Analytical Report – Mongolia

Model Mine Investment Agreement
Model Community Development Agreement

Hogan Lovells
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Table of Contents

I. Background and Resources 1

II. Executive Summary 2

III. Legal Framework 3

A. Minerals Law 3

(a) Agreement on the exploitation of a deposit 5

(b) Repeal of the provision on investment agreements under the Minerals Law 6

B. State Policy on Minerals 7

C. Investment Law 8

(a) General framework 8

(b) Investment Agreements 8

D. Conclusion 10

IV. Current Mining Agreements 11

A. Legislative Framework for Stability Agreements and Investment Agreements prior to 2014. 11

B. Existing Stability Agreements 12

C. Oyu Tolgoi Investment Agreement 13

D. Tavan Tolgoi Investment and Cooperation Agreement 15

E. Conclusion 16

V. Model Mineral Development Agreement 16

A. Current Models and Policy Considerations 16

B. The Model Mining Development Agreement as a Base Model 18

C. Key Contents of a Mineral Development Agreement 19

D. Best Practices 24

VI. Model Community Development Agreement 24

A. Background 24

B. Policy Considerations; Identifying and Engaging Stakeholders 26

(a) Mongolia's economic and geographical history 26

(b) Identifying Stakeholders 27

C. Current Examples and Models 29

D. Incentives 31

E. Current Trends and Best Practices 32

F. Monitoring, Evaluation and Accountability 34

VII. Detailed List of Resources 35

I. Background and Resources

Hogan Lovells will provide the Government of Mongolia (through its Ministry of Mines) with recommendations on the content and format of two model agreements: a Model Mine Investment Agreement ("**MMIA**") and a Model Community Development Agreement ("**MCDA**"). Hogan Lovells has gathered and reviewed resources on best practices in the development of both mining agreements and community development agreements. These resources include publications by the World Bank, the Centre for Social Responsibility in Mining, the International Council on Mining & Metals, the Mining Law Committee of the International Bar Association and the Extractive Industries Transparency Initiative, as well as case studies, academic presentations and journal articles. A full list of the publications we reviewed is located at the end of this Analytical Report.

In addition to reviewing these publications, we also conducted interviews with experts in the extractive industries sector and on human rights who are knowledgeable about the development and implementation of mining agreements and community development agreements. We conducted these interviews either in person or by phone and they lasted anywhere from 30 minutes to several hours each. Our discussions with these experts, who are listed at the end of this Analytical Report, provided us with a variety of perspectives on common issues that arise with these agreements and gave us guidance and insight into best practices in addressing such issues.

Finally, we also reviewed numerous mining agreements and community development agreements prepared for use in various countries around the world, including Canada, Australia, Russia, Ghana, Liberia, Zambia and Papua New Guinea. These agreements helped us see different approaches taken to address common issues and provided guidance on ways to structure and draft such agreements. The list of the agreements we reviewed is located at the end of this Analytical Report.

In regards to understanding the unique economic and political climate of Mongolia, we have conducted and will continue to conduct desk-based research and will, through our Ulaanbaatar office, complete a stakeholder engagement process, as more thoroughly described in this Analytical Report. We will use the Strategic Environmental and Social Assessment of the Mining Sector in Mongolia ("**SESA Report**") to understand the key environmental and social problems and opportunities associated with the rapid growth of the mining sector in Mongolia. The SESA Report proposes specific measures that the government of Mongolia can implement to improve the environmental and social sustainability of mining in Mongolia and we will work to incorporate these measures into our MMIA and MDCA where applicable.

II. Executive Summary

The purpose of this Analytical Report is to provide background information relating to the development and implementation of the MMIA and MCDA in Mongolia. Section III of this Analytical Report, which follows this Executive Summary, addresses the legal framework that provides the authority for and regulation of the MMIA, with a focus on the Mongolian Minerals Law and Investment Act. As discussed in Section III of this Analytical Report, these laws are constantly evolving to address the growth and anticipated investment in the extractive industries sector and thus do not yet provide clear and comprehensive authority or guidance for the MMIA and MCDA. We plan to work closely with the Ministry of Mines to ensure our that our MMIA and MCDA meet its needs.

Second IV of this Analytical Report describes the mining agreements currently in effect in Mongolia. This section is relatively short, as we are only aware of several types of such agreements in effect. The first is a set of tax stabilization agreements that went into effect in the late 1990s and early 2000s. The second is the Investment Agreement for the Oyu Tolgoi copper and molybdenum mineral resources, which became effective in March 2010 and is the first and only agreement concluded under Article 19 of the Minerals Act prior to its repeal in 2014. The third is the anticipated Investment and Cooperation Agreement for the Tavan Tolgoi coal deposit. The state has ownership over this coal deposit and has organized a bid to select potential operators to enter into this agreement sometime in 2015.

Section V of this Analytical Report addresses policy considerations and best practices for drafting the MMIA. It lists our proposed precedent, including the Model Mining Development Agreement developed by the International Bar Association in 2011 as well as other model agreements used in the mining sector which are helpful to understanding the different issues that need to be addressed in the MMIA. Finally, this Section includes a description of the key contents proposed for inclusion in the MMIA.

Section VI of this Analytical Report addresses the MCDA. It first describes community development agreements generally and provides a brief summary on the legal authority and regulations for the MCDA. It then discusses the importance of an effective stakeholder engagement process in light of Mongolia's economic and geographical history. This Section discusses current examples, incentives and best practices for consideration in preparing the MCDA. It also discusses the monitoring and evaluation process necessary once a community development agreement becomes effective.

Finally, Section VII provides a list of the resources we used in preparing this Analytical Report.

III. Legal Framework

The mining sector plays an important role in the economy of Mongolia and is expected to become the major force of economic growth for the country's development in the coming years. In 2011, the mining sector accounted for 21 percent of the gross domestic product and in 2012 it accounted for 18 percent of the gross domestic product.[1]

The main sources of law in Mongolia are: (i) the Constitution of Mongolia; (ii) international treaties to which Mongolia is a party; (iii) acts passed by the Mongolian Parliament ("**Parliament**"); (iv) legislative acts adopted by the Mongolian central government ("**Government**") and various state agencies; and (v) interpretations of the Supreme Court of Mongolia ("**Supreme Court**").

The Constitution of Mongolia, the Law on Land, the Law on Subsoil, the Law on the Protection of the Environment, the Law on National Security and the Law on Investment are the key pieces of legislation that regulate the mining sector in Mongolia. The Law on Minerals was first enacted on July 8, 2006 and subsequently amended ("**Minerals Law**"). The Minerals Law includes some provisions affecting mineral investment, but as discussed below, those provision have been superseded in part by provisions of the Law on Investment, enacted on October 3, 2013 ("**Investment Law**").

Mongolia has recently effected several important changes to its legal regime affecting the minerals sector, such as the adoption of the State Policy on Minerals, the enactment of the Law of Mongolia on Common Minerals on January 9, 2014 and several amendments to the Minerals Law, all in an effort to resuscitate the mining sector and ensure continued economic growth.

A. Minerals Law

The first Minerals Law which allowed the private sector to explore and mine minerals was adopted on September 30, 1994 ("**1994 Minerals Law**"). The 1994 Minerals Law was then revised extensively on June 5, 1997 ("**1997 Minerals Law**"). In 2006, Parliament adopted a revised version of the 1997 Minerals Law. Since then, the Minerals Law has been amended on an almost yearly basis. Most of those amendments are technical or clarifying in nature. The fundamental substance of the Minerals Law has remained relatively stable since 2006.

The Minerals Law regulates relations concerning the prospecting, exploration and mining of minerals, and protecting exploration areas and areas surrounding mines.

Under the Minerals Law, minerals are defined as "any concentration of usable and naturally occurring substances that have been formed on the Earth's surface or below ground as a result of geological processes." The Minerals Law applies to all types of mineral resources except water,

[1] Mongolia Extractive Industries Transparency Initiative, Mongolia Seventh EITI Reconciliation Report – 2012, p. 14

petroleum, natural gas, radioactive minerals and "common" minerals[2], which are regulated by separate laws.

The Minerals Law categorises minerals into three different classes: mineral deposits of strategic importance, common minerals and other minerals. The Minerals Law allows for state ownership in certain mineral deposits.

Mineral deposits of strategic importance are those deposits that may have a potential impact on national security or the economic and social development of the country, or that are producing or have the potential to produce more than five percent of the total gross domestic product of the country in any given year.

Parliament has the authority to designate a deposit as a mineral deposit of strategic importance upon the recommendation of the government through the Ministry of Mines or at its own initiative. In 2007, Parliament passed a resolution classifying 15 deposits as mineral deposits of strategic importance.[3] The same resolution anticipates that the list of strategic deposits will be further expanded.[4]

Except for the requirement to enter into an agreement regarding the exploitation of a deposit whose reserves were discovered using state funds or with respect to a mineral deposit of strategic importance, the Minerals Law does not require investors or license holders to enter into a mining agreement with the state. Rather, the rights and obligations of investors or license holders and their relationship with the state are governed by the Minerals Law and other legislation, which regulate certain activities pertaining to exploration and mining of minerals.

