

An aerial photograph of a pipeline stretching across a rugged, mountainous landscape. The terrain is characterized by deep, eroded gullies and ridges. The image is split diagonally: the upper-left portion shows the natural brown and green colors of the land, while the lower-right portion is overlaid with a semi-transparent blue filter. The pipeline itself is a prominent white line that winds through the terrain.

Investors' guide to Mongolia

July 2016



The Allens 2016 Investors' guide to Mongolia highlights key issues for foreign investors considering investment in Mongolia. Allens has a long history of acting for investors in Mongolia and we pride ourselves on working closely with clients to develop flexible entry strategies, enabling investment projects to commence even in times of regulatory uncertainty. Allens also publishes 'real-time' updates on changes to key laws affecting foreign investment — visit our website for more information.

In this guide

This Investors' guide to Mongolia provides a snapshot of the key legal considerations for investors looking to enter the Mongolian market.

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Allens is an international law firm which practices throughout the Asia Pacific region. It advises on international legal issues in Mongolia but does not provide Mongolian legal advice. Allens regularly works with Mongolian counsel where Mongolian legal advice is required.

SNAPSHOT

Foreign investment in Mongolia

Over the past decade Mongolia's substantial resource wealth has generated considerable interest from foreign investors. More recently, investors have also been attracted by opportunities in other sectors including energy, infrastructure, real estate and banking.

Mongolia's current foreign direct investment regime is considered to be very open. Both domestic and international investors have the freedom to invest in all legitimate sectors of the economy and no sector is specifically closed to foreign investment. The law of Mongolia on Investment (the **Investment Law**) which commenced on 1 November 2013, contains a number of provisions which aim to protect the rights and interests of foreign investors including:

- > tax stabilisation certificates, which provide for fixed taxation rates depending on the investment size, location and sector;
- > legislative protection from expropriation;
- > provisions to facilitate repatriation of profits; and
- > strengthened arbitration rights.

The Investment Law also reinforces the pivotal status of bilateral investment treaties. It provides that where there are inconsistencies between the Investment Law and the provisions of an international treaty, the treaty provisions prevail.

IN BRIEF

> the system of government

Mongolia is a parliamentary democracy with a directly elected President and a unicameral legislature, the State Great Khural, made up of 76 members. The Prime Minister is elected by members of the legislature. The current president is Tsakhiagiin Elbegdorj and the Prime Minister is Chimedijn Saikhanbileg, both of the ruling Democratic Party.

Both parliamentary and presidential elections are held separately every four years. The next parliamentary election is scheduled for mid-2016 while the next Presidential election will take place in mid-2017.

Mongolia is divided into 21 provinces (*aimag*), which are further subdivided into districts (*soum*), as well as three municipalities (*khot*). Provincial governments provide administrative services such as maintaining civil registries and also play an important role in planning, issuing licences and permits. Local governments also have authority over the sale, transfer and privatisation of local infrastructure.

> the legal system

Mongolia has a civil law system influenced by Romano-Germanic legal traditions. Under this system judicial decisions do not have precedential value. There are three levels of ordinary civil courts: the District Court, the Inter-District Court and the Provincial Court, which are located in all provincial capitals. Civil disputes involving amounts above MNT 10 million (approx. US\$5000) are dealt with at the Provincial Court level. The Supreme Court, Mongolia's highest court, is based in Ulaanbaatar and handles appeals from the Provincial courts as well as cases outside the purview of the ordinary courts. The Supreme Court can issue official interpretations regarding the correct application of any law, other than the Constitution.

International law becomes accepted into Mongolian law upon ratification, unless the provisions of the law contradict the Mongolian Constitution.

Mongolia is undergoing a major transition to democratic governance and a market-based economy, which involves the rapid development of its investment framework, systems of corporate, taxation, banking and other commercial laws. This transition brings both challenges and opportunities.

Currently, problems can arise due to Mongolian laws often being written in broad high-level language which can lead to alternative interpretations. Specific regulations are not always consistent with other laws, which can further contribute to legal uncertainty.

Allens has expertise and experience in advising clients on strategies for dealing with legal uncertainties in Mongolian law.

QUICK FACTS

Population:
2,992,908

Capital city:
Ulaanbaatar

Currency:
Togrog/tugriks (MNT)

Language:
Khalkha Mongol (Mongolian)

Predominant land use:
Pastoral land (73 per cent)



Structuring your investment

In determining the structure of an investment in Mongolia, a foreign investor will need to consider such factors as:

- > the amount of capital to be invested;
- > the tax implications of the available structures;
- > whether it is necessary or desirable to involve a local partner;
- > the sort of business activity that the business will undertake and related licensing requirements;
- > the employment needs of the Mongolian business and possible changes over time; and
- > the implications of the proposed investment structure under the Investment Law.

Typical structures

Direct investment in Mongolia generally occurs through investing, acquiring or setting up a legal entity, typically a limited liability company (**LLC**). It is also possible to establish a presence in Mongolia by entering into a partnership or opening 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, there are risks in integrating with local businesses, and therefore it is important to conduct thorough due diligence on potential partners (see more on page 25).

An arrangement described as a 'joint venture' is generally an incorporated joint venture and most often an LLC. Unincorporated or contractual joint ventures are not common because Mongolian law does not recognise tenancy in common (see page 20 for further details in the context of mining investments).

