

**Achieving Predictable Project Costs
in an Unpredictable World**

**Richard Westney -
Moderator
Westney Consulting Group, Inc.**

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Why Be Concerned About Predictability?

Wall Street Journal – 7/05: *“Shell’s Cost Soar for Russian Project .. Price Tag of Sakhalin II may double to \$20 billion”*

Houston Chronicle 5/06: *(explaining why Rich Kinder was initiating what could be the largest management buyout in US history) “At a share price of \$84.71 investors are saying “there are risks to these projects so we are putting a heavy discount on (the share price).”*

Upstream (5/03): *megaprojects have a 50% probability of becoming “mega-wrecks”*

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Why Be Concerned About Predictability?

- *Studies show major cause of ROCE degradation is capital cost overruns*
- *CAPEX performance is now an important measure of financial performance; SOX driving increased visibility*
- *“Boards have now become much more demanding in getting assurances from executives that the risks are identified, that they are quantified, and that quantification is translated into management action”.*

Financial Times, 25 April 2006

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Why Be Concerned About Predictability?

- *Economies of scale create mega-projects; difficult to manage & huge overruns are common*
- *Smaller companies (independents) doing major projects with minimal internal resources*
- *High demand has created an extraordinary seller's market*
- *Loss of experienced people diminishes critical competencies*
- *Organizations were designed for project portfolios of the 90's*
- *Owners can no longer transfer risks to contractors*
- *Increased influence of National Oil Companies impact economics and execution*

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Our Session Today

- **The NEUTRAL VIEW:**

Chris Carabetta – *IPA: Can Contracting Strategy Influence Cost Predictability?*

- **The CONTRACTOR'S VIEW:**

Scott Mahlberg – *Bechtel: A Contractor's View of Lump Sum Contracts*

- **The OWNER'S VIEW:**

Paul McNutt – *ConocoPhillips: An Owner's View of Estimating*

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Achieving Predictable Project Costs in an Unpredictable World

Christopher Carabetta
Independent Project Analysis, Inc.

**Can Contracting Strategy Influence Cost
Predictability?**

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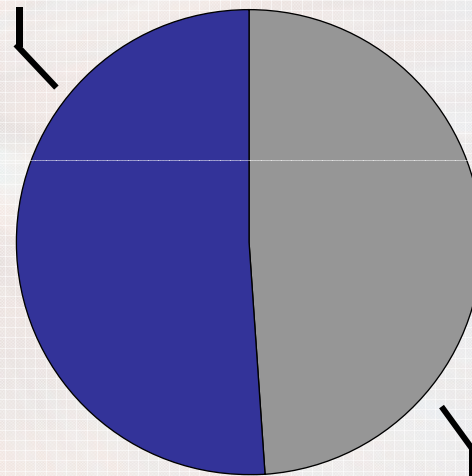


