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The Glencore Case: Transfer pricing and the world of possibilities

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Abstract

The important and contentious Glencore Case breaks new ground in the application of Australia's transfer pricing rules to an integrated global business, particularly in framing how the rules take into account business and market risks impacting on such a business. In applying the "arm's length principle" the Court restricted the search for comparables to cases where independent parties had used the same type of pricing structure as was imposed by the Swiss parent, despite an alternative market-related pricing structure that was a more attractive commercially rational option. The Court also analysed the financial circumstances and risk exposure of the Australian miner in isolation from the integrated business and multinational group of which it was part. The taxpayer's rationale was that the new pricing structure removed the risk of volatility between treatment and refining costs and copper prices. For the reasons set out in the paper, it did not reduce the volatility risk exposure for the integrated business, and had no real world impact beyond its natural and probable consequences: the reduction of the taxable sales revenue of the Australian miner and a corresponding increase in the profits of the Swiss parent company. Should the Commissioner be unsuccessful on appeal, there are good public policy grounds for a law change given the scope for tax avoidance created by the decision.

Keywords: Australia's transfer pricing rules, profit shifting, independent parties dealing at arm's length with each other, arm's length risk allocation in an integrated global business, reasonable expectation standard for arm's length comparability, penalties.

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Contents

	Pages
Overview and Summary	**3-15**
The Facts and Circumstances of the Glencore Case	**15-39**
CSA mine's operations, cost drivers and Glencore's integrated copper concentrate business	**15-20**
The separate responsibilities of CMPL and GIAG in the integrated business	**15-16**
The CSA mining operations	**16-17**
The cost structure of the CSA mine	**17-20**
Open market pricing of copper concentrate in sales between independent parties	**20-21**
The sale of copper concentrate produced by the CSA mine	**21-23**
Quotational period options for determining the copper reference price	**23-25**
Market practices for the setting of TCRCs	**25-26**
The setting of TCRCs prior to and after the February 2007 Agreement	**26-37**
The switch from a market-related agreement to price sharing	**28**
The state of the copper concentrate market around February 2007	**28-37**
TCRCs and the management of inventory risks related to CSA mine production	**37-39**
Observations in relation to the evidence	**39-49**
The Application of Australia's Transfer Pricing Rules	**49-97**
Assessing action taken by the Commissioner	**49**
Overview of the contested issues	**49-51**
Division 13 –relevant parts of the legislation and issues to be resolved	**51-57**
Subdivision 815-A – relevant parts of the legislation and issues to be resolved	**57-62**
OECD guidance on determining comparability in applying the arm's length test	**62-64**
"Reasonable expectation" test in Division 13, Subdivision 815-A and Part IVA	**64-70**
The concept of "independent parties dealing at arm's length (wholly independently) with each other"	**70-74**
Necessary causal link between non-arm's length dealing, inadequate consideration and understatement of profits	**74-80**
Risk management rationale for switch to price sharing is unsound	**81-85**
The cost structure of the CSA mine is not a sound rationale for price sharing	**86-87**
The cost control rationale for price sharing is not soundly based	**87-90**
Glencore's rationale for expanding quotational period optionality is unsound	**90-97**
Conclusions	**97-107**
Approaches to the arm's length hypothetical in Division 13 and Subdivision 815-A	**97-98**
Market realities impacting on the integrated mining, marketing and trading business	**98-99**
Financial and risk analysis divorces CMPL from the integrated business and the Glencore Group	**99-100**
Application of the relevant OECD guidance	**100-102**
Merits review and law change on public policy grounds if unsuccessful	**102-107**

Overview and Summary

The recent Federal Court decision in the *Glencore Case*[1] raises important interpretation and policy issues about the scope and practical application of the arm's length principle as articulated in the former Division 13 of the *Income Tax Assessment Act 1936* (*the 1936 Assessment Act*), Subdivision 815-A of the *Income Tax Assessment Act 1997* (*the 1997 Assessment Act*) and Article 9 of the Swiss Agreement[2]. These provisions are the forerunners to Australia's current transfer pricing regime, now contained in Subdivisions 815-B, C and D of the *1997 Assessment Act*, which is also based on the arm's length principle. While the principle is expressed in Division 13 in terms of consideration for the supply or acquisition of property or services under an international agreement between independent parties dealing wholly independently with one another, compared to the language of profits accruing under conditions in commercial and financial relations between parties that would be adopted by independent parties dealing wholly independently with each other that is used in Subdivisions 815-A, B, C and D, the different sets of statutory provisions have common underlying concepts based on the benchmark of what independent parties dealing wholly independently with one another would do (arm's length dealings).

The decision re-raises the question about how "comparable arm's length arrangements" should be identified when undertaking the statutory task of comparing the actual arrangement that operates between related group entities with arm's length dealings. In the *Glencore Case* this issue arises in relation to the setting of the consideration for the supply by Cobar Management Pty Ltd (CMPL) of all the copper concentrate production from the high-grade CSA mine under a life of mine agreement to its Swiss parent, Glencore International AG (GIAG). The case presents the complexity of applying the arm's length principle in the context of an integrated value chain; namely that of an integrated mining, marketing and trading business where the sales to independent parties of the copper concentrate produced by a subsidiary are exclusively transacted by the parent company.

The methodology adopted by the Court, broadly accepting the evidence and line of argument presented by leading global mining and commodity trader Glencore, raises issues of consistency with the approach and reasoning adopted by the Full Federal Court in the *Chevron Case*[3] - a decision that each of the parties to the dispute, and her Honour, Davies J, saw as a highly relevant authority[4]. The consistency between the two decisions needs to be explored in relation to:

(a) the approaches taken to the application of the definitions and machinery of the relevant statutory provisions;
(b) how the market and business realities impacting on the Glencore group's integrated mining, marketing and trading operations were (or were not) taken into account in the comparability analysis;
(c) the group policies and practices that applied to CMPL in order to optimise the financial performance of the Glencore Group as a whole;

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[1] *Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth* [2019] FCA 1432.
[2] The Swiss Agreement means the Agreement between the Government of Australia and the Swiss Federal Council for the avoidance of double taxation with respect to taxes on income and the protocol to that agreement, being the agreement and protocol a copy of each of which in the English language is set out in Schedule 15 of the *International Tax Agreements Act 1953*.
[3] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62.
[4] See [36] to [47].

(d) the approach the Court took to the survey of pricing options realistically available in the copper concentrate market and their economic consequences for CMPL; and
(e) the application of the relevant OECD guidance.

The *Glencore Case* raises an important issue in cases involving cross-border transactions entered into between parties not dealing at arm's length with each other: whether and to what extent (if at all) the terms of the actual transaction that bear exclusively on the pricing structures – and hence the prices - restrict the range of comparable arm's length dealings that can be used to benchmark the actual pricing structures and consideration in order to objectively discern what arm's length parties would have agreed in comparable circumstances. This issue arises whether Division 13 and Subdivision 815-A are being applied to legacy cases (as in the present case) or whether the replacement transfer pricing regime in Subdivisions 815-B, C and D are being applied to current cases.

Her Honour disregarded market-related agreements as an alternative option to price sharing agreements because she formed the view that the legislation did not permit the acceptance of market-related agreements as an arm's length comparable because to do so would be "a misapplication of the provisions of Division 13 and Subdivision 815-A"[5] in that it "***impermissibly restructures the actual contract entered into by the parties into a contract of a different character***"[6].

Davies J refers to the 1995 OECD Guidelines to support her view that the consideration for the supply of the copper concentrate needs to be worked out on the basis of the transaction as structured by GIAG.[7] She notes the OECD guidance that the transfer pricing analysis "ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them" and that:

> Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.[8]

Her Honour then notes the OECD observation that any restructuring of the actual agreement for the purposes of the comparative analysis involved in the application of the arm's length principle is limited to two exceptional types of case set out in Paragraph 1.37 of the 1995 OECD Guidelines. Nevertheless, she also notes that the OECD draws a distinction between "restructuring the controlled transaction under review" and "using alternatively structured transactions as comparable uncontrolled transactions".[9] Significantly in the *Glencore Case,* the example the OECD uses in Paragraph 1.41 to elaborate the distinction involves the purported allocation of risk between the controlled parties, which the OECD acknowledges can be disregarded if there is good reason, as there is in the *Glencore Case* for the reasons set out below*,* to doubt the economic substance of the allocation and assumption of the risk.

[5] See [6].
[6] See [314].
[7] See [315] to [319].
[8] Paragraph 1.36 of the 1995 OECD Guidelines.
[9] Paragraph 1.41 of the 1995 OECD Guidelines cited at [318].

It becomes clear when one reads the 1995 OECD Guidelines in their entirety that the OECD is using the notion of "restructuring" in a nuanced way. When the OECD speaks of the need to recognise, other than in exceptional cases, the actual transactions undertaken in order to avoid a "wholly arbitrary exercise the inequity of which could be compounded by double taxation",[10] it is talking about the underlying nature of the transaction, what it describes as the "character of the transaction". The two exceptional cases the OECD uses as examples each involve ***a different kind of property being used as the benchmark*** to conform the transaction (***not simply by reference to pricing***) for tax purposes to arm's length terms and conditions: the conforming of the use of interest-bearing debt in circumstances where at arm's length it would have been structured as a contribution of capital; and, the conforming of a sale of intellectual property where at arm' length it would be structured as a continuing research agreement.[11] In both of these scenarios the arm's length outcome is discerned by reference to the reasonable expectation of behaviour that would reflect rational commercial behaviour in the environment of an arm's length transaction; an evaluative prediction of events and transactions based on evidence and, where appropriate, admissible probative and reliable expert opinion as to what might reasonably be expected if the actual agreement had been unaffected by the lack of independence and lack of arm's length dealing.[12] The clear implication of the OECD analysis is that conforming a transaction by reference to arm's length pricing is generally in accord with Article 9 and that it is only the substantive restructuring of a transaction that has limited application.

In the *Glencore Case* "the character of the transaction" is the sale of copper concentrate under a life of mine offtake agreement for 100% of the production of the CSA mine. The Commissioner did not seek to "restructure" ***the character of the transaction***. It would be a misreading of the 1995 OECD Guidelines to say that the OECD is precluding the review and conforming, if necessary, the clauses of an agreement that relate to pricing for the purposes of applying the arm's length principle for tax purposes. It is not a "restructuring of the character of the transaction" to deal with pricing anomalies in the course of applying the arm's length test for tax purposes. There is nothing in the language or mechanics of Division 13 and Subdivision 815-A that would prevent pricing anomalies from being addressed; in fact, not to do so would undermine the operation of those provisions. It is on this basis that her Honour's view that the Commissioner is seeking to impermissibly restructure the agreement between the parties is open to question when due regard is had to the relevant legislation and the reasoning adopted by the Full Federal Court in the *Chevron Case*. As Allsop CJ said, bearing in mind that the *Chevron Case* involved an acquisition of property for a consideration that exceeded the arm's length consideration:

> Whilst the property remains the same, what consideration would be given for it in a real world of independence may lead, depending upon the evidence, to the reasonable expectation of different behaviour on the part of the person in the position of the taxpayer in relation to the giving of consideration for the property and of behaviour by another or others in relation to the dealing, and which would reflect rational commercial behaviour in the environment of an arm's length transaction. Such

[10] See paragraph 1.36 of the 1995 OECD Guidelines
[11] See paragraphs 1.37 and 1.38 of the 1995 OECD Guidelines.
[12] [2017] FCFCA 62 at [46], [60] and [62] per Allsop CJ and [121] and [126] – [129] per Pagone J (with whom Allsop CJ and Perram J agreed).

> behaviour may affect the terms of the hypothetical agreement in question to the extent that they can be seen as part of the consideration.[13]

Pagone J put it in the following way:

> …In each case the focus of inquiry must be to identify a reliable comparable agreement to the actual agreement by the actual taxpayer for the legislative assumption to have meaningful operation. The provisions of Division 13 are intended to operate in the context of real world alternative reasonable expectations of agreements between parties and not in artificial constructs. The comparable agreement may, therefore, usually assume an acquisition by the taxpayer of the property actually acquired under an agreement having the characteristics of the agreement as entered into but otherwise hypothesised to be between them as independent parties dealing with each other at arm's length in relation to that acquisition. The purchaser (or in this case the borrower) may therefore, as his Honour considered at [79], be a company like CAHPL which is a member of a group, but where the consideration in respect of the acquisition identified in the hypothetical agreement is not distorted by the lack of independence between the parties or by a lack of arm's length dealings in relation to the acquisition.[14]

The adjustments made by the Commissioner to the taxable profits in the 2007, 2008 and 2009 income years were all related to the pricing of the copper concentrate, the working out of the consideration that the supplier might reasonably be expected to have received under an agreement between independent parties dealing at arm's length with each other in relation to the supply. For the purposes of Subdivision 815-A the process required a determination of the profits that would have been received on the basis of the conditions that might be expected to operate in the commercial and financial relations between independent parties dealing wholly independently with one another.

There is a pivotal issue that arises in relation to the appropriateness of her Honour's acceptance of how the taxpayer actually restructured the pricing mechanism in the offtake agreement, because not only was it based on the acceptance of the taxpayer's rationale - that it was purported to be a risk management strategy despite it being ineffectual in reducing economic risk in the real world for the Glencore Group's integrated business - it forecloses the opportunity to have appropriate regard to all of the options regarding pricing structures that were realistically available in the copper concentrate market. This in turn forecloses any proper consideration of "the manner in which independent parties dealing at arm's length would be expected to behave in conducting their affairs"[15], namely by each of the parties acting in their own self interest.[16] To that end, a seller would undertake a market survey to determine what options in terms of pricing frameworks are realistically available and then considering the economic costs and benefits of each in order to select the best economic option realistically available. This aligns with the OECD guidance on determining comparability in applying the arm's length test and, in particular, the need to identify and consider the ***economic*** functions each party performs, the contractual terms, the economic circumstances in which the dealings occur and the business strategies being pursued by the

[13] [2017] FCAFC 62 at [46].
[14] [2017] FCAFC 62 at [129].
[15] This is a critical aspect in determining whether parties are dealing at arm's length that was highlighted in *AW Furse No 5 Will Trust v FC of T* 91 ATC 4007 at 4014-4015 per Hill J.
[16] *Australian Trade Commission v WA Meat Exports Pty Ltd* (1987) 75 ALR 287 at 291.

multinational group.[17] The arm's length seller "will only enter the transaction if they see no alternative that is clearly more attractive"[18]. To get to that point of selection the seller would have to undertake a market survey.

There was no evidence before the Court that a market-related pricing arrangement was not a realistic option that was available to a seller like CMPL. The only barrier to the selection of a market-related pricing framework, or rather the continuance of the pre-existing pricing framework, was the control exercised by GIAG over the decision to switch to a price sharing agreement, the risk management rationale for that switch proving to be fundamentally unsound. In other words, on the evidence before the Court, the selection of price sharing as the basis for the pricing framework between CMPL and GIAG was "distorted by the lack of independence between the parties"[19].

To undertake such a market survey to determine the terms and conditions that would be most acceptable to an independent party does not involve conflating the question of whether the parties are dealing at arm's length with the question of whether the actual consideration is less than the arm's length consideration.[20] The survey is part of the process of comparing the actual consideration, or the actual conditions in the commercial or financial relations, with the agreements reached by independent parties in arm's length dealings. The actual consideration is the product of the pricing framework that operates in the commercial and financial relations between parties to an agreement and, for this reason, different pricing frameworks available in the market need to be identified, compared and understood. To focus the enquiry on only one type of pricing framework, as happened in the *Glencore Case* biases the analysis "by a rigid constriction of the arm's length hypothesis in a shape and form controlled by the taxpayer" and undermines the sensible operation of Division 13 and Subdivision 815-A.[21]

Consideration of the manner in which independent parties are expected to behave is particularly important in a case like the present where the Court found that there was no evidence that the February 2007 Agreement (and the informal arrangement that preceded it in January 2007[22]) was a negotiated agreement, nor did the taxpayer put into issue or contend that it was a negotiated agreement and arm's length dealing.[23] It is also critical to keep in mind that the Glencore Group is conducting an integrated mining, marketing and trading business. The arm's length test as articulated in Division 13 and Subdivision 815-A should not be construed in a way that envisages that a hypothetical arm's length seller of copper concentrate would act in a commercially irrational manner and enter a price sharing agreement that was highly likely to carry significant economic and financial disadvantage when there were significantly better options realistically available to it in the open market.[24]

It is clear from the factors that the OECD specifies that the comparison of actual dealings with the arm's length hypothetical that underpins both Division 13 and Subdivision 815-A

[17] Paragraphs 1.21, 1.28, 1.29, 1.30 and 1.31 to 1.35. These paragraphs are summarised in the earlier section of this paper entitled, The Application of Australia's Transfer Pricing Rules.
[18] Paragraph 1.15 of the 1995 OECD Guidelines.
[19] [2017] FCAFC 62 at [129].
[20] See [324].
[21] Compare *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [55] per Allsop CJ.
[22] See [148].
[23] See [171].
[24] See paragraphs 1.15 to 1.18 of the 1995 OECD Guidelines.

necessarily entails, amongst other things, a market survey in order to properly understand the economic and commercial context in which the provisions are required to operate. In this case the survey would include: the size of the copper concentrate market; the stocks and flows of copper concentrate; the participants, their roles and market position; prevailing and forecast market conditions around the time that the February 2007 Agreement was being considered by the Glencore Group; and, the various bases on which long term sales of high grade copper concentrate were transacted between independent parties dealing at arm's length with each other. The purpose of that survey is to identify arrangements that are sufficiently comparable to the life of mine offtake agreement for the full volume of high grade copper concentrate produced by the CSA mine. The 1995 OECD Guidelines state that:

> In order to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (eg price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding of how unrelated companies evaluate potential transactions is required. Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter a transaction if they see no alternative that is clearly more attractive……independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options…[25]
>
> All methods that apply the arm's length principle can be tied to the concept that independent enterprises consider the options available to them and in comparing one option to another they consider any differences between the options that would significantly affect their value…[26]
>
> ……In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof) it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length dealings. Attributes that may be important include the characteristics of the property or services transferred, the function performed by the parties (taking into account assets used and risks assumed), the contractual terms, the economic circumstances of the parties, and the business strategies being pursued by the parties…[27]

This is particularly so in the *Glencore Case* because the purported risk management rationale for switching from a market-related to a price sharing framework is fundamentally unsound. A price sharing agreement in respect of intra-group sales does not remove the risk of volatility in treatment and copper refining charges (TCRCs) and between TCRCs and copper prices. Nor, would the proof of a risk management benefit on its own be sufficient to satisfy the statutory requirement of demonstrating what might reasonably have been expected to occur in terms of consideration received or conditions that operated in the commercial and

[25] Paragraph 1.15 of the 1995 OECD Guidelines.
[26] Paragraph 1.16 of the 1995 OECD Guidelines.
[27] Paragraph 1.17 of the 1995 OECD Guidelines.

financial relations between the parties if they were independent of each other and dealing at arm's length (or wholly independently) with each other. To do so would be tantamount to replacing the statutory arm's length hypothetical with a test based on the obtaining of a benefit, without regard to the relative costs and benefits of securing that benefit, or whether independent parties would generally seek to secure that benefit. The arm's length hypothetical requires evidence that price sharing to mitigate the volatility risks was more likely than not adopted in dealings between independent parties in offtake agreements for the life of a mine. No such evidence was led. This leaves the purpose and object of the February 2007 Agreement to be determined according to "the natural and probable consequences"[28] of that agreement having regard to industry practice and market conditions at the time. The natural and probable consequences of that agreement were the reduction of CMPL's taxable sales revenue in Australia and a commensurate increase in GIAG's profits in Switzerland through the reduction the of amounts GIAG paid for the copper concentrate it purchased from CMPL.

To accept that in the facts and circumstances of the present case, as objectively established by the evidence, that a hypothetical arm's length seller would agree to the price sharing framework introduced by the February 2007 Agreement would be to accept that commercially irrational behaviour can be encompassed within the arm's length principle, an approach that would defeat the statutory purpose of those legislative provisions.

The application of the arm's length principle involves the consideration of the functions performed, assets used and risks assumed by each party.[29] However, her Honour's approach, like that of the taxpayer, focusses for its justification as a reasonable and acceptable approach to risk management on an analysis of the financial viability and market and price risks faced by one party, the seller, without regard to the relative financial costs and benefits to CMPL on the one hand and the financial costs and benefits it confers on GIAG. The importance of this issue is underlined by the hallmarks of arm's length dealing: that neither party submits to the will of the other[30] and that each party acts in [its] own best interest[31].

The analytical approach applied by her Honour does not have sufficient regard to the fact that other parts of the integrated mining, marketing and trading business are continuing to provide managerial and financial support to the seller, or that those other parts of the integrated business are exposed to those same risks. Nor does the analysis sufficiently recognise that the different parts of the integrated business had distinct roles and responsibilities and that GIAG had the exclusive responsibility for the sale of copper concentrate to independent parties, including the sale of the production from the CSA mine. It is GIAG that is in a position to manage price risk and volatility; it is impossible for CMPL to manage that risk.

It is an unrealistic starting point for the transfer pricing analysis to assume that CMPL would sell its copper concentrate to an independent party in the open market, given the roles that CMPL and GIAG perform within the integrated business model. That would undermine the Glencore Group's business strategy of "[seeking] to derive value from its investments in industrial assets by operating those assets, conducting marketing/trading activities in respect of the commodities produced by those assets and from the integration of these operational

[28] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.
[29] Paragraph 1.20 of the 1995 OECD Guidelines.
[30] *Granby Pty Ltd v FC of T* [1995] FCA 259; 95 ATC 4240 at 4244
[31] *Australian Trade Commission v WA Meat Exports Pty Ltd* (1987) 75 ALR 287 at 291.

and marketing activities”[32]. There is no requirement in Division 13 or Subdivision 815-A that the Australian supplier deal directly with independent parties since the focus of those provisions is the supply of property between parties that are not dealing at arm’s length or, in the case of Subdivision 815-A, one enterprise directly or indirectly participates in the management, control or capital of the other enterprise.

GIAG had the exclusive responsibility of “generally managing the risks that Glencore was exposed to by virtue of the purchase and sale of…commodities”, and was tasked with “responsibility for marketing commodities”.[33] These functions included the management of risks associated with the copper concentrate inventory and the sale of that inventory (including the production from the CSA mine) on terms and conditions that optimised the profit of the integrated mining, marketing and trading business. More specifically those risks included the risks of changes in copper prices and changes in TCRCs. The risks would also include the price risk arising from different quotational period options between the purchases and sales that GIAG makes.

The general observation can be made that those risks, to the extent they present the possibility of negative impacts, may or may not materialise and the potential impacts may or may not be significant. The external environment also offers opportunities for economic upside in each of the areas in which risks may arise, like an increase in copper prices or a reduction in TCRCs. In managing those risks a commercially rational seller would have regard to the relative economic costs of doing so and whether any particular risk reduction strategy would be, in an overall sense, too costly because the seller would forego the chance to achieve a more than offsetting level of profits for any adverse impact those risks are likely to bring. This is particularly so where a multinational group operating an integrated business model like the Glencore Group’s copper concentrate business[34] is a publicly listed company. An overly conservative approach to risk management is something that may prompt an adverse impact on the share price of a publicly listed multinational group like Glencore since investors may be seeking exposure to a particular sector like mining in the expectation that the group will take advantage of any economic upside and the rate of return will be appropriate to the risk being assumed. The Glencore Group would have to have regard to investor expectations in setting its hedging and risk management policies and practices.

In any event the market and price risks used by the taxpayer to justify the restructuring of the market-related pricing structure into a price sharing structure cannot be mitigated in a real world economic sense in relation to the integrated mining, marketing and trading business by the pricing structure imposed for the intra-group sale of copper concentrate by CMPL to its Swiss parent, GIAG. The taxpayer’s rationale is based on false premises and its purported risk minimisation approach is ineffectual in the real world of the integrated copper concentrate mining, marketing and trading business.

In proceeding along this line of reasoning the analysis in the *Glencore Case* departs from the application of the arm’s length principle as articulated in Division 13, Subdivision 815-A and Article 9 of the Swiss Agreement, and as it explained by the Full Federal Court in the *Chevron Case* and in the relevant OECD guidance. The Court’s reasoning is based on evidence of examples of the existence of a particular pricing mechanism in the market,

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[32] See [105].
[33] See [106].
[34] See [105].

namely price sharing and quotational period optionality with back pricing[35]. The tendered agreements revealed significant differences from the facts and circumstances of the CSA mine which would materially affect their value; the contract volumes were, with one exception, relatively small and the pricing structures had marked differences to the pricing formula in the February 2007 Agreement. Accordingly, they cannot be accepted as unadjusted comparables[36]. In fact, the taxpayer accepted that there were differences, one could argue material differences, and in several instances the taxpayer did not argue that the examples were "directly analogous" to the February 2007 Agreement but that they were "relevant examples" of price sharing and broad quotational period optionality with back pricing being used in dealings between independent parties in the open market.[37] This evidence did not progress beyond showing that price sharing was a "possibility"[38], not that such examples were truly comparable and were sufficient evidence of what independent parties in comparable circumstances might reasonably be expected to have done.

The analysis of whether it made commercial sense for CMPL to adopt February 2007 pricing structure having regard to prevailing market conditions and industry practices, or how attractive it would be in relative economic and financial terms to the other pricing mechanisms that were available, was subordinated to the overriding (but mistaken) conclusion that price sharing was justified as an effective risk minimisation strategy. The arm's length test is not based on a mere possibility, the fact that a particular pricing mechanism can be found in the market, but on the premise that independent parties dealing at arm's length (or wholly independently) with each other will act independently in a commercially rational manner, evaluate all options realistically available to them in the market in terms of their economic costs and benefits, and will only enter a transaction if there is no other option that is more attractive.[39]

It is noteworthy that the Full Federal Court in the *Chevron Case* was able to accept the likelihood, based on expert evidence about the market, that on a stand alone basis the Australian borrower, CAHPL, would likely have had to pay above 9% for an AUD 2.5 billion loan for five years; that it had a stand alone risk rating on a scale approximately equal to BB+; and, that an entity's credit profile was critical to the pricing of loans available in the market.[40] In other words the Full Federal Court accepted that this type of pricing system existed in market:

> but the credit profile of the "hypothetical CAHPL" is not the inquiry required by s 136AD(3). The inquiry was not to determine the price of a loan which CAHPL obtained from CFC, nor to price a loan like that loan which CAHPL (with its credit worthiness) might have been able to obtain, as an independent arm's length party to such a loan, but to make a prediction about what might reasonably be expected to be given or agreed to be given under a hypothetical agreement if the parties had been independent and were dealing at arm's length in relation to the acquisition.[41]

[35] See [249] to [308].
[36] See paragraph 1.16 of the 1995 OECD Guidelines.
[37] See [258], [260], [267] and [276].
[38] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCFCA 62 at [127] per Pagone J.
[39] See paragraph 1.15 of the 1995 OECD Transfer Pricing Guidelines and *The Trustee for the Estate of the late AW Furse No 5 Will Trust v FC of T* 91 ATC 4007 at 4014-4015 per Hill J.
[40] [2017] FCAFC 62 at [54] per Allsop CJ and [124] and [131] per Pagone J.
[41] [2017] FCAFC 62 at [131] per Pagone J (with whom Allsop CJ and Perram J agreed).

Following the same line of reasoning, the inquiry in the *Glencore Case* is not to determine the pricing of the contract that was made between CMPL and GIAG, not to price a contract like that which CMPL might have been able to obtain if allowed by its parent to sell the copper concentrate to independent parties, but to make a prediction about what might reasonably be expected to be paid and received for the copper concentrate under a hypothetical agreement if the parties had been independent and were dealing at arm's length in relation to the supply. Since CMPL is part of an integrated mining, marketing and trading business the question then becomes: what might reasonably be expected to have been received by CMPL in respect of the supply of the copper concentrate if that integrated business sold the copper concentrate to an independent buyer that was dealing at arm's length with Glencore?

It is only by considering the organisational configuration of the integrated business, the full market context and the economic consequences of the different options realistically available in the market that it can be concluded, on an objective basis, what amount of consideration might reasonably be expected to have been received (subsection 136AA(3)) or what conditions might be expected to operate in the commercial or financial relations (Subdivision 815-A and Article 9), and hence what the Australian taxable profits would have been, if the parties were independent of each other and dealing at arm's length (or wholly independently) with one another in respect of the supply of copper concentrate.

The conclusion reached in this paper is that, having regard to:

- the integrated mining, marketing and trading business being conducted by the Glencore Group[42];
- the negotiating strength that GIAG had due to its market position in 2006 as the largest seller of copper concentrate in the world[43];
- the ongoing organisational, financial and managerial support the group was providing to CMPL and the recognition through ongoing capital investment and cash to meet operating costs that the CSA mine as a valuable group asset[44];
- the fact that GIAG, through its employee Mr Kelly, exercised financial control over the CSA mine and did so "with a view to maximising the profit for the Glencore Group" as a whole[45];
- the fact that CMPL was not in a position to deal with GIAG in a commercially rational manner and stick with the terms of the market-related agreement so that CMPL would be as profitable as possible[46];
- market conditions at the time the switch to price sharing was being considered and the probability, based on the forecasts for copper prices and TCRCs in the 2007 Budget[47] and the proposal in the February 2007 Agreement that TCRCs be calculated at 23% of the copper reference price[48], that CMPL would suffer a significant drop in sales revenue;
- the fact that actual TCRCs negotiated between independent parties in the open market, while notionally intended to cover smelting and refining costs and

[42] See [105].
[43] See [107].
[44] See [110], [128], [129] and [133].
[45] See [127] and [131].
[46] See [203].
[47] See [137] to [143].
[48] See [167].

provide the purchaser (whether a trader or a smelter) with an element of profit, are a result of market forces[49];

- the options in relation to pricing frameworks for long term copper concentrate offtake agreements that were realistically available in the market at that time included market-related agreements;
- the roles and responsibilities of the group members comprising the integrated mining, marketing and trading business that the Glencore Group was carrying on in the 2006 to 2009 income years and the fact that CMPL was required to sell all the production of the CSA mine to GIAG[50] and was not authorised or responsible for selling copper concentrate to independent parties or the management of inventory risks[51];
- the inability of a price sharing agreement in respect of intra-group sales to mitigate the volatility and price risks faced by the integrated mining, marketing and trading business;
- the fact that quotational period optionality favours the buyer who has the right to elect which period to select, and that such conditions when established in respect of intra-group sales are incapable of mitigating any price risk faced by GIAG in respect of sales to independent parties; and
- the absence of any evidence that the Glencore Group had a policy or took steps to reduce its exposure to the volatility and price risks faced by the integrated mining, marketing and trading business

it is more likely than not that in the relevant income years the copper concentrate from the CSA mine would have been sold through GIAG to independent parties under the market-related pricing arrangements comparable to that which operated between CMPL and GIAG prior to January 2007 when the price sharing framework was first informally introduced before being formalised in February 2007[52]. Looked at in a commercially rational way, having regard to the arm's length hypothetical as separately articulated in Division 13 and Subdivision 815-A, the taxpayer had no incentive to switch to a price sharing agreement with expanded quotational period optionality; it would have been significantly worse off financially. In comparison, the continuation of its existing market-based agreement provided the more attractive option.

The following factors provide a cogent argument that the taxpayer did not satisfy its onus of proof under section 14ZZO of the *Taxation Administration Act 1953* to demonstrate that the amended assessments raised by the Commissioner for the 2007, 2008 and 2009 income years were excessive:

- the misperception and misapplication of the arm's length hypothetical in Division 13 and Subdivision 815-A by the exclusion of market-related agreements as a realistic option for an arm's length pricing structure, the use of a risk management benefit test in lieu of the reasonable expectation test in the relevant legislative provisions, and the reliance on the mere existence of price sharing agreements in the marketplace as sufficient proof of the arm's length hypothetical being satisfied;

[49] See [78].
[50] See [2].
[51] See [106] and [109].
[52] See [148].

- the misperception and misapplication of the concept of "independent parties dealing at arm's length (or wholly independently) with each other" by basing its transfer pricing analysis on the approach of analysing CMPL's financial position and risk exposure in isolation from the integrated mining, marketing and trading business in which it operated and from the Glencore Group of which it was a part;

- the incorrect view that the intra-group transactions between CMPL and GIAG were effective in mitigating the economic risks to the integrated business presented by fluctuations in the copper price and TCRCs and the price risk from different purchase and sale quotational periods; and

- the manner in which the taxpayer conducted its case in not providing evidence of the performance of the integrated mining, marketing and trading business conducted by the Glencore Group, the terms and conditions on which GIAG generally sold to independent parties, or the group's policies and practices relevant to the use of price sharing agreements to remove the volatility of TCRCs and between TCRCs and copper prices.

