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Mongolian Investment Regulation and Arbitration

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Abstract. The author of the study presents the Mongolian legal environment regulating foreign direct investment. The evolution of the rules governing this field is presented in a chronological order from the democratization of Mongolia in the early 1990s to the present day. The author remarks the changes in the rules over time, which show an evolution towards a more level playing field between foreign investors, who were initially in a privileged position when compared to domestic investors. Other changes concern the authorization requirements for foreign investments, which evolved in order to hinder the activity of foreign state-owned enterprises in Mongolia and also to safeguard Mongolian mineral wealth. Investor protection mechanisms are emphasized, such as state commitments to not modifying the taxation environment. The study analyses international arbitration case-law pertaining to foreign investment protection in Mongolia.

Keywords: foreign direct investment, state-owned enterprise, expropriation, arbitration, Mongolia

1. Introduction

Foreign investment constitutes a considerable part of the Mongolian economy. Many immense projects and most of the mining industry is operating through foreign investment. Hence, foreign investment regulation has always been a sensitive yet very important part of Mongolian legislation. It had to synchronize the operations of government and the privileges of foreign investors in order to maintain the balance, which would consider the well-being of the nation and its environment on the one hand and preparing a pleasant legal and administrative atmosphere for the investor so that the investor would feel secure to invest in Mongolia on the other hand.

The Mongolian legislators' attempts to regulate this field started after 1991, when Mongolia became a democratic country. A number of specialized laws were enacted that would enable economic and social developments in the country. Foreign investment legislations were one of the very first projects which started after the transition to democracy and the introduction of market economy. A first draft of the proposed norms was introduced in 1990, but it was not adequate for the establishment of long-term investment operations due to the applicable rules, which limited the acquisition of foreign-owned shares in Mongolian business entities to just 49%.[1] Since then, the foreign investment law has changed several times and finally acquired its current form, with the Mongolian Investment Act of 2013. Following the entry into force of the new Mongolian Investment Act, its predecessors were repealed. This paper will analyse the past and current investment legislation of Mongolia. For obvious reasons, when the amount of investment increases, international arbitration is inevitable. So far, Mongolia has been part of five international arbitrations, before ICSID and UNCITRAL. We will discuss the most famous ones of them: Paushok v Mongolia and Khan Resources v Mongolia.

2. Past and Current Investment Laws of Mongolia

2.1. The Foreign Investment Act of 1993

The Foreign Investment Act (FIA) of 1993 was the first investment act in the country. It introduced the definitions of *investment* and *investor*, made clear the distinction between foreign and domestic investors, enacted special tax preferences exclusively for foreign investors, aimed to encourage the entry of direct foreign investment into the country, and established the rules of investor protection. FIA defined foreign investment as: 'Every kind of tangible and intangible property which is invested in Mongolia by a foreign investor for the purpose of establishing a business entity with foreign investment within the territory of Mongolia or for the purpose of jointly operating with an existing business entity of Mongolia'.[2]

It is safe to say that the FIA defined 'investment' in the broadest sense and gave the greatest possible amount of freedom to invest. Furthermore, the FIA differentiated domestic and foreign investors. Foreign investors which operated

1 *Investment Guide for Mongolia policy paper*. https://read.oecd-ilibrary.org/finance-and-investment/investment-guides-investment-guide-for-mongolia-2000_9789264189607-en (accessed on: 10.05.2021). 49.

2 Foreign Investment Law 1993, Art. 1. Translation by the author. Unless otherwise specified in the footnotes, all translations are by the author.

through business entities with foreign investment had special preferences and privileges. Such privileges would include exemption from taxes on special business capital, including technological equipment and machinery.

