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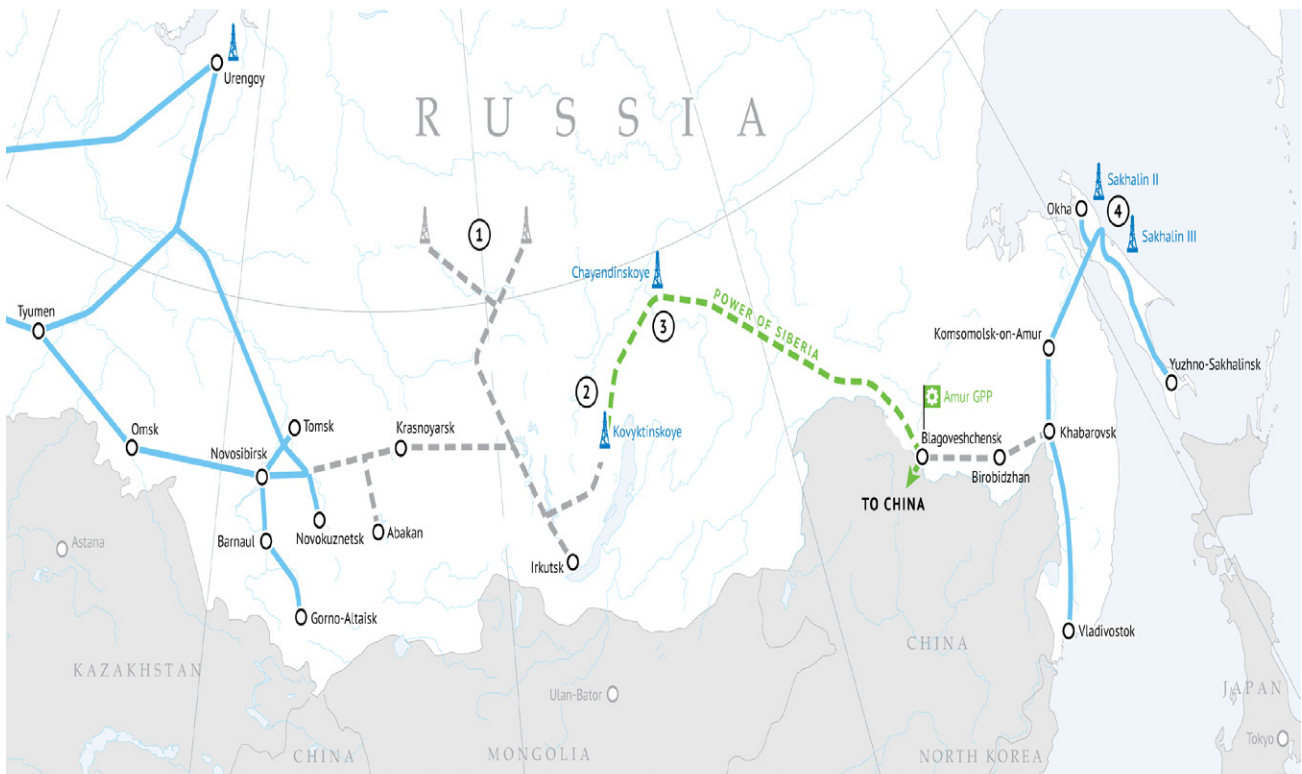
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- Gas pipelines in operation
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The economics of

NATURAL GAS FAVOR MONGOLIA

President Kh. Battulga is back from his trip to Vladivostok, where he attended the Eastern Economic Forum and had engagements with leaders from our neighboring countries. An agreement was made to upgrade power plants 3 and 4, as well as the Ulaanbaatar railway, with a soft loan of 100 billion rubles from Russia. In addition, the Russian president supported putting natural gas pipelines through Mongolia while the Chinese president promised to look into it from an economic perspective.

