Non-paper on Parent Company Liability Statements

1. This non-paper expands on seven textual proposals made by the Kingdom of the Netherlands before the 1 May 2024 deadline for submission. These proposals should all be read together. The Kingdom of the Netherlands is making those proposals in an effort to introduce the concept of "Parent Company Liability Statements" into the draft exploitation regulations.

2. This non-paper is structured as follows:

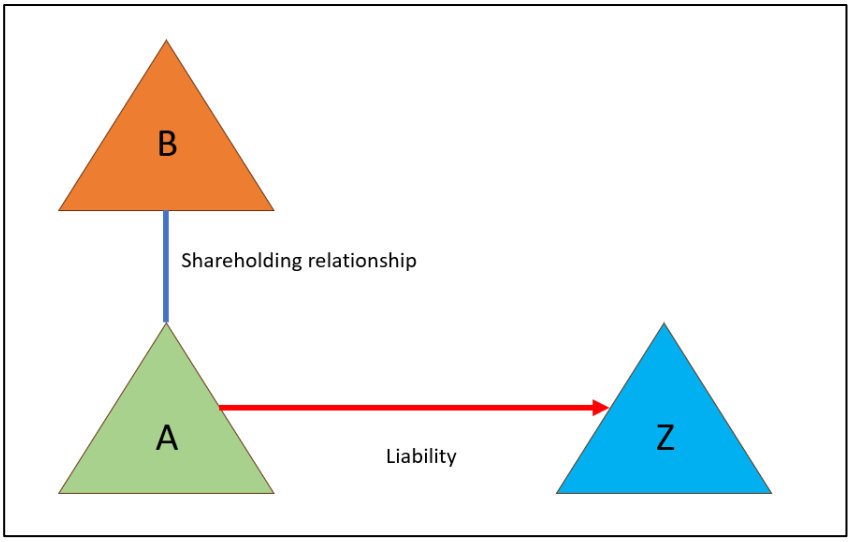
A. a chapter describing what Parent Company Liability Statements are;
B. a chapter setting forth the reasons why Parent Company Liability Statements should be requested before exploitation activities may be conducted; and
C. a chapter briefly describing how Parent Company Liability Statements should be included in the Draft Regulations currently being negotiated in the Council.

3. Ultimately, this non-paper concludes that adopting Parent Company Liability Statements would provide sufficient legal basis in the regulations and Exploitation Contract to ensure that parent companies of Contractors are jointly and severally liable towards the Authority for damage caused by a Contractor and for which the Contractor is liable.

A. What Parent Company Liability Statements are

4. Many internationally active businesses have adopted a group structure where their activities are conducted by various corporations (i.e., legal entities) which – through shareholdings or board positions – either own or are owned or controlled by other group companies. One of the reasons for businesses doing so, is to limit the overall liability of the companies performing the business. After all, many domestic legal systems recognize the concept that if a corporation is liable for certain conduct, this does not automatically lead to the liability of other companies in the group.