The substantive law clauses of FIA acknowledged the supremacy of international treaties over domestic norms,[3] expropriation became unlawful unless foreign investments were expropriated in the public interest, under due process of law, on a non-discriminatory basis, and against full compensation,[4] and it expressly secured the free remittance of income, profits, and payments of foreign investors outside the host country.[5] Furthermore, it included the duties of the investor to comply with domestic laws and corporate partnership agreements, to protect and restore the natural environment, 'to respect the customs and traditions of the people of Mongolia',[6] and to employ primarily Mongolian citizens.[7] Procedural law provisions on the settlement of investor–state disputes were constituted by the explicitly local-jurisdiction requirement. This meant that any legal dispute arising from investment between foreign investors and Mongolian natural or legal persons, including the state and its authorities, had to be resolved in the national courts unless provided otherwise by an international treaty or by a contract between the parties of the dispute.[8]

The FIA was amended dramatically in 2002 in order to comply with the requirements of the World Trade Organization and domestic investors in the country. Domestic investors were frustrated with the fact that only foreign investors could benefit from a tax-exempt status and demanded an amendment. The amendments increased the permitted percentage of foreign capital in business entities and reduced business activity exclusions from formerly 36 areas to just six.[9] Furthermore, they removed all taxation preferences that exclusively applied to foreign investors; however, the general norms of tax law in Mongolia still favoured foreign investors over domestic ones.[10] The most essential modification was the introduction of 'stability agreements', which were a legal guarantee for a stable legal environment to conduct business activities. Such agreements were granted – upon request – to investors who had invested over 2 million USD in Mongolia.[11] The main agenda of these stability agreements was to secure investors' tax privileges for a certain period of time, which differed depending on the investment amount. For example, when investors made an investment

3 Foreign Investment Law 1993, Art. 2.2.
4 Foreign Investment Law 1993, Art. 8.
5 Foreign Investment Law 1993, Art. 10.4.
6 Foreign Investment Law 1993, Art. 10.2.
7 Foreign Investment Law 1993, Art. 24.
8 Foreign Investment Law 1993, Art. 25.
9 Organization for Economic Cooperation and Development 2000. 55.
10 Scharaw 2018.
11 Foreign Investment Law 1993, Art. 19.

in Mongolia between USD 2 and 10 million or an investment of more than USD 10 million, the government was authorized to sign a stability agreement for 10 to 15 years respectively. In the matter of *Paushok v Mongolia* subjected to arbitration, the arbitration tribunal dealt with a stabilization agreement issued under the 2002 FIA. The tribunal defined it as an agreement 'between a State and an investor for the purpose of stabilizing (freezing), at least to a certain extent and for a certain period of time, the taxes payable by an investor and/or other legislative, regulatory, or administrative measures affecting it'.[12]

The Foreign Investment Act of 1993 aimed to encourage foreign direct investment (FDI) by defining special tax preferences and privileges and instituted a clear distinction between foreign and domestic investors. It introduced the basic rules of investment protection, defined 'investment' and 'business entities with foreign investment' in the broadest sense, and gave the greatest amount of freedom to invest.

2.2. Act on Foreign Investment in Strategic Sectors of 2012

The Act on the Regulation of Foreign Investment in Entities Operating in Strategic Sectors (in the following abbreviated as: SEFIA) was adopted by the Parliament of Mongolia in May 2012.[13] The purpose of the new law was to retain control over Mongolia's natural resources, the exploitation of which was becoming more and more dynamic at that time.[14] Mining being the main area of foreign investment, the scale at which natural resources were being exploited skyrocketed. The Government of Mongolia started to fret about the mineral wealth in the country, and it became a sensitive political issue.[15] SEFIA's purpose was to regulate investment-related cooperation between domestic entities and foreign investors, particularly in strategically important sectors that impacted national security. To put it in a simple way, Mongolia was trying to maintain control over foreign investments in the public interest as the further development of mineral resources was at stake. On top of that, the Government of Mongolia had to restore its reputation as a reliable and liberal investment partner.[16]

The law defined the 'mining', 'banking and finance', and 'media, information, and communications' sectors as strategic 'for the purposes of national security with a view to ensuring the basic needs of the population, the independence, the normal operations of the economy, and the national revenues and reinforcing national security'.[17] SEFIA established an obligation for investors to obtain

12 *Paushok v Mongolia*, Award on Jurisdiction and Liability, 28 April 2011, para. 97.
13 Foreign Investment Law 1993, Art. 10.2.
14 Scharaw 2018.
15 Jackson 2018. See the letters referenced in the article by Dolgorsürengiin Sumyaabazar.
16 Scharaw 2018.
17 SEFIA, Art. 5.

