WHAT IS TO BE DONE ABOUT RESOURCE NATIONALISM?: THE CASE OF OYU TOLGOI

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Foreign mining is as important now as ever. As the global population has continued to increase, so has the demand for natural resources. Developing countries richly endowed with natural resources have begun to realize that harnessing them presents a rare opportunity to fuel broader socioeconomic change and may, potentially, catalyze wholesale transformation. In this vein, countries have begun to increase their taxes and royalties on mining; and, to a greater extent, a “more indirect or insidious form of government intervention referred to as ‘creeping expropriation’” has begun to appear, whereby a “foreign investor is substantially deprived of the use or benefit of their investment even though formal title may continue to vest.”

This emerging tension is encapsulated in what is known as “resource nationalism.” In essence, resource nationalism broadly refers to governmental “dissatisfaction about the distribution of revenues from mining between company shareholders and the host nation.” Even after agreeing with foreign investors about the rights, royalties, taxes, and terms for a mining project, governments subsequently will attempt to renegotiate or even possibly breach their bargain in an effort to extract more control and

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1 Marc Frilet & Ken Haddow, Guiding Principles for Durable Mining Agreements in Large Mining Projects, 31 J. ENERGY & NAT. RESOURCES L. 467, 469 (2013).
3 Nader Mousavizadeh et al., Resource Nationalism, WILLIS MINING MKT. REV., Spring 2013, at 7.
4 Id.
5 David Humphreys, Transatlantic Mining Corporations in the Age of Resource Nationalism, TRANSATLANTIC ACAD. PAPER SERIES, May 2012, at 10.
revenue. As a result, foreign investors now face substantial uncertainty and risk when they enter into mining arrangements with sovereign countries.

The Oyu Tolgoi mine, within Mongolia, provides a case study in resource nationalism. As one of the world’s largest copper-gold mines, Oyu Tolgoi has the potential to comprise approximately 3% of the world’s total copper output, and 34% of Mongolia’s Gross Domestic Product (GDP). In 2009, Turquoise Hill Resources and Rio Tinto signed a long-term, comprehensive Investment Agreement with the government of Mongolia for the construction and operation of the Oyu Tolgoi copper-gold mining complex. The Agreement created a partnership between the Mongolian government—which acquired a 34% interest in the project—and Turquoise Hill Resources, which retained a controlling 66% interest in Oyu Tolgoi; global miner, Rio Tinto, subsequently joined Turquoise Hill Resources as a strategic partner to manage the development of Oyu Tolgoi.

Since 2009, Oyu Tolgoi has been plagued with delays, disputes, and disappointment. For almost two years, the second phase of the project was suspended after complaints of cost overruns and a dispute over taxes.
“Mongolia passed a series of laws and regulations designed to raise tax revenue and impose greater domestic control over ‘strategic’ mining assets,”15 while members of Parliament sought to renegotiate the terms of the original agreement.16 Even as the Mongolian government has sought to end the disputes with Rio Tinto and to restore Mongolia’s foreign-investor appeal, the Mongolian public remains wary of such negotiations; concerns about foreign investors, environmental damage, and the equitable distribution of mineral wealth linger.17

This Note examines how resource nationalism can hamper foreign mining agreements. Part I examines the problem of resource nationalism, which is a pervasive phenomenon among numerous countries in Europe, Asia, and throughout the world, and then examines the Public Private Partnership (PPP)—an alternative, and potentially promising, way to structure mining projects that have worked extremely well within the United Kingdom and Chile. Part II then delineates the Oyu Tolgoi mine as a case study of how ill-structured investment agreements and joint ventures can generate negative environmental, social, economic, and corrupt effects. Part III demonstrates how the government of Mongolia could have structured the original investment agreement under a PPP construct, that not only would have thwarted the problem of resource nationalism, but also would have maximized benefits for the nation as a whole.

I. RESOURCE NATIONALISM

Resource nationalism takes many forms. At its core, it is described as “an expression of dissatisfaction about the distribution of revenues from mining between company shareholders and the host nation.”18 Countries including Chile, Peru, Zambia, Ghana, Russia, Poland, China, and India have increased their taxes and royalties on mining in recent years.19 “Increasingly, a more indirect or insidious form of government intervention referred to as

15 Id.
16 Id.
18 Humphreys, supra note 5.
19 Id.
‘creeping expropriation’ has come to the forefront. Although the foreign investor holds the formal title, she is deprived of the use or benefit of the investment.

Whilst resource nationalism has often been correlated with the rise and fall of commodity prices—when prices fall, governments tend to loosen their fiscal regimes in an effort to encourage foreign domestic investment, but, in boom times, governments then demand a bigger slice of the pie—resource nationalism is now on the rise even when commodity prices are slipping. Where once expropriatory acts may have been driven by purely nationalistic policies that appeased the electorate, the resurgent resource nationalism of the 21st century now has wider political and social drivers in addition to the traditional economic ones.