Establishing a representative office

First-time investors in Mongolia may find that establishing a representative office will best meet their near-term business needs. 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 hire locally (to a limited extent). However, a representative office is not permitted to generate income and may only undertake limited, non-profitable activities as set out in their business licence. Additional conditions apply to representative offices of businesses operating in particular sectors, such as banking.

Advantages of this structure include that there is no requirement to inject initial capital and no requirement to pay business tax in Mongolia. On the other hand, a representative office is not a separate legal entity in Mongolia, which means the parent company is not shielded from potential liability incurred by the representative office.

Establishing a company

For investors who require a more robust on-the-ground presence in Mongolia, Mongolian law permits two types of foreign-invested companies:

- > an LLC; or
- > a joint stock company (**JSC**).

The minimum start-up investment required for a foreign-invested business entity is US\$100,000.

Investors tend to favour the LLC structure, as this form of entity offers greater flexibility in management structures and is the more common form of company in Mongolia (with JSCs remaining largely untested). Key differences between LLCs and JSCs include:

- > the shares of a JSC (specifically, an 'open joint stock company') may be publicly traded, whereas the shares of an LLC (and a 'closed joint stock company') cannot;
- > there is a maximum of 50 shareholders for an LLC, no equivalent restriction applies to a JSC;
- > LLCs are not required to have a board of directors whereas a JSC must have a board of directors (which must consist of at least nine directors (one third of whom must be independent)); and
- > the board of directors of a JSC must have audit, salary, bonus and nominating committees, whereas no similar requirement applies to LLCs.

As may be expected, establishing a company in Mongolia involves various regulatory procedures including lodging key company documents (such as the Company Charter) with Mongolian regulators. In our experience, the process of registering an LLC company takes approximately two weeks after all of the application documents are submitted to the regulators.

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 which is a party to a double taxation treaty and a bilateral investment treaty with Mongolia.

Bilateral investment treaties

A bilateral investment treaty is an agreement between two states under which both agree to promote and protect the investments made by entities from the other contracting state within their territory. Ensuring that your investment is protected under a bilateral investment treaty will 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 your investment prior to initiating a project to ensure that your investment will receive the full benefit of the ‘most-favoured nation’ clauses and other standard protections.

According to the UNCTAD, Mongolia has entered into 37 investment treaties which are in force at the date of publication of this guide, with countries including China, Korea, Singapore, Japan, France, the United Kingdom, the Netherlands and the United States of America.

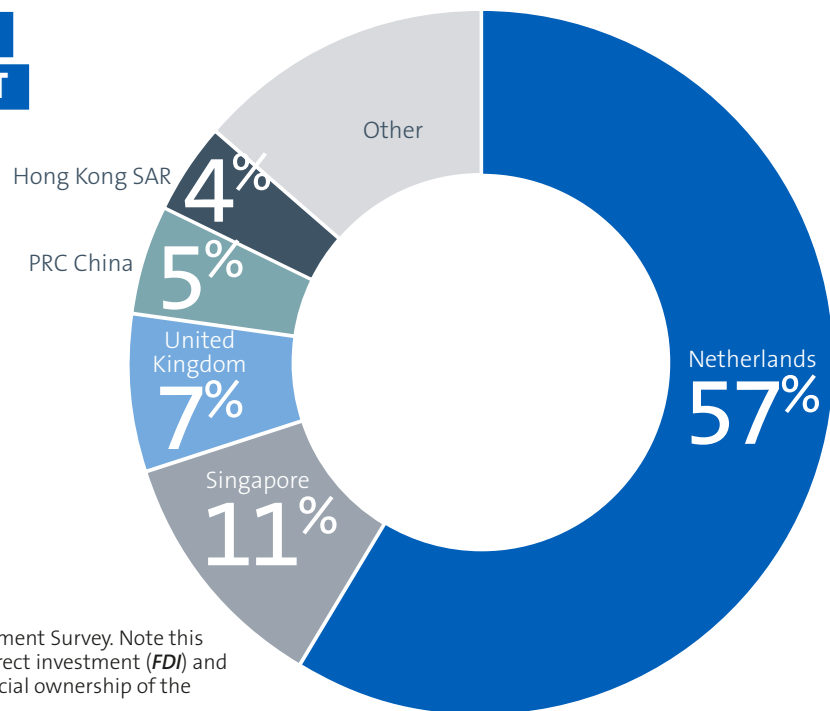
COUNTRIES WITH MONGOLIAN BITS

- | | | | |
|--|---------------------|------------------------------------|----------------------------|
| > Austria | > France | > Kuwait | > Singapore |
| > Belarus | > Germany | > Lao People’s Democratic Republic | > Sweden |
| > BLEU (Belgium-Luxembourg Economic Union) | > Hungary | > Lithuania | > Switzerland |
| > China | > India | > Malaysia | > Tajikistan |
| > Cuba | > Indonesia | > Netherlands | > Turkey |
| > Czech Republic | > Israel | > Philippines | > Ukraine |
| > Denmark | > Italy | > Poland | > United Kingdom |
| > Egypt | > Japan | > Romania | > United States of America |
| > Finland | > Kazakhstan | > Russian Federation | > Vietnam |
| | > Republic of Korea | | |



Source: <http://investmentpolicyhub.unctad.org/IIA/CountryBits/139>

TOP FIVE SOURCES OF INWARD DIRECT INVESTMENT



Source: IMF Coordinated Direct Investment Survey. Note this shows immediate source of foreign direct investment (**FDI**) and does not necessarily reflect the beneficial ownership of the FDI structure.