There is a strong conceptual argument to support a merits review in the *Glencore Case,* on the grounds that her Honour has made errors of law in applying the arm's length hypothetical. These relate to:

(i) the exclusion of market-related agreements for the purposes of applying the arm's length hypothetical as separately articulated in section 136AA(3)(c) in conjunction with section 136AD(1) and Subdivision 815-A in conjunction with Article 9 of the Swiss Agreement;
(ii) the analysis of market risks and financial viability by reference to the circumstances of CMPL in isolation from the integrated mining, marketing and trading business and group of which it was part: and
(iii) the acceptance of the taxpayer's risk mitigation rationales when the evidence showed that the real world risks were incapable of being addressed through the pricing arrangements imposed on intra-group sales and that the natural and probable consequences of the price sharing arrangement was a reduction in taxable Australian sales revenue and a corresponding increase in the profits of the Swiss parent company.

Allied with this, as set out above, several aspects of the case that support the view that the taxpayer has not satisfied its onus of proof under section 14ZZO of the *Taxation Administration Act 1953.* It is important in the public interest that the core concepts of "independent parties dealing at arm's length (or wholly independently) with each other" and the reasonable expectation test in the arm's length hypothetical be clarified in view of the opportunities for tax planning that the Court's reasoning provides and the fact that the decision has a continuing significance because the replacement provisions for Division 13 and Subdivision 815-A (Subdivisions 815-B, C and D) are based on the same concepts.

Based on the implausibility of the taxpayer's risk management rationale for the switch from a market-related agreement to a price sharing agreement (discussed in detail below) and the insufficiency of evidence on group policies and practices in relation to risk management, there are grounds for the view that, for the purposes of the penalty provisions in Subdivision 284-A of Schedule 1 of the *Taxation Administration Act 1953,* the taxpayer's position in

relation to the application of Division 13 and Subdivision 815-A was not "reasonably arguable" within the meaning of subsection 284-15(1) and that the scheme penalty provisions in subsection 284-145(1) may apply.

If, after all appeal rights have been exhausted, the Commissioner were to lose the case, there is a compelling argument on public policy grounds for a law change.

The following sections of this paper provide a more detailed analysis of the issues, addressing the points listed in (a) to (e) above.

The Facts and Circumstances of the Glencore Case

In broad terms the *Glencore Case* involved the sale by CMPL, the manager and operator of the CSA mine[53], of all of the copper concentrate produced at the Australian high-grade underground mine located near Cobar in New South Wales[54], to its Swiss parent company, GIAG[55] during the 2007, 2008 and 2009 income years[56]. The sales were made between the related companies as part of the integrated mining, marketing and trading business conducted by the Glencore Group which on-sold to external parties.[57] While the Court apparently had the relevant evidence before it[58], the actual ownership structure of the CSA mine during the relevant income years is not set out in the judgment beyond the reference to the fact that the mine was owned by two GIAG subsidiaries[59]. Nevertheless, it appears that the Court was satisfied that CMPL had the necessary title to the copper concentrate produced at the CSA mine to be able to sell it to GIAG.

CSA mine's operations, cost drivers and Glencore's integrated copper concentrate business

The separate responsibilities of CMPL and GIAG in the integrated business

GIAG was the Swiss parent company of CMPL[60] and owned the CSA mine through two GIAG subsidiaries[61], having acquired the mine in 1998[62]. At the time of acquisition, the mine was not operative and was under care and maintenance. With the recommencement of mining operations in 1999, CMPL entered into an offtake agreement with GIAG for GIAG to purchase the entire production of copper concentrate for the life of the mine, and CMPL has since continued to sell its entire production of copper concentrate to GIAG under a series of replacement and amending offtake agreements.[63] The Glencore Group seeks to derive value from its investments in industrial assets, including mines like the CSA mine and associated infrastructure like ports and rail, by operating those assets, conducting marketing/trading activities in respect of the commodities produced by those assets and from the integration of those operational and marketing activities. Moreover, through the integration of its marketing activities with the industrial assets it invests in it can optimise the logistics required to

[53] See [1].
[54] See [111].
[55] See [108].
[56] See [1].
[57] See [105].
[58] See [52].
[59] See [51].
[60] See [1].
[61] See [51].
[62] See [2] and [108].
[63] See [108].

process raw materials and deliver the end product (in this case copper concentrate) to its customers.[64]

In the organisational context in which CMPL and GIAG were operating as part of the group's integrated copper concentrate business CMPL had responsibility for managing the CSA mine, which it had done since 1999.[65]

Glencore's marketing team had responsibility for marketing commodities (which included the copper concentrate produced by the CSA mine), selling commodities to smelters, arranging the logistics needed to deliver those commodities to buyers in accordance with Glencore's contractual obligations, performing quality control for the commodities that were purchased and sold, managing trade finance and generally managing the risks that Glencore was exposed to by virtue of the purchase and sale of those commodities. Glencore's marketing team in the period between 2006 and 2009 had approximately 2,500 employees in 40 offices worldwide.[66] In 2006, Glencore was the largest seller of copper concentrate in the world. The copper concentrate which it traded originated either from mines it owned, or in which it held an interest, as well as mines owned by third parties.[67]

The risks that GIAG assumed under the entire production offtake agreement related to the CSA mine arose as and when the copper concentrate was ready to be shipped.[68] Those risks included those associated with the potential movements in copper prices and TCRCs. CMPL was not authorised or resourced to manage those risks.

The CSA mining operations

The following description of CSA mine and the steps involved in mining operations appears in her Honour's judgment and draws on the evidence of Mr Kelly who was the asset manager at the CSA mine, a director of CMPL and an employee of GIAG[69]:

> 112 During the relevant years, the mine's primary ore body, which was mined from an area known as QTS North, produced an homogenous copper concentrate of a consistently high grade. That ore body was comprised in a series of vertical lenses and was mined using the long hole open stoping method. Mr Kelly gave the following description of the steps involved in the mining operations:
>
> (a) mining of the underground stopes occurred at depths of about 1,400 metres to 1,500 metres;
>
> (b) vehicle and heavy machinery accessed the underground stopes via the decline, which was a road which descended into the mine from the surface in a corkscrew manner to a depth of about 1,400 metres to 1500 metres; regular worker and materials access to the mining operations was via a shaft that extended from the surface to a depth of 980 metres, and then via the decline to a depth of 1,400 metres to 1,500 metres;

[64] See [105].
[65] See [2].
[66] See [106].
[67] See [107].
[68] See [71].
[69] See [51].

(c) the stopes, once accessed, were drilled and blasted;

(d) once blasted, the ore was collected and transported in trucks to an underground stockpile located at a depth of about 980 metres;

(e) from the stockpile, the ore was transported via the ore pass to a primary crusher and then to the surface via the vertical shaft;

(f) once the ore reached the surface, the ore was transferred to mills where it was ground to a slurry;

(g) the slurry was then pumped to a flotation tank to separate the different minerals which were skimmed from the flotation cells and then dried. This skimmed and dried material is the copper concentrate which the mine sold; and

(h) copper concentrate produced at CSA was stockpiled before being transported by rail to the port at Newcastle from where it was then shipped to various ports in Asia.

113 In late 2006, mining also commenced in an area known as QTS South where the ore body was close to the surface but of a lower grade.

The cost structure of the CSA mine

Mr Kelly gave the following evidence to explain how the remote location of the mining site and the depth and complexity of mining operations drove the cost structure of the mine:

(a) the depth of the mine and the need to continue mining deeper into the ore body gave rise to significant technical and financial challenges for the mine and led to high operating costs. This was because the depth of the mine increased the complexity, time, effort and cost involved in extracting the copper ore from the mine face, getting it to the underground stockpile and then transporting it from the stockpile to the surface; the mine's depth required expenditure on infrastructure, extensive ground support and stabilisation regimes, as well as systems to provide adequate ventilation, power and air conditioning; and there were difficulties in accessing the deep underground stopes both to bring workers and equipment to and from the underground stopes and in transporting extracted ore to the surface and gave rise to congestion in the movements, as well as long trucking distances, restricting operations. Mr Kelly deposed that from at least 2004, CSA worked on projects with a view to making mining at depth more economical, including a proposal to extend the shaft to a depth of 1,500 metres;

(b) the remoteness of the mine made it difficult to attract and retain employees and there were significant vacancies in key roles for long periods of time. For an 18 month period leading up to October 2007, there was no mine manager and at other times the mine manager changed regularly; and

(c) the mine faced the issue of having enough water to support the mine's production. He explained that mining operations cannot occur without a water supply and Cobar is a dry town. Its main source of water is the Burrendong dam which caters for the greater Cobar region. The dam level fell to below 3% capacity in 2007 and there was not enough water to support the town, agriculture and mining. Priority was

> given to the town and agriculture and CSA was required to find alternative water sourced by drilling for water, retreating water and trucking water to the site.[70]

GIAG's financial and managerial control of the CSA mine

Mr Kelly, who was in the relevant income years an employee of GIAG and a director of CMPL and the two GIAG subsidiaries that owned the CSA mine[71], gave evidence that:

> ... once a year, the management at CMPL presented a budget and five year plan for the CSA mine to Glencore for approval.[72]

He gave evidence in cross-examination that he exercised financial control over the mine and did so "with a view to maximising profit for the Glencore Group" as a whole.[73]

The evidence shows that GIAG controlled CMPL's operational budgets, current account, capital funding, cashflow management and treasury operations. It also shows that GIAG exercised close management and governance of the CSA mine's operations. As her Honour found:

> 110 In addition to providing logistics support, between 1999 and 2009, Glencore, including through the support of a dedicated asset manager, provided ongoing assistance and expertise to CMPL in relation to CSA's operations. This assistance consisted of human resources contributions, mining expertise, as well as treasury services.
>
> 119 …CMPL spent significant capital in 2005 and 2006 on works to elevate mine production levels and improve the long-term productivity of the mine, which included commencing mining operations in the area known as QTS South in late 2006 to access an ore body close to the surface but of a lower grade ore. The 2007 Budget identified the completion of the QTS South development as another "key focus" for the 2007 year, with the expectation that it would be in full production in 2007 and "supplement output from the main operations in the QTS North area.
>
> 120 I accept Mr Kelly's evidence about the depth of the mine giving rise to significant technical and financial challenges and that the mine in 2006 and 2007 was experiencing difficulties with staffing and water supplies. In addition, there was documentary evidence showing that the mine had experienced difficulties in the past with ground instability, such as stope failures and ground collapses. However, as the contemporaneous documents also evidenced, as at late 2006 and early 2007 the mine had plans and steps in place dealing with these matters and there was nothing in the contemporaneous documents which identified any uncertainty for the mine in relation to its capacity to continue mining in 2007, 2008 or 2009 or to suggest that CMPL considered that there was any real risk that its level of production would not continue throughout those years. Indeed, the review of the 2006 year set out in the 2007 Budget noted that mine production of ore in 2006 had increased by over 30% to 810,000

[70] See [114].
[71] See [51].
[72] See [133].
[73] See [131].

[tonnes per annum] and concentrate production in 2006 would be "an all-time record for CSA". It also stated that "this [had] been achieved even with high turnover in both staff and AWA positions and finishing the year with over 20% vacancies in staff position [sic] due to the extremely difficult employment market".

126 It was not in dispute, and there was clear evidence, that GIAG exercised financial and managerial control over the CSA mine during the relevant years.

127 In his role as asset manager of the CSA mine (***whilst employed by GIAG***)[74] Mr Kelly undertook the following activities:

a) ***reviewing the mine's operating numbers and analysing them and liaising with the mine's general manager based on this analysis***;
b) financial modelling to support the value of the mine;
c) assisting with the preparation of statutory accounts;
d) benchmarking CSA's costs against other similar assets owned by Glencore;
e) assisting with recruitment;
f) ***reviewing any capital expenditure projects and analysing them***;
g) ***liaising with Glencore to obtain approvals for the capital expenditure CSA needed to fund new projects***;
h) liaising with individuals within Glencore to assist CSA to deal with specialist issues that arose, for example, health and safety issues at the mine;
i) liaising with Glencore about the mine's insurance needs;
j) ***assisting CSA with implementing exploration programs to locate new sources of ore at the mine that were economical to mine***;
k) liaising with CSA and Glencore about Glencore's involvement in the Cobar community; and
l) assisting CSA with general legal compliance.

128 In cross examination he said he also:

a) ***approved capital projects at the mine***;
b) ***assisted in the compilation and review of the mine's budgets (for approval by Glencore)***; and
c) ***authorised the payment of cash calls from CMPL's current account facility with GIAG***.

129 Mr Kelly explained that the current account facility is an intercompany account controlled by GIAG. ***GIAG uses the account to credit the payments in USD due to CMPL under the offtake agreement and when CMPL needs to access cash to meet operating costs in Australia, it makes a cash call to GIAG*** so that a nominated sum can be transferred into CMPL's Australian account. ***Mr Kelly deposed that he***

[74] See also [51] where Davies J notes that from 2006 to 2009, Mr Kelly was employed by GIAG as the CSA mine's asset manager.

> ***was not aware of any occasion when a cash call was not met by GIAG.*** GIAG also uses the current account facility for group purposes… [Emphasis added.]

As was found by her Honour, between 1999 and 2009 Glencore, including through the support of a dedicated asset manager, provided ongoing assistance and expertise to CMPL in relation to CSA's operations. This assistance consisted of human resources contributions, mining expertise as well as treasury services.[75]

GIAG's managerial and financial control extended to the determination of the terms and conditions on which CMPL sold copper concentrate to its parent. From 5 July 1999 CMPL was obliged to sell all of the copper concentrate produced over the life of the CSA mine to GIAG as part of an integrated mining, marketing and trading business model. In January 2007 the pricing framework for the copper concentrate was fundamentally changed by an informal arrangement, later formalised in February 2007. The original market-related pricing framework for copper prices and TCRCs in the offtake agreement was switched to a price sharing basis with a TCRC set at 23% of the copper reference price.[76] The taxpayer conceded that GIAG and CMPL did not at arm's length with each other in relation to the supply of copper concentrate on the terms of the February 2007 Agreement.[77] Suffice to say for the purposes of the present context that there was no evidence that the February 2007 Agreement was a negotiated agreement, nor did the taxpayer put into issue or contend that it was a negotiated agreement and arm's length dealing.[78] It can reasonably be concluded that the lack of arm's length dealing also applies to the informal arrangement put in place in January 2007 prior to the formalisation the following month. This switch of pricing frameworks is discussed in detail in following sections of this paper.

Open market pricing of copper concentrate in sales between independent parties

The price of copper is the starting point for determining the price of copper concentrate. Davies J found that it was common ground between the experts that the copper metal price was extremely volatile and unpredictable with "ups and downs"[79]. Her Honour accepted the evidence of Mr Wilson, who had been engaged by Glencore and whom the Court accepted as an expert in market analysis of the global copper concentrate industry[80], to the effect that copper metal prices are influenced by many factors which include:

> global industrial activity;
>
> overall copper metal inventory levels in London Metal Exchange approved warehouses;
>
> the value of the US dollar against other currencies;
>
> the general copper supply/demand outlook; and
>
> changes to metal supply and demand, such as disruptive elements like industrial action, flooding, and earthquakes.

[75] See [110].
[76] See [3], [148] and [321].
[77] See [28].
[78] See [171].
[79] See [74].
[80] See [54].

The Court also accepted Mr Wilson's evidence that prices also respond to the results of regularly published macroeconomic data from key countries/regions, such as China, the Eurozone and the USA.[81]

All of these factors are conditions of the market and they impact on all stages of the copper supply chain: on miners like CMPL, marketer/traders like GIAG, smelters and the end users of the copper produced. They are not ***on their own*** a basis for determining the relative rewards that a miner should obtain relative to a marketer/trader where these sets of activities are highly coordinated and operated as a highly integrated group business.[82] However, they are important considerations in understanding the copper concentrate market and in evaluating whether the behaviour of participants, particularly parties that are related, is commercially rational.

The evidence accepted by the Court was to the effect that copper concentrate sold under offtake agreements (as opposed to spot sales) will generally be priced by reference to:

a. the price of copper metal on a metal exchange, such as the London Metal Exchange, averaged over a given period of time (known in the industry as the "quotational period");

b. the deductions to be made from the reference price for the TCRCs; and

c. other adjustments for the payable copper content in the copper concentrate (noting that smelting processes will usually not recover 100% of the copper content in concentrate) and penalties for deleterious elements.[83]

The sale of copper concentrate produced by the CSA mine

The mining operations and the copper concentrate output of the CSA mine were closely managed[84] within the organisational framework of the Glencore Group's integrated mining, marketing and trading copper concentrate business.[85] The operational consequence was that the copper concentrate produced by the CSA mine was initially sold internally by CMPL to the part of the business responsible for marketing and trading, namely GIAG. These internal sales did not have economic impacts on the profits of the group's integrated business. The second phase of the integrated business involved sales of copper concentrate by GIAG to parties that were independent of the Glencore Group. It is this stage that generated the economic returns for the integrated business.

There was clear evidence that GIAG exercised financial and managerial control over the CSA mine during the relevant income years.[86]

GIAG, through Mr Kelly the asset manager of the CSA mine, exercised financial control over the CSA mine and did so "with a view to maximising profit for the Glencore Group" as a whole.[87]

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[81] See [74].
[82] See paragraphs 1.19 to 1.35 of the 1995 OECD Guidelines.
[83] See [73].
[84] See [126] to [150].
[85] See [105].
[86] See [126].
[87] See [131].

The intra-group sales of all of the copper concentrate produced by the CSA mine by CMPL to GIAG were required to be made pursuant to a "life of mine" offtake agreement that was entered into on 5 July 1999[88] Since that time CMPL has continued to sell its entire production to GIAG under a series of replacement and amending agreements[89]. There was a fundamental change to the pricing mechanism for these intra-group sales, first on an informal basis in January 2007[90], and then through a formal arrangement in February 2007[91]. That change involved a switch from a market-related basis to a price sharing basis. This is discussed in detail below. Her Honour noted that the taxpayer had conceded that GIAG did not deal at arm's length with CMPL in relation to the supply of copper concentrate on the terms of the February 2007 Agreement.[92] No evidence was adduced by the taxpayer about the negotiation of this agreement nor did the taxpayer put in issue whether, nor did it contend that, the February 2007 Agreement was a negotiated agreement and an arm's length dealing.[93]

GIAG marketed the copper concentrate on behalf of the Glencore Group[94] and "***for the most part"*** on-sold the concentrate it purchased from CMPL to independent smelters in Japan, Korea, India, The Philippines and China[95] that further processed and refined the concentrate to produce pure copper[96].

While not expressly stated in the judgment, it can reasonably be concluded, having regard to the structure of the copper concentrate market[97], that the unquantified balance of CMPL's production was sold by GIAG on the spot market. The largely consistent evidence of the expert witnesses was that, market-wide, sales to smelters accounted for around 80% of all sales to independent parties and that there was also a spot market for copper concentrate, which accounted for approximately 20% of all sales to independent parties.[98] In the context of the evidence being considered, while no timeframe is stipulated, it can reasonably be concluded that the respective allocations to smelters and the spot market that were heavily weighted in favour of the smelters were an enduring characteristic of the copper concentrate market generally given the essential role of smelters in copper metal production and the long term "symbiotic"[99] relationships needed to support the operations of both the miners and the smelters.

While the evidence noted the allocation of the global inventories in overall terms, there was no finding by the Court as to how much of CSA's production was sold to smelters and how much was sold on the spot market. The management of the group's copper concentrate inventory as a whole, and of the output of the CAS mine, were matters that fell within the scope of GIAG's marketing, trading and logistics functions. It is noted that prior to the

[88] See [162].
[89] See [108].
[90] See [148].
[91] See [3] and [321].
[92] See [28].
[93] See [171].
[94] See [106] and [172].
[95] See [1] and [109].
[96] See [68].
[97] According to the evidence at [69] the copper concentrate market comprised the miners, smelters and traders and within which copper concentrate could be sold under long term arrangements with a smelter or a trader, or on the spot market.
[98] See [67] and [69].
[99] See [70].

February 2007 agreement the allowance for costs associated with the treatment and refining of CSA's production was based on 50% reflecting the Japanese benchmark set by their smelters and 50% reflecting the spot market[100]. It is open to conclude that this proportioning was based on the relevant business data, bearing in mind GIAG's close governance of the group's business operations and its role in marketing its copper concentrate inventory, including CSA's high grade copper concentrate, which in 2006 represented only about 0.2% of world copper concentrate production[101]. It seems clear that GIAG's role included the use of its market position as the largest seller of copper concentrate at that time[102] to negotiate the best results for the Glencore Group as a whole. There is no evidence recorded by her Honour that provides an alternative quantification to the 50/50 allocation, though she makes the general observation that "[t]he evidence was that GIAG mostly sold the copper concentrate produced at the CSA mine to smelters…"[103]

The copper concentrate sold by CMPL to GIAG was either shipped as required or warehoused at the CSA mine site in Cobar or at facilities at the Port of Newcastle[104]. GIAG arranged transport and logistics and associated documentation and services like letters of credit, invoices, bills of lading, arranging assays and addressing any shortfalls in contractual specifications for ore content[105].

Quotational period options for determining the copper reference price

The TCRCs and "other adjustments for the payable copper content in the copper concentrate"[106] are calculated by reference to a copper price, which is determined in accordance with the options for the selection of a reference period that are provided in the contract. Her Honour gave the following overview based on the "largely consistent"[107]expert evidence provided:

> 75. Quotational periods vary from contract to contract but are typically linked either to the month of shipment of the copper concentrate from the port of embarkation or the month of arrival of the concentrate at the point of disembarkation. The quotational period can be specified as a single day, a week or a month. Where the quotational period is longer than a day, the average of the published daily settlement prices for the chosen quotational period is used. For example, for a contract with a quotational period of M+1, the average daily London Metal Exchange prices in the calendar month after the month of shipment are used to calculate the price of the copper concentrate.
>
> 76. Offtake agreements can contain one quotational period or multiple quotational periods for a given payable metal and, where multiple quotational periods are identified, the contract will stipulate the process for selecting which quotational period will apply (known in the industry as "quotational period optionality"). Additionally, some contracts allow the buyer to choose from several quotational

[100] See [170].
[101] See [111].
[102] See [107].
[103] See [109].
[104] See [1] and [109].
[105] See [109].
[106] See [73].
[107] See [67].

periods where the price in at least one quotational period is known at the time of selection. This type of optionality is commonly referred to in the industry as "quotational period optionality with back pricing".

77. Relevant quotational period abbreviations and their meanings include:

2MPMOSS Two months prior to month of scheduled shipment

1MPMOSS Month prior to month of scheduled shipment

M-1 Calendar month prior to month of shipment

M or MOS Calendar month of shipment

M+1 Calendar month following month of shipment

M+2 Second calendar month following month of shipment

M+3 Third calendar month following month of shipment

M+4 Fourth calendar month following month of shipment

M+5 Fifth calendar month following month of shipment

1MAMA Calendar month after month of arrival

2MAMA Second calendar month after month of arrival

3MAMA Third calendar month after month of arrival

4MAMA Fourth calendar month after month of arrival

5MAMA Fifth calendar month after month of arrival[108]

In the first offtake agreement between CMPL and GIAG that was entered into on 5 July 1999 there was one quotational period for material produced after 1 July 1999, which was the month following the month of production, with this single quotational period to remain valid for the life of the mine.[109] This was amended on 1 October 2004:

(a) For shipments during October 2004 until December 2004 to allow, at GIAG's option, one of three quotational periods to be declared on a shipment by shipment basis by, at the latest, the end of the second month following the month of arrival of the carrying vessel at the discharge port; and

(b) For shipments from January 2005 onwards the quotational period for copper was, at GIAG's option:
   (i) one of two classes, each of three quotational periods, to be declared on an annual basis at the time of negotiation of the terms for the new contractual year; and
   (ii) then, within each of those two classes, one of three quotational period options to be declared on a shipment by shipment basis by GIAG at a later time.[110]

This increased range of quotational pricing options was continued into an amended agreement entered into on 1 January 2005.

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[108] See [75] to [77].
[109] See [162].
[110] See [163].

A series of amendments appear to have been made to the 1 January 2005 agreement[111] but no changes in quotational periods are noted until a further amended agreement on 12 December 2005 made the following provision:

> (a) the quotational period was, at GIAG's option, either linked to the month of shipment of the copper concentrate or the month of arrival of the shipment, with the choice to be declared by GIAG on an annual basis at the time of negotiation of the terms for the new contractual year (1 January to 31 December). With either choice, GIAG had the option to select from three quotational periods with the quotational period to be declared on a shipment by shipment basis."[112]

These arrangements were amended by the 2 February 2007 agreement which provided that:

> (a) the election to be made by GIAG as to whether to link the quotational period to the month of shipment of the copper concentrate from the loading port of embarkation or the month of arrival of the copper concentrate at the port of disembarkation was to be made prior to each shipment from the loading port.[113]

The pattern that emerges from the evidence is that there was a significant expansion in quotational period options over the period from the 5 July 1999 agreement to the 2 February 2007 Agreement.

Market practices for the setting of TCRCs

Once a copper reference price is established on the basis of the quotational period options in dealings between independent parties in the open market, the next key step in determining the price for copper concentrate is the allowance that is made for TCRCs.

Davies J summarised the "largely consistent" evidence of three mining industry experts and Mr Kelly in relation to TCRCs as follows:

> 78. The notional purpose of TCRCs is to cover smelting and refining costs and to provide the buyer (whether a trader or smelter) with an element of profit but, as Mr Wilson explained, the actual TCRCs negotiated 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. As with copper metal prices, TCRCs are highly volatile and from time to time TCRCs and copper metal prices move in opposite directions.
>
> 79. TCRCs in long-term agreements can include both benchmark TCRCs and spot TCRCs and can be with or without price participation (with price participation, "**TCRCPP**"). Benchmark TCRCs, along with the level of any price participation, are established annually between major concentrate buyers and sellers during the so-called copper concentrate "mating season" that starts in around September of each year. Negotiations continue until TCRCs and the level of price participation are agreed between a major copper concentrate buyer and seller and these become the "benchmark" that may be adopted, with relevant adjustments, by other buyers and

[111] See [165].
[112] See [166].
[113] See [167].

sellers that use this style of contract. In long-term contracts adopting the benchmark TCRCs, the TCRCs are usually negotiated annually and are subject to significant variations from year to year.

80. Prevailing spot TCRCs reflect the market dynamics at a particular point in time and can be very volatile and vary greatly throughout a year. The spot TCRC will usually bear little, if any, relationship with the benchmark TCRC and may exceed or be well below the benchmark TCRC.[114]

The setting of TCRCs prior to and after the February 2007 Agreement

It appears that both the original pricing formula and the subsequent January/February 2007 pricing formula used the London Metal Exchange cash price for copper grade A averaged over a "quotational period" as the starting reference point for determining the pricing of copper concentrate since no change is reported in the judgment in respect of this aspect.[115] The Court accepted that the price for refined copper is typically set by reference to the price quoted on a metal exchange such as the London Metal Exchange[116], one of three metal exchanges and the largest in terms of the volume of copper and other metals transacted[117]. However, the pre- and post February 2007 pricing frameworks made significantly different allowances for TCRCs.

In what is known as the "custom concentrate market", where, as was the case with the Glencore Group, producers and marketers do not have smelting operations integrated into their production processes, the smelters acquire the copper concentrate directly from miners or through trading companies like GIAG, or through the metal exchanges.[118] The smelters also acquired copper concentrate from GIAG as the parent company of CMPL. The work involved by the smelter depends on the composition of the copper concentrates, which are highly variable in respect of their key elements (copper, iron, sulphur, and various precious metals such as gold and silver) and the presence and level of impurities. Accordingly, each smelter has different requirements as to the copper concentrate it purchases, based on its treatment processes and capabilities.[119]

Davies J accepted that the notional purpose of TCRCs is to cover smelting and refining costs and provide the purchaser of copper concentrate (whether a trader or a smelter) with an element of profit, but that ***in practice actual TCRCs negotiated are a result of market forces*** and often bear little relationship to the actual cost of treatment, and like copper metal prices, TCRCs are highly volatile but can from time to time TCRCs and copper metal prices can move in opposite directions[120].

Over the period 2006 to 2009 Glencore's marketing team had approximately 2,500 employees in 40 offices and in 2006 it was the largest seller of copper concentrate in the world, its sales being sourced from mines it owned, or in which it had an interest, as well

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[114] See [78] to [80].
[115] See [3].
[116] See [72].
[117] See [74].
[118] See [69].
[119] See [68].
[120] See [78].

mines owned by third parties.[121] It was acknowledged by her Honour that GIAG's status as a major player gave it negotiating and bargaining power in dealings with independent parties over matters affecting the pricing of the copper concentrate it was selling[122], like the allowance that would be made for TCRCs. This was particularly the case where, as in the *Glencore Case*, the Court observed:

> …both experts did agree that it was their analysis of the market as at early 2007 that ***balances for copper concentrates in 2007, 2008 and 2009 were likely to be tight and there was therefore an expectation that a significant increase in TCRCs was a relatively low probability***.[123] [Emphasis added.]

However, as the Court observed, relying on the authoritative Brook Hunt Report and the taxpayer's evidence, that while the market forecast a shortfall of copper concentrate stocks relative to smelter demand in 2007, it was "inherently uncertain" what stock levels would be and the copper concentrate market was:

> notoriously complex and is driven by many variables. An understanding of the key variables and their influence on this market is critical in assessing the outlook for concentrate supply and demand and hence treatment and refining charges (TCRCs). All too often concentrate market projections are based solely upon forecasts of mine supply/smelter demand ***in isolation to these other variables***, with the result that these forecasts are effectively meaningless.[124] [Emphasis added.]

In other words, neither did the Brook Hunt Report or the Court conclude that the evidence about the supply and demand for copper concentrate was not relevant or probative, but that it had to be weighed with evidence of how the other key drivers impacting on the copper concentrate market affected the reliability of predictions. Some of these drivers would be common to those impacting on the demand (and hence the price) for copper metal, like: global industrial activity; overall copper metal inventory levels in London Metal Exchange approved warehouses; the value of the US dollar against other currencies; the general copper supply/demand outlook; and changes to metal supply and demand, such as disruptive elements like industrial action, flooding, and earthquakes[125]. Others would be particular to CMPL, like its cost structure, operational efficiency and the likelihood of any disruptions as best they could be gauged in the lead up to the February 2007 agreement.

It is also noted that Davies J agreed with the evidence of the Commissioner's witness, Mr Ingelbinck that:

> The relationship between non-integrated mines and custom smelters is largely a symbiotic one. A copper concentrate producer who does not have a home to monetise its production has a serious problem. So does a custom smelter who does not have sufficient primary raw material supply to run its operation. This is reflected in the fact that ***in my experience the vast majority of copper concentrate purchase/sales agreements are structured on a long-term basis*** which provides the seller with a guaranteed home for its output, the buyer with security of raw material feed and

[121] See [106] and [107].
[122] See [181].
[123] See [103].
[124] See [102]
[125] See [74].

allows both parties to avoid a greater degree of volatility in commercial terms which tends to prevail in the spot market.[126]
[Emphasis added.]

While CMPL did not deal directly with the smelters[127], it was part of an integrated production and marketing/trading business conducted by the Glencore Group as a whole, Mr Ingelbinck's comments are relevant to the nature of the relationships between the Glencore Group and the independent smelters and, given it is a statement about the fundamental nature of the copper concentrate market, including as it operated in February 2007, it can reasonably be accepted that the features outlined by Mr Ingelbinck would have a bearing on how negotiations would have been conducted between GIAG and the smelters around the time that the pricing formula for sales from CMPL to GIAG was reset in February 2007. The fact that GIAG was the major player in the copper concentrate market in 2006[128] is evidence that it had significant skill and power in bargaining with independent smelters and on the spot markets.

