COMMENTARY ON LONG-TERM CONTRACTS

By John Garvey*

This commentary is concerned principally with two issues: the performance record of long-term iron ore sales contracts, and the manner in which prices are agreed for deliveries under iron ore contracts.

The priorities of most steel mills are to ensure security of supply and to optimise the metallurgical properties of their feedstocks. They consider diversification of their iron ore supply sources important, particularly in view of the relatively small number of producers. Supply diversification is of less concern to European steel mills than to Japanese mills in view of the number of suppliers in the Atlantic region and the captive mines in which the European mills hold substantial interests.

The original Australian long-term iron ore sales contracts were written with the Japanese steel mills during the 1960s. They were for periods of 10 to 15 years and provided for relatively firm tonnages and constant prices, subject to certain reviews.[1] However, during the late 1970s the contracts were effectively transformed into contracts to meet the requirements of the buyers.

The late 1970s and 1980s saw an oversupply of iron ore in world markets as well as industrial disruption in the Pilbara, which reinforced the desire of the Japanese to diversify their supply sources. As a result actual deliveries of Australian iron ore under Japanese sales contracts fell to as low as between 35 and 60 per cent of contracted annual tonnages.[2]

LONG-TERM SUPPLY ARRANGEMENTS

To a large extent, iron ore is non-specific as regards its source. However, the number of buyers and sellers in the market is limited. In these circumstances Professor Daintith has suggested that 'bilateral governance' will apply to long-term supply arrangements.[3] Bilateral governance in this context means that only two parties — the seller and the buyer — are involved in resolving adjustments or revisions to the contract

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1 See J.K. Hamilton, 'Iron Ore Marketing' International Marketing Institute Conference on Export Marketing of Bulk Commodities (Sydney, 20 Mar. 1981), 6.

2 A comparison of Hamersley's contractual tonnages with actual deliveries to the Japanese steel mills (all references in 1000 tonnes) is as follows:

	1986	*1987*	*1988*	*1989*
Contractual tonnages	31 187	31 187	25 450	25 450
Actual tonnages	16 977	10 883	16 673	21 500
Percentage of contractual tonnages taken	54.4%	34.9%	65.5%	84.5%

(Source: *Iron Ore Manual* 1986–87, 174; 1987–88, 172; 1988–89, 170; 1989–90, 167; 1990–91, 195 — Tex Report Co. Ltd, Tokyo.)

3 T.C. Daintith, 'The Design and Performance of Long-Term Contracts' in Daintith and Teuber (eds), *Contract and Organisation* (1986) 164, 165–166.

term, annual quantities and annual prices, without recourse to third parties such as arbitrators or independent experts.

A long-term contract may be contrasted with a vertically integrated (or unified governance) arrangement where the end-user has developed or acquired a mine in order to secure its supply of the raw material (a captive mine). Obviously the end-user will be in a position to decide unilaterally any questions of priority in relation to the supply and use of the raw material.

During the early 1960s, when the Pilbara mines were being developed, the suppliers and their customers were in approximately equal bargaining positions. The buyers provided the markets and the suppliers provided the investment necessary to develop the new mines. There were mutual advantages in genuine long-term contracts — which were, in fact, the norm.

As a result of the restructuring of the contracts during the 1970s, they remained long-term contracts in name only. Having got the mining companies to develop new supply sources (and thus not having to finance the new mines themselves), the buyers managed to convert the long-term sales contracts into flexible tonnage and price contracts, effectively at the buyers' option. Buyers' dominance in the market meant that they did not need to accept contractual constraints as the price of security of supply.[4]

Suppliers were unable to resist buyers effectively. Having made the investments necessary to develop the mines, they had little alternative but to continue supplying iron ore in a market dominated by buyers under the often-quoted euphemism 'long-term arrangements to mutual benefit'. This resulted in some appalling returns on capital investment.[5]

The suppliers found themselves in this position largely for commercial reasons. However, I believe there were also legal constraints which militated against the suppliers seeking to enforce their customers' obligations under the contracts. These included the arbitration provisions in the contracts and the absence of governing law clauses. Additionally, the sellers, who were usually represented by commercial people rather than by lawyers, tacitly accepted that the doctrine of 'changed circumstances' should be applied to the contracts for the benefit of their customers.

As a result, between the mid-1970s and the late 1980s buyers largely had their own way with regard to annual quantities and prices, so much so that in some ways the contracts came to resemble unified, rather than bilateral, governance arrangements.

