

African Group Remarks and Comments and interventions for Open Ended Working Group on the Financial Terms of Contracts Meeting on the 16-17/03/2023

Overarching Remarks

It is a great privilege and a pleasure to be able to make these remarks to the Open-Ended Working Group on the Financial Terms of Contracts.

The African Group made a detailed submission on the payment regime in April 2022. That submission evaluated the suggested payment regimes against nine tests drawn from UNCLOS, the 1994 Implementing Agreement and international best practice in extractive industry taxation.

The Chairman's Text includes payment regime option 4, which is a price varying royalty with rates of 2%/5% to 9%. That option did not pass six of the African Group's tests, including:

- the whenever miners make profits, mankind must be compensated test;
- the rates of payment test/effective tax rate test; and
- the knowledge and transparency test.

In the spirit of improving the payment regime, the African Group made a detailed submission in August 2022 which proposed draft text for two important new measures.

The first regards a profit share or tax on the direct and indirect transfer of rights. This measure is important as without it contractors could sell licenses for hundreds of millions of dollars in profits while mankind receives nothing.

The second proposed measure was an additional 6% equalisation royalty against which a contractor's sponsoring state corporate income tax payments would be creditable. This measure would normalise/equalise contractors' effective tax rates regardless of any tax exemptions that they had negotiated with their sponsoring state. It would lead to higher ISA revenues if tax payments to sponsoring states were lower than assumed by MIT, but would not reduce contractors' profits at all if their payments to sponsoring states were as assumed by MIT.

We regard this additional royalty as being beneficial to humankind as it can increase but not decrease ISA revenues from a mine. In addition, it would be highly beneficial to sponsoring states as it would motivate contractors to pay taxes to their sponsoring state and demotivate profit shifting and sponsoring state tax avoidance.

Since the African Group submission there have been two important documents relating to this topic; 1) a submission to the ISA by a group of commercial contractors, and 2) a report produced by the IGF.

The contractor submission takes a constructive approach and importantly it supports both the need for a profit share on the transfer of rights and an equalisation measure. Albeit the details of the measures proposed by the commercial contractors differ from those proposed by the African Group.

The IGF Report on the Proposed Payment Regime for Deep Sea Mining also supports many of the points made in the African Group's submissions. In particular, we draw the Working Group's attention to four points made by the IGF Report:

First, the IGF Report states that 'the average effective tax rate for land-based mining is typically between 40% and 50%' and that 'there may be good reason to set a higher target average effective tax rate for deep-seabed mining'.

Second, the IGF Report states that 'MIT assume that contractors will pay Corporate Income Tax in the sponsoring state at a rate of 25%. The existence of sponsorship agreements that exempt corporate income tax altogether suggests that this assumption is highly questionable'.

Third, the IGF Report notes that 'every payment regime option except Option 3 produces a lower average effective tax rate than the target average effective tax rate of 47%.' This is the case even when IGF include the highly questionable assumption that miners pay a 25% sponsoring state corporate income tax as a component of the average effective tax rate. With more realistic assumptions the IGF Report shows an average effective tax rate of 15% for option 4, which is less than half the rate of payment typical for land-based miners.

And fourthly, the IGF Report is clear that 'what level of CIT contractors pay to their Sponsoring States has a material impact on the average effective tax rate.'

Based on their analysis, the IGF Report concludes that 'An equalisation measure is a necessary addition to the payment regime options.' In this content equalisation measure means the additional royalty proposed by the African Group, or a similar measure, that equalises contractors effective tax rates regardless of sponsoring state tax.

The IGF Report also examines the African Group's specific proposal for an additional royalty, noting that it is easy to administer but unresponsive to profits. Thus, the IGF Report examines, as an alternative equalisation measure, an ISA additional profit share against which contractors could deduct sponsoring state tax payments. That equalisation measure would be more responsive to ex-post profits than the additional royalty proposed by the African Group, but would also be more complex to administer and more prone to tax avoidance.

The IGF Report is also clear that taxing the transfer of mining rights in the Area seems consistent with the ISA's legal mandate, that taxing such transfers is common practice in land-based mining jurisdictions, and that not applying such a tax would give deep-seabed mining a competitive advantage over land-based mining. The IGF Report was supportive of many of the details of the African Group's specific proposal for profit share on the transfer of rights, and also suggests areas where it could be strengthened.

