Federal Court Agrees with Glencore That Prices for Copper Concentrate Were Arm’s Length

In Glencore Investment Pty Ltd v. Commissioner of Taxation, Davies J has confirmed that the prices received by the taxpayer, on the sale of copper concentrate to its Swiss parent, were “arm’s length”. The decision demonstrates the difficulties and uncertainties associated with litigating transfer pricing cases that face taxpayers and the Commissioner alike. It confirms that transfer pricing, at least in Australia, is not simply a matter of economic analysis and pointing to an arm’s length result. Instead, determining the correct price requires a careful consideration of the statutory tests and a determination of whether the “amount of profits” that have accrued to a taxpayer, differ from the amount of profits that would have accrued, if arm’s length conditions had operated.

1. Introduction

In Glencore Investment Pty Ltd v. Commissioner of Taxation, Davies J of the Federal Court of Australia has held that the prices paid by an Australian subsidiary to its Swiss parent – under an agreement for the sale of copper concentrate – were within an “arm’s length” range. Davies J therefore allowed the taxpayer’s objection to the amended assessments issued by the Australian Taxation Office (ATO) and ordered that those assessments be set aside.

The prices were thus the same as would have been agreed if the parties had been unrelated and the prices had not been conditioned by the fact that the Australian and Swiss companies were part of the same corporate group.

While the taxpayer was successful in Glencore, the decision stands in contrast to the taxpayer’s recent lack of success in Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation. Glencore and Chevron demonstrate the difficulties and uncertainties associated with litigating transfer pricing cases, which face taxpayers and the ATO alike.

Both sides in a transfer pricing dispute will typically assert that the prices paid and received were, or were not, the same as would have been expected to be agreed by parties dealing at arm’s length. Glencore reinforces the fact that a party will only be successful if they can provide compelling and relevant evidence, and establish that they have addressed the questions directed by the Australian tax legislation.

This article commences by summarizing the background to the Glencore dispute (section 2.), including the relevant law and the three Australian transfer pricing decisions handed down since 2008 (section 3.).

The article then examines the evidence given by the taxpayer and the Commissioner’s respective witnesses, and the submissions made by parties (sections 4. and 5.), before analysing in some detail the decision of Davies J (sections 6. and 7.).

The article concludes with observations on the implications that Glencore may have on future Australian transfer pricing disputes (section 8.).

2. Background Facts

The taxpayer, Glencore Investments Pty Ltd (GIPL) was the head company of a consolidated group of companies for Australian taxation purposes. Cobar Management Pty Ltd (CMPL) was a member of that consolidated tax group.

In the relevant years, CMPL managed and operated a mine in Cobar, New South Wales (referred to as the Cobar mine or the CSA mine) and sold 100% of the copper concentrate produced in the mine to its ultimate Swiss parent company, Glencore International AG (GIAG).

The Commissioner took the position that the prices paid by GIAG to CMPL were less than the prices that might have been reasonably expected in an arm’s length dealing between independent parties, and that CMPL’s profits had therefore been understated by approximately AUD 241 million during the 2007, 2008 and 2009 income years.

The Commissioner thus issued amended assessments, increasing the tax payable by GIPL (as the head company of the tax consolidated group) by approximately AUD 72 million and imposing shortfall interest charges of approximately AUD 20 million.

In slightly more detail, from mid-1999 through February 2007, GIAG and CMPL entered into a series of “life of mine” offtake agreements, which were structured as “market-related” agreements. In February 2007, GIAG and CMPL entered into a fundamentally different form

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of agreement of a type known in the copper concentrate industry as a “price sharing” agreement (February 2007 Agreement). 4

Under the February 2007 Agreement: 5

- prices were determined using the official London Metal Exchange cash settlement price for copper graded“A”averaged over the “quotational period”;
- the quotational period was, at GIAG’s discretion, linked either to the month of shipment from the loading port of embarkation or the month of arrival at the port of disembarkation. Within either alternative, GIAG could choose one of three quotational periods, which had to be declared prior to each shipment from the loading port – at which time GIAG would be aware of the average copper prices in at least one of the periods from which it was to make its selection. That pricing mechanism is known in the copper concentrate industry as “quotational period optionality with back pricing”;
- a fixed deduction of 23% of the copper reference price was applied for treatment and copper refining charges (TCRCs). In the copper concentrate industry, that type of arrangement is known as “price sharing”.

The Commissioner reassessed the taxpayer on the basis that the February 2007 Agreement: 6

[...] was a non-arm’s length dealing which favoured GIAG to the detriment of CMPL, and that an independent mine producer with CMPL’s characteristics would not have agreed to price sharing at all or to quotational periods with back pricing optionality and, instead, might reasonably have been expected to have sold its production in the relevant years under a life of mine agreement on market-related terms and limited quotational period optionality with no back pricing.

3. Relevant Statute and Case Law

3.1. Division 13 and Subdivision 815-A

The Federal Court in Glencore was required to examine Australia’s previous transfer pricing rules – enacted in the early 1980s and contained in Division 13 of the Income Tax Assessment Act 1936 (ITAA 1936) – as well as the rules in Subdivision 815-A of the Income Tax Assessment Act 1997 (ITAA 1997). The latter rules were introduced in 2004 but were replaced in 2013 by Subdivisions 815-B to 815-D. The two sets of rules had concurrent operation during the 2007 to 2009 financial years.

Under Division 13, the Commissioner can deem “arm’s length consideration” to have been received for a supply of property or services, where the consideration that was in fact received was less than arm’s length consideration.

Under Subdivision 815-A, where profits do not accrue to an Australian taxpayer, owing to “non-arm’s length conditions” operating between associated entities, but which might have been expected to accrue, the Commissioner may negate the “transfer pricing benefit”.

The relevant provisions are set out in Appendix 1 to this article.

3.2. Case Law

There have been three significant Australian decisions since 2008 that have considered the rules in Division 13 and Subdivision 815-A, namely: Roche Products Pty Ltd v. Commissioner of Taxation (Roche), 7 SNF (Australia) Pty Ltd v. Commissioner of Taxation (SNF) 8 and Chevron.

Roche and SNF highlighted a number of the shortcomings of the previous transfer pricing rules in Division 13 of the ITAA 1936, which led to the insertion of the new rules in Division 815 of the ITAA 1997.