The switch from a market-related agreement to price sharing

Up until the 2 February 2007 amendment, the pricing framework for offtake agreements covering the sale of copper concentrate by CMPL to GIAG were structured as "market-related" agreements. In February 2007, CMPL and GIAG formally entered into a fundamentally different form of pricing framework ("**the February 2007 Agreement**"), known in the copper concentrate industry as a "price sharing agreement". The volumetric supply of copper concentrate was not affected by these changes to the pricing frameworks. This arrangement appears to have operated on an informal basis since January 2007.[129] The copper concentrate which CMPL sold to GIAG in the relevant years was priced by using, as a reference point, the official London Metal Exchange cash settlement price for copper grade "A" averaged over "the quotational period". The "quotational period" was, at GIAG's option, either linked to the month of shipment of the copper concentrate from the loading port of embarkation or the month of arrival of the copper concentrate at the port of disembarkation. Within either alternative, GIAG had the option to elect one of three quotational periods 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 (known in the copper concentrate industry as "quotational period optionality with back pricing"). A deduction was then made from the copper reference price for treatment and copper refining charges ("**TCRCs**") which, for the calendar years 2007, 2008 and 2009, were fixed under the February 2007 Agreement at 23% of the copper reference price (as calculated) for the payable copper content of the copper concentrate. In the copper concentrate industry, the fixing of the TCRC deduction as a percentage of the copper reference price is known as "price sharing".[130]

The state of the copper concentrate market around February 2007

Two of the expert witnesses, Mr Wilson and Mr Ingelbinck, who had been engaged by Glencore and the Commissioner respectively, gave evidence that a mine producer and buyer

[126] See [70].
[127] See [1] and [109].
[128] See [106] and [107].
[129] See [148].
[130] See [3].

would have regard to available information as to the state of the market in late 2006 and to the forecasts for copper prices and TCRCs for the period 2007 to 2009 in deciding what terms to agree to at the start of 2007. Her Honour found:

> 93 It was common ground between the experts and, similarly, it was the evidence of Mr Kelly, that market participants, including miners, traders and smelters, access information in relation to the copper market and particularly the copper concentrate market from industry publications such as the Brook Hunt Reports (which Mr Wilson authored/edited for around 30 years). The Brook Hunt Report presents a global analysis of the market each year. Mr Kowal and Mr Ingelbinck both acknowledged that Brook Hunt is an authoritative resource and, whether accurate or not, influences negotiations in the copper concentrate market. Mr Kowal and Mr Ingelbinck each gave evidence that they relied upon Brook Hunt publications to support their opinions in these proceedings.
>
> 94 It was also common ground between Mr Wilson and Mr Ingelbinck that a mine producer and buyer would have regard to available information as to the state of the market as at 2007 and over the period 2007 to 2009 in deciding what terms to agree to at the start of 2007. In oral evidence Mr Ingelbinck said:
>
>> So the Brook Hunt Report is well recognised and well respected. It is one of a number – actually a fairly limited number of reports that are issued on this particular industry. There's only really two of three that are worth reading and I think Brook Hunt is probably the most respected. Mining companies are always faced with decisions as to what to do, what makes sense, what doesn't make sense. They will most certainly pay close attention to reports like the Brook Hunt Report. They will check and verify that there is – there appears to be a degree of consensus between the different reports issued by different independent parties.
>>
>> They will – depending on how large the mining operation is and what their resource are – they will have done extensive work of their own to try and analyse where the market conditions are so they will look at various inputs to eventually make a decision as to whether a particular approach is more sensible than another approach.
>
> 95 Mr Kelly's evidence was to like effect, saying in cross examination that "we certainly reviewed the Brook Hunt Reports" though qualifying that "Glencore certainly had its own position" and would, from his experience, "calculate, quantify supply and demand, assess qualities on a quality by quality basis, form a view on credit, and – and trade around that as well.

Davies J noted the following evidence that was before the Court in relation to copper prices, TCRCs and copper concentrate stocks as they were forecast just prior to the time when the February 2007 Agreement was put in place:

> 98 …Brook Hunt's estimates as at December 2006 of the London Metal Exchange price moving forward were that, for 2007, in money of day terms, the

copper price would be around US$2.70/lb, in 2008 US$2/lb, in 2009 US$1.34/lb and in 2011 less than US$1/lb.

99 At the end of 2006, the Japanese benchmark TCRCs for the 2007 year were set at US$60/dry metric tonne ("**dmt**") and US6.0c/lb or US15.4c/lb for 30% concentrate, with price participation for benchmark TCRCs having been set at zero. The Japanese benchmark TCRCs for the 2008 and 2009 years would not be set until later in the 2007 and 2008 years respectively but were forecast to be around the same mark as follows:

Year	TC ($/dmt Conc)	RC (c/lb)	PP (c/lb)	Combined (c/lbCu)
2007	60	6.0	0.0	15.4
2008	65	6.5	0.0	16.7
2009	60	6.0	0.0	15.4

102 The Brook Hunt Report's analysis of the market forecast a shortfall of copper concentrate stocks relative to smelter demand in 2007…

103 Whilst Mr Ingelbinck disagreed with Mr Wilson about the reliability of market projections based on forecasts of supply and demand, both experts did agree that it was their analysis of the market as at early 2007 that balances for copper concentrates in 2007, 2008 and 2009 were likely to be tight and there was therefore an expectation that a significant increase in TCRCs was a relatively low probability. Mr Wilson's view at the time was that it was highly unlikely that TCRCs would go above US$70 a tonne in the following three years.

Mr Ingelbinck and Mr Kelly gave evidence that the Glencore Group would also have regard to its own forecasts. The following table shows the copper prices and TCRCs forecasts by the Glencore Group as shown in the 2007 budget[131] that was prepared around August or September 2006[132], noting that budgets required GIAG approval[133]. The table compares these to the Brook Hunt forecasts and the TCRCs of 23% of the copper reference price that was set in the February 2007 Agreement:

USD	2007	2008	2009
Cu Price (Glencore)	2.54/lb	2.27/lb	2.04/lb
Cu Price (Brook Hunt)	2.70/lb	2.0/lb	1.27/lb
TCRCs (Glencore)	0.167/lb	0.218/lb	0.192/lb
TCRCs (Brook Hunt)	0.154/lb	0.167/lb	0.154/lb
TCRCs as % of Cu Price (Glencore)	6.575%	9.604%	9.412%
TCRCs as % of Cu Price (Brook Hunt)	5.704%	8.350%	12.126%
TCRCs per February 2007 Agreement	23.000%	23.000%	23.000%

[131] See [137] to [142].
[132] See [133].
[133] See (b) at [128].

Her Honour made the following finding in relation to the 2007 budget:

> The Court was asked to find, and I accept, that the Budget was based on what, at the end of 2006 and start of 2007, both the mine and GIAG considered to be reasonable figures for both the copper price and the TCRCs for the coming years.[134]

It is noteworthy that the 2007 budget was set on the basis of a market-related contract approach. It is also noteworthy that the January 2007 Management Report records the impact of the February 2007 Agreement and Mr Kelly was unable to explain why the impact on revenue to CMPL of the price sharing agreement was recorded in the January 2007 monthly management report.[135] It is clear that the behaviour of the parties anticipated the formalisation of the arrangement. However, that behaviour can be taken as evidence of an informal arrangement that operated between the parties that the price sharing approach with TCRCs set at 23% of the copper reference price was intended to operate for the full income year and was implemented informally until it could be formalised via the February 2007 Agreement.

The evidence clearly shows that market expectations were that a significant rise in TCRCs was a relatively low probability.[136] Setting the TCRCs at 23% of the copper reference price meant that, more likely than not, CMPL would suffer a much higher reduction in its revenues than was reasonably expected to be incurred under a market-related TCRCs setting. On the evidence, that reduction in CMPL's revenues was the natural and probable consequence of the February 2007 Agreement and can therefore be taken to be the intended objective of that agreement.[137] The asserted risk management and mine viability objectives presented as the rationale for the replacement of the pricing mechanism in the market-related offtake agreement with a price sharing framework are discussed below and, for the reasons stated there, can be seen to be based on false premises.

Glencore's rationale for the switch from market-related TCRCs to price sharing

In the light of the probability that CMPL would suffer a significant disadvantage in reduced revenue due to the allowance for TCRCs it would have to bear in moving from the market-related contract to a price sharing agreement, it is appropriate to consider the Glencore Group's rationale for the switch and whether CMPL obtained a commensurate benefit.

The rationale is clearly explained in the following excerpts from Davies J's judgment:

> 151 In cross examination, Mr Kelly's evidence was that if costs were a main focus for 2007, it was "very reasonable someone would look to try and focus on the costs line because [CMPL] can't control the revenue line". His evidence was that:
>
> > … if you can put in place a formula that can take out that volatility in the treatment charge as a margin on your revenue line, then I think that's 100% what you would do. Just like what

[134] See [143].
[135] See [148].
[136] See [103].
[137] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.

> CSA might have considered doing with its fuel costs or its electricity costs or locking in the price of tyres going forward.

152 It was then put to Mr Kelly that it would fly in the face of the aim of cost control to agree to a TCRC figure of 23% when, on CMPL's own conservative assumptions, that cost was estimated to be 6.5% of the assumed copper price (US16.7c TCRC over US$2.54 copper price). The following exchange occurred:

> MR KELLY: No, I don't agree with you. I think that CSA or CMPL will consider many factors and in an environment where the ore body is getting deeper, they're spending more money to access it, the risk of being able to access it and recover all that's there with the stresses of the geology, all those factors ultimately drive their cost of mining upwards. That's one thing that they can influence over. They cannot influence on copper price. At that point in time, they've got a very unreliable budgeting process, they've been unable to accurately forecast and budget any of their production numbers or cost numbers. And I think if you look at treatment charge and refining charge as being a cost of production, which in effect it is because it's a reduction to revenue, then I think they would certainly look at putting in a formula that meant that that cost ultimately moved with the price of copper they were able to sell for. What it did do was lock in a margin whereby, yes, if the price went up, their treatment charges went up, of course that's how it worked and they were able to enjoy the benefits of a higher price. But likewise when a treatment charge as a percentage of the price goes down because the price is falling, they're able to manage their costs so they aren't exposed to that volatility. And in the 2005/2006 period, you've got this market where TCRCs had gone up and then gone down, tracking spot against benchmark, they had been volatile, you had a change in the way benchmark was being established at the end of 2006. You had no price participation included in it for 2007. You had Japan's influence in the market falling and China stepping up in terms of total concentrates brought under benchmark. All these factors going on, you have a look at your operating costs on the market that you're referring to reference to, it is very reasonable someone has a look at trying to manage its costs versus any other alternative.
>
> COUNSEL: But, Mr Kelly, why would you agree to something that's nearly four times what, on your own estimation, is the reliable costs you've put in your budget moving forward?
>
> MR KELLY: Your calculations are based on a forecasted price that at the end of 2006, not one person, not one investment company, not one analyst was forecasting to continue any trend other than a downwards trend. I think the history of budgeting was such that – I think it's very reasonable someone

> would look to try and focus on the costs line because it can't control the revenue line.
>
> COUNSEL: But, Mr Kelly, another thing you referred to then is all the risk moving forward but we just went through the executive summary. It's a very positive picture, contained metal resources continuing to increase each year. This is not a mine that is identifying in its guiding planning document any uncertainty as to its production moving forward, is it?
>
> MR KELLY: No. I read these reports and I see increasing operating costs, increasing capital costs, falling grade, the need to expose alternative mining phases closer to surface because the geological risks at mining at depth – I see all of them identified in these reports as risks to mine so, no, I don't agree with you.

153 Mr Kelly agreed that for the 2008 year, based on the forecast copper price figure and TCRCs for that year in the 2007 Budget, the TCRC was around 9.6% of the forecast copper price. For the 2009 year, based on the forecast copper price figure and TCRCs for that year in the 2007 Budget, the TCRC was around 9.4% of the forecast copper price.

154 A line of cross examination then followed directed to showing that the decision to switch to price sharing left a margin for CMPL based on its budget for 2008 of only three to four cents per pound between the forecast costs and forecast copper price at 23% price sharing and put the viability of the mine at risk moving forward if fuel or other costs increased. A similar proposition was put for the 2009 year. Factually, the line of cross examination was directed to having Mr Kelly agree that the decision to switch to price sharing was one that would have rendered the CSA mine financially unviable based on its own budget and forecasts. Mr Kelly disagreed, saying that "it did the opposite" and "actually guaranteed the viability of it".

155 This line of cross examination was shown to be based on an incorrect premise as the Commissioner deducted forecast costs in AUD from forecast revenues in USD. The analysis in fact showed that the mine, based on its own budgets, would have predicted a healthy profit margin as at the end of 2006 based upon a switch to 23% price sharing in the following year.

156 ***I accept Mr Kelly's evidence that the switch to price sharing was one that might be expected to have "guaranteed the viability" of the mine.*** The taxpayer's unchallenged calculations of the margins for the 2007, 2008 and 2009 years of the 23% price sharing based on CMPL's forecasts in the 2007 Budget, correctly accounting for the currency difference in the line items, showed margins over total cost as a percentage of copper price and C1 cost as follows:
Budgeted margin over total cost [C3] *as a % of copper price:*

2007: 34.63%
2008: 25.39%
2009: 27.39%

Budgeted margin over C1 cost as a % of copper price:

2007: 39.09%
2008: 30.22%
2009: 31.51%

[In paragraphs [121] to [123] of the judgment her Honour cites the 2006 edition of Brook Hunt's Copper Costs, Mines and Project – Summary and Analysis Report which defined C1, C2 and C3 costs as follows:

> (a) C1 costs: the direct cash costs which include mining, milling and concentrating, on-site administration, smelting, refining, concentrate freight and marketing costs, amongst others, net of by-product credits (such as silver);
>
> (b) C2 costs: the C1 costs plus depreciation; and
>
> (c) C3 costs: the C2 costs plus interest and indirect costs.
>
> The cash cost (C1) and total cost (C3) provide the cash margin and the operating margin of the mine respectively.

In oral evidence Mr Wilson (who was the co-developer of the C1, C2 and C3 costing analysis) described the difference between cash cost (C1) and total cost (C3) of a mine in the following way:

> So the cash cost should be the sum of mining costs, processing costs, which would be milling, the on-site administrative costs, the cost of delivering product to the smelter plus the treatment and refining charges less any by-product credit so, for example, from the CMPL perspective, that would be a silver credit of several cents a pound, so that would be the cash cost. **The total cost** would be the sum of the cash cost plus depreciation and amortisation of the mine plus various corporate-type overheads, like an assigned overhead might also include royalty payments, expiration charges, basically anything else that can be allocated to that mine so that would then give you a fully allocated total cost.]

…

195 Mr Wilson's opinion was that it was reasonable and prudent for a company in the position of CMPL, as the operator of a high cost mine with C1 costs[138] placing it on the 90th percentile of copper mine costs, to replace the TCRCPP formula with the 23% price sharing formula which it adopted in 2007. Mr Wilson reasoned that market sentiment was predicting a steep decline in London Metal Exchange prices from US$2.70/lb in 2007 to US$2/lb in 2008 and down to US$1.27/lb in 2009. He pointed out that the TCRC market was highly volatile and that, in 2004, the TCRC was US13c/lb and, in 2006, it had trebled to US46c/lb. He explained that the switch to price sharing terms in 2007 removed one of the two unknowns by eliminating the volatility of TCRCs and, for a mine concerned with cost, if the mine could have guaranteed on the basis of Brook Hunt's price forecast it would still would have been

[138] See [121] where C1 costs are defined as the following items: the direct cash costs which include mining, milling and concentrating, on-site administration, smelting, refining, concentrate freight and marketing costs, amongst others, net of by-product credits (such as silver).

profitable, that would have been a very strong commercial incentive to switch to price sharing. He stated that, on the basis of its own cost budgets, it would have still made money at Brook Hunt's US$1.27/lb price forecast for 2009.

196 In his second report, Mr Wilson elaborated:

> ***In considering the shift away from a long-term/spot market contractual arrangement to price sharing in 2007***, I would reiterate what I stated in my previous report that ***as a high cost mine*** with C1 costs placing it on the 90th percentile of copper mine costs, ***it remains my opinion that it was commercially reasonable and prudent for CMPL to have adopted this mechanism***. In the end, ***the adoption of a price sharing arrangement such as that which was adopted by CMPL is a matter of commercial judgment having regard to the particular risk appetite and cost pressures facing a particular mine.***
>
> ***The use of full price sharing terms as set out in the CMPL-GIAG Contract in 2007 removed one of the two unknowns by eliminating the volatility of TCRCs.*** The absence of a price sharing floor gave CMPL added protection as the buyer was not guaranteed a minimum share of the price. ***It also meant that CMPL would have known precisely at any time during this three year contract what CMPL's net price would have been for any given copper price. Put another way, by fixing the TCRC at 23% of the copper price CMPL would have known with a high level of certainty the breakeven copper price for the CSA mine in each of the three years through the fixing of the TCRC. In my opinion, this is particularly important for a high cost mine such as CMPL*** which can quickly move into a loss position as copper prices decline (as was anticipated by market commentators in late 2006 and as shown by the [London Metal Exchange] forward price curve for copper). Although it is apparent in hindsight that copper prices did not decline significantly over the three year period, benchmark TCRCs did not increase significantly, and price participation was not reintroduced, ***the use of the price sharing arrangement was, in my opinion, a conservative and reasonable approach to minimising risk***. If copper prices had fallen significantly over the three year period and TCRCs had increased, CMPL could have endured serious financial difficulties.

197 Mr Wilson also noted that typically in a price sharing agreement a minimum floor exists below which the buyer's fee does not change, but the February 2007 price sharing arrangement did not have such a minimum floor. It was said by Mr Wilson that the absence of such a term provided further protection to the seller in that, as the copper price fell, CMPL's revenue would also decline proportionately but, if there was a floor, it would decline disproportionally and by a greater amount.

> 198 Mr Wilson's evidence was that between 2007 and 2009, the normal range of price sharing was 21-26%. In his experience the lowest price sharing contract was 20%.
>
> 199 Mr Wilson was tested on the opinion he expressed that it was reasonable and prudent for a company in the position of CMPL, in February 2007, to agree to a three year 23% price sharing agreement.
>
> 200 He was asked whether he agreed if, in 2007, there was an escalation of operating costs above projected costs as there had been in 2006 of around 30%, a decision at the start of 2007 to adopt a 23% price sharing agreement would put the financial viability of the CSA mine at risk. ***Mr Wilson disagreed that a hypothetical mine producer like CMPL would have had a concern about costs escalating in 2007 as he believed that cost escalation had peaked but, on the assumption he was asked to make, namely that CMPL had a concern that costs may escalate in 2007, Mr Wilson did agree that the decision to adopt a 23% price sharing agreement would put the financial viability of the mine at risk.***
>
> 201 ***Mr Wilson was asked whether, if the hypothetical mine producer followed the Brook Hunt forecast at the end of 2006, it would be highly likely that the mine producer would be worse off financially by agreeing to a three year price sharing agreement instead of remaining on the terms they had at the start of 2007. He agreed with that proposition.***
>
> 202 ***Mr Wilson was asked whether he agreed that according to CMPL's own forecasts it was highly likely that it would be worse off by going to a 23% price sharing agreement rather than remaining with the terms as at the start of 2007. He agreed with that proposition.***
>
> 203 However, Mr Wilson maintained ***it was reasonable and prudent for CMPL, in February 2007, to switch to the 23% price sharing agreement because CMPL in 2009 could have guaranteed, under a 23% price sharing contract, it would have remained profitable and covered its cash production cost. He confirmed his opinion that even if CMPL went to 23% price sharing in February 2007, it was likely to remain profitable. But when asked whether he agreed if CMPL's aim was to be as profitable as possible, the commercially rational thing to do in February 2007 would have been to stick with the current terms, which were part benchmark and part spot, Mr Wilson replied that he did agree.***
> [Emphasis and commentary on costs following the citation of [156] of her Honour's judgment have been added.]

It can be observed from the 2007 budget that was prepared towards the end of 2006, and which GIAG approved[139], that CMPL was highly likely to suffer a significant reduction in its revenues once the 23% price sharing formula in the February 2007 Agreement (and the informal arrangement during January 2007 that preceded that formal agreement) was put in place.

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[139] See [133].

There is no evidence that any contemporary objective cost/benefit analysis was done to determine whether CMPL was more likely than not to derive sufficient economic benefit from the price sharing agreement to justify the switch from its pre-existing market-related agreement.

On the evidence of market practice and market conditions at the time, it was highly likely that the significant increase in TCRCs under the February 2007 price sharing agreement entailed a significant cost to CMPL without any commensurate benefit. The purported risk mitigation rationale for the switch from a market-related basis to a price sharing basis for pricing TCRCs in relation to the intra-group sales from CMPL to GIAG in order to remove volatility in TCRCs and between TCRCs and copper prices is unsound in the context of the integrated mining, marketing and trading business being conducted by CMPL and GIAG. (This purported rationale is examined in more detail in the next section of this paper). The evidence as a whole shows that "the natural and probable consequences"[140] of the switch from the market-related agreement to a price sharing agreement were the reduction in the profit of CMPL by reduction in its revenues, and the commensurate increase in the profit of GIAG in the 2007, 2008 and 2009 income years by reducing the prices it paid to acquire copper concentrate from CMPL.

TCRCs and the management of inventory risks related to CSA mine production

The Court accepted the expert advice that the advantage to the miner, namely CMPL in this case, of an entire production offtake agreement is that the miner is guaranteed that all of its production will be sold as and when it is ready to be shipped - which effectively transfers risk to the buyer, in this case from CMPL to GIAG[141]. The marketing of commodities, selling commodities to smelters, arranging the logistics needed to deliver those commodities to buyers in accordance with Glencore's contractual obligations, performing quality control, managing trade finance and generally managing the risk that Glencore was exposed to by virtue of the purchase and sale of commodities were the responsibilities of Glencore's marketing team.[142]

When considered at an entity to entity level, a key component of the risk transferred as a consequence of the life of mine offtake agreement[143] was in relation to the volume of production that was sold by CMPL to GIAG. Another key component of risk was the exposure to market forces impacting on the supply and demand for copper, which in turn impacted on the price of copper and the demand and price for copper concentrate, and in turn affected the overall value of the inventory. Associated with these risks were those related to the relative movements in TCRCs and copper prices. In these respects, it is noted that GIAG owned CMPL and it was not in dispute that GIAG exercised financial and managerial control over the CSA mine in the relevant years[144]. Nor was it in dispute that CMPL and GIAG were conducting an integrated mining, marketing and trading business.[145] The financial and managerial control exercised by GIAG included the provision of mining assistance, planning, budgeting, and performance management. In particular, the oversight included "reviewing the

[140] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.
[141] See [71].
[142] See [106].
[143] See [38].
[144] See [126].
[145] See [105].

mine's operating numbers and analysing them and liaising with the mine's general manager based on this analysis"[146]. The financial control included the approval of CMPL's operating budgets, capital expenditure requirements and meeting any other cash requirements the mine may have from time to time.[147]

It is clear from Mr Kelly's evidence, accepted by the Court, that the planning and management function, oversighted and approved by Glencore, included target levels of production of copper concentrate and the performance of the CSA mine against those targets.[148] The picture that clearly emerges from the evidence is that the operations of CMPL and GIAG were highly integrated[149] and that GIAG was, subject to operational contingencies, in a position to control the production levels of the CSA mine which would become available to GIAG in its trading operations. In fact, GIAG was in a position to cease mining operations at the Cobar mine, as was the case for a period after Glencore acquired the CSA mine in 1998 when mining operations were kept in suspension before operations recommenced in 1999.[150] In other words, GIAG was able to control the risks associated with production levels and inventories insofar as they related to the volumes of copper concentrate it would be obliged to buy under its life of mine offtake agreement with CMPL.

In any event it is clear from the purchase of the CSA mine in 1998 by the Glencore group and its retention that the mining operations were seen as a strategic and integrated component of Glencore's copper concentrate trading business[151]. Based on the evidence of the management and control exercised by GIAG over inventory levels and the shipments of copper concentrate, and conversely the lack of control CMPL had over the full range of risks related to the copper concentrate inventory, an independent miner in the position of CMPL would be unlikely to agree to take on substantial inventory risk, a view that is supported by the 1995 OECD Guidelines.[152]

Glencore's marketing division had exclusive responsibility for marketing commodities and "generally managing the risks that Glencore was exposed to by virtue of the purchase and sale of those commodities"[153]. This included the risks associated with the purchases and sales of the copper concentrate from the CSA mine. All of the expert witnesses agreed that the advantage to a miner, in this case CMPL, of an entire production offtake agreement is that the miner is guaranteed that all of its production will be sold as and when it is ready to be shipped, which effectively transfers risk to the buyer, in this case GIAG.[154] Those risks included potential loss of the physical inventory itself (for example, if a shipment were lost in transit) and any risk associated with the potential movements and volatility in copper prices and TCRCs. Insofar as market fluctuations in TCRCs are concerned, the risk would present where and to the extent (if any) that: market-related TCRCs increased by an amount that was not proportional to, or not covered by, increases in copper prices; or market-related TCRCs increased and copper prices fell; or market-related TCRCs remained constant and copper prices fell. The extent of the risk depended on the relative size of the respective increases and decreases and their impact on the remaining margin available to the group to cover the costs

[146] See (a) of [127].
[147] See [127] to [129] and [133].
[148] See [140] and [149]
[149] See [105].
[150] See [2].
[151] See [105].
[152] See paragraph 1.27 of the OECD 1995 Transfer Pricing Guidelines.
[153] See [106].
[154] See [71].

of producing copper concentrate, this process being referred to in the evidence as knowing "the breakeven copper price" of the CSA mine[155].

CMPL was not authorised and did not have the expertise, resources or the capacity from its subsidiary position (where it was divorced from the function of selling to external independent parties) to manage the risks associated with movements in market-related TCRCs and movements in copper prices. That was the responsibility of Glencore's marketing team.[156] Since CMPL was not authorised to sell to independent parties[157] it was not realistically in a position to manage these economic risks by the use of price sharing agreements.

In terms of commercially rational approaches, the question of whether the volatility in market-related TCRCs and the volatility between market-related TCRCs and copper prices were risks for Glencore's copper concentrate business that needed particular remedial action is one that would have had to be addressed in relation to the integrated mining, marketing and trading operations as a whole. It does not make commercial sense for that risk to be addressed separately by each of the mining, marketing and trading components of that business. Nor does it appear commercially rational that it be addressed merely in respect of the relatively small proportion of the group's total copper concentrate inventory (the part that was produced by the CSA mine and was the subject of the sales of copper concentrate by CMPL to GIAG).

In any event any risk that the volatility in market-related TCRCs and the volatility between market-related TCRCs and copper prices presented for the overall integrated business in terms of overall profitability could not be addressed by the terms of the intra-group dealings between CMPL and GIAG.

Observations in relation to the evidence

The following observations can be made about her Honour's findings in relation to the evidence presented:

1) GIAG was the parent company of CMPL[158] and owned the CSA mine through two GIAG subsidiaries[159], having acquired the mine in 1998[160];
2) The Glencore Group seeks to derive value from its investments in industrial assets, including mines like the CSA mine and associated infrastructure like ports and rail, by operating those assets, conducting marketing/trading activities in respect of the commodities produced by those assets and from the integration of those operational and marketing activities. Moreover, through the integration of its marketing activities with the industrial assets it invests in, it can optimise the logistics required to process raw materials and deliver the end product (in this case copper concentrate) to its customers;[161]
3) There were conditions operating between GIAG and CMPL which differed from those that might be expected to operate between independent parties dealing wholly at arm's

[155] See [196].
[156] See [106].
[157] See [106].
[158] See [1].
[159] See [51].
[160] See [2].
[161] See [105].

length with each other …and such conditions included GIAG's control and management of the CSA mine[162];

4) Mr Kelly, the asset manager of the CSA mine (while an employee of GIAG and a director of CMPL and the two GIAG subsidiaries that owned the CSA mine[163]) exercised financial control over the CSA mine and did so "with a view to maximising profit for the Glencore Group" as a whole[164] rather than maximising CMPL's profit;
5) Because CMPL was not a standalone miner in the relevant years the task of ascertaining the consideration that might reasonably be expected to have been paid to CMPL for the copper concentrate that it sold to GIAG is not to be undertaken upon the hypothesis that CMPL was not a member of the Glencore Group[165];
6) There was nothing in the contemporaneous documents which identified any uncertainty for the mine in relation to its capacity to continue mining in 2007, 2008 or 2009 or to suggest that CMPL considered that there was any real risk that its level of production would not continue throughout those years. Indeed, the review of the 2006 year set out in the 2007 Budget noted that mine production of ore in 2006 had increased by over 30% to 810,000 [tonnes per annum] and concentrate production in 2006 would be "an all-time record for CSA". It also stated that "this [had] been achieved even with high turnover in both staff and AWA positions and finishing the year with over 20% vacancies in staff position [sic] due to the extremely difficult employment market"[166];
7) Planning, budgeting, business and cashflow management and treasury operations in relation to CMPL and the CSA mine were centrally managed and approved by GIAG.[167] There had never been a case where CMPL's capital expenditure and cash requests had not been approved by GIAG[168], including significant capital funding in 2005 and 2006 on works to elevate mine production levels and improve the long-term productivity of the mine.[169] Between 1999 and 2009 Glencore also provided ongoing assistance and expertise to CMPL through a dedicated asset manager, human resource contributions, mining expertise and treasury services clearly showing that the investment in the CSA mine continued to have the support of the Glencore Group in the relevant income years;
8) Under the life of mine offtake agreement that commenced on 5 July 1999[170] and a series of replacement and amending offtake agreements on 1 October 2004, 1 January 2005, 20 April 2005, 21 June 2005, 7 July 2005, 21 July 2005, 5 December 2005, 12 December 2005, 2 March 2006, 14 August 2006, 2 February 2007, 3 February 2007, 23 April 2007 and 6 May 2009, CMPL was required to sell all the copper concentrate produced at the CSA mine to GIAG.[171] The role of GIAG within the Glencore Group in the relevant income years, insofar as relevant to the facts and circumstances of the present case, was to market and sell to independent parties, namely to smelters or on the spot market, copper concentrate that originated either from mines that it owned (like the CSA mine), or others in which it held an interest, as well as mines owned by third parties.[172]

[162] See [110], [126] and [132].
[163] See [51].
[164] See [131].
[165] See [181].
[166] See [120].
[167] See [126] to [129].
[168] See [129].
[169] See [119].
[170] See [162].
[171] See [108] and [162] to [168].
[172] See [107] and [109].