Double taxation treaty

As at the date of publication of this guide, Mongolia is a party to double taxation treaties with 24 countries, including China, Singapore, France and the United Kingdom. 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.

Since January 2014, the Mongolian Government has terminated its double taxation treaties with Kuwait, the United Arab Emirates, Luxembourg and the Netherlands. This decision followed an earlier recommendation from the Ministry of Finance to terminate all double taxation treaties. At the time of publication of this guide, we are not aware of any plans to terminate any other double taxation treaties.

Invest Mongolia Agency


Investment is largely overseen by the Invest Mongolia Agency (**IMA**), established in 2013 to provide a range of advisory services to investors and to facilitate streamlined approval processes.

The IMA is responsible for:

- > promoting a stable legal framework and favourable conditions for investment;
- > processing tax stabilisation certificates;
- > monitoring the investment activities of tax certificate holders; and
- > maintaining the State registration of tax stabilisation certificate holders.



Investment approvals



The Investment Law poses relatively few restrictions on private investment and generally affords foreign investors the same rights as their domestic counterparts. The focus of the approval regime is on foreign state-owned entities rather than private investors. This is a significant relaxation of the approval regime under the previous investment law which had more onerous permit requirements for foreign investors.

Entities and international organisations with foreign state ownership (in whole or part) must obtain investment approval prior to making an investment of more than 33 per cent in a business entity operating in a strategic sector (mining, banking & finance, and media & communications). A foreign state-owned legal entity is defined as a legal entity in which a foreign state directly or indirectly holds more than 50 per cent of the entity's share capital.

Investment approval requires obtaining a permit from the IMA. The IMA is required to make a determination within 45 days of receiving a permit application. Factors that the IMA may take into account include national security concerns, competition and the potential adverse impact on state budget and revenues.

To provide greater certainty to investors, the Mongolian Government has sought to entrench the new Investment Law by requiring that amendments are passed by at least a two-thirds majority of parliament.



Investment guarantees and incentives

The Investment Law gives investors a right to seek both tax incentives and other forms of government support for their investments.

Alongside various tax incentives and a tax stabilisation regime (discussed below) the Investment Law provides that the Mongolian Government may offer various other initiatives to promote investment in particular sectors. These include:

- > visa support for foreign investors, including family member visas and residential permits;
- > support to facilitate the implementation of projects in the infrastructure and science & education sectors to increase the number of foreign workers and specialists in those areas; and
- > Mongolian Government guarantees for the financing of export-oriented 'innovation' projects.

The Investment Law also prohibits the confiscation of an investment. The exception is where compulsory acquisition is required for public purposes in accordance with the due process of law and on payment of compensation. In such cases, compensation is determined on a market rate, however, neither the Investment Law nor any other legal instrument specifies how the 'market rate' will be calculated.


Investment agreements

For investments of more than MNT500 billion (equivalent to approximately US\$250 million) an investor may request that the Mongolian Government enter into an investment agreement to stabilise the investment operating environment. Regulations on Investment Agreements (the **Regulations**) set out the process of applying for, negotiating and executing an investment agreement for most types of investment.

The Regulations set out the standard content of an investment agreement. Some of the more important provisions that are codified under the Regulations include:

- > the terms of tax stabilisation and other regulatory or financial support from the Mongolian Government;
- > the mitigation of adverse health and environmental impacts from the investment; and
- > the project's contribution to regional development.

Investors may apply for an investment agreement with the IMA. The Regulations do not specify a timeframe within which the IMA will review and respond to an investment agreement application. If an applicant is successful, they will be invited to negotiate an investment agreement with a working group established by the IMA. The working group may retain independent advisers to assist it with the negotiation of the investment agreement.



Investment agreements in Mongolia: some common provisions

Investment agreements might typically include Government guarantees or undertakings to provide support in relation to:

- > a stabilised tax regime;
- > project permits and authorisations;
- > foreign personnel visas and permits;
- > currency and repatriation of funds;
- > revenue streams (in relation to government supply contracts); and
- > infrastructure access, energy and water supply.

In addition, investment agreements are likely to place obligations on investors, including in relation to:

- > project delivery and timelines;
- > local training and employment opportunities;
- > local and regional socio-economic development programs; and
- > applicable environmental protections, reporting and rehabilitation funds.

Tax stabilisation regime

The Investment Law includes a specific chapter on the stabilisation of the tax environment that introduces stabilisation certificates that the IMA can issue to an investor in the absence of an investment agreement. If a legal entity is to implement the investment on its own, a stabilisation certificate will be issued to the relevant legal entity registered in Mongolia. If one or more affiliated parties are to implement the investment together, a stabilisation certificate is issued to the parent company of those affiliates.

The stabilisation certificate sets out the rates of taxes to be stabilised together with the terms and duration of the stabilisation. It stabilises the percentage rates of four major taxes: corporate income tax, customs duty, value-added tax and royalties.

A stabilisation certificate is granted if:

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

The Investment Law provides that the IMA must make a decision within 30 days (with a possible further extension of 15 days) after the receipt of an application, taking into account:

- > the conclusion of the tax-stabilisation Council under the Investment Law; and
- > the criteria specified in the Investment Law.

If the IMA rejects the application it must provide the reasons for its rejection in writing.

