Deep Sea Conservation Coalition

Submission on Effective Control

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Introduction

This paper outlines some issues with respect to effective control. UNCLOS allows ISA contracts to be held by non-State entities. But any non-state entity must be 'effectively controlled' by a sponsoring State or by nationals of the sponsoring State[1]. This makes sense, because a non-State entity is not directly bound by UNCLOS or ISA rules.[2] So the ISA State sponsorship system ensures there is always a State (which is subject to those international

[1] Articles 139(1) and 153(2)(b)) of UNCLOS

[2] ITLOS said that "75. The purpose of requiring the sponsorship of applicants for contracts for the exploration and exploitation of the resources of the Area is to achieve the result that the obligations set out in the Convention, a treaty under international law which binds only States Parties thereto, are complied with by entities that are subjects of domestic legal systems."

rules) accountable to the rest of the international community for any contractor's conduct. The individual State can then hold its sponsored contractor to the same rules, by way of national law.[3] But that mechanism can only work in practice if the State actually can exercise control over the contractor: i.e. a relationship of 'effective control'.

The International Tribunal for the Law of the Sea (ITLOS) in its Advisory Opinion on seabed mining had this to say about effective control:

> "77. The connection between States Parties and domestic law entities required by the Convention is twofold, namely, that of nationality and that of effective control. All contractors and applicants for contracts must secure and maintain the sponsorship of the State or States of which they are nationals. If another State or its nationals exercises effective control, the sponsorship of that State is also necessary."[4]

Clearly nationality - being incorporated in the sponsoring State - isn't enough on its own. Effective control is something different. Yet as will be seen later in this non-paper, nationality is in reality the only test that the ISA has been applying for contractors in its so-called 'regulatory approach'.

UNCLOS and Effective Control

UNCLOS has placed 'effective control' at the heart of the 'system of exploration and exploitation' in Article 153, which provides that

> *2. Activities in the Area shall be carried out as prescribed in paragraph 3:*
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> *b. In association with the Authority by States Parties, or state enterprises or natural or juridical persons which possess the nationality of States Parties or are effectively controlled by them or their nationals, when sponsored by such States, or any group of the foregoing which meets the requirements provided in this Part and in Annex III.*

[3] Indeed, UNCLOS specifies that once a State has sponsored an ISA contractor, the State has a 'responsibility to ensure' compliance with the ISA's rules by the contractor, and the State may be liable for any damage caused as a result of the State's failure to meet that duty. The International Tribunal on the Law of the Sea produced a very helpful Advisory Opinion unpacking what that 'responsibility to ensure' entails: https://www.itlos.org/fileadmin/itlos/documents/cases/case_no_17/17_adv_op_010211_en.pdf. NB people very often confuse 'effective control' and 'responsibility to ensure', though they are two separate requirements. It may be helpful to think of 'effective control' as the status of the relationship between the State and the contractor which must exist in order obtain a contract (e.g. what nationality is the contractor?), and 'responsibility to ensure' as the ongoing actions of the State to exercise regulatory control over the contractor, once the contract has been granted (e.g. what laws and State administrative measures apply to the contractor?).

[4] ITLOS also emphasised that "159. Equality of treatment between developing and developed sponsoring States is consistent with the need to prevent commercial enterprises based in developed States from setting up companies in developing States, acquiring their nationality and obtaining their sponsorship in the hope of being subjected to less burdensome regulations and controls. The spread of sponsoring States "of convenience" would jeopardize uniform application of the highest standards of protection of the marine environment, the safe development of activities in the Area and protection of the common heritage of mankind."

Article 139(1) on liability provides similarly that "States Parties shall have the responsibility to ensure that activities in the Area, whether carried out by States Parties, or state enterprises or natural or juridical persons which possess the nationality of States Parties or are **effectively controlled** by them or their nationals, shall be carried out in conformity with this Part."

UNCLOS does not expressly define 'effective control'. But it does give some pointers in Annex III, which provides for basic conditions for prospecting, exploration and exploitation.

- If an applicant has more than one nationality, which may arise in a consortium or partnership, all States must sponsor the application except where the applicant is effectively controlled by another country or its nationals, in which case both States must sponsor the application.[5] This illustrates that nationality (e.g. incorporation) and effective control are not the same thing.
- Another example relates to the transfer of technology: where the contractor exercises effective control over the owner, failure to acquire from the owner the legal right shall be considered relevant to the contractor's qualification for any subsequent application for approval of a plan of work.[6] The closeness of a corporate relationship and the degree of "control or influence" is to be considered. Here, effective control is used to ensure that corporate structures and economic power are not used to circumvent UNCLOS.
- Yet another example relates to 'reserved areas', and applies a test for those that are able to apply for them being (1) natural or juridical persons (2) sponsored by a State and (3) effectively controlled by the sponsoring State or by another developing State which is a qualified applicant.[7] This makes it clear that being incorporated in a state ('juridical person') isn't enough: effective control is a separate test.