Typically, an investor would be granted a special license by the Mineral Resources Authority of Mongolia, an agency under the Ministry of Mining ("**MRAM**"), in order to engage in mining activities. Specifically, there are two types of licenses in Mongolia – exploration licenses and mining licenses. These can only be granted to legal entities that are incorporated in Mongolia. Reconnaissance of minerals can be conducted without any license subject to giving prior notice to the relevant government agencies. If an investor wishes to conduct geological work for the purposes of identifying the precise location and quantity of mineral substances, it must apply for an exploration license which is granted on a first come, first served basis (except for exploration in areas for which a license has been previously granted but vacated due to the expiration of license terms or because the license has been revoked). Under an exploration license, a mining company enjoys, among others, the following rights:

1. conducting exploration work within the boundaries of the exploration area;
2. obtaining a mining license for any part of the exploration area;
3. transferring its exploration license or surrendering all or part of the license area;

2 Common minerals include sand, gravel, clay, palisade, granite, being widespread and which are used for road and construction materials.

3 Parliament Resolution #27, enacted on February 6, 2007, Annex 1

4 Parliament Resolution #27, enacted on February 6, 2007, paragraph 3

and
4. erecting temporary structures for the purposes of conducting exploration work.

Only an exploration license holder has the exclusive right to convert its exploration license to a mining license covering the exploration license area. If an exploration license holder has not applied for a mining license by the end of its exploration license term, a mining license for such areas can be granted through a tender process.

Under a mining license, a mining company exercises, among others, the following rights and obligations:

1. mining of minerals other than radioactive minerals within a mining claim;
2. selling minerals and manufactured products at international market prices on foreign markets;
3. conducting exploration work within the boundaries of the exploration area;
4. transferring its mining license or surrendering all or part of the license area; and
5. erecting necessary structures and using the mining area in order to carry out mining activities.

The Mining Law does not restrict the type of minerals that may be explored or mined for under either an exploration or mining license, except for radioactive minerals, which require special license from the Nuclear Energy Agency of Mongolia. The term of an exploration license is three years with a possibility of extension by another nine years, and the term of a mining license is 30 years with a possibility of extension by another 40 years, depending on the deposit reserves.

(a) Agreement on the exploitation of a deposit

Under Article 5 of the Minerals Law, an investor is required to enter into an agreement with the state to exploit a deposit in the event that the state resolves to take an equity interest the following circumstances:

1. If the reserves of the particular deposit were discovered using state funds; or
2. If the deposit is a mineral deposit of strategic importance.

The Minerals Law does not specify a minimum or maximum level of state equity interest in respect of a deposit whose reserves were discovered using state funds. In the case of mineral deposits of strategic importance, the Minerals Laws provides that the state may take up to a fifty percent stake in a deposit if the reserves were discovered using state funds. The actual percentage stake will be calculated by taking into consideration the amount of investment made by the state. If the reserves were discovered through funding sources other than state funds, the state may own up to thirty-four percent of the shares of the investment made by a license holder by taking into consideration of the amount of investment to be made by the state. In either case, the exact percentage of a state's equity interest in a mineral deposit of strategic importance is to be

determined by Parliament upon the recommendations of the Government or at its own initiative.

The Minerals Law is silent as to the process to determine whether state funds have been used, the level of state expenditure necessary to trigger the state's right to acquire equity interest and the procedure for determining the percentage of the state's equity interest or how negotiations should be conducted. Consequently, the Government and Parliament have discretion to determine the exact percentage of equity interest as they see fit. The Minerals Law also does not prescribe the content of, nor the timeframe or procedure for entering into, agreements on the exploitation of a deposit. For example, it is not clear as to when a license holder would be required to enter into such agreements. Based on a strict reading, the state would have to understand the deposit reserve or declare a mineral deposit of strategic importance prior to taking an equity interest in such deposit. In other words, it appears that the agreement on the utilisation of a deposit applies to mining license holders rather than exploration license holders.

The Minerals Law is also silent in regards to content, it is also not clear as to what specific matters the agreement should regulate other than matters concerning the participation of the state. Further, to our knowledge no agreements on the exploitation of a deposit contemplated under Article 5 of the Minerals Law have been entered into by the state to date. Consequently, there are no model or precedent agreements that can be of use in negotiating and/or drafting such agreements.

It should also be noted that the Minerals Law requires a mining license holder of a mineral deposit of strategic importance to trade no less than ten percent of its shares on the Mongolian Stock Exchange. While not yet fully enforced in practice, this requirement could potentially hinder investors in participating in a mineral deposit of strategic importance.

(b) Repeal of the provision on investment agreements under the Minerals Law

Previously, Article 29 of the Minerals Law provided for investment agreements, stating that an investment agreement may be concluded at the request of a mining license holder provided that the license holder undertakes to invest in Mongolia not less than US$ 50 million during the first five years of its operation. The law further specified the following terms to be included in such investment agreements:

1. Maintaining a stable tax environment;
2. right of the license holder to sell its products at international market prices;
3. guaranteeing the rights of the license holder to receive and dispose at its own discretion of the income derived from its sales;
4. amount and term of the license holder's investment;
5. mining with minimum damage to the environment and public health;
6. environmental protection and restoration;
7. absence of adverse effects on other industries and operations;
8. development of the region and creation of employment; and
9. compensation for damage.

However, Article 29 and Article 30 on the Procedure for Entering into an Investment Agreement and Article 65 on Resolution of Disputes concerning Investment Agreements were removed from the Minerals Law when it was amended in July 2014. Therefore, the Minerals Law no longer refers to investment agreements and only refers to agreements for the exploitation of deposits mentioned above. In other words, mining companies are required to enter into an agreement on the exploitation of a deposit only if the deposit reserves were discovered using state funds or the concerned deposit is determined as a mineral deposit of strategic importance and they can no longer enter into an investment agreement as originally provided under the Minerals Law.

There is no publicly available information as to the number of investment agreements entered into pursuant to Article 29 of the Minerals Law, nor the content of the same, except for the investment agreement entered into by the Government with Ivanhoe Mines Mongolia Inc. LLC, Ivanhoe Mines Ltd and Rio Tinto International Holdings Limited ("**OT Investment Agreement**") in respect of one of the mineral deposits of strategic importance, Oyu Tolgoi. See below for detailed information on the OT Investment Agreement.

B. State Policy on Minerals

Parliament may adopt policy statements, which are not laws but a pronouncement of the government's aspirations and non-binding objectives regarding particular sectors.

On January 16, 2014, Parliament approved the State Policy of Mongolia in respect of the Minerals Sector for 2014 - 2025 ("**Minerals Policy"**). The Minerals Policy contains declarative and aspirational statements setting out the future direction and objectives for government policy in terms of the development of the minerals sector.

The Minerals Policy comprises four parts:

1. general provisions;
2. policy principles;
3. policy directions; and
4. implementation phases and methods, and expected results.

The Minerals Policy indicates that the state will support and encourage private investment in the minerals sector, limit its role to regulation and supervision, encourage transparent and responsible mining operations, and adopt policies to encourage environmentally-friendly and value-added operations.

C. Investment Law

(a) General framework

The Investment Law regulates the protection and promotion of investment of foreign and domestic entities in Mongolia. Investment is defined as tangible or intangible assets invested in the share capital of a legal entity carrying out profit-making activities in Mongolia as reflected in its financial statements.

Subject to approval requirements for foreign state-owned entities, foreign and domestic investors may invest in any production or services sector which is not prohibited (those which are prohibited being narcotics, gambling, pornography, or pyramid sales or marketing) or certain regulated sectors which are subject to licensing requirements.

The form of investment may be incorporation of a Mongolian-incorporated entity, purchase of securities, merger of companies, entry into of a concession, production sharing, marketing or management agreements, or franchise or financial leasing agreements.

The Investment Law provides legal guarantees to protect and promote investment in Mongolia by setting out tax and non-tax incentives for investors. The general legal guarantees of investments include protection from nationalisation (by setting out conditions under which nationalisation is permitted), protection of intellectual property rights, certain rights to repatriate profits (following the payment of relevant taxes), and freedom to choose a dispute resolution forum. The law also addresses certain non-tax incentives including land rights, customs clearance, foreign labour quotas, and immigration matters, the detailed regulations for which are to be provided in sector-specific laws. In terms of tax incentives, an investor would be entitled to enjoy stable tax treatment for a specific period of time in the form of a tax stabilisation certificate or an investment agreement.

(b) Investment Agreements

An investor who proposes to invest more than 500 billion Mongolian tugrugs (approximately US$ 270 million), may be eligible to enter into an investment agreement with the Government with the objective of stabilising the tax and other aspects of the operational environment for making such investment.

The scope of an investment agreement includes providing legal guarantees as specified in the Investment Law, the stabilisation of the tax environment, and certain regulatory and financial incentives.

