
THE MINING LAW REVIEW

FOURTH EDITION

EDITOR
ERIK RICHER LA FLÈCHE

LAW BUSINESS RESEARCH

THE MINING LAW REVIEW

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For further information please email
Nick.Barette@lbresearch.com

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ERIK RICHER LA FLÈCHE

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Gideon Robertson

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Nick Barette

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EDITOR'S PREFACE

I am pleased to have participated in the preparation of the fourth edition of *The Mining Law Review*. The *Review* is designed to be a practical, business-focused 'year in review' analysis of recent changes and developments, and their effects, and a look forward at expected trends.

This book gathers the views of leading mining practitioners from around the world and I warmly thank all the authors for their work and insights.

The first part of the book is divided into 22 country chapters, each dealing with mining in a particular jurisdiction. Countries were selected because of the importance of mining to their economies and to ensure broad geographical representation. Mining is global but the business of financing mining exploration, development and – to a lesser extent – production is concentrated in a few countries, Canada and the United Kingdom being dominant. As a result, the second part of this book includes eight country chapters focused on financing.

The advantage of a comparative work is that knowledge of the law and developments and trends in one jurisdiction may assist those in other jurisdictions. Although the chapters are laid out uniformly for ease of comparison, each author had complete discretion as to content and emphasis.

The mining sector is facing uncertain times. Commodity prices are lower and continue to be soft. Demand growth from China, the world's largest consumer of commodities, has slowed considerably. New markets such as India are not picking up the slack. Operating costs in certain markets exploded during the good years and must now be reined in. Traditional lenders to the industry are more highly regulated and have less flexibility to assist companies during this difficult time. Equity markets know that big declines in the price of commodities have preceded recessions and bear markets and as a result are doubly cautious.

While times are tough, we know that mining is cyclical and that continued world population and economic growth as well as the depletion of current resources mean that growth in the mining sector will resume. The only question is when.

In the meantime, we are seeing a return to basics coupled with innovation. Companies are reducing their operating costs and curtailing exploration efforts. Executives are looking at new ways of doing things, from cost sharing to automation to alternative financing. When financing projects, companies now attempt to secure most if not all of the financing upfront. To do this they have to cobble together financings from various sources, including stream and royalty arrangements that in the past were only available once a project had been considerably de-risked. Adapting the financings to the particulars of each project and making sure that the various bits work together and form a coherent whole is a source of interesting and sophisticated work for mining lawyers these days.

But companies are not the only ones implementing change. In some jurisdictions, Quebec for example, governments and other stakeholders (e.g., indigenous peoples) are taking advantage of the lull to put into place comprehensive strategies for welcoming new mining projects. Such strategies include clear timelines for the approval of projects, objective project approval standards, investments in infrastructure (e.g., ports, roads, railroads, airports and power lines), and transparent rules regarding the sharing of project benefits among local communities, indigenous peoples and government, all so as to be able to ramp up quickly when opportunity strikes.

As you consult this book you will find more on topics apposite to jurisdictions of specific interest to you, and I hope that you will find this book useful and responsive.

Erik Richer La Flèche

Stikeman Elliott LLP

Montreal

October 2015

Chapter 27

MONGOLIA

*Oyun Surenjav and David C Buxbaum*¹

I INTRODUCTION

The Mongolian economy is largely dependent on its natural resources. According to the survey of International Monetary Fund in 2015, it is estimated that Mongolia has an estimated US\$1 to US\$3 trillion in mineral deposits, with coal, copper, molybdenum, fluorspar concentrates and gold being the principal reserves; and only 25 per cent of the country has been geologically surveyed.² Among these abundant natural resources, Mongolia hosts 10 per cent of the world's known coal reserves, and the Tavan Tolgoi coal mine (TT) is one of the world's largest untapped coking and thermal coal deposits.³ More than 89 per cent of Mongolia's exports are minerals, and this proportion is expected to rise to 95 per cent in 2015. This makes the economy highly reliant on world commodity prices and Mongolia faces the same boom and bust cycles of any resources-dependent nation.

In the last three years, the Mongolian economy saw a rapid downturn since its significant double-digit growth where GDP reached 17.5 per cent and FDI accounted for US\$4.73 billion in 2011. In October 2009, the signing of one of Mongolia's biggest mining project – Oyu Tolgoi's Investment Agreement (OTIA) generated US\$6.2 billion foreign investment in the copper and gold mine's first phase (OT-1)(see Section III, *infra*) made the country's economy the fastest growing economy in the world. However,

1 David C Buxbaum is the managing partner and Oyun Surenjav is the legal specialist at Anderson & Anderson LLP.

2 UK Trade and Investment, Guidance Doing Business in Mongolia: Mongolia's trade and export guide, update 11May 2015, <https://www.gov.uk/government/publications/exporting-to-mongolia/exporting-to-mongolia>.