Natural gas is a strategically important source of fuel for the fast growing China. If the pipeline goes through Mongolia, we will be able to generate revenue from having natural gas transported on our territory. A part of this

income can come in the form of natural gas that will help eradicate air pollution in Ulaanbaatar, and the rest could be in cash, which will help our economy. Therefore, the importance of this topic is quite high.

Building pipelines to transport or import oil and gas is not only a technically challenging piece of work but also a complex issue dependent on many factors such as geopolitics and energy economics. Russia has spent nearly ten years negotiating with China to build natural gas pipelines that go around Mongolia and connect with China. In 2014, they signed an agreement in Shanghai. While the supply of gas was supposed to start in 2018, the date has been postponed to the end of 2019.

SOARING DEMAND FROM CHINESE MARKET

In 2017, China used 238 billion cubic meters of natural gas, which puts them only behind the United States and Russia. Sixty per cent of their total consumption came from domestic sources, 19 per cent from pipelines from neighboring countries (Turkmenistan, Myanmar), and 21 per cent in the form of liquefied natural gas (LNG) from exporters far away, which included Australia (50 per cent of LNG) and Qatar (20 per cent). China has become the global leader in imports of LNG.

Natural gas accounted for 7 per cent of China's total use of electric power, and the figure is expected to grow to 10 per cent in 2020. The U.S. Energy Information Administration reported that as a result of the war China waged against air pollution, their demand for this 'blue fuel' has grown every year and

will reach 360 billion cubic meters in 2020. China is turning its big cities over to the use of natural gas and converting the engines of all buses and trucks to LNG engines. Therefore, China is aiming to have reserves that can last at least ten days.

“ The Chinese demand for electric power, especially energy from blue fuels, is growing continuously. According to the U.S. Department of Energy, China's domestic production of natural gas will increase by threefold by 2040, but they will still need to meet two-thirds of their total demand from natural gas and LNG imports. ”

Given that China will continue increasing its natural gas imports, tariff wars still lurk around the LNG they import from the United States.

► RUSSIA'S NATURAL GAS EXPORTS

As of 2016, Russia held the biggest reserve of proven natural gas resources (47 trillion cubic meters) in the world. It is considered to have 25 per cent of the world's total natural gas reserves. Seventy per cent of Russia's reserves lie in three big gas fields in the western Siberia: Urengoy, Yamburg, and Medvezhye. The rest are located in the eastern Siberia and on Sakhalin.

Gazprom started a huge project named the Power of Siberia to build a 2,200-kilometer-long pipeline from the Chayanda oil field, which is located to the northeast of Baikal Lake, to the city of Blagoveshchensk, and then to connect with the Kovytkha gas field to the north of Irkutsk with a 800-kilometer-long pipeline. Vitaly Markelov, Deputy Chairman of the Gazprom

Management Committee, has recently announced that the first part of the project will be completed next year. As of today, 40 kilometers of pipelines are yet to be built.

The 2014 Shanghai agreement essentially said that Russia would invest 55 billion USD in building this pipeline, which will carry natural gas to China for 30 years, with a total estimate of sales worth 400 billion USD. It took a very long time for them to agree on the price, which is set to be cheaper than the gas sold to Europe (less than 350 USD per thousand cubic meters) on a take-or-pay arrangement. Therefore, this pipeline, which has a diameter of 1.4 meters, will transport 38 billion cubic meters of natural gas per annum.

MONGOLIA'S CORRIDOR

If we assume that the agreement between the presidents is realized, a project will be implemented to build a pipeline of more than 2,000 kilometers from the Kovytkha gas field, which is East Siberia's biggest gas field with a proven reserve of 2.5 trillion cubic meters, through Ulaanbaatar to the Chinese border. We can then develop a rough estimation of its impact on Mongolia's economy.

“If we based the estimation on the numbers from the Power of Siberia project published by Gazprom in 2015, it will require an investment of 246 billion rubles to build a 1,000-kilometer-long, 1.4-meters-diameter pipeline along with nearly ten compressor stations on Mongolia's territory.”

