

11 June 2013

Assistant Director of Rail
Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

By email: publicsubmissions@erawa.com.au

Dear Sir,

TPI'S FLOOR AND CEILING ACCESS COST DETERMINATION

1. Introduction

- 1.1 Flinders Mines Limited (**Flinders**) is an emerging iron ore miner. Flinders' main focus is the development of its Pilbara Iron Ore Project (**PIOP**), situated in the Pilbara region of Western Australia.
- 1.2 A Mining Lease has been granted and WA EPA environmental approvals are in place for the PIOP.
- 1.3 Flinders understands that the Economic Regulation Authority (**ERA**) is inviting public submissions in respect of The Pilbara Infrastructure Pty Ltd's (**TPI**) floor and ceiling costs determination for a section of TPI's railway between Christmas Creek mine and Port Hedland which starts at the 219.5km mark from Port Hedland and ends at the 23km mark from Port Hedland. As an emerging iron ore miner, Flinders is considering various infrastructure options which may be capable of meeting its rail transportation requirements. As such, Flinders considers itself a potential proponent of the access arrangements put in place under the *Railways (Access) Code 2000 (Code)* and wishes to make a submission to the ERA accordingly.
- 1.4 Flinders understands that Brockman Iron Pty Ltd (**Brockman**) has submitted an access application and proposal (**Proposal**) to TPI for access to TPI's railway under the Code. As a result of this development, on 17 May 2013, the ERA directed TPI to amend its current costing principles to redefine the TPI railway into six route sections from the previous three. This submission specifically relates to the following defined sections relevant to Brockman's Proposal:
 - the route section from chainage 219.5km to chainage 174.875km measured from Port Hedland
 - the route section from chainage 174.875km to chainage 23km, measured from Port Hedland.
- 1.5 Flinders notes that pursuant to section 50(3) of the Code, TPI has recently submitted its proposed floor and ceiling costs to the ERA on a confidential basis and therefore these costs are not available for review by Flinders or any other third party. Therefore, this submission seeks to make general comments in respect of the determination of TPI's floor and ceiling prices. In order to provide a more comprehensive analysis, Flinders would need to be provided with further information.

2. TPI's 2010 Costing Model

- 2.1 In July 2010, Fortescue Metals Ltd submitted, on behalf of TPI, A Floor and Ceiling Cost Proposal (**Cost Model**). The Cost Model provided a floor price of \$5.07 and a ceiling price of \$5.77 for the single segment route from Cloudbreak mine to Port Hedland based on an assumption that it would move 40 million tonnes per annum (**Mtpa**) across this single segment. The table below sets out the total floor and ceiling costs provided by TPI for 2010/11 and also predicted for 2013. The predicted increase in TPI's access price per tonne ranged from between approximately 1.5% to 7%.

	Year ending 30 June 2011	Forecast for year ending 30 June 2013
Total floor costs	\$203,005,767	\$205,814,788
Floor price per tonne based on volume of 40Mtpa	\$5.07	\$5.15
Total ceiling cost	\$230,930,978	\$248,187,131
Price per tonne based on volume of 40Mtpa	\$5.77	\$6.20

- 2.2 In April 2011, the ERA suspended its review of TPI's floor and ceiling costs, however, it subsequently released a report prepared for the ERA by PricewaterhouseCoopers (PwC)¹ focusing on TPI's floor and ceiling costs for 2010/11. In this report, PwC noted that the "*application of the TPI factors and processes means that the proposed floor cost represent around 88% of the ceiling cost.*" The report also noted that in the WestNet Rail floor and ceiling cost model that the floor costs represent around 5% of ceiling costs.

- 2.3 In its report, PwC recommended revising the 2010/11 floor and ceiling costs as follows:

	TPI Cost Model 2010/11 (40Mtpa)	PwC Recommended revisions 2010/11 (40Mtpa)
Total floor costs from Cloudbreak to the port dumper	\$203,005,767	\$24,123,408
Floor price per tonne based on volume of 40Mtpa	\$5.07	\$0.60
Total ceiling costs from Cloudbreak to the port dumper	\$230,930,978	\$173,026,374
Ceiling price per tonne based on volume of 40Mtpa	\$5.77	\$4.32

¹ PwC "Economic Regulation Authority - Review of Floor and Ceiling Cost Proposal of the Pilbara Infrastructure Pty Ltd – Draft Report" July 2011.

- 2.4 PwC's recommendations would make TPI's floor costs approximately 13% of the ceiling costs. However, Flinders understands that PwC's report recommended that the basis of the floor costs be determined by the ERA at the time a third party proposal for access to the network is made under the Code. In any event, in April 2011, the ERA suspended its review of TPI's costs to allow for TPI to remodel its costs to take into account the extension of TPI's line from Cloudbreak to Christmas Creek, which became part of the TPI railway network and subject to the Code and until now, no further public review has taken place.
- 2.5 Flinders notes that according to press reports, since 2011, numerous cost and price calculations have been conducted by analysts such as Credit Suisse using both TPI's 2010 Cost Model and PwC's pricing model as a basis. It is reported that Credit Suisse, for example, predicted a floor price between \$3.77 to \$4.36 per tonne and a ceiling price in the range of \$4.36 to \$4.99 per tonne which sits between the prices in TPI's cost model and PwC's recommended revisions.²
- 2.6 Both TPI's 2010/2011 cost model and subsequent report released by the ERA and prepared by PwC was on the basis of hauling 40Mtpa on this segment. If publicly available information is correct and TPI intends to accommodate 155Mtpa on existing infrastructure and it is assumed that no additional incremental cost is incurred in achieving this increased tonnage (it is understood there will be some incremental increase in total cost), then TPI's costs should be significantly lower on a cost per tonne basis as shown below.

