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Considerations relating to a proposal by Nautilus Minerals Inc. for a joint venture operation with the Enterprise

Report by the Secretary-General

I. Introduction

1. The Council has before it a proposal by Nautilus Minerals Inc. (Nautilus), a company incorporated in Canada, to enter into negotiations to form a joint venture with the Enterprise for the purpose of developing eight of the reserved area blocks in the Clarion-Clipperton Zone. The terms of the proposal by Nautilus are set out in a draft heads of agreement, which is annexed to the report on the proposal by the Interim Director-General of the Enterprise (ISBA/19/C/4).

2. Under the proposed agreement, Nautilus would work with the Enterprise to develop a proposal for a joint venture operation over a period of three years, commencing in 2013. A full proposal for a joint venture operation would be presented to the Council in 2015. As required by the 1994 Agreement relating to the Implementation of Part XI of the United Nations Convention on the Law of the Sea of 10 December 1982 (General Assembly resolution 48/263, annex), any such proposal would have to be based on sound commercial principles. Should the proposal be approved in 2015, the Council may decide to issue a directive for the independent functioning of the Enterprise in accordance with paragraph 2 of the annex to the 1994 Agreement. It should be emphasized that, at this point, no binding commitments have been made by the secretariat and the secretariat itself takes no position on the substance of the joint venture proposal, which is entirely a matter for the Council to consider.

3. The purpose of the present report is to provide the Council with the necessary background to the relevant provisions of the Convention and the 1994 Agreement relating to the initial operations of the Enterprise and to identify some of the most important legal issues relating to the commencement of operations by the Enterprise. The report also sets out some considerations with regard to the functions of the secretariat during the period prior to the independent functioning of the

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Enterprise, should the Council decide to proceed with the proposal put forward by Nautilus.

II. Legal status of the Enterprise

4. The present section of the report presents a review of the relevant provisions of the Convention and the 1994 Agreement and analyses some of the issues associated with the implementation of those provisions.

5. The Enterprise is established by article 170 and annex IV of the Convention. It is the organ of the Authority which is to carry out activities in the Area directly, as well as the transporting, processing and marketing of minerals recovered from the Area. While the Enterprise is to act in accordance with the general policies of the Assembly and the directives of the Council, it is autonomous in the conduct of its operations, which are to be directed by a Governing Board composed of 15 members elected by the Assembly. The Enterprise will also have a Director-General, elected by the Assembly on the recommendation of the Council and the nomination of the Governing Board, who will be its Chief Executive Officer and legal representative.

6. The provisions of the Convention relating to the Enterprise were radically affected by section 2 of the annex to the 1994 Agreement, according to which the functions of the Enterprise are to be performed by the secretariat of the Authority until such time as it begins to operate independently of the secretariat. The 1994 Agreement establishes a number of conditions that must be satisfied before the Enterprise may operate as an independent entity. Furthermore, the 1994 Agreement provides that the Enterprise is to conduct its initial deep seabed mining operations through joint ventures. Article 170 and annex IV of the Convention are to be interpreted and applied in accordance with section 2 of the annex to the 1994 Agreement, which provides that, upon the approval of a plan of work for exploitation by an entity other than the Enterprise, or upon receipt by the Council of an application for a joint venture operation with the Enterprise, the Council is to take up the issue of the functioning of the Enterprise independently of the secretariat of the Authority.

7. Two observations may be made in relation to these provisions. First, it may be observed that only the Council has power to issue a directive for the independent functioning of the Enterprise. Such a directive is to be issued only if joint venture operations with the Enterprise accord with sound commercial principles.

8. Only two potential trigger events would require the Council to take up the issue. They are:

(a) Approval of a plan of work for exploitation (by any qualified entity, for any mineral resource and whether in a joint venture or not); or

(b) An application for a joint venture operation with the Enterprise.

9. In the latter case, there is no requirement that the joint venture involve a specific proposal to apply for a plan of work, nor is there any stipulation that the joint venture proposal must include exploitation. A proposal to apply for a plan of work for exploration in a joint venture with the Enterprise would be sufficient to trigger this clause. Theoretically, a proposal to commence any form of joint venture

within the competence of the Enterprise as defined in annex IV to the Convention would also be enough (for example, a proposal for a joint venture marketing operation).[1]

10. Upon either of the above events taking place, the Council is required to take up the issue of the independent functioning of the Enterprise. It is not required to come to a decision, except that, if joint venture operations with the Enterprise accord with sound commercial principles, it is to issue a directive providing for such independent functioning. It is not clear whether this provision refers to joint venture operations in general, or to a specific joint venture proposal.[2] A reasonable interpretation may be that, where the trigger event is a proposal for a joint venture, the Council should consider whether that particular joint venture proposal accords with sound commercial principles. If it does, then the Council is to issue an appropriate directive.