On February 21, 2014, the Government approved Regulation #52 on the Procedures for Entering into Investment Agreements ("**Regulation**") specifying the terms of investment agreements and the procedure for entering into investment agreement with investors. Under the Regulation, an investment agreement must contain the following terms:

1. legal basis/grounds for the conclusion of the investment agreement;
2. parties to the investment agreement and the respective shareholding structures;
3. names and registration numbers of the legal entities that are subject to the investment agreement (in the event that the investor is implementing the investment project as part of an consortium or under a partnership arrangement or with its related parties);
4. the purpose and main activities of the investment;
5. the amount and source of the investment
6. the period and phases of the investment;
7. the term of the investment agreement;
8. the conditions for stabilising the tax environment and providing regulatory and financial support;
9. a feasibility study upon which the agreement is based and procedures on how the agreement is to be amended if the feasibility study is amended;
10. the impact on public health and environment, and measures to eliminate or reduce any adverse effects;
11. the impact on other production and services;
12. the contribution the investment will make to the regional development;
13. compliance with legislation on employment, creation of new jobs, training of personnel;
14. how infrastructure, city/settlement areas, social and cultural matters will be addressed;
15. whether business opportunities will be created for Mongolian citizens and business entities;
16. the volume and price of products to be manufactured, processed or sold under the main operation of the investor;
17. measures to be undertaken in the event of force majeure events;
18. rights and obligations of the government and the investor;
19. grounds for amending, revoking or terminating the agreement;

20. dispute resolution;

21. monitoring of the implementation of the agreement by the parties;

22. revocation of tax support and stabilisation and claim of taxes which was granted during the term of the agreement if the amount of investment did not reach the amount specified in legislation due to failure to comply with the obligations under agreement by the investor; and

23. other terms agreed upon by the parties.

24. Any dispute arising from the investment agreement should be settled in accordance with laws of Mongolia and the investment agreement itself.

Neither the Minerals Law nor the Investment Law discusses the relationship between the agreement on the utilization of a deposit contemplated under the Minerals Law and the investment agreement contemplated under the Investment Law. However, the Investment Law provides that stabilization of taxes shall be regulated solely by the Investment Law and an investment agreement. As such, a mining company would need to enter into an investment agreement with the state if it wishes to stabilize tax rates and amount provided that it satisfies the criteria to invest more than 500 billion Mongolian tugrugs whether or not it has entered into an agreement on the utilization of a deposit. To date, to our knowledge no investment agreement has been entered into pursuant to the Investment Law.

D. Conclusion

Although there are certain regulations pending approval, Mongolia has a rather comprehensive list of laws and regulations that regulate the mineral sector and it has continuously strived to improve the legislative framework in an effort to develop the mineral sector.

The key legislation are the Minerals Law and the accompanying regulations adopted by the Government and government agencies. Other sector specific laws such as the Law of Mongolia on Land, enacted on June 7, 2002, the Law of Mongolia on Subsoil, enacted on November 29, 1988, the Law of Mongolia on Water, enacted on May 17, 2012, the Law of Mongolia on the Protection of the Environment, enacted on March 30, 1995, Law of Mongolia on Environmental Impact Assessment, enacted on May 17, 2012, the Law of Mongolia on National Security, enacted December 27, 2001 and the National Security Concepts of Mongolia and the series of tax laws also play an important role in regulating the operation of mining companies. Mining companies would need to comply with obligations in respect of protecting and restoring the environment and obligations relating to the use of other natural resources such as land and water.

Further, the Law of Mongolia on Anti-Corruption, enacted on July 6, 2006, and the Law of Mongolia on Regulating Public and Private Interests in Public Service and Preventing Conflicts

of Interest, enacted on January 19, 2012, are key pieces of legislation in determining the rights and obligations of state organisations including local governments and their officials when interacting with mining companies. Although it is public officials who are primarily subject to these laws, certain restrictions, such as the obligation not to undertake any official duties in connection with a donor entity for a period of two years in the event of receipt of gifts/payments and the provision that agreements, contracts or licenses that were entered into or obtained in breach of the law are deemed to be void, could have could have a potential effect on the operations of mining companies in respect of cooperating with local governments and the drafting and/or implementing CDAs.

IV. Current Mining Agreements

A. Legislative Framework for Stability Agreements and Investment Agreements prior to 2014.

Before being revised, the 1997 Minerals Law provided for the possibility to enter into a stability agreement by an investor with the Government to stabilize tax environment. It provided that if a mining license holder undertook to invest at least US$ 2 million for the development of a mining project in Mongolia in the first five years of its operations, such investor was entitled to submit an application for the entry into of a stability agreement for a period of up to ten years with the minister in charge of finance who was authorised to act on behalf of the Government. If the proposed investment is US$ 20 million or more, the term of the stability agreement was to be increased to fifteen years.

On March 24, 2002, the Government adopted Resolution #46 approving the template stability agreement under Article 20 of the 1997 Minerals Law. The template stability agreement was a rather brief agreement with seven chapters and 26 clauses with a possibility to include additional terms subject to the specific nature of the investment and the investor's comments. The template stability agreement primarily focused on the stabilisation of the tax environment, the amount of investment to be made and the timeframe for investing the same.

In 2006, Parliament revised the 1997 Minerals Law and replaced stability agreements with investment agreements. Consequently, until July 2014, an investor with an initial investment of at least US$ 50 million in the first five years of its operations was entitled to submit its application for the negotiation and entry into an investment agreement upon a commitment to spend such amount for a mining project. If the proposed investment exceeded US$100 million, the investment agreement was to be discussed in Parliament. At the time this provision was in force, the revised Minerals Law did not authorize the Government to approve any template investment agreement nor was there any provision on the procedure. All that was provided was that the main terms of investment agreements should include investment terms, tax stabilisation, commercial freedom to sell its products at international market prices, a guarantee of the right to receive and freely dispose of the income derived from its sales, environmental protection and restoration, regional development and employment issues. An investor with an initial investment

of at least US$ 50 million in first five years of its operations was entitled to submit its application for the negotiation and entry into of an investment agreement. The former Minister of Mineral Resources and Energy (now the Minister of Mining) introduced the concept of a draft model investment agreement for the mining sector in May 2009 but the content of this is not publicly available.

Further, the Law of Mongolia on Foreign Investment ("**Repealed Foreign Investment Law**") enacted on May 10, 1993 also provided for stability agreements until its repeal following the approval of the Investment Law. Consequently, the Government adopted Resolution #24 approving a template stability agreement to be entered into with foreign investors whose proposed investment exceeded US$ 10 million. The template stability agreement had 13 chapters and 58 provisions addressing tax environment; land issues; environmental matters; infrastructure; labour and workforce; rights and obligations of the investor including the amount of investment and the timeframe for investing the same; rights and obligations of the minister; protection of investment; termination of agreement; force majeure; dispute resolution; and miscellaneous issues.

The requirement for amount of investment to be made and the term of the stability agreement differed between the 1997 Minerals Law and the Repealed Foreign Investment Law. However, this is of no relevance today as the Investment Law is the only law which provides for investment agreements.

B. Existing Stability Agreements

The Government entered into several stability agreements under the Repealed Foreign Investment Law, the 1997 Minerals Law and the General Taxation Law with foreign investors investing in mining and non-mining sectors.[5] The following three agreements were entered into in the mining sector and are publically available:

1. a stability agreement between the Government and Tsairt Mineral LLC dated May 13, 1998 in relation to its zinc mine project;
2. a stability agreement between the Government and Boroo Gold LLC dated July 6, 1998 in relation to its gold mine project; and
3. a stability agreement between the Government and Quinhua-MAK-Nariin Sukhait LLC and Mongolian Alt (MAK) LLC dated July 4, 2005 in relation to its coal project.

These three agreements are rather brief and primarily focus on the stabilisation of the tax environment. Amidst changing political and economic circumstances, the above stability agreements entered have been subject to extensive public discussions and accordingly to publicly available information, the parties have amended certain of the terms of these agreements as a

[5] The Government entered into Stability Agreements with nine legal entities (http://www.opensocietyforum.mn/index.php?sel=news&obj_id=1728) (in Mongolian)

result of the same.

C. Oyu Tolgoi Investment Agreement

Oyu Tolgoi is one of world's largest copper and molybdenum mineral deposits with an estimated 2.7 million tonnes of copper and 1.7 million ounces of gold reserves.[6] The deposit is listed among the mineral deposits of strategic importance.