If we assume the transport capacity stands at 30 billion cubic meters and use numbers from some contracts (1.09 USD for transporting one thousand cubic meters over a 100-kilometer distance), Mongolia can receive 3 billion USD every year. The exact number will clearly be different, given that the contract will be established with assistance from international experts on distance and weight of natural gas to be transported.

Building a gas or oil pipeline through Mongolia's corridor would be a relatively economic option to

connect Siberia to Beijing and other large cities in China. It will also be the shortest route – even closer than through central Asia or Manchuria.

Clearly, the economics of the project heavily depend on the international markets for oil and natural gas. For example, the Russian ruble is currently dramatically weakened, putting heavy pressure on Russia's economy. Since the annexation of Crimea, the sanctions on Russia by the western world have been getting stronger. It is also projected that China will see the most impact from a trade war between them and the United States.

However, regardless of international circumstances, Chinese energy demand, especially for natural gas, cannot be slowed down. It is on an upward trajectory, therefore building a pipeline in Mongolia would benefit all three countries. Also, building the pipeline around Mongolia would require overcoming mountain ranges and will be twice as long and as expensive as building it through Mongolia's territory.

Therefore, the economics of natural gas pipeline favor Mongolia. The only concern is that, because our public governance is corrupt and non-transparent, the pipeline project could even worsen the resource curse.



Outwith the Old, in with the New:

REFORMING MONGOLIA'S LAW ASSOCIATIONS

It may surprise some readers to learn that there are still institutions in Mongolia that have not yet transitioned to democracy. These associations which once were controlled by communist party members, are today governed by a small groups of individuals. But the first generation of Mongolians born since the democratic transition has come of age. And this generation, the oldest of whom are now in their late-30s, has only ever known the ideals of democracy, human rights and the rule of law. And as this generation begins to take part in the direction of our country, Mongolia's associations must begin to reflect the values they've come to expect.

“ In this column, we will explore this idea through the lens of Mongolia's law associations and their lack of internal democratic structure. ”

BAR ASSOCIATIONS IN EUROPE

The bar associations in Austria and Estonia serve as good starting points for comparison. Their organization and membership are typical for Europe and may place elsewhere.

As of 2017, there were 6,238 attorneys-at-law in Austria, and as a precondition to practising law

these lawyers have a statutory obligation to maintain membership with one of the nine [regional bar associations](#) in the country (the largest of which, the Vienna Bar Association, has more than 2900 members). Each of the nine bars has the status of a public law body. Each bar is responsible for licensing lawyers in its territory and maintaining professional ethics through a Disciplinary Council. There is an association at the national level, the Austrian Bar, but its powers are limited. Very generally it serves as a national moderator among the nine bars. Estonia, on the other hand, is a much smaller country in size and population, relative to Austria. Its 1,020 lawyers are united under one main entity, the [Estonian Bar Association](#).

The powers of the bars in both Austria and Estonia are held by general meetings that take place at least once a year. The procedural rules make sure that each of the bar members are informed about the general meeting well in advance. The Estonian Bar Association Act stipulates that the general meeting has a quorum only “if more than one-half of the attorneys with the right to vote participate”. In Austria, the quorum is regulated but the rules are a little more complex. But the takeaway here is that, in both countries, in ►►

- ▶ principle, each bar member has the opportunity and the right to participate in the general meetings of the bar associations.

LAWYERS' ASSOCIATIONS IN MONGOLIA

Things are a little different in Mongolia. The [Mongolian Lawyers Association](#) (MBA) is not an association of independent legal professionals (as was argued in [a previous column](#)). Judges and state prosecution officers hold statutory membership in the MBA. As of September 2017, there were 5,303 lawyers registered with the MBA (517 judges, 506 prosecutors, 2,077 advocates, 2,203 other lawyers). The MBA holds licensing authority for new advocates (attorneys-at-law).