Many resource-rich developing nations aspire to emulate China, and other successful emerging economies, based on what they have seen them achieve. Even if they cannot mimic China’s manufacturing-led transformation or India’s service-led transformation, they “believe that the development and exploitation of their nation’s minerals should be undertaken in such a way as to result in broader development in their nation, and that the mining enterprise should be shaped and subject to terms reflecting that. They seek resources-led transformation.”

These countries see the exploitation of natural resources as “a one-time economic opportunity to catalyze wider development”; hence, the expectation that mining projects should contribute to “economic development and the satisfaction of current national constituencies and of future generations.” It is also rooted in a conviction that “past mineral developments have given a disproportionate benefit to mining companies and to consumers, and that if foreigners wish to invest in the resources of the mineral-rich nations, then they must do so in ways which bring maximum benefit to the local population.”

For mining companies, “the robustness of their agreements,” and “their ability to defend their rights before an independent judiciary,” is of

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20 Resource Nationalism, supra note 3.
21 Id.
22 Id.
23 Frilet & Haddow, supra note 1, at 469.
24 Id. at 469–70.
25 Humphreys, supra note 5, at 20.
paramount importance.\textsuperscript{27} For them, the greatest concern is an “obsolescing
counterpart,” whereby a company invests in a project based on an agreement,
with the expectation that the terms of the agreement have been hashed out
with a host government, “only to be forced into a renegotiation on the terms
of the agreement after the investment has been committed.”\textsuperscript{28}

Therefore, mining companies need to ensure from the beginning that
projects are structured in such a way as to give locals a lasting self-interest
in the success of the operations, including, if required, through “direct share-
holdings.”\textsuperscript{29} Mining companies need to structure their arrangement pursuant
to “the requirements of the individual country and to the particular
expectations and priorities of its people.”\textsuperscript{30} Through demonstrating a clear
understanding of the potential economic impacts their operations will have,
threats posed by the “resource curse,” and a commitment to work with local
institutions towards realizing the full development benefits and mitigating
the negative effects, mining companies can succeed in persuading local
institutions that their needs will be better met through working with them
than by “insisting that local or state companies undertake all mining
activity.”\textsuperscript{31}

In the case of Mongolia, in September 2011, the Mongolian government
sought to increase its stake in the project from 34% to 50% through
renegotiations.\textsuperscript{32} The government has since reaffirmed the original agreement
stating that an increase can only take place in 2040, once the investors have
recouped their initial investment.\textsuperscript{33} The Mongolian government engaged in
such conduct “following the election of the Mongolian People’s
Revolutionary Party which placed a higher priority on developing
Mongolia’s mineral resources and reopening negotiations with the mine
operators.”\textsuperscript{34} Moreover, to highlight how much Mongolia wants a bigger
slice of the mine, in an interview from 2011, then Executive Director of Oyu

\textsuperscript{27} Id. at 14.
\textsuperscript{28} Id.
\textsuperscript{29} Id. at 20.
\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} Brenda Bouw, Mongolia Wants Bigger Stake in Massive Ivanhoe Copper Mine, GLOBE AND
mongolia-wants-bigger-stake-in-massive-ivanhoe-copper-mine/article595583/.
\textsuperscript{33} Id.
\textsuperscript{34} Resource Nationalism, supra note 3, at 9.
Tolgoi, LLC, Tserenbat Sedvanchig, said that the government of Mongolia regarded the investment agreement signed in October 2009, and capital expenditure, as two of its biggest issues. He added that the government of Mongolia also had qualms with the company’s “cost overruns, the funding and feasibility study for a $5 billion phase 2 underground expansion, the employment and pay of Mongolian workers, contractors and corporate governance, taxation, and the repatriation of earnings.”

II. PPP

Given the differing expectations of host countries and investors today, to address the modern realities, Marc Frilet and Ken Haddow favor use of the PPP model over the traditional approach to creating a durable mining agreement.

Frilet and Haddow think that the traditional approach, in its attempt to capture the essence of the agreement in detailed clauses, is static and “does not necessarily reflect the modern socio-political and geopolitical context” which is “continually evolving amidst the changing global economic balance.” Its failure stems from its rootedness at a fixed point in time; thus, they believe the traditional approach will not produce a durable contract.

On the other hand, a successful PPP agreement will “balance investor concerns with modern and evolving socio-economic and socio-political dynamics, while avoiding the hazards of too loose or too constraining an agreement.” With the ultimate goal of creating an agreement that “minimizes the possibility of disruptive future renegotiations that are costly for all concerned,” the agreement will delineate, at the outset, “the objectives and the fundamental rights and the obligations of both parties, including the key economic standards and ratios.”

