International Seabed Authority ISBA/21/LTC/12

Legal and Technical Commission

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Issues related to the sponsorship by States of contracts for exploration in the Area and related matters

Note by the secretariat

I. Introduction

1. In its decision relating to the summary report of the Chair of the Legal and Technical Commission at its twentieth session, the Council of the International Seabed Authority amalgamated two separate, but equally important, subjects, namely: "the test of effective control", which relates to the issue of State sponsorship of contracts for exploration in the Area, and the concept of "abuse of dominant position", a notion relating to the subject of monopolization of activities in the Area. Without specifically calling for an action from the Commission, the Council requested the Commission to continue its work on those issues (see ISBA/20/C/3, para. 7).

2. It is to be noted that, apart from the concept of dominant position, both the Council and the Commission, at recent sessions, have considered and deliberated on the test of effective control, State sponsorship of contracts and monopolization of activities in the Area. The purpose of the present note is to summarize what the Council and the Commission have thus far resolved in relation to those issues and to recommend to the Commission a suggested approach to continued consideration of those items in its work programme, as envisaged by the Council.

II. State sponsorship of contracts for exploration and the test of effective control

3. In its decision of 21 July 2011 (ISBA/17/C/20), the Council requested the Commission to analyse regulation 11.2 of the Regulations on Prospecting and Exploration for Polymetallic Nodules and the Regulations on Prospecting and

Exploration for Polymetallic Sulphides in the Area.[1] Regulation 11 concerns the certificate of sponsorship. Its purpose is to implement the provisions of the United Nations Convention on the Law of the Sea and 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 concerning the requirement of sponsorship by States parties.

4. Article 4 of annex III to the Convention stipulates that applicants must meet the nationality or control and sponsorship requirements of article 153, paragraph 2(b) and follow the procedures and meet the qualification standards set forth in the rules, regulations and procedures of the Authority. Paragraphs 1 and 2 of regulation 11, in all three sets of Regulations, provide as follows:

> 1. Each application by a State enterprise or one of the entities referred to in regulation 9 (b) shall be accompanied by a certificate of sponsorship issued by the State of which it is a national or by which or by whose nationals it is effectively controlled. If the applicant has more than one nationality, as in the case of a partnership or consortium of entities from more than one State, each State involved shall issue a certificate of sponsorship.
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> 2. Where the applicant has the nationality of one State but is effectively controlled by another State or its nationals, each State involved shall issue a certificate of sponsorship.

5. To assist the Commission, the secretariat prepared a preliminary analysis of regulation 11 (ISBA/20/LTC/10). The analysis discussed the issue of sponsorship, cited the relevant provisions of the Convention and the Agreement and noted dicta by the Seabed Disputes Chamber[2] on the subject. The analysis also provided an elaborate discussion of the meaning of the term "effective control". It concluded by stating that there was no single definition of the term and that the meaning attributed to it varied considerably depending upon the context and the purpose for which the test of effective control was being applied.[3] The second conclusion was that the conditions and standards that defined effective control fell under the competence of the State that exercised it. International law does not define further the meaning of effective control; that is left to municipal law if the State finds it necessary to elaborate on conditions and standards to exercise its regulatory control. The third conclusion was that the law and practice relating to both flagging of vessels and civil aviation as well as part XI of the Convention followed the same

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[1] It may be noted that, subsequent to the decision of the Council, the Council adopted, and the Assembly of the International Seabed Authority approved, the Regulations on Prospecting and Exploration for Cobalt-rich Ferromanganese Crusts in the Area (ISBA/18/A/11, annex), which contain an identical provision.

[2] Advisory opinion on the responsibilities and obligations of States sponsoring persons and entities with respect to activities in the Area, issued by the Seabed Dispute Chamber of the International Tribunal of the Law of the Sea on 1 February 2011, para. 78.