IPA Has Benchmarked 80 Recently-Completed Large Capital Projects

Project Characteristics

- US\$ 204 million to US\$ 2.1 billion
- 25 companies
- 22 countries

51% Lump-Sum
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49% Reimbursable
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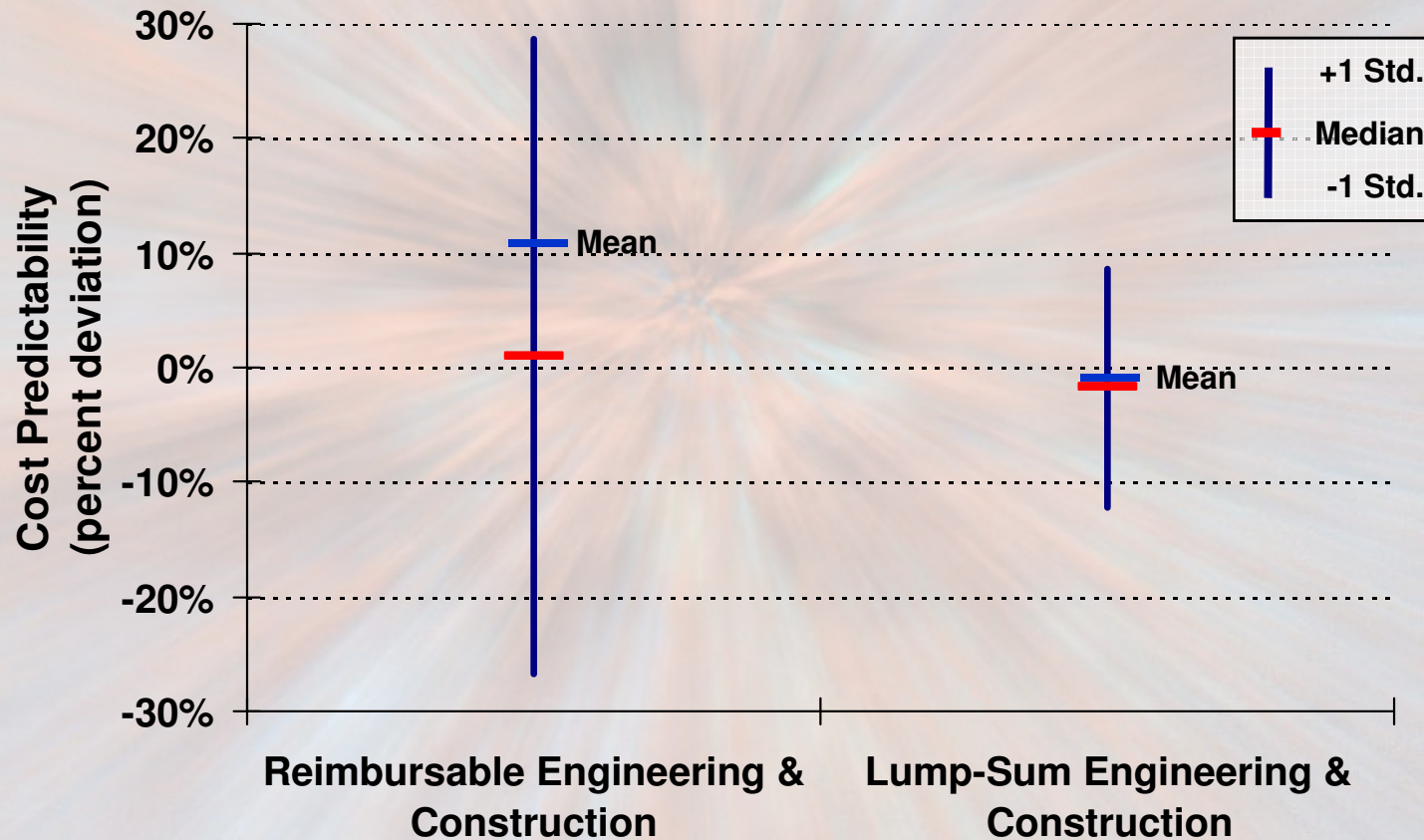
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Lump-Sum Contracting Improves Cost Predictability for Large Projects



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Questions

- **Lump-sum contracting improves cost predictability for the owner—do contractors then see the same cost variability as the owner would if the contract were reimbursable?**
- **Is the premium paid by the owner to achieve cost predictability on lump-sum contracts worth it?**
- **Use of best practices improves cost predictability for the owner in reimbursable contracts—is this a better route to achieving predictability?**

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Achieving Predictable Project Costs in an Unpredictable World

Scott A. Mahlberg
Bechtel

**A Contractor's View of Lump Sum
Contracts**

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Contractor's View of LS Contracts

- **Current EPC market factors:**
 - Material & equipment supply / delivery / price
 - Craft labor availability / cost
 - Professional staff availability / cost
- **Owner influences:**
 - Lack of firm scope
 - Decision process
- **Bid costs**
- **Contingency build-up**

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Questions

- **What risk should the Contractor take – risk allocation?**
- **How much contingency to be included for risks – the price of predictability?**
- **What other contracting strategies can provide predictability?**

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Paul B. McNutt
ConocoPhillips

An Owner's View of Estimating

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Cost Estimating: A New Problem?

- One carpenter's rule

- "Suppose one of you wants to build a tower. Will he not first sit down and estimate the cost to see if he has enough money to complete it?