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36 Id.
37 Frilet & Haddow, supra note 1, at 471.
38 Id.
39 Id.
40 Id. at 472.
41 Id.
42 Id. at 473.
“whereas” clause, the goal is “to provide an objective statement of the purpose of the agreement—indeed, of the whole enterprise the agreement facilitates—such that the legal mechanics of the agreement terms can be created and implemented from the substance of the objectives.” In the event there is a fundamental change in the future, “based on quite simple and well-tested mechanics embedded in the agreement, detailed terms can be adjusted to reflect the founding objectives of the parties, and thus re-establish the overall contractual equilibrium in line with the objectives.” Thus, through such an approach, the agreement is made more durable, and is subjected to lower risks than “a more traditional agreement constrained by its detailed clauses defined at a fixed point in time.”

Before proceeding further, it would be useful to define Public-Private-Partnership (PPP) and how it has been employed by some countries. But more importantly, rather than analyzing the durability of the Oyu Tolgoi mining agreement under a PPP construct, this note contemplates whether restructuring the Oyu Tolgoi Investment Agreement under a PPP construct could resolve the resource nationalism problem impeding its performance.

A. PPP Definition

The Federal Highway Administration defines a PPP as “any scenario under which the private sector assumes a greater role in the planning, financing, design, construction, operation, and maintenance of a transportation facility compared to traditional procurement methods.” While this definition is expansive, the overarching goal of all PPPs is to capitalize on the private sector’s management skills, expertise, innovations, and efficiencies. PPPs can be classified based on a set of general characteristics, including: (1) “cooperation between the public and private sectors on different aspects of the planned project”; (2) “a relatively long-

43 Id.
44 Id.
45 Id.
term relationship” between the public and private partners; (3) “project funding that comes either partially or entirely from the private sector”; (4) a public focus on defining the objectives and goals of the project and monitoring compliance with these objectives, and a private focus on the design, completion, implementation, and funding of the project; and (5) “the transfer of some risks traditionally placed on the public sector to the private partner.” Accordingly, PPPs provide certain assets that governments often lack, such as full financial resources and expertise, and, as a consequence, governments look to the private sector to assist in developing infrastructure, among other important public projects.

PPP projects differ from traditional procurement contracts in several respects. “They are typically large, long-term endeavors over which the private partner holds a significant amount of control and inherits greater risk.” Additionally:

There are many public benefits to transferring the risk infrastructure development to the private sector. Most importantly, the public gains an infrastructure asset, which can lead to growth and prosperity without taking on debt. Governments can free up capital to pursue projects that have high social benefits but are otherwise unprofitable and therefore unattractive to the private sector. Transferring risk also allows governments to tap private expertise and can lead to efficiency gains. The private sector is incentivized to reduce costs and increase efficiencies in order to maximize profits. On the whole, the cost over the life of the infrastructure asset can be cheaper than the traditional procurement model because the design, building, management, and maintenance are often bundled.

Some of the other benefits include infusion of capital into the target market, creation of local jobs, spur of consumption, increase in wealth, and the promotion of stronger economies.

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48 Id.
51 See Napoleon et al., supra note 49, at 122.
B. Common PPP Structures

i. Build-Own-Transfer (BOT)

“A build-own-transfer (BOT) arrangement is an agreement in which a private investor obtains funding for a public infrastructure project, builds the facility or project, and owns and operates the project for a period of time specified in the concession contract” to realize a reasonable return on its investments.52 At the end of this period, ownership of the facility or project reverts to the public sector.53 “The agreement can terminate either after a set period of time or when the initial investment plus an agreed-upon return on the investment has been repaid.”54

ii. Build-Transfer-Operate (BTO)

A build-transfer-operate (BTO) arrangement is similar to a BOT, but ownership of the infrastructure is transferred to the public sector upon the completion of the construction.55

iii. Operations and Maintenance, and Management (OMM)

“Under an Operations and Maintenance (“OM”) arrangement, a public partner contracts with a private partner to provide and/or maintain an already existing service.”56 Under this arrangement, while the public partner retains ownership and overall management of the service, the day-to-day management rests with the private partner.57 Furthermore, an OM arrangement typically lasts 3–5 years and offers relatively little revenue risk for the private partner.58 “An Operations, Maintenance, and Management (‘OMM’) project is typically the same as the OM model, however, OMMs

52 David W. Gaffey, Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships In the United States, 39 PUB. CONT. L.J. 351, 355 (2010).
53 Id.
54 Id.
56 Napoleon et al., supra note 49, at 128.
57 Id.
58 Id.
have longer term projects that provide private partners more time and opportunity to make their own capital investments and earn reasonable returns.\textsuperscript{59}