Notwithstanding the designated stabilisation rate, an investor may benefit from any changes to tax laws or regulations that have the effect of reducing the taxable amount payable by the investor under its stabilisation certificate. Accordingly, a holder of a stabilisation certificate can take advantage of favourable changes to tax laws in Mongolia after the stabilisation certificate has been issued.

Stabilisation period

The duration of a stabilisation certificate depends upon the amount of investment and the geographic location of the investment. Contact Allens for a complete list of up-to-date information for each relevant category.

The duration of a stabilisation certificate may be extended by a further 150 per cent (eg from a two-year period up to a period of five years) for projects deemed to have significance for Mongolia's long-term social and economic development, as well as projects that produce substitutes for imported goods or create value-added products for export, provided that certain conditions are met.

Investment obligations

Holders of stabilisation certificates are under a strict obligation to comply with the relevant terms under the Investment Law. If the investor fails to invest the stipulated amount within the investment term, this may result in the cancellation of the stabilisation certificate. The investment completion date is calculated from the stabilisation certificate issuance date. Under the implementing regulations, an investor that has already invested in a project in Mongolia can include its investments over the five years preceding the coming into force of the Investment Law when applying for a stabilisation certificate.

Note that a stabilisation certificate may not be sold, pledged, donated or otherwise transferred.

An aerial photograph of a winding river in a snowy, mountainous landscape. The river is a mix of white and light blue, flowing through a valley. The surrounding land is covered in snow and sparse, brown vegetation. A large, semi-transparent white diamond shape is overlaid on the right side of the image, partially covering the river and the surrounding terrain. The word "Land" is written in a bold, white, sans-serif font in the center of the image.

Land

For some potential foreign investors, the ability to hold an interest in land, and to deal with that interest, will be crucial to their investment decision-making. Mongolian law imposes certain restrictions on foreign-invested entities dealings with land which should be considered at the outset of any investment.

In Mongolia, Mongolian citizens may acquire freehold title to land in urban municipalities but most of Mongolia's rural lands remain the property of the State. Under the Law of Mongolia on Land (the *Land Law*), foreign invested entities and foreign individuals cannot hold land ownership or possession rights in Mongolia. However, foreigners and foreign invested entities can obtain an interest in land through acquiring a licence for land use.

Licences for land use

The Land Law limits contractual land use rights to a period of five years, with a possible further extension of five years. However, the Investment Law provides that in the context of investment projects the government has a discretion to extend land use lease periods to up to 60 years, with a possible further extension of 40 years.

It is important that foreign entities follow the correct approval and registration process when obtaining land use rights, as the government can terminate the underlying land possession and utilisation rights where Mongolian citizens or entities enter into lease agreements with foreign entities in breach of the requisite procedures. It is also important that foreign investors seek advice on associated land development rights, including rights in relation to any buildings.

Owners of land are prohibited from granting security over land or land possession rights in favour of foreign banks or companies. In practice, this restriction is sometimes overcome by using a local Mongolian bank as a security agent.

Land administration

Generally, governors of *soums* (district governments) and districts are responsible for the issuance of licences for land use and possession. These licences must be issued via an auction process and awarded to the highest bidder. Land issuance must be in accordance with the annual land management plan. Land management and planning laws are regulated at various levels of government and this can be a complex area of Mongolian law, making it important to obtain specialist advice.

There are few laws which formally recognise customary forms of land use by pastoral nomadic herders. In general herders do not have formal exclusive rights of pasturage or other forms of land title. However, *soums* in rural areas often require that traditional, customary access to land and other resources by pastoralists are taken into account when designating other non-resident land use and possession rights.

Note: in order to secure requisite land rights and authorisations for development projects it is important to comply with environmental regulations including the Law on Environment Protection, the Law on Environmental Impact Evaluation and the Cultural Heritage Protection Law. In addition to preparing an environmental impact assessment, developers are under an obligation to engage an approved institution to undertake a cultural heritage survey prior to commencing any infrastructure or mining work.

SPOTLIGHT ON

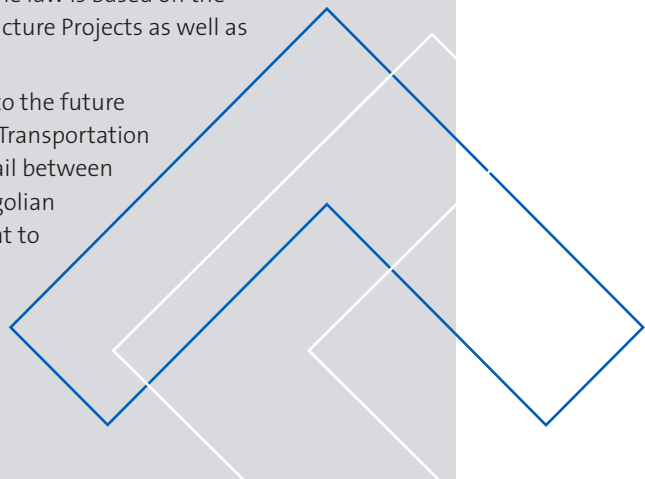
> Infrastructure development

Mongolia's Ministry of Industry is responsible for promoting infrastructure development and has identified a number of priority areas for future projects, including roads, power plants and power lines, airports and social infrastructure.