11. Second, it may be observed that the 1994 Agreement contains no guidance as to the form and content of the directive to be issued by the Council. Presumably, however, such a directive would have to be made with reference to annex IV to the Convention and could refer to such matters as, for example, the timescale for implementation of annex IV, the procedures for election of the Governing Board and Director-General and the initial funding of the Enterprise. One question that perhaps arises is the extent to which the directive may be general in nature, or must relate to the specific joint venture proposal in question. In other words, does the Council approve a specific joint venture proposal only, or does its directive simply "launch" the Enterprise into a formal existence, independent of the secretariat, whereupon the Governing Board would review the joint venture proposal further and take an independent decision on the matter. While both interpretations are possible, it is suggested that the latter is to be preferred on the basis that the Enterprise is intended to operate as an autonomous entity. This would also imply (consistent with paragraph 4 of section 2 of the annex to the 1994 Agreement) that any application for approval of a plan of work for exploration or exploitation by the Enterprise in a joint venture operation would need to be made separately, in accordance with the applicable regulations.

III. Governance arrangements

12. An important issue for the Council to consider, should it decide to authorize the opening of negotiations on a potential joint venture operation, is the question of

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[1] On the other hand, it is unclear whether an election to offer an equity interest in a future joint venture arrangement with the Enterprise, which is available to applicants for plans of work for exploration for polymetallic sulphides and cobalt-rich ferromanganese crusts under regulations 16 and 19 of the applicable regulations (ISBA/16/A/12/Rev.1 and ISBA/18/A/11, respectively), requires the Council to take a decision relating to the operation of the Enterprise.

[2] E. D. Brown is of the opinion that the meaning of this provision is not altogether clear. He raised the question as to whether it is open to the Council, following approval of a plan of work for exploitation for an entity other than the Enterprise, to make a general determination that "joint venture operations with the Enterprise accord with sound commercial principles" or whether such a determination may be made only after receipt of an actual application for a specific joint venture operation with the Enterprise. E. D. Brown, *Sea-Bed Energy and Minerals: the International Legal Regime*, vol. 2, *Sea-Bed Mining* (The Hague, Kluwer Law International, 2001), p. 325.

the governance arrangements that would apply during the period prior to the independent functioning of the Enterprise (the interim period).

13. In order to preserve the notional independence of the Enterprise and to avoid any potential conflict of interest for the Secretary-General, the 1994 Agreement provides that the functions of the secretariat with regard to the Enterprise are to be performed under the oversight of an Interim Director-General, who is to be appointed by the Secretary-General from within the staff.[3] In practice, however, such independence is difficult to achieve, given the very small size and limited capacity of the secretariat. In particular, since the staff member so appointed reports and is accountable to the Secretary-General, there is a potential for conflict of interest.

14. In the light of these considerations, and notwithstanding the provisions of the 1994 Agreement, the Secretary-General takes the view that it would not be appropriate for the secretariat to act on behalf of the Enterprise in any negotiations with Nautilus. In particular, it appears difficult, given the current size and capacity of the secretariat, to do this in a way that preserves the independent character of the Secretary-General and the secretariat, while at the same time ensuring that a credible business proposal could be researched, analysed and placed before the Council in 2015. There are also further potential conflicts of interest with regard to the secretariat's responsibilities in relation to existing and potential contractors and the proposed joint venture partner.

15. It is suggested that, should the Council wish to proceed with the proposal, it may also wish to consider an alternative model for governance of the Enterprise during the interim period, consistent with the Convention and the 1994 Agreement. Such an alternative model would need to allow for the provision of independent legal and financial advice to the Council through the Interim Director-General of the Enterprise, or his or her representative.

16. Two alternative models could be considered. The first possible option would be to increase the size and capacity of the secretariat to establish an independent unit within the secretariat under the leadership of the Interim Director-General of the Enterprise. Such a unit would require, at a minimum, legal, financial and technical expertise. Given that there can be no certainty that the Enterprise will be brought into existence in 2015, the Council may well consider that this option would be unnecessarily costly and premature. It may also not be in keeping with the evolutionary approach called for in the 1994 Agreement.