These articles are important as they show that "effective control" is (1) different from nationality; (2) has an economic element and (3) corporate relationships and structures are to be considered.

However, the ISA's approach to 'effective control' in granting contracts to non-state entities to date has focused on the location of the registration of the contractor company only applying what may be known as a regulatory test - but in reality is merely a formalistic test. i.e. the test for 'effective control' appears to have been satisfied for the ISA merely by the entity signing the contract with the ISA having a registered company in the sponsoring State. This is trivial: setting up a company can be done in a day, and in itself means little or nothing in terms of how that company is really controlled. This has led to ISA contracts being awarded to entities set up in a sponsoring State which in reality have very little local presence and are almost entirely owned and operated from overseas.

[5] UNCLOS Annex III Article 4(3)

[6] UNCLOS Annex III Article 5(3)(c)

[7] UNCLOS Annex III Article 9(4)

There are convincing arguments[8] that the correct and indeed logical interpretation of the 'effective control' criterion must look instead to economic control: the reality of the economic situation. This could also help to prevent forum shopping for sponsoring States (similar to the flags of convenience phenomenon that occurs with shipping).[9]

An economic control approach was taken in the 1988 Convention on the Regulation of Antarctic Mineral Resource Activities (CRAMRA), which has as its primary test "a substantial and genuine link", which in turn requires effective control. That is specifically defined as "the ability of the Sponsoring State to ensure the availability of substantial resources of the Operator for purposes connected with the implementation of this Convention, through the location of such resources in the territory of the Sponsoring State or otherwise".[10]

Although CRAMRA never came into force (being overtaken by a 50 year ban on commercial mining in Antarctica under the Madrid Protocol), its test of "effective control" can be seen as an effort by signatories to define "effective control" as used in UNCLOS, and in addition, CRAMRA remains an interesting precedent for the ISA, given the germane subject matter, and that it was signed by 19 States (including 9 ISA sponsoring States). In essence the test there is: (1) availability of (2) substantial resources of the Operator (3) for purposes connected with the implementation of this Convention.

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[8] For example, made in the paper by Rojas, A and Phillips, F.K. 'Effective Control and Deep Seabed Mining: Toward a Definition'. 2019. Centre for International Governance Innovation: https://www.cigionline.org/publications/effective-control-and-deep-seabed-mining-toward-definition-1

[9] There was a case of a similar nature before the International Court of Justice: the Barcelona Traction Case. (Barcelona Traction, Light and Power Company, Limited (Belgium v Spain) (New Application: 1962) – Judgment of 5 February 1970: Second Phase – Judgments. [1970] ICJ 1; ICJ Reports 1970 at 3; [1970] ICJ Rep 3 (5 February 1970). At https://www.icj-cij.org/files/case-related/50/050-19700205-JUD-01-00-EN.pdf.) This case involved nationality rather than effective control, so is of limited relevance. The Court found that Belgium had no legal standing to exercise diplomatic protection of shareholders in a Canadian company in respect of measures taken against that company in Spain. The Court said that state practice differed, with some jurisdictions only providing diplomatic protection to entities that have their headquarters or management control (the siège social) in the jurisdiction, or management or centre of control in their territory, or when a majority or a substantial proportion of the shares has been owned by nationals of the State concerned. (para 70) The International Court of Justice ("ICJ) has in *Military and Paramilitary Activities in and against Nicaragua* (Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America), Merits, Judgment, I.C.J. Reports (1986) p. 14 (hereafter, "Nicaragua"). At https://www.icj-cij.org/files/case-related/70/070-19860627-JUD-01-00-EN.pdf.

See also Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda), Judgment, I.C.J Reports (2005). At https://www.icj-cij.org/files/case-related/116/116-20051219-JUD-01-00-EN.pdf. Page 168.) required evidence of control in relation to the specific acts at issue (in this case, violations of human rights and humanitarian law). While not of assistance in a corporate sense, it does show that it is plausible to ask the ISA to investigate whether there is, in the particular circumstance, evidence of effective control over specific aspects of deep sea mining activities.

[10] CRAMRA Art. 1(14) The addition of the words "and substantial" can be seen as an attempt to build on the concept of "genuine link", but arguably the use of the term "genuine link" may have introduced confusion, since "effective control" is more than a "genuine link", and even more than a "substantial" genuine link: it is that control of the contractor is actually effective.