[3] Different meanings also apply in different legal systems. The Organization for Economic Cooperation and Development, for example, states that: "Control over enterprises is generally viewed to be exercised when an individual or group of investors hold more than 50 per cent of the common voting stock of the enterprise or firm. However, 'effective control' may be exercised when the investor(s) holds a large block of voting stock even when it is less than 50 per cent but the remaining shares are widely held by many smaller investors. Control of enterprises may also be exercised through interlocking directorates and inter-corporate ownership links between firms as in the case of conglomerates." (Organization for Economic Cooperation and Development, *Glossary of Industrial Organisation Economics and Competition Law* (Paris Publishing, 1993), p. 31).

approach: emphasizing the fact of incorporation or registration and the grant of nationality (i.e., regulatory control) as the critical, or dominant, factor, notwithstanding the practical realities as to control over policy, capital, finance and management.

6. It was recalled that, in ascertaining whether an applicant is qualified, the Commission must satisfy itself that the sponsorship requirements under article 153 of the Convention are met, in accordance with annex III to the Convention and with the Regulations. At least in relation to entities incorporated in or having the nationality of a sponsoring State, the act of incorporation, or the conferring of nationality, combined with the undertakings given as a sponsoring State, appear to be sufficient to establish "effective control" for the purposes of meeting the sponsorship requirements.

Consideration by the Commission

7. In its consideration of the matter (ISBA/20/C/20, paras. 25-29), the Commission noted that regulation 11.2 concerned the form and content of the certificate of sponsorship and set out the criteria and procedures for implementing the requirement of sponsorship by States parties as contained in article 153 and article 4 of annex III to the Convention. Those articles stipulate that, in order to carry out activities in the Area, natural and juridical persons must satisfy two requirements: first, they must be nationals of a State party or effectively controlled by a State party or its nationals; and second, they must be sponsored by one or more States parties to the Convention.

8. The Commission observed that the decision to sponsor an entity that otherwise possessed the necessary qualifications was left to the discretion of the relevant State party or States parties. That implied that the onus was on the sponsoring State to ensure that the entity to be sponsored satisfied the two above-mentioned criteria before it made a decision to sponsor. The Commission also noted that the Convention required the certificate of sponsorship as evidence of the decision to sponsor by the State or States of nationality and of effective control. Conditions and standards defining effective control fell under the competence of the State that exercised it. Thus, it was left to the sponsoring State to elaborate such conditions to grant its sponsorship within its national legal system, should it find it appropriate to do so. The Commission further noted that part XI of the Convention, as well as other legal contexts, used the same critical criteria of incorporation, registration and granting of nationality (i.e., regulatory control) to determine effective control. That meant that, at least in relation to entities incorporated in or having the nationality of a sponsoring State, the act of incorporation or the conferring of nationality, combined with the undertakings given as a sponsoring State, would appear to be sufficient to establish "effective control" for the purposes of satisfying the sponsorship conditions.

9. The Commission emphasized that information relating to the certificate of registration and the identification of the principal place of business and domicile of an applicant, together with the certificate of sponsorship, were critical for the Commission to satisfy itself that an applicant met the sponsorship requirements. In the light of those observations, the Commission came to the conclusion that any development of the conditions for the granting of sponsorship in the context of

part XI of the Convention would appear more appropriately addressed in the context of national laws, if a sponsoring State found it necessary.

10. Having expressed the above views and findings to the Council, the Commission concluded that it would not be necessary or advisable to develop regulation 11.2 further (ibid., para. 29).

III. Issues related to monopolization and abuse of dominant position

11. The issue of monopolization of activities in the Area was also discussed by the Council during its twentieth session. In the light of questions raised by several of its members, the Council requested the Commission to give further consideration to the issue and to consider, in particular, the possible alignment of the Nodules Regulations with the Sulphides Regulations and the Crusts Regulations in that regard.

12. In its consideration of the matter, the Commission was assisted by a background document prepared by the secretariat (ISBA/20/LTC/11) that reviewed the relevant provisions of the Convention, the Agreement and the regulations of the Authority relating to monopolization of activities in the Area. It was noted that nothing in the Convention or the Agreement specifically prevented one State (whether applying as a State party or as a State enterprise) from making more than one application for a plan of work for exploration, whether for polymetallic nodules or for any other type of mineral resource. Likewise, nothing prevented a natural or juridical person or a consortium of such entities from making more than one application. At the same time, the Convention was also unclear as to the maximum number of applications that might be made by any of the above entities or combinations of entities (para. 2).

