Structuring and implementing an investment in Mongolia

Commercial in confidence
The Mongolian economy’s rapid growth is placing increasing demands on the country’s legal framework, which is expected to undergo significant changes and become progressively more sophisticated over the next decade.

In this guide, Partner David Wenger provides a snapshot of some of the key legal considerations investors should take into account when looking to invest in Mongolia, and highlights some of the knowledge gained through his experience advising on past and ongoing transactions in Mongolia. This document is a guide only and should not be relied on for investment in any specific transaction. If you would like to discuss your investment strategy, or any of the issues raised in this guide, please contact David on telephone +852 2903 6256 or email David.Wenger@allens.com.au.

Political system

Mongolia is a parliamentary democracy with two main political parties, a single chamber of 76 members of parliament (known as the State Great Khural) and a directly elected president. Members of parliament are elected for terms of four years. The most recent parliamentary election was in mid-2012, at which the Democratic Party won 34 seats, the Mongolian People’s Party won 26 seats and a coalition of the Mongolian People’s Revolutionary Party (MPRP) and the Mongolian National Democratic Party won 11 seats. The Democratic Party formed a coalition government with the MPRP.

The latest presidential election was held on 26 June 2013 and the incumbent President from the Democratic Party, Tsakhiagiin Elbegdorj, was re-elected with a slim majority.

The 1992 Constitution of Mongolia provides for Mongolia to be governed as a unitary system, with certain minor decisions being made at the level of smaller administrative units consisting of 21 aimags, and the capital city of Ulaanbaatar. The Constitution enshrines the independence of the judiciary from the executive. The Mongolian president has the power to veto laws, but a presidential veto may be overridden by a two-thirds majority vote of the parliament.

Legal system

Mongolia has a civil law system based on a codification of laws. International treaties that have been ratified by the Mongolian government form part of Mongolian law. The main Mongolian statutes are also supplemented by regulations, parliamentary and cabinet resolutions, presidential decrees, rules and orders.

Some laws are less detailed and prescriptive than would be expected in a developed economy. Many of the laws are relatively new and have not been specifically considered by courts. Even where a provision has received consideration by a court, the common law concept of judicial precedent does not apply.

Consequently, there are currently some ‘gaps’ within the laws and there can be a degree of difficulty in reconciling what might be interpreted as conflicting provisions within individual laws. Coupled with the ambiguous or vague wording of some of the laws, this creates a level of uncertainty regarding the legal position on many matters and, at times, difficulty in providing definitive advice on how certain provisions will ultimately be interpreted.
English translations of the principal Mongolian laws are generally available, but particular care needs to be taken in relying on such translations, as the Mongolian parliament has ceased production of official English language translations, and many of the laws that can be found online are, in fact, out of date.

There are three levels of Mongolian courts with jurisdictions based on subject matter and monetary thresholds. Parties to proceedings in lower courts can generally appeal decisions to a superior court, with the Supreme Court being the highest court in Mongolia. Mongolia has ratified the 1958 ‘New York’ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, such that Mongolian courts should theoretically enforce arbitration awards made in foreign jurisdictions. However, Mongolian courts have very limited experience with foreign arbitration awards and enforcement experience to date has been mixed.

From general experience, Mongolian government and businesses generally initially seek Mongolian law as the governing law and the resolution of disputes by Mongolian courts. However, the principle of freedom of contract generally allows parties to negotiate an alternative governing law and dispute resolution forum, although not for certain types of contracts, for example those relating to land.

The Mongolian economy

Traditionally reliant on agriculture and herding, increased interest in Mongolia’s extensive mineral deposits has been at the centre of its economic expansion. In the early 1990s, the combination of the end of Soviet aid and the new market economy saw both severe economic hardship as well as fledging growth, including from extensive privatisation. The CIA reports that growth averaged nearly 9 per cent per year between 2004 and 2008, although this slowed significantly following the global financial crisis. The economy, however, grew by 6.4 per cent in 2010 and a significant 17.5 per cent and 12.3 per cent respectively in 2011 and 2012. This growth has been largely due to the strength of commodity exports and high domestic government spending.

Since Mongolia’s trajectory of rapid growth began in 2009, the nation has attracted considerable interest as a foreign investment destination. From 2009 to 2011, foreign investment increased rapidly, with investors encouraged by Mongolia’s young democratic government and generally open regulatory regime. Initial interest centred on Mongolia’s substantial natural resources, but investment interest has also broadened across opportunities in other sectors including energy, infrastructure, real estate and banking.