GIAG mostly sold the copper concentrate produced at the CSA mine in the relevant years to smelters in Japan, Korea, India, the Philippines and China[173];

9) There is no finding recorded in relation to the extent to which GIAG purchased copper concentrate from producers it did not control in the 2007, 2008 and 2009 income years or the relevant terms and conditions, though the evidence records that it bought from those sources[174]. Nor is there any evidence of the full extent of GIAG' sales to independent parties in those years or of the terms and conditions on which it generally sold its copper concentrate inventory. The terms and conditions on which it purchased and sold in dealings involving independent parties is relevant to an evaluation of whether the terms and conditions pertaining to the price sharing and back pricing optionality are truly representative of the way that the Glencore Group generally dealt with independent parties. The taxpayer did not put such evidence forward, relying instead on limited evidence of contracts containing price sharing arrangements[175] and contracts containing back pricing optionality[176]. (See also point 23 below);

10) In the organisational context in which CMPL and GIAG were operating as part of an integrated business model GIAG had exclusive responsibility for marketing the copper concentrate produced by the CSA mine and for managing the risks that Glencore was exposed to by virtue of the purchase and sale of that copper concentrate, risks that GIAG assumed under the entire production offtake agreement as and when it purchased the copper concentrate from CMPL.[177] Those risks included those associated with the potential movements in copper prices and TCRCs. CMPL was not authorised or resourced to manage those risks;

11) During the period from 5 July 1999 to January 2007 when a price sharing framework was first introduced on an informal basis, a period of seven and a half years, the Glencore Group priced intra-group sales on a market-related basis and did not see the need to use a price sharing approach to internally manage the real world volatility in TCRCs and between TCRCs and copper prices;

12) CMPL adopted the price sharing framework that was formally established by the 2 February 2007 amendment (and as subsequently amended on 3 February 2007, 23 April 2007 and 6 May 2009) ***fundamentally changed*** the way in which copper concentrate would be priced in relation to the offtake agreement between CMPL and GIAG. Under the market-related contract like the one that was in place prior to January 2007[178] the TCRCs were set by reference to a benchmark set annually and/or spot terms with no correlation to the prevailing copper prices. Under a price sharing agreement like the February 2007 Agreement the TCRCs are fixed as a percentage of the metal exchange copper price for the duration of the contract so that the TCRC deduction and the metal exchange copper price are directly correlated to one another[179];

13) The February 2007 Agreement also changed the way in which quotational periods were to be determined for the purpose of calculating the applicable copper price on the intra-group sales between CMPL and GIAG. Under that agreement the election to be made by GIAG as to whether to link the quotational period to the month of shipment of the copper concentrate from the loading port of embarkation or the month of arrival of the copper

[173] See [109].
[174] See [107].
[175] See [251] to [276].
[176] See [277] to [306].
[177] See [71] and [106].
[178] The evidence shows the price sharing framework was introduced on an informal basis in January 2007 before it was formally introduced by the 2 February 2007 agreement. See [148].
[179] See [3] and [321].

concentrate at the port of disembarkation was to be made ***prior to each shipment*** from the loading port[180];

14) The pattern that emerges from the evidence is that there was a significant expansion in quotational period options over the period from the 5 July 1999 agreement to the 2 February 2007 agreement[181];
15) The taxpayer's rationale for the expansion of quotational period optionality was that if a trader buys concentrate under an agreement with a fixed quotational period and sells to smelters on the basis of various quotational periods it will bear the price risk resulting from different quotational periods; traders want to avoid this risk and will try to match the purchase and sale quotational periods or hedge the absolute price exposure; traders typically include quotational period optionality in an offtake agreement which gives them an opportunity, in addition to hedging, to minimise the price exposure risk arising from different purchase and sale quotational periods;
16) Being intra-group transactions the impacts of quotational period options between CMPL and GIAG do not affect the Glencore Group's price risk exposure in the copper concentrate market. They do not, in a real world sense, create price risk for GIAG, nor do they mitigate price risk. It is only if one impermissibly ignores CMPL's connection to the Glencore Group and the integrated copper concentrate business that one could reach that conclusion. However, at an entity level they may have an impact on the profitability of CMPL in Australia relative to the profitability of GIAG in Switzerland;
17) There was no evidence before the Court that would allow it to consider the likelihood and consequence of the price risk that the taxpayer asserted as the justification for the increasing range of quotational period options available to GIAG through successive amendments to the 5 July 1999 life of mine offtake agreement;
18) There is nothing in the February 2007 Agreement or subsequent amendments that affects the character of the agreement between CMPL and GIAG, namely the supply of 100% of the copper concentrate produced over the life of the CSA mine. All changes in terms and conditions relate to the way in which copper concentrate is priced;
19) There is no contemporaneous evidence of:
    a. any market survey of the pricing options that were realistically available in the copper concentrate market or any evaluation of any economically relevant differences between such options; or
    b. any regard in the course of establishing the new pricing formula to the respective functions performed by CMPL and GIAG, having regard to the assets used and risks assumed by each of the parties; or
    c. any regard being had in the course of establishing the new pricing formula, or at all, to the terms and conditions on which GIAG bought and sold copper concentrate in its dealings with independent parties; or
    d. any negotiation occurring between CMPL and GIAG in relation to the creation of the February 2007 agreement, nor did the taxpayer put in issue whether, nor did it contend that, the February 2007 Agreement was a negotiated agreement and an arm's length dealing[182]; or
    e. the articulation of the reasoning, the basis for the reasoning and cost/benefit analysis for:
        i. changing the pricing formula from a "market-related" pricing method to a "price sharing" method[183]; and

[180] See paragraph (a) of [167].
[181] See [162], [163], [165], [166] and [167].
[182] See [171].
[183] See [3] and [321].

ii. widening the range of quotational periods that could be used by GIAG to select the reference price it could adopt for calculating the consideration it would pay for the copper concentrate it bought[184];

f. any cost/benefit analysis in relation to the February 2007 Agreement

g. any risk analysis in relation to each stage of the integrated copper concentrate mining, marketing and trading business the Glencore Group was conducting of the likelihood and consequence of the risks the taxpayer attributed to volatility in TCRCs and between TCRCs and copper prices;

20) The ex post facto rationale advanced by Glencore and accepted by Davies J at trial for the fundamental change in the pricing formula in the February 2007 was that:

a. the CSA mine achieved record production of 140,452 dry metric tonnes in 2006 but its operating costs (in AUD) exceeded the budgeted costs by 31% and the C3 costs (the total metal costs including capital costs) exceeded actual costs by 37% and while profit and net revenue exceeded budget, this was attributable to an increase in copper prices that was not forecast or budgeted[185]. While not connected in the taxpayer's argument or in her Honour's reasons, the overrun in budgeted costs in 2006 coincided with the fact that mine production of ore in 2006 also increased by over 30% to 810,000 [tonnes per annum] and that concentrate production in 2006 would be "an all-time record for CSA"[186] All of the cost categories listed by Mr Kelly (fuel, tyre costs, mobile fleet costs, power, cement, labour and royalties[187]) can reasonably be expected to have increased as a result of increasing production, which allowed the group to take advantage of an increase in copper prices;

b. the ore body was getting deeper and the risk of recovering all that's there with the stresses of geology ultimately drive the cost of mining upwards[188]; there were increasing operating costs, increasing capital costs, falling grade, the need to expose alternative mining phases closer to the surface because [of] the geological risks [of] mining at depth.[189] However, all of these cost structure characteristics had been reflected in the 2007 budget estimates and the evidence was that cost escalation had peaked[190];

c. cost control was a main focus for the CSA mine and it was "very reasonable someone would look to try and focus on the costs line because [CMPL] can't control the revenue line"[191]; CMPL cannot influence the copper price.[192] While all of this is true, it does not provide a sound rationale for price sharing in respect of intra-group sales;

d. the notional purpose of TCRCs is to cover smelting and refining costs and to provide the buyer (whether a trader or a smelter) with an element of profit but the actual TCRCs negotiated are, in practice, a result of market forces and often bear little relationship to the actual cost of treatment and refining of copper concentrate.[193] This is true in relation to transactions between independent parties who are dealing at arm's length on the open market. However, further factors have

[184] See [162] to [168] and [277] to [306].
[185] See 134].
[186] See [120].
[187] See [135].
[188] See [152].
[189] See [152].
[190] See [200].
[191] See [151].
[192] See [152].
[193] See [78].

to be considered in relation to how market risks impact on the different functional elements in an integrated mining, marketing and trading business;

e. treatment charges and refining charges are in effect a cost of production because they are a reduction to revenue.[194] This is not correct. TCRCs are a reduction on gross revenue and are not related to the production of copper concentrate. TCRCs are not an element that CMPL could in any sense influence since it was prevented from selling to anyone other than its parent[195], the terms and conditions of those sales being set without negotiation[196];

f. as with copper prices, TCRCs are highly volatile and from time to time TCRCs and copper prices move in different directions.[197] This is an observation of market behaviour related to dealings between independent parties on the open market. It is not a sound rationale for the purported management of volatility risks at the level of intra-group dealings, which have no impact on those external risks;

g. if you can put in place a formula that can take out the volatility in the treatment charge as a margin on your revenue line, you would do that.[198] While this may be true in certain circumstances it does not present a sound rationale for the use of price sharing in relation to intra-group dealings;

h. a formula, that meant that the costs moved with the price of copper they were able to sell for, locked in a margin "whereby…if the copper price went up their treatment charges went up…and [CMPL] were able to enjoy the benefits of a higher price" and "when a treatment charge as a percentage of the price goes down because the price is falling, [CMPL are] able to manage their costs so they aren't exposed to that volatility".[199] This rationale is unsound in relation to the intra-group dealings within an integrated mining, marketing and trading business since price sharing at that intra-group level does not protect the integrated business from the economic and financial impacts of the volatility in TCRCs and between TCRCs and copper prices in the real (external) world where independent buyers and sellers deal with each other on a wholly independent basis (at arm's length) in the copper concentrate market;

i. there were many examples of price sharing agreements being entered into between independent parties. While these examples were not directly analogous to the February 2007 Agreement they were presented by the taxpayer as examples of price sharing agreements being entered into between independent parties.[200] While price sharing was one form of pricing framework, it was not the only type. For seven and a half years CMPL and GIAG operated under a market-related agreement, which was acknowledged as an alternative pricing framework in the copper concentrate market[201];

j. some price sharing contracts are entered into in circumstances where there is significant bank financing. The reason for this is that banks may require or the producer may deem it appropriate, to minimise its exposure to TCRC volatility so that it can have more certainty over its cashflow to service its debt. The same commercial strategy of wishing to avoid TCRC volatility and to obtain a more

[194] See [152].
[195] See [206] to [208].
[196] See [171].
[197] See [78].
[198] See [151].
[199] See [152].
[200] See [250] to [276].
[201] See [3], [162] and [321].

predictable cashflow is one that… many producers, particularly high cost producers, might reasonably be expected to adopt.[202] There is no evidence that CMPL's cashflow was under threat, even with a TCRC of 23% of the copper reference price;

k. the CSA mine was a high cost mine and the change to a TCRC based on 23% of the copper price "removed one of the two unknowns by eliminating the volatility of TCRCs" and then "CMPL would have known with a high degree of certainty the breakeven copper price for the CSA mine in each of the three years".[203] For the reasons already set out above this line of argument is unsound;

l. even though it was highly likely that the 23% price sharing agreement would mean that the mine producer would be worse off financially than if it remained on the terms it had prior to the February 2007 agreement[204], and because CMPL was likely to remain profitable, though not as profitable as possible, it was a conservative and reasonable approach to managing risk even though it precluded CMPL from maximising its profit.[205] The difficulty with this argument is that, as discussed above, CMPL was not in a position to effectively mitigate this risk so the rationale is unsound and "the natural and probable consequences"[206] of the February 2007 point to the real purpose and effect, namely to reduce Australian taxable profits and commensurately increase the profits of the Swiss parent;

m. it was reasonable and prudent for CMPL, in February 2007, to switch to the 23% price sharing agreement because CMPL in 2009 could have guaranteed, under a 23% price sharing contract, it would have remained profitable and covered its cash production cost and even if it entered such an agreement in 2007 it was likely to remain profitable.[207] This analysis does not address the question of whether the consideration for the supply of copper concentrate was an arm's length consideration for the purposes of Division 13 and Subdivision 815-A. The fact that a non-arm's length arrangement leaves the taxpayer in a profitable position does not prevent the operation of Division 13 or Subdivision 815-A to ensure that the consideration received for the supply of the copper concentrate is increased to an arm's length amount and that the taxable profit is calculated according to the conditions which might be expected to operate in the commercial and financial relations between independent enterprises dealing wholly independently with one another;

n. the switch to price sharing was one that might be expected to have "guaranteed the viability" of the mine[208] and going to a 23% price sharing agreement did not put the viability of the mine at risk but after taking into account the 23% price sharing agreement the margins "look pretty healthy" for a high cost mine.[209] The risk management rationale for the switch to price sharing is unsound when it is based on the pricing of intra-group dealings. The probable reduction in gross revenue is a significant issue for a high cost mine; and

o. the terms governing pricing under the contractual arrangements which applied to the 2007, 2008 and 2009 years were terms that existed in contracts for the sale of

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[202] See [275].
[203] See [195] and [196].
[204] See [201].
[205] See [196].
[206] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.
[207] See [195], [199] and [203].
[208] See [154] and [156].
[209] See [205].

copper concentrate between independent market participants[210] and were thus terms that might be expected to be found in an agreement between the relevant hypothetical parties[211]; and

p. price sharing conferred a benefit on CMPL by making its income cashflows more predictable and thereby ensured the viability of the CSA mine[212];

q. it was more important for the CSA mine to remain viable, rather than whether or not price sharing would have produced a better or worse profit for the mine[213];

21) In the copper concentrate market the negotiation of TCRCs in dealings between independent parties is the means by which traders and smelters cover their costs and provide themselves with an element of profit[214] and it is reasonable to conclude that all independent parties dealing wholly independently with each other in that market would have been cognisant of the fact that that is how the market works. In contrast, the terms and conditions on which CMPL and GIAG undertake intra-group transactions do not in a real world economic sense provide the integrated mining, marketing and trading business with a reward for the marketing and trading functions performed by GIAG. The source of that economic reward comes from the terms and conditions, including TCRCs, that GIAG is able to secure in its dealings with independent sellers and buyers;

22) In the organisational context in which CMPL was operating it was not in a position in relation to the February 2007 Agreement to deal at arm's length with GIAG[215] to optimise CMPL's profits.[216] It was conceded by the taxpayer that CMPL and GIAG did not deal with GIAG at arm's length in relation to the supply of copper concentrate on the terms of the February 2007 Agreement.[217] Nor did the taxpayer contend that it was a negotiated agreement and an arm's length dealing.[218] CMPL was required in February 2007 to adopt a copper concentrate pricing arrangement, rationalised at trial as a risk minimisation strategy purportedly to secure for CMPL the benefit of removing the volatility in TCRCs and the volatility between the movements in TCRCs and copper prices[219], an outcome it was incapable of achieving since the integrated mining, marketing and trading business was still exposed to those volatilities in the real world of its dealings with independent buyers and sellers;

23) The 23% of copper prices set as the allowance for TCRCs in the February 2007 Agreement impacted on CMPL as a discount on its sales revenues, regardless of CMPL's profitability, and regardless of whether CMPL was obtaining an appropriate economic return for its functions, assets and risks. This allowance left CMPL in the position where, as a separate corporate entity and leaving aside the financial support it continued to receive from its parent, it had to cover its relatively high cost structure and hopefully derive a profit margin from the remaining 77% of the relevant copper reference prices, subject to any further adjustment to sales revenues that may ensue from the manner in which the copper reference prices were set. This had an adverse effect on CMPL's revenues as a separate corporate entity;

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[210] See [250] to [306].
[211] See [344].
[212] See [275].
[213] See paragraph (a) of [189].
[214] See [78].
[215] See [171].
[216] See [203].
[217] See [28].
[218] See [171].
[219] See [78], [151], [152], [195], [196] and [201].

24) In the 2007 Budget prepared in late 2006 for the CSA mine (which had to be approved by GIAG[220]) the TCRCs for the 2007, 2008 and 2009 income years were forecast to be much lower than 23%. For the 2007 year it was forecast, based on the forecast copper price for that year, to be around 6.5% of the forecast copper price. For the 2008 year, based on the forecast copper price figure and TCRCs for that year in the 2007 Budget for the CSA mine, the TCRC was around 9.6% of the forecast copper price. For the 2009 year, based on the forecast copper price figure and TCRCs for that year in the 2007 Budget, the TCRC was around 9.4% of the forecast copper price[221];
25) During 2006, the average copper price had risen by more than 80% year on year to US$6,279 per tonne.[222] At the end of 2006, the Japanese benchmark TCRCs for the 2007 year were set at US$60/dry metric tonne ("**dmt**") and US6.0c/lb or US15.4c/lb for 30% concentrate.[223]
26) Both experts, Mr Ingelbinck and Mr Wilson, agreed that it was their analysis of the market as at early 2007 that balances for copper concentrates in 2007, 2008 and 2009 were likely to be tight and there was therefore an expectation that a significant increase in TCRCs was a relatively low probability[224]. Mr Wilson's view at the time was that it was highly unlikely that TCRCs would go above US$70 a tonne in the following three years;
27) Around the time that the February 2007 price sharing agreement was put in place independent parties dealing wholly independently with each other were not constrained to adopting a price sharing agreement structure; market based benchmark TCRCs pricing (usually negotiated annually in cases of long-term contracts) was also available in the copper concentrate market.[225] In fact a market-related agreement was in place between CMPL and GIAG up until February 2007. While price participation agreements were another type of long-term contract[226], the Japanese benchmark TCRCs for 2007 made no allowance for them[227] and the evidence of both the taxpayer's and Commissioner's experts was that "as at the end of 2006 it was their analysis of the market that it was [also] highly unlikely price participation would be reintroduced in the 2008 and 2009 years".[228] For this reason price participation could not be seen as a pricing option realistically available at the time the February 2007 Agreement was put in place. Both the contesting parties and her Honour seem to have reached the same conclusion. More generally, the evidence accepted by the Court was that the detail and pricing of individual contracts for the sale and purchase of copper concentrate varied greatly depending on the needs and risk appetites of the seller and buyer and whether the contracts were for spot sales or medium/long term contracts[229];
28) The examples of price sharing agreements between independent parties put in evidence by the taxpayer included only three examples of contracts to which GIAG was a party: the Redbank Contract, the Red Earth Contract, and the Jiangxi Contract. The Redbank Contract for 100% of production for the life of the mine was executed in November 2006 and was for estimated annual production of less than 5,000 wet metric tonnes but the mine had not yet commenced production.[230] The Red Earth Contract was for 100% of the

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[220] See [128].
[221] See [152] and [153].
[222] See [97].
[223] See [99].
[224] See [103].
[225] See [79] and [81].
[226] See [82].
[227] See [99].
[228] See [99] and [100].
[229] See [72].
[230] See [255] to [258].

production for the life of the mine from the Tapgura mine, to begin on 1 January 2010, and estimated to be 5,000 wet metric tonnes per year.[231] The Jiangxi Contract's price sharing terms related to one shipment of 10,000 dry metric tonnes up to August 2003 and thereafter the parties reverted to TCRCs applicable to different qualities of copper.[232] In other words, the taxpayer led no evidence of actual physical purchases or sales of copper concentrate involving independent parties in respect of the 2007, 2008 and 2009 income years despite its position in 2006 the largest seller of copper concentrate in the world, its sales being sourced from mines it owned, or in which it had an interest, as well mines owned by third parties[233];

29) CMPL's offtake agreements prior to the February 2007 Agreement were structured as "market-related" agreements.[234] There was no contemporary analysis of the economically relevant differences between the market-related arrangement and the February 2007 price sharing agreement, as amended from time to time. Nor was there any analysis of which agreement would be more attractive to an independent party with the characteristics of CMPL dealing wholly independently with buyers in the copper concentrate market. Moreover, the taxpayer's evidence and arguments at trial did not address this issue;

30) TCRCs set by the market allow for a trader or smelter to make an element of profit. GIAG profited from charging CMPL an allowance for TCRCs in the form of a reduction in the amounts GIAG paid for the copper concentrate. The higher the TCRCs the less income CMPL would make and the more profit GIAG would make[235];

31) It can reasonably be concluded that the February 2007 Agreement had the effect of reducing the revenues CMPL received in the 2007, 2008 and 2009 income years relative to the previously existing market-related pricing arrangement with more limited quotational period optionality, on which the 2007 budget was based. This can be seen from the evidence of the prevailing conditions in the copper concentrate market in late 2006, the pricing structures reasonably available in that market at the time the February 2007 Agreement and subsequent amendments were put in place, and the strong position the Glencore Group held within that market. Having regard to the whole of the evidence these adverse revenue impacts were the "natural and probable consequences" of the changes GIAG imposed through the February 2007 Agreement (as amended from time to time) and GIAG's purpose and object can reasonably be inferred from those consequences.[236] Since the purported risk management rationale is unsound it does not impact on this conclusion;

32) If CMPL's aim was to be as profitable as possible the commercially rational thing to do in February 2007 would have been to stick with the current market-related terms which were part benchmark and part spot pricing for TCRCs[237]. In the copper concentrate market TCRCs in long term agreements can include both benchmark TCRCs and spot TCRCs[238], as was the case with the market-related agreement that was in place prior to January 2007[239];

[231] See [259] to [260].
[232] See [254].
[233] See [106] and [107].
[234] See [3] and [321].
[235] See [78].
[236] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.
[237] See [203].
[238] See [79].
[239] The market-related pricing structure was informally replaced in January 2007 pending formalisation of the arrangement via the February 2007 Agreement. See [148].

33) While the pricing of the sales of copper concentrate between CMPL and GIAG in the relevant income years impacted in an accounting sense on the revenue and profit of CMPL and correspondingly on the purchasing costs and profits of GIAG as separate legal entities, the transactions were internal to the Glencore Group and, apart from any taxation consequences, they did not affect the profits or cashflow earned by the Group as a whole in the relevant income years; they would not appear in the Glencore Group's consolidated accounts; and
34) The February 2007 Agreement did not reduce the Glencore Group's exposure to the risk of volatility in TCRCs or the volatility between the movements in TCRCs and copper prices and there is no evidence that the Glencore Group had a policy or took steps to reduce its exposure to those risks.

The Application of Australia's Transfer Pricing Rules

Assessing action taken by the Commissioner

The Commissioner sought to adjust the pricing framework in line with the "market-related" pricing method used by CMPL in previous years[240] and to reflect a "consistently applied quotational period".[241] The amended assessments for the 2007, 2008 and 2009 income years were based on determinations made in reliance on subsection 136AD(1) as a standalone provision, on subsection 136AD(1) in conjunction with subsection 136AD(4) and on the provisions of Subdivision 815-A and Article 9 of the Swiss Agreement.[242]

Glencore Investment Pty Ltd was assessed in relation to these transfer pricing adjustments as the head company of a multiple entry consolidated (MEC) group for Australian tax purposes, of which CMPL was a member[243].

Overview of the contested issues

The question for the Court was, given that the sales occurred between an Australian subsidiary and its Swiss parent, whether or not the pricing of those sales "was less than the consideration that might reasonably have been expected to have been paid in arm's length dealings between independent parties"[244] dealing wholly independently with each other, the Commissioner asserting that the consideration was less than the arm's length consideration, the taxpayer asserting that the actual consideration was the arm's length consideration. The alternative question presented by Subdivision 815-A and Article 9 of the Swiss Agreement was whether the taxable profits of CMPL (and thus Glencore Investment Pty Ltd as the head company for tax consolidation purposes) were less in the 2007, 2008 and 2009 income years than might have been expected to accrue because conditions, imposed through the successive amendments to the original market-related offtake agreement of 5 July 1999 and impacting on the pricing of the copper concentrate CMPL sold to GIAG in those income years differed

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[240] The adjustments removed the effect of the 23% price sharing mechanism introduced in February 2007 and replaced it with 50% benchmark/50% spot pricing for treatment and copper refining charges (TCRCs), which the Commissioner identified as the rate previously used by Cobar Management Pty Ltd (CMPL). See [4].
[241] See [4].
[242] See [1] and [11], noting that Article 9 of the Swiss Agreement is incorporated by reference into Subdivision 815-A by operation of sections 815-10 and 815-15.
[243] See [1].
[244] See [1].

from those that might be expected to operate between independent enterprises dealing wholly independently with one another in relation to setting the prices for the copper concentrate.

Her Honour expressed the question for decision differently:

> The competing cases of the parties require determination as to whether the hypothetical agreement for the purposes of the comparative analysis is to be a price sharing contract (as the taxpayer contended) or a market-related contract (as the Commissioner contended). The type of contract is important as the calculation of the TCRCs is an integer in the pricing of the copper concentrate under either type of agreement but the deduction from the copper reference price for TCRCs is calculated very differently under a price sharing contract to the way in which the deduction for TCRCs is calculated under a market-related contract, and so there will be differences in the pricing of copper concentrate depending on which methodology is employed. Thus, the application of the statutory provisions will depend (at least in the first instance) on whether the consideration is to be determined on the hypothesis of an agreement in which the deduction for TCRCs is calculated as a percentage of the referenced copper price or by reference to market-based benchmark/spot terms.[245]

Given the systematic approach to the application of Division 13 and Subdivision 815-A that is evident in the *Chevron Case*, and the significance the parties and her Honour attach to that case, it is worthwhile to start with the concepts, definitions and machinery of the relevant provisions and then consider the evidence. This approach will lead to the question posed by her Honour, placing it in its legislative context.

Insofar as relevant to the 2007, 2008 and 2009 income years, Australia's transfer pricing rules were contained in Division 13 of the *1936 Assessment Ac*t, Subdivision 815-A of the *1997 Assessment Act* and Article 9 of the the Swiss Agreement.

The provisions of Division 13 and Subdivision 815-A are the forerunners to Australia's current transfer pricing regime, now contained in Subdivisions 815-B, C and D of the *1997 Assessment Act*, which is also based on the arm's length principle; namely a comparison between the actual consideration (or conditions operating in the commercial or financial relations) with the consideration (or conditions) that would have been agreed (or might be expected to operate) between independent parties dealing at arm's length or wholly independently with each other. The provisions of Article 9 are incorporated by reference in Subdivision 815-A by the operation of sections 815-10 and 815-15. They are also relevant to the operation of Division 13 in the sense that Article 9 is given priority in the event of any inconsistency. The Swiss Agreement (including Article 9) is given the force of law in Australia by Section 11E of the *International Tax Agreements Act 1953* (the *Agreements Act)* and section 4 of that Act provides that:

> (1) Subject to subsection (2), the Assessment Act[246] is incorporated and shall be read as one with this Act.
>
> (2) The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (other than Part IVA of that Act) or in an Act imposing Australian tax.

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[245] See [35].

[246] Section 3 of the *International Tax Agreements Act 1952* provides: ***Assessment Act*** means the *Income Tax Assessment Act 1936* or the *Income Tax Assessment Act 1997*.

However, no question of inconsistency between Division 13, Subdivision 815-A and Article 9 as legislated in Australian law by section 11E of the *Agreements Act* arises on the facts and circumstances of the *Glencore Case.*

By virtue of section 14ZZO of the *Taxation Administration Act 1953* the taxpayer bears the onus of proof of showing that, on the balance of probabilities, the assessments made by the Commissioner are excessive.

Division 13 –relevant parts of the legislation and issues to be resolved

The Commissioner raised amended assessments for the 2007, 2008 and 2009 income year in reliance on determinations made under subsections 136AD(1) and subsection 136AD(1) as supplemented by subsection 136AD(4).[247]

Insofar as relevant to the facts and circumstances of the *Glencore Case,* subsections 136AD(1) and (4) relevantly provided:

> **136AD Arm's length consideration deemed to be received or given**
>
> (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 to the agreement, or any 2 or more of those 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 in relation to the taxpayer in relation to the supply;
>
> then, for all purposes of the application of this Act in relation to the taxpayer, consideration equal to the arm's length consideration in respect of the supply shall be deemed to be the consideration received or receivable by the taxpayer in respect of the supply.
>
> …
>
> (4) For the purposes of this section, where, for any reason (including an insufficiency of information available to the Commissioner), it is not possible or not practicable for the Commissioner to ascertain the arm's length consideration in respect of the supply or acquisition of property,

[247] See [11].

the arm's length consideration in respect of the supply or acquisition shall be deemed to be such amount as the Commissioner determines.

The following definitions relevant to the operation of subsections 136AD(1) and (4) are set out in section 136AA:

(1) In this Division, unless the contrary intention appears:

agreement means any agreement, arrangement, transaction, understanding or scheme, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings.

property includes:

(a) a chose in action;

(b) any estate, interest, right or power, whether at law or in equity, in or over property;

(c) any right to receive income; and

(d) services.

supply includes:

(a) supply by way of sale, exchange, lease, hire or hire-purchase; and

(b) provide, grant or confer.

(3) In this Division, unless the contrary intention appears:

(a) a reference to the supply or acquisition of property includes a reference to agreeing to supply or acquire property;

(b) a reference to consideration includes a reference to property supplied or acquired as consideration and a reference to the amount of any such consideration is a reference to the value of the property;

(c) a reference to the arm's length consideration in respect of the supply of property is a reference to the consideration that might reasonably be expected to have been received or receivable as consideration in respect of the supply if the property had been supplied under an agreement between independent parties dealing at arm's length with each other in relation to the supply;

(e) a reference to the supply or acquisition of property under an agreement includes a reference to the supply

or acquisition of property in connection with an agreement.

Section 136AC provided:

136AC International agreements

For the purposes of this Division, an agreement is an international agreement if:

(a) a non-resident supplied or acquired property under the agreement otherwise than in connection with a business carried on in Australia by the non-resident at or through a permanent establishment of the non-resident in Australia; or

(b) a resident carrying on a business outside Australia supplied or acquired property under the agreement, being property supplied or acquired in connection with that business; or

(c) a taxpayer:

(i) supplied or acquired property under the agreement in connection with a business; and

(ii) carries on that business in an area covered by an international tax sharing treaty.

There was no suggestion from any quarter that subsection 136AD(3) had any operation on the facts and circumstances of the *Glencore Case;* there was no suggestion that CMPL had acquired property (or services[248]) under an international agreement for more than the arm's length consideration. Nor was there any suggestion or was evidence led to support an application of section 136AF (dealing with consequential adjustments). Both sides, and Davies J accepted that the case was about the acquisition of property from a resident, CMPL, by a non-resident, GIAG and that the issue was whether CMPL had received less than the arm's length consideration for the copper concentrate that GIAG acquired.

Insofar as relevant to the facts and circumstances of the *Glencore Case* the relevant preconditions for the application of Division 13 are:

1) That "a non-resident acquired property under an agreement" (section 136AC(c)) thereby qualifying the agreement as an "international agreement". In this case GIAG, a resident of Switzerland, acquired "property", being 100% of the copper concentrate output of the CSA mine, from CMPL under a life of mine contract, including the copper concentrate produced in the 2007, 2008 and 2009 income years. The February 2007 Agreement had no impact on the "property" the subject of the life of mine offtake agreement. The operation of the Consolidation regime is discussed in 2) below;

2) That the taxpayer, in this case Glencore Investment Pty Ltd in its capacity for tax purposes as the head company of a multiple entry consolidated group, of

[248] Section 136AA(1) defines "property" as including "services".

which CMPL was a member, is taken by the single entity rule in the Consolidation regime[249] to have supplied that property, the copper concentrate, under an international agreement (subsection 136AD(1)(a), Part 3-90 of the *1997 Assessment Act* (Consolidated Groups) and section 136AC(c)). The evidence shows that CMPL supplied copper concentrate to GIAG in the relevant income years. Under the single entity rule in section 701-1 CMPL is taken to be part of the head company, Glencore Investment Pty Ltd, for certain purposes that include working out the amount of the head company's liability for income tax;

3) That CMPL and GIAG were not dealing at arm's length with each other in relation to the supply of copper concentrate (subsection 136AD(1)(b)) and this lack of arm's length dealing is imputed to Glencore Investment Pty Ltd under Part 3-90 of the *1997 Assessment Act* (Consolidated Groups). The lack of arm's length dealings between the relevant parties was not contested in the *Glencore Case*, it having in effect been conceded by the taxpayer that the precondition in subsection 136AD(1)(b) had been satisfied in relation the supply of copper concentrate on the terms of the February 2007 Agreement.[250] Nor did it contend that the February 2007 Agreement was a negotiated agreement and an arm's length dealing[251];

4) That the consideration received by Glencore Investments Pty Ltd (in its capacity for tax purposes as the head company of the MEC group of which CMPL was a member) was less than the consideration that might reasonably be expected to have been received or receivable as consideration in respect of the supply of copper concentrate if it had been supplied under an agreement between independent parties dealing at arm's length with each other in relation to that supply (subsections 136AD(1)(c) and 136AA(3)(c)). It is in this respect that the changes to the pricing framework made by the February 2007 Agreement (and the informal arrangement in January 2007 that preceded it[252]) are directly relevant to the machinery of subsections 136AD(1)(c) and 136AA(3)(c). That agreement fundamentally changed the pricing framework for the revenues CMPL would receive from the supply of copper concentrate to GIAG.[253] The changes made by the February 2007 Agreement had a direct impact on the "consideration" CMPL received in the 2007, 2008 and 2009 income years. As her Honour found:

> The price sharing term was not simply an "integer" in the pricing of the copper concentrate, as the Commissioner contended, but a different market

[249] Section 701-1 of the *1997 Assessment Act* has the effect that the subsidiary companies in a consolidated group are taken to be parts of the head company for certain purposes which include working out the amount of the *head company's liability (if any) for income tax. In relation to the operation of the MEC provisions in the tax consolidation regime, Glencore Investment Pty Ltd is a Tier-1 company in accordance with Item 2 of Column 1 of the table in section 719-20 which has been jointly appointed by the other Tier-1 company members of the MEC group as the provisional head company in accordance with subsections 719-60(1) or (3) and by operation of section 719-75 becomes the head company of a consolidated group and the other Tier-1 companies subsidiaries of that consolidated group. This triggers the application of section 701-1.

[250] See [28].

[251] See [171].

[252] See [148].

[253] See [3] and [321].

> mechanism altogether by which to price copper concentrate. As the experts agreed, ***a price sharing contract and a market-related contract are fundamentally different types of contracts as the copper concentrate is priced materially differently under a price sharing agreement to how it is priced under a market-related contract.*** Whereas under a market-related contract the TCRCs are set by reference to a benchmark set annually and/or spot terms, with no correlation to the prevailing copper prices, under a price sharing agreement the TCRCs are fixed as a percentage of the metal exchange copper price for the duration of the contract so that the TCRC deduction and the metal exchange copper price are directly correlated to one another. Thus, there will be differences in the pricing of copper concentrate and the price payable, depending on the pricing structure used.[254] [Emphasis added.]