CONTRACTUAL AMENDMENTS IN THE LATE 1970s

The dominance of the Japanese steel mills was formalised by the introduction of 'tonnage flexibility', 'price encouragement' and 'brick

4 T.C. Daintith, 'European, American and Japanese Conceptions of Contractual Obligation: Hard Minerals Contracts as a Case Study' in *Energy Law '88* (1988) 125, 128.

5 For example, in Hamersley's case the return on shareholders' funds for the 10 years 1966–1977 averaged 10% and for subsequent years: 6.2% (1978), 0.7% (1979), 7.7% (1980), 2.3% (1981), 4.4% (1982) and 6.9% (1983). (Source: Hamersley Holdings Limited *Annual Reports* 1978–84.)

pricing' provisions into long-term iron ore sales contracts in the late 1970s.

Tonnage flexibility clauses were expressed in approximately reciprocal terms, so that, theoretically at least, they could also be invoked by the suppliers. In practical terms, they operated so as to allow buyers to require sellers to reduce annual deliveries of contractual tonnages to suit the buyers' requirements. They also enabled buyers to exert downward pressure on price by threatening to exercise their rights under the tonnage flexibility clauses to reduce the quantities of product they would take in the relevant year.[6] However, the amended contracts usually contained undertakings by the buyers to treat their various suppliers equitably.

The combined effect of 'price encouragement' arrangements and the 'brick pricing' principle was that if the buyer and the seller were unable to agree on the price payable for deliveries in a particular year, the price applicable to deliveries during the previous year would continue to apply until the new price was agreed. After agreement on the new price, only half of the tonnage delivered during the relevant year would be subject to adjustment to take into account the new prices. Naturally this acted as an incentive on suppliers to concede to price increases offered by their customers.

Price encouragement provisions are no longer included in contracts, but the mills retain considerable flexibility in relation to the annual quantities of which they actually take delivery.[7]

GOVERNING LAW AND ARBITRATION CLAUSES

In my experience, governing law clauses have not been, and are still not, included in Japanese and many other iron ore sales contracts. The contracts also often exclude recourse to litigation and prescribe arbitration to resolve disputes between the parties. Sometimes they state that if the parties are unable to agree on an arbitrator they will request an independent body, such as the Court of Arbitration of the International Chamber of Commerce, to appoint one.

The law of the contract may be determined in three ways. First, by nomination by the parties in the agreement itself. Alternatively, in the absence of a nomination by the parties, as inferred from the contract in all the surrounding circumstances, or by determination of the system of law with which the transaction has the closest or most real connection.[8]

Ainslie QC[9] emphasises the importance, when agreeing on an arbitration clause, of specifying:

- the governing law of the contract;
- the country where the arbitration is to be held; and
- the rules by which the arbitrator is to conduct the arbitration.

6 *Supra* n.3, 186–187.

7 The *Tex Report* (26 Oct. 1990) indicates that, as at the end of Dec. 1990, the Japanese mills had annual 'contractual elasticity' of between 111 415 000 and 138 060 000 long tons, with Australian suppliers being committed to provide between 47 950 000 and 66 900 000 long tons representing more than 70% of this flexibility.

8 R.I. Ainslie, 'Export Sales Contracts' (1977) 1 *AMPLJ* 179, 182–183.

9 Ibid. 188.

These rules may, for example, be the rules of the International Chamber of Commerce, the rules contained in the UNCITRAL Model Law, or the UNCITRAL rules as adopted by the International Arbitration Act 1974 (Cth), or the Commercial Arbitration Act 1985 (WA) or the latter's equivalent in another State.

If no governing law is specified, the arbitrator would first have to determine which law to apply. There may be a strong argument that the law of the supplier has the closest connection with the contract if delivery takes place on loading, as under an FOB, CIF or CFR sale in accordance with INCOTERMS 1990. However, it is by no means certain that an arbitrator would decide that the law of the contract should be the law of the place from where the commodity is supplied.[10] The time and cost involved, particularly if the arbitrator has to be selected by an independent body and the arbitration is to be conducted in a third country, may be effective barriers to a supplier seeking to enforce its rights under the contract.

