

# Development of Mining Sector of Mongolia: Investor-State Arbitration and International Investment Agreement Clause Dilemma

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The research constitutes the host state's right and investor's right towards investment disputes, and legal protection for the host state in case of investment dispute. Although investment arbitration deals with cases mostly on infringement of investor's rights, the host state's right is mainly silent on bilateral agreements and other investment agreements. International Investment Agreements (IIAs) are concluded between states. Only states give consent to arbitration in IIA. International arbitration is a voluntary and consent-based method of settling disputes. It can be referred from the present investment agreement that offers and consent provisions are legislated not sufficiently in the investment agreement for the protection of the host state and investor. There exists no prevention and monitoring instrument, or clause in the investment agreement that prevents investor's "taking advantage" of consent to filing to arbitration. Taking advantage can be defined as exploit or make unfair use of one's own benefit. This also refers to example of disputes for the host states, which lack of international dispute experiences. The host states, which lack of international dispute experiences, are count to be developing countries, where natural resource and mining are a dominating sector. Mongolian mining disputes are counted to be around 10 in numbers since 2006. Comparing to average yearly number of investor-state dispute settlement (ISDS) cases, the number of cases arouse against Mongolian government is considered to be superior in quantities, and abstract in sequence of period of timing. Convention and Rules on Transparency are still silent on investment agreement infringements on offer and consent provisions. Thus, investment agreements and Bilateral Investment Treaties (BITs) should include clauses on offer and consent provisions of the host state and investor relations on investment dispute in order to protect both rights of the host state and investor, and prevent further infringements in the dispute process.

*Keywords:* investor-state arbitration, IIA, foreign direct investment, mining, Mongolia

## Investor-State Arbitration and International Investment Agreement (IIA) Clause Dilemma

The research constitutes the host state's right and investor's right towards investment disputes, and legal protection for the host state in case of investment disputes. Although investment arbitration deals with cases mostly on infringement of investor's rights, the host state's right is mainly silent on bilateral agreements and other investment agreements. The investment agreements lack of provisions towards the protection of the host

states. It can be concluded that the investment agreement is legislated for mere protection of investors and their rights.

At the present time, Mongolia has bound following investment agreements: Bilateral Investment Treaties (BITs) with 43 countries, among which Asian 16 countries, European 21 countries, Middle Eastern four countries, American two countries, and African one country; Economic Partnership Agreement (EPA) with Japan in 2015; Agreement Concerning the Development and Trade and Investment Relations with USA in 2004; The Energy Charter Treaty in 1994; Agreement on Trade and Economic Cooperation with European Economic Community and Its Member States in 1992. As it can be seen from the signature countries, the investment agreements have been bound with mostly European countries in the beginning of 1990's, after collapse of socialist regime in Mongolia in order to maintain the relationship. Mongolia has joined International Center for Settlement of Investment Disputes (ICSID) Convention and Convention on Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Mongolian government bound the biggest investment agreement with Ivenhou Mines (Oyu Tolgoi investment agreement) in 2009<sup>1</sup>.

Mongolia has transited from the communist and socialist system regimes to free market economy since 1990. Foreign investment in Mongolia has been realized in reality after transition period of 1990-1999. Since 2000's, foreign investment has been constantly increasing. The significant increase in the foreign investment can be seen since 2007. The most influential sector in the foreign investment has become the mining sector. Foreign investment in the mining sector was 437 million USD comparing to 126 million USD in 2006. The foreign investment has been constantly increasing and the peak investment was 5,195,486.5 million USD in 2011. In Mongolia it has been discovered 80 kinds of natural resources and over 1000 mines are now in operation. Mongolia has categorized 19 kinds of mineral resources. According to the statistical data of 2013 of National Registration and Statistics Agency of Mongolia<sup>2</sup>, Mongolian natural resources have been evaluated as, 20.6 billion tons of coal, 84.1 million tons copper, 1.08 billion tons iron, 2.4 thousand tons gold, 18.1 million tons lead, and 332.6 million tons petroleum. Mongolia's resource for the rare natural elements stands higher in the world ranking. Mining sector concludes 16.1% of gross domestic product (GDP), 67.2% of industry gross product (IGP), 78.8% of export revenue<sup>3</sup>. According to the static records of 2015, around 250 mining companies are in operation. Multinational corporations, such as Rio Tinto, Torques Hills Resource, Petro China Dachin Tamsag etc.... are operating in the mining sector.

