Review of Stakeholder submissions in respect of ISA’s Draft Exploitation Regulations

Common Contractor issues

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INTRODUCTION

• Another busy period for ISA – Article 154 review, extension of ‘first wave’ exploration contracts, development of Exploitation Regulatory regime

Presentation covers the following:

• Brief overview of current regulatory framework
• Process for development of draft regulations and extent of stakeholder participation
• Consider some key areas of Contractor concern:
  – Contract award process
  – Regulatory stability
  – Payment regime
  – Finance related provisions
  – Contract duration
BACKGROUND

• ISA = international organization established under UNCLOS to organize and control exploration and exploitation of resources on/under seabed beyond national jurisdiction

• Exploration regulatory regime in place
  – Separate but near identical regulations in place governing
    i. Prospecting/exploration of polymetallic nodules;
    ii. Prospecting/exploration of polymetallic sulphides; and
    iii. Prospecting/exploration of ferromanganese crusts.

• Supplemented by recommendations of the LTC in the form of “guidance for contractors”:
  i. content, format & structure of annual reports;
  ii. reporting of actual and direct exploration expenditure;
  iii. assessment of environmental impacts arising from exploration for marine minerals in the Area; and
  iv. training programmes under PoWs for exploration.

• Dual regime – Sponsoring State Legislation
  – e.g. China’s recent DSM legislation
  – SDC Advisory Opinion (Case No 17) – having legislation in place not a condition for ‘concluding the contract’ with the Authority. Does that still make sense?

PROCESS TO DATE

• Calls for development of exploitation regime in 2010
  – expiry of ‘first wave’ of exploration contracts in 2016 (now extended)

• Surveys/Papers
  i. Stakeholder Survey, March 2014
     – financial terms, environmental management, H&S and maritime security and general considerations
  ii. LTC Report, March 2015: Developing a Regulatory Framework for Mineral Exploitation in the Area
    – included draft framework for exploitation adopting similar outline to exploration regulations
    – stakeholder responses published on ISA website
  iii. LTC Discussion Paper on Payment Mechanism, March 2015

• Workshops, including
  – Singapore (2015)
  – Environmental and Assessment Management Workshop, Surfers Paradise (2016); Berlin (2017)

• Participation levels re survey and 2015 papers
  – significant NGO response, particularly environmental NGOs;
  – Good response from privately owned contractors, less so from other contractors;
  – limited response from Sponsoring States; and
  – poor response level from UNCLOS State Parties (only 8 in total including Sponsoring States out of a possible 167)
Draft Regulations

- July 2015 saw publication of 'Draft Zero' plus 4 discussion papers

- Draft split into 11 parts covering the following key areas:
  - Applications for approval of exploitation contracts (Part II + Annex)
  - Terms of Exploitation Contract (Part III, IV, Part V + Annex VII)
  - Information gathering (Part VI)
  - Inspection (Part VIII)
  - Enforcement and Penalties (Part IX)
  - Settlement of Disputes (Part X)

- Discussion paper on Environmental Regulations published in January 2017
  - Effectively a rough but fairly detailed first draft of separate Environmental Regulations
  - Draft split into 16 parts
  - Guiding principles + restrictions and prohibitions (Part II)
  - Initial Environmental Assessment (e.g. baseline; scoping report) (Part III)
  - Prep of Envir. Plans (EIS, EMS, EMMP, Closure Plan, Emergency Resp. Plan) (Part V)
  - Public consultation (Part VI)
  - Compensatory Measures (incl. environmental liability trust fund) (Part X)
  - Compliance, supervision, enforcement and penalties (Part XIV)

- Exploration regime = very light touch, not the approach being taken here
  - e.g. onerous development and production related obligations, establishment of Mining Inspectorate
  - ISA risks putting contractors off if regulations interfere too much in operational and commercial decisions

- ISA regulatory ‘to do’ list still significant
  - Draft Seabed Mining Directorate Regulations
  - ISA recommendations/guidelines including on documents to be submitted in application; criteria and quantum of performance guarantees, role and operationalization of Enterprise etc.

- Drafts do not reflect views of LTC, Council or Assembly

Stakeholder Submissions

- Submissions made in November 2016
  - Submissions in respect of Exploitation Regulations only
  - No submissions yet for Environmental Regulations

- 43 submissions
  - Adequate Contractor response (11/19)
  - Strong NGO response, particularly environmental NGOs (but mostly focused on environmental issues)
  - Limited State response (8, of which 5 were Sponsoring States)
  - More engagement by Stakeholders is key going forward

- Transparency
  - Generally good but notable exceptions (4 Contractors and one State did not expressly consent to publication)

- Quality
  - Variable quality
  - Privately owned contractors provided the most comprehensive submissions
  - GSR, OMS, NORI and UKSRL submissions = recommended reading

- Process going forward
  - Not entirely clear but expect consolidated exploitation code to be published in July/August 2017
  - A number of contractors and others have requested clear timeline and process for finalization of code (target date requested varies from 2018 to 2020)
  - Has to be in place by 2021 (my view!)
CONTRACT AWARD PROCESS

• Not dissimilar to process for exploration contracts
  ➢ first come, first serve basis application to LTC
  ➢ More clarity required around preference and priority of current exploration contractor