\textit{iv. Design-Build-Operate (DBO)}

“In a Design-Build-Operate (‘DBO’) project, a single contract is awarded to a private contractor to design, construct, and operate a new project until a contractually-agreed output, while the public sector maintains ownership and finances the project.”\textsuperscript{60} By holding one private entity accountable for multiple stages of a project, this arrangement reduces the risk of oversight on the part of the public sector had each stage been contracted out individually.\textsuperscript{61}

\textit{v. Concession}

A concession PPP is similar to a BOT, except it “can cover either an existing infrastructure or nonexistent, new project.”\textsuperscript{62} Furthermore, under a concession PPP, the public sector partner leases the infrastructure to a private investor for an upfront payment, “which the public sector partner will use to invest in other projects and which the private partner will presumably recover through the collection of tolls paid by people using the road,” in the case of a toll road.\textsuperscript{63}

\textbf{C. The Use of PPPs in the UK and Chile}

The United Kingdom (UK) provides one of the most notable examples of the widespread and successful implementation of PPPs. The private finance initiative (PFI), introduced in 1992, to upgrade public infrastructure such as schools, hospitals, roads, and other public facilities without burdening the UK treasury, was hugely successful.\textsuperscript{64} “Between 1992 and

\textsuperscript{59} Id.
\textsuperscript{60} Id. at 129.
\textsuperscript{61} Id.
\textsuperscript{62} Id. at 126.
\textsuperscript{63} Id.
\textsuperscript{64} Gaffey, supra note 52, at 361.
2008 the United Kingdom instituted over 700 PFI projects, and plans to implement over 200 more projects worth over $400 billion” between 2008-2013.\textsuperscript{65}

In response to the delays and inefficiencies that PFIs suffered early on, stemming “from a general lack of ability among public sector employees either to oversee the complex contracting process required for PPPs or to understand and manage the private business aspects of the agreement,”\textsuperscript{66} in 1999, the UK government created a “permanent, quasi-governmental organization specializing in PPP projects,” called Partnerships UK.\textsuperscript{67} It is considered one of the most significant innovations of the PFI system.\textsuperscript{68} “This organization is comprised of board members from both the public and private sectors, who assist the UK treasury in developing and implementing PPPs, and assist the private sector in negotiating and performing such projects.”\textsuperscript{69}

The UK also introduced standardized contracts and supporting documents to simplify and ensure equity in the PPP implementation process.\textsuperscript{70} Designed to include “set terms that govern almost every aspect of the contract or eventuality that may arise during performance,”\textsuperscript{71} these comprehensive standardized contracts cover “the commencement of services, a change in services, a change in law, contract assignment, early termination, penalties for early termination, indemnities, insurance, the replacement of subcontractors, retendering following contractor default, and permitted borrowing and refinancing.”\textsuperscript{72} With the aim of enabling parties to undertake the implementation of PPPs easily, this semi-rigid form of contract was introduced to “reduce the negotiations needed to establish individual

\textsuperscript{65} Id.
\textsuperscript{66} Id. at 362.
\textsuperscript{67} Id.
\textsuperscript{68} Id.
\textsuperscript{69} Id.
\textsuperscript{70} Id. (“In addition to Partnerships UK, the UK also created purely governmental agencies tasked with overseeing PF projects. The National Audit Office (NAO) is the primary office responsible for overseeing the UK PFI program, while a Public Accounts Committee assists in the oversight and responds to reports issued by the NAO. A third agency, the Audit Commission, is responsible for auditing the public money spent by local officials on PFI projects.”).
\textsuperscript{71} Id. at 364.
\textsuperscript{72} Id.
contracts and to assist in creating a business culture well versed in the terms and opportunities to be found in PPPs.”

Another country that has also had success with PPPs is Chile, specifically in the area of toll road concession. As the sole provider of infrastructure through the 1970s, to combat the rising infrastructure debts, the Chilean government initially, in the 1980s, turned to privatization, whereby it sold many of the state-run infrastructure companies to private buyers. However, when that did not resolve the problem, and by 1990, struggling to “keep pace with the growing burdens placed on its infrastructure,” the government created a PPP concession program to rebuild and improve the nation’s highways.

The strong regulatory framework, comprising sound concessions and investment laws, in Chile significantly contributed to the country’s success with PPPs. “The first concessions law was approved in 1991 (the “1991 law”), establishing the framework for private sector participation.” “It set the general standards for the execution, operation, and maintenance of public works, as well as for bids for public works contracts.” The 1991 law not only empowered the Minister of Public Works, it also prescribed terms pertaining to concessions contracts. “The legislation created a system of competitive bidding based on flexible arrangements for awarding concessions, establishing mutual rights and obligations, and setting up conflict resolution procedures. It also provided for the use of incentives, including subsidies and government guarantees to promote private investments.”