17. An alternative, and more cost-effective, option would be to authorize the Interim Director-General to appoint from outside the secretariat a special representative and such other technical and legal advisers as may be necessary (for example, consultants and legal firms), who will be independent of the secretariat of the Authority, and of Nautilus, for the purposes of conducting negotiations on behalf of the Enterprise between now and 2015. The special representative should be an eminent person with appropriate experience and qualifications. He or she would report directly to the Council through the Interim Director-General of the Enterprise, and not to the Secretary-General. This type of mechanism would also ensure that the

[3] In February 2013, at the time of writing of the present report, the Interim Director-General of the Enterprise was the Principal Legal Officer of the Authority, who subsequently retired on 28 February 2013. As at March 2013, no new appointment had been made.

Secretary-General and secretariat avoid any potential conflict of interest and are thus able to provide impartial advice and support to members of the Council.

18. To further ensure transparency and accountability, it is suggested that the Council may also wish to consider requiring the special representative to report on a regular basis, for example, every six months, to a representative group of members of the Council (for example, the Presidency and Bureau) to review the progress of joint venture negotiations.

19. It is recommended that whatever governance mechanism is selected should have no financial or budgetary implications for the secretariat or for member States. In this regard, the Council will note that Nautilus has proposed to underwrite the costs incurred by the Enterprise (or the secretariat performing the functions of the Enterprise) through an annual fee of $100,000 to be paid to and administered by the Authority for this purpose. The Council will need to consider whether this amount would be sufficient to fund the sort of governance arrangements described above.

IV. Implications for the reserved areas

20. The Council may note that acceptance of the proposal by Nautilus would have implications for future access to the reserved area blocks covered by the proposal, whether by the contractors which originally contributed the areas in question, or any other qualified entity.

21. In the case of the contractors which originally contributed the reserved areas in question, pursuant to paragraph 5 of section 2 of the annex to the 1994 Agreement and regulation 17 (4) of the Regulations on Prospecting and Exploration for Polymetallic Nodules in the Area (ISBA/6/A/18, annex), a contractor which has contributed a particular area to the Authority as a reserved area has the right of first refusal to enter into a joint venture arrangement with the Enterprise for exploration and exploitation of that area. This requirement would need to be taken into account in the context of any ongoing negotiation with Nautilus, or further development of the current joint venture proposal.

22. The situation is more complex with regard to applications by other qualified entities. Under article 9 of annex III to the Convention, the Enterprise is to be given an opportunity to decide whether it intends to carry out activities in each reserved area. At the same time, however, any State party which is a developing State or any natural or juridical person sponsored by it and effectively controlled by it or by any other developing State which is a qualified applicant may notify the Authority that it wishes to submit a plan of work with respect to a reserved area. Such a plan of work may be considered if the Enterprise decides that it does not intend to carry out activities in the reserved area in question.

23. Regulation 17 (2) of the Regulations on Prospecting and Exploration for Polymetallic Nodules in the Area establishes procedures for the implementation of article 9 of annex III and sets time limits for the Enterprise. It states that an application by a developing State for a reserved area may be submitted at any time after such an area becomes available following a decision by the Enterprise that it does not intend to carry out activities in that area or where the Enterprise has not, within six months of the notification by the Secretary-General, either taken a decision on whether it intends to carry out activities in that area or notified the

Secretary-General in writing that it is engaged in discussions regarding a potential joint venture. In the latter instance, the Enterprise is to have one year from the date of such notification in which to decide whether to conduct activities in that area.[4]

24. Should the Council decide to accept the proposal put forward by Nautilus, it would also need to note the impact of the provisions set out above on the reserved areas in question and in particular the effect of the time limit of one year within which the Enterprise must come to a decision following a notification that an application is ready to be submitted.

V. Conclusion

25. The Council has been invited to consider the proposal put forward by Nautilus through the Interim Director-General of the Enterprise. While neither the Secretary-General, nor the secretariat, wishes to express any position with regard to the content of the proposal, it is recommended that the Council take a decision on the matter during its nineteenth session in order not to unnecessarily block access by other qualified applicants to the reserved areas covered by the proposal.

26. Should the Council decide to proceed with the negotiation of a joint venture operation, it is recommended that, in the light of the lack of capacity within the existing secretariat structure, the Council provide clear direction on an appropriate interim management or governance structure for the Enterprise.

27. It is further recommended that the Council consider the cost implications of the proposal and in particular how an interim governance structure may be funded.

[4] In accordance with regulation 17 (2), the Council will note that two entities sponsored by developing States (Singapore and Fiji) notified the Secretary-General (on 22 February and 26 February 2013, respectively) of their intention to submit applications for approval of plans of work for exploration in respect of two of the reserved areas included in the present proposal.