

Working Group A – Implementation Guidelines

The task assigned to WG “A” concerned the implementation of Article 82 with regard to the interface between the obligation of OCS States to make payments or contributions in kind and the Authority’s responsibility to receive them. The WG did not address implementation aspects with regard to eventual distribution of benefits in accordance with the LOS Convention. The WG deliberations concentrated on four major themes, namely: (1) the nature of the relationship between the OCS State and the Authority for Article 82 purposes; (2) the terminology used in the provision; (3) explicit and implicit functions and tasks in the provision; and (4) possible options for structure and process to facilitate implementation. These are reported upon in turn. The WG’s deliberations also made (5) the recommendations presented at the end of the thematic narrative.

1. Relationship

Article 82 has relationships at two levels. At one level, mutual reciprocal duties among State Parties are created by virtue of subscription to the LOS Convention, hence the trade-off between Articles 76 and 82. Thus compliance with Article 82 is first and foremost an expectation of State Parties, i.e., the legal obligation to make payments or contributions in Article 82(1) is owed by the OCS State to other States Parties.

At another level, the procedure for compliance with Article 82 requires the OCS State to interact with the Authority. The latter is explained chiefly by the employment of the term “through” in Article 82(4). Clearly, the implementation of Article 82 requires a cooperative relationship between the OCS State and the Authority. That relationship must be guided by good faith. The Authority’s role in that relationship must be interpreted in accordance with its mandate in the LOS Convention. The WG emphasized the need to develop a cooperative relationship.

The Convention is silent on the precise point in time the relationship between the OCS State and the Authority emerges and what structure and process should govern it. In essence, the role of the Authority vis-à-vis the OCS State can be described as a “receiver” rather than “collector” of payments and contributions. The Authority then becomes a trustee of received amounts until they are distributed to beneficiaries in accordance with the Convention. While the Authority has not been expressly tasked by Article 82 or been conferred powers for monitoring and compliance, transparency in the

implementation of Article 82 towards other State Parties is an important aspect of implementation. It was also pointed out that although the Authority has not been expressly granted a monitoring function, it would need certain data and information from the OCS State in order to be able perform the role of receiver and eventually of channel of benefits to other State Parties.

Thus in order for the Authority to be in a position to receive payments and contributions and to further discharge downstream responsibilities, administrative procedures need to be established. In this regard, the Working Paper on “Development of Guidelines for the Implementation of Article 82” (Annex in this report) provided guidance for some of the tasks that could potentially be part of such procedures. Clear procedures are needed to address gaps and ambiguities in Article 82 while at the same time providing for convenience, efficiency and transparency. Procedures should include various administrative tasks, such as notices to be provided by the OCS State to the Authority (e.g., regarding commencement, suspension and termination of production), notices provided by the Authority to the OCS State (e.g., currency of payments, bank account for payments, delivery of contributions in kind), and provision of information by the OCS State (e.g., regarding production and the basis for the computation of payments).

The WG explored advantages and disadvantages of a standardized approach to effecting of payments and contributions in contrast to a case-by-case approach. For example, there is merit in encouraging OCS States to use commonly agreed procedures with the Authority in the interests of consistency, predictability and efficiency. A guidance document could be developed to assist OCS States for this purpose. At the same time, it was noted that different resources may require variable implementation and that therefore there is equal merit in maintaining a measure of flexibility.

The information flow between the OCS State and the Authority was considered in depth. While the Authority is not answerable to Member States for OCS State discharge of its obligation in Article 82, and cannot be expected to comment on Article 82 compliance, its annual report will be expected to report on payments and contributions actually received or not received. This would be analogous to information provided on operators’ certificates of expenditures with regard to activities in the Area. It is conceivable that the Authority’s Secretary-General is queried by Member States on various Article 82 matters, including the basis of computation of payments and amounts due. The provision of such

information by the Secretary-General would clearly draw on notices and information voluntarily communicated to the Authority by the OCS State concerned.

To facilitate information flow and to assist with transparency, one possible approach is to recommend to OCS States that they consider a standardized format for presentation of information to accompany payments and contributions. The format could include the amounts and contributions in kind made, an explanation of how those amounts are arrived at and the sites concerned.