Mongolia’s Ministry of Economic Development reports that, between 1990 and 2012, foreign direct investment in mining (prospecting, exploration and extraction) and the oil sector accounted for 73.9 per cent of total registered foreign direct investment, with a total value of more than $US8.5 billion in that period. By mid-2012, registered foreign direct investment in the mining sector for the year was valued at $US1.2 billion, approximately 75 per cent of the total at that time.

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Current state of foreign investment in Mongolia

2012 saw the introduction of legislation regulating foreign investment and a draft new minerals law, both of which posed significant challenges to investors keen to take advantage of the many opportunities in one of the world’s fastest growing economies. A series of other events and circumstances also led to a substantial decrease in foreign investment, mining activity and investor sentiment. John P. Finigan, the chief executive of Golomt Bank, the country’s second-biggest bank, was quoted in 2012 as saying ‘There are a series of elements that have built up less-than-welcoming attitudes to Mongolia at a time when the macroeconomic situation is deteriorating’4.

However, the introduction of the new Law on Investment, which came into effect on 1 November 2013, is a positive development which may potentially result in renewed foreign investor interest in Mongolia.

Law on Investment

Over the past two years, the Mongolian Government has implemented significant changes to the regulation of foreign investment. This first significant change occurred on 17 May 2012, when the State Great Khural passed the Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance (the SEFIL). Certain features of the SEFIL resulted in weakened foreign investor confidence and foreign investment in Mongolia declined substantially. In April 2013, the Government of Mongolia introduced amendments to the SEFIL in an attempt to address and reverse this trend. At the same time, reports emerged from Mongolia that the amendments to the SEFIL were a first step towards further foreign investment regulation reform, which was intended to provide greater assurance and comfort to foreign investors. In early October 2013, the State Great Khural repealed the SEFIL and passed the Law on Investment, which represents a significant step to recapturing foreign investor interest in Mongolia.

The Law on Investment intends to create a stable investment environment for all investors in Mongolia, both domestic and foreign, through the reversal of some restrictions on foreign investment, the provision of specific investment guarantees and the potential for tax stabilisation. The Law on Investment provides that investors may freely invest in all sectors and services, except those that are specifically prohibited or restricted under Mongolian law. The Government has also sought to entrench the Law on Investment and guarantee stable investment legislation by providing that the Law on Investment can only be amended with the approval of a two-thirds majority of the votes of the State Great Khural.

Key features of the Law on Investment

Perhaps the most significant feature of the Law on Investment is that investments by private entities no longer require authorisation, even in sectors of strategic importance, which includes the mining sector. The law also provides certain ‘legal guarantees for investment’, including recognition of foreign arbitration awards, prohibitions on confiscation of assets without due process and compensation and the ability to remit funds abroad.

The Law on Investment seeks to promote a stable investment environment by offering tax incentives, tax stabilisation certificates and investment agreements.

Tax incentives

The Law on Investment provides that the following tax incentives may be provided to investors: exemptions, credits, accelerated calculation of depreciation costs, carry-forward losses and the deduction of employee training costs.

Exemptions from customs duty and value added tax will also be available to investors importing machinery and equipment during the construction period of projects in the following industries: construction materials, petroleum, agricultural processing or exporting, nano, bio and innovation technology, power plants and railroads.

Tax stabilisation certificate

A critical aspect of tax stabilisation is the introduction of a stabilisation certificate that the Foreign Investment Regulations and Registration Department (FIRRD) can issue to an investor. The stabilisation certificate stabilises the percentage rates of the following four taxes: corporate income tax; customs duty; value-added tax; and royalties.

A stabilisation certificate will be granted if:

- the total investment amount specified in the business plan and feasibility study reaches certain specified thresholds;
- an environmental impact assessment has been prepared, if required by law;
- the investment will create stable workplaces; and
- the investment introduces new technology.

The term of a stabilisation certificate depends upon the amount of investment and the geographic location of the investment and ranges from 5 to 18 years for mining, heavy industry and infrastructure, and from 5 to 15 years for investment in any other sectors.