Public private partnerships (**PPPs**) are the principal model for infrastructure development in Mongolia. The current Mongolian Government PPP priority list includes 35 projects, largely in the infrastructure, energy and transport sectors, submitted by various ministries and some private sector proponents.

PPPs are largely governed under the Concession Law, which reflects internally accepted standards and is designed to provide mechanisms for the bankability of project finance based transactions. It provides for a range of PPP models and security instruments and includes provisions for government support and guarantees as well as a range of provisions for lender step-in rights. The law is based on the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects as well as other international guidelines.

Railway projects are a major priority in Mongolia and are seen as key to the future viability of its energy and resources sector. The Ministry of Roads and Transportation has announced plans for the development of more than 1900km of rail between 2015-20, as well as associated logistic centres. In mid-2015, the Mongolian Government approved the implementation of a concession agreement to build and operate the 547km Erdenet-Ovoot line, which will connect new coal mining developments in northern Mongolia to the rail network and is expected to form part of a new China-Russia link. Mongolian railway projects have been consistently cited as major investment opportunities for global engineering and construction firms.



Land for large scale projects

Under a recent amendment to the Land Law, the Mongolian Government has a special authority over land for purposes of major national-scale construction, development and infrastructure projects and programs. By designating such land as 'special needs land' the Mongolian Government has a greater ability to facilitate more direct and expedited access for development purposes. This means that investors in infrastructure and other major construction projects can deal directly with the national Government in resolving land issues, rather than a multitude of local governing bodies.

According to Mongolian Government statements, the amendment is designed to facilitate major regional, national and international projects, including the north-to-south highway project (Altanbulag-UB-Zamiin Uud), the Bogdkhan railway project, the Khushigt international airport and a new free trade zone to serve as a North Asia passenger and freight hub.

It is expected that this amendment will create enhanced certainty in relation to land dealings.

Allens has extensive experience advising on risk management and project structuring in the context of project land requirements.



Taking security

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

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

The main security options are:

- > **pledge** – this is the most commonly used security in Mongolia, and is somewhat analogous to the English law concept of a ‘charge’ over assets. Most objects (including movable and immovable objects, contractual rights, shares, and rights to payment) are capable of being pledged. However, in general, licences for carrying out commercial activities cannot be pledged. A notable exception to this rule is that a minerals licence can be pledged under the Minerals Law, subject to certain conditions. A pledge over immovable property may be registered with the Property Rights Registration Office (*PRRO*). Currently, it is not possible to register a pledge over movable property, however this is the subject of potential law reform and is discussed below.
- > **fiducia assignment** – a fiducia assignment contract transfers the legal ownership of an obligor’s property to a lender with a right to have such property returned if the secured obligations are successfully performed.
- > **hypothec** – similar to a real property mortgage, a hypothec is a method of security over immoveable property. Property subject to a hypothec is used to satisfy secured lenders prior to other parties who have a claim.
- > **penalty/forfeiture** – Mongolian law expressly recognises the concept of contractual penalty or forfeiture (in contrast to jurisdictions such as England and Australia where contractual penalties are unenforceable). A penalty may be agreed between the parties and takes the form of a fine (ie similar to a bond, a cash payment which is forfeited upon the non-performance of underlying obligations) or compensation for losses. Mongolian law caps the amount at which the fine or compensation may be set and the courts may reduce a penalty which is considered too high.
- > **guarantee** – third-party guarantees are recognised under the Civil Code. A guarantee entitles a creditor to demand performance of the obligation by the guarantor if the debtor fails to fulfil its obligations.

We have advised extensively on the various security arrangements available in Mongolia and the risks and limitations of the alternative techniques, as well as strategies to mitigate such risks. If this area is of particular interest to you, please contact a member of our team who will be able to provide more specific advice.

A new Movable Property Pledge Law was recently passed which sets out a new framework for registering pledges over movable property. Please contact Allens for more details on this development.



Repatriation of funds and foreign exchange

An investor's right to repatriate funds from the investment destination is of primary concern to all foreign investors. Mongolia's Investment Law provides that foreign investors have the right to remit their legitimate income and profits abroad.

Any assets and revenues can be transferred abroad provided that the entity has fulfilled its tax obligations.

Similarly, investors are entitled to convert moneys into any international currency and Mongolian law does not impose any foreign exchange controls, however, it does impose certain other restrictions that may impact on the repatriation of funds.

Investors should also be aware of certain banking restrictions and regulations with regards to domestic transactions. 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, Tugrik (the Mongolian currency). Any payment or advertisement of prices in a foreign currency is prohibited.

A 20 per cent withholding tax applies to foreign held interest bearing dollar accounts, unless an exemption applies under a relevant tax treaty.

We have considerable experience advising clients with operations in Mongolia on currency and banking restrictions, as well as practical ways of managing currency risk.

An aerial photograph of a Mongolian landscape. A paved road runs diagonally from the top left towards the center. To the right of the road, there is a lush green field. In the foreground, a large, brown, rocky hillside is visible, with a herd of dark-colored horses grazing on it. The overall scene is a mix of natural and man-made elements.

Company law

Mongolia's Company Law has a number of features that are important to consider when designing the structure of an investment in Mongolia.

Shareholder decision making

Under Mongolian law, the highest governing authority of a Mongolian company (whether an LLC or JSC) is the shareholders' meeting. 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. We have advised companies on various deal structures to ensure that their commercial deal can be achieved within the context of these compulsory voting thresholds.