Mongolian government puts efforts in attracting foreign investment. Mongolian government has implemented several new efforts towards foreign investment. New investment law has been entered into force. Comparing to the old investment law, it reflects and attracts foreign investment. The investment law has stabilization regulation, which is stated by "stabilization certificate" indicating investment amount by billions of tugrik<sup>4</sup>, and investment period by years, and regional diversity in investment amount. The stabilization certificate especially includes regional distinction distribution of investment amount in mining sector investments. Resources related to investment become available to public. The Extractive Industries Transparency Initiative (EITI) operates since 2006, where resources related to mining can be obtained, as it is goaled as empowering good governance for transparency and good usage for the revenue of the resource, and to

<sup>1</sup> Oyu Tolgoi Investment Agreement. Retrieved from <https://www.ot.mn/agreements/>

<sup>2</sup> Invest Mongolia Agency. Retrieved from [http://investmongolia.gov.mn/en/?page\\_id=259](http://investmongolia.gov.mn/en/?page_id=259)

<sup>3</sup> Mongolian Extractive Industries Transparency Initiative Report 2015, p.5. Retrieved from <http://www.eitimongolia.mn/>

<sup>4</sup> 1.00 USD = 2021.00 MNT. Mongolian Central Bank. Retrieved from <https://mongolbank.mn/>

empower liability of parties. Mongolia had become the second country, which fulfilled the all EITI's requirements in February, 2018. EITI Global Conference was held 18 November 2014 in Ulaanbaatar, Mongolia. Besides, Mongolian government has established Invest Mongolia Agency (IMA) in 2013. The agency promotes and facilitates business investment by enabling business and investment environment for both domestic and foreign investors, assistance in investment process, developing concession (PPP projects), etc.... It gives detailed description on doing business in Mongolia, by providing information on before building a company, during building a company, and after building a company. Moreover, National Registration and Statistic Agency (NRSA) has established Mongolian Statistical Information Service in 2013, where data records of foreign investment could be obtained. NRSA has made an access to information open to public by establishing online and electronic databases. Furthermore, UNCTAD and IMA have launched online guide of investment to Mongolia<sup>5</sup>. The guide will provide online with updated and hard-to-find information on operating costs, wages, rents and taxes that can be inserted into an investor's business model, as well as laws, special permissions, procedures and useful contacts to investors on economy, primary sectors of economy, investment environment, opportunity, etc....The guide has been launched since May, 2016. Lastly, National Development Agency (NDA), regulatory agency of government has been established on 21 July, 2016. NDA was established by Resolution 12 of "Law of Reforming of Government Administrative Organization System". Although NDA was established newly, historically it has been renovated first as State Planned Committee by Resolution 106 of Mongolian People's Republic Parliament in 1945, next as Foreign Investment Agency established in 1993, and last as National Development and Renovation Commission established in 2009. NDA aims to become the leading economy branch based on Mongolia's sustainable development concept to increase citizens living standard; to plan merged investment concession, state and private enterprise cooperation for preserving economy security; to coordinate branch development policy, population settlement, regional policy and urbanization policy to preserved ecologically stable working and living economically attractive environment. NDA operation strategy goals are to develop and legislate regional development policy and investment program example; to organize research and merge big development project opinions; to evaluate policy and program, project and provide policy guidance to fit to Mongolia's sustainable development concept. Also, NDA develops branch's development leading direction, and regional development policy example and suggestion; to make coherent branch development policy to population settlement, urbanization, and regional policy for providing intersectorial relationship to do research and maintain development policy document information fund. To organize investment law, regulation executive operation; to develop state investment and merged policy concession, state and private enterprise cooperation policy example suggestion; to support and develop guidance investment project by taxation and non taxation methods. To entertain investment law, regulations, policy, program, project and investment condition and opportunity both domestically and internationally; to maintain continuous bulk information operation; to merge state investment statistic information; to maintain investment information database; to consult and support investors by information and methods. To provide state administrative and human resource leaders; to evaluate and control of state development, investment project, and program executives. Also, NDA has established online and single window service platform for foreign investors. "Invest in Mongolia" one-stop service center (OSSC) has officially opened on 25th February 2019 by NDA. It provides all public services of state registration, social insurance, taxation, and immigration