Investment agreements

While the possibility for investors to enter into an investment agreement under the Minerals Law has been repealed, an investment agreement with the Government of Mongolia for large projects remains possible under the Law on Investment.
For investments over MNT500 billion (approximately US$300 million), upon the request of an investor, the Government can enter into an investment agreement to stabilise the environment in which the investor will be carrying out its operations. The investment agreement will be entered into by the Minister of Economic Development (MED). There is no express limit on the maximum term of the investment agreement: the Law on Investment only states that the term can be longer than the term of a stabilisation certificate.

It appears that if an investor is already holding a stabilisation certificate for an investment over MNT500 billion, the Government may enter into an investment agreement with such investor upon the request of the investor. The Cabinet is also expected to issue regulations regarding the process of entering into investment agreements.

Stabilisation agreements and investment agreements previously entered into under the Foreign Investment Law of 1993 and the Minerals Law will remain valid in accordance with their terms.

Investments by Foreign State Owned Entities (FSOEs)

An FSOE (defined as a legal entity in which at least 50 per cent of the shareholding is directly or indirectly owned by a foreign State) must obtain approval from the Ministry of Economic Development if it intends to acquire 33 per cent or more of the shareholding of a company operating in Mongolia in any of the following sectors:

- mineral resources;
- banking and finance; and
- media and communications.

The 33 per cent shareholding threshold is lower than the 49 per cent threshold that applied to FSOEs under the SEFIL. However, the Law on Investment only requires FSOEs to obtain approval from the Ministry of Economic Development, whereas the SEFIL required approval by the Great State Khural, which was a significantly more onerous requirement.

The Ministry of Economic Development will make its decision having regard to the following conditions:

- whether any activity of the applicant or the nature of the proposed investment conflicts with the national security of Mongolia;
- whether the applicant fulfils the conditions for complying with the laws and business norms of Mongolia;
- whether the investment is of a nature which restricts competition or creates a monopoly in the relevant sector; and
- whether the investment would have a serious impact on the budget income, other policies and activities of Mongolia.

The Regulation on Implementing the Investment Law provides grand-fathering to a certain extent: FSOEs that were already holding more than 75 per cent of the shareholding of a Mongolian entity in any of the three sectors described above will not need prior approval of the MED if the level of their shareholding changes.

Clear deadlines promoted by the Law on Investment

The Law on Investment sets clear deadlines for the regulatory bodies to provide their decision in response to an application to obtain a stabilisation certificate or an application by a FSOE to invest in a sector of strategic importance. The FIRRD will make a
decision within 30 days after the receipt of an application for a stabilisation certificate, which period may be extended by 15 days. The time period within which the Ministry of Economic Development shall take its decision with regards to approval of investment by an FSOE is 45 days.

**Outstanding issues regarding the Law on Investment**

The administration of the Law on Investment is not settled, and regulations will likely be required to implement its provisions. Foreign investors will undoubtedly be interested to see how the Law on Investment is applied in the coming months in order to better understand the new regulatory environment.

However, the removal of restrictions on investments by non-State owned foreign investors and the provision of certain important investment guarantees, tax incentives and tax stabilisation are all positive developments which should lead to an increase in investor sentiment. While foreign state owned entities continue to be subject to regulation and approval of certain investments, the change from parliamentary to ministerial approval should also be received positively.

**Ban on new exploration licences and limited licence transfer**

Currently, there is an effective ban on new mining licences and practical limitations on licence transfers.

Under relevant Mongolian laws, exploration licences provide:

- a right to conduct exploration for minerals within the boundaries of the licence;
- the exclusive right to apply for a mining licence for any part of the licensed area;
- a right to access the exploration area and construct temporary structures with the purpose of conducting exploration work;
- a right to pass through the land surrounding the exploration area for the purpose of entering the exploration area; and
- a right to exercise the rights provided by the Minerals Law by passing through land owned or possessed by other persons as approved by the owner or possessor of the land.