In noting the preference for arbitration in early iron ore long-term sales contracts, Professor Daintith suggests that the incorporation of arbitration clauses shows that the parties wished to avoid the possibility that a dispute would come before the ordinary courts.[11] It seems to me that it was, and remains, more likely to be in the interests of buyers than of their suppliers not to specify a governing law and to remove the contracts from the jurisdiction of the ordinary courts. Doing so has certainly complemented the buyers' preferred 'flexible' or 'commercial' approach to the performance, or in some instances non-performance, of the contracts. Such issues as buyers' failure to take delivery of agreed annual tonnages, failure to reach agreement on annual prices and claims for relief from hardship have effectively been left to the vicissitudes of 'long-term commercial arrangements'.

VIENNA INTERNATIONAL SALE OF GOODS CONVENTION

The Vienna convention on the international sale of goods[12] applies to contracts for the sale of goods between parties whose places of business are in different countries where either:

- the countries are contracting states for purposes of the convention, or
- the rules of private international law lead to the application of the law of a contracting state.[13]

The convention has been adopted by Australia and given effect in each of the Australian States and Territories.[14] Various provisions in the conven-

10 Art.28(2) of the UNCITRAL Model Law, for example, provides: 'Failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.'

11 *Supra* n.3, 186.

12 United Nations Convention on Contracts for the International Sale of Goods, adopted at Vienna, Austria, 10 Apr. 1980.

13 Ibid. Art.1(1).

14 See for example Sale of Goods (Vienna Convention) Act 1986 (WA).

tion impose obligations on sellers and buyers and deal with formation of contracts, passing of risk, damages, effects of avoidance of the contract and obligations to preserve the goods.

The parties should therefore be clear as to whether or not they want the convention to apply. Usually parties to long-term contracts would want to exclude the convention, as they will have exhaustively settled the arrangements between them in the contract. Failure to specify a governing law could lead to uncertainty as to whether or not the convention applies, and may in itself be reason for specifically excluding the convention.

CHANGED CIRCUMSTANCES

The doctrine of 'changed circumstances' is often cited in connection with long-term sales contracts, particularly in the Japanese context. This doctrine has only limited application, if any, in Japan outside the area of real property transactions. Even then, it appears to have been confined to drastically changed circumstances brought about by war and would not include circumstances within the control of a party seeking to invoke it, such as a buyer in an oversupplied iron ore market which that buyer has helped to create.

Referring to a Japanese paper presented at meetings of the Australia–Japan Business Cooperation Committee in Osaka between 11 and 13 October 1978, Rabinowitz and Wright[15] have commented that:

> . . . one might be tempted to query whether "change of circumstance" is not a, or even *the*, cardinal principle of Japanese contract law.
>
> We should be disabused of this notion. A contract in Japan does not have a fragility only slightly less than that of a plum blossom; the jurisprudence simply does not support any such proposition of evanescence. The leading scholar of the change of circumstance doctrine in postwar Japan, Professor Kiyoshi Igarashi of Hokkaido University, readily concedes that throughout the entire postwar period the Supreme Court has done no more at any time than acknowledge in dictum the existence of such a doctrine; it has never applied it as *ratio decidendi*.

They conclude that 'the doctrine of change of circumstance at best has a most tenuous existence within the corpus of Japanese municipal law'.[16] Despite these warnings myths about 'changed circumstances' abound and the doctrine has been accepted as having broad application by many foreign suppliers of raw materials to the Japanese market. It has been successfully invoked by buyers even in such cases as arose during the 1970s and 1980s, where the oversupplied iron ore market resulted to a large extent from the actions of the buyers themselves.

A similarly elusive issue is the Japanese approach to contracts. On this point I would again refer the reader to the work of Rabinowitz and Wright. They comment in relation to what they refer to as 'the socio-psychological orientation' of Japanese businessmen to contract:

> Let there be no mistake about it: while these businessmen and Governmental officials may

15 R.W. Rabinowitz and E.J. Wright, 'Some Legal Aspects of Japanese Involvement in the Australian Mining Industry' (1980) 2(2) *AMPLJ* 160, 174.

16 Ibid. 175; see also M.E. Wright, 'Effect of Changed Circumstances on Mineral and Petroleum Sales Contracts' [1984] *AMPLA Yearbook* 331, 358.

