May 2023

Revised ISA Contractor Submission Responding to the African Group Submissions and Suggesting Amended Text For the Payment Regime Provided for in the Draft Regulations on the Exploitation of the Mineral Resources in the Area

INTRODUCTION

1. A group of ISA Contractors has the pleasure of making this revised submission responding to the African Group (AG) submissions and suggesting amended regulatory text for the payment regime contained in the Draft Regulations on the Exploitation of Mineral Resources in the Area ("Draft Regulations") and related Standards.
2. Positions expressed and amendments suggested in this submission are informed by:
    i. Informal intersessional discussions convened at the AG's initiative on 19-20 Jan 2023 in New York and attended by four members of the AG, four ISA contractors (GSR, NORI, TOML, UKSR), representatives of Canada, UK, Nauru, and representatives from IGF and MIT;
    ii. Four AG submissions on the payment regime:
        - July 2019 submission titled African Group submission of two Payment Regimes for consideration by the Council of the International Seabed Authority
        - June 2022 submission titled African Group Submission on the Payment Regime for Deep-sea Mining in the Area
        - 22 August 2022 submission titled African Group Submission Suggesting Amended Text for the Payment Regime Provided for in the Draft Regulations on the Exploitation of Mineral Resources in the Area
        - Updated submission titled African Group Speaking Notes on the Payment Regime;
    iii. Two sources of the draft regulatory text: (1) The Chair of the Open-Ended Working Group on the Financial Terms of Contracts Briefing Note, July 2022) (BNFTC) and (2) Draft Regulations on the Exploitation of Mineral Resources in the Area, Collation of Specific Drafting Suggestions by Members of the Council, December 2019 (DRSDS). When a draft regulation is included in both the BNFTC and DRSDS, then the draft regulation is quoted from the BNFTC. This approach is followed as the draft regulations included in the BNFTC account for edits suggested in the informal working groups, while the DRSDS predates those working groups.
    iv. The discussions that were held as part of the 7th Open-Ended Working Group (OEWG) on 15-16 March 2023 during the first part of the 28th session of the ISA.
    v. The discussions that were held as part of Intersessional Workshop Hosted by Natural Resources Canada on 26th and 27th of April on Zoom.
3. We believe that positions expressed and amendments suggested in this submission offer a pragmatic accommodation of valid concerns raised in the above-mentioned AG submissions and, if adopted, would result in a payment regime that strikes the right balance in the implementation of the guiding objectives set forth in UNCLOS (Annex III, Article 13(1)) and the principles established by the 1994 Implementation Agreement (annex, Section 8(1)).
4. In summary, we assume the following positions in this submission:
    i. We support the adoption of the OEWG's "Option 4" payment regime (2-stage progressive ad valorem).

ii. We support a low ad valorem royalty for the initial 5-year term of each exploitation contract to ensure a revenue flow to the ISA while allowing the ISA Contractor to recoup part of their investment in developing a new industry, followed by higher royalty payments to the ISA thereafter.

iii. We support Effective Tax Rate (ETR) as an appropriate metric to assess fairness and competitive (dis)advantage of the ISA payment regime, as long as an ETR includes net taxes and levies paid by ISA Contractors to the ISA and to their Sponsoring States and is calculated based on acceptable standards that can be applied consistently across all ISA Contractors.

iv. We support the AG's intent in proposing a mechanism to enable the ISA to prevent ISA Contractors from avoiding or minimizing their tax burden on Area operations through Sponsorship Agreements and other arrangements with Sponsoring States.

v. We propose a different mechanism for the ISA to ensure that an ETR for ISA contractors is within the range of those prevailing in respect of land-based mining of the same or similar minerals ("ETR normalization levy") which would account for revenue, tax and profitability based on actual audited accounts (According to globally accepted Pilar Two model rules) rather than current projections made using low accuracy estimates.

vi. We agree that the royalty mechanism, including the system and rates of payments should be reviewed against the provisions of UNCLOS and the 1994 Agreement five years from the commencement of Commercial Production and propose continued regular rate reviews every five years thereafter.

vii. We continue to view the value of the nodules removed from the area as the most appropriate basis for the ISA royalty calculation and believe this approach can be operationalized from day one of Commercial Production.

viii. As an alternative, in view of the current uncertainties around the valuation of nodules and difficulties establishing a nodule ore price before the start of Commercial Production, we support a royalty based on metal prices for nickel, copper and cobalt and medium-grade manganese ore price for manganese contained in nodules for the first five years of Commercial Production, followed by moving to a royalty based on nodule ore price thereafter.

ix. We support in principle the concept of a financial imposition on profits or capital gains realised through the direct or indirect transfer of exploitation rights granted by the ISA when those gains are distributed from the company.

x. We propose amendments to the implementation details to address concerns around proportionality, potential impacts on project finance, group reorganizations and risk of double-taxation.

xi. We encourage the ISA to require high standards of financial disclosure of all ISA contractors (Pilar two model rules), including through independent audit, to enable efficient and flexible administration of the financial regime.

5. This submission is structured into three parts:
   - Operationalizing objectives and principles contained in UNCLOS and the 1994 Implementation Agreement
   - Defining provisional financial payment regime and rates
   - Draft Regulations and Standards: Suggested amended text on the payment regime.

OPERATIONALIZING OBJECTIVES AND PRINCIPLES CONTAINED IN UNCLOS AND THE 1994 IMPLEMENTATION AGREEMENT

6. **Effective tax rate (ETR) as a metric for assessing fairness and competitive (dis)advantage**: In his March 2022 note, the OEWG Chair summarized the Joint Summary given by the ISA consultants (CRU, RMG) as follows: “royalty rates and corporate income tax (CIT) rates are completely unrelated in theory and also in practice. No government sets a royalty rate depending on the prevailing CIT rate or the effective tax rate or the other way around. CIT rates and royalty rates are set in separate processes. Comparison of payment systems for seabed mining with land-based mining should thus not include CIT, and CIT should not be a factor of importance when considering a system of payments for the Authority.” Throughout its submissions, the AG however has maintained that an ETR (that includes CIT) should be used as a metric for ensuring that ISA is fairly compensated and that ISA contractors are not artificially advantaged compared to land-based miners. The AG also cites two publicly available Sponsorship Agreements with zero CIT due to the Sponsoring State as the basis to assume that most ISA contractors will not pay CIT to their Sponsoring State, thereby putting them at an unfair advantage. We partially support the AG position:

   i. Any ISA contractor granted the privilege to explore and develop a Common Heritage of Humankind resource should pay their fair share of royalties to the ISA and and taxes to their Sponsoring State(s).

