International Seabed Authority ISBA/25/C/32

Council

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Agenda item 11
Draft regulations for exploitation of mineral resources in the Area

Report of the Chair on the outcome of the second meeting of the open-ended working group of the Council in respect of the development and negotiation of the financial terms of a contract under article 13, paragraph 1, of annex III to the United Nations Convention on the Law of the Sea and section 8 of the annex to the Agreement relating to the Implementation of Part XI of the United Nations Convention on the Law of the Sea of 10 December 1982

I. Introduction and background

1. During the first part of the twenty-fifth session of the International Seabed Authority, in view of the recommendations of its open-ended working group in respect of the development and negotiation of the financial terms of a contract under article 13, paragraph 1, of annex III to the United Nations Convention on the Law of the Sea and section 8 of the annex to the Agreement relating to the Implementation of Part XI of the United Nations Convention on the Law of the Sea of 10 December 1982, the Council decided to convene, preferably prior to the second part of the session, a second meeting of the working group to advance work on the payment mechanism.

2. As requested by the Council, the Massachusetts Institute of Technology produced a report that included three options with different royalty rates. The Chair also prepared a briefing note on the basis of the report and the discussions of the working group at its first meeting, giving consideration to the nature of the payment mechanism, in particular to ensure that the rate of payment maximized returns to the Authority while ensuring the commercial viability of mining, and to a trigger or triggers for reviews of the payment mechanism. The mandate of the working group also included the consideration of environmental aspects and economic modelling and timing for resources other than polymetallic nodules.

3. The second meeting of the working group was convened on 11 and 12 July 2019, immediately prior to the second part of the Council session, in July, and was open to

all stakeholders.[1] On 11 July, the agenda for the meeting was adopted with no amendment.

II. Review of options

4. The discussions centred on the following options for the payment mechanism and the associated rates of payment, which are in line with the objectives and principles of the Agreement and the Convention:

(a) A fixed-rate ad valorem-only royalty mechanism;

(b) A two-tier ad valorem-only royalty mechanism;

(c) A combined ad valorem royalty and profit-based system.

5. Several participants expressed a preference for an ad valorem-only system, while many also expressed flexibility regarding the choice of model as long as it generated sufficient returns for the Authority. A few delegations expressed a wish to keep all three options open.

6. The participants expressed similar levels of support for the fixed-rate (one-tier) ad valorem-only mechanism and the two-tier ad valorem-only royalty mechanism. Other options were also mentioned, such as a progressive ad valorem system that would include different rates depending on changes in the market prices of minerals. Several participants expressed an interest in exploring that option further, while others noted the potential complexity that would be introduced by such a system. It was also noted that a study on the impact of the production of minerals from the Area on the economies of developing land-based producer States was in progress.

7. The working group also noted the information provided on behalf of the African Group that a proposed payment system would be introduced at the meetings of the Council.

8. Some delegates expressed the view that the proposed royalty rates of 2 per cent and then 6 per cent (not including the environmental compensation fund) were too low, while some other delegations reserved their positions to further consider the economic model.

9. Several contractors noted that, in their opinion, a fair and transparent process had been followed to reach the proposed royalty rates and that the rates were needed to encourage first movers to start commercial mining.

10. Many delegations raised the issue of further examining important assumptions in the model, in particular those concerning corporate income tax rates, metal prices and the deductibility of the royalty and other expenses from tax payments in sponsoring States.

III. Review

11. There was general agreement about the need for a review mechanism that struck the right balance between, on the one hand, the ability of the Authority to adjust the

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[1] Background documents for the meeting, including the reports of the Massachusetts Institute of Technology entitled "Financial regimes for polymetallic nodule mining: a comparison of four economic models" and "Report to the International Seabed Authority on the development of an economic model and system of payments for the exploitation of polymetallic nodules in the Area", are available at https://www.isa.org.jm/document/open-ended-ad-hoc-working-group-council-2019.

model after an implementation period and, on the other hand, the contractors' need for predictability. The group found that further discussion of the review mechanism would be necessary.

IV. Environmental aspects of the model

12. There was also agreement about the need to establish an environmental compensation fund that would cover any environmental liability that was not provided for under other mechanisms. The point was made that the fund needed to have sufficient resources to cover any damage to the marine environment that was not covered by insurance and environmental performance guarantees. The question was also raised as to whether it would be more appropriate to have contractors pay a fixed amount rather than an amount based on the value of the extracted minerals. As for the size of the fund, the discussion revolved around an annual levy of 1 per cent and a cap of $500 million and a proposal to change the 1 per cent levy to a fixed amount and reduce the cap to $100 million. The working group decided to revert to the issue of contributions to the fund at a later stage. There were also suggestions regarding the possibility of reimbursing part or all of the fund to contractors as an incentive for environmental performance and/or transferring part of the fund to the Authority. It was also noted that draft regulation 55 of the draft regulations on exploitation of mineral resources in the Area (ISBA/25/C/WP.1) included non-compensatory related purposes, which might be better addressed through a different mechanism.

V. Other mineral resources: economic modelling and timing

13. The working group was of the view that the focus should be on finalizing the financial model for polymetallic nodules at the present stage and that it would be more appropriate to revisit the other types of mineral resources at a later stage.

VI. Report of the Chair for the twenty-fifth session of the Council

14. The open-ended working group recommended that the Council:

(a) Convene a third meeting of the working group to advance work on, inter alia, the payment mechanism for polymetallic nodules and, to the extent possible, to begin work on other mineral resources;

(b) If so decided, request the secretariat to develop a new model that would include a progressive ad valorem royalty for consideration at the following meeting of the working group, to be convened preferably before the following session of the Council, which will be held in 2020.