Contracting Out In Mining

The fundamental purpose of any contract is to regulate the relationship of the parties whom the contract brings together. The intention is to set out the respective rights and obligations of each party. In the ideal contract, every conceivable factual and legal circumstance will be anticipated and provided for.

Regrettably, there is probably no such thing as the ideal contract. However, before entering into any contractual relationship, the parties should bear in mind that they should - as far as possible - attempt to identify circumstances which may arise during the contract's life and what is to happen in such circumstances.

It is indisputably correct that the best contract is one which is put in a drawer after signing and never referred to again because the parties have been able to regulate their relationship without having to refer to the fine print. Contracts are usually relied on most heavily when the parties are in dispute. Accordingly, although the parties may be aglow with the enthusiasm that usually surrounds the signing of a contract, they should try to agree what will happen in the event of various circumstances happening. The warm glow present at the beginning of a contractual relationship fairly quickly dims once disputes arise for which the contract provides no appropriate answer.

Given this, it is surprising how often even major undertakings are let on inadequate contracts. Some of the more fundamental matters which contracts quite often address inadequately are:

Identification of the appropriate parties

Care should be taken to ensure that the parties that are entering into the contract are the appropriate parties. Although this sounds obvious, it is surprising how often a wrong party ends up entering into a contract. This particularly so where there are relatively complex corporate structures or joint ventures.

Take, for example, a contract entered into between a contract miner and a company which is part of a larger group of companies which provides services to other companies in its group. If the service providing company is not the company which produces the end product, say gold, it cannot claim damages because of any loss of production brought about by failure on the contract miner's part to perform. The only exception would be if there was an appropriate agreement between the service providing company and the gold producing company.

Taking this example further, in the absence of some legal liability on the part of the service providing company to the gold producing company in the event of loss of production by the latter, no provision in the contract between the two which provided for damages would be enforceable. This would be true even in the case of liquidated damages.

Accordingly, care must be taken to ensure that the company entering into the contract with the contract miner would be entitled to claim damages for loss it may suffer because of the contract miner's failure to perform - either by virtue of actually losing revenue from production or, alternatively, being liable to the company which loses revenue under a separate contract.

Damages

It is common for parties to talk about contracts containing provisions for imposing penalties if any party fails to perform its obligations. At law, any provision that purports to impose a penalty, is void.

To be of any effect, a liquidated damages clause must provide for payment of a genuine pre-estimate of actual damages. This means that firstly the party who will seek the benefit of such a clause is likely to suffer actual damage and, secondly, that the amount payable represents a genuine estimate of the likely damages that will be suffered. It does not matter that damages may eventually be suffered at a greater or lesser rate, or even at all. All that is required is that when the contract is entered into, the liquidated damages figure represents a genuine pre-estimate.

Scope of work

One of the most significant areas of contractual dispute in engineering, construction and contract mining is whether or not work is included in the contract or is to be considered a variation. Care must be taken to ensure that the scope of works as set out in the contract fully describes that which is required to be done. Neither party should enter into a contract on the basis of any assumption that work is or is not included in the scope of works.

A point of confusion that sometimes arises in mining contracts is exactly what it is that the contractor is required to do. Mining contracts often provide for the production or delivery of so many tonnes of ore per week or per month. It is also often the case that even where the scope of works describes delivery of minimum quantities there is a general description of total tonnage to be delivered over a longer period or even over the duration of the contract. Not infrequently, however, the various ways of fundamentally describing the same thing conflict. For

example, if a contract provides for delivery of 10,000 tonnes of ore per week over a two year period, is that a contract of the delivery of 1,040,000 tonnes of ore? In other words, if within say 20 months, the contractor delivers 1,040,000 tonnes of ore, is its contractual obligation discharged? Similarly, if it takes the contractor 26 months to deliver 1,040,000 tonnes of ore, is the contractor obliged to stay on site for those additional two months?