The Ministry of Public Works oversees the entire concessions system, and it is in charge of tendering the projects, controlling the bidding process, and supervising the construction and operation of the projects. Between

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73 Id.
74 Hill, supra note 50, at 173.
75 Id. at 174.
76 Id. at 175.
77 Id.
78 Id. at 176.
79 Id. at 175.
80 Id. at 177.
81 Id.
82 Id. at 175.
1995 (when the first PPP infrastructure project was completed) and 2008, “55 concession contracts were awarded, representing a total investment in infrastructure of close to $11.5 billion . . . [and] . . . 120 private companies have participated in projects ranging from $8 million to $850 million in value.” While the Chilean government initially employed the concessions system to address the lagging transportation infrastructure, between 2003 and 2010, it used concessions to build airports, seaports, roads, and prisons; indications that the government has employed it for other uses.

An additional reason why Chile has had success with PPPs is due to the sound investment laws it passed to provide strong legal protection to both foreign investors and nationals alike. Buttressed by Chile’s Political Constitution, which provides protection to foreign investment, foreign investors who wish to invest in Chile can do so through two mechanisms: “under the general rules for foreign exchange found in Chapter XIV of the Central Bank’s Compendium of Foreign Exchange Regulations (CFER), or through the Foreign Investment Statue Decree Law No. 600 (DL 600).” Most large foreign investors opt for DL 600, as seen by the more than 81% of all foreign direct investment entering Chile between 1990 and 2004. “Under DL 600, investors have the right to enter into investment contracts with the Chilean government, to freely invest in all sectors of the economy, and to appeal any judicial rulings that may be discriminatory.” The National Congress of Chile promulgated DL 600 to govern the influx of foreign capital, and to provide equal legal treatment to both its nationals and foreign investors.
III. OYU TOLGOI MINE

Oyu Tolgoi is one of the world’s largest copper-gold mines, and is located in the South Gobi region of Mongolia, approximately 550 kilometers south of the capital, Ulaanbaatar, and 80 kilometers north of the Mongolia-China border.\(^{93}\) The Oyu Tolgoi mine, which is a “part of one of the world’s largest known porphyry deposit systems in terms of reserves and resources, has total estimated copper reserves of 13.1 million metric tons (Mt), and about 1 million kilograms (kg) of gold.”\(^{94}\) “Estimated resources (including indicated and inferred resources) accounted for about another 14 Mt of copper\(^{95}\) and more than 400,000 kg of gold.”\(^{96}\) Production began in 2013, and “is expected to reach full capacity by 2018 with copper ore output potentially composing 3% of total world output, and revenue from the mine expected to represent as much as 34% of Mongolian GDP by then.”\(^{97}\) When fully operational, “the mine is set to produce more than 1.2 billion pounds of copper (worth over $4 billion at today’s prices), 650,000 ounces of gold ($800 million), and 3 million ounces of silver (under $100 million) each year.”\(^{98}\)

On October 6, 2009, Turquoise Hill Resources and Rio Tinto signed a long-term comprehensive investment agreement with the government of Mongolia, for the construction and operation of the Oyu Tolgoi copper-gold mining complex.\(^{99}\) The agreement created a partnership between the Mongolian government, which acquired a 34%\(^{100}\) interest in the project, and Turquoise Hill Resources, which retained a controlling 66% interest in Oyu Tolgoi.\(^{101}\) Global miner, Rio Tinto, who joined Turquoise Hill Resources as

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94 Wacaster, supra note 8, at 17.1.
95 Id.
96 See ERNST & YOUNG, supra note 11 (Oyu Tolgoi is estimated to contain 45.032 million tons of copper; 157,000 tons of molybdenum; 12,049 tons of silver; 1,838 tons of gold).
97 Khan, supra note 9.
98 Ehs, supra note 35.
99 See INVESTMENT AGREEMENT SUMMARY, supra note 10.
100 ERNST & YOUNG, supra note 11, at 6.
101 INVESTMENT AGREEMENT SUMMARY, supra note 10.
a strategic partner in October 2006, is managing the development of Oyu Tolgoi. 102

Disagreements between the Mongolian government and Rio Tinto came to a head in 2013, with the government urging Rio Tinto to settle a 340 million dollar tax issue. Additionally, the cost of the project was initially projected to be $5.1 billion dollars, but went up to $7.1 billion dollars during the initial stage of the project. 103 In July 2013, shares in Turquoise Hill Resources dropped 20% after a dispute between Tserenbat Sedvanchig, the executive director of Erdenes Oyu Tolgoi, 104 and Rio Tinto. 105 Sedvanchig was fired in August, and replaced by Davaadorj Ganbold, a former deputy minister and Member of Parliament. 106 In the meantime, Rio Tinto cut 1,700 Mongolian employees from the mining operation. 107