The discharge of the Article 82 obligation through contributions in kind raises several issues and challenges for the relationship between the OCS State and the Authority. When negotiated at the Third United Nations Conference on the Law of the Sea, 1973-1982 (UNCLOS III), the intention behind insertion of contributions in kind was to secure resource access to State Party beneficiaries. The exercise of this option gives rise to several difficulties. For example, it is unclear at what point in time legal title over the share of the resource composing the contribution in kind actually passes. Provision for transfer of title would need to be made to enable the resource to be distributed or marketed by the Authority. Logistical arrangements would need to be made and it is unclear who bears this responsibility and related costs, in particular where logistics require storage and transportation. Different resources would pose different challenges (e.g., marketing of natural gas the price of which is determined by regional markets). The relationship between the OCS State and the Authority would likely require more onerous cooperation. The Authority does not have the capacity to receive contributions in kind and would effectively have to make appropriate brokerage and marketing arrangements. Costs would be incurred. Further, OCS States have the right to choose the option and there appears to be no restriction regarding possible change of discharge option. The complexity of implementation on the basis of contributions in kind is such that the WG reiterated the recommendation made at the 2009 Chatham House workshop, namely that OCS States should be encouraged to discharge the obligation solely on the basis of payments.

2. Terminology

Article 82 does not provide definitions for key terms used, in particular “resource”, “all production”, “value”, “volume”, “site”, “payments”, “contributions in kind” and “annually”. It is important to appreciate that these terms were employed in Article 82 in order to secure the compromise needed,

functioning more as instruments of compromise than terms of art. Each term requires individual clarification and with reference to the use of other terms to correctly and fairly reflect the intention behind the whole provision and in the context of the Convention. It was noted that in different OCS States some of these terms may not be understood in the same manner or might no longer be in use as a result of departure from royalty-based approaches to determine a government's share of produced resources to other forms of revenue-sharing (e.g., taxation). While a measure of flexibility of interpretation in particular cases might be desirable, the terms also represent common denominators for all OCS States for the implementation of Article 82. Therefore, reasonably consistent understanding among State Parties to facilitate implementation and avoid potential disputes regarding interpretation is an important consideration. The development of a guidance document to assist OCS States with the implementation of Article 82 would need to address this matter.

The meaning of "resource", while clearly referring to non-living resources, could have different meanings with regard to different resources in terms of what is effectively captured by Article 82 and at what point in time. For example, while on the one hand iron ore is exploited, on the other hand the purpose is a derived resource such as raw iron for the production of steel. The use of this term has a close relationship to "production" and "value" as it helps identify at what point production occurs and the value to be placed on the defined commodity at that time. A potential concern could be with regard to a produced resource which might not have market value until some processing occurs.

Article 82(2) refers to "all production". Similarly to value, this could mean gross or net production. During negotiations of Article 82 at UNCLOS III the possibility of using the net was considered, but it was thought that in the interests of simplicity it was simpler to consider the gross because of the diversity of accounting systems. The provision indicates what is excluded from the computation of production, namely that resources used in the exploitation of the resource are not to be included in calculating all production. However, clarification on this point is needed because a portion of the produced resource may be used for various purposes before marketing. For example, in the case of hydrocarbons such use of the resource may be for re-injection to enhance production, help stabilize a well, measure flow rates, to generate energy on board the installation and for flaring. In the case of the analogy to the production of iron ore, it is possible that the ambiguity may extend to whether production refers to the iron ore or the derived commodity (e.g., raw iron). However, a cross-reference to the term "site" (production at the site), assuming that site is defined so as to refer to the actual point of extraction, may give rise to a

meaning of the raw resource as and when produced at that location. The definition of “volume” is closely related to production and raises similar issues.

The term “value” is one of the more complex terms. It is capable of different meanings, in particular whether it refers to the gross or net value from production of the resource. The meaning could vary with reference to different resources (which are also commodities) and may further vary in tax and royalty regimes. It is a term that has a relationship to the meaning to be assigned to “production.” When Article 82 was negotiated in the 1970s value was used likely used with reference to production from relatively shallow wells in contrast to contemporary production and in particular in deep waters. In a contemporary context, deep water drilling has a particular cost structure and can be expected to exceed \$200 million dollars per well. Moreover, it may not be possible to refer to a global valuation of a resource (e.g., as in the case of the price of oil and various minerals) where the practice is to value the resource according to a regional market (e.g., as in the case of natural gas). It was felt that whatever meaning assigned it is essential that there be disclosure of the method of calculation in the interests of transparency, good faith and consistent application. Additional concerns with value arise where the price of a resource is artificial and when the currency used has an artificial or non-market based value. These issues strengthen the argument for the use only of convertible currencies.

