CHANGES TO IRON ORE ROYALTIES IN WESTERN AUSTRALIA

On 28 November 2014, the Western Australian Government made changes to the manner by which iron ore royalties payable to the Government are calculated. These changes more clearly prescribe the scope of permissible deductions for export sales and require royalties on domestic sales to be paid on an equivalent basis to export sales. This will have important implications for all iron ore producers in Western Australia. As well as impacting liabilities for Government royalties it may also impact liabilities for other royalties or payments, such as native title compensation payments, that leverage off the calculation mechanisms of the Government royalty regime. It is particularly important that producers selling ore on a domestic or 'mine gate' basis assess the full impact of the changes.

BACKGROUND

In Australia's federal system, minerals are generally owned by the relevant State or Territory. State and Territory governments then levy royalties on the production or sale of those minerals or, in some cases the profits derived from the sale of those minerals, with the objective of ensuring that the public receives a fair return on the extraction of non-renewable resources.

In Western Australia, State royalties are calculated in three principal ways, depending on the relevant commodity:

- for non-metallic minerals (such as aggregate, stone, clays, dolomite, gravel, gypsum, limestone, rock, salt, sand, silicia and talc), a fixed rate per tonne produced applies;
- for metallic minerals other than gold (including iron ore), a percentage of a 'royalty value' calculated as the 'gross invoice value' of the mineral less certain deductions, with the percentage varying depending on the type of mineral and the extent of any post-extraction beneficiation or other processing; and
- for gold, a percentage of an index price, specifically the quarterly average of the London Bullion Market Associations London PM Fix.

MINING AMENDMENT REGULATIONS (NO. 4) 2014 (WA)

On 28 November 2014, the Western Australian Government gazetted the *Mining Amendment Regulations (No. 4) 2014* (WA) which amend some of the provisions in the *Mining Regulations 1981* (WA).

Critically, the amended Regulations draw a distinction between a sale of iron ore:

- 'effected by delivery onto or from a ship exporting the ore from Australia', such as free on board/FOB or cost and freight/CFR sales (**Export Sales**); and
- effected in any other way, e.g. mine gate or other domestic/pre-export sales (**Domestic Sales**).

The amended Regulations then redefine the concept of 'royalty value' as it applies to those two categories of sales:

- by redefining the scope of the deductions applicable to Export Sales; and
- by fixing the sale value of Domestic Sales by reference to an index price (rather than gross invoice value), specifically the midpoint of the relevant assessment published in the Platts

Daily Iron Ore Price Assessments less a specified freight rate.

Both changes take immediate effect, with first payment of royalties under the revised regime payable in respect of sales made during the fourth quarter of 2014.

CHANGES TO DEDUCTIONS APPLICABLE TO EXPORT SALES

Prior to the amendment of the Regulations, the 'royalty value' of all sales of iron ore were assessed with reference to the 'gross invoice value' of the ore (as shown in relevant invoices) less a set of 'allowable deductions', comprising:

- any reasonable costs of transporting the ore incurred (a) after shipment date by the person liable to pay the royalty and (b) in relation to the transport of the mineral by a third party; and
- the cost of any packaging materials used in transporting the ore.

While the amended Regulations retain 'gross invoice value' for the purposes of calculating the 'royalty value' of Export Sales, the concept of 'allowable deductions' has been replaced with the concept of 'shipping costs', comprising costs reasonably incurred after shipment by the person liable to pay the royalty for any of the following:

- freight, adjusted for address commission and despatch or demurrage at the port of discharge;
- dead freight;
- marine and cargo insurance; and
- bunkerage.

CHANGES TO SALE VALUE ATTRIBUTABLE TO DOMESTIC SALES

The most significant change introduced is the redefinition of the 'royalty value' of Domestic Sales with the apparent objective of ensuring that iron ore producers selling their ore on a mine gate or other domestic/pre-export basis pay royalties equivalent to producers selling their ore on a FOB/CFR or other export basis.

In order to achieve this, the amended Regulations replace the concept of 'royalty value' as 'gross invoice value' less 'allowable deductions' with a requirement that royalties be calculated and paid on a 'reference amount' comprising:

- the quantity of ore sold (as shown in the relevant invoice), in dry metric tonnes, multiplied by the relevant 'index price'; less
- the quantity of ore sold (as shown in the relevant invoice), in wet metric tonnes, multiplied by the 'index freight component'.

The 'index price' is calculated by reference to the midpoint of Platts daily iron ore price assessment published in the SBB Steel Markets Daily for the day on which the ore is sold for ore of the same grade as the relevant ore (assessments are published for 62%, 63.5/63%, 65% , 58% and 52% Fe) or, if not the same grade, the grade-adjusted price of the ore of the nearest grade.

The 'index freight component' is two times the Platts freight rate published in the SBB Steel Markets Daily for the day on which the ore is sold.

COMMENT

Both sets of changes will require iron ore producers to revisit the way in which their royalties are calculated and reported.

In the case of producers making Export Sales, care will need to be taken to ensure that existing deductions fall within the categories specified in the new definition of 'shipping costs' and are reported accordingly.

Producers making, or proposing to commit to, Domestic Sales will be most acutely affected by the changes and will need to review the impact of what is likely to be a substantially increased State royalty on their commercial arrangements.

All producers should also consider the effects of these changes on any agreements with third parties which include production or sales based-payments that adopt or otherwise apply the same calculation mechanisms as State royalties, particularly asset sale, native title or landholder compensation agreements, in order to ascertain any consequences of these changes for those arrangements.

MORE INFORMATION

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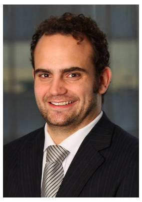

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