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<sup>5</sup> iGuide Mongolia. Retrieved from <http://www.theiguides.org/public-docs/guides/mongolia>

organizations, as well as other relevant ministries and public institutions through A Single Window system<sup>6</sup>. The purpose of the one-stop service center is to provide the following public services: providing information and advisory services on investment legal framework; investment tax and non-tax incentives; systemic investor response mechanism (SIRM)—maintaining an e-system for investor's grievance related to the public services; providing all advisory and procedural services of registration, verification of legal entity, amendments, reference, description, investor's card, and other services to the legal entity with foreign investment; providing tax information and advice, registration of taxpayer, digital signature, reference, description, tax statement, tax collection of motor vehicles of foreign invested companies and investors; providing information and advice related to visa, visa issuance, residence permission, temporary visitor's registration, and visa extension etc...; providing information and advice related to social insurance registration, reference, and receipts of statements from foreign invested companies<sup>7</sup>. SIRM has been established on June 16, 2020<sup>8</sup> and foreign investors have opportunity to file investment claims online<sup>9</sup>.

Expropriation, investment earnings, political violence, criminal offences are the main legal grounds for the investment disputes. Investment agreements provide protection environment for investment, which refers to the protection of investors by disclosing the host state's obligation in case of expropriation. Dispute settlement, investment protection, expropriation and other provisions in the investment agreement protect the investor's rights in case of investment disputes. The investment agreements do not conclude rights of the host state against investor's legal rights and obligations except in the dispute settlement clauses. All BIT and investment agreements have dispute settlement provisions of arbitration or court clauses, and negotiation instruments. The dispute settlement clauses in the investment agreement conclude opportunity to both parties to settle the dispute by negotiation and to use alternative dispute resolution (ADR). If negotiation is not concluded, then either party or mere investor files the case to the arbitration or the court.

Almost all 89% of the bilateral treaties that provide for investor-state dispute settlement (ISDS) require or recommend efforts to resolve disputes amicably prior to arbitration; 81% require such procedures and another 10% recommend them<sup>10</sup> as in Figure 1. According to the statistical data, ADR is more flexible, faster, and cheaper than arbitration, and can enable parties to avoid an arbitral award, which may create unwanted precedent. But on the other hand, ADR requires time and money and is not always successful. Moreover, it is non-transparent so that there is little public data about its use in arbitration<sup>11</sup>. Thus, ADR remains as not sufficient method for investment dispute resolution.

Majority of investment treaties permit investors to bring direct international claims against the host states<sup>12</sup>. According to an OECD study that examined 1,660 BITs, only 6.5 % of them do not provide for investor-state arbitration<sup>13</sup>. Recent examples of IIAs without ISDS provisions are the Australia-United States FTA (2004), the

<sup>6</sup> Opening of "Invest in Mongolia Center" One-Stop Service Center. Retrieved from <http://nda.gov.mn/1441.html>

<sup>7</sup> Id. Retrieved from <http://nda.gov.mn/1441.html>

<sup>8</sup> National Development Agency. Retrieved from <http://nda.gov.mn/1629.html>

<sup>9</sup> Investor Protection Council, Online application. Retrieved from <http://ipc.gov.mn/>

<sup>10</sup> Gaukrodger, D., & Gordon, K. (2012). *Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*. OECD Working Papers on International Investment, 2012/03, OECD Publishing, p.15.

<sup>11</sup> Id. at 22.

<sup>12</sup> UNCTAD Series on Issues in International Investment Agreements II: *Investor-State Dispute Settlement*, New York and Geneva, at 18, 2014.