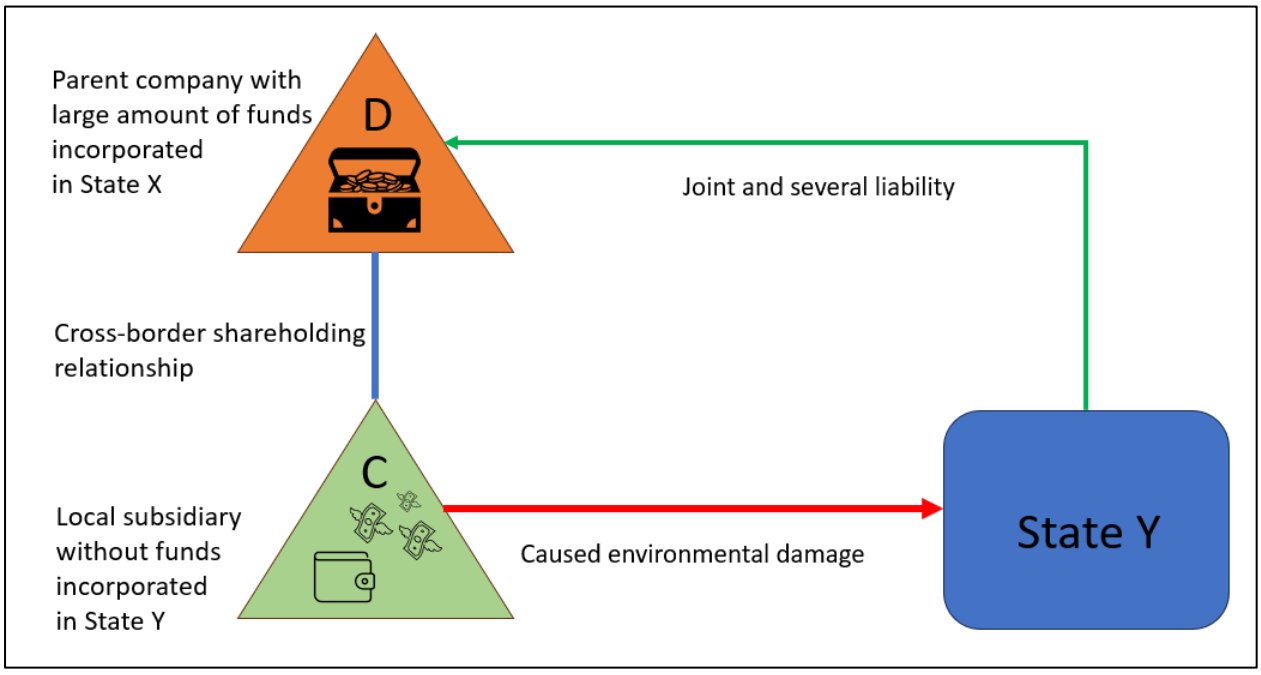
5. However, the practical consequence of such domestic laws, is that parties who suffer damage may be faced with a 'liability gap'. This is best explained through the following example (see also the simplified chart below): Party A may be liable towards Party Z but not have the means to satisfy such liability, while its affiliated company Party B has the means to compensate Party Z's damage but cannot legally be forced to make payments to Party Z. In that event, Party Z will ultimately bear its own damage, despite Party A having caused it. This can be perceived to be problematic.



6. One way through which the above-referenced liability gap can be solved, is through the concept of 'joint and several liability'. This means that two or more parties will share the legal responsibility for certain conduct and actions. In the above-referenced example: if Party B is jointly and severally liable for Party A, it will be possible for Party Z to hold Party B liable for damage caused by Party A.

7. Certain domestic laws may provide for instances in which parties are jointly and severally liable for another party's conduct under specific circumstances. However, the easiest and most common way for parties to be held jointly and severally liable, is on the basis of a contract through which they have agreed to such liability.

8. The above-referenced liability gap is not just a theoretical problem; it is readily imaginable that it may occur in the conduct of business in the extractive industries. The following example illustrates this (see also the chart below): a small and locally incorporated subsidiary (Party C) of a large international company run by a parent company in State X (Party D) may conduct oil or gas extraction activities that cause significant environmental damage in State Y. The compensation of such damage requires an amount of funds that may exceed the funds that Party C has at its disposal. In that event, State Y will want Party D to also assume liability for such environmental damage, considering that Party D has the funds to pay for remedial action.



9. Of course, States enjoy sovereignty over their natural resources. Therefore, States can demand that certain requirements are met by parties wishing to exploit their natural resources, before those parties are permitted to exploit the concerned State's natural resources.

10. Indeed, it is not uncommon for States to request companies that look to engage in extractive activities on their territory to ensure that the respective (ultimate) parent companies will be jointly and severally liable for any damage caused by those activities. This can be laid down in contracts or unilateral declarations made by the concerned companies. Such 'liability statements' can contain sophisticated legal

provisions setting out detailed arrangements, such as but not limited to: (i) a secondary obligation to maintain enough funds to be able to perform the primary obligation; (ii) provisions regarding non-compliance with the primary obligations; and (iii) dispute settlement provisions.

11. When such 'liability statements' are provided by a company that is higher in the corporate chain/group structure than the subsidiary performing the concerned activities, these could be termed "Parent Company Liability Statements". Of course it is relevant that such parent company is adequately financed to perform the possible legal obligation.