There is an official moratorium on granting new exploration licences, which is expected to continue until proposed reforms to the mining law are enacted. This moratorium does not prevent transfers of licences and most new investors in the mining sector obtained their interest in an exploration or mining licence through acquiring either a licence or an interest in the entity holding the licence from an existing licence holder. However, the enactment of the SEFIL in 2012 led to an (unofficial) regulatory stalemate in approving licence transfers, or acquisitions of interests in entities holding licences, by foreign-invested entities as a result of uncertainty over how to administer such transactions under SEFIL. Although uncertainty remains, the introduction of the Law on Investment, described in section 2.1 and recent statements suggesting that the existing Minerals Law may not be substantially amended may facilitate a resolution of this stalemate, and encourage renewed interest amongst foreign investors in acquiring and developing licences in Mongolia.
OT Investment Agreement

Prior to the introduction of the Law on Investment, under Mongolia’s Mineral Law, if a mining licence holder agreed to invest US$50 million or more during the first five years of its mining project, they were able to request the negotiation of an ‘investment agreement’ with the Mongolian Government in order to provide a stable operational environment. Investors may now conclude an investment agreement in accordance with the Law on Investment, as described on pages 4-5.

After six years of negotiations and a public review by the Parliament, the Oyu Tolgoi Investment Agreement was signed on 6 October, 2009, which set off a ‘boom’ in foreign investment into Mongolia, encouraged by the cooperation shown in the agreement.

As reported widely in the press, however, the Mongolian Government has subsequently made several attempts to renegotiate the terms of the OT Investment Agreement. Points of negotiation have centred around the level of Mongolian control of the OT project and royalties as well as tax rates, which were fixed in the original 2009 agreement. These attempts to renegotiate have been seen as attempts by the Mongolian Government to live up to pro-nationalistic sentiment, particularly promoted in the lead-up to the parliamentary elections in mid-2012.

Commentators have noted that any attempt to renegotiate or go back on the agreed terms of the OT Investment Agreement would have a significant negative effect on the flow of foreign capital into Mongolia. In one commentator’s view: ‘Mongolia’s star rose – and is now falling – with the fortunes of one company: Rio Tinto, the country’s largest investor’.

6 Macnamara, 2012b, op. cit.
8 Macnamara, Ibid.
9 Macnamara, 2012b, op. cit.
Outlook

Despite these difficulties, there remains a mood of cautious optimism for investment in Mongolia, in particular for its rich minerals sector. In April 2013, the IMF projected that GDP growth would remain high, at 14 per cent in 2013 and 11.6 per cent in 2014, with growth projected in mining and non-mining sectors supported by expansionary fiscal policy and government spending.

The first shipments of copper concentrate from the Oyu Tolgoi mine, which commenced in July 2013, will further cement this cautious optimism.

More broadly, legislative reform in the key areas of foreign investment, minerals law and securities law should, if properly implemented, cause a shift towards a more positive view of Mongolia as an investment destination.

New Minerals Law

A draft minerals law was released by the Mongolian Government in December 2012 and generated a considerable degree of concern and uncertainty within Mongolia’s mining industry and foreign investor community. Following sustained business lobbying, and a decrease in mining sector investment, the Mongolian Government announced that it would reconsider its approach to regulating the mining sector.

In January 2013, the President announced that the draft law had been withdrawn. At the same time, the President formed a working group to consider and develop a mining policy for Mongolia, which will form the framework for the development of a new minerals law and related regulations. In a recent address to the business community in Hong Kong, the President announced that the new Minerals Law would be released in 2014 and would be based on the existing Minerals Law of Mongolia with only minor amendments for ‘improvement’.

New Security Registration Law

In 2011, a draft law on the Movable Property Pledge Law was introduced to the Parliament. If the draft law is enacted, the Property Rights Registration Office (PRRO) will become responsible for registering pledges over movable property, including shares. Currently it is not possible to register a pledge over movable property. Even if the draft law is passed, the extent to which the PRRO will then commence to perform registrations will be subject to the introduction of a registration procedure that sets out the process for such registration. This would be a significant milestone in Mongolia’s legal framework, which should assist in facilitating the development of lending and financing activity in Mongolia.

The draft law has been developed by the Ministry of Justice in consultation with the International Finance Corporation and the European Bank for Reconstruction and Development. It is understood that, when the necessary formalities have been completed, the registration process will be similar to that in other jurisdictions which have recently implemented a personal property security registration system, including Australia.

Structuring

Structuring options

Common with other jurisdictions, in determining the structure of any investment in Mongolia, a foreign investor will need to consider how much capital will be invested, tax implications of the available structures, whether it is necessary or desirable to involve a local partner and what sort of business activity the business will undertake and the related licensing requirements.

Direct investment in Mongolia generally occurs through investment in, or acquisition of or setting-up of, a legal entity, typically a limited liability company (LLC). An alternative incorporated form is available in the Joint Stock Company (JSC). It is also possible to establish a presence in Mongolia by entering into a partnership or setting up a representative office.