The Government entered into the OT Investment Agreement with Ivanhoe Mines Mongolia Inc. LLC[7], Ivanhoe Mines Ltd and Rio Tinto International Holdings Limited on October 6, 2009 pursuant to Article 29 of the Minerals Law[8] and other resolutions of Parliament and the Government. The OT Investment Agreement became effective in March 2010. To our knowledge, the OT Investment Agreement is the first and currently the only investment agreement concluded under Article 19 of the Minerals Law.[9]

The OT Investment Agreement has 16 chapters, namely:

1. General Clauses;
2. Taxation Environment;
3. Core Operations;
4. Regional Development;
5. Land Affairs;
6. Environment;
7. Infrastructure;
8. Labour Relations, Employment and Training;
9. Rights and Obligations of the Investor;
10. Rights and Obligations of the Government and the Minister Responsible for Mineral Resources;
11. Protection of Foreign Investment;

[6] http://www.riotinto.com/copper/oyu-tolgoi-4025.aspx accessed on January 6, 2015

[7] Now Oyu Tolgoi LLC

[8] This article was repealed on July 1, 2014. See section 1.1 (b).

[9] Apart from Oyu Tolgoi LLC, Erdenet Mining Corporation LLC is one of the biggest ore mining and ore processing projects in Mongolia. It processes 26 million tons of ore per year and produces 530.0 thousand tons of copper concentrate and 4.5 thousand tons of molybdenum concentrates annually. Erdenet Mining Corporation was established in 1978 in accordance with an agreement between the Government and the former Soviet Union. The agreement to establish the mine pre-dates the Minerals Law.

12. Termination of the Agreement;
13. Force Majeure;
14. Dispute Resolution;
15. Miscellaneous; and
16. Definitions.

The purpose of the OT Investment Agreement is, among others, to maintain for a certain period a stable tax and operational environment, the sale of products at international market price, guarantee the investor's right to use and spend its income at its own discretion, set out the amount and term of the investment, ensure the undertaking of mining activities with minimum damage to the environment and human health, the social and economic development of the project area, the creation of new jobs and business opportunities for Mongolian companies and individuals and to record the rights and obligations of the parties during exploration, mining and processing operations.

Currently, the state owns 34 percent of Oyu Tolgoi LLC. The OT Investment Agreement provides that the state may acquire further 16 percent within one year after the extension of the agreement. The initial term of the OT Investment Agreement is 30 years with a possibility of extension for a term of 20 years subject to certain conditions. The percentage was determined in accordance with Article 5.5 of the Minerals Law and Resolution # 57 of Parliament dated July 16, 2009 which provided that the state should own 34 percent.

Parliament also approved Resolution #40 dated December 4, 2008 on Rejection of Draft Laws and the Approval of General Principles and Guidance ("**Resolution #40**") which provided instructions to the Government to consider various issues in negotiating the OT Investment Agreement. These include:

1. the possibility of considering the state's investment in the form of taxes, payments, fees, dividends and loans;
2. the payment of certain royalties and taxes in advance;
3. the issue of infrastructure-related facilities such as energy, roads, railways, and water supply to be constructed in connection with deposit development and cities and settlement areas and social and cultural issues;
4. the production lines and types of products with a view to producing finished products;
5. programmes and plans on educational training of national personnel for production industry;
6. the use of advanced environmentally-friendly technology, and the realisation of

environmental rehabilitation at all the phases of the deposit exploration and development; and

7. obtaining assistance from internationally reputable consulting firms.

The OT Investment Agreement is governed by and interpreted in accordance with the laws and regulations of Mongolia and international treaties to which Mongolia is a party. There have been certain criticisms of the OT Investment Agreement expressed primarily by politicians in respect of the equity interest of the state. Critics argue that the state's interest should have been higher given the value of the deposit and the fact that the Mongolian people are the owners of its natural resources. In general, however, the public lacks accurate, reliable and easy to understand information on the benefits or potential adverse effects of the OT Investment Agreement on the Mongolian economy and the lives of the Mongolian people, and thus may not have informed views on the matter. Additionally, local communities and civil society organizations have criticised the adverse effects resulting from the operation of the mine rather than the agreement itself.

D. Tavan Tolgoi Investment and Cooperation Agreement

Tavan Tolgoi is also a mineral deposit of strategic importance where the deposit reserves were discovered with the use of state funds. It is considered to be one of the largest coal deposits in the world. The state currently owns 100 percent of Erdenes Tavan Tolgoi JSC, which holds the mining license for the concerned deposit.[10]

Under Resolution #40, Parliament provided the same instruction to the Government in negotiating the investment agreement to be entered into with potential investor(s) save for the proposed state's ownership in the deposit.

On August 20, 2014, the Government adopted Resolution #268 on Measures concerning the Tavan Tolgoi deposit and determined certain terms and conditions for the Investment and Cooperation Agreement ("**ICA**") to be entered into with potential investors. These include, for example:

1. the grant of the right to use the Tavan Tolgoi deposit license by the investor without transferring the ownership of the license;

2. permitting the investor to conduct additional exploration within the licensed area with a view to increase reserves;

3. requiring the investor to expand coal processing capacity to at least 30.0 million tonnes per year and sell the produced concentrate to at least two foreign markets and

4. to build a railway base structure necessary for the project.

[10] We note that Parliament resolved to grant certain proportion of the shares of the company to Mongolian citizens.

As per Resolution #268, the Government organised a bid to select potential investors to operate the deposit and it is expected that the ICA will be finalised within 2015.

E. Conclusion

The regulation of the mining sector enabling an environment for private investment is relatively new in Mongolia, as is the negotiation and execution of mining agreements.

There is no publicly available information as to the processes and lessons learned in negotiating the OT Investment Agreement, other than demands made by certain politicians and civil organisations to renegotiate the agreement to better protect the interests of the people. Consequently, there are no local comprehensive models or precedent agreements or guidelines available in respect of drafting and negotiation agreements for mining projects that have the potential to have significant impact on the socio-economic situation of the country and thus international precedent and best practices will help guide the drafting and negotiations process.

However, there is no doubt that the OT Investment Agreement and the ICA and the lessons learned in the negotiations of these agreements will have certain influence as to the content and form of agreements to be concluded by the Government with potential investors in implementing large scale mining projects.

V. Model Mineral Development Agreement

A. Current Models and Policy Considerations

A mining development agreement is an agreement entered into between a state as the owner of mineral resources and an investor for the purpose of implementing mining projects that may have significant impact on national, regional and local development. Typically, under a mining development agreement, a state grants the right and/or license to mine minerals and the investor gives consideration for this right by means of paying taxes, royalties, fees and undertaking other types of obligations. Depending on the national legal framework, mining development agreement are also sometimes known as “mining investment agreements,” “mining agreements,” “mining exploration and development agreements,” “mining contracts” or “mining concessions.”

The practice of entering into mining agreements has been around for some time. Despite the fact that transparency in the mining sector is becoming the accepted and preferred practice and mining agreements are often not considered confidential, in practice mining agreements are often not publicly available. Further, there are very few models or standard mining agreements for countries, investors and other stakeholders to utilise, nor literature and guidance on lessons learned in respect of what has worked and what has not worked. These result in the lack of comprehensive analysis and assessment as to the current models, policy considerations and best and worst practices. Further, various research papers on mining agreements stress that there is no proven or widely accepted formula or best practice when it comes to drafting and negotiating mining agreements as each country is unique. Mining agreements are significantly affected by

and reflect the political, historical, social, economic, cultural environment and the existing legal framework of the country. Further, the issues of project financing and bankability of a mining project influence how a mining agreement is drafted to a certain extent.

Despite these issues, there has been efforts by experts to develop standard model agreements and some reviews and analysis of existing agreements to assist those interested in having a better understanding of mining agreements and in drafting such agreements.

Research shows that there has been a shift in objectives and approaches taken by countries in their mineral laws and policies as well as negotiating mining agreements. There is now more emphasis on the reciprocity and mutual benefit to the country and/or its people due to mining boom experienced in recent years and the perception that the public is not receiving its fair share because the majority of benefits are accruing to investors. Countries are becoming more aware of how the exploitation of mineral resources can have significant impact on economic growth and sustainable development of a country. This is demonstrated by increased government involvement in the mining sector by way of a country's equity participation in mining companies exploiting the mineral resources, the imposition of higher taxes and royalties, the imposition of the obligation to contribute towards the national and/or local economy with specific development timeframe and key milestones, and the imposition of extensive responsibilities in respect of protection, restoration and rehabilitation of the environment and local community development.[11] For example, in recent years, many countries have increased or are considering an increase taxes and royalties applicable to the mining sector.[12] In some countries, there is an emerging trend towards "resource for infrastructure" as opposed to the approach of "resource for revenue" whereby an investor is required to build certain infrastructures in return for the exploitation of minerals.[13] There is also increased resource nationalism in various parts of the world. As a result of this shift in direction, there have also been initiatives undertaken by countries to review mining legislation and existing mining agreements.