13. It was also recalled that article 6 of annex III to the Convention contained provisions in paragraphs 3 (c) and 4 that were intended to prevent one entity from gaining a dominant position in the Area by setting spatial limitations on the number of contracts that might be held (see ibid., para. 3). It was noted, however, that those provisions were applicable only to plans of work for exploration for polymetallic nodules. Article 6, paragraph 3 (c), of annex III is incorporated into the text of the current Nodules Regulations, although it is noted that the practical application of this provision is problematic. In particular, before the establishment of the outer limits of the national jurisdiction of all coastal States, it is impossible to define the size of the Area and, therefore, impractical to define 2 per cent of that part of the Area.

14. In the case of the Sulphides Regulations, the Commission had, at an early stage, decided that the limitations set out in article 6 of annex III could not apply because the provision itself was explicitly applicable only to polymetallic nodules and made no practical sense from a scientific perspective if applied to sulphides. Accordingly, the following alternative provisions appeared in the Sulphides Regulations and the Crusts Regulations: “The Legal and Technical Commission may recommend approval of a plan of work if it determines that such approval would not permit a State Party or entities sponsored by it to monopolize the conduct of

activities in the Area with regard to polymetallic sulphides or to preclude other States Parties from activities in the Area with regard to polymetallic sulphides.”

Consideration by the Commission

15. In accordance with the request of the Council, the Commission considered the issue of monopolization of activities in the Area, in particular the possible alignment of the Nodules Regulations with the Sulphides Regulations and the Crusts Regulations, at its twentieth session. After a full discussion, and in the light of the background information provided by the secretariat (ISBA/20/LTC/11), the Commission decided to recommend to the Council that the Nodules Regulations be aligned with the equivalent provision in the Sulphides Regulations and the Crusts Regulations.

16. At the conclusion of its meetings in July 2014, the Commission noted that there appeared to be emerging a new way of doing business insofar as applications for plans of work for exploration were concerned. While that new approach was compliant with the Regulations, the Commission was of the view that it needed to be brought to the attention of the Council.

Consideration by the Council

17. At its twentieth session, the Council conducted extensive discussions on the issues relating to monopolization of activities in the Area, the operation of the Enterprise, effective control by the sponsoring State and conflict of interest of members of the Commission. At its 198th meeting, on 18 July 2014, the Council considered and adopted the amendments to regulation 21 of the Sulphides Regulations, as recommended by the Commission (ISBA/20/C/22). The Council also adopted decision ISBA/20/C/23, by which regulation 21 of the Nodules Regulations was amended to bring it into alignment with the Sulphides Regulations and the Crusts Regulations.

18. Lastly, at its 201st meeting, on 23 July 2014, the Council adopted a decision relating to the summary report of the Chair of the Commission (ISBA/20/C/31) in which it requested the Commission to continue to work on issues related to the sponsorship by States of contracts of exploration in the Area, with particular attention to a test of effective control, as well as issues related to monopolization of activities in the Area, taking into consideration, in particular, the concept of abuse of a dominant position.

IV. Suggested way forward

19. The workload of the Commission has, in recent years, continued to increase. This has been due in part to the upsurge in new applications for contracts for exploration and to the rise in the volume and content of annual reports from current contractors. Also contributing to the increased workload has been the urgent need for the Commission to begin work on the formulation of a regulatory framework for exploitation. With seven of the current exploration contracts due to expire in 2016 and 2017, the Commission is under an enormous strain to ensure that its consultations and work on the draft regulations for exploitation are expedited in case an application for exploitation is received. These increased demands continue

to affect the working of the Commission, notwithstanding the fact that its meetings are now scheduled into February and July sessions.

20. Cognizant of the gravity of the request of the Council and the importance that it has placed on the item under consideration, and mindful of the constraints confronting the Commission in terms of the prioritization of its work, it may be necessary for the Commission to consider an arrangement whereby it keep this item on its agenda and requests the secretariat, taking into account trends and developments in deep seabed mining, to commission a more complete study on the issue of abuse of dominant position to gain a clear and definitive understanding of the implications of the new ways of doing business that have emerged in current and future activities in the Area and to report back to the Commission on the outcome of such a study at the twenty-third session of the Authority, in 2017.

21. The Commission is invited to take note of the present note and decide on the way forward, as appropriate.