permission from the Government of Mongolia on certain contracts and transactions between domestic business entities and foreign investors.[18]

SEFIA grouped investors into private and state-owned categories, and each investor would have different procedures for obtaining permits.[19] This way, investments by a foreign business entity partly or fully owned by a foreign government were subject to permission requirements without exemption, regardless of the sector in which the investment was made or the percentage of shares and interests in the Mongolian business entity. This was a strategic move to protect the market from state-owned enterprises (SOEs) of foreign countries. Permission was needed in situations where investors obtained a higher degree of control of the business entity, created a monopoly in the field in which the investment took place, and impacted the market price of mining products for export.[20] On the other hand, private foreign investors were either subject to a simple formal registration or had to obtain government permission as well, depending on the amount of investment and its respective sector. In continuation of the strategic policy on mineral resources, the Parliament of Mongolia adopted the 'Mineral Resource Policy Strategy' in May 2014, which aimed to reduce the negative impacts of natural resource exploitation on the environment and to maximize revenue while preserving the nation's mineral wealth.

SEFIA awarded public authorities ample discretionary powers when screening foreign investment projects in Mongolia.[21] It implemented a strict screening process among the foreign investments due to concerns of national security. In the meaning of SEFIA, concerns for national security permitted the proportional (reasonable) exploitation of natural resources and required maintaining the market monopoly free. The law was in force for seventeen months, and it was obvious that Mongolia needed a new complex legislation on investment matters. Hastily drafted, the SEFIA of 2012 resulted in major concerns on the part of established and potential investors who were met with uncertainty. SEFIA was cited numerous times for having contributed to the significant decline in FDI inflows along with external factors such as the slowdown of the Chinese economy and the fall in commodity prices.[22]

18 SEFIA, Art. 4 and 6.
19 SEFIA, Art. 5.
20 SEFIA, Art. 6.
21 UNCTAD noted that the importance of mining deposits has raised legitimate policy concerns related to national security and economic interests, including control over national resources. United Nations Conference on Trade and Development 2013. 40.
22 Forneris et al. 2018. 39.

2.3. The Mongolian Investment Act of 2013

In 2013, as a relief from the effects of SEFIA, a new Mongolian Investment Act (MIA) was developed and enacted.[23] The MIA entered into force in November 2013, and other relevant laws, such as the Act on the Registration of Legal Entities, the General Taxation Act, the Mineral Act, and the Nuclear Energy Act, were modified accordingly.

According to the MIA, in order to start business operations in Mongolia, investors must incorporate either a business entity with foreign investment or a representative office with a minimum capital requirement of USD 100,000 or more, 25% of which is invested by a foreign investor (or investors).[24] For the investors who are willing to make smaller investments at first, instead of committing the full amount, the mandatory minimum foreign contribution can be a burdensome requirement. There is no minimal equity requirement for representative offices as these function on a proxy basis, but such offices do not have the power to earn revenue from business activities in Mongolia.[25] Article 4.2 of the MIA excludes restrictions to private investment, which means that investors, domestic or foreign, may invest in any sector without any limitation or government approval. The only exception applies to foreign SOEs which seek to acquire more than a third of the equity of a Mongolian company in a few strategic areas, such as mining, media and telecommunications, banking, and financial services.[26]

The main novelty of the tax incentives in the MIA is the tax rate stabilization certificate, the purpose of which is to stabilize the rate and amount of tax and payment specified in the MIA, to an investing legal body that fulfils the requirements specified therein.[27] These certificates imitate the 2002 FIA's stability agreement, which was broader in its coverage. Tax rate stabilization certificates cover four types of state revenues: 1. the corporate income tax, 2. the custom duty, 3. the value-added tax, and 4. the royalty on mineral resources. The general criteria for issuing the certificates are the total amount of investment, which has to meet the required amount set forth by the act, the presentation of an environmental impact assessment, the creation of a stable workplace, and the introduction of modern, high-tech methods of production.[28] The certificates

23 In the summer of 2012, national parliamentary elections were held, and the new coalition started the discussion of a new fundamentally revised domestic investment law system to send a clear message to investors. In UNCTAD's opinion, 'the revision was necessary to restore adequate legal certainty and provide a coherent message regarding the country's openness to investors, while public concerns regarding competition, environment, and health are protected'. United Nations Conference on Trade and Development 2013. 40-1.