> not be enthusiastic about the manner in which a particular purchase contract evolves, they know full well the meaning of the contractual commitments made. . .
>
> Here we would urge an approach to contract negotiation, operation and dispute resolution precisely as would be adopted when dealing with representatives of any other society where the legal subsystem is in the Western tradition. Any attempt to do otherwise is likely to redound to the advantage of the Japanese party. . . Japan is quite capable of taking care of itself very nicely; you need not ensure that it is additionally advantaged to its satisfaction and that of our comparativists and sociologists of law, by your concern. Draw your contracts carefully and plan to enforce them very much as you would were the purchaser not in Japan but elsewhere in the Free world.[17]

On the other hand, it has been suggested that the Japanese have a different and more flexible attitude to contracts than Australians and Europeans may have.[18] In any event, lawyers acting for suppliers of raw materials to Japanese markets need to ensure that their clients are not disadvantaged by misconceptions about the doctrine of changed circumstances and the Japanese approach to contracting.

REASONS WHY LONG-TERM CONTRACTS ARE USED

As indicated previously, throughout the late 1970s and the 1980s long-term iron ore sales contracts changed fundamentally from fixed term, fixed quantity, fixed price to contracts servicing the requirements of the buyers. The contracts gave the buyers most of the advantages they would have had in vertically integrated supply arrangements. However, buyers did not suffer one of the major disadvantages: they did not themselves have to finance the development of the mines.

I have not found any completely satisfactory reason why sellers persevered with the contracts during the difficult times from the mid-1970s until the late 1980s. Perhaps it was a desire to maintain a 'privileged trading relationship'.[19] Tonnages that were not taken (other than minus options) were not cancelled but 'rolled over' to be delivered during the remainder of the term of the contract or at the end of the term.

However, since the contracts were no longer guaranteed minimum annual tonnage contracts, it seems at best that they only constituted *evidence* of a long-term relationship. Whilst this may be interesting historically, it is difficult to see what prospective comfort the contracts gave to suppliers.[20] Undelivered tonnages were cancelled in conjunction with the new 1989/90 contracts.

At the working level, contract terms and conditions have been, and continue to be, adhered to quite rigorously by contract administrators, shipping schedulers and samplers, and those negotiating payment. On the other hand, at an executive level they are viewed less in terms of creating legal obligations and more as evidence of a long-term privileged trading relationship.

A senior salt marketing executive recently expressed to me some irritation with what he referred to as 'naive' management's preference for

17 Rabinowitz and Wright, op. cit. 185; see also Daintith, *supra* n.4, 135, 138.
18 See for example P.J. O'Keefe and M.A.G. Tedeschi, *The Law of International Business in Australia* (1980) 14.
19 *Supra* n.3, 187.
20 See, for example, *supra* n.2.

legally enforceable price and tonnage clauses, which he said often created unnecessary difficulties on a personal level in dealing with buyers. His view is that salt sales contracts (which rarely contain firm commitments in excess of two years) should be seen as evidencing long-term arrangements which are supported by agreed procedures for administering actual deliveries to the customer and by which payment will be made by the customer.

In summary, it seems that long-term contracts are seen by suppliers as:

(1) evidencing long-term arrangements with their customers;
(2) providing a basis on which the long-term arrangements can be further developed if, for example, their customers' requirements for iron ore increase; and
(3) containing agreed procedures for administering actual deliveries and payments.

THE CURRENT POSITION WITH REGARD TO LONG-TERM CONTRACTS

Developments during the 1970s and 1980s came close to destabilising some Australian producers. However, the Japanese mills appear to have realised the importance of their Australian suppliers. At the same time, assisted by the considerable decrease in labour unrest throughout the 1980s, Australian producers are endeavouring to re-establish their reputation as reliable suppliers.

Current arrangements between Australian suppliers and the Japanese steel mills mostly date from 1989/90. They usually consist of two or more contracts, each of five to seven years, and comprise a mixture of firm and optional tonnage contracts. Thus, to some extent, buyers have reverted to making firm commitments to take delivery of agreed annual tonnages. However, the options that go hand in hand with the firm tonnage commitments, and are exercisable only by the buyers, could result in suppliers underutilising capacity if buyers were to fail to exercise their options to take substantial deliveries over and above the firm tonnage commitments.

