Contractual Arrangements between Sponsoring States and Contractors

The Commonwealth

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Overview

- Sponsor State-Contractor contract is one instrument by which a State can engage in activities in the Area under UNCLOS and the ISA Regulations

  - UNCLOS provides that any contractor exploring or exploiting minerals in the Area must be a State party, or sponsored by a State party [UNCLOS Article 153(2)]; and that "*damage caused by the failure of a State Party to carry out its responsibilities under this Part shall entail liability*" [UNCLOS Article 139(2)]

  - Further: "*The contractor shall have responsibility or liability for any damage arising out of wrongful acts in the conduct of its operations, account being taken of contributory acts or omissions by the ISA*." [UNCLOS Article 22 of Annex III]

Overview

- UNCLOS Part XI imposes a number of duties upon Sponsoring States which can broadly be described as a **responsibility to ensure** that the ISA contract-holders comply with UNCLOS and the rules, regulations and procedures of the ISA
  - A 2011 Advisory Opinion of the Seabed Disputes Chamber of the International Tribunal on the Law of the Sea clarified that Sponsoring States' responsibilities apply equally to 'developing' and 'developed' States.
  - If a Sponsoring State does not meet these responsibilities, it will be held liable for any damage arising from the actions of its sponsored contractor.

- Sponsoring State's 'responsibility to ensure' can be discharged by putting appropriate mechanisms in place within the national legal system, including:
  - the enactment and implementation of relevant domestic laws, and
  - the use of contractual arrangements that ensure that the contractor is held liable for any damage caused by it.

Sponsorship Arrangement Options

State Venture (State-owned Enterprise)

Joint Venture

Contracting Out

State Venture

- The State Venture (or State-owned enterprise) receives a contract from the ISA
- The State enterprise performs the contract in accordance with ISA's rules and regulations.
- When minerals are extracted, the State enterprise pays a royalty to the ISA and may keep any remaining profits.
- The State enterprise is likely to need a 'services contract' (subcontractor) with a company that has the requisite competence to perform the operations. The company (subcontractor) will be paid a fee or a share of the ultimate proceeds for their services.

Advantages

- The State can retain all of the proceeds, once the royalties to the ISA have been paid and the costs have been covered (including the fees of any service agreement)
- ISA takes responsibility for setting relevant rules

Disadvantages:

- ISA treats the State as the contractor – The State bears responsibility for all operations and liability for any damage caused or clean-up or compensation if required
- There are few companies with requisite technology to mine, so it may be difficult to find a service provider (at a viable rate) willing to strike a ‘fair deal’
- Unless a deal has already been signed with a company willing to provide the funding, the State will need to pay the ISA application fee and annual fees
- The State may need to find $$$$ upfront to fund the exploration and mining

Joint Venture

2 separate options:

- Contract with the ISA could be held by a JV (in which the State is a partner) sponsored by the State; or
- Contract with the ISA may be held by the State, and then sub-contracted to a JV (in which the State is a partner)

Advantages

- As both sponsoring State and JV partner, the State should be able to exercise a high degree of participation in, and control over, the activities
- As State involvement is crucial to the company's ability to access the ISA contract, the State may be in a strong negotiating position for deciding the terms of the JV agreement – share of proceeds, local employment/training, technology transfer, etc.

Joint Venture

Disadvantages:

- It may still be difficult for SIDS in practice to exercise influence over the JV, where the JV partner is a multinational corporation
- It is still unlikely that the State will bring much of commercial value to the JV apart from 'Sponsoring State' status, and so may not be able to negotiate significant financial benefit in return, as a term of the JV agreement
- The State is on the hook twice for liability for any damage arising from the JV's activities – first as sponsoring State, and second as JV partner
- The State will likely lose its independence as a regulator, as there is vested interest from the State in the project succeeding and minimising costs
- More time, effort and resources are required from the State for the success of the project than in the 'contracting out' model

Contracting Out

- The State enters into a sponsorship arrangement with a private company
- The company enters into an exploration contract (and later an exploitation contract) with the ISA
- The company is subject to ISA rules and the laws of the State

Advantages

- The State can select an appropriately qualified company (e.g. in a competitive tender process)
- The company will cover all the costs of the mineral activities and the ISA fees,
- The company has primary responsibility for all of the operations and liability for meeting appropriate standards (and any clean-up or compensation that is required),
- The ISA has primary regulatory responsibility, with the State as a secondary and independent regulator of the company

Contracting Out

Disadvantages:

- The State has responsibility to ensure that the company adheres to the rules of the ISA, and if the State does not implement appropriate laws to do so, the State may be liable for the company’s activities
- The State ‘take’ may be quite small
  - The company will bear the costs of extraction, and will pay fees and royalties to the ISA. The company needs the sponsorship of a State but will be looking to give only a small payment or share of profits to the State for that sponsorship. This will be open to negotiation.

Subcontracting

- ISA Regulations do not apply directly to subcontractors
  - Therefore, subcontractors are not directly liable to the ISA
  - UNCLOS places a duty on States to ensure that their contractors comply with its provisions

- Domestic law typically applies to contractors, and holds contractors liable for the actions of their subcontractors
  - Where subcontractor fails, the contractor will be liable under ISA Regulations

Disadvantage:

- Subcontractor’s failure will result in liability for the State

Minimising the Risk of Liability for the State

- Enact strict rules to give effective protection to the States by ensuring that subcontractors have the capacity to effectively discharge the obligations of the contractor
  - Rules that ensure the subcontractor meets the same Qualification Criteria applicable to the contractor
  - Subcontractor should be subject to the same duties, undertakings, guarantees and other requirements as those required of a sponsored party
  - A subcontract should be subject to approval by the Minister or Seabed Mineral Authority and obtain Cabinet consent
  - Subcontractor should be required to provide appropriate security to the Sponsoring State against future damage claims arising out of matters under the subcontractor's control
  - Subcontractor's activities should be monitored not only by the contractor but also by the Authority in charge of seabed mining in the Sponsoring State to enable effective oversight

Effective Control

UNCLOS requires Sponsoring States to show ‘effective control’ over the sponsored contractor.

- UNCLOS does not define ‘effective control’
  - Legal control (e.g. incorporation and registration in sponsored State)
  - Management control

Ensuring effective control

- Local registration of contractor in Sponsoring State
  - Gives the government and its institutions legal control over the company
  - Should apply also to subcontractors
- Establish appropriate mechanisms to verify the qualifications of prospective contractors
- Establish appropriate mechanisms to monitor, report, evaluate and provide feedback on Contractors’ activities and adherence to contractual arrangements/ legislation.

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