Luke 14:28



- Another carpenter's rule

- Measure twice, cut once



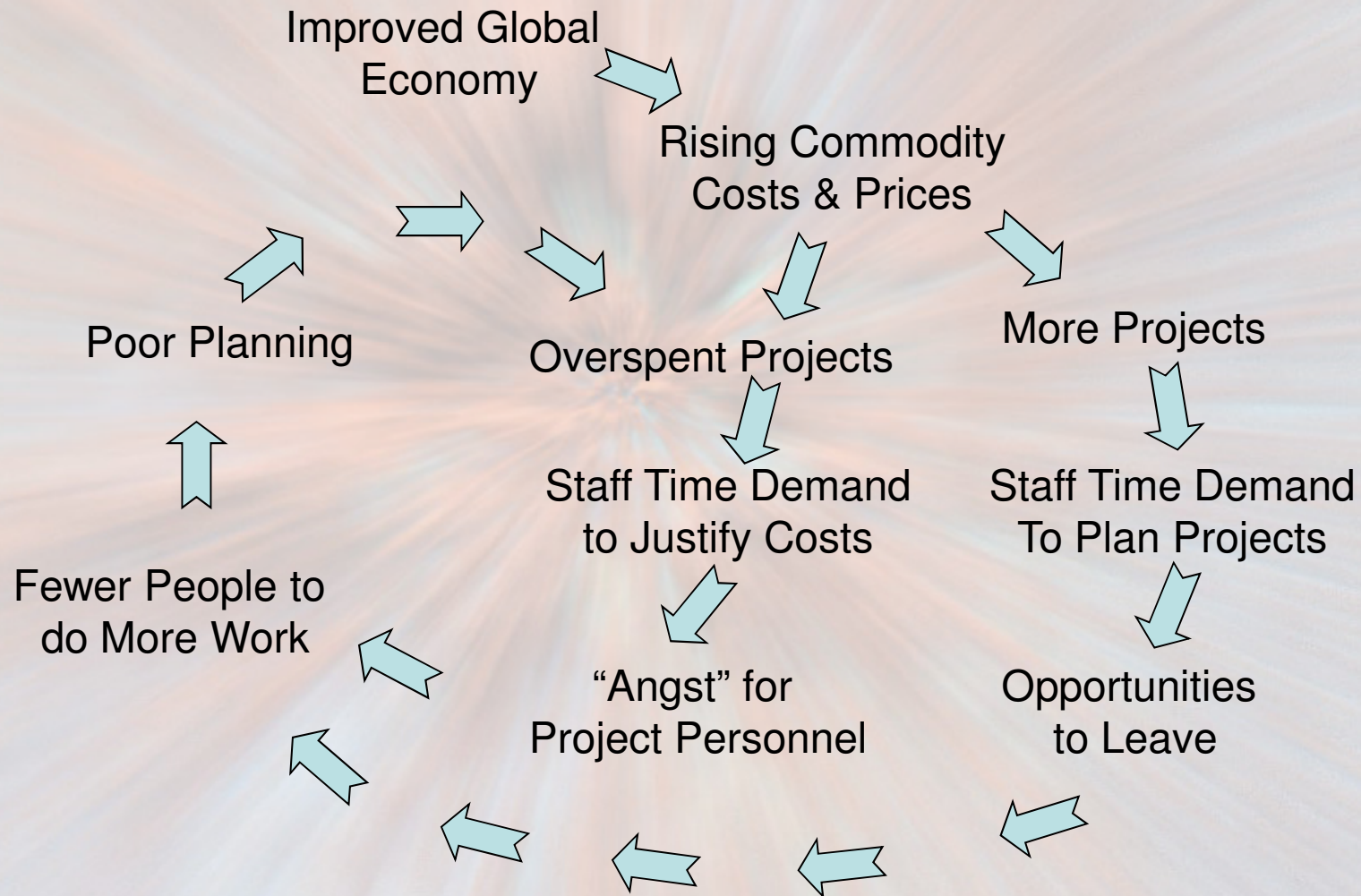
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A "Doom" Loop?



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Questions

- **What factors at the global market, industry, company levels makes this cycle spin faster?**
- **What factors at each level can slow it down?**
- **What companies are the best in your industry and why?
What do they do?**

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