Glencore made clear that when working out the amount of profits that would have accrued if the parties had been dealing at arm’s length, Subdivision 815-A does not require that the Australian entity be treated as an “orphan” (that is, as a “stand alone” company). The provisions instead require a determination of what an entity, in the Australian taxpayer’s position, might reasonably have been expected to give or receive as consideration.

The decisions in Roche, SNF and Chevron are summarized in Appendix 2 to this article.

4. Evidence

The evidence given by the parties’ witnesses was lengthy and detailed, with all but one of the witnesses providing a number of affidavits or reports.

The taxpayer’s witnesses were:

- Mr David Kelly, a chartered accountant, who swore four affidavits: 9

[...], in which he gave evidence about a range of matters, including: the copper market and pricing and terms of sale of copper concentrate; the Glencore Group and Glencore’s business; GIAG’s acquisition and ownership structure of the CSA mine; [...]; the mine’s financial performance in 2006; the challenges the mine faced from 2006 to 2009, the logistics and risks for CMPL in selling its copper concentrate in the period 2006 to 2009, if it had been independent of GIAG and sought to sell its copper concentrate directly to smelters; and the off-take agreements under which CMPL supplied copper concentrate to GIAG over the period 1999 to 2009.

- Mr Kelly annexed to one of his affidavits examples of a number of off-take agreements for the sale of copper concentrate, which involved third parties and contained price sharing and quotational period optionality terms. 10

- Mr Richard Wilson, an expert in market analysis of the global copper concentrate industry, and the

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4. Glencore, paras. 2 and 3.
5. Glencore, para. 3.
6. Glencore, para. 5.
9. Glencore, para. 52.
10. Glencore, para. 52.
author and editor of the Brook Hunt Report, who prepared three reports. Mr Tony Samuel, a forensic accounting expert, who prepared a report in response to the expert report of the Commissioner’s financial expert, Mr David van Homrigh.

The Commissioner’s expert witnesses were:

- Mr Mark Inglebinck, a mining industry expert, who had worked at Cargill, Magma Copper and BHP. Mr Inglebinck prepared two reports that addressed, in particular, whether:

  [...] the conditions that were operating between CMPL and GIAG in their commercial and financial relations, differ[ed] from the conditions which might have been expected to operate between an Independent Producer/Seller and Independent Buyer dealing wholly independently with one another.

- Mr Leonard Kowal, a mining industry expert with 35 years’ experience with Inco Ltd and 12 years as a consultant, who prepared two reports addressing the same issues as Mr Inglebinck.

- Mr David van Homrigh, a financial analysis expert, whose report considered, among other things, whether or not CMPL and/or the Cobar mine were profitable and whether there was uncertainty as to the profitability of future copper concentrate mining operations at the mine.

In addition, joint expert reports were prepared by:

- the mining industry experts (Messrs Wilson, Inglebinck and Kowal); and
- the financial experts (Messrs van Homrigh and Samuel).

### 4.1. Mining industry evidence

As noted above, a joint report was prepared by the Commissioner and the taxpayer’s respective mining experts. Evidence was also given by a chartered accountant, Mr Kelly, who was not a mining industry expert.

The lengthy evidence is summarized in Table 1.

### 4.2. Financial evidence

The financial evidence is summarized in Table 2.

### 4.3. Comparable contracts tendered by taxpayer

A table summarizing the comparable offtake agreements is set out in Appendix 3 to this article.

5. **Taxpayer and Commissioner’s Submissions**

Both the taxpayer and the Commissioner submitted that the decision of the Full Federal Court in *Chevron* supported their competing arguments.

However, the taxpayer submitted that the hypothetical transaction – that is, the agreement that parties dealing in an arm’s length transaction might be expected to enter into – should be a “price sharing” contract, whereas the Commissioner submitted that the Court should examine a “market-related” contract.

#### 5.1. Taxpayer’s submissions

In more detail, the taxpayer submitted that:

- The terms governing the prices charged and received between CMPL and GIAG for the relevant years were ones that existed in contracts for the sale of copper concentrate between independent market participants, and therefore they were terms that might be expected to be found in an agreement between the relevant hypothetical parties.

  - The task of the Court was thus to determine:
    - whether the agreed price sharing percentage of 23% was an arm’s length percentage or within an arm’s length percentage range;
    - if so, to what extent it might be expected that a discount would be allowed for quotational period optionality by independent parties in an arm’s length transaction.

#### 5.2. Commissioner’s submissions

In more detail, the Commissioner submitted that:

- The hypothetical transaction (i.e. the agreement that parties dealing at arm’s length might be expected to enter into) should not be constrained to one that adopted price sharing agreements for three years. Doing so would result in a price that was “unrealistic, artificial and contrary to the purpose of the transfer pricing provisions and would result in ‘a commercially unrealistic outcome ... controlled by the taxpayer’.”

- The evidence did not establish that an independent miner, with CMPL’s characteristics, would have entered into a price sharing agreement in 2007. Long-term contracts for the sale of copper concentrate were often renegotiated every year to reflect changing market conditions. The failure to do so over a three-year period by GIAG and CMPL was a “consequence of the distortion of commercial reality brought about by the lack of independence.”

- In addition, the evidence did not establish that an independent mine producer, with CMPL’s charac-
teristics, would have agreed to a quotational period optionality term, which would have been to the detriment of the mine producer.23 The hypothetical transaction for both Division 13 and Subdivision 815-A was a long-term contract, dated July 1999 and amended from time to time, between independent parties with the characteristics of CMPL and GIAG, for the sale of 100% of the copper concentrate, for the life of the mine, with the price to be negotiated and amended, as between the parties on an annual basis, to reflect market conditions (including changing benchmark terms and the parties' commercial needs).24