Taking into account such a changing environment, there have been discussions concerning the need for having agreements that match the objectives of investors with that of the expectations of communities and countries in which they invest.[14] There are a number of issues that have been identified as critical for a successful mining agreement. These include:

1. comprehensive review and/or due diligence to be undertaken by both parties;

2. review of and compliance with national legislation on mining, taxation, environment and so forth;

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11 John P Williams, Global Trends and Tribulations in Mining Regulation, p. 395

12 Allen & Overy, Guide to Extractive Industries Documents – Mining, January 2013, p. 8

13 Allen & Overy, Guide to Extractive Industries Documents – Mining, January 2013, p. 8

14 Mat Frilet & Ken Haddow, Commentary: Guiding Principles for Durable Agreements in Mining Projects, Journal of Energy & Natural Resources Law and Craig B. Andrews, Getting to Yes: The Practitioner's Guide to Negotiating Mining Investment Agreements – Lessons from Ecuador, 2012

3. establishment of effective communication strategy between the parties;
4. the preparation of reliable project specific information, particularly realistic economic, financial and/or commercial models and analysis/prospects;
5. taking into consideration the needs of both parties and ensuring the realistic allocation of benefits and risks between the parties, as well as the bankability of the project;
6. imposition of obligations in respect of protection, restoration and rehabilitation of the environment;
7. determination and the addressing of the needs of local communities and contribution towards community development to the extent possible;
8. periodic and regular monitoring and evaluations given the relatively long term nature of such agreements; and
9. timely disclosure of relevant information to the public during negotiation as well as implementation stages.

One of the most well-known model mining agreements is the Model Mining Development Agreement developed by the International Bar Association in 2011 ("**MMDA**"). There are also a few other model agreements used in the mining sector which can be useful tools in understanding the different issues that need to be addressed in a typical mining agreement between private entities. These include the model form agreements developed by the Rocky Mountain Mineral Law Foundation which are reported to be standard forms used primarily in the US and the Model Mining Joint Venture Agreement developed by AMPLA which was designed to be a standard form for use by Australian businesses.

Further, there are several existing mining agreements which can serve tools to understand current practice and trends. Some of the most referenced or cited agreements include are the agreements entered into by Australia, Liberia, Ecuador and Indonesia with private investors. Finally, we note that a thorough review and understanding of the Strategic Environmental and Social Assessment of the mining sector that was completed last year on behalf of the government of Mongolia will be useful in identifying issues specific to the country when reviewing precedent and drafting the MMIA.

B. The Model Mining Development Agreement as a Base Model

The MMDA was developed based on the research and analysis of over 60 mining agreements and consultations held with public and private sector stakeholders. Despite its name, the MMDA is a compendium of possible provisions rather than a model agreement. It is intended as a guide and template for negotiating and drafting mining agreements. The authors of the MMDA included Luke Danielson of Sustainable Development Strategies Groups (SDSG) and other

SDSG researchers. SDSG has been engaged to represent local communities in the development of the MMIA, and thus the MMDA provides a model for the MMIA that includes input from experts directly engaged in community outreach under this project.

The authors of the MMDA make it clear that the MMDA is not to be taken off the shelf and used as a mining agreement. Rather, the MMDA is a template for negotiation and drafting of mining agreements. Thus, this Analytical Report simply uses the MMDA as a starting point and a structural guide. Our review of the key provisions of the MMDA is augmented and tested by our review of other benchmark mining agreements and the related literature addressing such agreements.

The MMDA contains clauses applicable to all types of agreements as well as clauses that are specific to mining projects including the issue of tenure, obligations of the state, obligations of the investor in respect of use of local goods and services, local community development, employment and training, mining closure and post-closure matters and the protection of the environment. The MMDA addresses the following specific matters under each of the five key areas:

1. Tenure: term, legal title, feasibility study, environmental assessment and environmental management plan, social impact assessment and action plan, financing plan, permits and construction;

2. Finance: annual fee, royalties, customs duties, insurance, taxation, financing arrangements, financial records and statements and accounting standards;

3. Rights and obligations of the state: legislation to approve the agreement, tax stabilisation, fair and economical project operation, permits, expatriates and infrastructure;

4. Rights and obligation of the company: use of local goods and services; community health, employment and training, labour standards, mining closure and post closure obligations and rights of local citizens; and

5. Other: obligations of contractors and subcontractors, assignment, availability of information, force majeure, suspension of operations, dispute resolution, surrender, termination, notices, applicable law, modification and other ancillary provisions

Though the MMDA has its critics, it is a useful starting point and guidance for understanding mining agreements and the drafting of the same.

C. Key Contents of a Mineral Development Agreement

General Contract Clauses. A mining agreement will contain clauses to address technical and financial requirements of a project, as described further below, but they will also include general

clauses that are contained in all types of contracts. These common clauses include:

1. Parties;
2. Recitals/Background/Preamble/Objectives;
3. Effective date;
4. Definitions/Interpretations;
5. Tenure (including term of the agreement, exclusive right to mine in the mine area, title to assets and security interests);
6. Financial matters (including taxes and royalties, valuation of minerals, currency exchange control, insurance, equity interests of the parties (if applicable));
7. Representations and warranties, and indemnities;
8. Rights and obligations of the investor (community development, local procurement, employment of local citizens and contractors, access to land, protection of the environment);
9. Rights and obligations of the state (grant of license and other permits, tax and other stabilisation);
10. Miscellaneous (termination, force majeure, notice, amendment, assignment, dispute resolution, governing law, confidentiality, severability, entire agreement, waiver);
11. Schedules (if any).

Mining Rights and Mine Development. Most mining agreements contain provisions concerning various documents such as a feasibility study, studies and plans in respect of the protection of the environment as well as the social impact of the project, a financing plan and a closure plan which must be developed and undertaken by the investor. Various levels of information in relation to geological studies, engineering, environmental impact, infrastructure and socio-economic development and costs are required to be incorporated in each respective document and various criteria are imposed in developing and/or approving these documents.

The MMDA and most mining agreements are structured to follow the logical development of a mining project. Section 2 of the MMDA anticipates that the mining company will pursue its project in the following steps:

1. Securing an exclusive right to explore and develop a specified Mining Area for a specified term, and for so long thereafter as undeveloped commercial quantities of minerals remain within the Mining Area. (MMDA §§ 2.1, 2.2)
2. After securing the right to explore and develop the Mining Area, the mining

company will provide documents to the State setting forth standards for the development of the mine from initial construction through final reclamation (MMDA §2.4):

a. Feasibility Study (MMDA 2.4.1): This study is the key operational and economic document, because it demonstrates that the mining company has located a valuable mineral deposit and has designed a mining plan that will allow the recovery of that deposit in an economically viable manner. The Feasibility Study should identify the permits necessary for the mine

b. Environmental Assessment and Environmental Management Plan (MMDA § 2.4.2). This document is developed hand in hand with the mine plan. It sets forth the environmental effects of the mining process, and the various measures the mining company will adopt to manage and mitigate those effects.

   Note that the MMDA describes the purpose of the Environmental Assessment and Environmental Management Plan as to "prevent unnecessary and undue degradation." The phrase is used in the Federal Land Policy and Management Act (FLPMA), and United States statute governing the use of lands owned by the United States government. The phrase has given rise to substantial litigation concerning its meaning and scope, and thus may not be the best measure of the purposes of an Environmental Assessment and Environmental Management Plan.

c. Social Impact Assessment and Action Plan (MMDA § 2.4.3). This document looks beyond the immediate environmental effects at the mine site to the broader social impacts of the project. Like the Environmental Assessment and Environmental Management Plan, the document also sets forth the measures the company will take to manage and mitigate those impacts.

   As expected, the substance of this plan must be consistent with, and related to, the Community Development Agreement for the project (discussed in detail in the sections below), and reflect consultation with local communities and other affected stakeholders.

d. Financing Plan (MMDA § 2.4.4). None of the plans described above matter if the mining company does not have the financial wherewithal to implement those plans. While the mining company may wish to treat some of its internal financial information as confidential, it is common to require some assurance that the mining company has (or will have) access to financial resources commensurate with the proposed project. Note that the company need not have all the cash in hand at the beginning of the

project. Rather, the mining company may show how it will access capital and resources over the life of the project.

e. Closure Plan (MMDA § 26.0). The plan describes the process by which a mine will be reclaimed once the project is complete. The closure plan must be backed by the appropriate financial guarantees. (MMDA § 26.2).

Financial Matters. In terms of financial/fiscal matters, an investor often has the sole responsibility for ensuring the financing of the project. In this regard, agreements provide for debt and equity ratios applicable to the investor to be maintained prior to and during operation. Some states also require payment guarantees from third parties for various obligations of the investor. Investors are also sometimes required to maintain production at an agreed or minimum level or undertake minimum expenditure obligations. The issue of whether certain taxes, royalties and other fees are applicable to an investor and if so, the extent of their application depend on various factors such as the existing legal framework, the level of investment required and the bargaining power of the parties and so forth. There are different types of royalties used depending on how risk is allocated between the parties, including profit-based royalties, gross value based royalties, net value based royalties and unit based royalties.[15] Some countries also have a specific tax regime for the mining sector. Due to the unique nature of mining businesses, mining agreements often provide certain incentives for investors such exemptions from certain taxes or royalties for certain periods of time, specification of deductible expenses, provision of tax holidays for all or some taxes for certain period of time, stabilisation of taxes (and also non-tax provisions), accelerated depreciation and loss carry forward mechanisms.