24 SEFIA, Art. 3.1.5.

25 SEFIA, Art. 3.1.6.

26 SEFIA, Art. 21 and 22.

27 SEFIA, Art. 3.1.9 and 13–19.

28 SEFIA, Art. 16.1.

can be invalidated if the investor was subjected to insolvency proceedings, moved out of the country, or – most importantly – if the investor concluded an investment contract. According to Art. 20, the investment contract is concluded by the Government of Mongolia with the investor, which is to invest more than 500 billion MNT. Finally, tax rate stabilization certificates do not cover the production, import, and trade of tobacco and alcohol.

The MIA considers land as a non-tax promotion for investment.[29] Based on the contract, foreign investors may lease land for use for a period of up to sixty years, and an extension is possible once, for up to a supplementary period of forty years, which limits the use of the land for up to a total of one hundred years. In its Art. 17.1, the Land Act of Mongolia states that land lease contracts with foreigners require consent by the Mongolian Parliament. Further, it states a local jurisdiction requirement for non-contractual disputes arising from the land use of business entities with foreign investment,[30] which means that international arbitration is excluded with respect to non-contractual land-use-related disputes between host country and investor.

In addition, the Government of Mongolia set a quota for hiring foreign employees by investors. This quota ranges from 5% to 80%, 5% being the default. Employers also have to pay a workplace fee on a monthly basis, set at twice the minimum wage for every foreign employee in the company.[31] However, mining licence holders and their sub-contractors may have in their workforce a quota of up to 10% of foreign employees.[32] If the number of foreign employees exceeds the given ten percent, employers have to pay a penalty set at ten times the minimum wage for every employee by which the quota was exceeded. In this regard, the World Bank mentions that even the relatively new MIA has not provided a consolidated negative list placing restrictions on foreign investment. This has made it difficult to provide statistics in areas pertaining to the limits on foreign equity participation, partnership requirements, and the identification of restricted sectors.[33]

2.4. Investment Protection

In customary international investment law, there are four main principles that should be followed in the case of expropriation: 1. it must be for a public need or public purpose, 2. it must be preceded or followed by due compensation and payment, 3. it must be completed under due process of law, and 4. it must be non-

29 MIA, Art. 12.1.1.

30 Mongolian Law on Lands 2002, Art. 20.

31 Part 2, *Government Charter on Employment Payment*. In Mongolian available at: https://www.legalinfo.mn/annex/details/6652?lawid=10913.

32 Mineral Law of Mongolia 2006, Article 43.1.

33 Forneris et al. 2018. 44.

discriminatory.[34] The fundamental right to property and its protection is stated in Art. 5.2 of the Constitution of Mongolia, which says that the state recognizes the forms of both public and private property and shall protect the rights of the owner by law. However, the wording of Art. 16.3[35] explicitly provides that only citizens of Mongolia may own land. In the sense of the Constitution, only citizens can benefit from compensation forms subsequent to expropriation, and foreign investors are not covered by the expropriation clauses deriving from land ownership rules. According to the MIA, properties could be expropriated only in the public interest, on the condition of full compensation of expropriated owners, and in accordance with the procedures set forth by law.[36] Expropriated property shall be valued at the market rate of the assets when it was expropriated or the pending expropriation notified to the investor or the public.[37] In this regard, the important novelty of the MIA was that it filled the gap of foreign investor protection, which was covered vaguely in the Constitution. The MIA removed the definition of 'foreign' and stopped differentiating foreign and domestic investors, bringing them together under the umbrella definition of 'investor'.