Table 1 – Mining industry evidence

<table>
<thead>
<tr>
<th>Copper concentrate market</th>
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<tbody>
<tr>
<td>– Long term offtake agreements can provide ongoing sales over a fixed period or for the “life of the mine”. These can be for specified quantities of concentrate or for the whole of the mine’s production. In the latter case, the risk is transferred to the buyer, as the seller is guaranteed that all of its production will be sold.2</td>
</tr>
<tr>
<td>– There is no terminal market for copper concentrate where it can be traded at a precise known price. In contrast, the refined copper price is normally set by reference to the price quoted on London Metal Exchange. However, each contract is negotiated individually and has varying terms affecting the price, depending on the needs and risk appetites of both the seller and buyer, as well as the length of the contract.3</td>
</tr>
<tr>
<td>– It was common ground between the experts that the copper metal price is “extremely volatile and unpredictable” with “ups and downs”.4</td>
</tr>
<tr>
<td>– The taxpayer’s expert gave evidence that copper prices are dependent on many factors, such as global industrial activity, overall copper metal inventory levels, the value of the U.S. dollar and supply/demand outlook.5</td>
</tr>
<tr>
<td>– Quotational periods vary from contract to contract but are typically linked either to the month of shipment or the month of arrival.6</td>
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<tr>
<td>– Offtake agreements can contain “quotational period optionality” or “quotational period optionality with back pricing”.7</td>
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<tr>
<td>– The notional purpose of TCrCs is to cover smelting and refining costs and provide buyer (trader or smelter) with an element of profit; but TCrCs are, in practice, a result of market forces and often bear little relationship to the actual cost of treatment and refining of the copper concentrate.8</td>
</tr>
<tr>
<td>– Price participation is a mechanism which involves adopting benchmark TCrCs that enable both seller and buyer to participate in movements in copper prices.9</td>
</tr>
<tr>
<td>– Under a price sharing agreement, the TCrC deduction is fixed for the duration of the contract as a negotiated percentage of metal exchange copper price, so that the TCrC deduction and the metal exchange copper price are directly correlated to one another to remove volatility of benchmark and spot TCrCs.10</td>
</tr>
</tbody>
</table>

Market knowledge11

| – It was common knowledge between the experts and Mr Kelly that market participants access information from industry publications, such as the Brook Hunt Report.12 |
| – Messrs Kowal and Ingelbinck acknowledged that the Brook Hunt Report is authoritative and influences negotiations in the copper concentrate industry. They each gave evidence that they relied on Brook Hunt publications to support their opinions in these proceedings.13 |
| – Mine producers and buyers would have regard to available information at the time the contract was entered into.14 |

Copper market leading up to 200715

| – During 2006, the average copper price had risen by more than 80% year-on-year. At the beginning of 2007, London Metal Exchange copper prices were at an all-time high. This was described by Mr Wilson as “unprecedented”.16 |
| – At the start of 2007, there was an expectation that copper prices would decline in the second half of 2007.17 |
| – It was highly unlikely that price participation would be reintroduced in the 2008 and 2009 years.18 |
| – At the end of 2006, spot TCrCs for 2007 were unknown, volatile and difficult to predict.19 |
| – Copper concentrate stocks were forecast to be in demand in 2007, 2008 and 2009 were likely to be tight and that TCrCs were unlikely to increase significantly.20 |

2. Glencore, para. 71.
5. Glencore, para. 74.
6. Glencore, para. 75.
7. Glencore, para. 76.
8. Glencore, para. 78.
9. Glencore, para. 81.
10. Glencore, para. 82.
12. Glencore, para. 93.
14. Glencore, para. 94.
15. Glencore, paras. 96-103.
17. Glencore, para. 98.
18. Glencore, para. 100.
20. Glencore, para. 102.
22. Glencore, paras. 5 and 32.
23. Glencore, para. 33.
Table 2 – Financial evidence

<table>
<thead>
<tr>
<th>Questions</th>
<th>Mr van Homrigh (Commissioner’s expert) Expert in financial analysis</th>
<th>Mr Samuel (taxpayer’s expert) Expert in forensic accounting</th>
<th>Davies J’s response, and comments with respect, to each question</th>
<th>Davies J’s overall comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whether or not CMPL and/or the Cobar mine was profitable.</td>
<td>Agreed that the CSA mine was “very profitable during the relevant years”.(^2)</td>
<td>Irrelevant whether CMPL was profitable over the relevant years, “since the statutory questions must be answered by looking at the events at the time the price sharing agreement was entered into”.(^4)</td>
<td>Found that the evidence provided by both experts was “totally irrelevant to the issues for determination”.(^3)</td>
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<tr>
<td>To what extent there was any uncertainty as to the profitability of future copper concentrate mining operations at the Cobar mine.</td>
<td>Both agreed that mining operations are “inherently risky”.(^3)</td>
<td>Thought it was evident that CMPL was considering and managing various risks to the CSA mine, including the extent and quality of the resource, mine planning, operations and ore processing, capital expenditure, and copper prices. The CSA mine also had substantial reserves during the years in question to absorb the effects of cycles in the business.(^7)</td>
<td>Accepted both views as they were not irreconcilable, but noted that nothing turned on the experts’ views in terms of the application of the statutory tests under Division 13 and Subdivision 815-A.(^5)</td>
<td></td>
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<tr>
<td>Whether or not CMPL required bank or other financing in order to operate the Cobar mine and the nature of any such financing sought or provided.</td>
<td>Both agreed that “[as it transpired], the CSA mine &quot;generated more than enough cash to cover its operating and investing cash flows during the relevant years”.(^8)</td>
<td>No relevance to the issues for determination.(^10)</td>
<td></td>
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</tr>
<tr>
<td>The nature, and benefits to CMPL, of financial arrangements which were in fact in place as between CMPL and/or the Cobar Mine and the Joint Venture Participants and/or GlAG or any third party.</td>
<td>“Did not identify any specific benefits or detriments bearing upon statutory questions in these proceedings.”(^11)</td>
<td>Was instructed not to address this question.(^12)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Glencore, para. 244.
3. Glencore, para. 244.
5. Glencore, para. 245.
6. Glencore, para. 245.
7. Glencore, para. 245.
8. Glencore, para. 245.
– To discharge the onus of proof, the taxpayer had to establish that the terms governing price for the relevant years were entered into “unconditioned” by the relationship between GIAG to CMPL.\(^ {25}\)

The Commissioner also contended that the causal inquiry – that is, the inquiry directed by section 815-15(1)(c) concerning the conditions under article 9 of the OECD Model Tax Convention\(^ {26}\) and the profits which might have accrued, but did not accrue (the so-called “but for” analysis) – should be exercised flexibly.\(^ {27}\) The Commissioner relied on the following statement by Allsop CJ in \textit{Chevron}:

\[\text{A degree of flexibility is required especially if the structure and detail of the transaction has been formulated by reference to the group relationship and a “tax effective” outcome (even if, as here, one that is not said to be illegitimate). The form of that transaction may, to a degree, be altered if it is necessary to do so to permit the transaction to be analyzed through the lens of mutually independent parties.}\]

\section*{6. Decision of Davies J}

Davies J found in the taxpayer’s favour, rejecting the Commissioner’s submission that the hypothetical transaction should be a market-related contract. In her Honour’s view, that would produce “a hypothetical transaction based upon different commercial considerations and a different commercial structure to that which was actually entered into”.\(^ {29}\)

Davies J therefore held that the February 2007 Agreement was one that could reasonably be expected to be entered into between independent enterprises in the relevant years.