However, the changes made to the pricing framework did not alter the the underlying nature of the transaction, what the 1995 OECD Guidelines describe as the "character of the transaction."[255] In the *Glencore Case* "the character of the transaction" is the sale of copper concentrate under a life of mine offtake agreement for 100% of the production of the CSA mine; and

5) That the Commissioner determined that subsection 136AD(1) should apply. This is a procedural step in the assessment process (*W R Carpenter Holdings Pty Ltd v Federal Commissioner of Taxation* (2008) 237 CLR 198; [2008] HCA 33). It is noted that the Commissioner determined alternatively that:

    a. subsection 136AD(1) applied in its own right and the amount of the arm's length consideration was the amount worked out in accordance with the terms and conditions of the market-related agreement that was in place prior to February 2007; or
    b. subsection 136AD(1) applied with the assistance of subsection 136AD(4) on the basis that it was not possible or practicable for the Commissioner to ascertain the amount of the arm's length consideration in respect of the supply of copper concentrate and so he estimated an amount based on the market-related contract that was in place between CMPL and GIAG prior to February 2007, which amount he determined to be the arm's length amount for the purposes of subsection 136AD(1).

The reliance on subsection 136AD(1) in conjunction with subsection 136AD(4) places an evidentiary burden on the taxpayer to show that the arm's length consideration was in fact ascertainable and that it was the amount that the taxpayer adopted in calculating its liability for income tax in respect of the 2007, 2008 and 2009 income years. With regard to assessments raised in reliance on subsections 136AD(1) and (4), the Full Federal Court in the *WR Carpenter Holdings Case* stated:

> If, after evidence and argument, the applicants fail to show that the figure advanced by them is, on the balance of probabilities, the correct arm's length consideration,

[254] See [321].
[255] Paragraphs 1.36 to 1.38 of the 1995 OECD Guidelines.

then the assessments will be affirmed. It could hardly matter that at the time of the assessment it might have been practicable or possible for the Commissioner to ascertain the arm's length consideration. Logically, what tax liability must turn on is whether the applicants have managed to displace the Commissioner's deemed figure."
…
…it is open to a taxpayer to challenge the existence of the pre-conditions necessary to empower the Commissioner to make a determination under subsection 136AD(4), that is, by showing that it is possible or practicable for the Commissioner to ascertain the arm's length consideration in respect of the supply…It is a matter of the applicants proving that the assessment is excessive by showing that the correct arm's length consideration is less than the deemed amount of the Commissioner's determination.

Second, if the applicants were able to show that it was possible or practicable for the Commissioner to ascertain the arm's length consideration in respect of the supply, by proving that the correct arm's length consideration in respect of the supply was an amount less than the amount determined by the Commissioner under subsection 136AD(4) (they would hardly seek to do this if the ascertainable arm's length consideration in respect of the supply was greater than the amount determined by the Commissioner under subsection 136AD(4)), then the applicants would have done two things:

proved that the statutory pre-conditions for the Commissioner's reliance on subsection 136AD(4) did not exist; and

proved that the assessment was excessive: section 14ZZO(b) of the [*Taxation Administration Act 1953*].

In the result, the Commissioner's objection decision would be set aside and substituted by a decision allowing the objection to the extent of the excess.

Third, in seeking to show that the pre-conditions of the subsection 136AD(4) determination did not exist, the applicants would have to establish that there was an ascertainable arm's length consideration and that it was less than the Commissioner's amount (see [37]) above). If they failed to do so, the Commissioner's determination would stand. But that is no different from a taxpayer failing to discharge the onus in respect of an assessment issued in reliance on section 167 of the ITAS: see *Dalco.* [256]

The consequence of subsection 136AD(1) being found to apply, with or without the assistance of subsection 136AD(4), is that the amount determined to be the arm's length consideration would be deemed by subsection 136AD(1) to be the consideration received by Glencore Investments Pty Ltd as head company for all purposes of the application of the *1936 and 1997 Assessment Acts*, including the assessment provision in section 166 of the *1936 Assessment Act*.

[256] *WR Carpenter Holdings Pty Ltd & Anor v FC of T* [2007] FCAFC 103 at [33]; 2007 ATC 4679 at 4686 paragraphs [33] and [39] to [41] per Heerey, Stone and Edmonds JJ.

Her Honour concluded on the evidence that:

> ...it was not disputed that there were conditions operating between GIAG and CMPL which differed from those that might be expected to operate between independent parties dealing wholly at arm's length with each other …and I find on the strength of Mr Kelly's evidence that such conditions included GIAG's control and management of the CSA mine. [257]

While Davies J saw this fact as satisfying one of the preconditions for the operation of Subdivision 815-A through the incorporation by reference of the preconditions stipulated by Article 9 of the Swiss Agreement, it is also relevant to the question posed by Division 13 as to whether for the purposes of subsection 136AD(1)(b) the related parties were dealing with each other on an arm's length basis in relation to the supply of copper concentrate, the finding on the evidence supporting a negative conclusion on this issue. In fact, the taxpayer conceded that for the purposes of Division 13 that CMPL and GIAG did not deal at arm's length with each other in relation to the supply of copper concentrate on the terms of the February 2007 Agreement.[258] Nor did the taxpayer contend that the February 2007 Agreement was a negotiated agreement and an arm's length dealing.[259]

At trial only two aspects of the preconditions for the application of subsection 136AD(1) remained contestable between the parties:

a) the application of subsections 136AD(1)(c) and 136AA(3)(c) to determine whether the actual consideration received by CMPL in respect of the supply of copper concentrate in the 2007, 2008 and 2009 income years was less than the arm's length consideration for each of those years; and

b) the question of whether the taxpayer had proved that the amounts received by CMPL as revenue from the sale of copper concentrate to GIAG in each of the 2007, 2008 and 2009 income years were, on the balance of probabilities, the arm's length consideration or exceeded the arm's length consideration, such that the amended assessments were shown to be excessive.

Subdivision 815-A – relevant parts of the legislation and issues to be resolved

As is the case with Division 13, the relevant taxpayer for the purposes of the application of Subdivision 815-A is Glencore Investment Pty Ltd in its capacity for tax purposes as the head company of a multiple entry consolidated group, of which CMPL was a member.[260]

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[257] See [132].
[258] See [28].
[259] See [171].
[260] Section 701-1 of the *1997 Assessment Act* has the effect that the subsidiary companies in a consolidated group are taken to be parts of the head company for certain purposes which include working out the amount of the *head company's liability (if any) for income tax. In relation to the operation of the MEC provisions in the tax consolidation regime, Glencore Investment Pty Ltd is a Tier-1 company in accordance with Item 2 of Column 1 of the table in section 719-20 which has been jointly appointed by the other Tier-1 company members of the MEC group as the provisional head company in accordance with subsections 719-60(1) or (3) and by operation of section 719-75 becomes the head company of a consolidated group and the other Tier-1 companies subsidiaries of that consolidated group. This triggers the application of section 701-1.

Under the single entity rule in section 701-1 CMPL is taken to be part of the head company, Glencore Investment Pty Ltd, for certain purposes that include working out the amount of the head company's liability for income tax.

The relevant parts of Subdivision 815-A are set out in paragraphs [13] to [22] of Davies J's judgment and, for convenience, those provisions and her Honour's summary are reproduced here:

> 13 Subdivision 815-A of the ITAA 1997 was enacted in 2012 by the *Tax Laws Amendment (Cross-Border Transfer Pricing Act) (No 1) 2012* (Cth) but was made to apply retrospectively to income years starting on or after 1 July 2004: s 815-1 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) ("**Transitional Act**"). Subdivision 815-A was subsequently replaced by Subdivs 815-B to 815-D for income years commencing on or after 29 June 2013: s 815-1(2), s 815-15 of the Transitional Act.
>
> 14 The relevant object of Subdiv 815-A is set out in s 815-5(a) as follows:
>
> > **815-5 Object**
> > 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;…
>
> 15 Section 815-10(1) empowers the Commissioner to make a determination under s 815-30(1) for the purpose of negating a "transfer pricing benefit". The determinations which the Commissioner can make under s 815-30(1) include, relevantly, the determination of an amount by which the taxable income of a taxpayer is increased: s 815-30(1)(a). The Commissioner made such a determination for each of the relevant years in question.
>
> 16 Section 815-15 sets out what constitutes a "transfer pricing benefit". It provides:
>
> > **815-15 When an entity gets a transfer pricing benefit**
> > *Transfer pricing benefit—associated enterprises*
> > (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; or
(ii) the amount of a tax loss of the entity for an income year would be *less* than its actual amount; or
(iii) the amount of a *net capital loss of the entity for an income year would be *less* than its actual amount.

The amount of the **transfer pricing benefit** is the difference between the amounts mentioned in subparagraph (d)(i), (ii) or (iii) (as the case requires).

Transfer pricing benefit may be negated

[Subsection 815-10(1) provides:

(1) The Commissioner may make a determination mentioned in subsection 815-30(1), in writing, for the purpose of negating a * transfer pricing benefit an entity gets.]

17 By s 815-10(2), s 815-10(1) only applies to an entity if the entity gets the "transfer pricing benefit" at a time when an international agreement containing an associated enterprises article or business profits article applies to the entity. Section 815-10(2) provides:

(2) However, this section only applies to an entity if:
(a) the entity gets the *transfer pricing benefit under subsection 815-15(1) at a time when an *international tax agreement containing an *associated enterprises article applies to the entity; or
(b) the entity gets the transfer pricing benefit under subsection 815-15(2) at a time when an international tax agreement containing a *business profits article applies to the entity.

18 An "associated enterprises article" is defined by s 995-1 and s 815-15(5) of the ITAA 1997 as:

(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.

19 In the present case there is an applicable international agreement, namely the *Agreement between Australia and Switzerland for the Avoidance of Double Taxation with Respect to Taxes on Income, and Protocol* [1981] ATS 5 ("**the Swiss Agreement**").

20 Article 9 of the Swiss Agreement is in substantially the same terms as Art 9 of the United Kingdom Convention and, at the relevant time, provided as follows:

> Where -
> (a) an enterprise of one of the Contracting States participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or
> (b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the Contracting States and an enterprise of the other Contracting State,
> and in either case conditions operate between the two enterprises in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another, then any profits which, but for those conditions, might have been expected to accrue to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

21 Section 815-20 of the ITAA 1997 provides that:

> **815-20 Cross-border transfer pricing guidance**
>
> (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
> (b) 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.
>
> (3) However, a document, or a part of a document, mentioned in paragraph (2)(a) or (b) is not covered by this section if the regulations so prescribe.
>
> (4) Regulations made for the purposes of paragraph (2)(c) or subsection (3) may prescribe different documents or parts of documents for different circumstances.

> 22 The effect of s 815-20(1) of the ITAA 1997 was modified by s 815-5 of the Transitional Act which states that, despite s 815-20, for an income year that starts before 1 July 2012, the documents to which s 815-20 is taken to be referring are:
>
> > the Model Tax Convention on Income and Capital and its Commentaries, as adopted by the Council of the Organisation for Economic Cooperation and Development ("**OECD**"); and
> >
> > the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, in each case as last amended before the start of the income year.
>
> In the present case, thus, the relevant OECD Transfer Pricing Guidelines are the 1995 Guidelines (as updated in 1999) ("**the 1995 Guidelines**") and the relevant OECD Model Convention is the Model Convention that was in place before each of the relevant years.

It was found by Davies J that there were conditions operating between GIAG and CMPL which differed from those that might be expected to operate between independent parties dealing wholly at arm's length with each other. Her Honour found, "on the strength of Mr Kelly's evidence that such conditions included GIAG's control and management of the CSA mine".[261] Without stating the full extent of how the actual conditions between the parties in their commercial or financial relations differed from the conditions which might be expected to operate between independent enterprises dealing wholly independently with one another, her Honour did find that CMPL and GIAG did not deal at arm's length with each other in relation to the supply of copper concentrate on the terms of the February 2007 Agreement[262] and that the taxpayer did not put into issue whether, nor did it contend that, the February 2007 Agreement was a negotiated agreement and an arm's length dealing[263].

The consequence of her Honour's findings is that, like in the *Chevron Case:*

> The requirements in Article 9(1) which needed to be met for its application in the present case directed attention to the relationship and conditions existing between two enterprises in their commercial or financial relations to determine whether "conditions operate[d]" between them in their commercial or financial relations which differed from those which might be expected to operate between "independent enterprises dealing wholly independently with one another". Section 815-15(1)(b) will be satisfied if those conditions are met.[264]

What is left open by these findings is the question of whether the differences between the actual conditions and the arm's length conditions had the effect that an amount of taxable profits which might have been expected to accrue did not so accrue.

It is noted that Subdivision 815-A does not contain a provision like subsection 136AD(4) which allows the Commissioner to estimate and arm's length consideration in cases where, for any reason (including an insufficiency of information available to the Commissioner), it is not possible or practicable for the Commissioner to ascertain the arm's length consideration in respect of the supply or acquisition of property. Accordingly, the taxpayer will succeed if it

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[261] See [132].
[262] See [28].
[263] See [171].
[264] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [151] per Pagone J (with whom Allsop CJ and Perram J agreed).

satisfies the onus of proof it bears by virtue of section 14ZZO of the *Taxation Administration Act 1953*, namely by showing that, on the balance of probabilities, the assessments made by the Commissioner are excessive.

In approaching the application of Division 13 and Subdivision 815-A it was emphasised by Allsop CJ in the Full Federal Court decision in the *Chevron Case* that:

> …it is paramount to recognise the fiscal and commercial context in which the provisions [of Division13 and Subdivision 815-A] are operating. This is not to put to one side or to diminish the necessity to begin and end with the words of the statute. Nor is it to seek to find a purpose of [the relevant legislation] outside its words. To begin and end with the words of the statute does not reflect a call to narrow textualism; it is the recognition that, ultimately, it is the words used by Parliament which frame the question of meaning, and which provide the answer to that question of meaning. Context, however, is indispensable, whether an explicit or implicit consideration. It gives the place, the wholeness and the relational reality to words; it helps prevent linear thinking and sometimes beguilingly simple and attractive logic with words driving meaning to unrealistic and impractical ends; and it helps ascribe meaning conformable with commonsense and convenient purpose gained from the relevant part of the statute as a whole, here Division 13 [and Subdivision 815-A].[265]

OECD guidance on determining comparability in applying the arm's length test

The OECD 1995 Transfer Pricing Guidelines, as updated by publications in March 1996, August 1997, September 1997 and October 1999, ("the 1995 OECD Guidelines"), are the relevant Guidelines for the purposes of applying Subdivision 815-A.[266]

Those Guidelines set out the following factors as being relevant in applying the concept of comparability that is implicit in the statutory requirement to ascertain the conditions that might be expected to operate in the commercial or financial relations between independent parties dealing wholly independently with one another:

- *The characteristics of the property* the subject of the related party cross-border dealings, including in this case the quality of the copper concentrate, its availability and volume of supply[267];

- *The economically significant functions each party performs*, taking into account the assets used and the nature, extent and materiality of the risks each party assumes at each stage of the supply chain; whether the allocation of risks is consistent with the economic substance of the related party transactions; the ability of the respective parties to control their allocated risks; and the juridical capacity in which the taxpayer performs its functions. The 1995 OECD Guidelines emphasise that "particular attention should be paid to the structure and organisation of the group".[268] This process is generally referred to as a "***functional analysis***" or sometimes as an "***economic*** functional analysis", the

[265] [2017] FCAFC 62 at [3] per Allsop CJ
[266] Section 815-20 of the *Income Tax Assessment Act 1997* as modified by section 815-5 of the *Income Tax (Transitional Provisions) Act 1997.*
[267] Paragraph 1.19 of the 1995 OECD Guidelines.
[268] Paragraph 1.20 of the 1995 OECD Guidelines.

second descriptor underlining the distinction between the mere performance of a function (for example re-invoicing) and a function that is directed to adding economic value (whether or not it succeeds in this objective). What is important is the economic significance in terms of its frequency, nature and value to the respective parties to the transactions.[269]

The 1995 OECD Guidelines also underline the market reality that "In the open market, the assumption of increased risk will also be compensated by an increase in the ***expected*** return", "although the actual return may or may not increase depending on the degree to which the risks are actually realised". The 1995 OECD Guidelines also observe that ***a "[f]unctional analysis is incomplete unless the material risks assumed by each party have been considered since the assumption and allocation of risks would influence the conditions of the transactions between the associated enterprises"***[270];

- *The contractual terms*, ***due regard being had*** to whether the conduct of the parties aligns with those terms and ***to the economic principles that generally govern relationships between independent enterprises***[271];

- *Economic circumstances*, including the size of the market, the extent of competition and the relative competitive positions of buyers and sellers, the levels of supply and demand in the market as a whole, costs of production (including land, labour, capital and transport costs), the levels of the market (for example, the mining, refining, marketing and trading sectors and the customers acquiring the refined copper) and ***any other relevant characteristics of the market that have a bearing on pricing***[272]; and

- *Business strategies*, including approaches to risk management and other factors bearing on the daily conduct of business, ***any limits on a member of a group acting separately***, and the nature and extent of involvement the respective parties have in implementing the business strategies.[273]

It is clear from the factors that the OECD specifies that the comparison of actual dealings with the arm's length hypothetical that underpins both Division 13 and Subdivision 815-A necessarily entails, amongst other things, a market survey in order to properly understand the economic and commercial context in which the provisions are required to operate. In this case the survey would include: the size of the copper concentrate market; the stocks and flows of copper concentrate; the participants, their roles and market position; prevailing and forecast market conditions around the time that the February 2007 Agreement was being considered by the Glencore Group; and, the various bases on which long term sales of high grade copper concentrate were transacted between independent parties dealing at arm's length with each other. The purpose of that survey is to identify arrangements that are sufficiently comparable to the life of mine offtake agreement for the full volume of high grade copper concentrate produced by the CSA mine. The 1995 OECD Guidelines state that:

[269] Paragraph 1.21 of the 1995 OECD Guidelines.
[270] Paragraph 1.23 of the 1995 OECD Guidelines.
[271] Paragraphs 1.28 and 1.29 of the 1995 OECD Guidelines.
[272] Paragraph 1.30 of the 1995 OECD Guidelines.
[273] Paragraphs 1.30 to 1.35 of the 1995 OECD Guidelines.

> In order to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (eg price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding of how unrelated companies evaluate potential transactions is required. Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter a transaction if they see no alternative that is clearly more attractive……independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options…[274]
>
> All methods that apply the arm's length principle can be tied to the concept that independent enterprises consider the options available to them and in comparing one option to another they consider any differences between the options that would significantly affect their value…[275]
>
> …In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof) it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length dealings. Attributes that may be important include the characteristics of the property or services transferred, the function performed by the parties (taking into account assets used and risks assumed), the contractual terms, the economic circumstances of the parties, and the business strategies being pursued by the parties…[276]

"Reasonable expectation" test in Division 13, Subdivision 815-A and Part IVA

The application of the arm's length principle as articulated in Division 13 and Subdivision 815-A, like the language of the Associated Enterprises Article in the Swiss Agreement, requires a comparison, depending on whether one is applying Division 13 or Subdivision 815-A, of the actual consideration or conditions in the commercial or financial relations, as the case may be, with ***the consideration that might reasonably be expected to have been received*** or ***the conditions that might reasonably be expected to operate*** between independent parties dealing at arm's length (or wholly independently) with each other.[277]

The general anti-avoidance provision in Part IVA, makes extensive use of the expression "might reasonably be expected" in section 177C which defines the inclusions and exclusions comprising the concept of "tax benefit".

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[274] Paragraph 1.15 of the 1995 OECD Guidelines.
[275] Paragraph 1.16 of the 1995 OECD Guidelines.
[276] Paragraph 1.17 of the 1995 OECD Guidelines.
[277] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 includes observations in relation to this necessary comparison as part of applying Division 13 at [15] to [17] per Allsop CJ and [118] and [119] per Pagone J, with whom Allsop CJ and Perram J agreed; and in relation to Subdivision 815-A at paragraph [88] per Allsop CJ and at [156] per Pagone J, with whom Allsop CJ and Perram agreed. See also 1.15 of the 1995 OECD Guidelines.

In considering the operation of Division 13 and Subdivision 815-A, Davies J made the general observation that:

> …in construing and applying the provisions of Div 13 and Subdiv 815-A, it is essential in giving effect to the policy objectives of those provisions not to intrude into the analysis concepts more appropriately found in other provisions, such as Part IVA of the ITAA 1936. ***The arm's length principle does not introduce, or involve, any investigation or consideration of purpose or motive***: *W R Carpenter Holdings Pty Ltd v Federal Commissioner of Taxation* (2008) 237 CLR 198; [2008] HCA 33 at [38].[278] [Emphasis added.]

It may be that her Honour disagrees with the approach to arm's length comparability taken by the Full Federal Court in the *Chevron Case* in its reliance on what has been described as "the reasonable expectation test in the arm's length hypothetical"[279]. The Full Court described it in relation to Division 13 in terms of: the reasonable expectation of behaviour that would reflect rational commercial behaviour in the environment of an arm's length transaction; an evaluative prediction of events and transactions based on evidence and, where appropriate, admissible probative and reliable expert opinion as to what might reasonably be expected if the actual agreement had been unaffected by the lack of independence and lack of arm's length dealing.[280]

Division 13 involves a comparison of the actual consideration with, in the case of section 136AD(1), "the consideration that might reasonably be expected to have been received or receivable if the property had been supplied under an agreement between independent parties dealing at arm's length with each other in relation to the supply" (subsection 136AD(1) and subsection 136AA(3)(c)). Subdivision 815-A incorporates by reference[281] Article 9 of the Swiss Agreement which requires a comparison of the actual conditions that operate in the commercial or financial relations between the associated enterprises with the conditions "which might be expected to operate between independent enterprises dealing wholly independently with one another" in order to identify where the actual conditions differ from the arm's length conditions.

Accordingly, each set of provisions operates by way of requiring an evaluative prediction of the kind referred to by the Full Court. As Pagone J (with whom Allsop CJ and Perram J agreed) said:

> The comparison which Article 9 required to be undertaken is akin to that contemplated by Division 13.[282]

In analysing what was involved in undertaking this evaluative prediction Pagone J observed:

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[278] See [340].
[279] The Chevron Australian Holdings Case and the reach of the arm's length principle, Jim Killaly, 30 October 2018, ANU Crawford School TTPI Working Paper 17/2018, pages 19 to 28.
[280] [2017] FCFCA 62 at [46], [60] and [62] per Allsop CJ and [121] and [126] – [129] per Pagone J (with whom Allsop CJ and Perram J agreed).
[281] Section 815-10 and section 815-15 of the *1997 Assessment Act*.
[282] [2017] FCFCA 62 at [156].

> The standard of reasonable expectation found in the words "might reasonably be expected" in s 136AA(3)(d) calls for a prediction based upon evidence. In *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359 the High Court said at 385:
>
> > A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.
>
> The prediction contemplated by Division 13, like that contemplated by s 177C of the 1936 Act, involves an evaluative prediction of events and transactions that did not take place but the prediction must be based upon evidence and, where appropriate, upon admissible, probative and reliable expert opinion: see *Federal Commissioner of Taxation v Futuris Corporation Ltd* (2012) 205 FCR 274 at [79]-[81]; see also *Peabody v Commissioner of Taxation* (1993) 40 FCR 531, [39] (Hill J).[283]

As was said by Hill J in the *Peabody Case:*

> ..the meaning of words such as "reasonable expectation" depends upon the context in which they appear. Nevertheless, in the present context, as in *Cockroft*[284], the words were intended to receive, and should receive, their ordinary meaning. So too, as in *Cockroft,* the word "reasonable" is used in contradistinction to that which is "irrational, absurd or ridiculous". The word "expectation" requires that the hypothesis be one which proceeds beyond the level of a mere possibility to become that which is the expected outcome.[285]

The reference Pagone J makes to section 177C relates to the definition of tax benefit for the purposes of Part IVA, the general anti-avoidance provision. The definition makes extensive use of the expression "might reasonably be expected" in defining the inclusions and exclusions comprising the definition of tax benefit in connection with a scheme. It seems unobjectionable to draw on judicial observations as to the interpretation of that phrase in a different part of the tax legislation insofar as they throw light on the nature of the evaluative prediction implicit in those words, that is, the inherent content of those words and their ordinary meaning, due regard being had to the different statutory contexts in which they are used. This seems particularly apt given the extremely broad definition of "scheme" for the purposes of Part IVA:

> (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
> (b) any scheme, plan, proposal, action, course of action or course of conduct.

Paragraph (a) of that definition is in very similar terms to the definition of "agreement" in section 136AA(1):

[283] [2017] FCFCA 62 at [127].
[284] *Attorney General's Department & Anor v Cockroft* (1986) 64 ALR 97.
[285] *Peabody v Commissioner of Taxation* (1993) 40 FCR 531; 93 ATC 4104 at 4112.

> ***agreement*** means any agreement, arrangement, transaction, understanding or scheme, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings.

That the approach of the Full Federal Court in the *Chevron* Case, in referencing another statutory context in which the words "might reasonably be expected" have been used, appears to be standard judicial practice can be seen, for example, in how leading cases on the meaning of "at arm's length", "dealing at arm's length" and "not dealing with each other at arm's length" have drawn on examples of the use of those words in a range of statutory contexts. For example, Jessup J in *AXA Asia Pacific Holdings Ltd v FC of T*[286] considered cases involving the former section 26AAA (profitmaking undertakings or schemes), subsection 102AG(3) (The derivation of exempt trust income), section 160ZH(9) (capital gains), a contract for the exclusive right to supply and sales tax.

In the *Peabody Case* Hill J referenced other statutory contexts in which the words "reasonable expectation" or cognate expressions had been used in coming to his view as to the meaning of that expression.[287]

In noting the different contexts between Division 13 and Part IVA her Honour could be read as suggesting that any investigation or consideration of purpose or motive is always irrelevant to the operation of Division 13 and Subdivision 815-A. This can be elucidated by considering the case her Honour cites as authority.

In *WR Carpenter Holdings Pty Ltd & Anor v FC of T (*the *WR Carpenter Holdings Case)*, Lindgren J, in the context of rejecting motions filed by the taxpayers that the Commissioner provide particulars of the matters taken into account in "determinations" made that subsections 136AD(1) and (2) should apply to the derivation by the appellant of amounts of deemed or imputed income, made the following observations about the introduction of Division 13:

> Division 13 was introduced into Part III of the ITAA following the introduction of Pt IVA. The explanatory memorandum for the *Income Tax Assessment Amendment Bill 1982* (Cth) stated (at 4):
>
> > *"*The revised Division 13, which this Bill will insert into the Principal Act, is designed ... ***to provide in the international area a general supplement to the new Part IVA*** of the Principal Act. ***Because of policy and technical inter-relationships between the two, a number of the now proposed provisions draw on the measures contained in Part IVA.****"*
> >
> > In his Second Reading Speech on the Bill, the then Treasurer described Div 13 as follows (Cth, Parliamentary Debates, HR, 24 March 1982, 1367-8):
> >
> > ***Although complementary to Part IVA, the proposed measures are not limited in scope to arrangements that have a dominant tax avoidance purpose.***

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[286] [2009] FCA 1427; 2009 ATC20-151 at [92] to [102].

[287] *Peabody v Commissioner of Taxation* (1993) 40 FCR 531; 93 ATC 4104 at 4112.

> In that regard, it is important to recognise that an arrangement to shift profits out of Australia may be entered into for a complex mixture of tax and other reasons.
>
> However, ... the fact that tax saving is ***not a key purpose*** of the particular arrangement or transaction is no reason why we, as a nation, should not be in a position to counteract any loss of the Australian revenue inherent in it.
>
> The main requirements for the application of the revised provisions are that a taxpayer has supplied, or acquired property or services under an 'international agreement', one or more of the parties to which were not dealing at arm's length with each other, and that the supply or acquisition was at prices other than those that might have been expected in a transaction between independent parties dealing independently – that is, at arm's length.[288] [Emphasis added.]

In his specific references to the explanatory memorandum, Lindgren J was making the point that, unlike Part IVA, any stipulation that the existence of a dominant tax avoidance purpose is a precondition would limit the range of cases to which Division 13 could apply in a way that was inconsistent with the policy. This is not to say that he was expressing the view that the existence of such a purpose is never relevant. He acknowledged that there are policy and technical relationships between Part IVA and Division 13, that a number of the provisions of Division 13 draw on the measures contained in Part IVA and that Division 13 is "complementary to Part IVA".

When the *WR Carpenter Holdings Case* came before the Full High Court on appeal their Honours observed:

> There remains the proposition put in the Appellants' Statements that in making a determination under par (d) of s 136AD(1) [that subsection should apply in relation to the taxpayer in relation to the supply], the Commissioner was obliged to consider whether the transactions had "a tax avoidance purpose" and "a profit shifting motive".
>
> The appellants seek to draw some comfort from the circumstance that what became Div 13 was first proposed in Parliament in the second reading speech to the Bill which became the *Income Tax Laws Amendment Act (No 2)* 1981 (Cth). That statute inserted Pt IVA (ss 177A-177G) which is headed "Schemes to reduce income tax". It is true that the Treasurer described to the Parliament the proposed Div 13 as a further "anti-avoidance" measure which was "complementary" to Pt IVA. However, the Treasurer also said on that occasion:
>
>> There is also the point that, damaging as they are to the Australian revenue, international transfer pricing arrangements may be entered into for a complex mixture of tax and other reasons. ***The fact, if it is one, that tax saving is not a key purpose of an arrangement or transaction is, however, no reason why we as a nation should not be in a position to counteract any potential losses of Australian tax inherent in it. Other major countries have in recent times acted against the growing use of international arrangements that have a tax avoidance purpose or effect, especially those involving transfer pricing.***

[288] *WR Carpenter Holdings Pty Ltd & Anor v FC of T* [2006] FCA 1252 at [11] and [13]; 2006 ATC 4652 at 4656, paragraphs [11] and [13].

> Methods adopted by tax authorities to reallocate profits on a more appropriate basis than pricing arrangements throw up are usually based on the internationally accepted 'arm's length' principle, and this will form the foundation of our proposed new measures.

> ***With that background in mind, it is unsurprising that the criteria spelled out in pars (a), (b) and (c) of s 136AD(1) do not include any requirement of a profit shifting motive or tax avoidance purpose. To have included such criteria would have burdened the operation of what the Treasurer had identified as the internationally accepted "arm's length" principle which was the foundation of Div 13. Paragraph (d) of s 136AD(1) does not introduce under cover of general words a consideration which would be at odds with the scope and purpose of Div 13.***
>
> What on the applications for particulars the primary judge called "the real issues" on the Pt IVC appeals cannot include the requirement of any investigation or consideration by the Commissioner of these matters of motive and purpose ***when making the determinations under par (d) of s 136AD(1)***. [289] [Emphasis added.]

The gravamen of what the High Court was saying is that the scope of Division 13 is not limited to cases where there is a tax avoidance purpose, but will include cases where non-arm's length transfer pricing results in a loss of Australian tax, whether or not a tax avoidance purpose is present. However, for the purpose of applying paragraph 136AD(1)(d), the question of whether a tax avoidance purpose existed was irrelevant because the paragraph dealt with a procedural assessing issue, the validity of which was protected by sections 175 and 177 of the *1936 Assessment Act*. The paragraph did not go to the substantive legal basis of the transfer pricing adjustment being made under Division 13 and section 166 of the *1936 Assessment Act,* the basis of the transfer pricing adjustment being subject to review in proceedings under Part IVC of the *Taxation Administration Act 1953*.

The scope of section 136AD(1) is, on its terms, broad enough to cover any circumstance where there is non-arm's length dealing in relation to the supply of property and the consideration for the supply of property is less than the arm's length consideration as defined, whether or not a tax avoidance purpose exists. While the existence of a tax avoidance purpose is not a prerequisite for the operation of Division 13 (in the *Glencore Case* subsection 136AD(1), or subsection 136AD(4) when used in conjunction with subsection 136AD(1)), admissible evidence of a purpose to shift taxable profits from Australia would be relevant to the following questions arising in the application of those provisions: whether the precondition in paragraph 136AD(1)(b) that the parties were not dealing at arm's length with each other in relation to the supply is satisfied; and, the issue of whether, for the purposes of the precondition in paragraph 136AD(1)(c), the amount of the consideration in respect of the supply of property was less than "the arm's length consideration" as defined in paragraph 136AA(3)(c).[290]

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[289] [2008] HCA 33; 2008 ATC 20-040, at [35] to [38] per Gleeson CJ, Gummow, Kirby, Hayne, Heydon, Crennan and Kiefel JJ.

[290] Compare *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 where the Full Federal Court had regard to the fact that the taxpayer was seeking to avoid Australian tax through the use of excessive interest charges on a large, unsecured borrowing in circumstances where the interest income derived in the United States was returned to Australia in the form of exempt dividend income.

Similarly, it is not a precondition for the operation of Article 9 of the Swiss Agreement that there be a tax avoidance purpose, that article being focussed on the operation of non-arm's length conditions in the commercial or financial relations between the associated enterprises. However, the objective demonstration on the basis of admissible evidence of the existence of such a purpose is relevant to the question of whether the conditions that operate between associated enterprises in their commercial or financial relations differ from those that might be expected to operate between independent enterprises dealing wholly independently with one another. This question posed by Article 9 is incorporated into the machinery of Subdivision 815-A by the operation of sections 815-10 and 815-15.