In conclusion, since the last meeting of the Working Group there have been two important, detailed pieces of work on the payment regime. Both pieces of work support the need for an equalisation measure and for a profit share on the transfer of rights, but there are differences in the detailed design of these measures.

Overall, in terms of a constructive way forward, the African Group proposes that in the current session the Working Group agrees to three things:

1. the need for an equalisation measure in principal;
 2. the need for a profit share on the direct and indirect transfers of rights in principal;
- and

3. draft text on these measures to be inserted into the draft regulations from the African Group's August 2022 Submission, with alternate text included where available, to facilitate the detailed discussions necessary on these important mechanisms at the next meeting of the working group.

Regulation by Regulation Interventions

Draft Regulation 23 Transfer of Rights Under an Exploitation License

We note that the text provided by the African Group in its August 2022 submission requiring the payment of the profit share on the transfer as a condition for approval of the transfer has not been included in the Chairman's Text. Albeit we recognise that this was a deliberate omission to allow for a higher-level discussion on this matter.

We continue to regard a profit share on the transfer of rights as essential to ensure comparability to land-based mining and to ensure that the mankind benefits whenever licenses are sold.

The African Group notes that there is now considerable support for the idea of a profit share on the transfer of rights from both commercial contractor's submission and the IGF Report.

We note that if the Working Group agrees to a profit share on the transfer of rights it will be necessary to add text to Draft Regulation 23 to make the payment of that profit share and the submission of relevant documentation a requirement for the approval of the transfer.

In addition, the African Group notes that the text it provided for a new Draft Regulations 23Bis and Draft Regulation 23Ter providing for a profit share on the direct and indirect transfer of rights respectively has not yet been included.

Draft Regulation 27 Commencement of Production

The African Group welcomes and supports the new text which provides a new definition for the start of commercial production.

Draft Regulation 63 Incentives

The African Group's position is that providing incentives for contractors to invest does not conform to international best practice.

With regards to incentives, Annex 3 Section 13.1.d provides for incentives for joint arrangements with the Enterprise, the transfer of technology and training only. It does not provide for incentives to attract investment, despite this being an objective under Annex 3 13.1.b.

Annex 3 Section 14 does provide that the authority may provide incentives to contractors for all the objectives in paragraph 1, including attracting investment. However, the language in Section 14 makes clear that this is something that the Authority may or may not do.

The African Group's view is as international best practice speaks against incentivising investment, and as UNCLOS does not mandate the provision of incentives to attract

investment, then the Working Group should propose Draft Regulations that do not provide for investment incentives.

However, as currently drafted, Draft Regulation 63 provides for incentives for all the objectives of Article 13, which includes attracting investment to the Area.

In our August 2023 submission we proposed amended text Draft Regulation 63.1, which has not been included in the Chairman's text. We would like to repropose that text, so that Draft Regulation 63.1 reads:

'The Council may, taking into account the recommendations of the Commission and the Finance Committee, provide for incentives on a uniform and non-discriminatory basis, to Contractors to further the objectives of the Enterprise participating in the activities in the Area, the transfer of technology to developing states and the training of nationals of developing states as provided for in annex III to the Convention.'

Draft Regulation 64 Bis

The African Group notes that it provided text for an additional royalty against which any contractor sponsoring state corporate income tax payments would be creditable. We note that this text has not been included in the Chairman's Text. Albeit we also note that this is a deliberate omission pending a higher-level discussion of the additional royalty and other equalisation measures.

We continue to consider that an equalisation measure is an essential part of the payment regime and that there is support for this from the submission by commercial contractors and the IGF Report. If the additional royalty was supported by the Working Group then the African Group's text could be added here. In the alternate that another equalisation measure was agreed then substantial new text would be required.

Draft Regulation 70 Payment of Royalty Shown by Royalty Return

The African Group considers that there are no circumstances where payment of the royalty should be deferred or paid in instalments. As such we proposed for Draft Regulation 70.4 to be deleted and we note that that amendment has been included in the Chairman's text. We continue to support that deletion.

Draft Regulation 77 General Anti-Avoidance Rule

The African Group notes that there is a new Draft Regulation 77.4 which provides for the exploitation license to be suspended or rescinded if a contractor fails to pay the royalty. We support this new text as it provides a further incentive for compliance and is consistent with provisions in many land-based mining tax regimes.