3 IFM Working Paper, From Natural Resource Boom to Sustainable Economic Growth: Lessons for Mongolia, p.5 (2015).

the country experienced a foreign direct investment slowdown when the government and Rio Tinto Group had a dispute over the US\$5.4 billion second phase underground expansion of the Oyu Tolgoi copper and gold mine. At the end of 2014, foreign direct investment surged by 70 per cent, following the 43 per cent rise in 2013.⁴ After two years of negotiation, the new Prime Minister of Mongolia, Ch Saikhanbileg, settled the dispute with Rio Tinto on 18 May 2015.

Furthermore, anti-foreign legislation affected foreign investment, but this legislation was revised in 2015. Ch Saikhanbileg was appointed by the parliament of Mongolia replacing former Prime Minister N Altankhuyag amid concern about economy slumps and no confidence.⁵ In the wake of the settlement of the dispute with Rio Tinto, the government is looking to recover from the economic downturn, as Prime Minister Ch Saikhanbileg stated, 'Mongolia is back in business again.' The government is now working to create a more open and welcoming business environment for foreign investors by improving the legal frameworks to remove existing barriers in favour of mining expansion and private sector growth.

Several key pieces of legislation with regard to the capital market have been passed recently with help reform the environment for raising capital in the country. Namely, the amendment of Security Market Law, the Investment Law, the Investment Fund Law, the Law on Combating Money Laundry and Terrorism, and the amendment of Minerals Law all of which play a key role in encouraging increased foreign investment. The amendment of Security Market Law enables the Mongolian Stock Exchange (MSE) to undertake managerial and technical reform to meet international standard requirements in line with the London Stock Exchange (LSE). The MSE is established in January 1991 by decree of the government to privatise state-owned assets as a base of transition from a central planned economy to market economy.⁶ The first initial public offering (IPO) of the MSE since its reform was on 10 April 2014, with Mongolian concrete manufacturer, Merex JSC, selling 26 million shares to the public at 100 togrogs per share. This was the result of the reform making the stock market more appealing to domestic and foreign investors. In September 2014, the MSE also signed an agreement with the LSE Group to extend the partnership between the two exchanges for another three years, following on the original agreement, which was signed in early 2011. The MSE and the LSE concluded a master service agreement that included a US\$14 million contract and the implementation of the latter's millennium IT trading and payments system. The new system enables greater transparency in the market through use of international disclosure requirements to meet international standards.

4 Oxford Business Group, the Report: Mongolia, p. 28(2015).

5 <http://www.reuters.com/article/2014/11/21/us-mongolia-politics-idUSKCN0J50J020141121>.

6 MSE, the Historic Background of MSE, <http://mse.mn/content/show/id/7>.

II RAISING CAPITAL

i General overview of the legal framework

It should be noted that many of the newly passed and revised laws have been considered positive changes for the country in terms of encouraging foreign investment and increasing transparency and multi-stakeholder involvement. The following laws form the general legal foundation for investment activities in the country's mining sector: the Civil Code; the Company Law; the Investment Fund Law; the Investment Law; the Law on Asset-Backed Securities; the Minerals Law; and the Securities Market Law. These laws are seen as those most closely related to capital-raising ventures in Mongolia and, therefore, at the moment, both domestic and foreign investors have focused on this legislation.

The Securities Market Law

The amendment of the Securities Market Law passed on 24 May 2013 outlines Mongolia's current capital market. Amendments included the incorporation of a greater variety of financial instruments, including options, futures, derivatives and convertible securities.⁷ Amendments also provided for the issuance of depositary receipts, both in Mongolia and globally,⁸ to be traded in the market, as well as the recognition of nominal or legal, and beneficial ownership of securities.⁹

The inclusion of futures and depositary receipts in Mongolia's market instruments will mark a step forward in Mongolian companies' ability to conduct capital raising on a global scale. Prior to the amendments of Securities Market Law, futures had yet to be included or traded on the marketplace; however, the country's banking institutions had and are already utilising foreign-currency forward contracts, while futures are not yet traded. In view of Mongolia's rich metal and coal resources, futures trading may be a very important part of the country's development. Indeed, the country already has a Law on the Commodities Exchange of Agricultural and Raw Materials, which was adopted in 2011.¹⁰

In addition to futures, the existence of Mongolian depositary receipts will allow companies registered outside Mongolia greater access to the MSE. Article 18 of the amendment of Securities Market Law specifically provides a legal entity 'registered in a foreign jurisdiction'¹¹ with the ability to 'register with the Mongolian Stock Exchange and trade its securities'.¹² The amended Securities Market Law expressly provides for the

7 The Securities Market Law, Articles. 4.1.6, 4.1.7, 4.1.10, 4.1.11, 10.5.12, 13.2 (revised 2013) (Mong.). It should be noted that the 2002 version of the Securities Market Law did recognise and include 'derivative securities' within its text and definitions. See e.g., Securities Market Law, Article 3.1.4 (2002) (Mong.).