For many investors, entering the market with a Mongolian company through a joint venture arrangement offers advantages in terms of local knowledge and networks. However, contractual joint ventures are rare in Mongolia and not something that Mongolian businesses or the Mongolian government are familiar or comfortable with. Typically an arrangement described as a ‘joint venture’ will be an incorporated joint venture, most often an LLC.

Representative office

First-time investors in Mongolia may find that establishing a representative office will best meet their near-term business needs. A representative office is not a separate legal entity. The representative office structure is well suited to investors who are interested in establishing a ‘light’ on-the-ground presence initially while developing local relationships and an understanding of Mongolia’s business and political environment. Representative offices may apply for business visas and, to a limited extent, hire locally. Representative offices may undertake limited, non-profitable activities as set out in their business licence. Importantly, a representative office may not generate income and may only undertake limited, non-profitable activities as set out in their business licence.

Partnerships

Under Mongolian law, partnerships are for-profit legal entities that can be general partnerships, where all members of the partnership have unlimited liability for the debts of the partnership, or limited partnerships where at least one of the members must have unlimited liability for the debts of the partnership. Voting rights in partnerships are determined by reference to the member’s contribution to the partnership and all matters, unless otherwise stated in the partnership agreement, are resolved by an ‘overwhelming majority’, except for amendments to the partnership agreement and change of business scope, which require unanimous approval. Members of a partnership cannot be members of another partnership.

Partnerships are uncommon in Mongolia due to the requirement for unlimited liability and the undeveloped nature of the legislation governing partnerships.
LLCs and JSCs

In terms of establishing a legal entity, the Company Law provides for the establishment of LLCs and JSCs, both of which are separate legal persons. Shareholders of LLCs and JSCs both enjoy 'limited liability' (liable only to the extent of the value of their shares), except that:

- a shareholder having more than 10 per cent of a company’s shares or otherwise having the power to control the management of the company is liable to the extent of their own assets for any loss incurred by the company resulting from the unlawful exercise of such power; and

- in the case of an LLC, a shareholder that holds 20 per cent or more of the company’s common shares is personally liable (as a ‘governing person of the company’ in the same way as directors are) for certain unlawful acts.

Both types of companies can have two classes of shares: common and preferred shares. The Charter, the principal constituent document of a Mongolian company, specifies the number of shares of each class that the company is authorised to issue. Common shares are closest to what are commonly called ‘ordinary shares’ in other jurisdictions, having one vote per share on all matters considered by shareholders’ meetings. Holders of common shares also have, under the Company Law, a pre-emptive right to purchase any additional common shares issued by a company in proportion to their existing shareholding at not less than 90 per cent of the market price of the shares. Preferred shares have a right to receive dividends before dividends are distributed to common shareholders, but can only vote on matters specified in the Company Law, the company’s Charter or the terms of their issue.

While the Company Law broadly makes no distinction between companies based on whether their shareholders are foreign or Mongolian, the minimum start-up investment required for a foreign-invested LLC, and certain JSCs, is US$100,000. Foreign investors tend to favour the LLC structure, as this form of entity offers greater flexibility in management structure and is the more established form of company in Mongolia. JSCs remain largely untested.

Unincorporated joint ventures are impractical

Mongolian law does not prohibit unincorporated joint ventures. In fact, Mongolian law does not contemplate unincorporated joint ventures at all. However, the peculiar requirements and principles under Mongolian law make it impractical to conclude a contractual joint venture for resources investments.

Common ownership of property is a big issue for unincorporated joint ventures, particularly in the resources industry, as only one party can be registered as the licence holder for each exploration or mining licence. This fundamental requirement for a single licence holder is set out in the Minerals Law, as is the fact that foreign entities cannot hold these licences. What makes this more problematic is that there is no concept of equitable interest in property in Mongolia. That is, the law offers no protection in safeguarding one’s equitable interest in property. This is very risky for joint venture partners who solely rely on their contractual agreement for their respective interest in property.
However, as noted above, there are no foreign ownership restrictions presently in relation to investments by private entities and, accordingly, a Mongolian company that is a registered titleholder may have foreign shareholders without a requirement for any governmental consent because of that foreign ownership.

