
The International Seabed Authority

An overview of the ISA's structure, current issues, the Stakeholder Survey & financial regime considerations

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MAKING THE MOST OF DEEP SEA MINERAL RESOURCES



Main objectives of this session

1

- Provide an overview of the ISA's structure & function

2

- Update on the status of exploration contracts in the Area

3

- Outline current issues and focus areas

4

- Introduce the exploitation regime & stakeholder survey

5

- Outline the development of a financial regime for the Area

6

- Conclusions / exercise / questions

The ISA and its function

- Main purpose: to regulate and manage resource exploration and exploitation activities in the “Area” – to realize the Common Heritage of Mankind
- Equitable sharing of economic benefits
- Protection of the marine environment
 - to protect natural resources & prevent damage to “fauna and flora” from “Activities in the Area” through developing RRPs – currently, no integrated marine environmental protection
- Facilitate capacity building through training initiatives
- Promote marine scientific research
- Commercial exploitation of the Area on an environmentally sound footing

ISA Structure

1

The Assembly

- 166 Member States (States Parties to UNCLOS)
- Elects members of the Council
- Key decisions based on Council recommendations

The Council

- Executive / decision-making body
- 36 Members in 5 representative groups or “chambers” – Fiji (Group D)
- Preference for decision-making by consensus – RRP must be by consensus
- Based on recommendations of LTC

Legal & Technical Commission

- 25 Members
- Recommendations to Council – incl. develop legal framework
- Review of applications (plans of work), technical guidance

Finance Committee

- 15 members
- Budgetary matters / financial control

The Secretariat

- Legal, environmental & administrative management – day-to-day
- Support & guidance to above organs

Exploration (& exploitation) contracts

- Based on parallel system of exploitation by:
 - States Parties to UNCLOS (ISA member states)
 - State enterprises
 - Sponsored Contractors
 - The Enterprise (future)
- Reserved areas – developing States / Enterprise
- ISA can take “all necessary measures” to ensure compliance with contract, RRP and conventions
- Key role played by Sponsoring States in realising the CHM principle including assisting the ISA and necessary measures to secure compliance
 - ITLOS advisory opinion
 - “to deploy adequate means, to exercise best possible efforts, to do the utmost”

2

- **Status of exploration contracts in the Area**

ISA – exploration contracts: Status

- **Polymetallic nodules**
 - 13 approved exploration plans of work
 - Sponsoring States include Nauru, Kiribati and Tonga
 - 3 decisions pending including the Cook Island's application
 - 6 exploration contracts expire in 2016
- **Seafloor Massive Sulphides**
 - 4 approved exploration plans of works
 - 2 pending approval (20th Session)
- **Cobalt-rich crusts**
 - 2 approved plans of work
 - 1 pending approval (20th Session)



3

- **Current issues and focus areas**

Capacity Building

3

- Promotion of marine scientific research and capacity building
- Legal obligation of Contractors
 - Recommendations for the guidance of contractors and sponsoring States relating to training programmes under plans of work for exploration, issued by the LTC, July 2014
 - Perhaps 20 training opportunities in next 2 years
 - JOGMEC At-Sea Training Programme 2015: 3 short-term training opportunities (ferromanganese crusts)
 - Application deadline: 15 June 2014
- ISA Endowment Fund
 - promotes and encourages the conduct of MSR in the Area
 - 56 individuals to date from developing countries, including the Cook Islands and Fiji
- UKSRL Training Programme
 - At least two (2) students who are citizens of developing nations through a four (4) year PhD course at the world-renowned Plymouth University Marine Institute
 - Details not yet available