<sup>13</sup> UNCTAD Series on Issues in International Investment Agreements II: *Investor-State Dispute Settlement*, New York and Geneva, at 18, 2014 from OECD, 2012, p.11.

Japan-Philippines EPA (2006) and the Australia-Malaysia FTA (2011)<sup>14</sup>. These BITs have provisions of state-state dispute settlement mechanism.

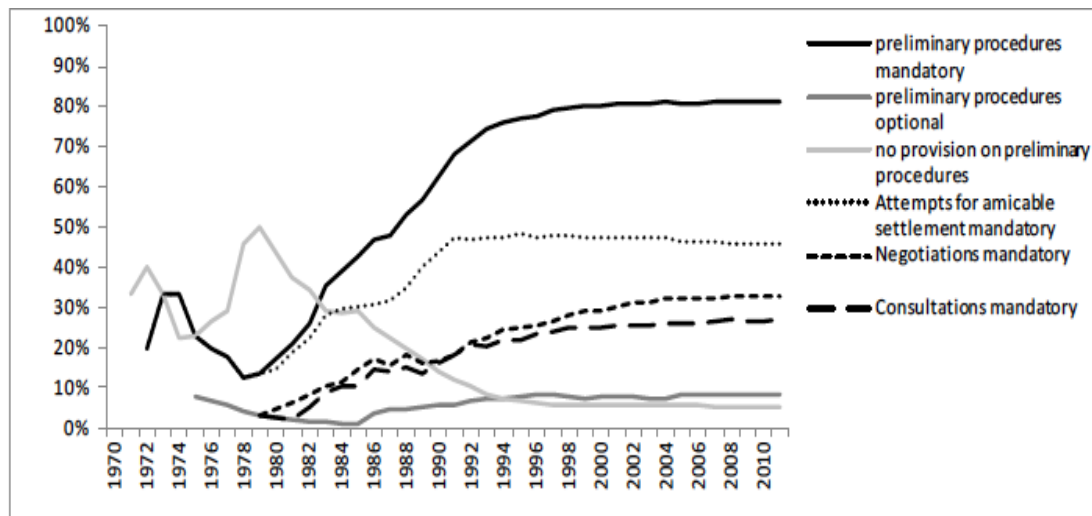


Figure 1. Treaties with specific clauses on non-confrontational dispute settlement procedures (percentage of stock of treaties in the sample in existence at the end of a given year)<sup>15</sup>.

IAs are concluded between states. Only states give consent to arbitration in IIA. According to the leading school of thought, the relevant clauses in IAs represent a unilateral offer of consent to arbitration by the contracting states, which can be accepted by the other party to the dispute, i.e., an investor. Investors typically express their consent to arbitration by filing a request for arbitration. When this happens, the consent is “perfected” and can no longer be revoked unilaterally<sup>16</sup>. Consent of investor in request of arbitration against the host state, and offer of consent to arbitration by the host state can be defined as *vertical* to investment arbitral procedure. One of the characteristics of investment arbitration is that the state does not lose its immunity through the arbitration procedure. Thus, the state, which is going through the litigation with immunity, justifies *verticality* to the arbitration.

Investment arbitration deals with cases on investment disputes between the state and investor, but in some instances the investment agreements also include state-to-state dispute settlement provisions. It is a dispute concerned to the public law, where investment relationship is based on investment agreements compared to commercial arbitration. Commercial arbitration deals on claims based on investor and state, but on private law, i.e., contracts. The important difference of investment and commercial arbitration is the state and investor relationship. In commercial arbitration, the state joins to the dispute as a legal enterprise status, as the same level as to the investor. The state loses its immunity over property disputes, where the state achieves the same legal status as to legal enterprises in the investment disputes. Thus, state to investor arbitration is categorized as *vertical* to arbitration comparing to commercial investment disputes as *horizontal* to arbitration by the relationship of parties and by issuing legal acts.

<sup>14</sup> Id. at 18.

<sup>15</sup> Gaukrodger, D., & Gordon, K. (2012). Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community. OECD Working Papers on International Investment, 2012/03, OECD Publishing, p. 5.

<sup>16</sup> Id. at 32.