The general meeting of the MBA normally takes place once every two years. The general meeting is held by representatives of the association's members, although every member of the MBA has the right to nominate himself/herself as a representative (the election for which is via online balloting). The number of representatives may vary. In October of last year, 534 representatives were elected to the general meeting, at which they cast votes for President and members of the Board.

Another lawyer's association, the [Association of Mongolian Advocates](#) (AMA), has roughly 1,200 members, but it no longer holds licensing authority. The highest governing body of this association is the general meeting of the representatives that is organised normally once every three years.

“ *The organisational structures of the MBA and the AMA are hierarchical; their decision making and controlling functions are centralised at the national level and are in the hands of their Presidents and Boards (the*

governing board of the MBA is comprised of around 30 members while the AMA's has nine). ”

Importantly, unlike their counterparts in Europe, the majority of members of both organisations do not have the opportunity to participate directly in the decision-making of either association.

OUTLOOK

Earlier this year, the [Defacto Institute](#) published [a report](#) on the internal democratic structures of Mongolia's political parties. Their findings suggested the parties have a ways to go before they are properly participatory. Likewise with Mongolia's law associations. This begs the question: How can the democracy of our country grow and strengthen if such foundational institutions are not themselves democratic?

No matter how hard the Presidents and the Boards of public associations such as the MBA and the AMA work, they will not be able to gain the support of Mongolia's "democracy" generation unless the associations allow greater participation by their members.

“ *Gaining and maintaining the public's support is essential to the survival of these institutions.* ”

The 2013 law that stripped the AMA of its authority to license advocates is an example of what is at stake. In light of the organizational structures of Europe's bar associations and democratic participation of their members, Mongolia's law associations have no good reason not to work toward this as a goal.

September 2018 ■



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ARTICLE

FALL SESSION AGENDA

It's always an exciting moment for lawyers when the Parliamentary agenda for the next session is published and there are some interesting legislative developments pencilled in for discussion during the fall session of Parliament. While this time is typically dominated by debates around the state budget, a number of other interesting points are worth highlighting.

Tax

The long-awaited amendments to last year's imposition of a 30 per cent tax on indirect transfers of rights over mineral licences and interests in land is scheduled for discussion. [In previous articles](#), I have suggested that this has been the government's SEFIL 2.0, seriously impacting on foreign investment, especially in the mining sector. Almost every major investment transaction that we have advised on in 2018 has required careful consideration of the impact of the amendments made last year to the tax laws, increasing costs for foreign investors and making them highly cautious of investing into Mongolia. For example, the inclusion, or the risk of inclusion, of exploration costs, which may yield no results in terms of moving an asset forward, in the overall valuation of an exploration or mining licence, results in a prohibitive additional cost which no serious investor would be prepared to consider.

“Moreover, most businesses looking for investment have land rights of one kind or another, particularly where the energy sector is concerned. As the law currently operates, the acquisition of a company holding land

rights would result in a tax charge to the target company holding the land at 30% of the value of the land based on the sale price of the company, regardless of its other assets or business.”

While it is difficult to put a number on the impact, I would estimate the reduction in FDI inflows as a result of this legislation to be something in the region of USD 500 million and would doubt that overall it has resulted in a tax revenue windfall.

Business associations have been actively lobbying the government to reverse the legislation entirely, but the likely outcome will be a reduction in the tax rate of 30 per cent to 10 per cent. With other markets offering tax incentives to invest in their jurisdictions, an additional tax of 10 per cent remains difficult for some investors to consider.

We can only hope that there will be no late surprises to the tax laws during the budget discussions this time around.

Labour Law

Proposed amendments to the labour law have been on the cards for many years. The last attempt to introduce amendments to the law was in 2016, but that ended in controversy. Among the key issues with the previous draft was a proposal to compensate workers for their time spent travelling to work. For large mining companies, such as OT, which operate on a roster basis at their site, this would have a big impact – driving to OT from Ulaanbaatar can be up to 8 hours and taking a flight probably four hours ►►

- ▶ overall. Aside from mining companies at site, given the horrific traffic in Ulaanbaatar itself this becomes potentially a significant issue for employers.