• Issues raised by Contractors include:
  ➢ amount of information required and significant number of criteria for LTC to consider (e.g. commercial viability, optimization of recovery of minerals, ISA production policy)
  ➢ lack of commercial mining expertise at LTC level – use of AQE
  ➢ requirement for public consultation – needs to be tightly controlled by ISA to avoid delays
  ➢ Costs relating to applications to be borne by applicant and likely to be very significant – fixed fee of USD 1 million suggested by a number of contractors
  ➢ no time limits in which application must be considered (but note comments in Environmental Discussion Paper)
  ➢ limited meetings of various review/approval bodies
    • LTC meets twice yearly (suggestion to move to 3)
    • Council and Assembly only once per year (suggestion to move to 2)

REGULATORY STABILITY

• Regulatory stability key for Contractors, esp. first movers given high risks
  ➢ Point made repeatedly by Contractors

• Draft Regulation 59
  ➢ Regime fixed for first 5 year after which Council may adopt and apply amendments to Regulations
  ➢ Any changes are expressed to be ‘without prejudice’ to rights conferred under a contractor’s exploitation contract but note limited contractor rights under the contract itself. Contractor rights:
    ☐ Exclusive right to exploit for relevant mineral resource
    ☐ Title
  ➢ Stabilization provisions in the exploitation contract provide for negotiations only – no legally binding mechanism to keep Contractor whole for changes in regulations which materially impact its financial position
    ☐ Either enforceable stabilization provision (OMS), longer stability period (UKSRL) or changes don’t apply to contracts already entered into (NORI)
  ➢ ISA draft appears to suggest that the system of Contractor payments will be subject to a separate time period for review (presumably longer than the first 5 years to encourage stability for first movers)
PAYMENT OBLIGATIONS

• 3 core elements in addition to a number of other financial obligations:
  ➢ Annual Contract administration fee
  ➢ Annual Fixed Fee
  ➢ Royalty
  ➢ BUT, also plans for environmental fees, trust fund contributions, contract renewal, transfer of interest, temporary suspension in commercial production, material change to PoW, use of contract as security.

• Annual Administration fee
  ➢ as determined by Council ‘from time to time’ to reflect costs incurred in administration and supervision of Exploitation Contract
  ➢ San Diego workshop report - a figure of +/- USD 100k may be appropriate but requires further analysis

• Annual Fixed Fee
  ➢ payable from contract award but offset against royalty for that year
  ➢ Surprising as San Diego workshop report talked about this applying from commencement of commercial mining

• Royalty
  ➢ royalty formula yet to be determined

• While options still on the table, draft indicates that initial royalty will be calculated on an ad valorem basis
  ➢ Given the information requested by ISA in the draft regulations ISA is giving themselves the flexibility to switch to a different type of Royalty after a certain period (e.g. profit sharing)

• Contractor consensus
  ➢ payment regime to be lower for first movers and require certainty (e.g. no change or caps on increases for a fixed period (e.g. 15 years of commercial production)

FINANCE RELATED PROVISIONS

• Draft Regulation 16 proposes draft terms on the use of the exploitation contract as security by project lenders
  ➢ Very much welcomed by privately owned contractors

• Positives:
  ➢ ISA consent to lender taking security over the exploitation contract not to be unreasonably withheld or delayed
  ➢ Creation of Seabed Mining Register to record security interests (and generally evidence of title)
  ➢ Contemplates that ISA will enter into agreements and other formal documents that project lenders may reasonably require

• Issues identified by some Contractors:
  ➢ Lenders enforcing security or exercising step-in rights may need certificate of sponsorship
  ➢ In the interests of fairness and transparency, forms of lender direct agreements will need to be published and need to contain identical terms and conditions to other lender direct agreements entered into by ISA
  ➢ Lenders should also consider direct agreement with Sponsoring State
PROPOSED CONTRACT DURATION

• What does UNCLOS provide?
  – Considerations under Annex III of UNCLOS include:
    ✓ economic life of mining project;
    ✓ reasonable time for construction for commercial scale mining; and
    ✓ short enough to give ISA opportunity to amend terms and conditions of ‘PoW’ at the time it considers renewal in accordance with RRPs it has adopted since approving ‘PoW’.

• Proposed term
  – maximum of [20] years or such shorter period applicable to economic life of exploitation activities. 20 years is an indicative number.
  – Broad consensus for at least 30 year term (TOML wants 40 years)

• Is this sufficient given potential time from contract start to commercial exploitation?

• Option to renew for periods of not more than 10 years’ upon such terms and conditions as the Contractor and Authority shall agree
  ✓ No cap on number of extensions (cf IBA’s model mining development agreement)

Conclusion

• Long way to go but publication of draft regulations is a welcome step in the right direction
  – Other positives include Article 154 review, increase in ISA budget, appointment of new ISA SG and expansion of LTC
  – Key points for ISA to take on board in next draft is the level of ISA involvement in Contractor commercial and operational decisions, these may be better left to contractor

• ISA still lacks sufficient resources and expertise, Stakeholder assistance key
  - Important for Stakeholders, esp Contractors/Sponsoring States to respond constructively to ISA with detailed submissions on consolidated draft and workshops
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