By the same token, is a term in a contract to the effect that the contractor will produce 10,000 tonnes of ore a week, a warranty by the contractor that it will average 10,000 tonnes per week over the period of the contract or some shorter period, or is it a warranty that it will, week in and week out, produce 10,000 tonnes of ore?

In drafting contracts, care must be taken to ensure that these questions are resolved up front. This is far better than getting six months down the track only to find that the parties have differing views about their respective obligations and rights under the contract.

Mechanism for payment

It is trite that probably the most fundamental term of a contract, certainly as far as the contractor is concerned, is the term relating to remuneration. It is common in mining contracts to have a sliding scale of remuneration depending upon the level of output. The provision of such differential rates presupposes the ability of one or other of the parties, usually the principal, to determine the rate of output. The contract must, therefore, provide an appropriate mechanism for determining the level of output over a specified period.

For example, a contract may provide that no later than seven days before the commencement of any calendar month, the principal shall provide the contractor with details of the production required over the forthcoming month. Such a mechanism would not only determine the rate at which the contractor will be entitled to remuneration but would also allow it to allocate its resources appropriately.

Variations

It is inevitable that during the course of the contractual relationship matters will arise which the parties had not envisaged at the beginning of the contract. Alternatively, the principal will want additional or less work carried out. A well drafted contract will provide appropriate mechanisms for implementing and valuing variations. Again, as with most other aspects of the contract, at the time of negotiation the parties should try to identify the likely types of variations which could arise and put in place an appropriate rate or mechanism for valuation.

As an example, a matter which sometimes arises in a contract mining situation, is whether a direction given by the principal as to how work should be carried out or from where ore should be taken, is a variation. Directions as to the level ore is to be taken from may well affect the appropriateness of a rate and may also be contrary to assumptions made by the contractor in structuring its price. Again, as far as possible, the parties should attempt to explore their respective attitudes to such directions and the impact they have on the contractor's rates so that appropriate schedules and provisions can be incorporated into the contract.

Dispute resolution

There are only three things in life of which we can be sure. They are death, taxes and contractual disputes.

As stated at the beginning of this article, in an ideal world the parties would sign contracts and dispatch them to the bottom drawer never to be seen again. That, however, is a naive hope.

The reality is that disputes between contracting parties are almost inevitable. Hopefully, a properly drafted contract will limit the scope of dispute by properly, fully and explicitly setting out the parties' respective rights and obligations. The more thorough and comprehensive the contract is, the less scope there is for contractual dispute.

However, where the contract does not - on its face - provide the answer to the dispute or, for whatever reason the parties are unable to agree on the answer, the contract must provide a practical and sure means of resolving the dispute.

It has recently become fashionable - particularly with the rise of partnering, alliances, joint ventures and the like - to have extensive mechanisms for the parties to attempt to agree on disputes rather than have them resolved by the binding decision of a third party.

While this is an admirable ideal, to be effective, the contract should provide a proper and definite mechanism for determination in the event of a failure to agree. A contract should basically be drafted on the assumption of disagreement rather than of agreement. If parties agreed all the time there would probably be no need for contracts in the first place.

While it is probably helpful and conducive to settlement to have a provision that before a matter is referred to arbitration or is litigated the parties will attempt to reach a resolution, this is rarely enough satisfied. Often, it is not until well into the arbitration or litigation process that senior management becomes intimately involved with the dispute and it is only then that, say the managing directors, get together and settle the matter. It is often the case that the nature of contractual disputes, such as those that arise in mining contracts, is that the people charged with administering the contract have been in conflict for some considerable time, usually on an escalating basis. The risk is that in these circumstances such people feel that they cannot back down. Accordingly, the dispute becomes one of personalities rather than issues.

An appropriate dispute resolution provision could provide for identified, reasonably senior management to attempt to resolve any dispute but, if they cannot, then it entitles either party to refer the matter to arbitration for determination.

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