At the end of December 1990, the Japanese mills had annual flexibility or 'elasticity' from all their suppliers of between approximately 111 million and 138 million long tons, i.e. flexibility of approximately 27 million long tons. Australian suppliers were committed to supply between approximately 48 million and 67 million long tons to the mills.[21] Thus, approximately 70 per cent of total flexibility available to the mills is currently provided by Australian suppliers, even though they supply only about 46 per cent of the Japanese market.[22]

The general consensus in the industry seems to be that the move back towards firm tonnage contracts is likely to continue. If buyers are confident of their supply sources, they tend to take a more relaxed attitude when it comes to contract renegotiation and annual tonnage commit-

21 See *supra* n.7.
22 *Tex Report* (8 Apr. 1991).

ments. But performance is crucial. If a supplier fails to perform, it will expect to see its actual deliveries reduced substantially in that year and in succeeding years. Judging on past experience, it is unlikely that suppliers would take steps legally to enforce performance by their customers or to seek other legal redress if their customers were to renege on contractual tonnages.

IRON ORE PRICES AND QUANTITIES

The price for iron ore is usually expressed in terms of US cents per iron (Fe) unit. A unit is 1 per cent of either a tonne or a long ton. Thus, for prices in tonnes a unit is 10 kilograms of Fe; for prices in long tons a unit will be 22.4 pounds of Fe. Taking Robe River fine ore as an example, one tonne of iron ore at 53.58 per cent Fe (natural basis) contains 53.58 units of Fe. A price of US28.5 cents per Fe unit would be equivalent to US$15.27 per wet tonne or US$16.26 per dry tonne, after allowing for moisture content of approximately 6.5 per cent.

Long-term contracts provide the framework within which iron ore deliveries are made. However, actual quantities to be delivered are agreed annually within the constraints of the contracts, for example by plus or minus 20 per cent of base tonnages or in accordance with an allocation of a 'fair share' of the buyer's total requirements for the year. Prices are also agreed almost entirely by reference to commercial considerations. There is no published spot price similar to the London Metals Exchange price for copper, lead or zinc.

Most commentators agree on the desirability of price adjustments being by reference to a formula, or at least to a process by which a formula can be derived.[23] Peter Bobeff has canvassed this issue admirably and made several interesting suggestions with regard to pricing mechanisms. No such formula exists in the case of iron ore prices.

The major producers are usually keen to be the first to agree on annual prices, as agreement is reached at the same time on actual tonnages to be delivered during the relevant year. In a depressed market the first to agree on prices is more likely to see a higher portion of its contracted tonnages actually delivered.

ANNUAL PRICING NEGOTIATIONS

Usually, either the Japanese or the German mills settle a price with one of the major Australian or Brazilian producers first. This price will then set the benchmark for other contracts, with appropriate adjustments being made for differences in physical and chemical composition for products from various mines around the world.

Australian iron ore is sold on an FOB basis to Japanese buyers. The Japanese ore year runs from April to March. Annual pricing negotiations

23 See R.W. McCaskill, 'Contract Flexibility — Oil and Gas' *Energy Law* '86 (1986) 111; Shane B. McCarthy, 'LNG Sales and Shipping Agreements' *Energy Law in Asia and the Pacific* (1982) 653, 668–670; M.E. Wright, *supra* n.16, 340–343; Noel Fabri, 'Stability of Contractual Relations in Long-Term Transnational Agreements' [1987] *AMPLA Yearbook* 563, 585–586.

usually commence in December in Tokyo with suppliers being summoned, one after the other, to meetings with the Japanese mills. The mills conduct their negotiations as a cartel through a lead mill.

Different influences come into play during price negotiations each year. Issues to be discussed which may have an impact on the price include:

- the world economy, particularly the economies of the United States, Europe and Japan;
- the wellbeing of the steel industry and the consequent demand for iron ore;
- the tightness of supply of iron ore (if there is a comparative shortage, the price may increase);
- the relative profitability of the operations of buyers and sellers; and
- currently, the need for reinvestment in the Australian iron ore industry. The ore reserves of various mines such as Tom Price were substantially reduced during the 1980s, when no new mines were opened. No doubt this issue will continue to be significant due to the need for development capital for new Pilbara mines, including Hamersley's Marandoo and BHP's Yandicoogina.

The 1990–91 Tex *Iron Ore Manual*[24] provides some indication of the issues that were discussed during the 1990 price negotiations. Sellers contended that, as a result of prices having been kept at low levels over the preceding several years, they did not have the funds required for the reinvestment necessary to maintain supply stability and competitiveness. They said that a price rise which justified this investment was necessary. They also argued that iron ore was in tight supply and demand, and that position was likely to continue into 1991. They pointed out that demand was strong in Europe and other Asian markets such as Taiwan, Korea and China, even if demand in Japan were to decline. The suppliers argued that these circumstances justified a substantial price increase.