Liability of directors and managers as 'governing persons'

Mongolia's Company Law provides that governing persons may be personally liable for any loss caused to the company, its shareholders or its creditors, if certain unlawful acts or omissions have been intentionally committed. The concept of 'governing persons' comprises the directors of the company and certain senior personnel, including the chief financial officer, secretary and general managers. By way of example, a governing person who gives false information to a company's shareholders or creditors, or uses the company name for his/ her personal benefit may be found liable under these provisions.

Potential shareholders' liability

Mongolian law provides that shareholders may be personally liable for the obligations or liabilities of the company under certain circumstances. Though there is the potential for liability to attach to shareholders under particular provisions of Mongolian law, it should be noted that such provisions are yet to be tested.

Implications for foreign investment

Investors may need to take into account the structuring implications of the Company Law requirements (including those summarised above) when planning their investment. In a joint venture context, adopting an offshore holding company structure can provide greater flexibility in determining the company's management structure — however such structures can also have drawbacks, which should be considered individually in the case of each investor. Foreign investors are advised 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.



SPOTLIGHT ON

> Mining

Mongolia's mining sector has long been a focus of inbound foreign investment as the nation is rich in mineral resources such as coal, copper, gold, fluorite, iron ore, tungsten, lead, oil, phosphates, tin and uranium.

Mongolian law provides that mineral resources are the property of the Mongolian State. Under the **Minerals Law of Mongolia** legal entities may apply for exploration licences and mining licences which authorise exploration and mining activities (respectively) for minerals within the licence area. Unlike in many other jurisdictions, a licence under the Minerals Law relates to minerals generally rather than specific minerals.

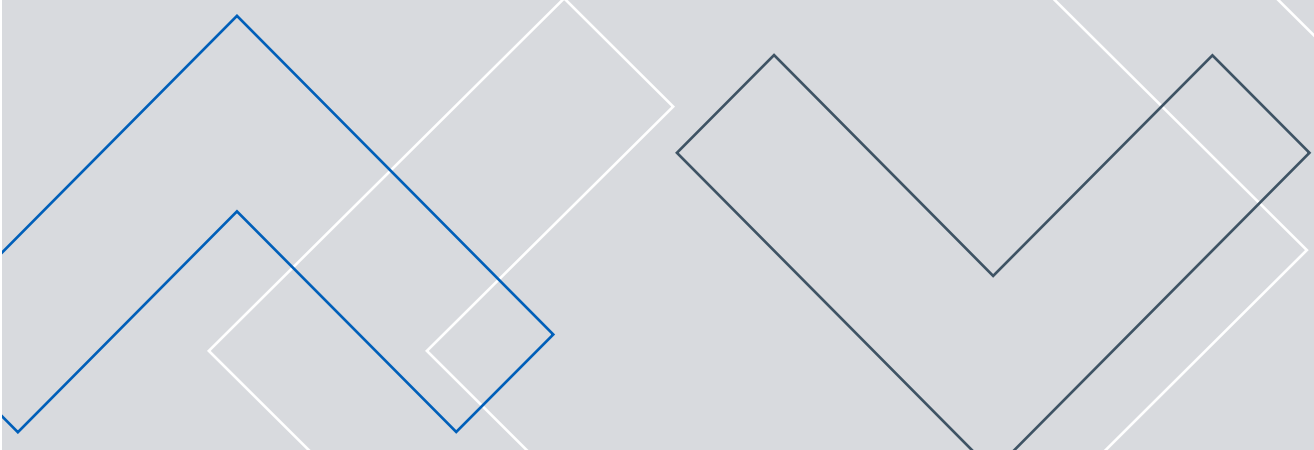
Notably for all investors, a licence may have only one registered holder, which must be a Mongolian entity. Mongolian law also does not recognise a beneficial or equitable interest as separate from a legal interest. As a result of this legal environment, it is relatively difficult, if not entirely impractical, to form unincorporated joint ventures (where all joint venturers hold an interest in the tenement).

On 1 July 2014, the Mongolian Parliament passed amendments to the Minerals Law which reflect the new State Minerals Policy. This policy aims to:

- > establish a stable investment environment;
- > improve the quality of mineral exploration, mining and processing;
- > encourage the use of environmentally friendly and modern technology; and
- > strengthen the competitiveness of the Mongolian mining sector in the international market.

The most significant measure introduced by the reforms lifts the ban on the issue of exploration licences, with effect from 1 July 2014. The ban on new exploration licences had been in place since 2010.

Investors are subject to a number of obligations designed to maximise benefits from the mining sector for the local population. Mineral licence holders are required to engage contractors and suppliers who are registered Mongolian taxpayers in priority to other contractors and suppliers, provided that such goods, works or supplies are of the required standard. Minerals exploration and mining companies are also required to engage in local CSR initiatives by developing local development plans with the **soum** (district) in which they operate.