ISA – Current issues

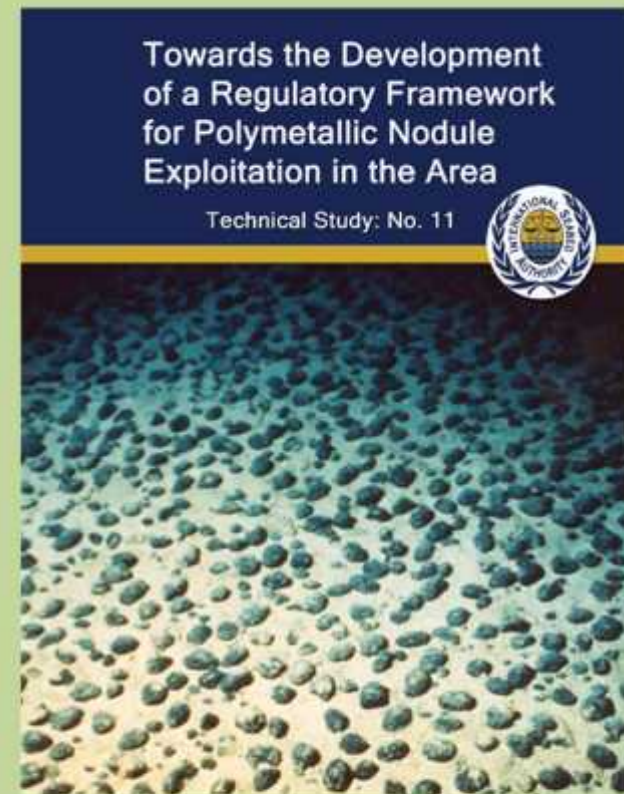
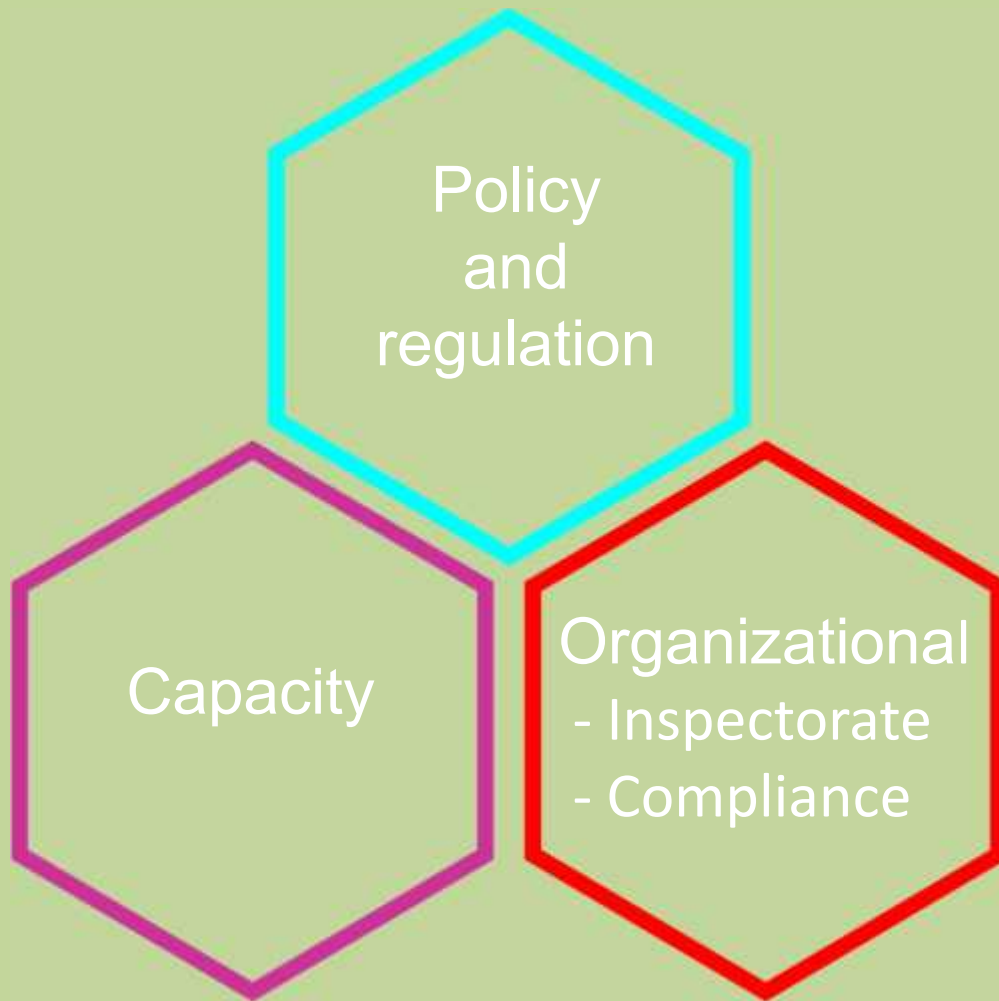
- Consideration of proposed amendments to regulation 21 of the Regulations on Prospecting and Exploration for Polymetallic Sulphides in the Area
- Issue of effective control
- Monopolisation in the Area
- Issues relating to the operation of the Enterprise, in particular the legal, technical and financial implications for the Authority
- Issues relating to extensions for plans of work for exploration
- CCZ Environmental Management Plan
 - Approved by Council 2012
 - Network of nine Areas of Particular Environmental Interest
- Implementation of Article 82
- Taxonomy standardisation
- And development of an **exploitation regime**.....