It can generally be observed that the use of non-arm's length dealing and non-arm's length pricing in relation to Division 13, or the use of non-arm's length conditions in the commercial or financial relations between associated parties in relation to Subdivision 815-A are necessary elements of ***deliberate*** profit shifting. The consequence of the use of these devices for the avoidance of Australian tax is that one party is deliberately disadvantaged in terms of its profits and a related party is correspondingly advantaged. This is inconsistent with what Courts have understood to be required to find that parties dealt with each other at arm's length[291].

When the similarities in language in subsections 136AD(1), the definition of "agreement" in 136AA(1), the definition of "arm's length consideration in subsection 136AA(3)(c), Article 9 of the Swiss Agreement, section 177C and the definition of "scheme" in section 177A are considered, and the relevant case law is examined, there appears to be no error in the Full Federal Court's expression of what has been referred to as "the reasonable expectation test in the arm's length hypothetical".

The concept of "independent parties dealing at arm's length (wholly independently) with each other"

The question for the Court in the *Glencore* Case was, given that the sales occurred between an Australian subsidiary and its Swiss parent, whether or not the pricing of those sales "was less than the consideration that might reasonably have been expected to have been paid in arm's length dealings between independent parties"[292] ***dealing wholly independently with each other*****,** this being the assertion made by the Commissioner as the basis for increasing the tax payable in Australia. The additional text, acknowledged by Davies J at paragraph [181] of her judgment, is critical to properly framing the context in which tested dealings have to be considered in applying the arm's length principle as articulated in Division 13, Subdivision 815-A and Article 9 of the the Swiss Agreement.

Under Australia's transfer pricing rules there is an important distinction between dealings between parties that are wholly independent - which is not the focus required or authorised under those rules - and the statutory focus, in the case of Division 13 of the consideration that might reasonably be expected to have been received or receivable as consideration in respect of the supply if the property had been supplied under an agreement between independent parties dealing at arm's length with each other in relation to the supply. This issue was fully argued in the *Chevron Case* and which is discussed below. In her Honour's words:

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[291] *Trustee for the Estate of the Late AW Furse (No 5) Will Trust v Federal Commissioner of Taxation* [1990] FCA 676; 21 ATR 1123; 1991 ATC 4007 at 4015; *Granby Pty Ltd v Federal Commissioner of Taxation* (1995) 129 ALR 503; 95 ATC 4240 per Lee J at 506-507.

[292] See [1].

> …CMPL was not a standalone miner in the relevant years. As made clear in *Chevron*, the task of ascertaining the consideration that might reasonably be expected would have been paid to CMPL for the copper concentrate that it sold to GIAG is not to be undertaken upon the hypothesis that CMPL was not a member of the Glencore Group**.** As Pagone J cautioned at [130][293], to do so would distort the application of Div 13 and fundamentally undermine its purpose of substituting as a comparable a real world arm's length consideration which could predictably have been agreed between them on the hypothesis that they had been independent and dealing at arm's length. In the present case, the relevant mine producer for the purposes of the hypothetical agreement is a mine producer with all the characteristics of CMPL, which include, as earlier stated, that it had no need for a logistics or marketing division because it sold the whole of its production for the life of the mine to a buyer with GIAG's characteristics, namely a trader with a substantial marketing team which purchased the whole of the mine's production for the life of the mine.[294]

While her Honour's observations related to Division 13, a similar observation may be made in relation to the application of Subdivision 815-A and Article 9 (the associated enterprises article) of the Swiss Agreement, which is incorporated by reference into Subdivision 815-A by the operation of sections 815-10 and 815-15. The commonality with Division 13 is that in framing the arm's length hypothetical both sets of provisions incorporate a reasonable expectation test of what ***independent parties dealing at arm's length, or wholly independently with one another,*** would have done, noting though that Division 13 does this in relation to the setting of the consideration for the supply or acquisition of property, whereas Subdivision 815-A does this in relation to whether the actual conditions that operate in the commercial or financial relations between the associated parties differ from those that would operate in that hypothetical context and that difference has an adverse effect on taxable profits.

This analysis accords with Pagone J's judgment in the appeal on the *Chevron Case*, Allsop CJ and Perram J in agreement. His Honour said:

> 153 …The purpose of Article 9(1), as explained in *SNF*, and its function through the operation of s 815-15(1)(b), is to identify those conditions existing between enterprises in two countries affecting their financial or commercial relations. The identification of those conditions permits a broad and wide ranging inquiry into the relations existing between the enterprises concerned. ***There is not excluded from that inquiry the relationship existing between the parties such as parent or subsidiary.*** The factual inquiry of the conditions operating between the enterprises which needs to be undertaken is unconfined by the terms of Article 9(1), or by the terms of s 815-15(1)(b), by any circumstance other than that there be identified those conditions which bear relevantly and probatively upon whether they operate between the relevant enterprises "in their commercial or financial relations which differ from those which might be expected to operate between independent enterprises dealing wholly independently with one another"…

[293] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [130].
[294] See [181].

156 ***The evaluative judgment required by Article 9 required comparing the conditions which operated between CAHPL and CFC with those expected to operate between "independent enterprises" but that did not require his Honour to compare CAHPL and CFC with a wholly standalone company.*** The purpose of the comparison is to determine whether profits have not accrued for tax in a jurisdiction which "might have been expected to accrue" but for the condition found to operate. [Robertson J at first instance] was correct to reject CAHPL's contention that an "independent" company within Article 9 was a company which stood alone with no corporate affiliations. At [604] [Robertson J at first instance] said:

> ***While I accept the applicant's submission that one must consider the conditions that one might expect to see between a lender and a borrower who are independent, and are dealing wholly independently with one another, which is the language of Art 9, it by no means follows that where, as here, the entities in question are sister companies, also to be eliminated is the relationship between each of them and their common parent on the basis that, otherwise, it could not be said that the lender and borrower were independent or were dealing independently. In my opinion, independent enterprises dealing wholly independently with one another may still be subsidiaries and may still have subsidiaries even if the enterprises are independent of each other.*** I therefore accept the respondent's submission insofar as he contended that there was ***no legislative warrant for ignoring affiliation between a hypothesised party to a transaction and other members of that party's group of companies***. [Emphasis added.]

Allsop CJ also observed in the context of applying Article 9 (the Associated Enterprises Article) of the US Agreement[295] as incorporated by Subdivision 815-A, the OECD 1995 Transfer Pricing Guidelines that:

> There is nothing in the Guidelines that requires other than the independent status of the enterprises **from each other** in the transaction"…...[296]

In the *Glencore Case* the application of the concept of "independent parties dealing wholly independently (or at arm's length) with one another" for the purposes of applying Division 13 and Subdivision 815-A has to have regard to CMPL's position within the Glencore Group and the integrated copper concentrate mining, marketing and trading business the group was operating.[297] This business model and strategy was described by Mr Kelly in his evidence and summarised by Davies J in the following terms:

> The evidence of Mr Kelly was that Glencore seeks to derive value from its investments in industrial assets by operating those assets, conducting marketing/trading activities in respect of the commodities produced by those assets

[295] *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (6 August 1982) ATS 16.

[296] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [91].

[297] See *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [60], [92] to [95] per Allsop CJ and [130] to [132], [153] and [156] per Pagone J.

> and from the integration of these operational and marketing activities. Mr Kelly explained that by integrating its marketing activities with the industrial assets it invests in and operates, Glencore can optimise the logistics required to process raw materials and deliver the end product to its customers.[298]

As Davies J said in relation to the formulation of the arm's length hypothetical for the purposes of undertaking the comparison between the actual consideration (or actual conditions that operate in the commercial or financial relations) and the "arm's length consideration" (or the arm's length conditions):

> the relevant mine producer for the purposes of the hypothetical agreement is a mine producer with all the characteristics of CMPL, which include, as earlier stated, that it had no need for a logistics or marketing division because it sold the whole of its production for the life of the mine to a buyer with GIAG's characteristics, namely a trader with a substantial marketing team which purchased the whole of the mine's production for the life of the mine.[299]

The commercial reality was that GIAG managed the sales of copper concentrate that was produced by the CSA mine to independent parties and was responsible for managing the risks associated with that inventory.[300] It is unrealistic to commence the application of Division 13 and Subdivision 815-A on the basis that CMPL is selling to independent parties and managing the inventory risks. CMPL has no authority or capability to sell to independent external parties; it is required, both by virtue of the life of mine offtake agreement and the organisational context of Glencore's integrated business model and strategy, to sell all of the CSA mine production to GIAG.[301]

There is no requirement in Division 13 or Subdivision 815-A that an Australian supplier of property, like CMPL, supply property directly to independent parties. The focus of those provisions is the supply of property between parties that are not dealing at arm's length or, in the case of Subdivision 815-A, one enterprise directly or indirectly participates in the management, control or capital of the other enterprise. It is sufficient if the consideration received was "in respect of the supply"[302] or that the supply of property is a matter that was affected by conditions in the commercial or financial relations between the associated enterprises.[303] Reading the relevant legislative provisions as encompassing indirect flows of supplies reflects the commercial reality of how integrated businesses deal with their customer bases.

Proceeding on the reality that CMPL is part of an integrated mining, marketing and trading business the question then becomes: what might reasonably be expected to have been received by CMPL in respect of the long term supply of copper concentrate if that integrated business sold the copper concentrate to an independent buyer that was dealing at arm's length with Glencore? The answer has to be informed by evidence of comparable long term sales of high grade copper concentrate between independent parties dealing at arm's length (or

[298] See [105].
[299] See [181].
[300] See [106].
[301] See [2] and [108].
[302] See subsections 136AA(3)(c) and 136AD(1)(c).
[303] Sections 815-10 and 815-15 and Article 9 of the Swiss Agreement.

wholly independently) with each other in the open market, GIAG being one, if not the biggest, of the independent sellers[304].

It is noted in passing that the 1995 OECD Guidelines include the following statement in relation to the statement of the arm's length principle as encapsulated in Article 9 of the OECD Model Tax Convention:

> By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances, the arm's length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities attention is focussed on the nature of the dealings between those members.[305]

The following observations can be made about this statement which may have been seen in some quarters as having a bearing on the interpretation of the concept of "independent parties dealing wholly independently with each other" used in the Article 9 text in Australia's treaties, but is not used in the OECD model article which refers only to "independent parties"[306].

First, it would be an overreach to say that the arm's length principle as articulated in tax treaty provisions treats member companies of a multinational group as separate entities for all purposes and in all respects. The Guidelines and commentary are intended as an aid to interpretation and cannot go beyond the language used in the treaty, or extend or qualify that language.

Secondly, the concept of "independent parties dealing wholly independently with each other" may be read as implicit in the concept of benchmarking the actual conditions in the commercial or financial relations between associated enterprises with the conditions "that would be made between independent enterprises" when regard is had to the fiscal purpose of that benchmarking.

Thirdly, the notion of "independent enterprises" might be read as not recognising the possibility that independent enterprises may deal with each other on a non-arm's length basis, but it still places the focus on the relationship of the parties in the arm's length hypothetical; namely that they need to be independent from each other; not that they need to be treated as "orphans" divorced from their group context.

Necessary causal link between non-arm's length dealing, inadequate consideration and understatement of profits

The operation of section 136AD(1) is predicated on a causal link between the objective fact that the parties to the agreement were not dealing at arm's length with each other in relation to the supply and the factual determination that, on the balance of probabilities, having regard

[304] See [106] and [107].
[305] Paragraph 1.6 of the 1995 OECD Guidelines.
[306] OECD Model Tax Convention on Income and on Capital, Updated 21 November 2017. Paragraph 1 of Article 9 of the current Model corresponds to Article 9 of the 1963 Draft Convention (adopted by the OECD Council on 30 July 1963).

to all the evidence, the consideration received by the taxpayer in respect of the supply was less than the consideration that might reasonably be expected to have been received if the property had been supplied under an agreement between independent parties dealing at arm's length with each other in relation to the supply (subsection 136AA(3)(c)).

Similarly, the operation of Article 9 of the Swiss Agreement is dependent on the objective demonstration of a causal link between:

(a) the fact that the actual conditions that operate in the commercial or financial relations between the parties differ from the conditions that might be expected to operate between independent enterprises dealing wholly independently with one another; and
(b) the fact that profits which, but for those non-arm's length conditions, might have been expected to accrue to one of those enterprises did not, by reason of those non-arm's length conditions, so accrue.[307]

To properly assess whether the necessary causal link is objectively demonstrated for the purposes of Division 13 and Subdivision 815-A it is therefore necessary to have regard to the nature of arm's length dealing; what it is and what it is not.

As Hill J said in *Trustee for the Estate of the Late AW Furse (No 5) Will Trust v Federal Commissioner of Taxation* [1990] FCA 676; 21 ATR 1123; 1991 ATC 4007 at 4015:

> What is required in determining whether parties dealt with each other in respect of a particular dealing at arm's length is an assessment ***whether in respect of that dealing they dealt with each other as arm's length parties would normally do***, so that the outcome of their dealing is a matter of real bargaining.

The switch from the market-related pricing framework to a price sharing framework without any negotiation at a time when the switch would have the natural and probable consequences of significantly disadvantaging CMPL by reducing its sales revenue while providing a commensurate advantage to GIAG through its reduced cost of purchases is not consistent with how independent parties dealing at arm's length (or wholly independently) with each other would be expected to behave. Such parties would bargain with each other in a way that sought to protect and advance their separate economic and financial interests. It cannot be said that the parties to an agreement for the supply of property were dealing at arm's length with each other in respect of the supply if they colluded to achieve a particular result or one of the parties submitted the exercise of its will to the dictation of the other, whether or not the parties themselves are related or at arm's length: *Granby Pty Ltd v Federal Commissioner of Taxation* (1995) 129 ALR 503; 95 ATC 4240 per Lee J at 506-507.

It was accepted by both parties in the *Glencore Case* that CMPL and GIAG "did not deal at arm's length with each other in relation to the supply of copper concentrate on the terms of the February 2007 Agreement".[308] No evidence was adduced by the taxpayer about the negotiation of the February 2007 Agreement and the taxpayer did not put into issue whether, nor did it contend that, the February 2007 Agreement was a negotiated agreement and an arm's length dealing.[309] This concession by the taxpayer in relation to the precondition (b) in subsection 136AD(1) is also relevant to the operation of Subdivision 815-A and Article 9 of

[307] Article 9 of the Swiss Agreement.
[308] See [28].
[309] See [171].

the Swiss Agreement and supports a finding that there were conditions in the commercial or financial relations between CMPL and GIAG that differed from those that might be expected to operate in the commercial or financial relations between independent parties dealing wholly independently with one another.

It does not automatically follow that the consideration paid for the copper concentrate supplied by CMPL was less than the arm's length consideration, or that taxable Australian profits were understated. That can only be determined by comparing the actual consideration received by CMPL with the hypothesised consideration that independent parties dealing at arm's length with each other in respect of the supply of copper concentrate might reasonably be expected to have agreed for the supply of copper concentrate under a long term supply agreement for a similar quantity and quality of copper concentrate.

Her Honour disregarded market-related agreements as an alternative option to price sharing agreements because she formed the view that the legislation did not permit the acceptance of market-related agreements as an arm's length comparable because to do so would be "a misapplication of the provisions of Division 13 and Subdivision 815-A"[310] in that it "***impermissibly restructures the actual contract entered into by the parties into a contract of a different character***"[311].

Davies J refers to the 1995 OECD Guidelines to support her view that the consideration for the supply of the copper concentrate needs to be worked out on the basis of the transaction as structured by GIAG.[312]

Her Honour notes the OECD guidance that the transfer pricing analysis "ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them" and that:

> Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.[313]

Her Honour then notes the OECD observation that any restructuring of the actual agreement for the purposes of the comparative analysis involved in the application of the arm's length principle is limited to two exceptional types of case set out in Paragraph 1.37 of the 1995 OECD Guidelines. Nevertheless, she also notes that the OECD draws a distinction between "restructuring the controlled transaction under review" and "using alternatively structured transactions as comparable uncontrolled transactions".[314] Significantly in the *Glencore Case,* the example the OECD uses in Paragraph 1.41 to elaborate the distinction involves the purported allocation of risk between the controlled parties, which the OECD acknowledges can be disregarded if there is good reason, as there is in the *Glencore Case,* to doubt the economic substance of the allocation and assumption of the risk.

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[310] See [6].
[311] See [314].
[312] See [315] to [319].
[313] Paragraph 1.36 of the 1995 OECD Guidelines.
[314] Paragraph 1.41 of the 1995 OECD Guidelines cited at [318].

It becomes clear when one reads the 1995 OECD Guidelines in their entirety that the OECD is using the notion of "restructuring" in a nuanced way. When the OECD speaks of the need to recognise, other than in exceptional cases, the actual transactions undertaken in order to avoid a "wholly arbitrary exercise the inequity of which could be compounded by double taxation",[315] it is talking about the underlying nature of the transaction, what it describes as the "character of the transaction". The two exceptional cases the OECD uses as examples each involve ***a different kind of property being used as the benchmark*** to conform the transaction (***not simply by reference to pricing***) for tax purposes to arm's length terms and conditions: the conforming of the use of interest-bearing debt in circumstances where at arm's length it would have been structured as a contribution of capital; and, the conforming of a sale of intellectual property where at arm' length it would be structured as a continuing research agreement.[316] In both of these scenarios the arm's length outcome is discerned by reference to the reasonable expectation of behaviour that would reflect rational commercial behaviour in the environment of an arm's length transaction; an evaluative prediction of events and transactions based on evidence and, where appropriate, admissible probative and reliable expert opinion as to what might reasonably be expected if the actual agreement had been unaffected by the lack of independence and lack of arm's length dealing.[317] The clear implication of the OECD analysis is that conforming a transaction by reference to pricing is in accord with Article 9.

In the *Glencore Case* "the character of the transaction" is the sale of copper concentrate under a life of mine offtake agreement for 100% of the production of the CSA mine. The Commissioner did not seek to "restructure" ***the character of the transaction***. It would be a misreading of the 1995 OECD Guidelines to say that the OECD is precluding the review and conforming, if necessary, the clauses of an agreement that relate to pricing for the purposes of applying the arm's length principle for tax purposes. It is not a "restructuring of the character of the transaction" to deal with pricing anomalies in the course of apply the arm's length test for tax purposes. There is nothing in the language or mechanics of Division 13 and Subdivision 815-A that would prevent pricing anomalies created by non-arm's length dealings from being addressed; in fact, not to do so would undermine the operation of those provisions.

None of the changes made by GIAG in relation to switching from a market-related agreement established in the 5 July 1995 agreement to a price sharing agreement in February 2007 affected the underlying character of the agreement between the related parties, which was the supply by an Australian resident company, CMPL, under a life of mine agreement of "property", being 100% of the copper concentrate produced by the CSA mine, to its Swiss parent GIAG as and when it was ready to be shipped. The "property" supplied under the market-related agreement first signed on 5 July 1999 was the same as the "property" supplied under the price sharing agreement that was introduced in February 2007.[318] It is on this basis that her Honour's view that the Commissioner is seeking to impermissibly restructure the agreement between the parties is open to question when due regard is had to the relevant legislation, the reasoning adopted by the Full Federal Court in the *Chevron Case* and the 1995 OECD Guidelines. As Allsop CJ said, bearing in mind that the *Chevron Case* involved an acquisition of property for a consideration that exceeded the arm's length consideration:

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[315] See paragraph 1.36 of the 1995 OECD Guidelines

[316] See paragraphs 1.37 and 1.38 of the 1995 OECD Guidelines.

[317] [2017] FCFCA 62 at [46], [60] and [62] per Allsop CJ and [121] and [126] – [129] per Pagone J (with whom Allsop CJ and Perram J agreed).

[318] See [162] to [171].

> Whilst the property remains the same, what consideration would be given for it in a real world of independence may lead, depending upon the evidence, to the reasonable expectation of different behaviour on the part of the person in the position of the taxpayer in relation to the giving of consideration for the property and of behaviour by another or others in relation to the dealing, and which would reflect rational commercial behaviour in the environment of an arm's length transaction. Such behaviour may affect the terms of the hypothetical agreement in question to the extent that they can be seen as part of the consideration.[319]

Justice Pagone put it in the following way:

> The focus of the inquiry called for by these provisions is an alternative agreement from the one actually entered into where the alternative agreement was made by the parties upon the assumptions that they were independent and dealing at arm's length. In that regard it may be useful to note in passing that ***the nexus between the consideration and the acquisition is expressed by reference to the words "in respect of" rather than the word "for" and that the agreement in the hypothetical is described by reference to the indefinite article "an", indicating that the hypothetical in the comparison may be different from the actual agreement with which it is to be compared.*** The provisions do not require the construction of an abstract hypothetical agreement between abstract independent parties. The hypothesis in the definition of arm's length dealing is of an agreement which was not affected by the lack of independence and the lack of arm's length dealing. The task of ascertaining the arm's length consideration is, therefore, fundamentally a factual inquiry into what might reasonably be expected if the actual agreement had been unaffected by the lack of independence and the lack of arm's length dealing.[320] [Emphasis added.]
>
> …In each case the focus of inquiry must be to identify a reliable comparable agreement to the actual agreement by the actual taxpayer for the legislative assumption to have meaningful operation. The provisions of Division 13 are intended to operate in the context of real world alternative reasonable expectations of agreements between parties and not in artificial constructs. The comparable agreement may, therefore, usually assume an acquisition by the taxpayer of the property actually acquired under an agreement having the characteristics of the agreement as entered into but otherwise hypothesised to be between them as independent parties dealing with each other at arm's length in relation to that acquisition. The purchaser (or in this case the borrower) may therefore, as his Honour considered at [79], be a company like CAHPL which is a member of a group, but where the consideration in respect of the acquisition identified in the hypothetical agreement is not distorted by the lack of independence between the parties or by a lack of arm's length dealings in relation to the acquisition.[321]

The adjustments made by the Commissioner to the taxable profits in the 2007, 2008 and 2009 income years were all related to the pricing of the copper concentrate, the working out of the consideration that the supplier might reasonably be expected to have received under an

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[319] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [46].

[320] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [126].

[321] [2017] FCAFC 62 at [129].

agreement between independent parties dealing at arm's length with each other in relation to the supply. For the purposes of Subdivision 815-A the process required a determination of the profits that would have been received on the basis of the conditions that might be expected to operate in the commercial and financial relations between independent parties dealing wholly independently with one another.

There is a pivotal issue that arises in relation to the appropriateness of her Honour's acceptance of how the taxpayer actually restructured the pricing mechanism in the offtake agreement, because not only was it based on the acceptance of the taxpayer's unsound rationale - that it was purported to be a risk management strategy but it was ineffectual in reducing economic risk in the real world for the Glencore Group's integrated business - it forecloses the opportunity to have appropriate regard to all of the options regarding pricing structures that were realistically available in the copper concentrate market. This in turn forecloses any proper consideration of "the manner in which independent parties dealing at arm's length would be expected to behave in conducting their affairs"[322], namely by each of the parties acting in their own self interest.[323] To that end, a seller would undertake a market survey to determine what options in terms of pricing frameworks are realistically available and then considering the economic costs and benefits of each in order to select the best economic option realistically available. This aligns with the OECD guidance on determining comparability in applying the arm's length test and, in particular, the need to identify and consider the ***economic*** functions each party performs, the contractual terms, the economic circumstances in which the dealings occur and the business strategies being pursued by the multinational group.[324] The arm's length seller "will only enter the transaction if they see no alternative that is clearly more attractive"[325]. To get to that point of selection the seller would have to undertake a market survey.

There was no evidence before the Court that a market-related pricing arrangement was not a realistic option that was available to a seller like CMPL. The only barrier to the selection of a market-related pricing framework, or rather the continuance of the pre-existing pricing framework, was the control exercised by GIAG over the decision to switch to a price sharing agreement, the risk management rationale for that switch proving to be fundamentally unsound. In other words, on the evidence before the Court, the selection of price sharing as the basis for the pricing framework between CMPL and GIAG was "distorted by the lack of independence between the parties"[326].

To undertake such a market survey to determine the terms and conditions that would be most acceptable to an independent party does not involve conflating the question of whether the parties are dealing at arm's length with the question of whether the actual consideration is less than the arm's length consideration.[327] The survey is part of the process of comparing the actual consideration, or the actual conditions in the commercial or financial relations, with the agreements reached by independent parties in arm's length dealings. The actual consideration is the product of the pricing framework that operates in the commercial and

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[322] This is a critical aspect in determining whether parties are dealing at arm's length that was highlighted in *AW Furse No 5 Will Trust v FC of T* 91 ATC 4007 at 4014-4015 per Hill J.

[323] *Australian Trade Commission v WA Meat Exports Pty Ltd* (1987) 75 ALR 287 at 291.

[324] Paragraphs 1.21, 1.28, 1.29, 1.30 and 1.31 to 1.35. These paragraphs are summarised in the earlier section of this paper entitled, The Application of Australia's Transfer Pricing Rules.

[325] Paragraph 1.15 of the 1995 OECD Guidelines.

[326] [2017] FCAFC 62 at [129].

[327] See [324].

financial relations between parties to an agreement and, for this reason, different pricing frameworks available in the market need to be identified, compared and understood. To focus the enquiry on only one type of pricing framework, as happened in the *Glencore Case* biases the analysis "by a rigid constriction of the arm's length hypothesis in a shape and form controlled by the taxpayer" and undermines the sensible operation of Division 13 and Subdivision 815-A.[328]

It would be extremely detrimental to the operation of Australia's transfer pricing rules if a multinational group can develop a pricing framework that ensures that an Australian company supplying property on a long term basis to an offshore associate is forced to select the lowest price seen in the market, regardless of how prevalent that pricing framework is in the market, or how unsound its rationale for using it.

On the basis of the foregoing analysis it is not necessary to consider her Honour's reliance on the Tax Court of Canada decision in *Cameco Corporation v The Queen* 2018 TCC 195. Arguably, the passage of the judgment cited at [325] of her Honour's reasons supports the Commissioner's argument in the *Glencore Case.* There also seems to be a significant difference between Canadian and Australian legislation or the judicial approach to dealing with transfer pricing since the language of section 136AD(1), section 136AA(3)(c) and Article 9 of the Swiss Agreement all embody the reasonable expectation of behaviour that would reflect rational commercial behaviour in the environment of an arm's length transaction; an evaluative prediction of events and transactions based on evidence and, where appropriate, admissible probative and reliable expert opinion as to what might reasonably be expected if the actual agreement had been unaffected by the lack of independence and lack of arm's length dealing.[329]

Consideration of the manner in which independent parties are expected to behave is particularly important in a case like the present where the Court found that there was no evidence that the February 2007 Agreement (and by clear inference the informal arrangement that preceded it in January 2007[330]) was a negotiated agreement, nor did the taxpayer put into issue or contend that it was a negotiated agreement and arm's length dealing.[331] It is a significant feature of the case that the Glencore Group is conducting an integrated mining, marketing and trading business. The arm's length test as articulated in Division 13 and Subdivision 815-A should not be construed in a way that envisages that a hypothetical arm's length seller of copper concentrate would act in a commercially irrational manner and enter a price sharing agreement that was highly likely to carry significant economic and financial disadvantage when there were significantly better options realistically available to it in the open market.[332]

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[328] Compare *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [55] per Allsop CJ.
[329] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCFCA 62 at [46], [60] and [62] per Allsop CJ and [121] and [126] – [129] per Pagone J (with whom Allsop CJ and Perram J agreed).
[330] See [148].
[331] See [171].
[332] See paragraphs 1.15 to 1.18 of the 1995 OECD Guidelines.

Risk management rationale for switch to price sharing is unsound

In an economic sense, the relevant TCRCs allowances from the perspective of their ability to impact on GIAG's and the Glencore Group's profits from the integrated copper concentrate business are the TCRCs allowances that were agreed in setting the prices at which GIAG sold to independent smelters and on the spot market.

Unlike the impact of market forces on dealings between independent parties dealing wholly independently with each other, the setting of the TCRCs related to the sale of copper concentrate between CMPL and GIAG was an internal matter for the Glencore Group. The intra-group pricing washed out on consolidation of the Glencore Group's accounts. While it does impact on the reported profits of CMPL and GIAG as individual companies, it does not impact on group profits, apart from the overall amounts of tax the group has to pay on the channel profits from the production, marketing and trading of copper concentrate from the Cobar mine.

It is noted that the evidence accepted by the Court was that financial control was exercised over the mine "with a view to maximising profit for the Glencore Group" as a whole[333] and her Honour's found on the evidence that there were conditions operating between GIAG and CMPL which differed from those that might be expected to operate between independent parties dealing wholly at arm's length with each other and "that such conditions included GIAG's control and management of the CSA mine" [334]. No evidence was adduced by the taxpayer about the negotiation of the February 2007 Agreement. Nor did the taxpayer put into issue whether, nor did it contend that, the February 2007 Agreement was a negotiated agreement and an arm's length dealing.[335]

Any purported abatement of the volatility risks by use of a price sharing agreement between CMPL and its parent would still leave the inventory of the integrated mining, marketing and trading business exposed to those risks in the real world. The rationale for the change from a market-related contract to a price sharing contract is misconceived; the related party dealings cannot remove the risks of volatility in a real world sense - only in an artificial sense, and only if one impermissibly views CMPL as "an orphan" separated from the integrated mining, marketing and trading business the group is conducting. From the group perspective, the purported abatement of the volatility risks by use of a price sharing agreement between CMPL and GIAG is a "zero sum" game; on the then prevailing market conditions CMPL could reasonably be expected to lose some of its sales revenue and GIAG could be expected to gain to a commensurate extent by reducing the amounts it paid CMPL for its copper concentrate. In other words, the taxpayer's argument is based on false premises.

It can readily be accepted that all independent parties operating in the open market have to make judgments about the likelihood as to whether particular risks (like volatility in TCRCs and between TCRCs and copper prices) will in fact materialise and, if so, what the extent of the exposure would be, and what would be the extent of any actual loss. Participants in the market would then have a basis for deciding whether, and to what extent if any, steps should be taken to mitigate that risk. There was no evidence led at trail, or in any contemporaneous cost/benefit analysis, that would allow the Court to consider the likelihood and consequence for CMPL of the volatility risks that the taxpayer asserted as the justification for the switch

[333] See [131].
[334] See [132].
[335] See [171].

from the market-related pricing framework to the price sharing framework. Nor was there any such evidence in relation to the integrated mining, marketing and trading business the Glencore Group was operating.

From a group perspective, and in order to maximise the profits to the Glencore Group as a whole, decisions about whether and to what extent the volatility risks should be hedged, and how, could only be determined by GIAG in accordance with the group's policies and practices that were relevant to its revenue efficiency, cost efficiency and risk management. The Glencore Group's business strategy in these respects would be evident from the terms and conditions on which GIAG generally bought and sold copper concentrate in arm's length dealings with independent parties. The taxpayer did not lead that kind of evidence and her Honour does not record any findings of fact in relation to the Glencore Group's policies and practices as they applied in the 2007, 2008 and 2009 income years in relation to managing the risk of volatility in market-related TCRCs and the volatility between market-related TCRCs and copper prices, or in relation to risk management and hedging in general. Nor was evidence led in relation to its general policies and practices in setting prices in its purchases and sales transactions with independent parties. This raises a question in terms of the standard of comparability required by the arm's length principle, as separately encapsulated in Division 13 and Subdivision 815-A, as to whether the taxpayer has properly satisfied its burden of proving that, on the balance of probabilities, the consideration that GIAG paid for the copper concentrate was the amount that CMPL might reasonably have expected to receive for that supply under an agreement between independent parties dealing at arm's length with each other, and that the amended assessments were therefore excessive. [336] Without evidence there is no basis for assuming that GIAG adopted a general policy and practice of managing any volatility in market-related TCRCs and of managing any volatility between market-related TCRCs and copper prices through the use of price sharing agreements in its dealings with independent parties, or otherwise hedged. If this was not GIAG's general policy and practice then it could reasonably be concluded that the price sharing agreement between CMPL and GIAG had a purpose other than the purported management of the volatility risk.

