

Mongolian Mining Law Brief

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Mongolian Mining Law: Issues of Note for Foreign Investors

Introduction

With an estimated 6000 deposits of some 80 different minerals (including coal, copper, gold, iron ore, tungsten, molybdenum, phosphate, uranium, and oil) and with recent discoveries of some of the largest deposits of coal and copper in the world, foreign investor interest in Mongolia has been strong in recent years. In 2006, however, Mongolia introduced two significant changes to its minerals law regime: the Windfall Profits Tax and the policy of State participation in the exploitation of certain mineral deposits of “strategic importance”. These changes have led to concerns among the estimated 200 foreign and joint-venture exploration and mining companies in Mongolia as to the future profitability and safety of their investments.

In the overview below, we set out just a few of the significant issues that companies doing or considering doing business in the Mongolian mining sector should be aware of.

Legal framework

Regulation of Foreign Investment and Ownership

The Foreign Investment Law of Mongolia 1993 (“Foreign Investment Law”) regulates matters relating to the operations of foreign-invested business entities within Mongolia. Key aspects of the foreign ownership and investment regime include the following:

- Foreign investors are permitted to own 100% of any registered business and are not required to have a Mongolian partner except for in the case of certain mining projects in which the State has a right to participate (discussed further below).
- Foreign firms may not own land but may own physical structures such as buildings and are able to lease land upon Government approval for an initial term of up to 60 years (extendable for a second term of up to 40 years).
- Only legal entities registered in Mongolia are able to hold exploration and mining licenses.

- A mining license holder investing US \$50 million in the first five years of a project is entitled to enter into an Investment Agreement with the Government which provides a legal guarantee of stable rates for corporate income tax, customs duty, value added tax (“VAT”), minerals royalties, etc.

Exploration and Mining Licenses

At the end of March 2009, some 5,221 exploration and mining licenses had been issued covering a total area of approximately 48 million hectares of land (32% of the total land of Mongolia).

Key features of note with respect to exploration licenses include the following:

- Licenses have an initial term of three years and are granted for areas of land between 25 and 400,000 hectares (although there is no limit placed on the number of individual exploration licenses any one business entity may hold).
- Other than for land which has been explored with State funds or which the prior holder has forfeited its exploration rights, licenses are granted on a first-come-first-serve basis.
- Annual license fees begin at US \$0.10 per hectare in the first year and gradually increase to a maximum rate of US \$1.50 per hectare in the seventh through ninth years.
- License holders are required to spend certain minimum amounts of funds on exploration activities beginning in the second year of a license.
- A license may be extended twice, each for a period of three years.

Significant features of note in relation to mining licenses include:

- Mining licenses are granted for an initial term of 30 years and may be extended twice for terms of 20 years each.
- A mining license holder investing US \$50 million in the first 5 years of the project is entitled to enter into an Investment Agreement with the Government which can stabilize rates of corporate income tax, customs duty, VAT and minerals royalties.
- Annual license fees are US \$5 per hectare for coal and common mineral deposits and US \$15 per hectare for gold, copper, zinc, and iron.
- A 2.5% minerals royalty is imposed on coal and common mineral resources whereas the royalty on gold, copper, zinc, and iron is 5%.

Environmental Regulation

The minerals law regime places various environmental obligations on exploration and mining license holders. License holders are required to prepare an environment protection plan and environment impact assessment to address any adverse impacts that their operations may have on the environment. To ensure compliance with the environment protection plan, license holders must deposit an amount equal to 50% of their environmental protection budget for a particular year in a special bank account with the Government. These funds are accessed by the Government if a license holder fails to fully implement its environment protection plan.

State Participation in Mining Projects

In 2006 the Minerals Law was amended to provide for State participation in the exploitation of any mineral deposit of “strategic importance”, defined as a deposit with a size that may have a potential impact on national security, economic and social development of the country at the national and regional levels or that is producing or has a potential of producing more than 5% of total Mongolian GDP in a given year.

- The Parliament of Mongolia is given the ultimate power to determine what qualifies as a mineral deposit of strategic importance.
- The State may acquire up to a 50% share of a mineral deposit of strategic importance if the State has contributed to the exploration of the deposit at some point in the past. For all other mineral deposits of strategic importance, the State’s maximum share is set at 34%.
- In order to encourage investors to develop projects which the State intends to participate in, the Government may offer additional investment incentives above those available in the case of a standard Investment Agreement.
- License holders of mineral deposits of strategic importance are required to trade at least 10% of their shares on the Mongolian Stock Exchange. However, regulations have not yet been introduced to govern this requirement and it is still not known how this rule will be implemented in practice.

Windfall Profits Tax and other Taxes

The Windfall Profits Tax of 2006 imposed a 68% tax on the portion of metal sales price (defined by reference to the London Metal Exchange) in excess of US \$2,600 per tonne of copper and US \$500 per ounce of gold (raised to US \$850 per ounce in 2008).

- Copper cathode smelted in Mongolia is exempt from the Windfall Profits Tax.
- A taxpayer may deduct its tax liability for the Windfall Profits Tax from its taxable income.

Aside from the Windfall Profits Tax, the Mongolian tax regime is generally thought to be competitive with other major foreign mining jurisdictions. The principal taxes imposed in Mongolia are:

- VAT of 10% and customs duty of 5% on the import of most goods.
- Corporate income tax of 10% on income up to MNT 3 billion and 25% thereafter.
- A one tier personal income tax rate of 10%.

Note Concerning taking Security in Mongolia

A significant challenge to doing business in Mongolia for both foreign and domestic businesses is the lack of an effective system for registering and enforcing pledges over certain types of property.

- Pledges of mineral licenses and immovable property can be registered and enforced.
- Only banks and so-called “non-banking financial institutions” are eligible to be registered as pledgees of mineral licenses.
- There is no system to centrally register pledges over movable property such as mining equipment, company shares, inventories of mined minerals, etc. This can be a particular concern for investors looking to enter into joint venture relationships.
- As the Minerals Law makes current mining license holders responsible for environmental liabilities incurred by former license holders, companies should ensure that they conduct sufficient due diligence before taking over licenses from third-parties.

Dispute Resolution

- Mongolia is a signatory (October 24, 1994) to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (otherwise known as the “NY Convention”) and will recognize and enforce commercial arbitration awards made in the territory of other NY Convention States.
- A bilateral investment treaty exists between Japan and Mongolia pursuant to which Japanese investors may be able to submit investment disputes between themselves and the Government of Mongolia to international arbitration.

Current Projects of Note

Two of the most significant up-and-coming mining projects in Mongolia are the Tavan Tolgoi coal deposit and the Oyu Tolgoi copper and gold deposits.

Tavan Tolgoi

- Tavan Tolgoi has an estimated reserve of 6 billion tonnes of coking and thermal coal, making it one of the largest undeveloped coal reserves in the world.
- The State-owned company that holds the mining licenses to this deposit is seeking investment partners.
- It is understood that investors from several countries, including Russia, China, the U.S, Korea and Japan have shown strong interest in investing in this project.

Oyu Tolgoi

- Regarded as the world’s largest undeveloped gold and copper deposit, the project is estimated to produce in excess of one billion pounds of copper and 330,000 ounces of gold per year for at least 35 years.
- Beginning in 2007, the Mongolian Government and Ivanhoe Mines (along with its strategic partner Rio Tinto) have been negotiating an investment agreement for Oyu Tolgoi.

- The current proposed draft allows for Ivanhoe Mines to be exempted from the 68% Windfall Profits Tax and gives the State a 34% share in the project through its first 30 years, increasing up to 50% thereafter.

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