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- The exploitation regime & stakeholder survey

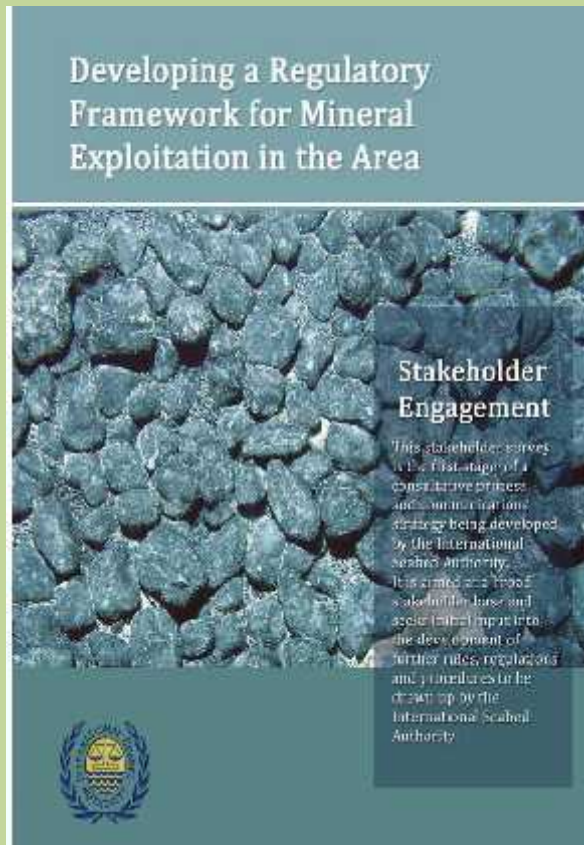
Towards a new regulatory framework

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Stakeholder Survey

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Part A: Financial terms and obligations

- Payment mechanism
- Capability
- Term
- Incentives – Penalties – Insurance
- Environmental bond – Environmental Fund

Part B: Environmental management obligations

- Restoration obligations – EIAs & EMPs
- “Serious harm” – Monitoring & inspection
- Environmental management standards
- Procedure: Precaution, BEP & Adaptive mgt

Part C: Health and safety and maritime security

Part D: Other considerations

- Communication – Transparency
- Other

5

- The development of a financial regime for the Area

Exploitation and financial terms / obligations

- *Developing Financial Terms for Deep Sea Mining Exploitation* – Working Paper for consideration by the Members of the Legal and Technical Commission, International Seabed Authority
- Presented at LTC February 2014 meeting
- Covered payment mechanisms (comparative study) & key financial obligations including environmental management obligations
- Financial & legal obligations – clarity for financial investment decisions