What constitutes Effective Control?

To ascertain effective control, a Rojas and Phillips paper suggests examining:[11]

- ownership of a majority of the applicant's shares;
- ownership of a majority of the applicant's capital;
- holding a majority of the applicant's voting rights;
- holding the right to elect a majority of the applicant's board of directors or equivalent body having an influence over the applicant sufficient to determine its decisions.

These are all important indicators of who controls the contractor. But there may be others. CRAMRA points the way to one: "substantial resources" which are available for purposes connected with implementation of (in that case) CRAMRA.

An agreement between the sponsoring State, a contractor incorporated in the sponsoring State and the parent company, whereby the parent company acknowledges full responsibility and liability for the activities of the contactor, and which provides for enforceability, through arbitration or submission to the sponsoring State jurisdiction, may be of assistance in ensuring that substantial resources are available, including other than in the territory of the sponsoring State.

It is not certain that test is adequate. Is it the availability of substantial resources enough? How much is substantial? The test would help for enforcement to some extent, but will it really ensure control over the company's ongoing activities? That would depend on where control over the company is based. If it is based other than territory of the sponsoring State, for all practical purposes - i.e. were the operator is in fact controlled by a multinational head office located overseas - then can effective control properly be said to be in the sponsoring State? Availability of resources may be one indicator, but is it enough? The quantum of substantial assets would in turn depend on the valuation of ecosystem services and the deep sea: see the report by Dr Luke Brander and Ms Victoria Guisado Gõni, "Report on the value of ecosystem services and natural capital of the Area,"[12] commissioned by the Authority upon the request of Council. Such a valuation, notes the report, is not feasible at the moment, in light of the very limited existing data on the value of deep-sea ecosystem services. This also raises the question: how can those resources be manifested?

[11] Rojas and Phillips, page 8.

[12] Dr Luke Brander and Ms Victoria Guisado Gõni, "Report on the value of ecosystem services and natural capital of the Area. 2023. At https://www.isa.org.jm/wp-content/uploads/2023/06/Report-on-Valuation-of-ecosystem-services.pdf.

Why does it matter in the context of deep-sea mining?

There are in essence three reasons: integrity of the ISA, enforcement and liability.

Integrity

If economic control criteria were applied by the ISA to the relationship between contractor and sponsoring State, it is probable that some of the current private sector contractors seen at the ISA would fail the test, at least partly because the majority of their shareholders and/or their directors are not located in the sponsoring State. For instance Tonga Offshore Mining Limited (TOML) and Nauru Ocean Resources, Inc. (NORI): local companies sponsored by Tonga and Nauru respectively, but which are in turn owned by The Metals Company, which is listed on the NASDAQ stock exchange and incorporated in Canada and with shareholders spread across numerous jurisdictions; and UK Seabed resources Ltd (UKSRL): a company registered in the UK but owned by a Norwegian company Loke Marine Minerals. If 'effective control' is exercised in Norway, should Norway not be a sponsor?

Section 20 of the standard Terms and Conditions reads as follows:

> *Section 20 Termination of sponsorship*
>
> *20.1 If the nationality **or control** of the Contractor changes or the Contractor's sponsoring State, as defined in the Regulations, terminates its sponsorship, the Contractor shall promptly notify the Authority forthwith.*
>
> *20.2 In either such event, if the Contractor does not obtain another sponsor meeting the requirements prescribed in the Regulations which submits to the Authority a certificate of sponsorship for the Contractor in the prescribed form within the time specified in the Regulations, **this contract shall terminate forthwith.** (emphasis added)*

Clearly if control of the Contractor changes – as has occurred with TOML – the Contractor (TOML) should notify the ISA. Clause 20 requires that the Contractor would then obtain "another sponsor".

DeepGreen told the United States Securities and Exchange Commission (SEC) that

> "Additionally, there is little jurisprudence or interpretative guidance regarding the application of the sponsorship regulations that are applicable to our business. For example, with respect to the question over the regulation of which State can impact the activities of any contractor (such as NORI or TOML), we have taken the view that incorporation, registration and the grant of nationality are critical factors, amongst others, notwithstanding the beneficial ownership of a subsidiary by its parent ("beneficial ownership"). While this position has not been challenged by our sponsoring States or the ISA, certain organizations that oppose the deep sea polymetallic exploration and collecting industry have advocated for the use of a beneficial ownership test for state sponsorship, and there are no guarantees that our interpretation will be universally accepted in the future."

Enforcement

If a contractor can escape enforcement sanctions through inadequate capitalization, that is both a moral hazard in encouraging contractors to minimise their exposure, and a major hindrance to effective enforcement. The ability of States to effectively enforce contracts and their own laws is central to the ISA regime and is undermined if there is no certainty that contractors can be held responsible for breaches.