8 Securities Market Law, Articles 13.11.1, 13.11.2 (revised 2013) (Mong.).

9 Id. at Articles 4.1.25 and 4.1.26.

10 Law on the Commodities Exchange of Agricultural and Raw Materials (2011) (Mong.).

11 Securities Market Law, Article 18 (revised 2013) (Mong.).

12 Id. at Article 18.1.

opportunity for dual or secondary listings by foreign entities, though, it must obtain permission from Financial Regulatory Commission (FRC) prior to the registration with the stock exchange,^{13,14} On the other hand, for those domestic Mongolian entities already listed on the MSE, the amended Law allows for listings on other international markets.¹⁵

In a February 2014 interview, former MSE CEO, Altai Khangai stated '[a]lthough Mongolia has been on the radar screen of international investors for quite some time, they weren't able to enter the market due to lack of custodians, proper market legislation, and infrastructure'.¹⁶ Many of these shortcomings have seen marked improvements over the past few years, as demonstrated by the MSE's collaboration with the LSE,¹⁷ the 2013 passing of the amended Securities Market Law and the promulgation of market regulations. While hurdles continue to exist for the MSE to overcome, including perceived in-fighting, disorganisation and bureaucratic inefficiencies,¹⁸ the country appears to be committed to the market's continual development and growth. Those investors savvy enough for Mongolia's frontier market may well find themselves rewarded in the long run. The country remains rich in mineral resources that while vulnerable to the fluctuations of commodity pricing and largely reliant on the demands of its Chinese neighbor,¹⁹ are still as yet largely untapped. As indicated by the Oxford Business Group, '[t]he thinking is that prices have been so knocked down as a result of generally negative news about the market and economy that companies can now be purchased on the exchange at or near book value. Some foreign investors are beginning to argue that the difficult times have actually been good for the market.'²⁰

On 18 June 2014, the FRC signed the International Organization of Securities Commissions' (IOSCO) Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU). In a

13 Id.

14 Id.

15 Id. at Article 17.1.

16 Jacopo Dettoni, 'Mongolia pins hopes on new laws to breathe life into stock market', Business New Europe, 6 February 2014, www.bne.eu/content/mongolia-pins-hopes-new-laws-breathe-life-stock-market.

17 See Phillips and Buxbaum, footnote 18, *supra*, at p. 314: '[t]he role of the London Stock Exchange in helping to shape the Mongolian capital market's future cannot be understated. Cooperation between the entities began in 2011, when the London Stock Exchange Group agreed to administer management, training, and oversight to the Mongolian Stock Exchange. In addition, the London Stock Exchange was to provide information technology services via its MillenniumIT platform, which would serve to bolster Mongolia's "trading and surveillance infrastructure...". The London Stock Exchange's services have not come cheap. In return for London's services to manage and develop the country's capital market, the Mongolian Stock Exchange agreed to pay US \$14.2 million.'

18 Oxford Business Group, footnote 19, *supra* at 67.

19 It should be noted that although China does purchase much of Mongolia's coal, Mongolia has been selling copper concentrate for many years, and not always to China.

20 Oxford Business Group, footnote 19, *supra* at 66.

19 June 2014 news release from the FRC, the Commission stated that as an IOSCO MMoU signatory, the 'FRC has an opportunity to exchange information and mutually assist more than 180 regulatory bodies across the world which will enhance supervision and law enforcement in the securities market'.²¹ In addition to the IOSCO MMoU, the FRC has also signed a memorandum of understanding (MoU) with the Financial Services Agency of Japan (JFSA). Signed on 9 January 2014, the MoU calls for authorities of the FRC and JFSA to 'work together to identify and address the development of a legal and regulatory framework and financial markets in each jurisdiction'.²² On September 2014 also saw the MSE enter into discussion on cooperation with the European Bank for Reconstruction and Development (ERBD) on the back of a broad MoU.