   ii. ETR is a reasonable metric for the ISA to adopt to ensure that its payment rates—when considered together with payments to Sponsoring States related to contractor activities in the Area—are “fair both to the contractor and Authority” (Article 8(1)(b), annex, 1994 Agreement) and are “within the range of those prevailing in respect of land-based mining of the same or similar minerals” (Article 8(1)(c), annex, 1994 Agreement). Indeed, average ETR is a metric routinely used by organizations like IMF when comparing fiscal regimes across land-based mining countries (see IMF formula for average ETR below from IMF’s Technical Note and Manual, 2016).

      Average Effective Tax Rate (AETR)
      The AETR is the ratio of the NPV of government revenue (composed of royalty, income tax, resource rent tax, withholding taxes, and so on, as specified by the fiscal regime) to the NPV of the pre-tax net cash flows of a successful project, both calculated in discounted value. The AETR thus indicates how much revenue a fiscal regime raises and is one of the definitions of “government take.”

$$AETR = \frac{NPV(Gov\ Revenue)}{NPV(Revenue - Exploration - Dev\&ReplacementCapex - Opex - Decomm)}$$

   iii. It is not reasonable to assume that most ISA contractors will not pay CIT to their Sponsoring States. The two contractors whose Sponsorship Agreements are cited by the AG (Nauru Ocean Resources, Inc (NORI) and Tonga Offshore Mining Limited (TOML)) expect to pay taxes in other jurisdictions and the zero CIT in the Sponsoring State Agreements was an accommodation by the small developing island states in the absence of double-taxation treaties. NORI and TOML have both committed to paying CIT to their respective Sponsoring States, the Republic of Nauru and the Kingdom of Tonga and are negotiating with these Sponsoring States to amend their Sponsorship Agreements to reflect this commitment.

   iv. The IMF formula is commonly used to compare the total government take over the lifetime of a typical mining project for the purpose of setting or updating national fiscal policies—we propose to use IMF’s methodology for the purpose of setting ISA payment regime and rates. Once ISA contractors commence commercial production, a robust, transparent and consistent system for annual reporting based on globally agreed accounting principles is required. We propose to use of Pillar Two model Rules by ISA Contractors to calculate the taxable profit during operations.

> **Pillar Two Model Rules**: On 8 October 2021, 136 countries agreed to a plan of the OECD to implement a global minimum tax rate, starting in 2023. A two-pillar solution has been implemented by the OECD to address the relationship between parent companies and their subsidiaries. Consenting governments are currently discussing implementation plans and truning the agreement into law.
>
> https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf

7. **Inferring ISA royalty payments from the ETR range**: In principle, accepting average ETR range for the same or similar minerals as a metric for assessing fairness and competitive (dis)advantage at the pre-commercial phase of the industry allows us to infer the value of payments due to the ISA based on the current MIT project lifetime model as follows:

    i. Establish an ETR range prevailing in respect of land-based mining of the same or similar minerals. *[For illustration purposes, we assume it is 30.9-70.7% or a median of 39.2%. We have taken this range from Figure 1A below that shows average ETRs on an undiscounted basis as per March 2022 analysis by IMF. Figure 1B shows that based on 2022 production, this data set covers most of the world's land-based mine production of nickel, copper and cobalt but only quarter of manganese—an issue that can be remedied by adding South Africa and Gabon AETR estimates into this data set.]*

    ii. Assume the same ETR range for ISA contractors. [*For illustration purposes,* we assume *30.9-70.7% or a median of 39.2% as above*.]

    iii. For the purpose of inferring the payment due to the ISA, assume that ISA contractors will pay similar rates of CIT and other payments to their Sponsoring State. [*For illustration purposes,* we assume *25%*.]

    iv. "Payment due to the ISA" equals "ETR median" less "CIT and other payments to the Sponsoring State." [*For illustration purposes, we use the median of the range or 39.2%. Then the value of payment due to the ISA = 39.2% median of the ETR range minus 25% Sponsoring State payments, or 14.2% on lifetime profits of a DSM project.]*

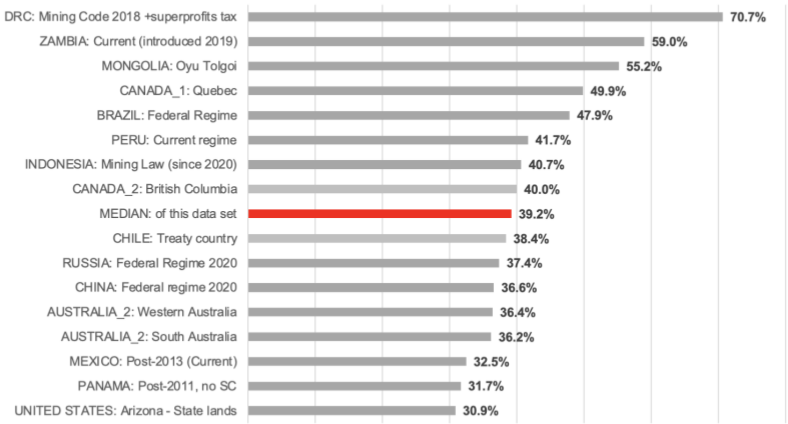
    v. This total inferred royalty payment due to the ISA over lifetime of a DSM project can then be translated into stages and rates depending on the type of payment system chosen (see paragraphs 16-18 below).

FIGURE 1A

EFFECTIVE TAX RATES IN LAND-BASED MINING JURISDICTIONS OF SAME OR SIMILAR MINERALS

Based on analysis by the IMF and the information available in December 2021.
AETRs shown are undiscounted.