\section*{7. Reasons for Decision}

In a 128-page decision, Davies J carefully summarized the copper concentrate market, the relevant statutory and treaty provisions, the competing arguments, the decision in \textit{Chevron}, the evidence given by the taxpayer and the Commissioner’s respective witnesses, and the third-party offtake contracts. Her Honour then applied the law to conclude that the prices paid by GIAG to CMPL were within an arm’s length range.

\subsection*{7.1. Task for the Court}

As both parties relied on \textit{Chevron} for their competing arguments, Davies J examined the decision at first instance, and on appeal, in some detail.\(^ {30}\) Her Honour placed particular emphasis on statements by both the primary judge and the Full Court in \textit{Chevron} that:

\begin{itemize}
  \item To discharge the onus of proof, the taxpayer had to establish that the terms governing price for the relevant years were entered into “unconditioned” by the relationship between GIAG to CMPL.
  \item The Commissioner also contended that the causal inquiry – that is, the inquiry directed by section 815-15(1)(c) concerning the conditions under article 9 of the OECD Model Tax Convention and the profits which might have accrued, but did not accrue (the so-called “but for” analysis) – should be exercised flexibly.
  \item Davies J therefore held that the February 2007 Agreement was one that could reasonably be expected to be entered into between independent enterprises in the relevant years.
  \item In a 128-page decision, Davies J carefully summarized the copper concentrate market, the relevant statutory and treaty provisions, the competing arguments, the decision in \textit{Chevron}, the evidence given by the taxpayer and the Commissioner’s respective witnesses, and the third-party offtake contracts. Her Honour then applied the law to conclude that the prices paid by GIAG to CMPL were within an arm’s length range.
  \item As both parties relied on \textit{Chevron} for their competing arguments, Davies J examined the decision at first instance, and on appeal, in some detail.
\end{itemize}

The Court was required to “depersonalise the agreement... so as to make it, hypothetically, between independent parties dealing at arm’s length”.\(^ {31}\) and

\begin{itemize}
  \item the hypothetical transaction directed by the statute required the Court to examine the consideration that might reasonably be expected to have been given by a party in the taxpayer’s position, if the parties were independent from one another and dealing at arm’s length.\(^ {32}\)
  \item According to Davies J, two statutory directions were required to be examined.\(^ {33}\)
\end{itemize}

The first question is whether there has been a non-arm’s length dealing between enterprises in an international dealing. That question is directed at establishing the precondition to permit an adjustment of the actual consideration received or paid by an entity to an amount which is an arm’s length equivalent.

The second question is whether the consideration received for that dealing was less than or greater than an arm’s length amount [or] whether there was a causal relationship between the non-arm’s length conditions and profits not accruing to the taxpayer.

\subsection*{7.2. Hypothetical transaction should be based on actual transaction}

Davies J stated that, as was made clear in \textit{Chevron}, the task of forming a hypothetical transaction was not to be construed upon the hypothesis that CMPL and GIAG were unrelated, but that CMPL was a member of the Glencore Group.\(^ {34}\) If CMPL were a “stand alone” company – that is, a company without the support of GIAG, including the provision by GIAG of a logistic and marketing team – CMPL could not have sold its copper concentrate.\(^ {35}\)

Forming a hypothetical transaction under the assumption that CMPL was not a member of the Glencore Group would “distort the application of Division 13 and fundamentally undermine its purpose”.\(^ {36}\)

Instead, the hypothetical transaction was to be construed between:

\begin{itemize}
  \item an independent mine producer, with the characteristics of CMPL, including its lack of a logistics and marketing division;\(^ {37}\) and
  \item an independent buyer with the characteristics of GIAG. That independent buyer would acquire the whole of the CMPL’s copper concentrate for the life of the mine and provide logistical and marketing support to CMPL.\(^ {38}\)
\end{itemize}

Davies J emphasized that \textit{Chevron} was neither authority for the proposition that the hypothetical transaction requires the determination of the form of agreement that might have been negotiated by parties dealing with each other at arm’s length: nor did \textit{Chevron} support the argu-
7.3. Non-arm’s length dealing may nonetheless have arm’s length consideration

Davies J noted that it was important to “bear in mind the international context” in which the arm’s length principle has been adopted.41 The objective of the legislation is to ensure that the fiscal obligations of parties in cross-border transactions, for domestic tax purposes, are based on the arm’s length equivalent of the actual transaction entered into.42 In her Honour’s view,43 A construction and application of those provisions that distorts the application of the arm’s length’s principle [...] by applying some different measure for determining an arm’s length price than one based on the arm’s length equivalent of the transaction actually entered into, would not give effect to that policy objective.

Davies J observed that Division 13 and Subdivision 815-A will not apply to all non-arm’s length, cross-border transactions since “a non-arm’s length dealing may nonetheless have an arm’s length consideration.”44 In support, her Honour referred to the following passage from SNF:45

A finding reached for the purposes of Sec. 136AD(3)(b) that any two or more of the parties to an agreement were not dealing at arm’s length with each other will not necessarily be determinative in considering whether the consideration given or agreed to be given for the purposes of Sec. 136AD(3)(c) was not arm’s length consideration. Where it can be concluded that, even though there was an absence of real bargaining, an arm’s length consideration was given or agreed to be given, then Sec. 136AD(3)(c) will not be satisfied and Sec. 136AD will have no application.