The Investment Law

While developments in Mongolia's securities market may be significant to capital raising in the mining sector, the recent passing of a new Investment Law and amendments to the Minerals Law,²³ on 3 October 2013 and 1 July 2014 respectively, will also play a pivotal role in encouraging increased foreign investment into the country. As the Investment Law's stated purpose, Article 1.1 provides '[t]he purpose of this law is to protect the legal rights and interests of investors within the territory of Mongolia [...] to promote investment, to stabilize the tax environment, and to determine the powers of government organizations and the rights and obligations of investors'.²⁴ Enacted in October 2013, the Investment Law replaced both the Law on the Regulation of Foreign Investment in Entities Operating in Strategic Sector (SEFIL) and the Foreign Investment Law. With the inclusion of several articles intended to level the playing field between foreign and domestic investors, the new Investment Law also streamlined the registration process for foreign-invested entities, relaxed restrictions on investment by foreign state-owned entities, and provided for the Ministry of Economic Development's creation of the Invest Mongolia Agency (IMA) 'to promote, advertise and regulate investment activities in Mongolia'.²⁵ In a November 2013 interview, Sereeter Javkhlanbaatar, Director General of the IMA, explained:

21 FRC signed in the MMoU of the IOSCO (Financial Regulatory Commission, Ulaanbaatar, Mong.), 19 June 2014, www.frc.gov.mn/en/index.php/information-database/item/332-frc-acceded-to-the-mmou-of-the-iosco.

22 MOU Signed between Financial Regulatory Commission of Mongolia (FRC) and Financial Services Agency of Japan (JFSA) (Financial Regulatory Commission, Ulaanbaatar, Mong.), 13 January 2014, www.frc.gov.mn/en/index.php/information-database/item/325-mou-signed-between-financial-regulatory-commission-of-mongolia-frc-and-financial-services-agency-of-japan-jfsa.

23 Amendments to the Minerals Law will be discussed below (see Section III, *infra*).

24 Investment Law, Article 1.1 (2013) (Mong.).

25 Mongolia revises its regulatory framework for foreign and domestic investment (Hogan Lovells, Ulaanbaatar, Mong.), October 2014, www.hoganlovells.com/files/Uploads/

[T]he new law introduces a more liberal business environment. Previously there were many approval systems in place for companies willing to enter Mongolia's market, a lot of bureaucracy. The new law eliminates entry barriers... In addition, the new law lifts any foreign investment limitation for key sectors such as mining, telecommunications, banking and finance and introduces equal treatment for foreign and domestic investors. It also includes international standardized protection clauses such as no expropriation and free repatriation of profits.²⁶

A permit, issued by the Ministry of Economic Development, is required for investments of 33 per cent or more by a foreign state-owned entity in the mining, banking and finance, or media and communication sectors.²⁷ The law defines foreign state-owned entities as those entities with 50 per cent or more of their total issued shares 'owned, directly or indirectly, by a foreign state'.²⁸ These restrictions are taking into account of limiting the entry, and also the influence and dominance, of foreign state policies in the national strategic sectors. In addition to restrictions placed on foreign state-owned entities, the new Investment Law effectively increased the minimum share capital requirement for foreign investors. Whereas the former Foreign Investment Law required a minimum capital investment of US\$100,000 for foreign-invested entities,²⁹ the new Investment Law stipulates that capital contributions must be US\$100,000 per foreign investor.³⁰ Those foreign-invested entities already incorporated in Mongolia were grandfathered under the previous capital contribution mandates and have not been required to meet the new per-investor minimum thresholds.

In partial contrast to the Investment Law's restrictions on investment outlined above, the law has paved the way for a streamlined company registration process. No longer are foreign-invested entities required to hold both a company certificate and a foreign-invested company certificate. All company registration renewals and establishment processes are carried out solely through the Legal Entity State Registration Office (LESRO), a sub-office under the country's overarching State Registration Office (SRO). The Foreign Investment Regulation and Registration Department has now been restructured as the IMA. In addition, the Investment Law, Chapters 5 and 6, provides investors with the ability to secure tax stabilisation certificates³¹ or investment agreements (or both).³² Investment agreements may be established between the government of Mongolia and investors who 'will make an investment of more than 500 billion

Documents/13.11.01_F_Mongolia_revises_its_regulatory_framework_for_foreign_and_domestic_investment_October_2013.pdf (Hogan Lovells).

26 Jacopo Dettoni & Sereeter Javkhlanbaatar, *The Diplomat*, 27 November 2013, <http://thediplomat.com/2013/11/sereeter-javkhlanbaatar/>.

27 *Id.* at Article 21.1.

28 *Id.* at Article 3.1.11.