	155Mtpa Estimate based on TPI Cost model 2010/11	155Mtpa Estimate based on PwC Recommended revisions 2010/11
Total floor costs from Cloudbreak to the port dumper	\$203,005,767	\$24,123,408
Floor price per tonne based on volume of 155Mtpa	\$1.31	\$0.16
Total ceiling costs from Cloudbreak to the port dumper	\$230,930,978	\$173,026,374
Ceiling price per tonne based on volume of 155Mtpa	\$1.49	\$1.12

² Source: Australian Financial Review, 29 May 2013.

3. Brockman's Proposal

3.1 Flinders understands that Brockman's Proposal is based upon the transportation of 20Mtpa and relates solely to two of the six sections of TPI's railway outlined in TPI's Amended Costing Principles. Pursuant to section 9(1)(c) of the Code TPI has reportedly furnished Brockman with its floor and ceiling prices and underlying costs for the relevant sections of its railway and indicated that its proposed prices will be as follows³:

2013 PROPOSED COSTS	\$AUD
Total floor costs	\$73,412,642
Price per tonne based on volume of 20Mtpa	\$3.67
Total ceiling costs	\$575,642,663
Price per tonne based on volume of 20Mtpa	\$28.78

3.2 It has been reported that if the figures are based on a Brockman request to move 20Mtpa on the TPI railway, these prices would potentially equate to a floor price \$3.67 per tonne and a ceiling price of \$28.78 a tonne.

3.3 If these figures are correct, it is immediately apparent that the total ceiling costs and the ceiling price per tonne proposed by TPI for granting access to Brockman are far in excess of any prices previously cited by either TPI, PwC or third party analysts in relation to the single segment route from Cloudbreak to the port dumper. This large increase in TPI's access price (particularly the ceiling price) suggests a substantial increase in TPI's underlying costs over the previous three years since the publication of its original Cost Model. Without access to TPI's revised cost model, it is difficult to understand how TPI's floor and ceiling costs could have increased by so much, particularly given that Brockman's proposal seeks access only to those sections of TPI's railway which had already been completed by the time TPI proposed its original Cost Model.⁴ Accordingly, it remains unclear to Flinders why there is such a significant discrepancy between the prices quoted by TPI in 2010/11 in relation to the section of track from Cloudbreak to the port dumper and the new prices quoted for two sections of the same track to which Brockman now seeks access.

3.4 Flinders understands that TPI has submitted complex modelling data and information to the ERA on a confidential basis which is not currently available for third party review. Given this lack of transparency and the failure of TPI to provide a publicly available cost model, it is not possible at this stage for Flinders to draw definitive conclusions about the discrepancies in TPI's 2010 and 2013 cost bases or TPI's new proposed floor and ceiling pricing. The large difference between floor and ceiling pricing is not understood but drawing upon the previously submitted cost model from 2010 and extrapolating for current installed capacity (without adding any assumption for additional incremental cost), this would result in the following incremental cost model:

³ Source: The West Australian, 20 May 2013.

⁴ Whilst it is conceivable that the construction of new infrastructure may have increased TPI's capital costs across the whole railway, it seems unlikely that such costs would account entirely for such a significant increase.

Tonnes	155Mtpa Estimate based on TPI Cost model 2010/11	Current (110Mtpa) Estimate based on TPI Cost Model 2010/2011	Calculated incremental cost based on PwC Recommended revisions 2010/11
Total floor costs from Cloudbreak to the port dumper	\$203,005,767	\$203,005,767	\$37,000,000
Floor price per tonne based on volume of 155Mtpa	\$1.31	\$1.85	1.85
Total ceiling costs from Cloudbreak to the port dumper	\$230,930,978	\$230,930,978	\$42,000,000
Ceiling price per tonne based on volume of 155Mtpa	\$1.49	\$2.10	2.10

- 3.5 The transparency of the process would be markedly improved if TPI would consent to the ERA making publicly available a cost model outlining the cost structure relevant to the six routes to which TPI's Amended Costing Principles are applicable. Such disclosure would be consistent with section 9(1)(c) of the Code requiring TPI to provide to proponents (and other third parties who request it) the costs for each route section on which the floor and ceiling prices have been calculated.
- 3.6 At this stage, without access to TPI's 2013 cost model, Flinders wishes to reserve its rights to challenge that cost model, should it underpin any of TPI's future prices in response to any access request made in future by Flinders.

Yours faithfully,

Robert Kennedy
Executive Chairman