The next fundamental guarantee of investment protection for foreign investors is the ability to freely repatriate funds and capital from the host country. In other words, it is the certainty that the investor may exit the host country without hassle whenever the investor sees it appropriate. Domestic law can make alterations by adding specific requirements such as the fulfilment of all fiscal duties by the foreign investor, subject the legal guarantee to foreign exchange regulations, or confer upon the host governments the right to limit the free transfer of funds and capital during balance-of-payment difficulties.[38] An exhaustive list of assets and revenues which investors can transfer out of Mongolia was given in Art. 6.7 of the MIA, and it stated that investors transferring monetary assets shall be entitled to convert their assets into any internationally freely convertible currency.[39] A precondition to the transfer was to properly fulfil the tax obligation in the territory of Mongolia.[40]

National treatment is mostly preferred in developed countries in order to provide the same privileges to the foreigners as are provided for nationals. However, some countries put foreign investors higher in privileges than their own nationals:

34 Subedi 2008, Sornarajah 2010.

35 Art. 16.3 of the Constitution of Mongolia reads: 'Right to fair acquisition, possession and inheritance of moveable and immoveable property. Illegal confiscation and requisitioning of the private property of citizens shall be prohibited. If the state and its bodies appropriate private property on the basis of exclusive public need, they shall do so with due compensation and payment.'

36 MIA, Art. 6.4.

37 MIA, Art 6.5.

38 Scharaw 2018.

39 MIA, Art. 6.8.

40 MIA, Art. 6.7.

for example, the 1993 FIA provided comprehensive tax preferences to foreign investors, while domestic investors could not apply for such a tax preference. Nonetheless, national treatment does not mean that the foreign investor would have all the rights that nationals have, such as political rights. As for the 2013 MIA, it does not contain direct or explicit clauses for the national treatment of foreign investors. Yet the MIA removed the wording 'foreign' form its title, and Art. 4.1 states that the act applies to investments 'made by foreign and domestic investors in the territory of Mongolia'.

An internationally recognized fair and equitable treatment guarantee is not included in the 2013 MIA. Usually, it is provided by the vast majority of international investment treaties, and thus the national legislator did not see the need to include the clause in domestic law.[41] This does not mean that investors should be alarmed. As stated in the Constitution, Mongolia must adhere to the universally recognized norms and principles of international law.[42] Hence, even if the 2013 MIA does not contain directly the principles of equating foreign entities with domestic ones as a form of an investment protection guarantee, the investors will be protected by international norms and treaties.

The Investor–State Dispute Settlement (ISDS) clauses are an important part of the Mongolian investment protection framework, especially in situations where the investor is not protected by an international investment treaty, which usually allows investors to initiate ISDS. As a general rule, the domestic investment protection clauses are focused on customary international law and international investment treaties with their substantive standards of investment protection and investor–state dispute settlement mechanisms. Unless the host state has consented to investment arbitration by international treaty, arbitration agreement, investment contract, or in their domestic laws, the ISDS is subject to the jurisdiction of the host state. The inclusion of arbitration clauses in domestic laws is a standalone and unilateral offer to settle arising disputes by an independent international tribunal.[43] And this unilateral offer should be accepted by the investor, usually when initiating the ISDS procedure itself. The downside of the standing offer is that the host state could revoke the offer anytime by amending the law. However, it is suggested that the performance of some reciprocal act leads to the perfection of the host state's unilateral arbitration offer, which thereby becomes similar to a binding bilateral instrument.[44] As Schreuer mentioned, once the instrument is perfected, consent to arbitrate investor–state disputes becomes isolated from the state's unilateral arbitration promise in the domestic investment law and is maintained in effect even if the legal norm containing the promise is itself

41 Parra–de Alwis 1992.
42 Constitution of Mongolia, Art. 10.1.
43 Dolzer–Schreuer 2012.
44 Scharaw 2018.

repealed.[45] Furthermore, the host state might include some preconditions and general rules for ISDS issues such as a negotiation period, exhausting the local remedies before invoking ISDS, etc.