Key rights and terms of a licence under the Minerals Law

	Exploration Licence	Mining Licence
Rights of a licence holder	<ul style="list-style-type: none"> > exclusive right to conduct exploration for minerals > exclusive right to obtain a mining licence > right to transfer or pledge all or any of the exploration licence > right to explore for radioactive minerals if special licence is granted 	<ul style="list-style-type: none"> > right to engage in the mining of minerals > right to sell mineral products at international prices > right to transfer or pledge all or any of the mining licence > right to engage in mining of radioactive minerals if a special licence is granted
Max. term	> 12 years	> 70 years
Annual licence fees	<ul style="list-style-type: none"> > 1st year – US\$0.15 per hectare (gradually increases) > maximum fee – US\$3.70 per hectare 	<ul style="list-style-type: none"> > coal and common mineral deposits: US\$3.5 per hectare > other minerals: US\$11 per hectare
Royalty	> Nil	<ul style="list-style-type: none"> > domestically sold coal base rate: 2.5 per cent of the sales value > other minerals and exported coal base rate: 5 per cent of the sales value > additional rate depending on mineral type, market price and degree of processing: maximum 30 per cent
Minimum investment	<ul style="list-style-type: none"> > 2nd to 3rd years – US\$0.50 per hectare > 4th to 6th years – US\$1.00 per hectare > 7th to 9 years – US\$1.50 per hectare 	> Nil

There is a further requirement that mined/processed minerals to be sold on a priority basis to processing plants in Mongolia at market prices. The Mineral Law does not specify whether the term ‘market prices’ refers to international market prices or domestic market prices. Foreign investors in Mongolia are advised to seek assurance that they could sell at international market prices to ensure that they are not disadvantaged by this provision.

An aerial photograph of a large-scale mining or industrial site. The image shows extensive areas of dark, excavated earth and rock, with various structures and infrastructure visible. A prominent diagonal line, possibly a road or a boundary, runs across the lower-left portion of the image. The overall scene is one of significant land alteration and industrial activity.

Employment

A foreign investor intending to employ staff in Mongolia will need to ensure that it complies with foreign worker quotas as well as local laws governing the terms and conditions of employment.

Terms of employment

Generally, foreign investors may include employment terms similar to those they would ordinarily use in employment contracts globally. That said, as in many other jurisdictions, Mongolian law does mandate certain minimum employment conditions that will apply regardless of the terms of the employment contract. These relate to minimum wages, the redundancy or firing of employees and maternity leave. Employees also have a right to join trade unions, which are vested with power and authority under the Trade Union Law.

It is important that foreign investors acquaint themselves with the basic principles of Mongolia's employment law when planning for their local workforce. Generally, Mongolia's courts have a reputation for being 'employee friendly'.

Foreign worker quotas and other requirements

The Mongolian Government sets an annual quota of foreign workers, which varies according to the sector, total employees and invested capital of the foreign invested entity. For example, for 2015, business entities supporting the extractives industry had a foreign specialist quota of 20 per cent where there were 50 employees or less and 25 per cent where there were more than 50 employees. A 30 per cent quota applied to foreign business representative offices regardless of the total number of employees. A foreign investor will need to consider which quota will apply to their business when considering how to structure their local operations.

Mongolian law also specifies a general ratio of foreign workers to local employees which applies to companies that carry out business activities not listed in the annual quota and with up to 20 employees. The general ratio is 1 to 20 (ie 5 per cent of total employees may be foreign employees). In limited circumstances, a company may apply to be exempted from complying with the foreign worker quotas.

Mongolian law also imposes levies for each foreign worker employed by an individual or entity (with some limited exceptions). The levy is equivalent to twice the minimum wage as set by the Mongolian Government from time to time.



Compliance, risk management and sustainable business relationships

Demonstrating corporate sustainability and adopting appropriate compliance and risk management systems is increasingly vital in attracting finance and ensuring the sustainability of your investment model. Various domestic and international obligations apply to the conduct and operations of foreign investments.

Anti-bribery and corruption

As in many developing countries' economies, corruption is a significant risk in Mongolia. Investors into Mongolia need to ensure compliance with local laws relating to anti-bribery and corruption, as well as any obligations under foreign laws with transnational application such as the United States' *Foreign Corrupt Practices Act*, the United Kingdom's *Bribery Act*, or the Bribery of Foreign Officials provisions under Australia's *Criminal Code*.

In the past decade, Mongolia has taken a number of steps which seek to strengthen the domestic anti-corruption framework. Under the Investment Law, all investors are required to maintain independent accounts and records in respect of the given business entity in accordance with international accounting standards. The Anti-Corruption Law of Mongolia creates a general obligation on economic entities and organisations to comply with business ethics in the private sector. Under this law, in relation to government officials and managers of Mongolian-owned legal entities (or entities with a local equity component) it is a criminal offence to:

- > exert pressure on, and interfere, with a view to influence state officials who perform their duties in a due form;
- > give, or promise to give, bribes to other persons;
- > provide illegally preferential treatment or promise to provide such treatment to other persons, or limit the rights of other persons when performing official duties;
- > receive bribes from other persons when performing or not performing official duties; and
- > abuse official power and office.

Mongolia's Anti-Corruption Agency (the Independent Authority Against Corruption or, the IAAC) is empowered to conduct criminal investigations for the purposes of preventing and disclosing corruption and has powers to review and verify the declaration of assets and income of individuals. In 2012, there were 204 convictions for corruption and related offences in Mongolia. IAAC investigated a further 239 cases in 2014 and 155 cases in the first half of 2015. In 2014 Mongolia ranked 80/175 countries on the Transparency International Corruption Perceptions Index, with a moderately improved score compared to the previous two years.

Recently, the likelihood of facing regulatory scrutiny and potential prosecution from foreign anti-corruption authorities has also increased. The United States and the United Kingdom, in particular, have been acknowledged for active enforcement of their foreign anti-corruption laws.