Objectives and principles

- The following slides provide an overview of the objectives and guiding principles relevant to financial terms
- **“Objectives”** drawn from the **1982 UNCLOS**
- **“Principles”** from the **1994 Implementation Agreement** – UNCLOS objectives presented were not amended or deleted
- Need to validate back to these

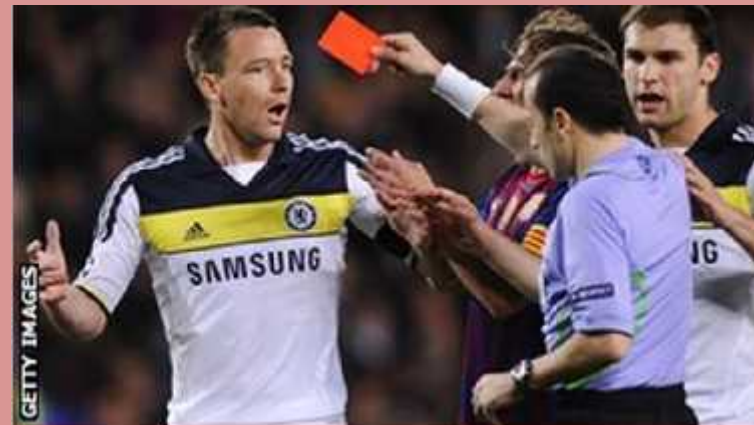
Policy objectives - UNCLOS

- **Optimum revenues** from proceeds of commercial production
- **Attract investments and technology**
 - no artificial advantage nor disadvantage must be afforded to deep sea miners
- **Equal treatment** and **comparable financial obligations** for contractors
- **Incentives** to undertake JVs with Enterprise and developing States / stimulate technology transfer & training
- **Financial incentives** no artificial competitive advantage - “uniform and non-discriminatory basis”
- **Penalties** in lieu of suspension / termination or other cases monetary penalties may be imposed – proportionate to the seriousness of the violation

Financial mechanism principles IA 1994

- Fair system to ISA and Contractor
- Adequate means to determine compliance by a contractor
- Rates of payment “within range” of land-based mining for same minerals ... no artificial competitive advantage or competitive disadvantage
- Not complicated ... with no undue administrative burden – enforcement & compliance
- Royalty or royalty / profit-share system
- Annual fixed fee
- Periodic review – may change in circumstances

What is fair?



The key findings from Working Paper I

1. The complex financial interaction between all parties drives the need for an international conference of key stakeholders.

2. Financial terms are not independent and must be seen as part of a total package including environmental impacts, CSR and CHM benefit sharing.

3. Detailed financial modelling and economic analysis is required to support any high level findings.

4. Some land-based mining fiscal regimes are now inherently flawed. Most are in transition.

5. There is one simple trade-off in any payment mechanism: administrative capacity versus optimal (best) revenue opportunity.

6. There is a complex trade-off & discussion between the division of normal profit and economic rents.

The key findings from Working Paper II

7. Fiscal transparency in Extractive Industries is driving exponential change. EITI principles will need to be reflected in the ISA financial regime.

8. Aligning financial accounting requirements and profit share will reduce administrative complexities.

9. A full understanding of the DSM value chain is needed to determine an appropriate valuation point.

10. Establish a trust fund to cover damage to the environment not covered by the LOSC / contracting parties (ITLOS recommendation).

11. Whether a premium should be attached to the non-renewable nature of mineral resources is undecided.

12. A "safety valve" should be built-in to the mechanism which kicks in during periods of high pricing or end of mine life.

The key findings from Working Paper III

13. In developing any incentives for attracting investments these should be specific, targeted, costed and temporary. Some country incentives make little financial sense.

14. A profit / rent-share model need not be unnecessarily complicated. But any discussion over defining acceptable levels of financial return is complex.

15. Closure & reclamation require upfront consideration under the payment mechanism.

16. The payment mechanism must support commercially sound principles. It must not support wasteful & inefficient mining practices.