In some countries, the state opts to acquire a certain equity interest in the company which will exploit the minerals. The percentage levels generally vary from 10 to 51 percent. In other countries investors may be required to divest a certain percentage of their interest over a certain period to the government and/or local entities. In either case, agreements often provide for provisions on the determination of the acquisition price, the payment mechanism and the sale (or acquisition) of such interest by the state and so forth. In practice, there are three main approaches to the acquisition of equity interest by states, being paid interest equity, free interest equity and carried interest equity. Equity in exchange for infrastructure or reduced tax liability is also sometimes used.[16]

Mining agreements usually contain provisions concerning facilities and infrastructure (such as water, power, railways, roads and ports) required for the project. States grant investors the right to either construct the related infrastructure at the cost of the investor with the state providing support in obtaining relevant permits and/or licenses or allow an investor to use existing infrastructures for a certain fee. Some agreements provide exclusive control and access rights to the investor in respect of the related infrastructure, and in some cases, some agreements provide

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[15] International Institute for Sustainable development, Model Mining Development Agreement – Transparency Template, 2012, p. 7

[16] Farid Tadros, Kristina Svensson, Investment Climate In Practice: Using Taxation to Enable a Fair and Thriving Mining Industry, p. 3

for third party access with certain conditions - such as third party access does not restrict the work of the investor and the ability to impose payment of fees by the investor to recover associated costs. In relation to other properties, some agreements provide that an investor holds the title to property for movable and fixed assets but such title may transfer to the state free of charge or at a specified price upon termination if the investor fails to remove such property within certain period.[17]

Another key feature of mining agreements are the provisions on stabilisation. Stabilisation clauses often apply to change of laws and regulations in respect of tax and other financial matters. Traditionally, stabilisation clauses covered the whole agreement throughout the term of the agreement. However, there has been criticism as to the application stabilisation clauses in respect of obligations concerning environmental, labour and social policies in particular. As a result, the scope of stabilisation clauses has diminished. Some terms or clauses are excluded from the scope of the stabilisation clauses. Others specify a stabilisation period or address how a change of law or regulation would be dealt with. For example, an investor may be entitled for receive compensation for any material damage caused as a result of adverse impact of change in laws and regulations.

Most mining agreements contain extensive provisions in respect of community development, contribution towards the national/local economy and the protection of the environment. In terms of community development, provisions include training and employment of local people and contractors, undertaking social impact assessments and implementing measures to mitigate any adverse impacts, arrangement of resettlement of local communities and the protection and preservation of cultural heritage areas. Funding obligations for such undertakings vary from one-time lump sum payments to annual payments based on the percentage of revenue. In some cases, national laws require an investor to enter into a separate community development agreement which addresses these development matters and the relationship between the two agreements is addressed in a mining agreement. See Section VI for detailed information on community development agreements. In terms of supporting the national/local economy, investors are required to support the private sector by means of local procurement of services and goods or be expected to meet domestic demand before exporting minerals or obligation to process or refine the minerals within the country.

In terms of protecting the environment, investors are often required to comply with international and national legislation on the environment, undertake environmental impact assessments, develop and implement environmental protection plans and undertake expenditure obligations in respect of the same.

The obligations of the investor in respect of closure and post-closure matters are also often an important part of mining agreements. Most countries require an investor to plan closure in advance and involve relevant stakeholders in the closure process.

[17] Allen & Overy, Guide to Extractive Industries Documents – Mining, January 2013, p. 13

Another emerging area that is increasingly reflected in mining agreements is the issue of anti-bribery/corruption under which corruption and anti-bribery obligations are primarily imposed on investors.

D. Best Practices

There is no one size fits all solution as each agreement is negotiated and drafted based on the national and/or local context. The content of mining agreements will vary depending on various factors including the legal system and the existing legal framework, the development stage and needs of a country, the political climate, the global market conditions, the financing arrangements, the level of funding required and other factors such as the development goals and strategies of the country, the composition and the level of technical, financial and legal expertise and skills of the negotiators.

The main lessons learned are that it is important that a mining agreement comply with national legislation and embody the concept of reciprocity and mutual benefit. It should have realistic benefit and risk allocation and address the needs and expectations of the parties in clearly defined terms. Further, the reliance and adherence to international standards and best practice in various areas such as the protection of environment and the engagement of local communities will help to ensure the long term sustainability of the agreement.[18]

We anticipate that the model mining agreement will follows the structure provided in Section V(C) above. However, given that the Minerals Law is silent as to the scope and content of the agreement on the utilisation of a deposit and the laws regarding investment agreements under the Investment Act are relatively new, we will present our findings and consult with the Ministry of Mining regarding their position and understanding for the purposes of the model mining agreement.

VI. Model Community Development Agreement

A. Background

A Community Development Agreement ("**CDA**") used in the extractive industries sector is a negotiated agreement usually between (i) a mining company, (ii) the local government authorities who represent the communities that will be affected by such mining company's operations, and, depending on the country and the type of project, (iii) representatives from the Ministry of Mines and other certain affected government ministries, through which the benefits and obligations of the mining project can be shared directly with such local communities and other project-affected stakeholders. CDAs are also sometimes known as "benefits sharing

[18] Some of the well-known standards include the International Council on Mining and Metals Toolkits, the IFC Performance Standards and ISO 14001 standards, the Extractive Industries Transparency Initiatives and the Voluntary Principles for Security and Human Rights

agreements," "partnership agreements," "community joint ventures," "landowners agreements," "investment agreements" or "impact benefit agreements," to name a few. They may be legally binding agreements or voluntary and aspirational in nature and vary in structure and content, depending on the context of the situation.

CDAs are a key component of good practices that, if drafted properly, are mutually beneficial to the mining company, the affected communities and the government. They acknowledge and address the needs of affected stakeholders, provide clarity and transparency regarding the obligations of each party and give the investor some assurance that the community will support rather than disrupt its operations.

The Mongolian Minerals Law as currently adopted does not specifically address the concept or requirement of a CDA, but does acknowledge the need for certain community development activities and provides that mining holders should cooperate with local administrative bodies regarding issues of environmental protection, mine exploitation, infrastructure development and job creation and may hold a public forum to address such issues.

It should be noted that the Minerals Law make a general reference to "license holders" without specifying whether this means "exploration" or "mining" license holders. Thus, it appears that both types of license holders should be required to enter into a CDA regardless of the size of the mining company, the project or the investment made. Based on as strict reading of the Minerals Law, it also appears that a CDA can only be negotiated and entered into after the issuance of the relevant license. The Minerals Law does not provide further guidance on how community engagement activities should be organized, at which administrative level a CDA must be entered into or what the contents of a CDA should entail. Thus, the government has a fair degree of flexibility in preparing the policy and legal framework related to the procedures for drafting and negotiating the CDA as well as the content of the model CDA.

Further, it should be noted that the Minerals Law does provide for the involvement of the local administrative bodies and local parliaments in other related matters. For example, administrative bodies and local parliaments are empowered to monitor the compliance by license holders of their obligations with respect to environmental protection and restoration, the protection of public health and obligation to make payments to the treasury of the local administrative body. Further, MRAM must consult with province or the capital city governors when granting exploration licenses. The respective governor must undertake consultations with local parliaments before providing a formal response to MRAM.

As discussed in earlier sections of this Analytical Report, in addition to entering into a CDA, a mining company may opt to enter into an investment agreement with the Government if its proposed investment exceeds 500 billion Mongolian tugrugs. In such cases, the investment agreement must address, among others, the following community development issues:

1. Public health and environment and measures to eliminate or mitigate any adverse effects;
2. the impact on non-mineral production and services;
3. the contribution towards regional development;
4. compliance with legislation on employment, creation of new jobs and training of personnel;
5. infrastructure, city/settlement areas, social and cultural matters; and
6. business opportunities for Mongolian citizens and business entities.

Further, the Law of Mongolia on Petroleum, enacted on July 1, 2014, also provides that an extraction license holder (which grants the right to mine crude oil, gas and unconventional oil) must enter into agreement with soum or district governor concerning the protection of the environment and voluntary contribution towards the local development.

Before discussing recommended considerations and content for a model CDA, it is important to first briefly discuss the current policies and state of affairs in Mongolia, as well as the importance of stakeholder engagement, current trends and best practices, and the purpose and incentives for entering into CDAs.

B. Policy Considerations; Identifying and Engaging Stakeholders

(a) Mongolia's economic and geographical history

Mongolia, a landlocked nation known for its vast landscapes and nomadic herders, is now one of the world's fastest growing economies due to foreign interest in the country's undeveloped coal, copper, gold, molybdenum, fluorspar, uranium, tin and tungsten deposits. While these natural resources provide the country with a tremendous amount of opportunity for economic growth and development, they also come with a risk of detrimental effects to both the environment and to society as a whole. Traditional livelihoods based on herding and agriculture are under threat as mine operations take over pasture lands and compete for limited water resources. Understanding Mongolia's economic and geographical history is important in determining who will be affected by mining operations; thus, the paragraphs below discuss important aspects in considering stakeholder interests.