International arbitration is a voluntary and consent-based method of settling disputes<sup>17</sup>. It can be referred from the present investment agreement that offers and consent provisions are legislated not sufficiently in the investment agreement for the protection of the host state and investor. There exists no prevention and monitoring instrument, or clause in the investment agreement that prevent investor's "taking advantage" of consent to filing to arbitration. Taking advantage can be defined as exploit or make unfair use of one's own benefit. Further, as described in Black's law dictionary, "... unfair use of the power arising out of the parties' relative positions and resulting in an unconscionable bargain", unfair use of one's own benefit results to undue influence or fraud. Thus, the bound agreement between the host and investor towards arbitration settlement is avoidable. This also refers to example of disputes for the host states, which lack of international dispute experiences. The host states, which lack of international dispute experiences, are count to be developing countries, where natural resource and mining is a dominating sector.

Mongolian mining disputes are counted to be around 10 in numbers since 2006. In 2012, treaty based ISDS cases have grown to 514 at the end of the year (see Figure 2). This constitutes the highest number of known treaty based disputes ever filed in one year, with general trend being 30-40 new cases of 140 cases annually since 2006<sup>18</sup>.

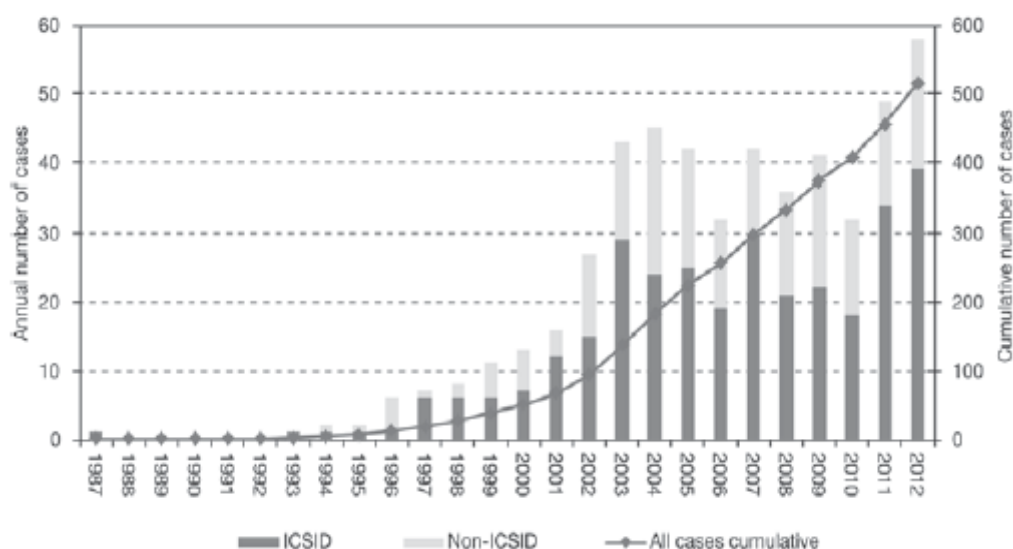


Figure 2. Known ISDS cases (cumulative, as of end 2012)<sup>19</sup>.

Comparing to average yearly number of ISDS cases, the number of cases arouse against Mongolian government is considered to be superior in quantities, and abstract in sequence of timing. Among investment disputes, where Mongolian government has been a defendant, most of the arbitral decisions were on the side of the defendant<sup>20</sup>. It can be concluded that investors could have taken advantages of their consents to filing

<sup>17</sup> UNCTAD Series on Issues in International Investment Agreements II: Investor-State Dispute Settlement, New York and Geneva, at 31, 2014.

<sup>18</sup> Id. at 19.

<sup>19</sup> UNCTAD Series on Issues in International Investment Agreements II: Investor-State Dispute Settlement, p.19, New York and Geneva, 2014.

<sup>20</sup> Benson, S., & Orlovski, V. (2014). Arbitration on International Investment Agreement. USAID, Gibson Dunn, Business Plus Initiative.

requests to arbitration, as numerous cases are filed to the international arbitration for such short period of timing, and decisions are in the host states side.

