hiring people or ordering equipment and materials before the contract is signed in order to meet the contract requirements. A letter of intent is not a contract, but simply a letter stating that the buyer intends to hire the seller. It is intended to give the seller confidence that the contract will be signed soon and to make them comfortable with taking the risk of ordering the equipment or hiring the staff that will eventually be needed.
- **Privity** This simply means a contractual relationship. The following explains privity and shows how questions on this topic may be asked.

Privity Example

Question: Company A hires company B to do some work. Company B subcontracts to company C. The project manager for company A is at the job site and tells company C to stop work. Generally, does company C have to listen?

Answer: No. Companies C and A have no contractual relationship. Company A needs to talk to company B, who needs to talk to company C.

Can you see how this would be important to understand? Any directive that the project manager from company A may give to company C can cause liability for company A. For example, company A may have to pay delay claims to company B, plus the costs of delay to company C if company C stopped work at company A's direction.