Investment Banking Law

Another important piece of legislation for discussion could be a new Investment Banking Law. Several international banks have been trying to break into the Mongolian market and obtain a full banking licence. The Investment Banking Law represents a compromise in terms of allowing foreign banks to enter the market in a limited way, focused on high profile transactions with restrictions on the type of lending that can be made. Investment banks would effectively be prohibited from competing with local banks in terms of opening accounts for retail customers.

The draft law previously circulated sets out key activities of investment banks, including investment advisory services, underwriting, brokering for clients in stock investments, limited long-term and short-term lending, issuing guarantees, certain fund management activities, M&A activity and consultancy services, buying and selling securities, loans and other financial instruments, and engaging in other

financial services permitted by the BoM. Early drafts were criticized by foreign banks already operating in or aware of the Mongolian market, due to a proposed minimum share capital requirement of MNT 200 billion (USD 80 million) and a limitation on lending of a minimum of MNT 100 billion (USD 40 million). While the latter requirement appears to have been removed from the latest drafts, it will be interesting to observe the discussions around this law and whether foreign banks may be interested to enter into the market in a limited way.

Other

Among other interesting laws slated for discussion is a Law on Promotion of Small and Medium-sized Enterprises, which I expect will focus on potential tax incentives to encourage development and growth of smaller businesses.

“In summary, there should be some important developments on tax to look out for over the next few months and intriguing to see the reaction to and effectiveness of the Investment Banking Law on the Mongolian economy.”

September 2018 ■



PRIME MINISTER'S OFFICIAL VISIT TO THE UNITED STATES

Prime Minister Khurelsukh is currently paying a visit to the United States to meet with Vice President Pence to discuss views on extending U.S-Mongolia relations and cooperation.

The most highlighting agreement was the second Millennium Challenge Corporation compact. This is the second time Mongolia is receiving a bilateral U.S aid. The Millennium Challenge Corporation is a doctrine program of the United States, which was established in 2004 by President George Bush's initiative. Along with aids, the U.S has started helping developing countries in the socioeconomic area but under certain conditions. First of all, there has to be competitive selections, meaning that selections would be based on 17 transparency policy indicators and how the country is performing on them. Secondly, it should be country-led solutions and the country should identify their priorities. Lastly, there should be country-led implementations, meaning that everything should be by a local MCA-accountable entity.

The 17 policies are measured by the country's performance on the following indicators: access to credit, business start-up, child health, civil liberties, control of corruption, fiscal policy, freedom of information, gender in the economy, girls' primary education completion rate, girls' secondary education enrollment ratio, government effectiveness, health expenditures, immunization rates, inflation, land rights and access, natural resource protection, political rights, primary

education expenditures, regulatory quality, rule of law and trade policy. These indicators are usually sourced from institutions such as Freedom House, World Bank, International Finance Corporation, International Monetary Fund, and etc. Mongolia received its first compact of \$285 million in 2007, which went into development of property rights, pastureland, infrastructure and technical education. Six mega projects have been implemented with this money; however, the renovation of the railroad couldn't be completed as the Russian side strongly opposed it.

In 2014, after finishing the first compact, Mongolia had to set its priority to water management in Ulaanbaatar city. This priority has finally been approved by the management committee of the Millennium Challenge Corporation and our parliament. A compact for \$350 million assistance for Ulaanbaatar water supply management, starting with grey water has been signed during this visit. There will be a new water treatment plant, built by a Chinese company. The grey (re-filtered) water will be used to cool Power Station No. 4, which uses around a quarter of our clean water. 52 new underground water wells will also be built.