7.4. “Comparable” contracts were probative evidence of percentages agreed in arm’s length contracts

Twelve contracts were provided as examples of agreements that were entered into between independent parties for the period leading up to, and during, the relevant years. The taxpayer did not contend that any of the 12 contracts was directly analogous to the contract between CMPL and GIAG; but submitted that those contracts “provided illustrations of price sharing arrangements between arm’s length parties under copper concentrate arrangements between 2002 and 2011,” and of the broad variety of the quotational period clauses, including those with back pricing optionality.46

The Commissioner disagreed, arguing that none of the 12 contracts were “truly comparable transactions.”47 As noted in the table in Appendix 3 to this article, some of the distinguishable features were: (i) the differences in the quantities of copper concentration subject to the contracts; (ii) the number of quotational periods available to the buyers; and (iii) the times at which the contracts were entered into with regard to the production times. Relying on those differences, the Commissioner argued that the Court could not, on the basis of the 12 contracts, reach a conclusion as to what might have been expected of a mine producer, with the characteristics of CMPL.48

Davies J rejected the Commissioner’s argument, stating that if it were to be accepted, the taxpayer, “who bears the onus in tax appeals, could never succeed in such a [transfer pricing] case for the bar will be set at an unattainable height.”49 Such an approach was “deeply impractical” and “impermissibly restructures the actual contract entered into by the parties into a contract of a different character.”50

Her Honour went on to accept that:51

– the February 2007 Agreement was “a form of agreement seen in the market between independent enterprises in the relevant years”; and
– the price sharing methodology adopted by CMPL and GIAG was:

[...] a recognised, legitimate and accepted way for copper concentrate to be priced and one which other market participants, independent of each other and dealing at arm’s length, also adopted at the time in respect of the supply of concentrate by a mine producer to a trader.

7.5. Subjective motive is irrelevant

The Commissioner urged the Court to draw an inference from the fact that there was no evidence from any person at CMPL to suggest that it was in the company’s best interests to enter into a price sharing agreement in early 2007.52 That submission was not accepted. According to Davies J, subjective motive was “completely irrelevant” to the application of Division 13 and Subdivision 815-A.53

39. Glencore, para. 47.
40. Glencore, para. 40.
41. Glencore, para. 48.
42. Glencore, para. 48.
43. Glencore, para. 48.
44. Glencore, para. 49.
45. Glencore, para. 49.
46. Glencore, para. 253.
47. Glencore, para. 277.
48. Glencore, para. 308.
49. Glencore, para. 308.
50. Glencore, para. 344.
51. Glencore, para. 344.
52. Glencore, para. 314.
53. Glencore, para. 320.
54. Glencore, para. 396.
55. Glencore, para. 396.
The arm’s length principle does not introduce, or involve, any investigation or consideration of purpose or motive [...]. Nor does the assessment of an arm’s length consideration involve an inquiry into what profits might reasonably be expected to have been obtained on a differently structured transaction, nor is the question whether, had the transaction been structured differently, it might reasonably be expected that greater profits would have accrued.

7.6. Hindsight reasoning is irrelevant

The Commissioner also argued that:57

[...] on the available market information at the end of 2006, it was highly likely that CMPL (and it would follow any independent mine producer with its characteristics) would be worse off financially by agreeing to the price sharing agreement for three years rather than remaining on the terms as between CMPL and GIAG at the start of 2007.

Davies J rejected that line of reasoning, noting that such an argument, being one that could only be made with the benefit of hindsight: “could not be used to second-guess the commercial judgment made at the time as to the pricing methodology to adopt”.58 Her Honour referred to the decision in Cameco Corporation v. The Queen (2018 TCC 195),59 where a similar argument was also rejected.

7.7. Independent mine producer in position of CMPL might be expected to enter into price sharing agreement

Davies J concluded that it was not irrational for CMPL to enter into a price sharing contract, taking into account “the benefits of such contracts and the market circumstances” at the time the contract was entered into.60 Her Honour noted that:

- The CSA mine was a high-cost mine and was susceptible to a reduction in the margins between its revenues and operating costs. Hence, CMPL “might be expected to have an interest in removing the uncertainty [...] by fixing a margin of the copper price that ensured that it would remain in operation”.61
- An independent seller in 2007 would have known that benchmark TCRCs had been historically volatile. While CMPL had forecast significant profits, there was no guarantee that such profits would eventuate.62
- While price participation had been set to zero in the benchmark TCRC for 2007, there was no certainty that it would be reintroduced in later years.63
- Spot TCRCs had been even more volatile in the years preceding 2007, and spot TCRCs were “virtually impossible to predict” for 2007 to 2009.64

- At the beginning of 2007, the London Metal Exchange copper price was “extremely volatile and difficult to predict”65
- There was no correlation between benchmark TCRCs, spot TCRCs and the London Metal Exchange copper prices. As each of them had been extremely volatile, different participants could have taken different views about the importance of avoiding such volatility, and “this would ultimately be a commercial decision”.66
- Evidence showed that CMPL would have expected to generate a profit margin of at least 25% and up to 40% in each of the relevant years, with a 23% price sharing percentage. The taxpayer’s expert stated that the margins “looked pretty healthy” and “pretty much in line with what [he would expect to see]”.67

7.8. Price need not be the arm’s length price, but an arm’s length price

Davies J held that the price sharing percentage of 23% was within an arm’s length range, relying on the statement in SNF that:68

Where there is more than one arm’s length price (as often there will be), the Commissioner may determine which he will apply. Correspondingly, in review proceedings the taxpayer will be entitled to succeed if it shows that the prices paid by it were arm’s length prices or less than arm’s length prices. If it pursues the latter course there is no need for it to establish a particular price as the arm’s length price. It will be sufficient to show that it paid less than an arm’s length price. [Emphasis added.]

Davies J noted that:

- The percentage sat within the “normal range of price sharing” of between 21% to 26%, as indicated by the 2006 Brook Hunt Report, and the reliance of this “normal range of price sharing” had not been challenged by either party.70
- The comparable contracts had TCRCs ranging from 20% to 27.5%. Whilst none of those contracts was considered to be truly comparable, collectively they provided probative evidence of the range of TCRCs agreed in arm’s length dealings.71
- The Brook Hunt Report suggested that, in late 2006, the long-term historical average ratio of Japanese benchmark TCRCs to the London Metal Exchange copper price was 22%.72
- The BMAG-Tintaya contract, with which the Commissioner’s expert had been involved, had a margin of 8.5% over the top range of TCRCs (17% at the time).