Land issues

Similar issues arise in relation to land. In Mongolia, only Mongolian citizens or entities are entitled to land ownership rights and land possession rights. Foreign investors can only hold land use rights, which can be held for up to 100 years. A significant difference between land ownership and possession rights, and land use rights, is that land use rights cannot be transferred or pledged under Mongolian law, while land ownership and possession rights cannot be pledged in favour of foreign banks or companies. In practice, parties have sought to overcome these restrictions by incorporating an interspersed wholly owned local subsidiary to hold and pledge land possession rights and by the use of a local Mongolian bank as security agent.

An issue for investors to be aware of is that if there is any dispute between the joint venture partners, only the registered person will have the legal interest in the land, leaving other parties no legally registered protection of their interest in the land regardless of the capital contributed or invested in the land.

Dominance of incorporated joint ventures

Given the limitations described above, the most common approach for foreign investment, particularly in resources, is through an incorporated joint venture, using an LLC as the business vehicle and underpinned by a shareholders’ agreement. The LLC will be the registered entity that holds the licence and the land use right (assuming the LLC has direct foreign investment, it can only obtain land use rights). If there is a dispute among the joint venture partners, interests of each party in the property will be equally protected by law as they are all the legal shareholders to the joint venture vehicle.

That said, the LLC vehicle is not without limitations. Investors will need to take particular care of certain Company Law requirements when planning their investment and consider structuring implications such issues may raise. For example, under Mongolian law, the highest governing authority of a Mongolian company (whether an LLC or JSC) is the shareholders’ meeting. As noted, Mongolia’s Company Law mandates that certain matters must be decided by a meeting of the shareholders, and also imposes minimum voting thresholds on particular shareholder decisions. Where an investor is entering Mongolia through a joint venture, these mandatory matters and voting thresholds should be considered at the outset of negotiations and in light of the joint venturers’ respective share ownership. Of course, this process is further complicated by the possibility of State ownership, but various deal structures can be considered to ensure that agreed commercial deals can be achieved within the context of these compulsory voting thresholds.
Foreign investors may, in particular, wish to consider having a holding company offshore Mongolia, in which they hold their respective shareholdings and which serves as the ‘JV vehicle’ in terms of managing the relationship between the joint venturers. However, our experience has shown that Mongolian individuals or companies may be reluctant to hold shares in offshore vehicles. Additionally, while adopting an offshore holding company structure can provide greater flexibility in determining the company’s management structure, such structures may also have drawbacks, which should be considered individually in the case of each investor. It may also be advisable for foreign investors to seek detailed advice on the possible exposure of directors and officers of the Mongolian company, and ‘upstream’ liability for the investing company, so that relevant risks can be adequately dealt with through group structuring, internal controls and insurance policies.

Other considerations

Forms of security

The ability to take security over property is important for investors seeking international financing for their Mongolian projects, and is, of course, of primary importance to lenders who are looking to engage with the Mongolian market.

Security techniques available in Mongolia are principally governed by the Civil Code which, compared with other emerging market jurisdictions, provides a relatively detailed framework.

Most relevant for resources investments, as discussed above, is the ability for a minerals licence holder to pledge all or part of that licence, subject to certain conditions. Restrictions on pledging various forms of land rights have also been discussed above.

Repatriation of funds

An investor’s right to repatriate funds from the investment destination is of primary concern to all foreign investors. In this regard, Mongolian law affords broad rights to investors.

Mongolian law provides that foreign investors may possess, use and dispose of their assets, transfer the assets that they contributed as equity in their investment, and remit abroad income, profit and payments such as dividends, income and loans. Similarly, Mongolian law does not impose any foreign exchange controls; however, it does impose certain restrictions that may impair repatriation of funds.

There are, however, certain banking restrictions and regulations with regards to domestic transactions of which investors should be aware. In particular, under the Law on Settlement of Payments in the National Currency, all contracts for goods, services and wages in the territory of Mongolia must specify prices in, and be paid in, Tugrug (the Mongolian currency). Any payment in or advertisement of prices in a foreign currency is prohibited. The Financial Regulatory Commission of Mongolia has issued guidelines that exclude cross-border transactions from falling within the ambit of these currency restrictions.
Dispute resolution

Many foreign investors will be keen to ensure that any dispute arising in connection with their investment is subject to international arbitration. As a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mongolia recognises and enforces foreign arbitral awards through its domestic court system. Mongolian courts do, however, have exclusive jurisdiction over a limited range of disputes, such as disputes regarding real property located in Mongolia. A contract cannot seek to exclude these disputes from the court’s jurisdiction. Accordingly, it is important for any compulsory arbitration clause to include an appropriate carve-out.