17. The treatment of exploration costs requires close attention and careful consideration.

18. The concept of a “fair and equitable” share among mining participants has yet to be determined.

The challenges

- No one fiscal regime so far has captured both government policy, including social benefits and reform, and investor satisfaction – petroleum sector closer to this goal than mining regimes
- Mining regimes are currently in a high state of flux – resource nationalism
- No pre-existing fiscal system at ISA
- How to capture environmental concerns / biodiversity loss in financial terms
 - Not just about financial payments – other obligations with financial impact
 - Any fiscal model must support commercially sound practices and promote environmental objectives
- Interaction between actors – complex. Perhaps.
- Uncertainty in predicting and forecasting
 - Economic behaviour of players

The biggest challenge in design

- The payment system – should not be complicated
 - This is the biggest trade-off area – not complicated versus optimum revenues
 - All parties want an uncomplicated structure
 - Land-based miners tend to prefer royalties to rent taxes
 - Governments may prefer royalties too but they don't always catch upside (prices / production efficiencies) -progressive profit mechanisms are increasing but relatively complex to administer
 - Has a time element – what appears complicated now...becomes the norm
- Think a better term here is “efficiency” – system needs to be efficient and capture optimum revenues for CHM
- Key question: what is the appetite / capacity for handling profit-related mechanisms?

Financial mechanism – Key guiding principles



- Its ability to generate optimal revenue levels for the CHM
 - equally a financial regime should ensure that any DSM development which is economically sound before applying financial terms, remains so after their application
- Its equivalent treatment of contractors
- Its simplicity – administration – enforcement / compliance – transparency
- Its flexibility & responsiveness to change
- Its stability for investors & predictability for the ISA / CHM

Main fiscal instruments considered

1. Ad valorem royalty (Value Based)

Base on realised value (NSR / FOB) or the market value of the mineral product sold	Administratively simpler Economically inefficient
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2. Profit-based royalty

Rate applied to a measure of net income or linked to profitability Levied at project level on accounting profit	Higher compliance costs Economically more efficient Revenue less stable
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3. Hybrid royalty / tax

Has a minimum ad valorem royalty Also has a profit / rent based tax - as below or a progressive tax / windfall-related tax	Minimum allows for some revenue As for above
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4. Resource Rent Tax
(additional profits tax, surtax, rate of return tax)

Applies a % rate to a calculated economic rent "Cash" rather than profit based	Potentially significant compliance costs High economic efficiency (theoretically) No stable revenue flow but potential for upside
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Complexity increases
Revenue (ISA) stability decreases
Economic efficiency increases
Opportunity (optimal tax base) to share in upside increases
Transparency challenges increases
Note: does not reflect CIT-based instrument.