B. Reasons why Parent Company Liability Statements should be requested before exploitation activities may be conducted

12. It is desirable to demand that a parent company of a Contractor agrees to their joint and several liability for the actions of the Contractor in the performance of an Exploitation Contract, because Parent Company Liability Statements resolve a clear risk to the Authority itself that is present under the existing legal regime.

13. In the current practice under Exploration Contracts, it can be observed that Contractors incorporated in a certain State, are actually part of a group of companies that conducts its business internationally. In the hypothetical scenario that this Contractor (i.e. the particular company that will be party to the Exploitation Contract) is liable for causing environmental damage during exploitation activities and does not have the financial means to remedy such damage or is bankrupted in the process of conducting its business, there will be no way for the Authority to collect on that liability. In addition, pursuant to Article 139(2) of UNCLOS, if the State Party which sponsors the concerned Contractor has taken all necessary and appropriate measures to secure effective compliance under Article 153(4) and Annex III Article 4(4) of UNCLOS, it will also not be liable. As such, a liability gap materializes in the context of activities in the Area because neither the Contractor nor the sponsoring State will have to compensate the environmental damage. The costs of the damage will then therefore fall upon the Authority itself, i.e. the States Parties. This could be resolved by being able to hold liable the parent companies of Contractors, which will have more financial means (or even the requisite amount) than their subsidiary Contractors.

14. Indeed, the Authority is competent to demand Parent Company Liability Statements in exchange for a Contractor receiving an Exploitation Contract. This follows from *inter alia* Article 137(2) UNCLOS, which provides that minerals recovered from the Area may only be alienated in accordance with Part XI of UNCLOS and the rules, regulations and procedures of the Authority.

15. It would not be burdensome for parent companies of Contractors to provide Parent Company Liability Statements. *First*, as noted above, this practice is not uncommon in the extractive industries. *Second*, the administrative burden for companies will not significantly increase either, as it is envisaged that the Parent Company Liability Statements will be provided in the form of a compulsory schedule to the Exploitation Contract which is merely filled in with the relevant information of the companies. *Third*, there are practical ways for parent companies to ensure that they have the financial capability to comply with their joint and several liability obligations throughout the term of the Exploitation Contract. For instance, they do not have to maintain a large amount of liquid funds in their bank accounts, but could instead suffice with providing guarantees which are secured through pledges on their assets.

16. If parent companies of Contractors are ultimately unable or unwilling to provide Parent Company Liability Statements, it is highly questionable whether the Authority should want to provide such

businesses with Exploitation Contracts in the first place. After all, in general commercial practice, one would expect companies that desire to enjoy the upside of their business to also be prepared to bear the risks thereof. Moreover, if businesses are free to conduct their activities without any risk, they will have insufficient incentive to adopt appropriate damage mitigation measures.

C. How to include Parent Company Liability Statements in the Draft Regulations currently being negotiated in the Council

17. It is proposed that the Parent Company Liability Statements will form a compulsory schedule to the Exploitation Contract. This is considered logical because the Parent Company Liability Statements make reference to the Exploitation Contract. As such, a new Annex XI is proposed.

18. Further textual changes are proposed to DR 7 (Form of applications and information to accompany a Plan of Work); DR 18bis (Obligations of the Contractors); DR 23 (Transfer of rights and obligations under an Exploitation Contract); DR 24 (Change of Control); Annex IX (Exploitation Contract and schedules); and the Schedule.

19. The textual proposals also introduce the term “Managing Company”, which is to be used for the particular parent company/companies that is/are to provide the Parent Company Liability Statements. A remaining point for the negotiating delegations to discuss is which particular parent company/companies should provide the Parent Company Liability Statements. In any event, it is submitted that the Parent Company Liability Statements should be handed down by a company in the business’ group structure that is able to comply with the provisions set forth in the document. Among others, this means that such company needs to have the ability to ensure the Contractor’s compliance with the Exploitation Contract.

20. Lastly, in addition to the concerned parent company, the Contractor should also be included as a signatory to the Parent Company Liability Statements, as the Miscellaneous Provisions should also be enforceable upon the Contractor in order to ensure the proper working of the Parent Company Liability Statements.

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