It is common business practice for cross-border transactions to include a compulsory international arbitration provision nominating a seat of arbitration outside of Mongolia (such as Hong Kong or London). Transactions between or involving any Mongolian entity, including a foreign-invested Mongolian entity, may also be made subject to international arbitration, and we would ordinarily expect this to be the case in any significant transaction.

Treaty protection

A foreign investor should also consider the foreign jurisdiction from which the investment will be made. In particular, an investor may wish to ensure that the investing entity is from a jurisdiction that is a party to a bilateral or multilateral investment treaty and a double taxation treaty with Mongolia.

Ensuring that your investment is protected under a bilateral investment treaty can provide you with guarantees from the Mongolian Government that your right to fair and equitable treatment will be protected in Mongolia. While the terms of many bilateral investment treaties are similar, it is worth considering the specific treaty that will apply to the investment before making the investment to ensure that your investment will receive the full benefit of the ‘most-favoured nation’ clauses and other standard protections. Mongolia has entered into bilateral investment treaties with 43 countries, including countries such as China, Singapore, Japan, the United Kingdom and the United States of America.

Mongolia is also a party to the 1994 Energy Charter Treaty pursuant to which is provides certain legal protections for investments in the energy sector.

Ensuring that your Mongolia investment is covered by a double taxation treaty will provide you with greater tax certainty and reduce the risk of double taxation. As of February 2014, Mongolia is a party to double taxation treaties with 26 countries, including China, Singapore, France and the United Kingdom. The treaties with Luxembourg and the Netherlands terminated on 1 January 2014, and the treaties with Kuwait and the United Arab Emirates will terminate in 2015.
Spotlight on Mining

Mining sector

Mongolia has extremely rich mineral resources including coal, copper, fluorite, gold, iron ore, lead, molybdenum, oil, phosphates, tin, uranium, and wolfram. According to the Mongolian Mineral Resource Authority, 24.8 per cent of the Mongolian territory is covered by general exploration work and geological mapping at a scale of 1:50,000. Preliminary figures for 2012 show that mining accounts for 18.6 per cent of Mongolia’s GDP, the highest percentage of any sector.

Mining JVs

To date, foreign resources investments in Mongolia have tended to occur through investments in, or acquisitions of, corporate vehicles rather than by direct acquisitions of exploration or mining licences. This has occurred for a number of reasons, including the impracticability of unincorporated joint ventures in Mongolia and issues of land ownership.

Minerals law framework

Mongolian law provides that mineral resources are the property of the Mongolian State. Under the Minerals Law, individuals and legal entities may apply for exploration licences and mining licences that authorise exploration and mining activities respectively for minerals within the licence area. Importantly, only one party can be registered as the licence holder for each exploration or mining licence and the licence holder must be a Mongolian-incorporated entity or Mongolian partnership.

Unlike in many other jurisdictions, a licence under the Minerals Law relates, in most cases, to minerals generally rather than specific minerals; however the Minerals Law does not apply to:

- exploration and extraction of radioactive minerals such as uranium and thorium, which are covered by the Nuclear Energy Law of Mongolia of 2009;
- exploration and extraction of petroleum and gas, which are covered by the Petroleum Law of Mongolia of 1991; or
- the utilisation of water resources, which is covered by a variety of water-related laws.

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12 Library of Congress, Ibid.
Exploration and mining licences

An exploration licence under the Minerals Law provides the licence holder with an exclusive right to conduct exploration for minerals and to obtain a mining licence. An exploration licence holder also has the right to transfer or pledge that licence. An exploration licence has a maximum term of eight years with payment of an increasing annual licence fee dependent on the number of hectares covered.

The Minerals Law does not contain any retention or development tenements of the type sometimes seen in other jurisdictions, used where exploration has revealed a mineral deposit that the licence holder does not consider currently economically viable to develop into a mining operation. The closest equivalent is a ‘pre-mining operation agreement’ that provides a type of bridging authorisation between an exploration licence and a mining licence. In practice, few, if any, of these pre-mining operations agreements exist, as they were a new concept introduced with the current version of the Minerals Law in 2006.