Liability

This is a central consideration. If contractors can escape paying compensation in the event of liability, both the sponsoring State and the environment will suffer. As the ITLOS Seabed Disputes Chamber (SDC) said in its Advisory Opinion, the obligation to ensure the availability of recourse for compensation in respect of damage caused by pollution is a direct obligation incumbent on sponsoring States (para. 122) according to Article 235(2) of UNCLOS. The SBD pointed out that a gap in liability may occur if, notwithstanding the fact that the sponsoring State has taken all necessary and appropriate measures, the sponsored contractor has caused damage and is unable to meet its liability in full. (para. 203) The liability of the sponsoring State arises from its own failure to comply with its responsibilities under the Convention and related instruments, whereas the liability of the sponsored contractor arises from its failure to comply with its obligations under its contract and its undertakings thereunder (para. 204). Therefore, situations may arise where a contractor does not meet its liability in full while the sponsoring State is not liable under article 139(2) of UNCLOS. (para. 205). While the SDC suggested a fund to compensate for damage, the first step must be to ensure that contractors cannot escape their liability.

Other issues

Any effective control test needs to be properly enforced and implemented. For example, a contractor may try to avoid an effective control test by being owned by the sponsoring State and then subcontracting to an arms-length entity which is not a contractor but which is actually conducting mining activities. This kind of subterfuge must be avoided.

How can this issue be progressed?

The DSCC brought this issue to the attention of the Secretary-General of the ISA (Michael Lodge) in a letter with respect to DeepGreen's takeover of Tonga-sponsored ISA contractor Tonga Offshore Minerals Ltd. There was no satisfactory response[13] and a follow-up letter asking for more specific information was not answered. Thus it is not clear that the new ownership was reviewed by the Legal and Technical Commission to examine whether effective control is

[13] The Secretary-General replied to DSCC on 10 February 2021 that "In response to your letter, I confirm that the Secretariat has been notified of changes to the ownership structure of TOML. However, these changes do not involve any change of sponsorship. The Kingdom of Tonga, as the sponsoring State, has also confirmed to the Secretariat that it has no objection to the change in ownership structure. In this connection, there are no further regulatory issues to be considered."

satisfied, or whether the new owners were subject to any examination for technical or financial suitability.

The criteria for 'effective control' could be laid out in rules, regulations and procedures of the ISA. If appropriate clarity cannot be achieved in this way, then an ITLOS Advisory Opinion could be sought. This requires either an Assembly decision, with one-quarter of Members to sponsor the request (Article 159(10)), or a Council decision (it needs to be a legal question arising within the scope of their activities: Article 191).

Conclusion

What is certain is that effective control has not been properly debated by Council or defined to date. It is also certain that it is central to the system laid down by the Convention. Otherwise there are far more questions than answers. Is the CRAMRA test of "the ability of the Sponsoring State to ensure the availability of substantial resources of the Operator for purposes connected with the implementation of this Convention, through the location of such resources in the territory of the Sponsoring State or otherwise" sufficient, or helpful? To what extent is the financial control relevant? To what extent is effective control relevant to reserved areas and the common heritage of humankind? The TMC model seems to raise many relevant questions. TMC repeatedly describes the contractors NORI, Marawa and TOML as 'subsidiaries'. When the ISA examines applications for exploration contracts, should it look at the financial and technical ability and resources of the contractor only or the parent company? To what extent are the resources and ability of the parent company relevant if there is no effective control and the contracts are only with the subsidiary? And what if the subsidiary is transferred to an entirely different parent company as was the case with TOML? What then is the relevance of effective control? Should the ISA re-examine the financial and technical ability and resources of the contractor, parent company or both?

And what are the consequences for liability of the contractor and sponsoring State and how can contractors be made to pay compensation for damages Perhaps most crucially, as the Brander and Gõni report shows, the data is not available to quantify the value of the deep sea, so the amount of resources necessary is not able to be quantified.

It is clear that no deep-sea mining should be permitted, for many reasons including the issue of the lack of effective control. It is crucial that this issue is satisfactorily resolved. This is part of the suite of strong reasons for a moratorium on deep-sea mining, including the need to ensure that damage is not caused when it cannot even be valued and to ensure that full enforcement by a sponsoring State is not rendered ineffective due to lack of effective control. As such, effective control is an essential component of the need for effective functioning of the Authority, effective protection of the marine environment, adequate scientific information including a comprehensive understanding of the environment, including ecosystems and impacts, including cumulative impacts, and social licence.