On the other hand, the mills predicted that demand for iron ore would decline throughout 1990 and the overall supply/demand situation would ease. They agreed with suppliers that reinvestment was necessary in order to maintain and expand production levels, but argued that price rises should be moderate. They acknowledged that there had been cumulative price cuts during the preceding six years amounting to 30 per cent. However, they said that during that period the Japanese steel industry had suffered from a sharp rise in the value of the yen. Finally, the Tex *Iron Ore Manual* records that the mills hoped 'to discuss the matter amicably paying due attention to respective positions'.

Prices payable under contracts with other Asian buyers are usually determined annually by reference to the Japanese price. These markets

24 *Iron Ore Manual* (1990–91) 23, 24. The annual *Iron Ore Manual* and periodic *Tex Report* are internationally circulated trade journals published in Japan. Hamilton (op. cit. 17) comments that the *Tex Report* contains 'a blend of factual information and the Japanese points of view'.

are more dependent on Australian suppliers as their supply sources are less diversified.

Australian sales to Europe are usually on a C&F or CIF basis. Generally, European mills place more emphasis than the Japanese on setting prices by reference to current market conditions. After taking into account chemical and physical composition, they expect to pay equal landed costs for ore from various sources. This means that Australian suppliers receive a C&F price comparable to that which the Brazilians receive in European markets. Unlike the Japanese, European mills are not prepared to compensate distant suppliers for their greater freight costs: they see no need to do so in view of their access to considerable supply diversification. As the freight payable per tonne of landed ore will vary depending on the source of the ore, notional FOB prices received by the various suppliers to European markets also vary considerably.

On the other hand, the Japanese notionally 'share' any freight differentials between geographically distant and close suppliers. In fixing the Australian FOB price they generally allow Australian suppliers only half of the notional differential between the Brazil/Japan and Australia/Japan freight rates.

The Japanese place more emphasis on long-term stability of prices in their purchasing policy. This may help to explain their antipathy to what they saw as an attempt to set up a suppliers' cartel in 1987. On 27 January 1987 five major producers — Hamersley, BHP, CVRD and MBR of Brazil and LKAB of Sweden (the so-called 'Group of 5') — wrote jointly to the presidents of the Japanese steel mills offering to conduct joint pricing negotiations in an apparent attempt to counter the joint negotiations conducted by the Japanese mills. A reading of the 1987–88 Tex *Iron Ore Manual* indicates the chagrin with which this was greeted in Japan:

> Japanese Steel Mills, however, exerted their maximum effort to crush G5 regarding this as an action of pressure in an aim to lead iron ore price negotiations in favour of G5 by formation of a cartel. Japan pulled down the cartel reaching an agreement on the price with BHP, the supplier of Mt Newman iron ore and member of G5, in about 3 weeks time . . .
>
> In the face of the formation of a cartel by iron ore suppliers, an event having never been seen before in the long history of iron ore price negotiations, Japanese steel makers were rather quick in reaction, as it still is fresh in our memory.[25]

BHP and the Japanese steelmakers reached agreement on 20 February 1987 and BHP increased its market share in Japan to 14 per cent. Therein lay the carrot that went with the stick. In a declining market BHP was able to peg its share of 1987/88 deliveries at 14 per cent of the Japanese market. Hamersley's share, on the other hand, declined dramatically as that producer was made the scapegoat for the 'Group of 5'.[26] In early March 1987 the five producers wrote to the Japanese steelmakers withdrawing their offer for joint talks, thus effectively conceding defeat.

Apart from the obvious disadvantages of dealing with a buying cartel, there are two benefits for suppliers:

25 *Iron Ore Manual* (1987–88) 17.
26 See *supra* n.2.

(1) they need to deal only with one lead mill rather than conduct separate negotiations with up to seven individual mills; and
(2) mills which may individually be reluctant to accept prices have been even more reluctant to break ranks with the lead mill negotiating on behalf of themselves and the other mills.

However, it seems that the long-standing Japanese approach to price negotiation through a lead mill on behalf of the others may be undergoing some review. In 1991, Kawasaki Steel Corporation was unhappy with the prices negotiated by Nippon Steel Corporation as lead mill; as a result, further minor adjustments to the current price were made. In the *Tex Report* for 28 June 1991 Kawasaki Steel was reported as also having expressed doubts about the continued linkage of Japanese prices with European prices. As Kawasaki Steel's concerns have been made public, it will be interesting to see what transpires during the 1991/92 price negotiations.