57. Glencore, para. 337. See also paras. 253, 312 and 396.
58. Glencore, para. 341.
60. Glencore, para. 394.
61. Glencore, para. 387.
63. Glencore, para. 389.
64. Glencore, para. 390.
65. Glencore, para. 391.
67. Glencore, para. 393.
68. Glencore, para. 346.
70. Glencore, para. 347.
71. Glencore, para. 348.
72. Glencore, para. 349.
The Commissioner’s expert gave evidence that the percentage of 22.5% was a “fair transfer price”.73

- Evidence showed that the historical average median ratio of CMPL’s TCRCs to its copper sales was around 21%.74
- There was no evidence to suggest that independent parties dealing at arm’s length would only have regard to the prevailing forecasts in determining the price sharing percentage.75
- The Commissioner’s expert accepted that independent parties might reasonably agree to uplift the forecast percentage for the other benefits of a price sharing agreement, that is, reducing volatility and increasing certainty.76

7.9. Discount for price sharing percentage was not reasonably expected to be allowed by CMPL and GIAG

Davies J rejected the Commissioner’s argument that because a quotational period optionality with back pricing mechanism was included in the February 2007 Agreement, a discount on the price sharing percentage would have been expected to be allowed between independent parties.77 In coming to that conclusion, her Honour had regard to the following:78

- It was common ground that it was “very hard, if not impossible to place a precise value on back pricing”, and “that the value that was provided to GIAG by the quotational period optionality could not be quantified”.79
- Both the taxpayer and the Commissioner’s experts gave evidence that the quotational period optionality with back pricing mechanism is usually considered as a part of the overall bargain between parties.80
- Of the seven contracts provided by the taxpayer that included back pricing optionality terms, only one of them applied a price on back pricing privileges. That contract, however, appeared to be unusual.81
- It was neither the evidence of the Commissioner’s expert, nor the taxpayer’s expert, that the quid pro quo for quotational period optionality “is likely to be substantial discount to TCRC”.82
- It was not evident that other terms in the February 2007 Agreement – ones that the Commissioner claimed to have conferred significant advantages to GIAG to the detriment of CMPL – would have influenced independent parties in allowing a discount on the price sharing percentage.83

7.10. Experts’ evidence

Davies J concluded her judgment by making clear that “the outcome in the case did not turn on preferring the evidence of one expert over another”.84

In a telling passage, her Honour stated:85

 [...] The role of the expert is to provide independent assistance to the Court by providing an objective and impartial opinion on matters within the specialist knowledge of the expert. Sec. 79 of the Evidence Act 1985 (Cth) [...] It is not the role of the expert to be an advocate for the party calling them nor to express views or speculate on matters about which the expert does not have specialist knowledge. An expert should make it clear when a matter falls outside his or her expertise. [Emphasis added.]

Her Honour continued:

Experts need to exercise particular caution to avoid making assertions of fact which have no foundation, otherwise they are seen to be advocating a case rather than providing objective and impartial assistance. Unfounded or speculative reasoning may also undermine or diminish the persuasiveness and cogency of the opinions expressed by the expert on matters on which she or he is qualified to give an opinion, eroding confidence in the accuracy, reliability and objectivity of such opinions. [Emphasis added.]

Her Honour concluded:86

In the present case, each of the experts, obviously keen to supply with the Court with reasoning supporting the position of the party on whose behalf they gave evidence, strayed from time to time into becoming advocates for the party by proffering opinions and making comments on matters which they were not qualified to give. Experts should be mindful of their role to assist the Court and take care to comply with the Code of Conduct in expressing their views. [Emphasis added.]

8. General Observations

One of the notable features of the Glencore decision is the complexity of the evidence and the fact that the parties’ respective witnesses, at least on some points, took strongly opposing positions.

Another notable feature is the focus by Davies J on the specific legal requirements of Division 13 of the ITAA 1936 and Subdivision 815 of the ITAA 1997 – and on the importance of determining whether the evidence provided by the parties and their witnesses in fact satisfied those legal requirements, as previously interpreted by the Federal Court in Chevron.

It has long been recognized that transfer pricing cases are very fact specific and ultimately are decided on the evidence; but parties in future transfer pricing litigation will need to take even greater care when assembling and presenting their evidence. Especially given that Davies J did not believe some of the evidence provided by the witnesses in Glencore, including the expert witnesses, was relevant.
or of any assistance, for determining the legal questions under consideration.

Future litigants will also need to bear in mind the remarks by Davies J on the importance of expert witnesses assisting the Court, rather than advocating their instructors’ positions.

Perhaps above all, Glencore demonstrates that transfer pricing, at least in Australia, is not simply a matter of economic analysis and pointing to an “arm’s length” result; but involves a careful consideration of the statutory requirements and a determination of whether the “amount of profits” that have accrued to a taxpayer, differ from the amount of profits that would have accrued, if arm’s length conditions had operated.

9. Appeal to Full Federal Court

In a dramatic turn, the Commissioner lodged his appeal against the decision of Davies J six minutes late and was therefore required to apply to the Federal Court for an extension of time within which to lodge the appeal.87

Fortunately for the Commissioner, that application was granted on 28 November 2019 by Perram J, who listed the appeal for a four-day hearing before the Full Federal Court in 2020.88

Taxpayers and advisors will certainly await with great interest the outcome of that appeal.

10. Appendix 1: Relevant Provisions in Division 13 and Subdivision 815-A

ITAA 1936, Division 13

Under Division 13, the Commissioner can deem “arm’s length consideration” to have been received for a supply of property, where the consideration that was in fact received was less than arm’s length consideration.

In more detail, section 136AD provides that:

(1) Where:
(a) a taxpayer has supplied property under an international agreement;
(b) the Commissioner, having regard to any connection between any 2 or more of the parties to the agreement or to any other relevant circumstances, is satisfied that the parties [...] were not dealing at arm’s length with each other in relation to the supply;
(c) consideration was received or receivable by the taxpayer in respect of the supply but the amount of that consideration was less than the arm’s length consideration in respect of the supply; and
(d) the Commissioner determines that this subsection should apply [...];

then [...] consideration equal to the arm’s length consideration in respect of the supply shall be deemed to be the consideration received or receivable [...].