Average Effective Tax Rate in Selected Mining Jurisdictions



- IMF analysis is based on Fiscal Analysis of Resource Industries (FARI) Methodology. A technical note and manual can be found here (see page 37 for AETR formula): https://www.imf.org/external/pubs/ft/tnm/2016/tnm1601.pdf
- Proper evaluation of fiscal regimes for extractive industries requires economic and financial analysis at the project level, and FARI is an analytical tool that allows such fiscal regime design and evaluation. The FARI framework has been primarily used in IMF's Fiscal Affairs Department's advisory work on fiscal regime design: it supports calibration of fiscal parameters, sensitivity analysis, and international comparisons.

Source: Analysis by the Fiscal Affairs Department of the International Monetary Fund presented in Figure 8 on page 26 of March 2022 IMF Country Report No 82/22, "Peru: Technical Assistance Report—Proposals for the 2022 Tax Reform—Mining Sector Fiscal Regime, Capital Gains, and IGV on Digital Services. https://www.imf.org/-/media/Files/Publications/CR/2022/English/1PEREA2022002.ashx

FIGURE 1B

LAND-BASED MINE PRODUCTION OF SAME OR SIMILAR MINERALS (tonnes/%)

Covered by the IMF dataset for AETRs		71%
NICKEL	**2022e**	**%**
Indonesia	1,600,000	49%
Philippines	330,000	10%
Russia	220,000	7%
New Caledonia	190,000	6%
Australia	160,000	5%
Canada	130,000	4%
China	110,000	3%
Brazil	83,000	3%
United Sates	18,000	1%
Other countries	440,000	13%
TOTAL	3,281,000	100%

		80%
COPPER	**2022e**	**%**
Chile	5,200,000	24%
Peru	2,200,000	10%
DRC	2,200,000	10%
China	1,900,000	9%
United States	1,300,000	6%
Russia	1,000,000	5%
Indonesia	920,000	4%
Australia	830,000	4%
Zambia	770,000	4%
Mexico	740,000	3%
Kazakhstan	580,000	3%
Canada	530,000	2%
Poland	390,000	2%
Other countries	3,400,000	15%
TOTAL	21,960,000	100%

		87%
COBALT	**2022e**	**%**
DRC	130,000	70%
Indonesia	10,000	5%
Russia	8,900	5%
Australia	5,900	3%
Canada	3,900	2%
Cuba	3,800	2%
Philippines	3,800	2%
Madagascar	3,000	2%
Papua New Guinea	3,000	2%
Turkey	2,700	1%
Morocco	2,300	1%
China	2,200	1%
United States	800	0%
Other countries	5,200	3%
TOTAL	185,500	100%

		24%
MANGANESE	**2022e**	**%**
South Africa	7,200,000	36%
Gabon	4,600,000	23%
Australia	3,300,000	16%
China	990,000	5%
Ghana	940,000	5%
India	480,000	2%
Ukraine	400,000	2%
Brazil	400,000	2%
Cote d'Ivoire	360,000	2%
Malaysia	360,000	2%
Mexico	230,000	1%
Georgia	220,000	1%
Burma	200,000	1%
Vietnam	150,000	1%
Khazakstan	110,000	1%
Other countries	150,000	1%
TOTAL	20,090,000	100%

- The AETR data set published by the IMF in March 2022 under-represents production of manganese.
- This could be remedied by performing the AETR analysis for just two additional countries – South Africa and Gabon – which would bring the total manganese coverage from the current 24% to 83%.

Source: USGS, 2023 Commodity Summaries, https://pubs.usgs.gov/periodicals/mcs2023/mcs2023.pdf

8. **Introducing additional ETR "normalization" mechanism**: In its August 2022 submission, the AG proposes a normalization mechanism to guard against potential avoidance and minimization of taxes on activities in the Area by the ISA contractors and ensure ISA Contractors pay their fair share to the ISA and Sponsoring States. This mechanism envisions that an additional and separate ISA royalty set at a rate of 6% of ad valorem gross metal value (chosen because it is equivalent to 25% CIT in the MIT model) is put in place from the 5th year of Commercial Production against which the ISA Contractor can credit actual and verified cash payments of CIT to the Sponsoring State. We support AG's intent to create a mechanism for an additional financial levy by the ISA in cases where the ISA contractors' ETR on activities in the Area fall outside the ETR range prevailing in respect of land-based mining of the same or similar minerals. However, we do not support the specifics of the mechanism proposed by the AG because we believe it is based on an inaccurate assumption (i.e., "the miner does not pay sponsoring state corporate income tax on their profits from mining in the Area") and proposes a rigid mechanism that can

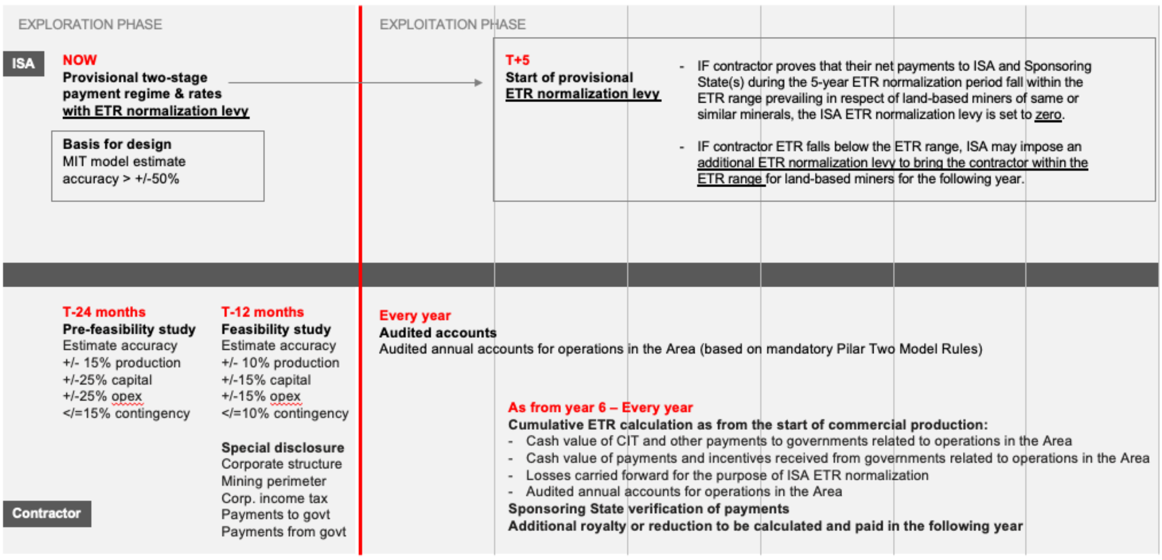
result in unintended consequences and failure to meet the objectives set out in UNCLOS and 1994 Implementation Agreement:

- If the ISA Contractor's cash payments to their Sponsoring State(s) exceed the value of the 6% additional ISA royalty, there is no mechanism for the ISA Contractor to claw back any amounts paid above the 6% additional royalty. As a result, the ISA Contractor can end up paying an ETR that exceeds the ETR range prevailing in respect of land-based miners of the same or similar minerals.
- If the ISA Contractor's actual ETR falls within the ETR range prevailing in respect of land-based miners of the same or similar minerals (e.g., *30.9-70.7%)* but the absolute value of their payments to their Sponsoring States is lower than the absolute value of the 6% additional ISA royalty, there is no recourse for the ISA Contractors to claim the difference back from the ISA, again resulting in ISA Contractor's ETR exceeding the range prevailing in respect of land-based miners.
- If the ISA Contractor is much more profitable than currently expected, it's possible that limiting their additional ISA royalty to 6% would result in an ETR that falls below the ETR range prevailing in respect of land-based miners.

The above described cases are plausible because the level of estimate accuracy in the MIT model is low (as discussed in paragraph 11 below) and real world project economics could diverge from current assumptions used to set a 6% additional ISA royalty. Even if the MIT model outcomes comported with real-world DSM project economics, the proposed mechanism would effectively dictate a 25% Sponsoring State CIT, impinging on Sponsoring State sovereignty to set their tax policy.

We propose a modified mechanism (see Figure 2 below):

FIGURE 2
EFFECTIVE TAX RATE (ETR) "NORMALIZATION" MECHANISM THROUGH ADDITIONAL ISA LEVY



i. ISA will be entitled potentially to an additional payment from the ISA Contractor ("ETR normalization levy") if the contractor's ETR on operations in the Area falls below the ETR range prevailing in respect of land-based mining of the same or similar minerals.

ii. Twelve months before the start of Commercial Production, the ISA Contractor will submit to the ISA a detailed disclosure of the corporate structure used to conduct activities in the Area (including the entity that will hold the ISA Exploitation Contract, its subsidiaries, sister companies and third-party companies involved in the Contractor activities in the Area).

iii. Following the start of Commercial Production and on an annual basis, the ISA Contractor will submit to the ISA its audited accounts (based on Pillar Two Model Rules) for the operations in the Area.

iv. Every year, the contractor will disclose to the ISA all payments made to the Sponsoring State(s) (e.g., production-linked fees, administration fees, taxes, levies or royalties) and payments received from the Sponsoring State(s) (e.g., R&D credits, government finance or guarantees, etc) related to the contractor's exploitation activities in the Area. To increase the confidence level in contractor disclosure, the ISA could require the Sponsoring State(s) to verify ISA Contractor disclosure on net payments to the Sponsoring State(s).

v. As proposed by the AG, an additional ETR normalization levy will come into force five years after the first day of Commercial Production - the provisional timing of when ISA Contractors are expected to depreciate part of their initial capital investment, scale up technology,establish an ecosystem of suppliers and become profitable.

vi. From Year 6, annual ETR normalization reviews for each ISA Contractor will calculate the cumulative project ETR from the start of commercial production to the previous year. This ETR will be compared to the ETR range determined by the Economic Planning Commission (see paragraph 10 below).

vii. If the ISA Contractor proves to the ISA that their cumulative ETR since the start of commercial production years falls within the ETR range prevailing in respect of land-based miners of same or similar minerals, the ISA ETR normalization levy is set to zero. [*For illustration purposes, if the target ETR range was determined to be 30.9-70.7% / 39.2% median and Contractor proves that they paid the equivalent of 20% to the ISA + 25% to the Sponsoring State = 45% ETR, then the levy due to the ISA is set to zero.]*

viii. If the ISA Contractor cumulative ETR since the start of commercial production falls below the ETR range prevailing in respect of land-based miners of same or similar minerals, ISA may impose an additional ETR normalization levy to bring the contractor within the ETR range for land-based miners. [*For illustration purposes, if the target ETR range was determined to be 30.9-70.7% and Contractor proves that they paid the equivalent of 20% to the ISA + 5% to the Sponsoring State = 25% ETR, then the ISA may decide to impose an additional levy of 14.2% to bring the Contractor in line with the 39.2% median of the 30.9-70.7% ETR range.]*

9. **Assessing cummulative ETR for ISA Contractors annually from year 6**: Any assessment of cummulative ETR as from year 6 should be based on a pre-agreed list of "net payments to governments" ("The numerator") and the group entity's profit following audited accounts following Pillar Two Model Rules ("The denominator").

The unique aspect of applying this methodology to ISA Contractors is the fact that—unlike land-based miners of the same or similar minerals—ISA Contractors will make payments to both ISA and their Sponsoring State(s) related to Contractor's operations in the Area. For the avoidance of doubt, we propose that "net payments to government" ("GovRev" in the IMF formula for AETR) for the purpose of ETR assessments of ISA Contractors include

i. ISA Contractor payments to the ISA, including:
- Royalty
- Environmental levy (including, contribution to the ISA environmental compensation fund)
- Administrative and other payments.

ii. ISA Contractor payments to the Sponsoring State(s), including:
- Production-linked payments and royalties

- CIT
- Other payments (e.g., other taxes, dividends, bonuses, infrastructure payments, and entitlements).

iii. Net of incentives from the Sponsoring State(s) to the ISA contractor, including:
- Deductions from the CIT for expenditures deemed eligible by Sponsoring State(s) (e.g., R&D, production asset capital, capacity building, technology transfer, etc.)
- Government loans and guarantees
- Other forms of fiscal and non-fiscal incentives.