The 1993 FIA and the 2012 SEFIA did not expressly direct consent to the ISDS nor contained a standing offer to arbitrate. Investment-related disputes were solely under the jurisdiction of the national courts of Mongolia.[46] But the 2013 MIA has corrected that situation and included an explicit arbitration offer in Art. 6.9, which states that 'unless it is provided by law or in the international treaties, to which Mongolia is a party, an investor is entitled to select an international or domestic arbitration to settle any disputes which may arise regarding the contract concluded with the state authority of Mongolia'. However, this offer is limited to disputes arising with respect to 'investor–state contracts'.

3. A Survey of Arbitral Jurisprudence

3.1. Khan Resources v Mongolia

CAUC Holding Company Ltd (abbreviated in the following as CAUC Holding) was an offshore company registered in the British Virgin Islands (BVI), investing in the Dornod Project for uranium exploration and extraction through its majority-owned Mongolian subsidiary, the Central Asian Uranium Company (abbreviated as CAUC). Khan Resources B.V. (abbreviated as Khan Netherlands) was a Dutch company investing in the Dornod Project through its fully owned Mongolian subsidiary, Khan Resources LLC (abbreviated as Khan Mongolia). Khan Resources Inc. (abbreviated as Khan Canada) was a Canadian company that wholly owned both CAUC Holding, through a Bermuda-registered offshore entity (investment vehicle), and Khan Netherlands. The latter companies brought a claim against the Government of Mongolia. They claimed that their investment in a uranium exploration and extraction project in the Mongolian province of Dornod was wrongfully and indirectly expropriated when the Government of Mongolia annulled their licences. CAUC operated in the Dornod Project under mining Licence No 237A, initially covering two deposits, but which later, on CAUC's application, was reduced to exclude a segment in order to save on taxes and fees. The excluded segment was later acquired by Khan Mongolia and covered by a separate mining licence, No 9282X.

45 Schreuer 2009.

46 Art. 25 of both FIA and SEFIA stated that disputes should be generally settled in competent national courts unless Mongolia gave consent to international arbitration in BITs, ECT, or via direct arbitration agreement with the foreign investors.

In October 2009, the Mongolian Nuclear Energy Agency (NEA) suspended the claimants' licences No 237A and No 9282X among others. The licences were then invalidated and subjected to re-registration under the Nuclear Energy Law of 2009. In March 2010, after inspecting the Dornod Project, NEA concluded that the project failed to rectify violations mentioned during the time of licence invalidation. In April 2010, the NEA declared that licences No 237A and No 9282X remain invalidated and could not be re-registered to the claimants' name. The claimants initiated the arbitration in 2011. Khan Canada and CAUS Holding invoked the Founding Agreement, which created the joint venture CAUC. They claimed that the suspension and invalidation of the licences constituted an unlawful expropriation, in breach of Mongolia's obligations under the Founding Agreement, Mongolian law, and customary international law. Khan Netherlands invoked the Energy Charter treaty via the umbrella clause on the allegations of Mongolia's breach of Foreign Investment Law.

The case presented two jurisdictional challenges. Firstly, whether Khan Canada, a non-signatory of the Founding Agreement, may be party to the dispute (the problem of *locus standi*). On Mongolia's objection to the tribunal's jurisdiction over Khan Canada, the tribunal found that the latter is not a signatory; however, as a non-signatory it could become party to the agreement and consequently to the dispute if it shared the common intention with the signatory (the claimant).[47] As the burden of proof of the matter at hand fell on the claimant, the tribunal held that the evidence the claimant presented sufficed to prove such a common intention between CAUC Holding and Khan Canada. Secondly, the question arose whether the Government of Mongolia and MonAtom (the Mongolian state-owned nuclear monopoly) are different entities or not. Mongolia further argued that it should not be bound by the arbitration clause of the Founding Agreement as it was not a party to that agreement. However, based on the claimant's legal expert's testimony, the tribunal found that MonAtom, a Mongolian company wholly owned by the state, acted as Mongolia's representative and undertook obligations that only a sovereign state could fulfil, namely committing to reduce the natural resource utilization fees to be paid by CAUC, thereby giving the tribunal personal jurisdiction over Mongolia under the Founding Agreement.[48]

The tribunal disagreed with Mongolia on the interpretation of Mongolian law. Mongolia first argued that the mining licences were outside the scope of its Foreign Investment Act, which defined 'foreign investment' as 'every type of tangible and intangible property'. Mongolia further argued that mining licences were not 'properties' under Mongolian law as a decision of the Mongolian Supreme Court

47 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, paras 329–330.