Almost most of the investment agreements conclude “the fair and equitable treatment” provision. An analysis of the opinions of the arbitral tribunals which have attempted to interpret and apply “the fair and equitable treatment” standard, identified there are two elements, due diligence and due process, while only a few mentions transparency and good faith<sup>21</sup>. Due diligence and due process including non-denial of justice and lack of arbitrariness are elements well grounded in international customary law, while transparency is an element which is often defined in international agreements as an obligation under a separate provision<sup>22</sup>. According to OECD studies, good faith is considered to be more a basic principle underlying an obligation rather than a distinct obligation owed to investors pursuant to “the fair and equitable treatment” standard.

In the dispute settlement clause in investment arbitration, the host state has equal right as to investor by offering an offer to arbitrary. Investor consents to the offer and then files to the arbitration. Regulation of investor’s consent to arbitration is legislated in the investment agreement clauses. However, protective clauses from fraud are not legislated in the investment agreements. Taking advantage or unfair use of consent refers to lack of instrument that monitors the infringement in the agreement. Lack of arbitrariness exists in the investment agreement, which refers to infringement of “the fair and equitable treatment provision” in the agreement. Due to non-existence of implementation provisions and monitoring instrument in the arbitration agreement, lack of arbitrariness or “the fair and equitable treatment” provision does not fulfill accordingly. Thus, monitoring clause in investment agreement should be legislated in investment agreements and BITs for prevention of unfair use of consent.

Regarding investment dispute, monitoring mechanism should be in effect in investment agreements and disputes. Lately United Nations has adapted Convention on Transparency in treaty-based investor-state arbitration, i.e., the Mauritius Convention on Transparency in 2014. The Convention is an instrument by which parties to investment treaties concluded before 1 April 2014 express their consent to apply the UNCITRAL Rules on Transparency in treaty-based investor-state arbitration (“Rules on Transparency” or “Rules”). The Rules on Transparency, effective as of 1 April 2014, are a set of procedural rules for making publicly available information on investor-state arbitrations arising under investment treaties. In relation to investment treaties concluded prior to 1 April 2014, the Rules apply, *inter alia*, when Parties to the relevant investment treaty agree to their application. The Convention is an efficient and flexible mechanism for recording such agreement<sup>23</sup>. The Rules on Transparency has provision on third party involvement in the investment dispute. Article 4 and 5 “...the arbitral tribunal may allow a person that is not a disputing party, and not a non-disputing Party to the treaty (‘third person(s)’) to file a written submission with the arbitral tribunal regarding a matter within the scope of the dispute”, “the arbitral tribunal ... may invite submissions on issues of treaty interpretation from a non-disputing Party to the treaty”<sup>24</sup>. Involvement of third party in the investment dispute can be described as an eliminating body of “lack of arbitrariness” and monitoring body of “the fair and equitable treatment” provision. However, Convention and Rules on Transparency are still silent on investment agreement infringements on

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<sup>21</sup> OECD. (2004). Fair and Equitable Treatment Standard in International Investment Law. OECD Working Papers on International Investment, 2004/03, OECD Publishing, p. 41. Retrieved from <http://dx.doi.org/10.1787/675702255435>

<sup>22</sup> Id.

<sup>23</sup> UNCITRAL. Retrieved from <http://www.uncitral.org>

<sup>24</sup> Id.

offer and consent provisions. Regulation and protection on offer and consent provisions are lacking in investment agreement and BITs at the present time. Thus, investment agreements and BITs should include clauses on offer and consent provisions of the host state and investor relations on investment dispute in order to protect both rights of the host state and investor, and prevent further infringements in the dispute process. Based on the verticality and the horizontality of the arbitration, consent can be braked. In case of braked consents, taking advantages of consent would reduce in amounts. Lack of the mentioned monitoring instrument in the investment agreement can be described as a lack of transparency and good faith. As taking advantage of consent to arbitration is considered to exploit or make unfair use of one's own benefit, and considered to be intentional act of investor. Thus, intentional act of investor can be prevented by act of good faith. Investor should act in accord to good faith towards the host state. Acting in a good faith would prevent investor from infringing investment agreements.

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