SPC-EU Deep Sea Minerals Project

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Deep Sea Minerals: Securing State Benefits

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Different jurisdictions

- The incentive for States to see their seabed minerals developed is largely: new income.
- Important to ensure that there is a reasonable return for the State, and the benefit outweighs any costs.

- Three different jurisdictions:
    - The Area
    - The EEZ / CS (up to 200 nm)
    - Extended Continental Shelf

The Area (1)

- Remember, the Area is the ‘common heritage of mankind’.
- A States, State entity, or company sponsored by a State, granted an exploitation licence by the ISA, can use minerals for profit, but must pay royalties to the ISA when commercial production commences, to be distributed by the ISA for the benefit of all.
- These arrangements are yet to be established.
- UNCLOS requires that the system will be: fair both to the contractor and the ISA, not complicated, include an annual fee, provide adequate means of determining compliance, and shall be within the range of prevailing rates in respect of land-based mining.

The Area (2)

- So what is the return for State sponsorship of a company in the Area? Remember:
  - the company will pay a royalty to the ISA. It will also have made application fee payments (US$500k) and may be paying annual fees.
  - The sponsoring State has no ownership of the Area's minerals, and the main duty as a sponsoring State is likely to be lending its flag as a developing State.
- So the sponsorship 'deal' will be subject to negotiation, and probably should not be over-estimated. It may include:
  - an application fee and an annual administration fee (cover costs)
  - taxes (presuming the company has presence in-country)
  - a small production payment (profits-linked?)

National Jurisdiction

- The State may places royalties, taxes, fees as it likes on seabed mineral activities within its EEZ.
- There are special rules for the extended CS: a Coastal State shall make payments or contributions in kind in respect of the exploitation of the mineral resources of the CS beyond 200 nm from the baseline The payments and contributions shall be made annually, after the first five years of production at the site, starting at 1% and increasing each year to a cap of 7% (Art. 82 UNCLOS).
- The ISA is tasked to distribute these payments in accordance with equitable criteria.
- The specifics are as yet unclear....

National Jurisdiction: Challenges

- Non-renewable resource:
  - Taxation is a one-shot deal
- Finding a balance:
  - Adequate compensation for the loss of finite resources vs a favourable climate for investors.
- Unknowns of a pioneering industry:
  - Designing a tax system for an industry whose viability, and risk / return profile is not yet known.
  - Volatility of the metals markets.
  - How to capture ‘super-profits’?

National Jurisdiction: Components

- A variety of mechanisms, to mix-and-match!
  - royalties
  - income / withholding tax
  - additional profits tax (resource rent tax)
  - production levies
  - payments to a community development fund
  - import / export duties
  - State equity stake in the company

- Consider 'ripple' effect on State economy, and monetary objectives (e.g. business development, employment)
- Also consider tax breaks or incentives, or avoidance of upfront fees or bonds, to encourage new or sustained investment in the sector – particularly at exploration phase.

National Jurisdiction: Options

•**Profit-based** (may not yield return for some years, may be hard to calculate or verify) vs. **Production-based** (may dis-incentivise DSM operators who anticipate non-profit-making production periods, may not capture 'super-profits', by weight or by value?)

• **Project-specific negotiated contract** (vulnerable to striking a bad bargain, lack of transparency, administratively burdensome, open to undue influence or variation by future Government) vs. **universally applicable legislation** (inflexible, may dis-incentivise pioneering investment, can't be tailored to particular project context)

• Find some middle ground?

National Jurisdiction: Objectives

- Stable, predictable, equitable and transparent
- Established by law, at the outset
- Progressive: higher 'take' as profitability increases
- Simple to calculate, collect and audit
- Supporting macro-economic stability (avoid 'Dutch disease')
- Allowing sufficient returns to investors to encourage continued investment and development of the industry
- Appropriate judicial forum for settlement of disputes
- Encouraging non-monetary contributions and further value-adding and expansion
- Making allowance for the volatility of the minerals commodities market

DSM Revenue Management

- For States to secure development advantage from DSM industry, it is paramount not only to secure that income, but also to manage it responsibly. This includes:
  - Mechanisms to prevent corrupt practices, and
  - Inter-generational equity in sharing the resource wealth
- EITI is recommended
- A protected savings fund is recommended
  - a separate ring-fenced savings vehicle
  - governed by non-discretionary rules
  - managed by professional financial managers?
  - aimed to provide a steady and permanent income
  - while funding immediate development priorities