At UNCLOS III “site” was understood in very simple terms. Site is potentially ambiguous as it could have several different meanings including a resource field, geological structure, well site, license area and a whole development area subject to multiple licenses. The technical term could be understood differently with regard to different resources. In relation to hydrocarbons, new wells to enhance resource recovery and multiple satellite wells drilled at different times over a long-term development could add additional complexity. A production site might also be restructured over the life of a field to enhance production. Further, if sites are defined with reference to very small areas of the same field, the resources of some sites could be exhausted in short periods, for example during the grace period. Defining site can have additional complex dimensions in the case of a transboundary resource (straddling neighbouring extended continental shelves or an extended continental shelf and the Area) that might require unitization and/or joint development. It is conceivable that production might take place on only one side of the maritime boundary. The most practical approach is likely to leave the determination of “site” for Article 82 purposes to the OCS State, possibly with the assistance of guidelines.

“Payments” was generally understood as monetary transfers. Article 82 does not prescribe a particular currency and in the absence of a common denomination it is conceivable that various currencies may be used depending on the originating OCS States. The international practice is for international payments (e.g., assessed contributions for membership in intergovernmental organizations, trust funds, and payments to the International Oil Pollution Compensation Fund) to be effected in an international currency or a widely used convertible currency, such as the US dollar, euro or other denomination. The US dollar is in current practice with regard to payments made to the Authority. Payments in different currencies could carry a potential risk of loss (or gain) in the amount transferred in fluctuating currency markets and likely conversion costs. Also, the prices of resources in commodity markets fluctuate, raising a question as to the relevant point in time to determine value for the purpose of effecting payment. A complicating factor is the possibility that the amount of payment (as it represents value) at the time received may be different from the amount at the time it is transmitted. For this and other reasons, it will be important for payments to be made within a reasonable time frame.

The difficulties to be encountered when an OCS State opts to make “contributions in kind” have already been addressed in this report. In addition to those difficulties, an understanding of what is acceptable as a contribution in kind within the letter and spirit of the provision is necessary. Discussions in the WG proceeded on the assumption that this phrase refers to a share of the resource, but other possible interpretations were not discussed.

There is considerably less ambiguity in the term “annually”. Different OCS States may have varying financial years. Annual could also mean a calendar year commencing from the date of first production for a site. It was pointed out that different dates of commencement for different sites within the same jurisdiction could pose a potential onus for industry, which is likely to prefer a single definition to apply to all sites. In this respect, a first year of production could be prorated to the actual number of months of production, using a value based on average prices for the period covered. A definition should aim at simplicity and convenience.

The WG felt that a clear and common understanding of the terminology, and especially the functions performed by those terms in the contemporary context of Article 82, requires expert input into the discourse, which could be in the form of a study of the use of those terms in contemporary regulatory and industry practices across different jurisdictions. Some WG participants felt that the responsibility for interpreting those terms ultimately lies with the OCS State whereas others were of the view that an

understanding of comparative practices would be useful. Such a study would help inform deliberations and would not be prescriptive in nature. A glossary of terminology would be useful.

In the event that even after further study the issues raised still require authoritative interpretation, the matter may have to be referred to States Parties to the LOS Convention (SPLOS).

3. Functions and tasks

Apart from the making of payments or contributions by the OCS State through the Authority, Article 82 contains no express text regarding specific tasks for the performance of the State's obligation. However, as noted earlier in the report, the provision generates an administrative relationship between the OCS State and the Authority. There are certain functions that must be performed through specific tasks, some of which were identified in the Working Paper. In particular, information needs to flow through formal notice between the OCS State and the Authority on various matters. Insofar as possible notices from the OCS State to the Authority are concerned, the following were mentioned:

- that a particular site has become Article 82 eligible;
- date of commencement of production;
- suspension of grace period, including explanation;
- suspension of production that affects payments or contributions, including explanation;
- announcement of forthcoming payment, including explanation of how the amounts concerned were arrived at (payment to be made within a reasonable period following the end of the production year);
- announcement of forthcoming contribution in kind and related arrangements, including explanation of how the amounts concerned were arrived at (deliveries, timeframes and related arrangements for contributions in kind would need to be made with the Authority);
- announcement of change of option;
- date of termination of production.