MONGOLIAN COPPER CORPORATION WON AT THE SUPREME COURT

The Supreme Court recently ruled in favor of the Mongolian Copper Corporation that the government acted illegally in its attempt to nationalize the copper mine, thus ending a 2-year dispute over the ownership of the mine. The legal decision was clear that the government was wrong to try and nationalize 49% of the corporation. The government should not have tried to nationalize a company as they are not the decision-makers, the court is.



Minister of Justice, Mr. Nyamdorj, made the following remarks during his speech on February 10, 2017: "It was just after the parliament inquiry working group report was released that they said where the money came from." He also mentioned that the President of the Bank of Mongolia at the time made a secret resolution to give 360 billion tugriks to the Trade and Development Bank and committed other wrongdoings. In that working group report, the Trade and Development Bank erased \$500 million to the same or identical 5 bank accounts within a day. Nevertheless, no one talks about it, it's as if nothing happened.

There are almost no cases where political influences are not involved in court cases. The 49% of Erdenet is still hanging with a penalty of \$112 million to the

Standard Bank by the Arbitration Court. Logically, it is Mr. Batkhui, who is responsible for paying this off as he forged the CEO of Erdenet's signature. Mr. Batkhui had been using this money to save his bank, which has been confiscated and given to the State Bank. He needs to help pay this penalty as much as he can, but the money is confiscated. However, nothing will likely happen because many politicians from both parties are secretly involved in this scandal. Both parties are collateral now and it's hard to find justice. In the end, it always comes down to the taxpayers and ordinary people. For example, Khan Resources had their license confiscated and was taken to arbitration court, which cost them \$70 million. None of the decision-makers were held responsible for the penalty and it had to be paid off by taxpayers' money.

ILLEGAL APPOINTMENTS BY THE MINISTRY OF EDUCATION, CULTURE, SCIENCE AND SPORTS

Last Friday, the UN and Mongolia organized a National Consultation Meeting of Public Managers. During the conference, it was noted that there were incidents of 132 public managers being appointed illegally. 30 of them were high officials in the Ministry of Education, Culture, Science and Sports. The head of the Mongolian People's Party said that 132 public managers are found to have been appointed by whoever the minister was. He also mentioned that the State Public Council received 626 complaints in 2015, 630 in 2016 and 514 in 2017, related to public officers.

There have been requests for the revoke of the status of those illegally appointed, but this will not help the public sector. People are often selected for their position as a public officer by the amount of contributions to their party before and during the election. The Washington Post has written about this situation.

Unfortunately, because of the secrecy of Mongolian political parties' financing, there is a lot of corruption, especially among such high positions in public office. This is a way of paying back for the investments. These people also make decisions in favor for their related companies when it comes to bidding, tender or public procurement. This system has been in place for so long that some people make a living off of it.

Nobody can put sanctions on these elected officials or the people appointing them because the justice system is also nominated in the same way. The people may change, but the principles of choosing public officers remains the same.

From 2013 to the first half of 2018, the state has had a loss of 14.4 billion tugriks because of these illegal public officers. Whenever a new person becomes in charge after each election, people are fired and replaced. The people who are fired take their cases

to court, which then orders for them to be rehired. There are many cases like this that has cost taxpayer's money. The person who fired them and then had to rehire should pay for the salary losses as well, but nobody does. A total of 1235 public officers were proven to have done illegal acts and half of them are serving prison time. Statistics like this shows that the state governance is in big crisis.

Our public service council have received aid from the Canadian government to make better laws and train people, who have unfortunately changed and we don't know where they are now. You can find quite young and inexperienced people in their 30s being public officers, which is unacceptable and violates the principles of a public officer.

It was also revealed that the State Service Council has been investigating these illegal appointments and has made a couple of suggestions to the Ministry of Education, Culture, Science and Sports. The name of the council is misleading because they are serving the people, not the "state". The council is trying their best, but there are thousands of people getting employed without proper reference or training, resulting in late public service.

This review has been edited here for space and clarity. You can watch the full 30-minute review on the Defacto website [\[HERE\]](#).



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