While the taxpayer led evidence of price sharing agreements being entered into between independent parties, only three included examples of contracts to which GIAG was a party: the Redbank Contract, the Red Earth Contract, and the Jiangxi Contract. The Redbank Contract for 100% of production for the life of the mine was executed in November 2006 and was for estimated annual production of less than 5,000 wet metric tonnes but the mine had not yet commenced production.[337] The Red Earth Contract was for 100% of the production for the life of the mine from the Tapgura mine, to begin on 1 January 2010, and estimated to be 5,000 wet metric tonnes per year.[338] The Jiangxi Contract's price sharing terms related to one shipment of 10,000 dry metric tonnes up to August 2003 and thereafter the parties reverted to TCRCs applicable to different qualities of copper.[339] In other words, the taxpayer led no evidence of actual physical purchases or sales of copper concentrate involving independent parties that would shed light on the group's general policies and practices in the lead up to the February 2007 Agreement, despite its position in 2006 the largest seller of copper concentrate in the world. This is somewhat surprising given its sales were in respect

[336] Section 14ZZO of the *Taxation Administration Act 1953.*
[337] See [255] to [258].
[338] See [259] to [260].
[339] See [254].

of copper concentrate it acquired from mines it owned, mines in which it had an interest, as well mines owned by third parties.[340]

By comparison with the small volumes of actual and potential production covered in the three GIAG contacts cited, the CSA mine achieved a record production of 140,452 dry metric tonnes in 2006[341] and there was nothing in the contemporaneous documents which identified any uncertainty for the mine in relation to its capacity to continue mining in 2007, 2008 or 2009 or to suggest that CMPL considered that there was any real risk that its level of production would not continue throughout those years[342]. Although the CSA mine was the largest of the copper mines in the Cobar region, in relative terms it is a small mine. The evidence before the Court was that by way of comparison some copper mines in South America (like Escondida) mine in a day or two what CSA mines in a year and, in 2006, the CSA mine's annual production of concentrate represented about 0.2% of world copper concentrate production.[343] One can reasonably conclude that the volumes of actual and potential production covered by the GIAG price sharing agreements disclosed to the Court were very low relative to the volumes of copper concentrate the Glencore Group sold each year, noting that in 2006 Glencore was the biggest seller of copper concentrate in the world[344].

Given the fact that the three GIAG contracts disclosed to the Court involved no actual physical purchases or sales of copper concentrate by the Glencore Group that would shed light on its policies and practices relative to the time the February 2007 Agreement was put in place, and the fact that it can reasonably be concluded that the volumes of actual and potential production covered by those contracts were very low relative Glencore’s annual sales of copper concentrate, it is not reasonably open to conclude that those contracts were representative of Glencore’s general practice during the relevant income years in relation to: the pricing of its purchases and sales of copper concentrate; the extent to which it used price sharing; the circumstances in which it used price sharing; or the general allowances it made for TCRCs in dealings with independent parties.

The evidence presented by the taxpayer in relation to price sharing agreements does not pass the evidentiary threshold set by the arm’s length hypothetical. The best that can be said of this evidence is that it showed there was a “possibility” that a price sharing agreement might be agreed between independent parties, whereas the standard the reasonable expectation in the arm’s length hypothetical in Division 13 and Subdivision 815-A calls for a prediction, going beyond a mere possibility, based on evidence as to what independent parties dealing at arm’s length (or wholly independently) with each other might reasonably be expected to have done. [345] The taxpayer’s approach impermissibly excludes the other pricing framework that is a realistic option available in the market, namely market-related agreements. Having regard to the language of Division 13 and Subdivision 815-A the scope of comparable arm’s length dealings that can be used to benchmark the actual pricing structure is limited only by reference to whether they are truly comparable, so as to provide a reliable prediction of what might reasonably be expected if the dealings occurred between independent parties dealing at arm’s length (or wholly independently) with each other.

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[340] See [106] and [107].
[341] See [134].
[342] See [120].
[343] See [111].
[344] See [107].
[345] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCFCA 62 at [127].

In the light of the foregoing it can reasonably be concluded that the taxpayer misperceived and misapplied the arm's length hypothetical embodied in the relevant statutory provisions in that it asserts that proof of a risk management benefit replaces the need to demonstrate the reasonable expectation called for by the relevant legislative provisions.

The February 2007 changes to the pricing formula, and in particular the switch from market-related TCRCs to a TCRC calculated at 23% of the copper reference price[346], were highly likely, based on the forecast copper prices and TCRCs in the 2007 Budget[347], to result in less sales revenue for CMPL in the relevant income years.

The changes were highly likely to produce correspondingly lower costs of acquisition for the Swiss parent relative to what could reasonably be expected to have occurred under the continuation of the previous market-related pricing formula.

It can be concluded on the balance of probabilities that the "natural and probable consequences"[348] of the changes were the reduction of the taxable Australian profits and the corresponding increase in the Swiss profits for the 2007, 2008 and 2009 income years. The realisation of the "highly likely"[349] adverse impact on CMPL's sales revenue and the causal link with the imposition of the TCRCs at 23% of the copper reference price are evidenced in the January 2007 Management Report and the 2007 Review in the 2008 Budget and Five Year Plan. The January 2007 report noted that:

> Revenue for January is down as a result of low December stocks, sold in January, lower copper prices, 2006 shipment finalised at lower copper prices and the first effects of the new 2007 sales contract price sharing agreement.[350]

The 2007 Overview notes that the CSA mine did not perform as well as expected. It noted a number of factors that contributed to a shortfall in budgeted production and that staff turnover had been high, but somewhat less than the previous year. It noted that income in USD was 13% over budget, with stronger copper prices more than compensating for lower sales. It also reported that:

> the biggest impact on cost was the change to price sharing, rather than TCRC as previously budgeted…[351]

GIAG would be able to make a profit margin from its dealings with CMPL once the copper concentrate was on-sold to independent parties if the allowance it made for costs associated with refining the copper concentrate in setting the purchase prices was greater than the allowance for such costs that was made in setting the prices at which it on-sold to the smelters or spot market, as the case may be.

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[346] See [167].
[347] See [137] to [143].
[348] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.
[349] See [202].
[350] See [147].
[351] See [150].

The contested issues in the case related to a fundamental change in February 2007 to the formula for calculating the sale price from CMPL to GIAG from a "market-related" pricing method to a "price sharing" method and a widening of the range of quotational periods that could be used by GIAG to select the reference price it could adopt for calculating the consideration it would pay for the copper concentrate it bought.[352]

Having regard to:

(a) the importance of copper concentrate pricing to the profits of the integrated business model being conducted by the Glencore Group;
(b) the financial and management control exercised by GIAG over the CSA mine[353];
(c) the fact that functions allocated to CMPL as mine manager were confined to the development, operation and provisioning of mining activities[354];
(d) the fact that the mining, marketing, trading, cashflow management and treasury activities were managed centrally by the Glencore Group in a highly integrated manner[355];
(e) her Honour's finding that there were conditions operating between GIAG and CMPL which differed from those that might be expected to operate between independent parties dealing wholly at arm's length with each other and such conditions included GIAG's control and management of the CSA mine[356];
(f) the concession by the taxpayer that CMPL and GIAG were not dealing at arm's length with each other in relation to the supply of copper concentrate on the terms of the February 2007 Agreement[357]; and
(g) no evidence was adduced by the taxpayer about the negotiating of the February 2007 Agreement, nor did the taxpayer put into issue whether, and nor did it contend that, the February 2007 Agreement was a negotiated agreement and an arm's length dealing[358]

there is a compelling basis for concluding that CMPL had no effective say in relation to the establishment of the terms and conditions of the February 2007 Agreement, and in particular in relation to the profit margin CMPL would receive for the functions it performed, the assets it used and the risks it assumed. The February 2007 Agreement was ineffective as a means of removing the volatility risk that was put forward as the justification for the switch from a market-related agreement to a price sharing agreement. It is therefore open to conclude, on the basis of the "natural and probable consequences" of the changes made in January 2007[359] (and then formalised in the February 2007 Agreement), that the reconstructed pricing framework had the impacts that GIAG intended it to have[360], namely, the reduction of the taxable profits of CMPL under the consolidation regime as a subsidiary of a MEC group and the commensurate increase in the profits of the Swiss parent company, GIAG.

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[352] See [3].
[353] See [126] and [132].
[354] See [106] and [111] to [133].
[355] See [110], [126], [129], [132] and [133].
[356] See [132].
[357] See [28].
[358] See [171].
[359] See [148].
[360] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.

The cost structure of the CSA mine is not a sound rationale for price sharing

The argument, presented by Mr Kelly's evidence, that the risk of cost escalation over the 2007, 2008 and 2009 years is a sound basis for CMPL to switch from the existing market-based pricing to a price sharing basis does not bear close scrutiny. Mr Kelly's evidence in cross examination was that "if costs were a main focus for 2007, it was "very reasonable someone would look to try and focus on the costs line because [CMPL] can't control the revenue line".[361] When pressed in relation to the aim of cost control Mr Kelly pointed to factors related to the actual mining process, like the increasing depth of mining and the extent of mineral recovery; that he saw increasing operating costs, increasing capital costs, falling grade. Mr Kelly explained that many of the operating costs were affected by matters beyond CMPL's control, such as fuel costs, electricity costs, tyre costs, mobile fleet costs and labour, which had all increased in 2006. He said that operating costs in 2006 had been high due to external factors outside the control of the mine, such as fuel, power and cement increases and increased royalties due to higher revenue due to record high metal prices.[362]

The CSA mine achieved record production of 140,452 dry metric tonnes in 2006 but its operating costs (in AUD) exceeded the budgeted costs by 31% and the C3 costs (the total metal costs including capital costs) exceeded actual costs by 37% and while profit and net revenue exceeded budget, this was attributable to an increase in copper prices that was not forecast or budgeted[363]. While not connected in the taxpayer's argument or in her Honour's reasons, the overrun in budgeted costs of 31% in 2006 coincided with the fact that mine production of ore in 2006 also increased by over 30% to 810,000 [tonnes per annum] and that concentrate production in 2006 would be "an all-time record for CSA"[364]. All of the cost categories listed by Mr Kelly (fuel, tyre costs, mobile fleet costs, power, cement, labour and royalties) can reasonably be expected to have increased as a result of increasing production. It is therefore reasonable to conclude that the overrun in operating costs was associated with the increased level of mine production. It also seems reasonable to conclude that the Glencore Group would have been accepting of, rather than concerned about, cost overruns that were broadly proportional to the rate of increase in production levels and which took advantage of the record high copper metal prices.

The 2007 Budget prepared by CMPL in 2006 and approved by GIAG forecast unit cost mining to rise slightly on a tonnage basis and to fall slightly on a recovered metal basis.[365] Moreover, Mr Wilson, an expert in market analysis of the global copper concentrate industry and mine costing analysis[366], disagreed that a hypothetical mine producer like CMPL would have had a concern about costs escalating in 2007 as he believed that cost escalation had peaked.[367]

In the light of the foregoing no weight can be put on the argument that the cost structure of the CSA mine is in itself a sound basis for switching from a market-related agreement to a price sharing agreement.

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[361] See [152]
[362] See [135].
[363] See [134].
[364] See [120].
[365] See [137]
[366] See [54].
[367] See [200].

The complexity and risk associated with the underground mining operations is evident from the description of the mining processes. It can readily be accepted that there were significant costs involved in these operations. As Davies J recorded in her judgment:

> Based on the budgeted C1 and C3 costs for the 2006 year, in March 2007 Brook Hunt listed the CSA mine as being at the 83rd percentile of C1 costs of the total copper concentrate being produced and going into the market. On the actuals for the 2006 year, which were higher than the budgeted costs, Brook Hunt placed CMPL at the 89th/90th percentile, meaning it was a "high cost" mine. Brook Hunt defined a high cost mine as one whose competitive position places it at about the 75th percentile of the cost curve.
>
> Mr Wilson's evidence was that ***the high costs of the mine made CMPL vulnerable to fluctuations in gross revenue for its concentrate***. Neither Mr Ingelbinck nor Mr Kowal gave contrary evidence.[368]

Given the mine's vulnerability to fluctuations in gross revenue, the real vulnerability being a significant drop in gross revenue, it can reasonably be concluded that it would be commercially rational in the prevailing market conditions for the integrated mining, marketing and trading business to seek to optimise mine production and maximise the amounts received from the sale of the copper concentrate produced by the CSA mine while market prices for copper metal were still high and market-related TCRCs were not expected to increase significantly. On the balance of probabilities that is what a mine management company in the position of CMPL would do. Having regard to the integrated mining, marketing and trading business as a whole, it would not make commercial sense for CMPL, or GIAG, to enter an arrangement that would significantly reduce the gross revenue that integrated business could receive over the 2007, 2008 and 2009 income years when copper prices were forecast to remain reasonably high and TCRCs were not expected to increase significantly, based on what the Court regarded as "reasonable figures for both the copper price and the TCRCs"[369]. Moreover, both expert witnesses, Mr Ingelbinck and Mr Wilson, agreed that it was their analysis of the market as at early 2007 that balances for copper concentrates in 2007, 2008 and 2009 were likely to be tight and there was therefore an expectation that a significant increase in TCRCs was a relatively low probability, supporting the view that it was more likely than not that the integrated mining, marketing and trading business conducted by the Glencore Group would reject a price sharing agreement with a TCRCs of 23% of the copper reference price and would instead seek another option realistically available in the market, namely a market-related agreement that would take advantage of the prevailing higher prices for copper metal and the significantly lower projected TCRCs.

The cost control rationale for price sharing is not soundly based

The application of the arm's length principle in both Division 13 and Subdivision 815-A requires an examination of whether the allocation of risks and rewards between GIAG and CMPL accords with what independent parties dealing wholly independently with each other would have agreed. In framing how that comparison is undertaken the decisions of the Full

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[368] See [124] to [125].
[369] See [137] to [143].

Federal Courts in *SNF Australia*[370] and *Chevron*[371] - to the effect that it is neither required or authorised by Division 13 or Subdivision 815-A that CMPL be regarded as an orphan entirely separate from the Glencore Group[372] - have to be taken into account. Her Honour acknowledged the correctness of this approach at paragraph [181] of her judgment.

It is difficult to see the suggested connection between TCRCs and the cost control objectives being pursued in relation to the CSA mine[373]. The suggestion that the switch to price sharing was one that might be expected to have "guaranteed the viability" of the mine, which her Honour accepted[374], does not seem to be borne out by the evidence. The TCRCs have the effect of reducing revenues[375], they are not a cost associated with CMPL's production of copper concentrate and they do not have any impact, for better or worse, on the capital and operating costs associated with mining. In addition to the income flows that CMPL receives, the funding of the capital and operating costs is also supported by CMPL's membership of the Glencore Group and GIAG's history of providing ongoing support for the CSA mine, and its evident intention, through the 2007 Budget which GIAG approved, to support it in the 2007, 2008 and 2009 income years. Nor are TCRCs within the control of CMPL.

While it is true that the cost structure of the CSA mine is a factor, the viability of the CSA mine also depends on the market forces that impact on the integrated mining, marketing and trading business conducted by the Glencore Group. The significantly increased allowance made for TCRCs in intra-group transactions as a result of the 2007 price sharing agreement have no effect on those external risks or the net group cashflow, other than the consequential tax savings from the reduction in Australian profits relative to a correspondingly higher profit in Switzerland that is subject to a lower rate of tax.

In the light of these facts it appears that the taxpayer emphasised the cost structure of CMPL's operations and the volatility in TCRCs and the volatility between TCRCs and copper prices with the consequence that the analysis of CMPL is isolated from its proper context as a member of the Glencore Group, from the group's centralised funding strategy and from its integrated mining, marketing and trading business. This treatment of CMPL as an "orphan" disconnected from the Glencore Group is inconsistent with the decision of the Full Federal Court in the *Chevron Case*. Her Honour's finding that the switch to price sharing guaranteed the viability of the CSA mine sits uncomfortably with her finding that:

> …there was nothing in the contemporaneous documents which identified any uncertainty for the mine in relation to its capacity to continue mining in 2007, 2008 or 2009 or to suggest that CMPL considered that there was any real risk that its level of production would not continue throughout those years.[376]

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[370] *Commissioner of Taxation v SNF(Australia) Pty Ltd* (2011) 193 FCR 149; [2011] FCAFC 74 at [97] and [98] per Ryan, Jessup and Perram JJ.

[371] *Chevron Australia Holdings Pty Ltd v Federal Commissioner of Taxation* (2017) 251 FCR 149; [2017] FCAFC 62 at [43], [44], [60], [62] and [63] per Allsop CJ and at [125], [130], [131] and [132] per Pagone J, with whom Allsop CJ and Perram J agreed.

[372] See also *The Chevron Australian Holdings Case and the reach of the arm's length principle*, Jim Killaly, ANU Crawford School of Public Policy, TTPI Working Paper 17/2018, October 2018.

[373] See [152]

[374] See [156].

[375] See [78].

[376] See [120].

The financial profile and viability of the CSA mine became a central focus of the taxpayer's argument and her Honour's reasoning in finding that the price sharing formula for the pricing of copper concentrate that made an allowance of 23% of the relevant copper price for TCRCs ensured the viability of the CSA mine. One question that arises from that line of reasoning is whether it pays sufficient regard to the reality that the financial position of the CSA mine and CMPL is enhanced by that connection, as long as the CSA mine remains to be seen as part of the group's integrated business model and strategy.[377] The support for the CSA mine is seen as evident in 2006 and around the time that the February 2007 pricing sharing agreement was put in place given the integrated operational planning, budgeting and the capital planning that was occurring and being approved by GIAG.

It is also important to recognise the highly integrated mining, marketing and trading business model that the Glencore Group was pursuing as a market strategy, as a consequence of which the cashflow that the group derived from the operations of the CSA mine, in terms of economic value from that integrated business, was from the sale of copper concentrate to smelters and on the spot market, not from the intra-group sales between CMPL and GIAG. Those real world income streams are naturally connected to the activities of CMPL and the CSA mine to the extent that the physical copper concentrate produced by the CSA mine is on-sold by GIAG to independent parties. Those real world income streams will be net of the allowance made for TCRCs in those arm's length dealings and will in broad terms represent the capacity out of which GIAG pays CMPL for its copper concentrate, bearing in mind the timing differences between CMPL's entitlement to be paid for its production and GIAG's derivation of income from the on-selling of the CSA mine production, for which GIAG will require an internal or external source of interim funding.

Having regard to the real world context in which the Glencore Group's integrated mining, marketing and trading business operates, the basic equation that determines the viability of the CSA mine is based on the group's costs of producing the copper concentrate, any further costs it incurs in marketing and transport and the return the group can obtain from selling that copper concentrate. There may also be some overheads and indirect costs. Once the profit channel is seen in this light it becomes clear that the integrated business, including the CSA mining operations, are exposed to market forces and business dynamics that impact on the demand and supply of copper metal and how an individual firm like Glencore can position itself competitively relative to other participants in the copper concentrate market.[378]

As a high cost mine it seems clear that the integrated mining, marketing and trading business would have to optimise its income in order to ensure that the CSA mine remains viable, because the mine remains exposed to market risks such as input cost and output price fluctuations. To the extent that GIAG on-sold its inventory of CSA mine copper concentrate pursuant to price sharing agreements that made a higher allowance for TCRCs than those available under market-related contracts, GIAG would be forgoing profits and making itself less competitive. As a publicly listed company GIAG may also expose its share price to adverse reaction, particularly from investors seeking exposure to the mining sector in the hope that they would obtain higher rewards commensurate with the economic and business risk attached to their investment.

[377] Compare *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [60], [92] to [95] per Allsop CJ and [130] to [132], [153] and [156] per Pagone J.
[378] See [102].

On the evidence of market conditions as they existed in 2006 and those forecast for 2007, 2008 and 2009 in terms of copper prices and market-related TCRCs relative to a price sharing agreement with an allowance for TCRCs of 23% of the copper price it appears more likely than not that CMPL and GIAG would, at February 2007, use their combined strength in negotiation and bargaining to achieve allowances for TCRCs in line with then prevailing market conditions and the forecasts for market-related TCRCs for the 2007, 2008 and 2009 income years.

In summary, a careful analysis of the facts and circumstances of the dealings between CMPL and GIAG does not, on the balance of probabilities, support the conclusion that the switch from a market-related pricing arrangement for copper concentrate to a price sharing agreement with a 23% allowance for TCRCs would guarantee the viability of the CSA mine. On the contrary, the evidence suggests it would make the CSA mine more vulnerable given its high cost structure. If price sharing were adopted by GIAG as a standard approach in its sales to independent parties it would expose the integrated mining, marketing and trading business to the probability of lower overall profits given the market conditions prevailing in 2006 and at the time the February 2007 Agreement was put in place. Such a conservative approach to risk management with the probability of lower overall group profits would be likely to have adverse implications for how the investment market viewed the group and its share price as a publicly listed company.

Glencore's rationale for expanding quotational period optionality is unsound

Because GIAG was an intermediary trader between CMPL and independent purchasers of the copper concentrate produced by the CSA mine, at an entity level it obtained a financial benefit if the copper price derived from the quotational period optionality in the February 2007 Agreement for its purchases of copper concentrate from CMPL produced a price that was lower than the copper price used to set the pricing in copper concentrate sales to independent parties. The sales between CMPL and GIAG did not affect the profits of the integrated copper concentrate mining, marketing and trading business. On the other hand, the lower the copper reference price used for the sales between CMPL and GIAG the lower the TCRC deduction in respect of those sales since the TCRC was calculated at 23% of that reference price.

The question then arises as to why GIAG successively expanded the quotational period options it had in its life of mine offtake agreement with CMPL.

Mr Ingelbinck, the Commissioner's expert witness, gave evidence that:

> In [his] experience fixed quotational periods "are the norm" in long-term contracts, although most use the month of shipment or the month of arrival at the destination port as the anchor point to define the quotational period. Mr Ingelbinck stated that maintaining a regular shipping schedule and consistent fixed quotational periods provides the miner with a degree of comfort that market average prices are being achieved for its output, though that was not to say that some mines would not consider granting some degree of quotational period optionality, particularly if the buyer was prepared to offer "compensation" for the flexibility. However, he stated that "most if not all mines would balk at allowing an optionality structure which incorporates back pricing privileges" in long-term contracts. He stated that this was exactly the type of structure that GIAG introduced in 2004, where the buyer can elect

> to apply the average price of any one of three consecutive months with the election to be made by the end of the middle month (by which time both the averages of the first and middle months are known), and this modification "dramatically improved the value of the contract for GIAG at the expense of CMPL". He stated that he did not recall having ever seen "anything quite as liberal in long-term benchmark contracts".[379]

The taxpayer led evidence, through its market expert Mr Wilson, that if a trader buys concentrate under an agreement with a fixed quotational period and sells to smelters on the basis of various quotational periods it will bear the price risk resulting from different quotational periods. His view was that traders want to avoid this risk and will try to match the purchase and sale quotational periods or hedge the absolute price exposure. His opinion was that traders typically include quotational period optionality in an offtake agreement which gives them an opportunity, in addition to hedging, to minimise the price exposure risk arising from different purchase and sale quotational periods. In his view, since an offtake agreement with a trader effectively replaces multiple contracts between the producer and several smelters that will collectively contain many differing quotational periods, it is to be expected, and is common in his experience, for an offtake agreement with a trader to provide for quotational period optionality. In his view optionality is critical for a trader and, in a commercial sense, is the "price paid" by a producer such as CMPL to obtain the benefits under an offtake agreement with a trader. He went on to say that:

> so called price optionality is virtually impossible to determine in advance bearing in mind that mines such as CMPL are price takers, and that if a mine such as CMPL were to sell to a range of smelters and also sell a portion of their production on the spot market, they would be exposed to a similar and unpredictable range of quotational periods.[380]

Although the taxpayer led no evidence as to how GIAG managed the entire inventory of copper concentrate, its thesis in relation to the expansion of quotational period optionality for the purchases GIAG made from CMPL carries the implied assertion that the copper concentrate from the CSA mine was managed separately from the rest of the inventory. It is not clear how such an approach would allow the group to optimise its marketing, trading and logistics functions in the manner outlined in Mr Kelly's evidence.[381] Moreover, the thesis seems to imply that all sales of copper concentrate were made to traders whereas the evidence was to the effect that in the integrated mining, marketing and trading business conducted by the Glencore Group GIAG was responsible for sales to independent parties and sold mostly to smelters.[382]

Mr Ingelbinck disagreed with Mr Wilson's opinion that the advantage of quotational period optionality and back pricing to a trader lies principally in the risk management opportunity it provides having regard to the variety of end purchasers to which the trader will sell. He was of the view that traders "crave optionality" because it can enable them to create profitable quotation period mismatches, even in cases where the optionality does not include back

[379] See [229].
[380] See [207].
[381] See [105].
[382] See [106] and [107].

pricing privileges.[383] He explained the enhancement of profit-making opportunities as follows:

> … the [quotational period] optionality awarded to GIAG in 2004 was further enhanced with the 2 February 2007 amendment in that the buyer could now, on a shipment by shipment basis, choose between an "early" or a "late" set of potential [quotational period] alternatives from which to make a final election. That choice had to be made by the time the vessel sails. The "early" option gave the buyer the choice between M-1, M or M+1 whereby M is the month of shipment. The "late" option gave them the choice between the first month after the month of arrival at discharge port (1MAMA), 2MAMA or 3MAMA. In both cases, the final election had to be made by the end of the middle month. The enhancement for the buyer lies in the fact that, if price activity does not enable buyer to realize a back pricing margin in the period between the start of the month prior to the month of shipment and the Bill of Lading date, they get another bite at the cherry by opting for the "late" [quotational period] which allows them to seek back pricing margin opportunities in the 1MAMA – 2MAMA period.[384]

Davies J noted that in oral evidence Mr Ingelbinck elaborated on his opinion that the quotational period optionality with back pricing clause in the February 2007 Agreement provided substantial value to GIAG without a quid pro quo for CMPL in the following way:

> …the shift from an annual declaration to a shipment by shipment declaration means that, in effect, as starting in 2007, the buyer had the ability to look at two instances – an early instance and a late instance – to take advantage of optionality and back pricing, meaning that if they failed to be able to take advantage in the first instance, there was a second bite at the apple. There is still no guarantee they would have always been able to take advantage of it but it basically doubled their chances in a volatile market to be able to take advantage of it. So, again, my view is, in a situation like that, whatever compensation is agreed on ought to be greater than what would have been agreed on in the annual declaration of the early versus late quotational periods.[385]

The following observations can be made about the expansion of quotational period options and the rationale presented by Mr Wilson. First, ***quotational period optionality favours the buyer, in this case GIAG, who has the right to elect which option it will pursue***. That choice will be driven by the purchaser's assessment of which option will be best for it in relation to determining the copper reference price. As a buyer, the lower GIAG could get its purchase prices, the greater the opportunity for it to maximise its profit through on-selling. ***Mr Wilson, the taxpayer's expert witness, said he wouldn't disagree with Mr Ingelbinck [the Commissioner's expert witness] that back pricing quotational period optionality is far more likely to have a discernible negative impact on the seller's revenue.[386]*** Accordingly, a seller in the open market dealing with independent parties would be cautious about the scope of price options. That tension between interests of sellers and buyers is absent in relation to the February 2007 Agreement given the group relationship, the fact that GIAG exercises

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[383] See [233].
[384] See [230].
[385] See [234].
[386] See [209].

managerial and financial control over the CSA mine, and the fact that the taxpayer did not contest the Commissioner's assertion that CMPL and GIAG were not dealing at arm's length with each other in relation to the supply of copper concentrate on the terms of the February 2007 Agreement.

Secondly, price optionality is not properly classified as a "price paid" by the seller to secure the benefits of an offtake agreement with a trader. The 2006 Brook Hunt Report, which was a global analysis of the copper concentrate market each year and regarded as an authoritative resource[387], acknowledged that quotational period optionality was valuable to a trading company and something a buyer would pay for in the terms and conditions of the overall agreement. It stated:

> ***Some contracts with trading companies include the option for the trading company to nominate in advance an early or late Quotational Period, paying elsewhere in the terms for this right.***[388] [Emphasis added.]

Mr Wilson, the taxpayer's expert witness, was cross-examined on this aspect of his evidence. Davies J summarised his evidence as follows:

> ***He agreed that if a buyer can nominate a quotational period with the benefit of hindsight, he would expect them to pay elsewhere in the terms.*** When put to him that he would agree that he would expect a buyer to pay even more for that right, if a buyer can nominate a quotational period not just with hindsight but on a shipment by shipment basis, Mr Wilson responded "potentially, yes". When questioned why "potentially" and not "yes", Mr Wilson explained that he had not seen it in any contract other than the February 2007 Agreement and the Barminco Contract (to which reference is made later in these reasons). He stated that such a term was "highly unusual".[389] [Emphasis added.]

Thirdly, the analysis ignores CMPL's position as part of the GIAG group and its function as a key part of an integrated business. Globally, GIAG was the biggest seller of copper concentrate in 2006 and accordingly had significant experience as a trader in identifying opportunities for arbitrage between its buying and selling prices, and considerable bargaining power given its strong market position as a trader. It therefore seems incorrect and inappropriate to suggest CMPL was a "price taker" in the open market and that optionality was the price it had to pay 'to obtain the benefits of an offtake agreement with a trader and a home to monetise its production'"[390]. CMPL did not have the authority or expertise to market its own production. It did not sell to independent parties. It was required to sell all of its production to GIAG. The organisational context of the integrated mining, marketing and trading business meant that the marketing and trading was done exclusively by GIAG. This is why Davies J saw the analysis suggesting CMPL's need for its own marketing capacity as unsound. As her Honour said:

> In the present case, the relevant mine producer for the purposes of the hypothetical agreement is a mine producer with all the characteristics of CMPL, which include, as earlier stated, that it had no need for a logistics or marketing division because it sold

[387] See [93] and [95].
[388] See [213].
[389] See [214].
[390] See [207].

> the whole of its production for the life of the mine to a buyer with GIAG's characteristics, namely a trader with a substantial marketing team which purchased the whole of the mine's production for the life of the mine.[391]

Fourthly, while differing quotational periods between the purchase and sale contract can present a price risk for traders in dealings between independent parties in the open market, mismatches in quotational periods can also present an opportunity for the purchaser to derive a profit margin when it on-sells. In this regard, Mr Ingelbinck pointed to the ability for traders to create profitable quotational mismatches even in cases where the optionality does not include back pricing privileges.[392] However, being intra-group transactions the impacts of quotational period options between CMPL and GIAG do not affect the Glencore Group's price risk exposure in the copper concentrate market. They do not, in a real world sense, create price risk for GIAG, nor do they mitigate price risk. It is only if one impermissibly ignores CMPL's connection to the Glencore Group and the integrated copper concentrate business that one could reach that conclusion. However, at an entity level they may have an impact on the profitability of CMPL in Australia relative to the profitability of GIAG in Switzerland.

Fifthly, the price risk for a trader in the open market is not confined to different quotational periods. For example, there is the risk that copper prices will fall and reduce the value of its inventory. In other words, the fact that a trader obtains quotational period options, even with back pricing, does not eliminate price risk, as seems to be suggested by the taxpayer's evidence.

Sixthly, all participants in the open market have to make judgments about the likelihood as to whether a particular price risk (including that arising from different quotational periods) will in fact materialise and, if so, what the extent of its exposure would be, and what would be the extent of any loss. This then becomes the basis for deciding whether, and to what extent if any, steps should be taken to mitigate that risk. There was no evidence before the Court that would allow it to consider the likelihood and consequence of the price risk that the taxpayer asserted as the justification for the increasing range of quotational period options available to GIAG through successive amendments to the 5 July 1999 life of mine offtake agreement.

Finally, all of the amendments of the 5 July 1999 life of mine offtake agreement for 100% of the CSA mine's production of copper concentrate relate to the copper reference price component of the pricing formula. They do not alter the property that was the subject of the 5 July 1999 agreement. Each of the amendments relate only to the consideration to be paid for the supply of the property.