In relation to 9. iii. above, for the avoidance of doubt, the value of CIT deductions should be credited to the overall ETR calculation. This is in order that Sponsoring State(s) may, through their national tax codes, implement domestic policies through fiscal mechanisms including tax relief for capital investment and R&D.

10. **ETR range for ISA Contractors**: For the purpose of modelling the impacts of proposed ISA payment regimes and finalizing Draft Regulations and Standards & Guidelines, we support using the 39.2% median ETR (see Figure 1A above) or commissioning a similar analysis that includes average ETRs for South Africa and Gabon to better reflect the mix of land-based jurisdictions of same or similar minerals. We also propose that once the Draft Regulations have been adopted, the ISA's Economic Planning Commission should be mandated to conduct or commission regular independent third-party reviews of the ETR range prevailing in respect of land-based mining of the same or similar minerals (see paragraphs 11 and 12 below).

11. **Fairness and (dis)advantage in the face of high level of uncertainty**: It's important that all stakeholders acknowledge the challenge of designing a fair ISA payment regime and setting rates of payments in the absence of real-world data from commercial operations in the Area. While MIT drew on inputs from several contractors in designing their model, these inputs included just one published standards-compliant (Canadian 43-101 and US SEC SK1300) preliminary economic assessment of a DSM project signed off by Qualified Persons. The accuracy level for such an assessment is +/- 50%, suggesting most of the inputs in the MIT model would have even lower accuracy levels. And yet—despite high level of uncertainty about DSM project economics—a payment regime needs to be put in place before any commercial exploitation contracts can be granted. We believe a pragmatic way to deal with this high level of uncertainty would be as follows:

    i. **Put in place provisional payment regime and rates for the first five years**. We strongly believe that a two-stage approach is needed with reduced rates of payment imposed on contractors during the first five years of commercial operations to "attract investments and technology to the exploration and exploitation of the Area" (Article 13(1)(b), Annex III of UNCLOS). At this pre-commercial stage of development, without decades of actual economic performance to draw from, the industry faces greater uncertainties compared to the mature industry of land-based mining: development, build and operational cost uncertainty is much higher with nodule collection technology and processing technology still in the pilot phase and no commercial off-the-shelf solutions available to contractors offshore or onshore, while land-based miners enjoy access to established mining and processing technology and a well-developed ecosystem of suppliers; sovereign risk may be lower compared to certain land-based jurisdictions (as AG points out in their June 2022 submission citing one of the contractor's public presentations) but regulatory uncertainty remains elevated in the Area until exploitation regulations have matured. We believe that it will take at least five years for contractors to scale and optimize technology, recover part of their investments in technology development and extensive environmental research, establish an ecosystem of suppliers and a market for a new type of feedstock (i.e., polymetallic nodules) and new intermediate products (e.g., Manganese silicate)—and ultimately get to a level-playing field with the mature industry of land-based miners of same or similar minerals. A provisional regime with lower ISA payments for the first five years (e.g., 15% ETR) and normalized payments thereafter (e.g., *30.9-70.7%* ETR range) are therefore justified in our view and arguably required by the Convention and the 1994 Agreement. We expect that during the first five years, most contractors will be starting at small volumes and ramping up gradually. As a result, only 10-15% or less of production over the contract term would be subject to lower ISA rates. We propose that the ISA reviews both the payment regime and rates at the end of the first five years based on much better-quality real-world data for the contractor operations in the area and an updated analysis of the ETR range prevailing for land-based miners of the same or similar minerals.

ii. **Impose continuous disclosure obligations.** The quality of project economics data available to the ISA will improve dramatically already 12-24 months before the start of Commercial Production with contractors submitting a pre-feasibility study as part of their exploitation Plan of Work (e.g., estimate accuracy required in SEC SK1300 mining standard – production: +/- 15%, capital and operating costs +/-25% with </=15% contingency) and a feasibility study 12 months before the start of Commercial Production (e.g., estimate accuracy required in SEC SK1300 mining standard – production: +/- 10%, capital and operating costs +/-15% with </=10% contingency). Once in production, the Authority should require annual submission of audited accounts for the Contractor's operations in the Area (based on mandatory Pillar Two Reporting). Standards-compliant prefeasibility and feasibility studies and at least four years of audited accounts will give the Authority a greater insight into real-world project economics in the Area.

iii. **Regime and rate review at the end of the first five years**. Equipped with the above-mentioned real-world data for ISA Contractors and a new independent and current analysis of prevailing ETR rates for land-based miners of same or similar minerals, the Authority's Economic Planning Commission (EPC) should have the mandate to review both the practicality of the agreed regime and the fairness of the rates agreed for beyond the first five years in the light of the updated understanding of ISA Contractor economics and ETR rates for land-based miners of same or similar minerals. Based on this review, the EPCshould be empowered to propose to the Council changes both in the regime and the rates to ensure that the ISA payment regime delivers on the objectives outlined in UNCLOS and 1994 Implementation Agreement.

12. **Fiscal stabilization:** In its last undated submission, AG points out that "Draft Regulations 81 and 82 effectively provide contractors with fiscal stability for the 30-year term of an exploitation contract" and cites a recent IGF report that states that "periodic review of financial terms of extractive industry contracts is increasingly seen as best practice. Stabilisation of the financial terms for the tenure or a contract (up to thirty years in this case) is not.' We support this position and believe that 5-year rate reviews by EPC following the initial five years would ensure the principle of fairness to both ISA and contractors and enable the ISA to ensure that its rates of payments continue to be within the range of those prevailing in respect of land-based mining of the same or similar minerals—thereby delivering on the provisions of Article 8(1)(b) ("fair both to the contractor and Authority") and 8(1)(c) ("avoid giving deep seabed miners an artificial competitive advantage or imposing on them a competitive disadvantage").

13. **Financial imposition on profits or capital gains from direct and indirect transfers of exploitation rights:** In all three of its latest submissions, the AG advocates for a position to include a tax on capital gains accruing to the ISA Contractor from the direct and indirect transfers of exploitation rights. In principle, we support AG's position—in line with emerging best practice—that the Authority should share in the financial upside accruing to the ISA Contractor from the direct or indirect sale of exploitation rights. However, the mechanism proposed by the AG—"withholding tax of 25% on any gain made from the transfer of a 20% or greater interest in any

entity which derives 50% or more of its value from the exploitation license"—raises several issues:

i. First, we support the principle that the Authority should benefit from growth in value of exploitation rights in the Area— growth that will likely be enhanced by the commercial viability and environmental robustness of the regulatory regime to be adopted by the ISA. This, in our view, represents the "immovable property" which falls within the Area and is therefore taxable by the ISA. However, any auxiliary value created by ISA Contractors that is sold as part of the transfer should not be taxable by the Authority.