Ulaanbaatar, Mongolia's capital and its largest city, is home to approximately 1.3 million people, or 45 percent of the country's population. The remainder of the population is spread throughout the country, with an estimated 30 percent to 40 percent of the total population relying on animal herding or agriculture for survival and 75 percent of the country's land being used for such

pursuits. Traditionally, herders raise cattle, sheep, goats, horses and camels, which provide sources of meat, milk, wool and cashmere. Herders' families usually move two to four times a year between winter and summer camps.

The development of mine infrastructure is changing the way herders live. There are already few herders remaining near the Tavan Tolgoi coal mines in southern Mongolia, in part due to recent harsh zuds, but also in part due to the dust pollution and decreased water levels available in mining areas. The concern is that other areas that have historically and traditionally been occupied by herders will suffer the same fate.

The interests of the nomadic herders and the mining sector are, in many ways, incompatible. While the model mining development agreements and community development agreements will address these environmental and societal impacts and require that mining companies take actions to mitigate them, the agreements will also provide for education, training and increased alternative employment opportunities aimed at assisting herders who wish to stay in the area and pursue other economic opportunities.

(b) Identifying Stakeholders

A well drafted CDA involves a process whereby groups or individuals who will be affected by mining operations have an opportunity to participate throughout the negotiations and implementation of the CDA. The engagement process should be robust, transparent and participatory by community stakeholders, as well as the government and the applicable mining company.

The first step in soliciting stakeholder engagement is proper identification of such stakeholders. This begins with "desk-based research" that involves a review of publically available information sources, such as statistics, studies, maps and government documents. This desk-based research will provide insight into the community characteristics, such as the geography, history, population and culture.

The nomadic herders described above are one example of a stakeholder group discovered through desk-based research, and it is easy to understand how this group will be affected by mining projects and the growth of the extractive industries sector in Mongolia. Other easily identifiable stakeholders that will be affected include local community members who have established roots in a particular area or reside along transportation routes used by the project, landowners, artisanal miners (often known in Mongolia as "ninja miners"), interested environmental groups, non-government organizations, religious and traditional groups and other commercial and industrial enterprises.

These stakeholders are apparent based upon our "desktop-based research" and general knowledge of Mongolia's economic and geographical information, but a successful stakeholder

identification process involves more than desk-based research; it also involves on-the-ground consultation. In preparing the model CDA, we have started and will continue to undertake on-the-ground consultation through workshops and open public forums to discuss issues and impacts related to mining projects, but this step will need to be repeated by the local governments and the investor prior to negotiating and finalizing any actual CDA to be used with a proposed mining project. This is because stakeholders may vary by location and project, and such consultation early in the process will build trust among the parties.

Discussion during these public forums may fill in gaps in information in regards to who will be affected by the mining operations. These forums may be especially helpful in indigenous communities where the parties to the CDA need to understand societal structure and cultural values and priorities to fully appreciate who may be affected by mining operations. Stakeholder identification through public forums does, however, have drawbacks. Those who are likely to attend are those who have access to communication mediums, such as newspapers, radio and the internet. A barrier to attendance may be cost, as stakeholders may have to travel and miss work to attend. Further, members of vulnerable groups may feel that attending is not in their best interest due to fear, intimidation or perceived threats to their property through expropriation or other circumstances. Thus, it is important to use multiple methods to identify and engage stakeholders.

A third way to identify stakeholders includes stakeholder mapping, which is a visual mapping that helps pinpoint where the community is situated in relation to the project and each other. Such mapping exercise also helps identify other helpful information about stakeholders, such as potential influence of the various groups, the interactions between them and geography and physical relationship. Below are a few questions for consideration in the stakeholder mapping process:

- Who will be affected by the positive and negative impacts of the proposed mining project?
- Whose cooperation and expertise would be beneficial to the project?
- Who are the most vulnerable or marginalized members of the community?
- What relationship do different groups have amongst each other?
- What are the land boundary and ownership concerns and are there any unresolved land disputes?

Additional ways to identify stakeholders include consultation with independent experts and consultants, as well as relevant impact assessment reports conducted by third parties that identify the impacts and risks associated with the development of a specific project and the groups affected by such impacts and risks. Certain impact assessment reports are required by law in some countries. In Mongolia, the Minerals Law requires a mining license holder to prepare an environmental impact assessment that will identify the possible adverse environmental impact resulting from the proposed mining operations, and shall include preventative measures to avoid

and minimize such adverse impact. The Minerals Law separately requires the state administrative agency in charge of geology and mining to conduct research and evaluation regarding the impact of the mining industry on the social and economic development of Mongolia.

Stakeholder engagement is particularly important in Mongolia, as the extractive industries sector is growing at a rapid pace and is expected to dominate the Mongolian economy in the years to come. All Mongolians are affected by the sector in one way or another, whether benefitting from the increased government revenues and new infrastructure or being adversely affected by the negative environmental and social impacts. Those who are or will be directly affected deserve a voice in the process.

Our stakeholder identification process for the model CDA is underway, beginning with desktop research and including active participation in an initial stakeholder workshop in Ulaanbaatar organized by the Ministry of Mining. This workshop included representatives from the Ministry of Mining, the Anti-Corruption Agency, the Petroleum Authority, the MRAM and local government officials of various provinces as well as representatives from mining companies. The purpose of the workshop was to share current international trends concerning CDAs and to discuss issues to be reflected in the model CDA.

During the upcoming months, we will continue our desktop research and thoroughly examine the Strategic Environmental and Social Assessment completed last year on behalf of the Government of Mongolia to better understand the country and the affected stakeholders for purposes of our model CDA. We will also consult with third party experts and, through our Ulaanbaatar office, host or attend public forums.

C. Current Examples and Models

In addition to effective stakeholder identification and engagement, another important aspect of developing a successful model CDA is examining the current precedent and models available. We have a number of toolkits and best practices manuals which are helpful in examining each provision. In drafting the model CDA, we will use a combination of the Community Development Agreement Model Regulations and Example Guidelines prepared for the World Bank by James Otto ("**Annotated Model**"), relevant provisions in the MMDA and various precedent CDAs or similar agreements used in parts of Africa, Asia, North America and Australia.

The Annotated Model is a helpful resource as is acknowledges that every nation, mine and community is different and provides annotations for consideration in various situations. The MMDA also provides helpful annotations. This is the approach we plan to take with our CDA. While it will be tailored to the known issues and needs of Mongolia, it will also provide room to

address the unique situations associated with each mining project and each affected community in the country.

The basic structure of our model CDA will include the following topics:

1. **Description of Parties and Stakeholders**
   The model CDA will provide guidance to all parties who may be involved in the negotiation, drafting, implementation and monitoring of any subsequent CDA. While each CDA is unique, we envision the parties to include the applicable mining company and the local government authorities who will represent the affected communities. Although the Minerals Law does not directly contemplate the involvement of the Government in CDAs, we will consult with the Ministry of Mining regarding the possibility of the Government and/or its representatives being a party to CDAs for large scale mining projects.

2. **Goals and Objectives**
   This topic will describe the goals and objectives of the CDA, which will formulated throughout the stakeholder identification and engagement process. Broadly described, goals are likely to include (i) enhancing the sustainable social, culture and economic well-being of communities impacted by mining operations, (ii) defining obligations of both parties and providing a framework for undertaking such obligations, and (iii) ensuring accountability and transparency in mining related community development.

3. **Obligations and Responsibilities**
   This topic will be extremely fulsome as it will lay out a number of provisions for discussion, negotiation and agreement upon by the parties. Depending upon the outcome of the stakeholder identification and engagement process, likely provisions include:
   - Community Responsibility (obligations regarding economic and social viability)
   - Community Funding Obligations (annual contributions and fund usage)
   - Public Health and Safety
   - Medical Care
   - Employment, Training and Education
   - Local environmental Protection and Management
   - Infrastructure
   - Expropriation and Land Usage and Access Rights

4. **Post-Closing Obligations**

This topic will address environmental, social and economic issues that are likely to exist after a mine closure and the eventual transition from a mining economy to a post-mining economy.

5. **Monitoring and Evaluation**

This topic will address monitoring and evaluation plans and framework to ensure that progress is being achieved in line with expectations. Transparency is a key component to monitoring and evaluation, and the model CDA will include certain reporting requirements.

6. **Dispute Resolution and Grievance Mechanisms**

This topic will address the mechanisms under relevant laws and regulations whereby members of the affected community and the mining company may lodge grievances and the process for addressing such grievances.