A. Environmental Impact

Rio Tinto has a poor record of environmental management; a number of its mines, including Oyu Tolgoi, are routinely criticized by prominent international environmental groups. 108 The Oyu Tolgoi mine is located in one of the driest areas in Mongolia. 109 Rainfall in the desert area ranges between zero and 50 millimeters per year. 110 It is estimated that the water demand will triple in the coming two decades, due mainly to mineral exploitation in the

104 The Mongolian Government owns its interest through a state-owned company called Erdenes Oyu Tolgoi.
106 Id.
107 Id. supra note 103.
109 Id.
Leaders worry that Oyu Tolgoi is draining the region’s water supply, since it uses more than a billion gallons of water per month. In addition, there is a substantial risk of acid rock drainage from the mine, caused by tailings storage facilities, and any overburden or waste rock stored on the surface and not deposited back into the mine.

South Gobi is also a critical habitat for at least six endangered and threatened species, found nowhere else in the world. They are the Mongolian Wild Ass-Khulan (Equus hemionus—threatened), Goitered (Black-tail) Gazelle (Gazella subgutturosa—vulnerable), Mongolian Gazelle (Procapra gutturosa—near threatened), Houbara Bustard (Chlamydotis undulate—vulnerable), and Saker Falcon (Falco Cherrug—endangered). Two protected areas, the Small Gobi Strictly Protected Area A (SGA), and the Small Gobi Strictly Protected Area B (SGB), are located in close proximity to Oyu Tolgoi, and are included in the mine’s area of impact. In order to compensate for the loss of habitat, Oyu Tolgoi, LLC, the Rio Tinto/Turquoise Hill subsidiary that manages the mine, released a biodiversity offset strategy; however, the NGOs are not convinced. They stress that Oyu Tolgoi, LLC did not consider avoiding, minimizing or mitigating the damage, and went directly to offsetting. They urge the company to develop a strong, detailed, long-term species conservation and habitat protection plan that includes a rigorous monitoring strategy. They view the current mitigation strategies described in the ESIA as too general and not based on empirical data, calling the offset strategy into question.  

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111 Id.
112 Schneider, supra note 108.
115 Id.
116 Id.
118 Id. at 6.
119 Id. at 4.
B. Social Impact

Mongolia’s southern and central zones occupy terrain traditionally used by nomadic herdsmen. Diverting already scarce water resources to mining could jeopardize their livelihoods. In the harsh conditions of the Gobi Desert, herdsmen have a very specific way of organizing summer pasture, its rotation, access to water, hay collection, and hay storage. Any changes to these unique practices could hamper the livelihoods of nomads. Steel fence that surrounds the gaping mine blocks traditional herding corridors, and makes it difficult for the herd animals to find water. Roads constructed by the mine owners present also additional barriers to animals.

Some Mongolian herders forced to resettle because of the Oyu Tolgoi expansion have already experienced herd loss. They were forced to move to inferior locations, without adequate time to select spots that would protect their animals from harsh winter storms. The minimal assistance provided at the time of resettlement was not sufficient. Furthermore, they were forced to accept inadequate compensation based on their location in proximity to the mine, rather than the size of pasture taken away from them.

C. Economic Impact

Mining in Mongolia currently contributes about one third to the nation’s GDP, and accounts for 89.2% of the country’s total exports. Building an economy on minerals puts a country at risk of Dutch disease, a term used to describe the relationship between the increase in the economic development of natural resources, and a decline in the manufacturing sector or agriculture. The cashmere industry and the agricultural sector are already

120 Balch, supra note 110.
121 Goodland, supra note 113, at 3.
122 Schneider, supra note 108.
126 Id.
feeling the side effects.\textsuperscript{127} Although Mongolia’s economic growth has helped to reduce poverty by more than 11\% in recent years, income distribution inequality has also risen. “Poverty is higher in the rural areas (35.5\%) compared to the urban areas (23.2\%), as herders in the countryside struggle to survive as their traditional livelihood dissolves.”\textsuperscript{128}

D. Corruption Related Issues

Gantömörin Uyanga, a Member of Parliament has announced that former Prime Minister, Sanjaagiin Bayar, who signed the Oyu Tolgoi (OT) Investment Agreement with three of his cabinet members, owns several properties abroad worth several billion dollars.\textsuperscript{129} However, Bayar has approached the Independent Agency Against Corruption with a request to conduct an investigation on himself.\textsuperscript{130} Also Sangijav Bayartsogt, the former Deputy Speaker of Parliament, and one of the three ministers who signed the OT agreement, has had his secret offshore account revealed by “The Guardian,” a British Newspaper.\textsuperscript{131} According to the report, Bayartsogt confirmed that he maintained a secret Swiss bank account containing more than one million US dollars, in the name of an offshore entity “Legend Plus Capital Limited.”\textsuperscript{132}