For this reason, it is important that investors conduct appropriate due diligence for corruption risks in relation to the operating environment as well as business partners or joint venture participants. Such due diligence may include a review of business practices, government engagement strategies, contracts and contracting practices, payment and accounting procedures, with a focus on poor legal compliance or unusual consultancy arrangements.

In addition to legal due diligence, it is essential that companies implement active anti-bribery and corruption compliance programs. This may include anti-corruption controls within all budget approval and auditing processes, as well as clear avenues to report any suspicious conduct. In some cases, it is also advisable to seek contractual warranties from each party to ensure that its own employees, representatives, contractors and agents do not engage in corrupt acts in relation to the operation.

Allens is experienced in designing and implementing anti-bribery and anti-money laundering policy and compliance programs tailored to the Mongolian context, including designing due diligence tools, conducting face-to-face training and tailored online training programs to meet the needs of specific clients.

Human rights, social and environmental obligations

A range of social and environmental obligations apply to both foreign and domestic investors under Mongolia's Investment Law. These include obligations to:

- > ensure that products, projects and services comply with national and international standards;
- > carry out investment activities that respect environmental and consumer interests and contribute to human development;
- > improve the knowledge, experience, qualifications and skills of employees and implement sound management and corporate governance practice; and
- > respect the national heritage, customs and traditions of the Mongolian people.

Given these requirements are only set out in very general terms, applying international standards to investment activities may provide greater guidance and assist investors in demonstrating compliance. Upholding international standards but also can be very important in securing finance for large-scale investments.

The Equator Principles (*EPs*) are a risk management framework for financial institutions used to identify, assess and mitigate the environmental and social risks involved in financing large-scale projects. As of March 2015, the EPs have more than 80 financial institution members and now cover a significant proportion of international project finance.

In Mongolia, the EPs apply the standards set out in the International Finance Corporation Performance Standards on Environmental and Social Sustainability (*IFC Performance Standards*) and the World Bank Group Environmental, Health and Safety Guidelines. The IFC Performance Standards cover:

- > assessment and management of environmental and social risks and impacts;
- > labour and working conditions;
- > resource efficiency and pollution prevention;
- > community health, safety and security;
- > land acquisition and involuntary resettlement;
- > biodiversity conservation and sustainable management of living natural resources;
- > the rights of indigenous peoples; and
- > cultural heritage.

Allens has expertise in advising clients on the implementation of the Equator Principles frameworks, including conducting human rights impact assessments and other regulatory compliance checks across a range of businesses and projects. Allens also has experience designing and implementing company-community agreements and other project-level risk-management strategies that align with relevant international and domestic law standards. Our experience reflects that negotiating and maintaining positive relationships with employees, indigenous groups and other community stakeholders throughout the investment lifecycle can also help mitigate a range of risks — including operational and construction, financial, litigation and reputational risks — and increase the long-term security of project assets.



Mongolia's participation in the Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative (*EITI*) is designed to bring greater accountability to the management of revenues from the resource sector. The initiative requires that resource companies disclose all payments to government (at all levels) and that government must disclose all payments received. The EITI then produces a reconciliation report to identify and analyse discrepancies.

Mongolia has participated in the EITI since 2006 and became EITI compliant in 2010. Under the Minerals Law companies must disclose and publish all taxes and other payments paid.

An aerial photograph of a river delta with a forested background. The river is a milky turquoise color, flowing through a sandy, light-colored delta. The background is a dense, dark green forest. A large, white, semi-transparent triangular graphic is overlaid on the bottom right portion of the image. The text "Dispute resolution" is centered in the upper half of the image.

Dispute resolution

Many foreign investors will be keen to ensure that any dispute arising in connection with their investment will be subject to international arbitration.


Mongolia is 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*. Accordingly, foreign arbitral awards are formally recognised through Mongolian law and the domestic court system.

The Investment Law provides that unless otherwise provided by law or international treaties to which Mongolia is a party, an investor is entitled to select an international or domestic arbitration body to settle any dispute that may arise in relation to a contract concluded with a state authority in Mongolia.

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. As such, it is important for any compulsory arbitration clause to include an appropriate carve-out.

Certain specific laws, such as the Mongolian Water Law and the Energy Law, also designate local administrative dispute resolution processes which may apply to investor's disputes in certain circumstances.

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, the Hague or London). Transactions involving domestic entities, including one or more foreign-invested Mongolian entities, may also be made subject to international arbitration.



Investing in any foreign country is a complex and challenging process. We regularly advise clients not only on their strict legal requirements, but also on the practical steps they need to take to avoid the pitfalls and risks that arise when investing. Please speak to one of our experts to discuss your investment needs. We are committed to helping our clients succeed in Mongolia.

Contacts



Igor Bogdanich
Partner
T +61 3 9613 8747
M +61 403 346 411
Igor.Bogdanich@allens.com.au



Kate Axup
Partner
T +61 3 9613 8449
M +61 420 647 104
Kate.Axup@allens.com.au



Erin Feros
Partner
T +61 7 3334 3313
M +61 418 627 575
Erin.Feros@allens.com.au



Ben Farnsworth
Partner
T +61 8 9488 3877
M +61 450 473 368
Ben.Farnsworth@allens.com.au



Rachel Nicolson
Partner
T +61 3 9613 8300
M +61 414 215 444
Rachel.Nicolson@allens.com.au

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