29 Foreign Investment Law, Article 11.1 (repealed 2013) (Mong.).

30 Investment Law, Article 3.1.5. (2013) (Mong.).

31 See the Investment Law, Article 15 (2013) (Mong.).

32 See the Investment law, Article 20 (2013) (Mong.).

Mongolian togrogs [...] for the purpose of stabilizing its operational environment'.³³ With regard to stabilisation certificates, the Investment Law includes several criteria that will be used to determine whether an entity may be issued a certificate. Article 14 provides that the following types of taxes may be stabilised under the law: corporate income tax; customs duties; value added tax and mineral royalties.³⁴

ii Market overview

According to the IMA, as of 31 December 2014, total foreign direct investment in Mongolia was equal to US\$17 billion, with more than 12,000 foreign-invested companies representing 112 countries registered in Mongolia.³⁵ Foreign direct investment by country included nations such as the Netherlands, China, Luxembourg, the British Virgin Islands, Singapore, Canada, Korea and the United States. The largest investor by country listed was the Netherlands, which constituted 29.96 per cent of all foreign direct investment by country. This is likely due to the corporate structure of Oyu Tolgoi LLC (see Section III, *infra*), in which Oyu Tolgoi Netherlands BV presently has a 100 per cent voting equity ownership interest.³⁶ China followed closely with 26.65 per cent. With regard to investment by industry, geological prospecting and mining dominated Mongolia's foreign direct investment with 72.5 per cent of all total investment. Other notable industries included trade and catering services at 17.8 per cent.³⁷

Overall capitalisation of the MSE is at about US\$1 billion, with around 237 listed companies at a time. The IPO market has slowed to a trickle in Mongolia.³⁸ Only two new companies have listed on the exchange during the past six years, which include E-Trans Logistics and Merex. The former listed in 2012, selling 7.7 million of its shares in an oversubscribed offering for a total of 924 million togrogs, or 120 togrogs per share. Two years later, in January 2014, Merex sold 26 million shares for 100 togrogs each. By early 2015 Merex shares were trading at 90 togrogs, while E-Trans Logistics shares were down around 100 togrogs. The equity market has also fallen short of expectations. Liquidity is limited and trade is minimal. In February 2015 the average daily trading volume was 64.1 million togrogs and the average number of trades per day was 46. As of mid-March 2015, the top-20 benchmark index was down by almost 60 per cent from its February 2011 peak.³⁹

iii Structural considerations

The amended Securities Market Law contains a number of considerations for structuring a capital-raising transaction, in addition to those described above. Generally, the

33 Id. at Article 20.1.

34 Id. at Articles 14.1.1-14.1.4.

35 Invest Mongolia Agency, *Invest in Mongolia*, p. 67(2015).

36 Annual Information Form, Turquoise Hill Resources Ltd, p. 12 (26 March 2014), available at www.turquoisehill.com/i/pdf/2014-TRQ_AIF.pdf.

37 Invest Mongolia Agency, *Invest in Mongolia*, p. 67(2015).

38 Oxford Business Group, footnote 19, *supra* at 56.

39 Op.cit. *Emerging Markets: Mongolia, Truly the Final Frontier*.

Securities Market Law has incorporated important strengthened requirements related to increased transparency and ease of capitalisation. Applications to register securities for approval for a public offering must contain an application form, a detailed securities prospectus, documentation which evidences ‘payment of [a] regulatory service fee’, and other additional items determined by the FRC’s implementing regulations.⁴⁰ Article 10 of the Securities Market Law, outlines the information to be included within a securities prospectus, and includes ‘information concerning the amount of share capital of the securities issuer, the number, type, and par value of securities that were previously authorized, issued, and redeemed, [and] the net asset value and information concerning the securities issuer’s tangible and intangible assets’.⁴¹ Other requirements include the securities issuer’s financial statements⁴² and ‘details of the contracts and transactions having a value of an amount equal to [5 per cent] or more of the share capital of the securities issuer’.⁴³ In addition, Article 10.6 requires that securities prospectuses be reviewed for accuracy by an authorised law firm or legal entity.⁴⁴ These firms will thereafter issue an opinion regarding the veracity and accuracy of the information included, which will form a part of the prospectus for later review by potential buyers.⁴⁵

Article 5 of the amended securities law stipulates what financial instruments are subject to regulation. The Article lists nine different instruments, including shares of an open joint stock company,⁴⁶ company debt instruments,⁴⁷ debt instruments issued by the government or the governors of aimags or the capital city,⁴⁸ shares or unit rights in an investment fund,⁴⁹ depositary receipts,⁵⁰ asset-backed securities,⁵¹ rights to purchase a certain number of shares or debt instruments that are offered by a securities issuer to an investor, within a certain period of time and at an agreed price,⁵² derivative financial instruments,⁵³ and such other financial instruments deemed by the FRC to be securities.⁵⁴ During an IPO offering of the shares of an open joint-stock company, a securities issuer

40 Securities Market Law, Article 9.5 (revised 2013) (Mong.).

41 Id. at Article 10.5.5.

42 Id. at Article 10.5.6.

43 Id. at Article 10.5.7.

44 Id. at Article 10.6.

45 Id. at Articles 10.6, 10.7.

46 Id. at Article 5.1.1. An open joint stock company is defined by the Company Law, Article 3.7 as ‘a company whose capital invested by the shareholders is divided into shares, which are registered at the securities trading organisation and which may be freely traded by the public’. Company Law, Article 3.7 (2011) (Mong.).