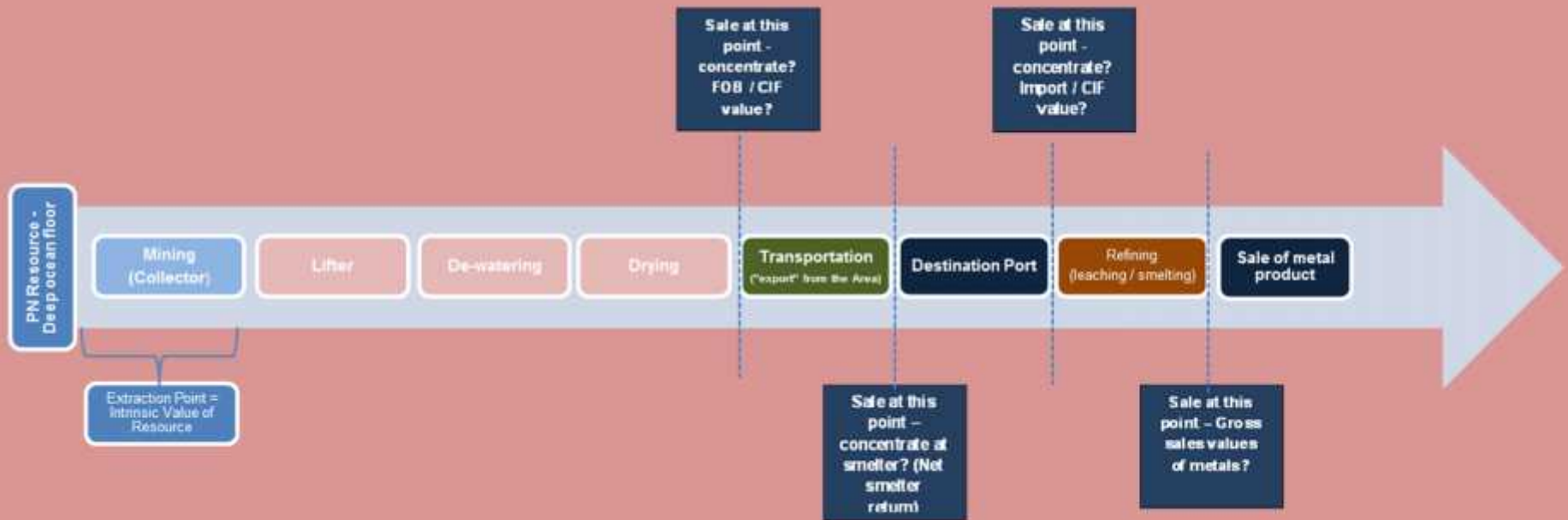


Specific issues & concerns

- **Valuation point** (& transfer pricing) - on the mining vessel / at port: need to uncover sales points. Perhaps multiple
- **High-grading** - part of production policy to be determined?
- **Different entities**
- **Interaction with Sponsoring States / host country taxing States** - point for Council – fees, levies, taxes on DSM income / no tax / withholding on monies paid to ISA

Specific issues & concerns

- Valuation point



Interaction with other DSM actors

- “States must respect the extra-territorial nature of deep seabed mining in the international area and should avoid or minimize double taxation on the proceeds of deep seabed mining in order to ensure optimum revenues for the Authority”
- “States shall cooperate with the Authority in order to review problems which may arise from payments to States by operators from the income of deep seabed exploitation and to solve such problems”
- These were early principles but not in final IA 1994

Environmental management

- Environmental Impact Assessment
- Environmental management systems – procedural obligations
- Environmental guarantee – quantum / duration
- Trust fund for liability (ITLOS)? – rationale, calculation, application
- Decommissioning and restoration / rehabilitation
- Emergency orders
- Penalty mechanisms
- Cost of environmental obligations as part of financial package including insurance obligations
- Role of Sponsoring State

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- **Conclusions / exercise**

Some conclusions I

- The journey ahead is exciting but enormous challenges, not least financial terms
- We need, as far as possible, to harmonise the rules & regulations both within national jurisdictions and the Area
- We need to share information and best practice, subject to commercial confidentiality
- Paper rules and regulations are a start, but the robustness of DSM regimes will be tested through adequate administration, enforcement and DSM industry codes of conduct
- We need to maintain transparent and accountable decision-making processes

Some conclusions II

- Stakeholder survey:
 - Deadline: 16 May 2014
 - no penalties for a late submission 😊
 - no obligation to complete all parts
 - no anonymous submissions
 - Make use of “Other considerations”
 - “Making a submission” – structure / express consent
 - Initial responses to be presented to LTC / Council July 2014
 - Pacific Islands region has an invaluable contribution to make

An exercise – fair & equitable

- A fair and equitable share remains at the very centre of this debate
- So.....

An exercise for participants....

- Any financial / fiscal system should be “fair and equitable”
- But what is a **fair and equitable share** for the ISA & the CHM?
- Would participants kindly write down on a piece of paper what percentage share they consider is fair and equitable
- So, if there is an amount (net profit after all DSM costs) of say 100, what percentage of that should be directed to the CHM?
 - Assume the amount includes the royalty, profit share, additional rent / profit share – the ISA’s total effective share or take
- I will collect the paper (no names) and present the findings later in the workshop
- Thank you.