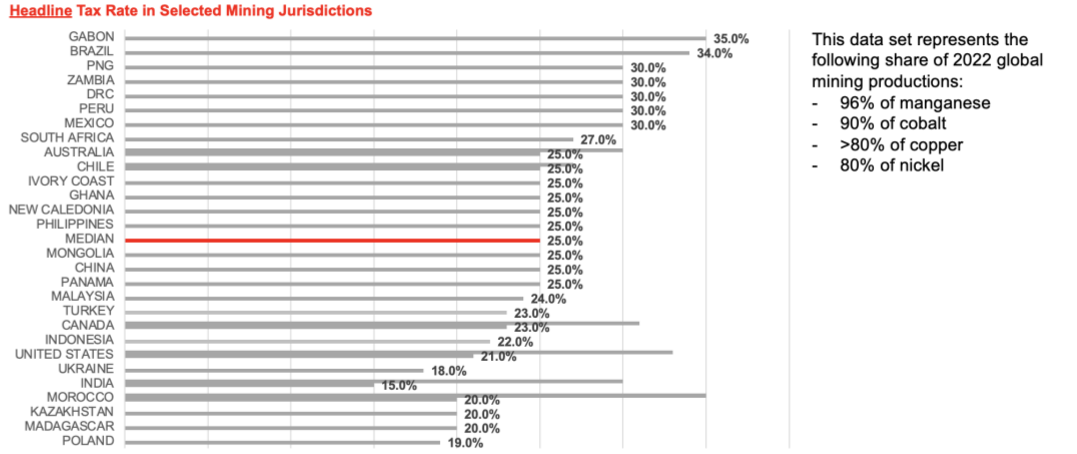
ii. Second, as junior miners often use a sale of a stake in the project to raise funding to finance their project development or expansion, we must avoid creating a system which taxes these transactions, which are not intended to generate profit for the contractor but rather finance its operations.

iii. Third, we need to make sure that internal group restructuring and reorganisations are not captured by these provisions.

iv. Fourth, the proposed rate needs further validation through an independent study of CIT and capital gains tax (CGT) rates prevailing in respect of land-based mining of the same or similar minerals. While in some jurisdictions, corporate capital gains are subject to CIT rates, in others the rates are lower (see PWC capital gains tax rates summaries). Our preliminary analysis of land-based mining jurisdictions accounting for 96% of manganese, 90% of cobalt, >80% of copper and 80% of nickel production globally (USGS 2023 commodity summaries) shows that the median headline CIT is 25% and CGT is 20.5% (see Figure 3 and 4 below). We also note that headline rates can diverge significantly from effective tax rates paid by land-based miners (20-80%) due to both, financial incentives granted by local governments and land-based miners structuring their operation to minimize their local tax burden.

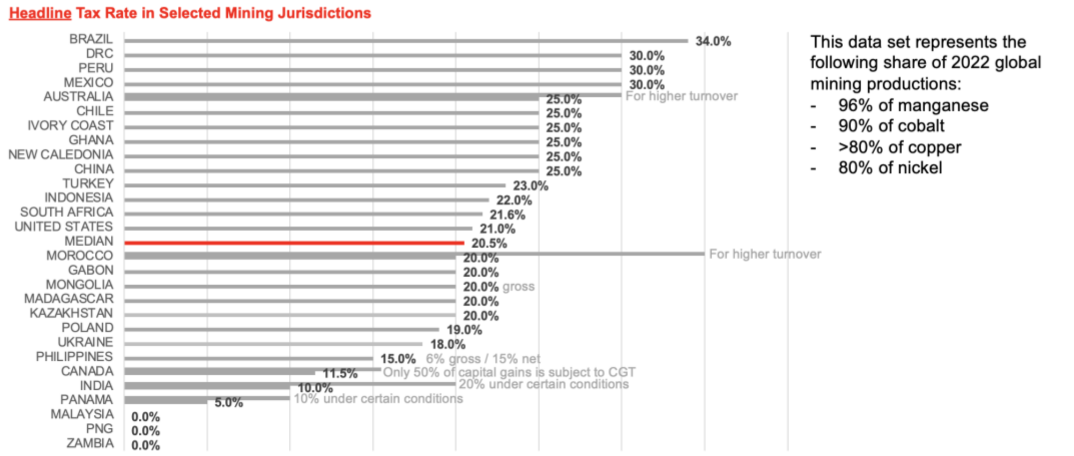
v. Fifth, we believe the withholding tax format would put the ISA Contractor at high risk of being double-taxed for the same capital gains—once by the Authority and again by the Sponsoring State (in case of direct transfers) or another jurisdiction (in case of indirect transfers). We view the ISA putting in place double-taxation treaties with Sponsoring States and other potentially relevant jurisdictions as unlikely, leaving the ISA Contractor no recourse against double taxation.

FIGURE 3
CORPORATE INCOME TAX (CIT)



Source: PWC global tax summaries, visited on April 30, 2023

FIGURE 4
CAPITAL GAINS TAX (CGT)



Source: PWC global tax summaries, visited on April 30, 2023

To rectify for these issues, we propose an alternative mechanism:

i. **Capital gains distribution as threshold:** The levy should only be imposed on the gain related to exploitation rights when those gains are distributed from the company. Alternatively, when the income resulting from the sale is used to finance the project development or expansion, no taxes are due.

ii. **Focus on the net value of exploitation rights:** The relevant base for the purpose of the levy should be the value of the exploitation rights net of development expenses to the point of sale. Other business elements that contributed to the valuation (i.e., price paid by the Transferee to the Transferor) like IP and knowhow, patent estate, physical production assets and on-land facilities, good will, etc should be excluded from the value relevant for the purpose of determining the base for the ISA transfer levy.

iii. **Notification and approval of direct and indirect transfer:** The ISA Contractor will be required to notify the Authority of the intent to transfer directly or indirectly a controlling stake in the entity holding the ISA Exploitation Contract within two weeks of the transaction. The payment of the transfer levy to the ISA can be a Condition Precedent (CP) for the Authority granting its approval for such a transfer.

iv. **Indemnity by the Authority:** The Authority will indemnify the Contractor against any double-taxation of the ISA exploitation rights. If the ISA Contractor can prove that they have been taxed twice on the same capital gains related to the direct or indirect transfer of ISA exploitation rights, the ISA will compensate the Contractor for the double-paid amount.