47 Securities Market Law, Article 5.1.2 (revised 2013) (Mong.).

48 Id. at Article 5.1.3.

49 Id. at Article 5.1.4.

50 Id. at Article 5.1.5.

51 Id. at Article 5.1.6.

52 Id. at Article 5.1.7.

53 Id. at Article 5.1.8.

54 Id. at Article 5.1.9.

will be required to engage a legal entity to carry out underwriting activities.⁵⁵ In addition, any prospective buyers of securities generally, will be entitled to view the issuer's securities prospectus free of charge.⁵⁶ The amended Securities Market Law also contains reporting requirements for securities sold on the country's market, which should evidence that the issuer is in compliance with all legal and regulatory guidelines.⁵⁷

As indicated above, many of the procedures to be implemented under the amended Securities Market Law are the responsibility of the FRC, which is tasked with devising a plethora of regulatory activities, which include:

- a* approving procedures related to issuing securities via a public offer;
- b* application requirements for the registration of securities;
- c* establishing regulations related to issuing and registering depository receipts;
- d* establishing regulations related to registering company debt instruments; and
- e* issuing regulations pertaining to the purchasing and sale of shares in a listed company.

The above-listed responsibilities of Mongolia's FRC cover only a fraction of those regulatory obligations with which the Commission has been tasked. It is likely that it will take the FRC some time to fully implement the Securities Market Law in its entirety; however, the structural foundation has been laid and, as stated previously, the Securities Market Law's amendments mark a decisive improvement to Mongolia's overall capital market framework.

With an improved legal framework in place, it is hoped that the Mongolian market will, albeit slowly, see improvements via increased market capitalisation in the not-too-distant future. Change is somewhat trying for the country as it struggles with an underdeveloped risk-management system, an untrained judiciary in market and corporate matters, and a lack of skilled human resources. Training, however, has been one of the primary objectives in the country's collaboration with the LSE, and on 6 and 7 August 2014, the MSE offered a 'Custody and Securities Services Masterclass' aimed at persons desiring to learn more about custodian services and how those services would be incorporated into the Mongolian market place.⁵⁸ The class, taught by a senior post trade adviser from the LSE, was stated to have the objectives of acquainting organisations with 'the intricacies of' the custody and securities industry, while at the same time assisting such organisations 'in their ongoing development as a Mongolian sub-custodian'.⁵⁹ In addition, the masterclass was to 'address the important principles of the business and the [...] services required by the international investment community'.⁶⁰ This training for

55 Id. at Article 11.3.

56 Id. at Article 11.4.

57 See generally, Securities Market Law, Article 12 (revised 2013) (Mong.).

58 MSE to Conduct Custodian & Securities Services [sic] Masterclass (Mongolian Stock Exchange, Ulaanbaatar, Mong.), 31 July 2014, www.mse.mn/news/show/id/910.

59 Id.

60 Id.

the Mongolian business community will undoubtedly prove beneficial to the country and increase the perceived sophistication of market service providers to investors.

iv Tax considerations

Mongolian tax legislation offers many advantages for entities operating in the mining sector. In particular, the country's corporate tax rates are considerably attractive to foreign investors. If a corporate entity's taxable income is 3 billion togrogs or less, the entity is taxed at a rate of merely 10 per cent. For annual taxable income that exceeds 3 billion togrogs, the tax rate is 300 million togrogs plus 25 per cent of the entity's income that exceeds 3 billion togrogs. Income derived from dividends, royalties and interest income is also taxed at the 10 per cent rate. Other taxes that may apply to foreign-invested entities include a value added tax, customs duties and personal income tax.

With the passing of the Investment Law, several new tax incentives have become available to investors. Chapter 4 of the law, entitled 'Promotion of Investment', contains a number of benefits. These incentives include the possibility for the following:

- a* exemption from taxes;
- b* provision of tax rebates;
- c* estimation of depreciation costs that could then be excluded from taxable income;
- d* having losses excluded from taxable income; and
- e* exclusion of employee training costs from taxable income.⁶¹

Other important incentives include the ability to conclude tax stabilisation agreements, as briefly described above. Investors may obtain tax stabilisation certificates to effectively lock in a favourable tax rate for a given period of time. The following taxes may be covered by a stabilisation certificate: corporate income tax; customs duties; value added tax; and mineral royalties.⁶²

