

# Client Alert

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## **Mongolian Mining Sector Update: Regulatory Uncertainty and Risk Mitigation Strategies**

Recent developments in the Mongolian mining sector depict an increasingly unpredictable business environment, which severely constrains the foreign mining companies' ability to invest and operate in the country. Major regulatory uncertainties ranging from the security of mineral tenure and resource rights to the enforcement of commercial contracts have resulted in an increased number of foreign players delaying capital investment projects or canceling them altogether. Foreign direct investment in the country has been reduced by almost half over the past year, triggering a sharp drop in the country's reserves and causing an 18% depreciation of the Mongolian tögrög against the U.S. dollar. The resulting economic crisis has in turn ratcheted up the pressure on the Mongolian government to capture an increased share of the mineral revenues generated in the country.

The uncertainties plaguing the Mongolian mineral sector run deeper than the government's ability to navigate this challenging economic environment. The parliament's ongoing efforts to overhaul the mineral law have caused increasing apprehension with respect to royalty rates, extent of state ownership in mineral projects, and the concept of strategic deposits accompanied by restrictions on foreign investment. More recently, a series of corruption cases involving Mongolian mining officials has brought into question the validity of 106 mining licenses covering an area six times larger than the currently-active mining licenses in Mongolia. The uncertainty associated with these cases has caused foreign mining companies to suspend investments in these areas for an indefinite period of time. Experts predict that many of these foreign investors will definitely leave the country if the issue is not resolved in a timely manner.

In this rapidly deteriorating context, international companies operating or investing in the Mongolian resources sector are advised to pay particular attention to ensuring that they will be able to navigate through potential disputes under the best conditions possible. These conditions may be optimized in investors' investment agreement, in the structure of their investment, and in their relationship with their local partners and the government.

First, all of the parties involved should clearly delineate individual areas of responsibility for the different risks associated with mining projects (political, fiscal, trade, environmental, supply, or price risks—to name a

few) and provide for adequate adaptation and dispute resolution mechanisms. As a way to achieve that allocation of risks, parties to mining agreements should consider the opportunity to provide for stabilization and force majeure provisions in their contracts.

Second, foreign parties in mining projects must obtain or preserve the right to seek resolution of their contractual disputes before international arbitration tribunals. Failure to do so would expose them to the uncertainties associated with litigating their disputes before local courts.

Third, all parties involved in mining projects should actively manage the structure of their investments to obtain or preserve access to investor-state arbitration in case of adverse regulatory actions. A party should invest through a corporate vehicle from a country providing comprehensive treaty coverage (bilateral investment treaties (BITs), free trade agreements, or multilateral agreements) in order to obtain optimal protection. Adequate investment treaty protection plays a substantial role in procuring political risk insurance (particularly when offered by international organizations or public entities) and/or reducing the insurance premiums associated with international projects and operations. Mongolia currently has BITs in force with thirty seven foreign countries, including the United States, United Kingdom, France, Germany, Netherlands, Belgium and Luxemburg, but also China, Russia, Singapore, Japan and Israel. Subject to the provisions of the applicable investment treaty, the definition of investor and investment (enabling treaty protection and investor-state arbitration) will generally cover the investment and activities of the wide array of parties involved in mining or metals projects. Operators and direct investors, as well as lenders, long-term purchasers, and traders are advised to evaluate how to structure (or re-structure) their activity in a way to maximize available treaty protection.

Finally, mining and metal companies should continue to engage with governmental entities in Mongolia to develop a better understanding of the value that a project brings to the country and its population. Mining companies investing in Mongolia could also partner with foreign state-owned companies that have strong State-to-State ties with the Mongolian government or its State-owned companies. Judicious choices of lenders (including public or multilateral lenders, such as the International Finance Corporation or the European Investment Bank) and financial partners can also play an important role in unlocking disputes caused by adverse governmental actions.

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