14. **Revisiting AG's nine tests**: In the context of the above positions, we submit the following comments and proposed modifications of the AG's nine tests set out in the AG's June 2022 submission:

Test	**Comment**
Test 1: The Fair Compensation to Mankind	We believe this test is passed by any payment regime and rates that have been defined - Using an ETR range for land-based miners of same or similar minerals as a metric for judging fairness and (dis)advantage - Using ETR "normalization" mechanism described above as a means for the ISA to eradicate tax avoidance and minimization among the ISA Contractors.
Test 2: The Whenever Miners make Profits Mankind must be Compensated	We believe this test is passed if the above discussed provisions on direct and indirect transfers of exploitation right are implemented in the Draft Regulations.
~~Test 3: The Economic Efficiency~~ New Test 3: Attracts investments and technology to the exploitation of the Area	With the introduction of the ETR range as the controlling metric in defining the ISA financial regime, hurdle rates are no longer relevant for the purpose of defining payment rates using the MIT model. We would like to propose to replace this test with a new test based on Article 13(1)(b), Annex III of UNCLOS. We see this stated ISA objective to attract investments to the Area as the main rationale for a lower-rate first stage of the payment regime. As we discuss above, pre-commercial DSM industry is subject to high levels of uncertainty compared to a mature land-based mining industry and will require lower rates of payments to attract investment during the startup phase of Commercial Production. In their August 2022 submission, the AG interprets Article 13(1)(b) referenced above as providing for "…incentives (**<u>not financial incentives</u>**) for objective 13.d which refers to the Enterprise, technological transfer and training only. Article 13 does not provide for incentives to be provided for the other objectives specified in it, such as attracting investment in the Area. Moreover, the subsidisation of contractors through the provision of subsidies does not concord with international best practice in the regulation of extractive industries and would not be beneficial to humankind. The Authority should be encouraging efficient, low cost, profitable contractors that can and should pay taxes: not inefficient high-cost contractors that can only mine if they receive financial incentives." We disagree with this interpretation: the title of the Article 13 is "**<u>Financial</u> Terms of Contracts.**" The fact that 13(1)(d) references the Enterprise, does not imply that all other sub-paragraphs in the Article 13(1) are only applicable to the Enterprise—indeed, only two subparagraphs (d and e) out of six explicitly reference the Enterprise. Furthermore, paragraph 14 allows the Authority to adopt rules, regulations and procedures relating to incentives (which could include financial incentives – direct reference in 13(1)(f)) to further the objectives set out in paragraph 1 of Article 13. Importantly, paragraph 14 requires that the recommendations of the Economic Planning Commission and the Legal and Technical Commission (LTC) be taken into account in the adoption of any rules relating to incentives. We believe the LTC acted in line with these provisions when proposing a two-stage royalty in the original draft regulations. Incentives contemplated by Article 13 are not subsidies per se. In a land-based context, national fiscal regimes do provide fiscal incentives, for example to attract

Test	Comment
	investment, through tax incentives in the form of tax stability agreements or accelerated tax deprecation. Incentives could also be in the form of tax or other credits for R&D investment. This could be of interest in connection with investment in environmental protection technology beyond the regulatory requirements and promoting innovative practices (as contemplated in regulation 3(f)(vi)). Article 13(1)(b) explicitly states an objective, this objective is aligned with common practice in many land-based regimes—we believe it merits being included into AG's nine tests.
Test 4: The Rates of Payment	We believe this test is passed by any payment regime and rates that have been defined - Using ETR range for land-based miners of same or similar minerals as a metric for judging fairness and (dis)advantage - Using ETR “normalization” mechanism described above as a means for the ISA to eradicate tax avoidance and minimization among the ISA Contractors.
Test 5: The Progressivity	We agree with the AG position that a payment regime with a rate that increases or decreases with metal prices meets this test only partially (ISA does not get higher share of profits if they increase due to lowering of the costs). However, as AG acknowledges, this needs to be traded off against the complexity of administering a profit-share based payment regime. It will likely be easier for the ISA to start with a progressive ad valorem royalty and review if a regime shift to a profit-based system would be manageable to implement after the first five years of Commercial Production.
~~Test 6: The Full Compensation to Land Based Mining Countries~~	As the AG points out, “the 1994 Implementing Agreement provides for an economic assistance fund… to be financed from a portion of the revenues the ISA collects from miners, and its purpose is to compensate developing land-based mining states whose economies have been negatively affected by DSM.” We believe that this issue should be dealt with as part of the discussion on the allocation of the ISA royalties derived from ISA Contractors and is not relevant for the purpose of designing an ISA payment regime and rates.
Test 7: The Simple to Audit and Administer	We agree with AG that OEWG options 3 and 4 are easy to administer. We also acknowledge that the ETR normalization mechanism, managing contractor disclosure and regular rate reviews, fiscal impositions related to direct and indirect transfers of exploitation rights would introduce a degree of complexity into the Authority’s operations. However, we believe that the trade-off between increased complexity and achieving other UNCLOS/1994 Agreement objectives are worth it. We also believe that by leveraging existing globally agreed rules such as Pillar Two, the administrative pressure on the ISA would be greatly reduced.
Test 8: The Knowledge and Transparency	We believe that extensive disclosure requirements we propose to impose on ISA Contractors above – if adopted—would meet this test.
Test 9: The Sensitivity Test.	We believe that we have proposed a practical way to meet the sensitivity test by imposing high disclosure requirements on the ISA Contractors, mandating ISA to do a payment regime and rate review at five-year mark and regular 5-year rate-reviews thereafter.