In order to qualify for the use of stabilisation certificates in Mongolia, investors must meet certain criteria outlined in Article 16 of the Investment Law. Specifically, investors must meet a minimum investment threshold, which is 10 billion togrogs and over, depending on the sector in which investment is occurring. In addition, the investment project must show that an environmental impact assessment has been conducted, if required.⁶³ Investors must also demonstrate that they are employing advanced technology⁶⁴ and that a 'sustainable work place' has been created.⁶⁵ The duration of stabilisation certificates will be determined by the total amount invested and the location in which an investment project will be undertaken. For example, in the 'mining, heavy industry and infrastructure sectors', an investment of greater than 500 billion togrogs in the Ulaanbaatar area will allow for a stabilisation certificate for up to 15 years, whereas that same amount invested in the western region of the country (i.e.,

61 Investment Law, Articles 11.1.1-11.1.5 (2013) (Mong.).

62 Id. at Articles 14.1.1-14.1.4.

63 Id. at Article 16.1.2.

64 Id at Article 16.1.4.

65 Id. at Article 16.1.3.

Bayan-Ulgii, Gobi-Altai, Zavkhan, Uvs or Khovd) will allow for a certificate lasting 18 years.⁶⁶ For sectors other than mining, heavy industry and infrastructure, similar criteria are used to determine the period for which a stabilisation certificate will be issued, but the duration and investment thresholds are not identical.⁶⁷

With the exception of those tax considerations discussed above, there is no unique tax structure that applies specifically to the mining industry in Mongolia. Corporate mining entities, whether domestic or foreign-invested, will be taxed in accordance with the provisions of the Law on Economic Entity Income Tax. This law applies to any economic entities formed under the laws of Mongolia, their subsidiaries, and representative offices,⁶⁸ foreign economic entities with headquarters located in Mongolia,⁶⁹ and foreign economic entities or their subsidiaries earning income in Mongolia.⁷⁰ Gross taxable income deductions, many of which may be utilised by mining entities, are found in Article 12.⁷¹ The deductions are numerous and include a variety of expenses, including social and health insurance premiums,⁷² raw materials, primary and auxiliary materials,⁷³ and employee bonuses, incentives, and allowances for housing and transportation.⁷⁴ Corporate entities may also deduct for maintenance expenses, lease payments, loan interest, customs duties, transport and labour safety expenses, and more.⁷⁵

III DEVELOPMENT

Mongolia's legal framework governing tax issues also has seen significant change in 2015. Starting from 2014 to 2017, Mongolia launched its second phase of tax reform. The first phase of tax reform took place between 2007 and 2012, and its 'Four 10's' tax policy made Mongolia the lowest taxed nation in the world.⁷⁶ Taxes are 10 per cent of personal income, 10 per cent of corporate income, 10 per cent of social insurance tax and a 10 per cent of value added tax. The second tax reform aims to improve tax environment with principals of simple, easy, equal and fair taxes. In 2015, a series of tax laws have promulgated or revised, including General Tax Law, Value Added Tax Law, Auditing Law, Accounting Law, Personal Income Tax Law, Law on Banking and Law on Economic Transparency. The revision of the Value Added Tax Law passed in July 2015 raises the VAT threshold from 10 to 50 million togrogs as well as clarifying the definition of some ambiguous legal terms, and provides a refund of 20 per cent of VAT

66 Id at Article 16.2.1.

67 Id. at Article 16.2.2.

68 Id. at Article 3.1.1.

69 Id. at Article 3.1.2.

70 Id. at Article 3.1.3.

71 Id. at Article 12.

72 Id. at Article 12.1.3.

73 Id. at Article 12.1.1.

74 Id. at Article 12.1.4.

75 Id. at Articles 12.1.6, 12.1.7, 12.1.10, 12.1.14, 12.1.21, 12.1.23.

76 The Second Phase of Tax Reform, <http://mongolianeconomy.mn/en/p/6106>.

paid by certain end users. The main purpose of revising the Accounting Law and the Auditing Law is to tackle operational hindrances, particularly when legal entities submit their financial statements. For instance, the amended Accounting Law now enables legal entities to use online filing systems for their financial statements and also reduces the number of mandatory submissions of financial statements from each quarter of a year to once a year. Also, according to the amended Auditing Law, financial statements of legal entities are not required to be audited prior to their submissions. All these changes will come into effect from 1 January 2016. In addition, the second stage tax reform also includes creation of the Tax Debt Prevention Centre (TDPC), to provide taxpayers with information on tax debts and remind them of possible debt risks in the future.