48 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 345.

had held that '[a] mining licence […] is possessed but not owned by any entity, and therefore there is no legal ground to consider such mining licence to be a property right which is transferable to the ownership of others'.[49] The tribunal held that the general notion of rights under licences as well as contractual rights to exploit natural resources constitute intangible property,[50] hence invalidating the Mongolian Supreme Court's interpretation.

On the validation of the licences, the tribunal conducted a proportionality analysis and concluded that the penalty of invalidation was not appropriate for the alleged violations. The tribunal stated that Mongolia failed to 'point to any breaches of Mongolian law that would justify the decisions to invalidate and not re-register' the mining licences.[51] During the analysis of the evidence, the tribunal found that Mongolia's motive for licence invalidation was to develop the Dornod Project deposits at a greater profit with a Russian partner.[52] The tribunal found that Mongolia had an obligation to re-register the mining licences as there was 'no legally significant reason why the Claimants would not have fulfilled the [prescribed] application requirements'. By failing to do so, Mongolia denied due process of law.[53] Based on all these reasons, the tribunal concluded that the Mongolian Government had breached the Energy Charter Treaty[54] (ECT) by invalidating licences of uranium mining of CAUC Ltd. Consequently, when the tribunal found that Mongolia had breached the Foreign Investment Act, it also found its violation of the ECT under its umbrella clause. In calculating damages, the tribunal valued the investment of the Dornod Project by analysing the offers received from 2005 to 2010. Thus, the final damages were set at USD 80 million as opposed to USD 358 million claimed by the investors.

3.1. Paushok v Mongolia

Sergei Paushok, sole shareholder of the CJSC Golden East Mongolia (abbreviated as GEM) and CJSC Vostokneftgaz brought a claim against the Government of Mongolia in 2007 following the introduction of a Windfall Profit Tax Act[55] (WPT)

49 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 303.

50 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 302.

51 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 319.

52 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, paras 340–342.

53 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, paras 359–360.

54 *The Energy Charter Treaty*. https://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/ (accessed on: 10.05.2021).

55 Law on Imposition of Price Increase (Windfall) Taxes on Some Commodities, 2006.

by the Parliament of Mongolia, which placed a 68% tax on gold sales exceeding USD 500 per ounce. Furthermore, the claimant was affected by the newly enacted Mineral Law clause that imposed a monthly penalty of 10 times the minimum wage for every foreign employee that exceeded the usual 10% quota of foreign workers.[56] By the time the arbitration proceedings were initiated, 50% of GEM's employees were Russian nationals. GEM invoked the Russia–Mongolia Bilateral Investment Treaty[57] of 1995 (BIT) and claimed that the respondent Mongolian Government breached its treaty obligations on fair and equitable treatment, expropriation and compensation, full protection, and security by introducing discriminatory tax rates and employment rules.

According to the claimant, its competitor, KOO Boroo Gold, a Canadian-owned gold mining company, was not affected by the WPT as it had a stabilization agreement with the Government of Mongolia.[58] Negotiations between GEM and Mongolia were not successful as GEM was not willing to make long-term future investments requested by the Government of Mongolia. When the WPT came into force, GEM entered into a contract with the Central Bank of Mongolia (MongolBank), according to which gold was placed under the custody of the Bank for safekeeping and subsequent sale, and GEM would get 85% of the sale price.[59] However, MongolBank, without notifying GEM, used the gold for refinement purposes in the United Kingdom. Following this issue, the arbitral tribunal found that even though Mongolia was not a party to the contract between MongolBank and GEM, it breached its fair and equitable treatment obligation by removing ownership of GEM's gold in contravention of the safe custody contract with MongolBank.[60]

By default, the Government of Mongolia was liable for actions of the Mongol Bank under the international law rules of attribution.[61] With respect to the introduction of the WPT, the tribunal did not find a breach of the BIT, stating that a breach of an investment treaty did not automatically occur only because a legislative act may be considered as ill-conceived, counter-productive, or excessively burdensome.[62] And the tax rate increase is one of the great risks that an investor ought to know, especially in developing countries.[63]

56 Art. 16.3 of the Constitution of Mongolia.

57 *Mongolia–Russian Federation Bilateral Investment Treaty (1995)*. https://investmentpolicy.unctad.org/international-investment-agreements/treaties/bit/2568/mongolia---russian-federation-bit-1995- (accessed on: 10.05.2021).