IV. PPP APPLIED TO OYU TOLGOI

Borrowing lessons from the Chilean and UK success stories, at the outset, Mongolia currently has in place a favorable Investment and PPP framework. While a handful of laws that govern capital raising for mining activities still remain in Mongolia, the legal framework has been transformed

\textsuperscript{130} Id.
\textsuperscript{132} Id.
through the repeal of previous laws, enactment of new legislation, and amendments to existing statutes. Notably, the Law on the Regulation of Foreign Investment in Entities Operating in Strategic Sectors (SEFIL) had been controversial since its passing in 2012, and was observed to be problematic in encouraging foreign investment in Mongolia.\textsuperscript{133} SEFIL has now been repealed, and the country’s newly-drafted Investment Law has replaced both the Foreign Investment Law and SEFIL.\textsuperscript{134} The new Investment Law “streamlined the registration process for foreign-invested entities, relaxed restrictions on investment by foreign state-owned entities, and provided for the Ministry of Economic Development’s creation of the Invest Mongolia Agency (IMA) ‘to promote, advertise and regulate investment activities in Mongolia.’”\textsuperscript{135}

“The wider framework for PPPs is provided by the Constitution of Mongolia, the Law on Government, the Civil Code, the Law on State and Local Property, the Law on Investment, and the Integrated Budget Law.”\textsuperscript{136} Parliament adopted the State Policy on PPP in 2009 to promote private sector participation in all areas of the national economy, and in 2010 adopted the Law on Concession, which defines all processes of PPP implementation.\textsuperscript{137} “The Comprehensive National Development Strategy, adopted in 2008, identified PPPs as a potential mechanism to mobilize the private sector’s contribution.”\textsuperscript{138} PPP responsibilities fall under the Ministry of Industry. This role was shifted from the State Property Committee to the Ministry of Economic Development (MED) in 2012, and then to the Ministry of Industry, where it rests now. Since the Law on Concessions was introduced in 2010, Mongolia’s PPP Unit has expanded the regulatory framework, and gained

\textsuperscript{134} Id.
\textsuperscript{135} Id.
\textsuperscript{138} Mongolia PPP, supra note 136.
significant project experience. Under the new government, the PPP unit is now housed under a new National Development Agency (NDA).

As stated at the outset, the government of Mongolia entered into a joint-venture with Ivanhoe Mines to develop the Oyu Tolgoi mine when it signed the Investment Agreement in 2009, thereby owning 34% of the shares. After the government’s failed attempt to increase its share to 50% in 2011, it is unlikely that Mongolia will be able to increase its share in the near term. The Mongolian government could have been far better off had it entered into a PPP agreement with Ivanhoe Mines in the beginning, Mongolia Mining Law permitting.

Under a BTO PPP, the Mongolian government would have retained full ownership of the Oyu Tolgoi mine. As defined earlier, under the BTO arrangement, ownership of the infrastructure is transferred to the public sector upon the completion of the construction. In this case, had Ivanhoe Mines or Rio Tinto agreed to a BTO arrangement, upon the construction of the Oyu Tolgoi mine, they would have transferred ownership of the mine back to the government of Mongolia, staving off a potential serious concern raised by leasing the mine once construction is completed.

As the quantity of minerals at Oyu Tolgoi is finite, a potential major concern for the Mongolian government is permitting the private partner to operate the facility for a long period of time, once construction is completed. Given its modern and advanced technology, a global miner, such as Rio Tinto, could easily extract most of the minerals within a short period of time; thereby, foreclosing the possibility for the Mongolian government to operate and benefit from the Oyu Tolgoi mine once control reverts back to the public sector. The same problem arises under a short-term scenario. This problem could be resolved through close and regular governmental monitoring of the amounts extracted from the site, but this approach is not foolproof. Would the Mongolian government be willing to incur a significant expense in measuring everything that is being mined out of Oyu Tolgoi during the lease? Or will it have to rely on the timely reports prepared by Rio Tinto that can be

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139 A Government unit or agency focused on PPP, often located in a powerful central agency (e.g., planning or finance) able to enforce the PPP policy and provide the support needed to implement PPP transactions.

140 Mongolia PPP, supra note 136.

141 Susan Taylor & Barbara Lewis, Mongolia sees no change in Oyu Tolgoi copper stake, REUTERS (Mar. 8, 2017), http://www.reuters.com/article/mongolia-riotinto-idUSL5N1GL5KY.
susceptible to reporting inaccuracies? Even if there is close monitoring, Rio Tinto could either willfully or mistakenly underreport the amount it is extracting from the Oyu Tolgoi mine, thereby harming the Mongolian government.

