

ISA's Zero Draft Regulations

What Contractors should be concerned about

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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 stakeholder participation to date
- Regulatory matters yet to be developed – what’s missing?
- Consider some key areas for Contractors to focus on:
 - Contract award process
 - Regulatory stability
 - Payment regime
 - Contract Area size
 - 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 (2000/2013);
 - ii. Prospecting/exploration of polymetallic sulphides (2010); and
 - iii. Prospecting/exploration of ferromanganese crusts (2012).
- 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.
- Parallel regime – Sponsoring State Legislation
 - e.g. Singapore’s recent DSM legislation
 - 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 (see Report of the Secretary-General of the ISA, 16th Session)
 - 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)
 - Payment regime workshop, San Diego (2016)
 - Environmental and Assessment Management Workshop, Surfers Paradise (2016)
- 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 from Member States

What is and isn't covered

- July saw publication of 'Draft Zero' plus 4 discussion papers
- Stakeholder comments to be received by ISA by 2 November 2016 (extended to 25 November)
- 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)
- Exploration regime = light touch, not the approach being taken here
 - e.g. establishment of Mining Directorate, onerous development and production related obligations
 - ISA risks putting contractors off if regulations interfere too much in operational and commercial decisions
- ISA regulatory 'to do' list still significant
 - Draft Environmental Regulations
 - 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.
- Draft does not reflect final views of LTC
 - Nothing is agreed until everything is agreed

CONTRACT AWARD PROCESS

- Not dissimilar to process for exploration contracts
 - first come, first serve basis application to LTC
- No automatic right for exploration contractors to move to exploitation phase
- Issues include:
 - amount of information required and significant number of criteria for LTC to consider (e.g. commercial viability, optimization of recovery of minerals, no monopolization, production policy, satisfactory discharge of obligations under other ISA contracts etc);
 - extent of commercial mining expertise at LTC level
 - requirement for public consultation under environmental regulations;
 - Costs relating to applications to be borne by applicant and likely to be very significant;
 - no time limits in which application must be considered (cf IBA's Model Mining Development Agreement); and
 - limited meetings of various review/approval bodies
 - LTC meets twice yearly
 - Council and Assembly only once per year

REGULATORY STABILITY

- Regulatory stability key for Contractors, esp first movers given high risks
 - Point made repeatedly by Contractors in responses to ISA
- Draft Regulation 59
 - Regime fixed for first 5 years 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
 - FM
 - 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.
 - 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
 - already discussed but note that this is 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
 - Royalty Return to be submitted half yearly and payable within 90 days at following end of Royalty Period
- 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)

SIZE OF CONTRACT AREA

- Significant discussion in March 2015 Report
 - Limited stakeholder consensus on area size in responses
 - expected to see mining area size limits suggested for different resource types
- UNCLOS specifies factors for determining size of exploration area including:
 - production requirements (eg what is commercially recoverable);
 - technology to be employed; and
 - physical characteristics of relevant part of Area.
- Surprisingly, no express restrictions on size contained in draft regulations. This ignores ISA position adopted in PN Exploration Regs:
 - Maximum Contract Area of 150,000 square kms for PN Exploration PoW
 - Convention provides that Exploration Area may be up to 2 x size of Exploitation Area
- BUT see draft Regulation 22
 - PN Exploration Contractors will be concerned that annual fee is proposed to be based on size of relevant mining area (charge per square km determined from time to time by Council)
 - Nodules littered across vast areas of Pacific Ocean mining areas for nodules may well not be too dissimilar in size to current exploration areas
- Whatever size included, preference and priority of Exploration Contractor should be honoured

FINANCE RELATED PROVISIONS

- Draft Regulation 16 proposes draft terms on the use of the exploitation contract as security by project lenders
- Positives:
 - ISA consent to lender taking security over the exploitation contract not to be unreasonably withheld or deployed
 - 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:
 - Any lender seeking to enforce its security (or step into the contract to remedy a default etc.) needs to consider complications arising from parallel regime.
 - 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 RRP's 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 at this stage.
- Is this sufficient given potential time from contract start to commercial exploitation?
 - Note extensions for force majeure events (but see proposed termination right for prolonged F/M)
- Option to renew for periods of not more than 10 years' upon such terms and conditions as the Contractor and Authority shall agree
 - later wording states terms and conditions of contract during period of renewal shall be the terms and conditions in force on date of extension
 - No cap on number of extensions (cf 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 resourcing and expertise, Stakeholder assistance key
 - Important for Stakeholders, esp Contractors/Sponsoring States to respond constructively to ISA with detailed submissions on draft regulations, discussion papers and key questions asked by ISA (e.g. on process)

Back-up slides

- **Plan of Work** (see section 2 of Annexe VII (standard contract clauses))
 - Mining Plan
 - Financing Plan
 - Emergency Response and Contingency plan,
 - Environmental Management and Monitoring plan,
 - Closure Plan
 - HE and Maritime Security Plan



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