58 See Part 2.1.

59 Paushok v Mongolia, Award on Jurisdiction and Liability, 28 April 2011, paras 97, 111.

60 Klager 2012.

61 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 576.

62 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, paras 298–299.

63 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, paras 302, 305.

On the foreign employee penalty, the tribunal decided that the Respondent could not violate 'fair and equitable treatment' as stated in Article 3.1 of the BIT by enacting the Mining Law of 2006 and increasing the penalty for exceeding the 10% quota of foreign employees.[64] Consequently, the tribunal brought other mining companies as an example and noted that 10% of the foreign employee quota was manageable and setting a foreign worker quota would not qualify as a breach of fair and equitable treatment requirements.[65] The bottom line was that in such circumstances investors should enter a stability agreement covering taxation and other matters, otherwise the investor would face a much more difficult task to demonstrate that breach of a BIT occurred.[66]

4. Conclusions

Certain challenges and opportunities exist in international investment. Overviews of these challenges should be updated frequently as the regime governing the relations between international investors and governments constitutes the most important form of international economic transaction in the globalizing world economy. In addition to that, the role of international tribunals in these updates is significant. We analysed the arbitration procedures that Mongolia has been a party to. Such cases as Khan Resources v Mongolia and Paushok v Mongolia touch upon all the necessary issues within the area, and the tribunal sets out the interpretation to eliminate further misunderstandings. As most of the host states are implementing new legislation to attract more investors or make the legal environment more favourable to them, these cases point out that the legislator should be more careful in order to ensure investor protection.

Further, we focused on Mongolian domestic legal statutes on foreign investment. Effectiveness and predictability provided by domestic laws have a great impact on attracting new investments to the country. Mongolia enacted its first ever Foreign Investment Act in 1993, which aimed to encourage foreign direct investment by defining special tax preferences and privileges only available to foreign investors, creating a clear distinction between foreign and domestic investors, introducing the basic rules of investment protection, and defining 'investment' as well as 'business entities with foreign investment'. The definition of 'investment' in the 1993 FIA had the broadest sense and gave the greatest amount of freedom to invest. The 1993 FIA was amended in 2002 as a result of complaints from

64 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, paras 360–362.

65 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 368.

66 Khan Resources Inc., Khan Resources B.V., and Cauc Holding Company Ltd. v The Government of Mongolia, para 370.

domestic investors regarding foreign investors' exclusive tax preferences and requirements of the WTO regarding the safety and stability of investments.

In 2012, Mongolia enacted the Act on Foreign Investment in the Strategic Sector, the main agenda of which was to maintain control over Mongolia's natural resources and prevent the establishment of undesired foreign investment in strategic sectors by foreign state-owned entities. With its strict screening process, SEFIA aroused some uncertainties among investors alongside with the significant drop in foreign direct investment, which limited the longevity of the law to only one year.

In 2013, the Mongolian Investment Act was adopted to cover all the gaps that its predecessors had left. The MIA applies to both foreign and domestic investors, which avoids the reverse discriminations of the latter and secures equal legal treatment for the former. The MIA kept the controls for the entry of state-owned enterprise investors in place. The main novelties of the MIA were to introduce tax stabilization certificates, which are issued by the Government of Mongolia to the investors who qualify for certain requirements of the law, making an open offer to arbitrate investment-treaty-related disputes in international arbitration and enacting a number of clauses to aid sustainable development in the host country. We believe that Mongolia is still learning from its mistakes and works vigorously towards keeping the balance between its own advantage and the foreign investors' interests.

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