Generally, an exploration or mining licence holder may pledge or transfer the licence. The Department of Geological and Mining Cadastre maintains a register of the holders of exploration and mining licences granted under the Minerals Law, and transfers or pledges of licences must be registered with the department in order to be effective.

While an exploration or mining licence cannot be sold by itself, an exploration licence holder may transfer its licence to another person eligible to hold the licence, provided there is evidentiary proof that ‘original materials and reports on prospecting and exploration work’ were sold in conjunction with the licence. Similarly a mining licence holder may transfer its licence, provided there is evidentiary proof that the mine, together with its ‘machinery, equipment and documents’, were sold in conjunction with the licence. This appears to be a case of managing the form of the transaction to meet the technical requirements of the legislation, while still in substance permitting tenement transfers.

Along the same lines, the Minerals Law permits a licence holder to pledge its licences to a bank or non-bank financial organisation provided that the related documents (such as the exploration work results, geological information, feasibility study and other assets that may be pledged under law), are also pledged.

Importantly, there are currently no ‘change of control’ related restrictions in the Minerals Law that would prevent the indirect ownership of a licence being altered by an upstream corporate transaction.
State participation in resources development

While the Minerals Law permits only one licence holder, the Minerals Law contains two concepts that are particularly worthy of note, as they provide the potential for partial Mongolian Government ownership in a resources development. First, as noted above, certain mineral deposits are designated as ‘mineral deposits of strategic importance’. Because the strategic deposits identified to date are defined by reference to names for particular mineral concentrations rather than specified coordinates or boundaries, it can be difficult to conclusively determine whether a licence area may be overlapped by a strategic deposit. A concern is that the definition is sufficiently vague so that the determination of the boundaries of the strategic deposit may become a political rather than strictly legal or technical decision.

The second concept of importance is ‘State funded exploration’, which is where a particular deposit has been the subject of previous exploration work funded by the Mongolian Government (including by the USSR when Mongolia was affiliated with the Soviet bloc).

The two concepts combine to determine the level of the Mongolian State’s share in any mineral deposit. The exact percentage of Mongolian Government ownership shall be determined by the agreement ‘considering the amount of investment made by the State’, essentially providing for a negotiated outcome.

In addition, under the Minerals Law, a ‘legal person’ holding a mining licence for a strategic deposit is also required to trade no less than 10 per cent of its shares on the Mongolian Stock Exchange, which may require a partial listing.

Investment agreements

Prior to the introduction of the Law on Investment, the Minerals Law provided that if a mining licence holder undertakes to invest US$50 million or more during the first five years of its mining project, they may request that an ‘investment agreement’, with the purpose of providing a stable operational environment, be concluded with the Mongolian Government.

Investment agreements are now made available under the Law on Investment, and are ostensibly available to investors in all sectors, including the mining sector. Existing investment agreements made under the Minerals Law continue to apply in accordance with their terms.

Investment agreements are intended to provide a stable environment for investors and generally contain clauses on each of the following matters: stable tax environment, right of the licence holder to sell its products at international market prices, guaranteed rights of the licence holder to manage income derived from its sales, amount and term of the licence holder’s investment, mining of the minerals with minimum damages to environment and public health, protection and reclamation of the environment, no-negative effect on other industries and operations, development of the region and creation of more employment, and compensation for damages caused.

The duration of an investment agreement varies from 10 years up to 30 years, depending on the amount of the investment in the first five years of the mining project.

While the OT Investment Agreement described on page 7 may provide a useful precedent for the sorts of topics an investment agreement may cover, several attempts to renegotiate aspects of the agreement and the changing political climate should be kept in mind.
Contacts

David Wenger
Partner, Hong Kong
T +852 2903 6566
David.Wenger@allens.com.au

Kate Axup
Partner, Beijing
T +86 10 8515 0250
Kate.Axup@allens.com.au

John Koshy
Senior Associate, Hong Kong
T +852 2903 6253
John.Koshy@allens.com.au

Anthony Lepere
Senior Associate, Hong Kong
T +852 2903 6206
Anthony.Lepere@allens.com.au

Bridget Povey
Senior Associate
Registered Foreign Lawyer, Hong Kong
T +852 2903 6211
Bridget.Povey@allens.com.au

Tserendulam Yumjav
Senior Associate
Registered Foreign Lawyer, Hong Kong & Mongolia
T +852 2903 6208
Tserendulam.Yumjav@allens.com.au