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May 12, 2003

Australian Pipeline Trust
PO Box 934
MASCOT NSW 2020

Attention: Mr Rob McMaster

Dear Rob:

RE: EAST AUSTRALIA PIPELINE LIMITED
OPTIMISED REPLACEMENT COST – ESTIMATE CONTINGENCY

You have asked me to comment on the purpose of the contingency in the estimate provided by Venton and Associates in 1999 for the optimised replacement coat of the East Australian Pipeline Network.

I understand that the ACCC chose to delete this amount from the capital cost estimate.

The contingency allowance in the estimate was provided as an allowance for omissions based on an assessment by the pipeline estimator and myself, based on the knowledge of the limited detail behind the estimate.

It is not applied as an allowance to establish the maximum possible cost for project financing purposes, as if the estimate was being presented to a Board of Directors for budget authorisation.

Even though considerable knowledge of the pipeline routes existed at the time of the estimate, detailed knowledge of the terrain and soil types, metering and pressure regulating facility size and configuration, land and other costs was not available.

Consequently it was necessary to establish costs using assumptions, general industry knowledge and historical cost estimate data.

Experience has shown that it is usual for estimates of this type to present optimistic estimates of the project cost, not because the estimate was incorrect, but by selecting the major cost items to provide the estimate basis, inadequate allowance is made for the great many lesser cost items that exist, but that are only discovered through a detailed estimating process based on well developed designs, and detailed investigation of other contributing cost factors.

The amount of contingency applied to the capital cost estimate presented in the 1999 report (and retained in the 2003 estimate) was 10% of the estimated cost including indirects.

It could be argued that this percentage is high, given:

- the large percentage of the capital cost that pertains to the supply of the linepipe and,
- that the length of the pipeline route is known with a high degree of certainty and,
- the unit cost of line pipe is known with a higher level of certainty than the cost of other items at the time that most estimates are made.

However the uncertainty (omissions and cost) pertaining to the other cost items is generally greater than 10%.

While a detailed analysis of the estimate for omissions and cost accuracy was not undertaken at the time of the 1999 report, it was considered that 10% was reasonable. A more detailed analysis may show that 7.5% would have been a more appropriate allowance.

It would be most unlikely to find that 0% was an appropriate allowance.

Consequently, as the author of the report, I consider that the removal of the contingency by the ACCC has resulted in the capital cost of the optimised system being understated by the amount of the contingency.

Similar comments apply to the cost estimate for the 2003 load forecast developed by Venton and Associates recently.

Sincerely,
Venton and Associates Pty Ltd

Philip Venton

Cc: Chris Harvey, Agility.