Insofar as likely notices from the Authority to the OCS State are concerned, the following were mentioned:

- acknowledgement of receipt of all formal notices from the OCS State;
- banking instructions regarding payments;
- receipting of payment;
- receipting of contribution in kind and related arrangements;
- annual statement of account certifying received payments or contributions.

Further to the discussion on contributions in kind reported above, it was felt that where an OCS State opted to discharge its obligation in this manner that the contribution should be liquidated at the earliest opportunity, ideally at the point of production or reasonably thereafter. A brokerage service might be an efficient way to undertake this task. In any case, where an OCS State opts in this direction, it should give sufficient advance notice to the Authority bearing in mind the requirements of marketing. Expenses (e.g., brokerage) are likely to be incurred by the Authority would be incurred. How these might be covered should be the subject of specific study. In a hypothetical scenario where an OCS State chooses to alter a prior exercised option, i.e., to change contributions to payments or vice versa, specific advance notice should be given to the Authority, bearing in mind that the payment or contribution is to be made on an annual basis.

The annual report of the Authority's Secretary-General would inform Member States of payments and contributions received and related matters on the basis of information received from OCS States.

4. Structure and process

A major theme addressed by the WG throughout its deliberations is what form of structure (formal or informal) and process would be needed to facilitate the administrative relationship between the OCS State and Authority. The WG generally felt that a "do nothing" approach was not helpful or tenable. An implementation agreement similar to those for Part XI and straddling stocks and highly migratory species was considered highly undesirable. A model formal Article 82 agreement between the OCS State and the Authority as proposed in the Working Paper was not considered appropriate or feasible because of the limited mandate given to the Authority in Article 82 and its terms of reference. However, some elements discussed in the Working Paper, as long as within the mandate of the Authority, were considered useful to consider in some other form. A memorandum of understanding between the OCS State and the Authority was proposed, but not discussed in depth. Generally, the WG preferred a

different option, namely a voluntary “guidance document” which would provide helpful guidelines for all OCS States.

By and large, the content of the guidance document should be a practical instrument that would capture much of what has been presented in this report, and in particular terminological matters, format for certification and explanations to accompany the methodology used for determination of amounts of payments and contributions, notices that could be provided to the Authority and information and notices to expect in return. The document would in essence be advisory in character and would assist OCS States in the discharge of the obligation and to do so in a transparent manner. One suggestion was to encourage OCS States to undertake an annual audit of the payments or contributions in accordance with public sector auditing standards and requirements. This would further strengthen transparency. The document would need to take into consideration the needs of different resource scenarios. The document must not embark on an independent interpretation of Article 82, as this is a responsibility of State Parties to the Convention. The Authority would take the lead in preparing the guidance document in accordance through its own internal structures and procedures. The Authority has significant experience in bringing to bear appropriate expertise to assist with the development of a document of this type.

5. Recommendations

The Working Group felt that the initiative to facilitate the pragmatic and functional implementation of Article 82 should continue to move in the Authority. Despite the intensive discussions in the WG, it was felt that some issues could not be covered (e.g., dispute settlement) or did not receive sufficiently thorough and informed consideration. Clearly, further intensive deliberations are called for. To assist with the next steps, the WG produced the following recommendations:

- The Authority should encourage OCS States, in particular those that are issuing or plan to issue offshore licenses for non-living resources of the extended continental shelf, to consider and anticipate the implementation needs of Article 82 within their respective jurisdictions.
- OCS States, while enjoying exclusive choice to make payments or contributions in kind, should be recommended to opt only for payments in the interests of simplicity and efficiency of

implementation. It is conceivable that a SPLOS resolution may be needed to move this recommendation forward.

- Further examination of the implementation needs of Article 82 would benefit from a study of key terms discussed in this report as they are used in contemporary regulatory and industry practices across different jurisdictions. The study should consider various hydrocarbons and mineral resource scenarios. As an information document, the study would help identify possible paths for a practical approach. The study would help build and deepen understanding of the terminological issues in realistic settings, but would not have prescriptive value.
- The Authority should explore further the concept of a guidance document and take steps to prepare a draft for discussion, bearing in mind that such instrument will be essentially voluntary and aim to provide practical guidelines and advice to assist OCS States in the implementation of Article 82. The content should reflect terminological matters, functions and tasks, and other appropriate implementation matters discussed in this report. It could be undertaken in three sections, namely: (a) practical and administrative arrangements, (b) provisions regarding contributions in kind, and (c) considerations for OCS States to take into account.