INFLUENCE OF FREIGHT RATES ON PRICES

For shipments from Australia to Europe, freight currently represents up to about 35 per cent of the landed cost. Australia has a freight disadvantage when compared with Brazil of about US$4 per tonne into Europe and an advantage over Brazil of about US$6 per tonne into Japan. Against this there is the Japanese willingness to pay a higher price for iron ore from distant as compared with nearby sources ('freight sharing' which does not apply in European markets).

Freight is such an important component of the landed price of Australian ore in European markets that as freight rates increase Australian ore becomes less viable. This has been countered, to some extent, by the use of larger, more fuel-efficient vessels. However, the increasing size of vessels restricts the number of ports they can enter and, in turn, acts as a limiting factor on sales to Europe.

Selling on a C&F or CIF basis (as is the case in most Australian iron ore sales to Europe) may enable a supplier to take advantage of competitive freight rates, thereby enabling it to be competitive with suppliers situated geographically much closer to the market.

A common trading pattern involves vessels carrying iron ore from Brazil to Japan. After discharging in Japan they ballast to north-west Australia to take on a cargo for Europe. After delivering that cargo they ballast back to Brazil to take on a further cargo for Japan. Generally the volume of iron ore and other bulk cargoes moving from the Atlantic to the Pacific exceeds that carried from the Pacific (which includes Australia) to the Atlantic. Consequently, downward pressure has been exerted on freight rates from Australia to Europe by vessel owners seeking to reposition their vessels in the Atlantic. This has assisted Australian producers to deliver ore in Europe at prices competitive with those for Brazilian ore.

Because profitability in European markets is so freight-sensitive for Australian producers, they often enter long-term contracts of affreightment and consecutive trip charter arrangements to service their European

sales. These provide some certainty as to freight rates over longer periods and allow for planning deliveries into European markets over a number of years.

Bunker prices are an important component of freight rates. Since the oil crisis of the mid-1970s, long-term shipping arrangements and C&F ore sales contracts have usually contained provision for bunker cost escalation. In the event of oil price increases, additional costs are then shared among the shipowner, the supplier and the steel mill.

FORCE MAJEURE

Peter Bobeff and David Barnett have both made reference to the developing nature of *force majeure* clauses and how they now often extend to include commercial impracticability and other events which are not necessarily beyond the control of the party seeking to invoke *force majeure.*

Suppliers often also extend *force majeure* to include consequential delays to vessels at the loading port, irrespective of whether the vessel arrives before or after the cessation of the event which gave rise to the *force majeure.* This may enable the shipper to avoid paying demurrage for vessels that have to wait in a queue for a berth after the conclusion of an event, such as a long strike, which may have resulted in the suspension of port operations for some time.[27]

THE ROLE FOR LAWYERS

Whilst price and tonnage clauses are of paramount importance, other provisions in long-term contracts are also important and may, in fact, require greater drafting skills. Long-term contracts should contain provisions and procedures for handling day-to-day contractual issues. Many of these have been canvassed in detail by Peter Bobeff and David Barnett. They include vessel scheduling, sampling and analysis, the method and procedure for handling provisional and final payments, the basis for adjustments to the price, demurrage and dispatch, and *force majeure.* All require careful drafting and warrant the input of lawyers.

In contracts between new suppliers and buyers, these issues are particularly important because they set the framework within which the parties will conduct their long-term relationship. As the parties grow more confident they may dispense with or modify some of these procedures. For example, a supplier to a new buyer may insist on payment by letter of credit for initial deliveries but, as time passes, may allow the buyer to pay by telegraphic transfer for subsequent deliveries, usually reserving the right to revert to letter of credit if the arrangements do not prove satisfactory. Similarly, as the long-term relationship grows the parties may become less likely to invoke the *force majeure* provisions. They may also become more flexible with regard to demurrage and dispatch, depending on their arrangements with shipowners.

27 But note P.G. Willis, 'The Shipping and Insurance Aspects of International Marketing of Commodities' (1980) 2 *AMPLJ* 134, 140.

As indicated previously, I believe that there is also a role for lawyers in ensuring that the doctrine of 'changed circumstances' is kept within reasonable bounds.

Although lawyers will usually not be included in actual negotiations, or, if they are, their true identity may not be revealed, they certainly have an important role in drafting long-term contracts and advising on contract administration.