The seven contracts the taxpayer tendered to the Court were put in evidence to show that back pricing clauses had been adopted in contracts between independent parties.[393] Her Honour records that it was common ground between the industry experts that the impacts of quotational period optionality on a seller could be either positive or negative, depending on market conditions.[394] ***It was also common ground that quotational period optionality was desirable for a trader but "it was very hard, if not impossible to place a precise value on***

[391] See [181].
[392] See [233].
[393] See [277] to [306].
[394] See [355].

back pricing."[395] Her Honour accepted Mr Kelly's unchallenged evidence that bargains were struck more holistically rather than negotiating on the basis of one particular benefit being given for another particular benefit, like granting quotational period optionality in return for a discount to benchmark TCRCs.[396]

Mr Ingelbinck's evidence was that without the information about what was negotiated, market terms at the time, and information as to precisely when the terms were negotiated made it impossible to form a reliable view about what discount to TCRCs was agreed from simply reviewing contracts after the event.[397]

The Commissioner sought to rely on a 2002 contract between Placer Pacific (Osborne) Pty Ltd and GIAG (the Placer Contract) and GIAG as buyer and Barminco Investments Pty Ltd (the Barminco Contract) as evidence that the quid pro quo for quotational period optionality is likely to be a substantial discount to TCRC.[398] He also relied on the evidence of Mr Ingelbinck and Mr Kowal that the quotational period optionality with back pricing clause in the February 2007 Agreement "provided substantial (but not necessarily quantifiable) value to GIAG for which there was no quid pro quo" but her Honour found that each of these opinions was based on an incorrect view: on Mr Ingelbinck's part that a trader cannot make a mistake on back pricing optionality; or flawed analysis in the case of Mr Kowal's analysis that was based on the use of hindsight.[399]

Her Honour formed the view that ***"while both the Placer Contract and the Barminco Contract demonstrate some obvious quid pro quo for the optionality, they appear to be unusual"*** and supported this finding on the basis that Mr Wilson and Mr Ingelbinck agreed that the Barminco Contract was the only one they had seen which appeared to put a specific price on back pricing privileges.[400]

Her Honour noted that whilst the Commissioner argued that other terms in the February 2007 Agreement conferred significant advantages to GIAG to the detriment of CMPL, such as the freight terms, it is not evident that because of such terms it might reasonably be expected that there would be a substantial discount to TCRCs in a comparable transaction between independent parties acting at arm's length.[401]

At the end of the day, her Honour's assessment of the evidence as a whole led her to the conclusion that she was not satisfied that a discount to TCRCs might be expected to have been allowed between independent parties for the benefit of the quotational period optionality provided for in the February 2007 Agreement.[402]

The weight of the expert evidence to the effect that it was extremely difficult to put a value on the benefit of back pricing; Mr Wilson's evidence that the discount to TCRCs in the Barminco Contract was not material[403]; and Mr Ingelbinck's view that it was not possible to

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[395] See [355].
[396] See [356].
[397] See [358].
[398] See [359].
[399] See [360].
[400] See [368].
[401] See [369].
[402] See [370].
[403] See [282].

form a reliable view simply on the basis of the contracts about what discount had been allowed, make it difficult to challenge her Honour's conclusion.

However, the fact remains that the price risk associated with different quotational period optionality in relation to purchases and sales cannot be abated by the terms and conditions that apply to intra-group dealings. It should also be noted that the taxpayer did not lead any evidence that would allow the Court to consider the likelihood and consequence of the price risk that the taxpayer asserted as the justification for the increasing range of quotational period options available to GIAG through successive amendments to the 5 July 1999 life of mine offtake agreement.

On balance, it can reasonably be concluded that on the basis of:

- the long term nature of the copper concentrate offtake agreement being for the life of the CSA mine[404];

- the uncontroverted expert evidence that in long term agreements fixed quotational periods "are the norm", most using the month of shipment or the month of arrival at the destination port as the anchor point to define the quotational period, because maintaining a regular shipping schedule and consistent fixed quotational periods provides the miner with a degree of comfort that market average prices are being achieved for its output[405];

- Mr Wilson's evidence that he wouldn't disagree with Mr Ingelbinck that back pricing quotational period optionality is far more likely to have a discernible negative impact on the seller's revenue;[406]

- the common ground that quotational period optionality with back pricing was desirable for a trader but "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.[407];

- the fact that quotational period optionality favours the buyer because that party determines which option to exercise;

- the 2006 Brook Hunt Report, which was a global analysis of the copper concentrate market each year and regarded as an authoritative resource[408], acknowledged that quotational period optionality was valuable to a trading company and something a buyer would pay for in the terms and conditions of the overall agreement[409]; and

- back pricing is something that independent sellers would expect compensation for[410];

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[404] See [2].
[405] See [229].
[406] See [209].
[407] See [355].
[408] See [93] and [95].
[409] See [213].
[410] See [214].

it is more likely than not that an independent seller would reject an expansion of quotational period optionality and back pricing contained in the February 2007 Agreement because it would not be satisfied that such an option would be "***clearly*** more attractive" than the previous arrangements by which the parties were bound.[411]

More fundamentally, it can be concluded on the evidence, and for the reasons set out above and elsewhere in this paper, that the price risk management rationale for the expanded quotational period optionality with back pricing in intra-group dealings between CMPL and GIAG is unsound.

Conclusions

Approaches to the arm's length hypothetical in Division 13 and Subdivision 815-A

While the facts and circumstances of the *Glencore Case* are quite different from those in the *Chevron Case,* both cases involved the application of Division 13 and Subdivision 815-A. The judicial guidance given by the Full Court on the interpretation of those provisions and the principles their Honours applied in the formulation of the arm's length hypothetical are equally relevant to the *Glencore Case.* Each of the parties to the dispute, and her Honour, Davies J, saw the *Chevron Case* as a highly relevant authority[412]

It is clear that her Honour acknowledges the reality that a pricing framework drives the resultant consideration received, because she accepts the use of a price sharing agreement as the basis for working out the consideration for the supply of the copper concentrate. However, her Honour limits the scope of the search for objective evidence of an arm's length hypothetical to cases where independent parties have used price sharing agreements to establish their pricing framework. Her Honour reaches this point by reading into the language of Division 13, Subdivision 815-A, Article 9 of the Swiss Agreement and the 1995 OECD Guidelines a limitation on the scope of those provisions that she sees prevents the operation of those provisions where the cross-border dealings between subsidiaries of a multinational group are based on terms and conditions that can be observed in dealings between independent parties dealing at arm's length (or wholly independently) with each other. One difficulty with this approach is that it makes the comparability analysis mandated by the language of Division 13 and Subdivision 815-A captive to "a rigid constriction of the arm's length hypothesis in a shape and form controlled by the taxpayer"[413]. The other difficulty is that it is tantamount to replacing the arm's length hypothetical enshrined in Division 13 and Subdivision 815-A with a test based on the obtaining of a benefit, without regard to the relative costs and benefits of securing that benefit, or whether independent parties would generally seek to secure that benefit. The arm's length hypothetical requires evidence that price sharing to mitigate the volatility risks was more likely than not adopted in dealings between independent parties in offtake agreements for the life of a mine. No such evidence was led.

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[411] See paragraph 1.15 of the 1995 OECD Guidelines.
[412] See [36] to [47].
[413] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [55] per Allsop CJ.

There is nothing in the wording of sections 136AD(1), 136AA(3)(c) and Article 9 of the Swiss Agreement[414], or in the articulation of the arm's length hypothetical by the Full Federal Court in the Chevron Case, or in the 1995 OECD Guidelines, that supports a narrowing of the search for pricing options that were realistically available to a seller of copper concentrate in dealings between independent parties dealing at arm's length with each other in the open market. The statutory requirement to determine what arm's length parties would have done necessitates a market survey to assist that determination. That survey would encompass a consideration of all pricing framework options realistically available, including cases where independent parties dealing at arm's length (or wholly independently) with each other had used market-related agreements. The information thereby obtained would then need to be refined to identify the arm's length dealings that were truly comparable.

Accordingly, her Honour's reasoning is open to question on the basis that it misperceives the statutory requirements in relation to the formulation of the arm's length hypothetical.

Market realities impacting on the integrated mining, marketing and trading business

Davies J has based her reasoning on the efficacy of the purported risk management rationale presented at trial a justification for the switch from a market-related agreement to a price sharing agreement with broader quotational price optionality. The principal elements of the risk management rationale are:

(a) That the use of a price sharing agreement in February 2007 between CMPL and GIAG in respect of the intra-group sales of copper concentrate removes the volatility in TCRCs and the volatility between TCRCs and copper prices; and

(b) The broader quotational price optionality conferred by CMPL in the February 2007 Agreement enabled GIAG to manage price risk associated with different quotational period optionality between purchases and sales.

There is good reason to doubt the economic substance of the purported risk management rationale for the adoption of price sharing and broader quotational price optionality.[415] As the foregoing analysis demonstrates, the terms and conditions imposed in respect of intra-group dealings between CMPL and GIAG were incapable of removing these risks in an economic sense in the real world of the integrated mining, marketing and trading business being conducted by the Glencore Group. Despite the price sharing agreement between CMPL and GIAG the integrated copper concentrate mining, marketing and trading business remained exposed to these real world risks. To the extent thought necessary, on the basis of the likelihood and impact of those risks and other relevant factors, the mitigation of those risks to the integrated business could only be achieved by the terms and conditions negotiated in sales of copper concentrate by GIAG to independent parties, or otherwise by hedging with external parties in accordance with the Glencore Groups policies and practices. The commercial realities are that an approach of invariably mitigating these risks is accompanied by a foregoing of any potential economic upside, including from increased copper prices, reductions in TCRCs or opportunities for margins in trading activities. Shareholders in a publicly listed group like Glencore may react negatively to an overly conservative risk

[414] Article 9 of the Swiss Agreement is incorporated into Subdivision 815-A by reference through the combined operation of sections 815-10 and 815-15.
[415] Paragraph 1.41 of the 1995 OECD Guidelines.

management approach that would reduce their returns on what is inherently a risky investment in the mining sector.

Financial and risk analysis divorces CMPL from the integrated business and the Glencore Group

Her Honour recognised the need to see CMPL as part of a multinational group and an integrated business of mining, marketing and trading copper concentrate for the purposes of the arm's length hypothetical by acknowledging it had "no need for a logistics or marketing division because it sold the whole of its production for the life of the mine to a buyer with GIAG's characteristics, namely a trader with a substantial marketing team which purchased the whole of the mine's production for the life of the mine".[416] However, the analysis of the risks related to the volatility in TCRCs and between TCRCs and copper prices is based on the premise that an intra-group price sharing agreement between CMPL and GIAG would remove the volatility caused by external forces that the group could not control. Despite the price sharing agreement in February 2007, the integrated mining, marketing and trading business conducted by the Glencore Group is still exposed to those same risks in the real world. CMPL is not in a position to mitigate those risks in an economic or market sense in relation to the integrated business because it does not sell to independent parties. Nor was there any evidence before the Court as to what the group's policies and practices were in relation to risk management, or whether the group assumed the economic risk or hedged it to some extent.

The Court could only have reached the position it did by considering the circumstances of CMPL's financial position and risk exposure divorced from the integrated business of which it was part. This is inconsistent with her Honour's earlier approach in finding that CMPL had no need for a logistics or marketing division because it sold the whole of its production for the life of the mine to a buyer with GIAG's characteristics[417], and with the *Chevron Case*[418], in terms of how the concept of "independent parties dealing at arm's length (or wholly independently) with each other" is applied in the context of the arm's length hypothetical as separately articulated in Division 13 and Subdivision 815-A.

Treating CMPL as separated from the integrated business misdirects the formulation of the arm's length hypothetical in a way that is inconsistent with the approach adopted by the Full Federal Court in the *Chevron Case.* This had the effect that her Honour based her hypothetical on the mere existence of price sharing agreements between independent parties in the open market. The alternative of market-related agreements was not taken into account because her Honour formed the view that conforming the actual transaction, in terms of its pricing structure, would be "a misapplication of the provisions of Division 13 and Subdivision 815-A"[419] in that it "impermissibly restructures the actual contract entered into by the parties into a contract of a different character"[420], notwithstanding that the "property" the subject of both the market- related and the price sharing agreements remained the same.

[416] See [181].
[417] See [181].
[418] See *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [60], [92] to [95] per Allsop CJ and [130] to [132], [153] and [156] per Pagone J.
[419] See [6].
[420] See [314].

Contrary to the approach taken in the *Chevron Case,* her Honour, by limiting the comparability analysis to price sharing agreements, has based her arm's length hypothetical on a "possibility" rather than the arm's length hypothetical of the reasonable expectation as enshrined in Division 13 and Subdivision 815-A. As Pagone J (with whom Allsop CJ and Perram J agreed) said:

> The standard of reasonable expectation found in the words "might reasonably be expected" in s 136AA(3)(d) calls for a prediction based upon evidence. In *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359 the High Court said at 385:
>
> > ***A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place*** if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.[421]
>
> [Emphasis added.]

Having regard to both of the pricing frameworks that were realistically available in the market around the time that the February 2007 Agreement was put in place, it is more likely than not that an independent party would have seen a market-related agreement as more attractive option realistically available[422], given the industry practice at the time, the prevailing market conditions, the probable adverse impact a 23% TCRC would have on sales revenue relative to a market-related TCRC, and the inability of CMPL to mitigate, in a real world economic sense, the volatility risk through the use of a price sharing agreement with GIAG.

As discussed above, the analysis of quotational price optionality adopted by her Honour also looks at CMPL separately from the integrated mining, marketing and trading business. It is difficult to see how, in a real world economic sense, broader quotational price optionality in respect of intra-group sales assists the integrated business in managing the price risk from different quotational price optionality in respect of purchases and sales of copper concentrate by a trader in dealings with independent parties. The rationale for broader quotational price optionality in the agreements between CMPL and GIAG is unsound.

Application of the relevant OECD guidance

Her Honour read the 1995 OECD Guidelines as supporting the view that the approach of the Commissioner to re-assess tax liabilities by reference to a market-related approach in lieu of the price sharing approach with broader quotational price optionality adopted by the Glencore Group constituted an impermissible restructuring of the actual agreement between CMPL and GIAG. Her Honour notes the OECD view that ordinarily the examination of a controlled transaction should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them.[423] Her Honour then notes the two classes of exceptional cases where the OECD says, "it may, "exceptionally", be appropriate and legitimate to disregard the structure adopted by the taxpayer in the controlled transaction"[424]. While her Honour lists the two classes of case, only one example, the one in respect of the

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[421] [2017] FCAFC 62 at [127].
[422] See paragraph 1.15 of the 1995 OECD Guidelines.
[423] See [314].
[424] See [315].

second class of case, is mentioned in her reasons, possibly because it related to the circumstance of conforming the terms of a long term agreement which her Honour may have seen as the more relevant example to the facts and circumstances of the *Glencore Case.*

However, the consideration of both examples provides the necessary insight into the context that the OECD had in mind in prescribing the two classes of case. The first example involved conforming an investment in the form of interest bearing debt for the purposes of the arm's length hypothetical with the result that the loan is treated as a subscription of capital, because that is what independent parties would have done when regard is had to the economic circumstances of the borrowing company. The second example involves a sale under a long term contract of the unlimited entitlement to intellectual property rights arising as a result of future research for a lump sum payment. The OECD expresses the view that it would be appropriate to conform this arrangement for the purposes of the arm's length hypothetical with the result that the transfer is treated for tax purposes a continuing research agreement because that is what independent parties might reasonably have expected to have done given it would be impossible to reliably value any future discoveries. In other words, what the OECD was contemplating in the two examples were situations where a change in the "property" the subject of the related party agreement was conformed to the type of "property" that independent parties would have made the subject of an agreement. Of course, the nature and amount of consideration is impacted by the conforming of the actual transactions, but this is derivative from the fundamental redefinition of the "property" for the purposes of the arm's length hypothetical.

When the "exceptional" classes of case and associated examples are considered in the context of the arm's length hypothetical, it becomes apparent that the OECD is drawing a nuanced distinction between a restructuring that changes "the character of the transaction"[425] and "using alternatively structured transactions as comparable uncontrolled transactions"[426]. This is why in the context of the second example the OECD talks about "[conforming] the terms of the transfer in their entirety, not simply by reference to pricing". As the exceptional cases are contextualised within the broader framework of the OECD's articulation of the arm's length principle and its application, it is clear that the OECD does not see a limitation in the language of Article 9 that would narrow the ability to address non-arm's length pricing in respect of the acquisition or supply of property or services between associated enterprises in differing contracting states by appropriately conforming the terms of the agreement relating to pricing in the way independent parties would have done. By way of comparison, the Full Federal Court in the *Chevron Case* saw no impediment in Division 13, Subdivision 815-A or Article 9 of the US Double Taxation Convention[427] to conforming the clauses of an agreement that provided the basis for calculating the consideration for a five year unsecured loan for USD 2.5 Billion[428] for the purposes of the arm's length hypothetical. The ensuing effect was that the borrowing was treated for tax purposes as being on a secured basis[429] or as guaranteed by the ultimate parent company[430] because, on the evidence, in an agreement with an independent party dealing wholly independently with the borrower it could be predicted

[425] Paragraph 1.38 of the 1995 OECD Guidelines.
[426] Paragraph 1.41
[427] The *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* ("the US Double Taxation Convention") which entered into force on 31 October 1983.
[428] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [131]
[429] Ibid at [131] to [132] per Pagone J.
[430] Ibid at [62] to [64] per Allsop CJ.

that security or a parental guarantee would have been provided as part of the consideration for the loan.

There is no limitation in the language of Division 13 or Subdivision 815-A that would preclude the consideration of market-related agreements as a realistic option for working out the pricing of the copper concentrate produced by the CSA mine. In those circumstances it would be inappropriate to read the 1995 OECD Guidelines as supporting a contrary position to the language of the relevant legislation. In any event, for the reasons outlined above, the OECD guidance should not be read as prohibiting the conforming of the pricing framework imposed by the February 2007 Agreement for the purposes of applying the arm's length hypothetical, with the effect that the previously existing market-related agreement is used for tax purposes to calculate the sales revenue CMPL should be regarded as receiving.

Merits review and law change on public policy grounds if unsuccessful

As set out in the Overview and Summary section of this paper, having regard to the evidence of:

- the integrated mining, marketing and trading business being conducted by the Glencore Group[431];
- the negotiating strength that GIAG had due to its market position in 2006 as the largest seller of copper concentrate in the world[432];
- the ongoing organisational, financial and managerial support the group was providing to CMPL and the recognition through ongoing capital investment and cash to meet operating costs that the CSA mine as a valuable group asset[433];
- the fact that GIAG, through its employee Mr Kelly, exercised financial control over the CSA mine and did so "with a view to maximising the profit for the Glencore Group" as a whole[434];
- market conditions at the time the switch to price sharing was being considered and the probability, based on the forecasts for copper prices and TCRCs in the 2007 Budget[435] and the proposal in the February 2007 Agreement that TCRCs be calculated at 23% of the copper reference price[436], that CMPL would suffer a significant drop in sales revenue;
- the fact that CMPL was not in a position to deal with GIAG in a commercially rational manner and stick with the terms of the market-related agreement so that CMPL would be as profitable as possible [437];
- the fact that actual TCRCs negotiated between independent parties in the open market, while notionally intended to cover smelting and refining costs and provide the purchaser (whether a trader or a smelter) with an element of profit, are a result of market forces[438];

[431] See [105].
[432] See [107].
[433] See [110], [128], [129] and [133].
[434] See [127] and [131].
[435] See [137] to [143].
[436] See [167].
[437] See [203].
[438] See [78].

- the options in relation to pricing frameworks for long term copper concentrate offtake agreements that were realistically available in the market at that time included market-related agreements;
- the roles and responsibilities of the group members comprising the integrated mining, marketing and trading business that the Glencore Group was carrying on in the 2006 to 2009 income years and the fact that CMPL was required to sell all the production of the CSA mine to GIAG[439] and was not authorised or responsible for selling copper concentrate to independent parties or the management of inventory risks[440];
- the inability of a price sharing agreement in respect of intra-group sales to mitigate the volatility and price risks faced by the integrated mining, marketing and trading business;
- the fact that quotational period optionality favours the buyer who has the right to elect which period to select, and that such conditions when established in respect of intra-group sales are incapable of mitigating any price risk faced by GIAG in respect of sales to independent parties; and
- the absence of any evidence that the Glencore Group had a policy or took steps to reduce its exposure to the volatility and price risks faced by the integrated mining, marketing and trading business

it is more likely than not that in the relevant income years the copper concentrate from the CSA mine would have been sold through GIAG to independent parties under the market-related pricing arrangements comparable to that which operated between CMPL and GIAG prior to January 2007 when the price sharing framework was first informally introduced before being formalised in February 2007[441]. Looked at in a commercially rational way, having regard to the arm's length hypothetical as separately articulated in Division 13 and Subdivision 815-A, the taxpayer had no incentive to switch to a price sharing agreement with expanded quotational period optionality; it would have been significantly worse off financially. In comparison, the continuation of its existing market-based agreement provided the more attractive option.

On the basis of the foregoing analysis of the evidence, legislation and jurisprudence, and the fact that the taxpayer's risk management rationales related to volatility risk and price risk are unsound, one is left with the fact that the February 2007 Agreement had the "natural and probable impacts"[442] of reducing the sales revenue of CMPL in Australia during the 2007, 2008 and 2009 income years and correspondingly increasing the profits of GIAG in Switzerland. CMPL bore the full cost of the purported risk management strategy to deal with the volatility in TCRCs and between TCRCs and copper prices, despite the fact that it was not in a position to control that risk in a real world economic sense. Properly analysed, the switch in the pricing framework from market-related to price sharing did not produce any economic outcome for the integrated mining, marketing and trading business but it did affect the jurisdictional tax outcomes, adversely in Australia's case. While Division 13 and Subdivision 815-A do not stipulate that the existence of a tax avoidance purpose is a prerequisite for their operation, evidence of such a purpose is relevant to the question of whether the parties were dealing with each other at arm's length and in discerning what independent parties might reasonably be expected to do. Conversely, both Division 13 and

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[439] See [2] and [108].
[440] See [106] and [109].
[441] See [148].
[442] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.

Subdivision 815-A were intended to operate where non-arm's length dealings were undertaken for purportedly business reasons but had the effect that the consideration for the supply of the copper concentrate was less than an arm's length amount or where taxable Australian profits were understated due to the operation of non-arm's length conditions in the commercial or financial relations between CMPL and GIAG.

It follows from the foregoing analysis that questions arise in relation to the application of Subdivisions 284-A and 284-C of Schedule 1 of the *Taxation Administration Act 1953* (the general and scheme penalty provisions). In particular, there is a question of whether the taxpayer's position, properly analysed, is reasonably arguable. Subsection 284-15(1) provides:

> A matter is ***reasonably arguable*** if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.

Having regard to the fundamental flaws in the taxpayer's rationale for the switch from a market-related agreement to a price sharing agreement, coupled with the evidence showing that the "natural and probable consequences of the February 2007 Agreement were a reduction in the taxable Australian sales revenue of CMPL and a corresponding increase in the profits of its Swiss parent, GIAG, there seems to be a cogent argument that the taxpayer's position is not reasonably arguable. In this regard see: *Walstern Pty Ltd v FC of T* [2003] FCA 1428; 2003 ATC 5076 at [103] to [114] per Hill J, noting in particular the importance his Honour placed on key findings of fact at [113] and [114]; *Cameron Brae Pty Ltd v Federal Commissioner of Taxation* (2007) FCR 468; 2007 ATC 4936 at [70] per Stone and Allsop JJ, where the test was explained in terms of whether the question was "open to debate in the sense of being arguable"; *Allen v Commissioner of Taxation* (2011) 195 FCR 416 per Keane CJ, Greenwood and Middleton JJ at [75] to [76] where the Court noted at [77] that , like *Cameron Brae*, and in contrast to *Walstern*, the case they were considering turned on questions of statutory interpretation, whereas in *Walstern* the case involved an erroneous position founded upon an unreasonable view of, or disregard for, the facts. The taxpayer's rationale is fundamentally flawed because the purported risk management strategy of using price sharing was incapable of mitigating the volatility risk in an economic sense in the real world of the integrated mining, marketing and trading business being conducted by the Glencore Group. The real purpose and object of the arrangement appears to have been to reduce the taxable Australian sales income of CMPL by reducing the consideration paid for the copper concentrate it supplied and correspondingly increasing the profits of CMPL's Swiss parent, GIAG by reducing the amounts it paid for the copper concentrate it acquired from CMPL. These were the "natural and probable consequences"[443] of the February 2007 Agreement and the informal arrangement that proceeded it in January 2007. It is therefore arguable that the scheme penalty provisions in subsection 284-145(1) apply.[444]

There are also evidentiary gaps in the taxpayer's case. No evidence was led regarding the economic impacts of adopting the price sharing approach to pricing relative to a market-

[443] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.

[444] See subsection 284-145(1)(b)(i) and section 284-150 of the *Taxation Administration Act 1953; FC of T v Spotless Services Ltd* (1996) 186 CLR 404 at 416; *Commissioner of Taxation v Star City Pty Ltd (No 2)* (2009) 180 FCR 448; *Lawrence v Commissioner of Taxation* [2006] FCA 1497; and *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* [2015] FCA 1092 at [630].

related approach. There was no evidence of the potential economic impacts of volatility in TCRCs and between TCRCs and copper prices for the integrated copper concentrate mining, marketing and trading business. No evidence was led regarding the likelihood that this volatility would produce a significant adverse impact on that business. There was no evidence that the comparative adverse impact of volatility outweighed any potential upside that might reasonably have been expected to arise if the volatility risk was not mitigated.

There is no evidence before the Court that would allow an understanding of the channel profit derived by the integrated mining, marketing and trading business. There is no evidence of what GIAG was able to sell the copper concentrate produced by the CSA mine to independent external parties or what allowances for TCRCs were made in each of the relevant income years. The only evidence is a small sample of price sharing agreements that account for a relatively minor portion of GIAG's copper concentrate inventory.

No evidence was put before the Court in relation to how price sharing agreement between CMPL and GIAG would effectively manage the risk of volatility in the real world of the integrated business. Nor was there any evidence before the Court in relation to the Glencore Group's policies and practices in relation to risk management and hedging, or whether the price sharing agreement between CMPL and GIAG was consistent with those policies and practices. Nor was it objectively demonstrated that the management of the volatility was in fact pursued as a standard practice by GIAG in setting the terms and conditions of its sales to independent parties. If the use of price sharing agreements was not the standard practice of GIAG it would be reasonable to conclude that the use of a price sharing agreement between had another purpose other than the management of the volatility risk.

In other words, there is no evidence of dealings between independent parties dealing at arm's length (or wholly independently) with each other that demonstrates that the switch in comparable circumstances from a market-related agreement to a price sharing agreement conforms to the arm's length hypothetical. All that is demonstrated is that the Glencore Group presented an ex post facto rationale for the switch based on managing volatility risk. The existence of some asserted benefit is insufficient to satisfy the evidentiary requirements of the arm's length test as encapsulated in Division 13 and Subdivision 815-A, especially where the realisation of that benefit in a real world economic sense is open to serious doubt.

The evidence did not progress beyond showing that price sharing was a "possibility"[445], not that examples presented to the Court by the taxpayer were truly comparable and were sufficient evidence of what independent parties in comparable circumstances might reasonably be expected to have done. The arm's length test is not based on a mere possibility, the fact that a particular pricing mechanism can be found in the market, but on the premise that independent parties dealing at arm's length (or wholly independently) with each other will act independently in a commercially rational manner, evaluate all options realistically available to them in the market in terms of their economic costs and benefits, and will only enter a transaction if there is no other option that is more attractive.[446]

The analysis of whether it made commercial sense for CMPL to adopt February 2007 pricing structure having regard to prevailing market conditions and industry practices, or how attractive it would be in relative economic and financial terms to the other pricing

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[445] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCFCA 62 at [127] per Pagone J.
[446] See paragraph 1.15 of the 1995 OECD Transfer Pricing Guidelines and *The Trustee for the Estate of the late AW Furse No 5 Will Trust v FC of T* 91 ATC 4007 at 4014-4015 per Hill J.

mechanisms that were realistically available, was subordinated to the overriding (but mistaken) conclusion that price sharing was justified as an effective risk minimisation strategy. The arm's length test is not based on proof of a risk management benefit, regardless of the cost to sales revenue of obtaining that benefit or any consideration of whether independent parties in comparable circumstances would have sought to mitigate that particular risk in whole or in part. It is based on the prediction of what independent parties dealing at arm's length (or wholly independently) with one another would have done. The taxpayer has misperceived and misapplied the arm's length hypothetical that is separately articulated in Division 13 and Subdivision 815-A.

The following factors provide a cogent argument that the taxpayer did not satisfy its onus of proof under section 14ZZO of the *Taxation Administration Act 1953* to demonstrate that the amended assessments raised by the Commissioner for the 2007, 2008 and 2009 income years were excessive:

> the misperception and misapplication of the arm's length hypothetical in Division 13 and Subdivision 815-A by the exclusion of market-related agreements as a realistic option for an arm's length pricing structure, the use of a risk management benefit test in lieu of the reasonable expectation test in the relevant legislative provisions, and the reliance on the mere existence of price sharing agreements in the marketplace as sufficient proof of the arm's length hypothetical being satisfied;
>
> the misperception and misapplication of the concept of "independent parties dealing at arm's length (or wholly independently) with each other" by basing its transfer pricing analysis on the approach of analysing CMPL's financial position and risk exposure in isolation from the integrated mining, marketing and trading business in which it operated and from the Glencore Group of which it was a part;
>
> the incorrect view that the intra-group transactions between CMPL and GIAG were effective in mitigating the economic risks to the integrated business presented by fluctuations in the copper price and TCRCs and the price risk from different purchase and sale quotational periods; and
>
> the manner in which the taxpayer conducted its case in not providing evidence of the performance of the integrated mining, marketing and trading business conducted by the Glencore Group, the terms and conditions on which GIAG generally sold to independent parties, or the group's policies and practices relevant to the use of price sharing agreements to remove the volatility of TCRCs and between TCRCs and copper prices.

Nor did the taxpayer prove what the actual arm's length consideration was in order to displace the assessments issued in reliance on subsection 136AD(1) as applied in conjunction with subsection 136AD(4). As the Full Federal Court said in the *WR Carpenter Holdings Case*:

> Had the Commissioner taken the position, as he may well have, that it was possible or practicable for him to ascertain the arm's length consideration in respect of the relevant supply of property and ascertained it to be the same amount as he determined it to be under subsection 136AD(4), then, and subject to what we have to say below, it

> does not appear to us that there would be any difference in the nature of the contest between the Commissioner and the applicants.
>
> The only difference may be this: in order to show that an assessment made in reliance on determinations made under paragraph (d) of subsections 136AD(1) or (2) and subsection 136AD(4) is excessive, it would be necessary for the applicants to show that the arm's length consideration is both ascertainable and less than the deemed amount; that, in itself, would seem to require the applicants to prove the actual amount of the arm's length consideration….[447]

As stated above, there is a strong conceptual argument to support a merits review in the *Glencore Case,* on the grounds that her Honour has made errors of law in applying the arm's length hypothetical. These relate to:

(i) the exclusion of market-related agreements for the purposes of applying the arm's length hypothetical as separately articulated in section 136AA(3)(c) in conjunction with section 136AD(1) and Subdivision 815-A in conjunction with Article 9 of the Swiss Agreement;

(iv) the analysis of market risks and financial viability by reference to the circumstances of CMPL in isolation from the integrated mining, marketing and trading business and group of which it was part[448]: and

(v) the acceptance of the taxpayer's risk mitigation rationales when the evidence showed that: the real world risks were incapable of being addressed through the pricing arrangements imposed on intra-group sales; and, that "the natural and probable consequences"[449] of the price sharing arrangement was a reduction in taxable Australian sales revenue and a corresponding increase in the profits of the Swiss parent company.

Allied with this, as set out above, several aspects of the case that support the view that the taxpayer has not satisfied its onus of proof under section 14ZZO of the *Taxation Administration Act 1953.* It is important in the public interest that the core concepts of "independent parties dealing at arm's length (or wholly independently) with each other" and the reasonable expectation test in the arm's length hypothetical be clarified in view of the opportunities for tax planning that the Court's reasoning provides and the fact that the decision has a continuing significance because the replacement provisions for Division 13 and Subdivision 815-A (Subdivisions 815-B, C and D) are based on the same concepts.
If, after all appeal rights have been exhausted, the Commissioner were to lose the case, there is a compelling argument on public policy grounds for a law change[450]. The arm's length hypothetical and the concept of "independent parties dealing at arm's length (or wholly independently) with each other" that are contained in Division 13 and Subdivision 815-A are critical building blocks in Australia's transfer pricing regime.

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[447] *WR Carpenter Holdings Pty Ltd & Anor v FC of T* [2007] FCAFC 103 at [36] to [37]; 2007 ATC 4679 at 4687.

[448] This approach is inconsistent with the implications of the concept of "independent parties dealing at arm's length (or wholly independently) with each other" which is included in both Division 13 and Subdivision 815-A. See also *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2017] FCAFC 62 at [60], [92] to [95] per Allsop CJ and [130] to [132], [153] and [156] per Pagone J.

[449] Compare *Raymor Contractors Pty Ltd v FC of T* 91 ATC 4259 at 4270 per Hill J; cited in *Walstern Pty Ltd v FC of T* [2003] FCA 1428 at [64] per Hill J; 2003 ATC 5076 at 5088.

[450] The proper application of the comparability requirements could be assisted by the inclusion of a method statement in Subdivision 815, should that prove necessary.