ITAA 1997, Division 815

Subdivision 815-A of the ITAA 1997 applies to income years commencing on or after 1 July 2004 until 29 June 2013 (being the start date for Subdivisions 815-B, 815-C and 815-D, which replaced Division 13).

Under Subdivision 815-A, where profits do not accrue to an Australian taxpayer, owing to “non-arm’s length conditions” operating between associated entities, but which might have been expected to accrue, the Commissioner may negate the relevant “transfer pricing benefit”.

In more detail, section 815-5 states that:

The object of this Subdivision is to ensure the following amounts are appropriately brought to tax in Australia, consistent with the arm’s length principle:

(a) profits which would have accrued to an Australian entity if it had been dealing at “arm’s length, but, by reason of non-arm’s length conditions operating between the entity and its foreign associated entities, have not so accrued; [...]”

As explained above, section 815-10 allows the Commissioner to negate a “transfer pricing benefit,” with section 815-15 providing that:

(1) An entity gets a transfer pricing benefit if:
(a) the entity is an Australian resident; and
(b) the requirements in the “associated enterprises article for the application of that article to the entity are met; and
(c) an amount of profits which, but for the conditions mentioned in the article, might have been expected to accrue to the entity, has, by reason of those conditions, not so accrued; and
(d) had that amount of profits so accrued to the entity:
(i) the amount of the taxable income of the entity for an income year would be greater than its actual amount; [...]

The amount of the transfer pricing benefit is the difference between the amounts mentioned in subparagraph (d)(i) [...].

(5) An associated enterprises article is:

(a) Article 9 of the United Kingdom convention (within the meaning of the International Tax Agreements Act 1953); or
(b) a corresponding provision of another “international tax agreement.”

[Emphasis in original.]

In the present case, the applicable “international tax agreement” was the Australia/Switzerland double taxation agreement.

Section 815-20 continues:

(1) For the purpose of determining the effect this Subdivision has in relation to an entity:
(a) work out whether an entity gets a “transfer pricing benefit” consistently with the documents covered by this section, to the extent the documents are relevant, and

interpret a provision of an "international tax agreement consistently with those documents, to the extent they are relevant."

(2) The documents covered by this section are as follows:
(a) the Model Tax Convention on Income and on Capital, and its Commentaries, as adopted by the Council of the Organisation for Economic Cooperation and Development and last amended on 22 July 2010;
(b) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by that Council and last amended on 22 July 2010;
(c) a document, or part of a document, prescribed by the regulations for the purposes of this paragraph. [...]"

Subdivision 815-A therefore incorporates, and is to be interpreted by reference to, the OECD Model Tax Convention and Commentaries, as well as the OECD’s Transfer Pricing Guidelines. 89

As a result of transitional provisions, the relevant documents for income years commencing before 1 July 2012 were the 1995 Transfer Pricing Guidelines and the relevant OECD Model Tax Convention that was in place before each of the relevant years. 90

Section 815-40 prevents double taxation arising from the simultaneous operation of Division 13 and Subdivision 815-A. Section 815-40 provides:

(1) The amount of a “transfer pricing benefit that is negated under this Subdivision for an entity is not to be taken into account again under another provision of this Act to increase the entity’s assessable income, reduce the entity’s deductions or reduce a *net capital loss of the entity

(2) Subsection (1) has effect despite former section 136AB of the Income Tax Assessment Act 1936.

11. Appendix 2: Summary of Decisions in Roche, SNF and Chevron

Roche 91

The decision in Roche was handed down by the Administrative Appeals Tribunal (AAT) in July 2008 and was the first transfer pricing dispute in Australia to proceed to formal judgment.

The case considered the transfer prices of pharmaceuticals acquired by Roche Products Pty Ltd (Roche), an Australian distributor and subsidiary of the Swiss company, F. Hoffman-La Roche Ltd. The Commissioner concluded that the prices paid by Roche in the 1993 through 2003 income years were excessive, and issued transfer pricing adjustments under Division 13, increasing the taxable income of Roche in those years by AUD 126 million.

AAT President Downes J accepted gross margin evidence to support the use by Roche of the resale minus method, in preference to the Commissioner’s application of net profit methods that were not directly based on comparable transactions. His Honour therefore reduced the transfer price pricing adjustment to AUD 45 million.

SNF 92

SNF considered whether the Australian taxpayer had paid arm’s length prices for chemical flocculants and coagulants purchased from its French parent company. The Commissioner audited SNF and issued transfer pricing adjustments under Division 13, which increased SNF’s taxable income for the 1997 to 2003 income years to reflect arm’s length consideration that he claimed should have been paid for the products purchased from the French parent.

The Full Court of the Federal Court upheld the decision of the primary judge, rejecting the Commissioner’s use of the transactional net margin method. The Full Federal Court instead relied on a version of the comparable uncontrolled price method adopted by SNF, and concluded that the prices paid by SNF were at arm’s length. The Commissioner’s appeal was therefore dismissed.

Chevron 93

The issue in Chevron was whether the interest paid under a credit facility agreement between Chevron Australia and Chevron Finance was arm’s length consideration. Chevron Finance was a wholly owned subsidiary of Chevron Australia, which was in turn a subsidiary of Chevron Corporation, a United States company.

Under the credit facility agreement, Chevron Finance agreed to advance to Chevron Australia up to the Australian dollar equivalent of USD 2.5 billion. Chevron Australia paid interest to Chevron Finance monthly, at a rate equal to 1-month AUD-LIBOR-BBA (British Bankers Association) + 4.14% per month, which during the relevant periods was approximately 9% per annum, with no security.

Chevron Finance funded the advances by borrowing in the US commercial paper market, paying interest at a rate of approximately 1.2% per annum. Chevron Australia did not provide any guarantee or security over its assets to Chevron Finance, and Chevron Finance was entitled to terminate the facility at any time without cause.

The Full Federal Court disagreed with Chevron Australia’s submission that it was sufficient to price a loan by reference to third party loans that were perceived to be comparable borrowings. The Court held that the proper test instead required the determination of what a borrower, in the taxpayer’s position, might reasonably have been expected to give as consideration for the loan.

89. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD 2017), Primary Sources IBFD.
90. Glencore, para. 22.
91. See M. Butler, Swiss Pharma Company Subject to Transfer Pricing Adjustment, 14 Asia-Pac. Tax Bull. 3, p. 198 (2008), Journal Articles & Papers IBFD.
The Full Federal Court confirmed the decision at first instance (of Robertson J) that the interest paid by Chevron Australia to its US parent company exceeded “arm’s length” for Australian transfer pricing purposes. The Full Federal Court therefore dismissed the appeal by Chevron Australia and upheld the Commissioner’s transfer pricing assessments, involving AUD 340 million of primary tax, penalties and interest.

12. Appendix 3: Offtake Agreements

<table>
<thead>
<tr>
<th>Contracts with price sharing mechanisms¹</th>
<th>Terms of contract</th>
<th>Commissioner’s contentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jiangxi Contract</td>
<td>Executed in December 2001, amended several times between November 2002 and February 2011. TCRC of 22.5%.</td>
<td>Price sharing terms applied to only one 10,000 dmt shipment. Terms applied only up to August 2003, then reverted to TCRCs applicable to different qualities of copper, with only one quotational period. TCRC of low grade copper concentrate was 24.5%.</td>
</tr>
<tr>
<td>Redbank Contract</td>
<td>Executed in November 2006, no mention of amendments. TCRC of 20%.</td>
<td>Production had not commenced. Only two quotational periods and no back pricing privileges. GIAG had to cover the freight costs.</td>
</tr>
<tr>
<td>Red Earth Contract</td>
<td>Executed in January 2010. TCRC of 21%.</td>
<td>Quantities were significantly smaller than CSA’s annual production. Production never commenced, only at exploration stage.</td>
</tr>
<tr>
<td>Tritton Contract</td>
<td>Executed in 2002, amended in 2004, 2005 and 2007. TCRCs ranging from 22% to 27.5%, depending on copper price over quotational period.</td>
<td>Contract was entered into “a number of years prior to production starting”.</td>
</tr>
<tr>
<td>PTFI/PASAR Contract</td>
<td>Executed in 2005 but applied to tonnages beginning in 2008. TCRCs of 21%.</td>
<td>Contract was entered into well in advance of production.</td>
</tr>
<tr>
<td>BMAG-Tintaya Contract</td>
<td>Executed in 2003. TCRC of 25.5%.</td>
<td>Terms were not negotiated by parties but set by BHP Group’s commercial department. Percentage was determined by reference to historical data and not on ratio of TCRC forecasts to predicted copper prices.</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Other price sharing agreements referred to in the Brook Hunt Report¹</th>
<th>Terms of contract</th>
<th>Commissioner’s contentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapada and Birla Copper</td>
<td>TCRCs from 21%-23%. Entered into before production and the price sharing only covered part of the production.</td>
<td>Both contracts were entered into when the mine was “financing its build and bringing the mine into production”. In relation to the Cerro Corona and LS Nikko contract, the Commissioner argued that it differed from the February 2007 Agreement in the sense that the February 2007 Agreement did not contain a floor and ceiling below and above which the price sharing formula did not apply, whilst the Cerro Corona and LS Nikko contract did contain such a floor and ceiling.</td>
</tr>
<tr>
<td>Cerro Corona and LS Nikko</td>
<td>Agreement had floor and ceiling below and above which TCRCs did not apply. Entered into before production and the price sharing only covered part of the production.</td>
<td></td>
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</tbody>
</table>

## Contracts with "back pricing optionality"

<table>
<thead>
<tr>
<th>Contract</th>
<th>Back pricing terms</th>
</tr>
</thead>
</table>
| Barminco Contract         | Taxpayer argued that it contained "materially identical degree of optionality" to the February 2007 Agreement:  
  - Entered into in July 2004.  
  - Mine had similar size to the CSA mine.  
  - Similar amount of ore extracted.  
  - GIAG chooses two groups of three quotational periods, with back pricing.  
  - Contract negotiated with degree of sophistication.  
  Quotational period was, at buyer's option, either A or B as follows:  
  A. Either the calendar month prior to the month of shipment; the calendar month of shipment; or the calendar month following the month of shipment. To be declared by end of the month of shipment, by which time the former two options would be known, but the latter would not.  
  B. Either first, second or third calendar month after month of arrival To be declared by the end of the second month following the month of arrival, by which time the former two options would be known, but the latter would not. |
| Peak Gold Contract       | Two-year contract (July 2004-June 2006) for the supply of the entire mine production of concentrate.  
  Quotational period was, at buyer's option, either:  
  1. the calendar month prior to the month of shipment; or  
  2. the calendar month of shipment; or  
  3. the third calendar month after the month of arrival. To be declared prior to shipment, by which time option 1 would be known, but options 2 and 3 would not. |
| Erdenet Contract         | For the sale of copper between June-September 2007.  
  Quotational period was, at buyer's option, either:  
  1. the calendar month of shipment; or  
  2. the calendar month following the month of shipment; or  
  3. the second calendar month following the month of shipment. To be declared by the buyer on last day of the month after shipment, by which time options 1 and 2 would be known, but option 3 would not. |
| Montana Contract         | For the sale of copper in second half of 2007.  
  Quotational period was, at buyer's option, either A or B as follows:  
  A. Either two months prior to the month of scheduled shipment; one month prior to the month of scheduled shipment; or the calendar month of shipment.  
  B. Either third, fourth or fifth calendar month after the month of arrival. To be declared by the buyer by the first day of the fifth month after the month of shipment, by which time former two options would be known, but the latter would not. |
| Oxiana Golden Grove       | Contract For the sale of copper concentrate in mid-2008. Quotational period was, at buyer's option, either August 2008 or September 2008 and was to be declared at the end of August 2008. |
| Oxiana Jaguar Contract   | For the sale of copper concentrate in 2008. Quotational period was, at buyer's option, either the second or third month after the month of arrival. To be declared by the last day of the second moth following the month of arrival, by which time the former would be known, but the latter would not. |
| BMAG-Tinyaya Contract    | The contract was mentioned in relation to its price sharing terms. Quotational period was, at buyer's option, any month from two months prior to the month of shipment to the fifth calendar month following the month of shipment, to be declared prior to the first shipment. Terms also allowed buyer to change quotational period once during contract year, provided that the change did not affect the metal in any shipment for which the quotational period had already commenced. |