DEFINING PROVISIONAL FINANCIAL PAYMENT REGIME AND RATES

15. **Revisiting AG starting position**: In its June 2022 submission, the AG shows that all four options currently being discussed by the OEWG fail to pass the AG’s proposed nine tests. We believe that the accommodations outlined in the previous section (e.g., using ETR range as a metric for comparing ISA Contractors with land-based miners of same and similar minerals, introducing ETR “normalization” mechanism in the form of a provisional additional levy, etc) allow us to return to some of the OEWG payment options and modify them in a way that can meet most of AG’s tests.

16. **Revisiting OEWG payment regime options**: We support Option 4 as the basis for defining a provisional payment regime and rates:

i. ~~Option 1: a one stage fixed ad valorem only royalty~~ – is not flexible and variable enough to accommodate changing market conditions;
ii. ~~Option 2: a two-stage time-varying ad valorem only royalty~~ – does not contain required progressivity / variability;
iii. ~~Option 3: a two-stage blended ad valorem and profit share system~~ – could be considered but it could be more difficult to administer, albeit we do recognize that the normalization mechanisms described above do introduce a certain level of complexity and administrative burden for the regulator.
iv. Option 4: a two-stage progressive / variable price-varying ad valorem only royalty – contains sufficient number of elements to serve as a reasonable base case to build on.

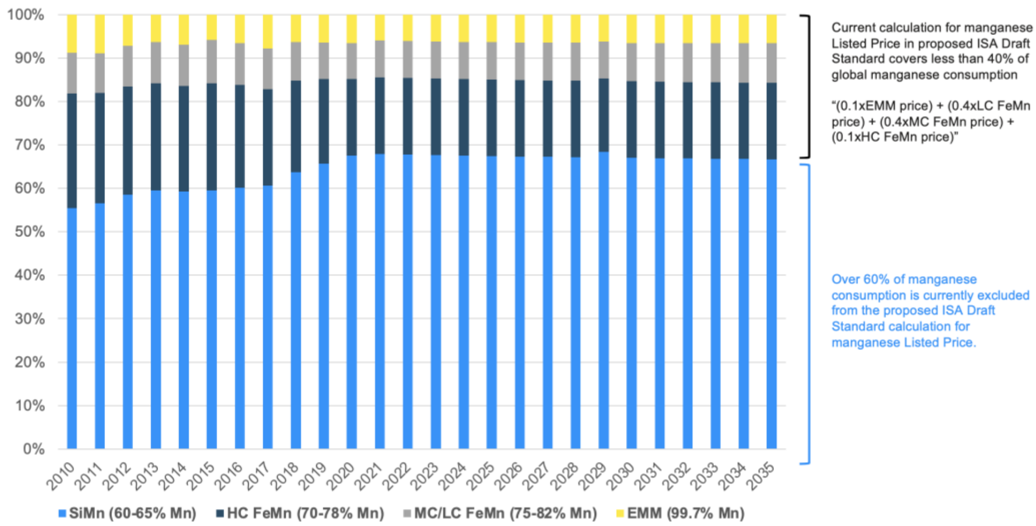
17. **Manganese price**: In their latest submission, AG recommends that the base for the Manganese royalty is calculated using electrolytic manganese metal (EMM) prices because it's "simple to understand," "it is unlikely that nodules will be processed to the same grade" and "contractors are not legally responsible, and may not even know, the grade to which the manganese in the nodules is processed." We do not disagree with any of these arguments. However, we cannot support the AG's conclusion that Manganese royalty should be calculated using EMM prices for one simple fact: EMM is a niche product that accounts for just 6% of the total Manganese market (see Figure 4 below). Manganese is fundamentally different from Copper, Nickel and Cobalt markets where high-purity metal product formats account for most of the market. By contrast, manganese is largely used in the steel industry as an alloying agent and 94% of all Manganese units are never refined to high-purity EMM. Asking ISA Contractors to pay Mn royalty using EMM prices is akin to asking a diamond miner to pay a royalty on the price of the biggest, best clarity and best colour diamonds that account for a fraction of overall production. We propose two alternative ways forward:

    i. **Mn ore price** - calculate Mn royalty using medium-grade Mn ore prices. Mn ore is closely comparable to nodules and its market price is easily discoverable on several publicly traded commodity exchanges.

    ii. **Nodule ore price** – alternatively, we can set aside ad valorem royalty on gross metal value and use a nodule ore price instead. This approach aligns with the above-referenced AG observations that "contractors are not legally responsible, and may not even know, the grade to which the manganese in the nodules is processed." Indeed, once nodule processing ecosystem is developed, ISA Contractors may simply choose to sell nodules to third-party processors. Nodules sales contracts will be submitted to the ISA for review and potential audits to verify transactions took place at an arm's length and contract sales price represents fair value. For the purpose of deriving provisional rates for the ISA regulations, MIT nodules transfer price can be used as a proxy for nodule ore value. With lower base for royalty, payment rates would need to increase accordingly.

FIGURE 5

GLOBAL CONSUMPTION OF MANGANESE UNITS BY PRODUCT



Source: Wood Mackenzie commodity summaries

18. **Arriving at provisional payment rates for option 4**: We suggest that the OEWG Chair requests the MIT team to model two scenarios for the purpose of inferring the value of the ISA payment and rates that would deliver these outcomes:

iii. **Scenario 1: Two-stage royalty on gross Ni, Cu, Co metal and Mn ore value**

- Sponsoring State CIT 25%
- ETR 15% for stage 1 (first 5 years)
- ETR range 30.9-70.7% or median of 39.2% for stage 2 (remaining 25 years)
- Price of medium-grade Manganese ore as the basis for Mn royalty
- Keep the same price-dependent rate variability for stage 2 as per current Option 4.

iv. **Scenario 2: Two-stage royalty on nodule ore price**

- Sponsoring State CIT 25%
- ETR 15% for stage 1 (first 5 years)
- ETR range 30.9-70.7% or median of 39.2% for stage 2 (remaining 25 years)
- Nodule transfer price in the MIT model as a proxy for nodule ore price
- Keep the same price-dependent rate variability for stage 2 as per current Option 4.