Draft Regulation 81 Review of the System of Payments, and Draft Regulation 82 Review of the Rates of Payment

The African Group has consistently argued that providing contractors with fiscal stability over the term of the exploitation contract is not consistent with international best practice in extractive industry taxation. We, therefore, proposed and continue to support the new text included under these Draft Regulations that provides for a review after five years of commercial production, with changes applying to contractors with or without their consent.

We do have some concerns about the new text stating 'taking into account the economic viability of projects'. Of course, economic viability will be an important criterion in any review, but other criteria such as the maximising ISA revenues, comparability to land-based

mining and administrative simplicity will also come into play. Our view would be that either all relevant criteria should be listed which would be cumbersome, or that the Draft Regulations should be silent on this matter.

Draft Regulation 83 Bis Beneficial Ownership

The African Group supports this new regulation providing for a beneficial ownership register, which is important for understanding who is ultimately profiting from deep-seabed mining in the Area.

The African Group continues to consider that the deep-seabed mining in the Area should conform to the highest standards of transparency.

Draft Regulation 89 Confidential Information

The African Group notes that new text has been provided that makes clear that payments to sponsoring states and sponsoring state agreements are not regarded as confidential information.

The African Group supports this text, as such information should certainly not be confidential and should be published.

We do, however, question as to whether classifying that information as non-confidential is, alone, sufficient to guarantee its publication. An alternative would be to include complementary text mandating the publication, and process for publication, of sponsorship agreements, other contractual arrangements between sponsoring states and contractors, and payments between contractors and sponsoring states.

Appendix IV 1Bis Additional Minerals

The African Group notes that the Chairman's Text provides for additional minerals to be included in the royalty calculation. The African Group previously provided draft text to include additional minerals under the relevant metals section. We continue to support relevant metals being included and have no strong preference as to whether the text to provide for that is included here or under the relevant metals section.

Enclosure III Draft Standard

The Chairman's Text provides for the royalty base to use medium-carbon ferromanganese metal prices.

The African Group previously suggested that electrolytic manganese metal was used as the manganese price in the royalty base. One reason for that proposal was that the MIT model originally assumed that manganese was processed to that grade and included prices and costs consistent with that assumption. Albeit more recent discussions indicate a movement away from that assumption in the MIT model.

The medium-carbon ferromanganese manganese metal price is lower than the electrolytic manganese metal price. Thus, all else being equal, moving to the medium-carbon ferromanganese manganese metal price will lower the royalty base, ISA revenues and the effective tax rate. To counteract this the African Group will likely have to revise upwards the additional royalty rate and minimum acceptable royalty rates. This will require further detailed calculations which we have not yet undertaken.

While we understand the benefits of updating the MIT model as new information becomes available, changing the base does complicate discussions around what the royalty rates should be.

Enclosure III Draft Standard (third period of commercial production)

We note the inclusion of text proposed by the African Group providing for a third period of commercial production.

We provided this text as it was unclear in the previous draft of the regulations how many periods of commercial production there were and whether the second period of commercial production did or did not last until the end of the term of the contract. In addition, previous drafts of the regulation provided for fiscal stability for the first two periods of commercial production.

The key point from the African Group's perspective is that fiscal stability should only be provided for a defined term, likely five years, and thereafter changes to the rates of payment should be applicable without the consent of contractors.

Enclosure III Draft Standard (additional metals)

The African Group welcomes the inclusion of the text it provided for additional metals in the Draft Regulations. As mentioned previously, we do not have a strong preference as to whether additional metals are included here or under Appendix IV.

Enclosure III Draft Standard (royalty rates)

The African Group welcomes the inclusion in the Chairman's Text in brackets of the royalty rates it proposed. These are the rates that maximised ISA revenues in the previous MIT model with realistic assumptions about required investor returns and sponsoring state tax and in the absence of an equalisation measure.

It is important, however, to note that these will have to be revised upwards in light in the movement to a calculating the royalty base with a lower metal price. On the other hand, if there were agreement on the equalisation measure and profit share on transfers then there would be a rationale for revisiting these proposed rates.

Concluding Remarks

[To be provided]