In 2009, the government established a joint venture with Turquoise Hill Resources (a majority-owned subsidiary of Rio Tinto) to develop the Oyu Tolgoi copper and gold deposit (OT), which is the biggest foreign-investment project ever in Mongolia and has attracted US\$6.2 billion (50 per cent of GDP) in FDI for the first phase development (OT-1) with another US\$5.4 billion in the pipeline for the second phase (OT-2). OT-1, which exploits the open pit mine of the deposit, started commercial production in 2013. Nevertheless, the second phase, which exploits the underground deposit and appears crucial to recover the cost of the project, has been stalled by disputes between the Mongolian government and Rio Tinto. On 18 May 2015, Mongolia and Rio Tinto Group settled their dispute over the US\$5.4 billion underground expansion of the Oyu Tolgoi copper and gold mine, ending two years of often bitter negotiations and giving a boost to the country's economy. The plan also resolves a tax dispute between the two parties, with Rio Tinto Group agreeing to pay US\$30 million in tax, a figure reduced from an original charge of US\$127 million.⁷⁷

Another new development in 2015 was the international arbitration between the government of Mongolia and Khan Resources Canadian Company. Khan Resources Inc, and its predecessor companies, have been involved in the development of the Dornod uranium property in Mongolia since 1995. Khan completed a full definitive feasibility study on the property in the spring of 2009, which demonstrated highly positive economic prospects for the project. However, in January 2009, Mongolia and Russia announced their intention to form a new Mongolian–Russian joint venture to replace Khan in mining the Dornod property. In July 2009, the government of Mongolia promulgated its Nuclear Energy Law, which among other items, gave the state 51 per cent of the Dornod property without compensation to prior owners. Further, in 2010, the government of Mongolia refused to reissue to Khan the required licences for the Dornod property, which effectively resulted in 100 per cent expropriation of the asset without any compensation. As a result of these actions, Khan launched an international arbitration action against Mongolia for the illegal expropriation of its assets in January, 2011. On 5 March 2015, the arbitration tribunal administered by the Permanent Court of Arbitration located in The Hague, Netherlands, rendered an award in favour of Khan for US\$80 million, plus costs of US\$9 million, plus interest at LIBOR, plus 2 per cent

77 IFM Working Paper, From Natural Resource Boom to Sustainable Economic Growth: Lessons for Mongolia, p. 5 (2015).

from July 2009 to the date the award is paid. The award aggregated approximately US\$103 million as of the award date. Although the award is due and payable, the government of Mongolia has been recalcitrant about making payment and enforcement procedures have been initiated.⁷⁸

The Mongolian Prime Minister Saikhanbileg Chimed has promised to honour a court decision on the enforcement of the arbitration award and will pay Khan Resources Inc, according to an interview with Bloomberg in New York on 26 June 2015. This could further ease tensions with foreign investors looking for signs of proper legal action by the Mongolian government.

78 <http://www.khanresources.com/>.

Appendix 1

ABOUT THE AUTHORS

OYUN SURENjav

Anderson & Anderson LLP

Oyun Surenjav is a legal specialist of the Ulaanbaatar, Mongolia office of Anderson & Anderson LLP. Her legal practice focuses on a commercial transactions, public and private international law, labour and employment relation, mining and foreign investment, corporate law, social insurance and social welfare law. She obtained her bachelor's degree in law at China Foreign Affairs University in 2011.

DAVID C BUXBAUM

Anderson & Anderson LLP

David C Buxbaum is the managing partner of the Ulaanbaatar, Mongolia, office of Anderson & Anderson LLP. He has been an active law practitioner in China since 1972 and Mongolia since 1992. Mr Buxbaum, who has been active in the securities market in the United States and elsewhere, worked with other attorneys at the firm's office in Ulaanbaatar and the bank's outside counsel to assist the Trade and Development Bank to offer their bonds on the Singapore Exchange, and assisted two Canadian corporations with investments in Mongolia in going public on one of the Canadian exchanges. He has advised international corporations on the acquisition of mineral interests within Mongolia, and has also assisted asset-management organisations to navigate Mongolia's legal environment. In addition, Mr Buxbaum is an active litigator, and has litigated matters pertaining to international business disputes as well as energy, commodities and securities. His work in the energy field spans a spectrum that includes coal-fired power plants, mining, oil and gas, and nuclear power. He has been honorary counsel to the Independent Power Producers Forum since 2000. Until 2007, Mr Buxbaum was the primary author and editor of the *Mongolia Law Digest* for the Martindale-Hubbell directory.

ANDERSON & ANDERSON LLP

Suite 1008
10th Floor, Grand Plaza
Enkhtaivan Ave 46
Bayangol District
Ulaanbaatar 210628
Mongolia
Tel: +976 7011 9339
Fax: +976 7001 9669
anderson.mongolia@anallp.com
www.anallp.com