Another benefit flowing from the BTO arrangement is the approximately $2.3 billion in public debt (out of the near 7 billion spent on the development of the open-pit mine) that the government of Mongolia has incurred due to its 34% share ownership under the existing Investment Agreement, from which it could have avoided liability. A BTO would have freed up the $2.3 billion, which the government of Mongolia could have invested in other sectors. Mongolia, with its current focus on mineral extraction to produce economic growth, is already suffering from a condition known as Dutch disease, i.e. overdependence on the development and sale of natural resources, which has hindered its efforts to promote inclusive growth, and dampened its ability to resolve issues like severe poverty and inequality. The World Bank defines inclusive growth as “being broad-based across (economic) sectors and inclusive of the large part of the country’s labor force.” According to data collected by the Oxford Business Group in 2012, although mining was responsible for about a third of GDP, the industry only employed 5% of the Mongolian workforce. Contrast this with the traditional pastoral herding sector, which produced less than 15% of the GDP, but employed about 40% of the workforce. The government of Mongolia could have invested $2.3 billion into the traditional pastoral herding or agricultural sectors, thereby strengthening those sectors, employing a greater share of the workforce, and further reducing severe poverty and inequality.

Several issues arise with the use of BTO structure. A major issue is whether Rio Tinto would be interested in a BTO PPP arrangement from the beginning. If global miners, like Rio Tinto, see the value behind Oyu Tolgoi, they want to stay in the business as long as possible to maximize profit. As of December 2015, according to Rio Tinto, some $6.4 billion has been

143 Khan, supra note 9.
144 Id.
145 Id.
invested to develop the open-pit mine at Oyu Tolgoi, with an additional $500 million of capital costs for initial development of the underground mine.\textsuperscript{146} Oyu Tolgoi is seeking to raise up to $6 billion of limited recourse project finance to refinance existing shareholder funding, and support development of the underground phase.\textsuperscript{147} Assuming, arguendo, that the combined total construction cost of both the open-pit and underground mining averages around $15 billion, a concession and OMM type arrangements would permit Rio Tinto to realize reasonable returns on its investment, after control of the mine reverts back to the government of Mongolia under a BTO arrangement. The concession structure can cover an existing asset or utility. In return for an upfront payment (in this case the $15 billion investment), under a concession PPP arrangement, the government of Mongolia leases Oyu Tolgoi to Rio Tinto for a set number of years to recover its initial investment, and earn some agreed-upon profit. Under an OMM, as already explained, the public partner provides the service, while day-to-day management rests with the private sector. Should the government of Mongolia have the capability to mine and export minerals which will be addressed below, and should a global miner like Rio Tinto be interested in managing the day-to-day operations, an OMM arrangement could be an attractive option to Rio Tinto.

Assuming that Rio Tinto transfers the Oyu Tolgoi mine back to the government of Mongolia, another issue is whether the Mongolian government would possess the capacity and know-how to operate it effectively on its own. This problem can be easily resolved. As Rio Tinto is already investing in education, and technical and vocational training, to develop a Mongolian work force to run the mine,\textsuperscript{148} the government of Mongolia should continue this practice. As always, risk transfer to the private sector, and cost savings are major reasons why PPPs are attractive. It will be up to the government of Mongolia to decide how to proceed.

\textsuperscript{146} Oyu Tolgoi Project Finance Agreement, supra note 142.
\textsuperscript{147} Id.
\textsuperscript{148} Oyu Tolgoi, supra note 102 (by the end of 2015, the workforce at Oyu Tolgoi was more than 95% Mongolian. In addition, under a Memorandum of Understanding signed between Oyu Tolgoi and the Mongolian Ministry of Education, Culture and Science, Oyu Tolgoi committed to invest US $126 million for the implementation of a program focused on development of the Mongolian workforce and improvement of the technical and vocational training system.).
V. CONCLUSION

At least for the foreseeable term, the government of Mongolia is stuck with its 34% share interest in the development of the Oyu Tolgoi mine, and it will be liable for the loans Rio Tinto borrows. Instead of agreeing to a joint-venture, the Mongolian Mining Law permitting, had the government of Mongolia employed a private-public-partnership to develop the Oyu Tolgoi mine, the outcome would have been different, and the Mongolian people could have been far better off. While still retaining public ownership of the Oyu Tolgoi mine, the government of Mongolia could have used the BTO structure to develop the mine, and once Rio Tinto transfers ownership back to it, it could have either employed the Concession, OMM, or PPP structures to operate the mine, while cultivating and training the future Mongolian mining labor force. Or it could continue to employ the two PPP arrangements (concession and OMM), laid out above, to keep public spending low, and use the money from concessions arrangement to invest in other areas to further promote the economy, and reduce poverty.