D. Incentives

Certain studies and scholarly articles assert that resource rich countries must be wary of the "resource curse" which is the idea that such resource rich nations tend to have worse economic outcomes than countries with fewer natural resources because of government mismanagement of resources, volatility and unpredictable in revenue streams and a decline in the competitiveness of other economic sectors. While this concept is heavily debated, there is no question that a boom in the extractive industries sector will have an effect on local communities and the country as a whole. A well drafted CDA will address these effects. It will also address negative impacts such as the impact on traditional livelihoods, displacement or resettlement, local environmental issues, migration creating an increased demand in housing, school, energy and water. It will seek to develop mutually beneficial and sustainable arrangements between the mining company, the local government and the affected communities with an emphasis on benefit sharing and transparency. While each mining project is unique and each stakeholder's set of goals may vary based on such project, below are some of the benefits a CDA provides, many of which overlap:

Mining Company:

- Reduced uncertainty and reduced delays in project development
- Efficiency and productivity and local support services
- Local workforce
- Improved employee retention
- Enhanced reputation
- Availability of local resources
- Eased approval process
- Fair and predictable dispute resolution process
- Framework for ongoing engagement

Communities and the Government:

- Acknowledgement of the economic and social impacts
- Community acceptance of resource development
- Fair compensation (in the case of the government, increased revenue)
- Infrastructure development
- Transparency, clarity and accountability
- Employment and training opportunities
- Fair and predictable dispute resolution process
- Framework for ongoing engagement

E. Current Trends and Best Practices

Community development agreements are fairly new over the last decade, but their usage is being supported globally due to the growing expectation that resource companies should contribute to the long term development of the communities in which it operates. This is especially true in the extractive industries sector where projects involve the removal of a finite physical resource rather than those in the agricultural industry which can be managed through effective renewal and replenishment processes.

In recent years, over 30 countries have adopted community development provisions in their national or regional mining laws and or policy framework and even more are in the process of adopting or improving their laws to address the need for community development provisions.[19] These countries are located all over the world, but are primarily developing countries in mineral rich areas throughout Africa, Asia and South America such as Peru, Nigeria, Laos, Sierra Leone, Yemen, Ecuador, Vietnam, Papua New Guinea, South Africa, Egypt, Guinea, Afghanistan, Ghana, Namibia, Tanzania and India.

The increase in legislation around community development initiatives as well as published CDAs provide us with a glimpse of what the current trends are and what is important to stakeholders. Below are some best practices for drafting our model CDA.

- Effective Stakeholder Identification and Engagement. Effective stakeholder identification and engagement, as described more thoroughly in the sections above, is extremely important to having a successful CDA. Stakeholder groups at all levels, including government entities, NGOs and affected communities, with consideration given to potentially marginalized and vulnerable groups.

- Fair Negotiation Process. Negotiations between the parties should be entered into in good faith with a genuine desire to reach a fair agreement. The relationship between the parties should be based on mutual respect, understanding and management of

[19] Dupuy, Kendra E. (2014). "Community Development in Mining Laws, 1993-2012". Forthcoming in The Extractive Industries and Society.

expectations. This type of relationship takes time to develop; thus, a fair negotiation process will not be rushed. Our model CDA will have annotations and discussion points for use during negotiations where outcomes may differ based on the individual mining project and the interests of the affected stakeholders.

- Mutual Obligations between Parties. A well drafted CDA will impose clearly defined obligations on all parties and describe the roles, responsibilities and expected behavior of the signatories.

- Long-term Development Objectives (in addition to financial compensation). CDAs should address financial compensation, but rather than focus solely on the payment of funds they should address long-term development goals which may include key infrastructure, education rates and poverty reduction.

- Stakeholder Council. A fairly new practice involves establishing a multi-stakeholder council that serves as a channel for dialogue between the company, government entities and members of civil society affected by the mining project. The purpose of this council is to guide and monitor the long-term sustainability agenda, address ongoing initiatives and provide a forum for discussion and collaborative action. One example of this is the Sustainable Juruti Counsil, known as CONJUS, which was formed in Brazil in connection with Aloca's Juruti mining project and consists of 15 members who meet regularly. Of particular interest is this quote from one Alcoa's Sustainability Officer in Juruti: *"A good example of the role of the Government sector within the framework of CONJUS occurred in 2009. A movement emerged that was opposed to the building of the mine, and it had the potential of radicalization early in the year. When this happened, the government mediated negotiations between the community and the company to address the main complaint of the movement, which concerned the regularization of land ownership. If it hadn't been for this action by the State, the land ownership negotiations would not have happened as they did. The presence of the public authorities, therefore, is essential for the governance and sustainability of the territory."*

- Development Fund. A development fund is a unique fund in which the parties allocate resources to be invested in sustainable initiatives proposed by the community. The initial funds usually come from the mining company either in place of or in addition to requiring certain infrastructure development obligations or spending obligations in the CDA. This allows the community, through a Stakeholder Council or similar body, to make decisions regarding its needs on an evolving basis over many years. If the fund is managed properly is can live beyond the life of the mine to provide a continuing source of local project financing.

- Agenda and Sustainability Indicators. A best practice for monitoring progress is to create an agenda of desirable initiatives that may not be detailed in the CDA (for example, when certain funds go into a development fund as described above) and then implement a system of social, environmental and economic sustainability indicators and metrics that are agreed upon in advance to measure on-going performance. These might include specific initiatives such as "construction of three deep water wells to provide clean water to city residents" as well as general initiatives such as "improve and preserve the region's biodiversity." Active and ongoing dialogue between all parties is important to the success of this approach.

- Transparent Practices and Effective Dispute Resolution. Affected communities and governments desire evidence of socially and environmentally responsible practices. A successful CDA will support transparency efforts, in both the monitoring of activities and the allocation of funds. An aggrieved party will have an opportunity, through an effective grievance mechanism, to address concerns and seek out resolution.

F. Monitoring, Evaluation and Accountability

Appropriate monitoring and evaluation of CDAs is necessary to increase accountability and transparency for all parties. Monitoring helps those involved with community development projects to assess if progress is being achieved in accordance with expectations and evaluation looks at the long-term impacts of the project to determine what works and what does not. Questions for consideration include:

- *Who will be responsible for monitoring?* Common practices include self-reporting by the mining company, peer review, government oversight and partnerships with NGOs who will work on behalf of local stakeholders. In some cases, it may be helpful to create a committee comprised of stakeholders to oversee the monitoring process.

- *Who will be responsible for compiling metrics?* This includes concepts that are easily quantified, such as programs initiated, percentage of mining revenue distributed, dollars spent, houses built and clinics operating. Often, this is reported by the mining company and confirmed by other parties responsible for monitoring, including the government.

- *How do you monitor projects with long-term goals?* Certain project obligations will take place over a long term and are bigger picture in scale. These are harder to monitor and must be captured through impact indicators. On the environmental side, this may be addressed through an environmental impact assessment or similar report that addresses environmental performance and sustainability in a broader sense. On the social side, this may be addressed through social impact assessments or using indicators such as the UNDP's Human Development Index to gauge the impact of a CDA on a stakeholder group.

- *What action will be taken in the case of noncompliance?* The parties will address non-compliance concerns through the dispute resolution process.

According to the Mongolia Seventh Extractive Industries Transparency Initiative Report 2012, 149 mining companies reported to have entered into agreements with local governments for cooperation in the area of social responsibility, land use, water use and other matters. Out of the 149 companies, 16 companies entered into contracts for cooperation on social responsibility with 19 local governments. However, these agreements are not available to the public. One of the well-known mining projects in Mongolia, Oyu Tolgoi, is yet to conclude a CDA with the local government.

In addition to monitoring and evaluation, the CDA should include transparency initiatives for accountability purposes. This is especially important when the mining company is making direct payments to the government or managed fund for the purpose of undertaking a defined project, such as building a school or clinic. All parties to the CDA should agree to make financial records publicly available to increase accountability. The parties may also agree to an audit process, including an audit committee with broad representation.

We will also look to the Extractive Industries Transparency Initiative ("**EITI**") for guidance on transparency. EITI is a global coalition of governments, companies and civil society working together to promote openness and accountable management of natural resources. It was founded on the idea that while natural resources can help raise living standards across the world, if they are not well managed they can lead to corruption and conflict and, for many people, a lower quality of life. Mongolia is one of over thirty countries that is currently compliant with EITI standards, which include the timely publication of reports that provide contextual information about the extractive industries and disclosure about revenues and payments made to the government. Mongolia has produced seven reports since 2006 and remains committed to EITI. We hope to expand on Mongolia's active and successful participation in this initiative.

VII. Detailed List of Resources

The following resources have been beneficial to us in drafting this Analytical Report and will be useful to understanding best practices and commonly concepts for purposes of preparing the model mining agreement and the model community development agreement.

Publications

1. Allen & Overy, *Guide to Extractive Industries Documents – Mining*, January 2013.

2. CEE Bankwatch Network, Urgewald (Germany), Bank Information Center (USA) and Oyu Tolgoi Watch (Mongolia), *Spirited away – Mongolia's Mining Boom and the People that Development Left Behind*, December 2011.

3. The Centre for Social Responsibility in Mining, *Good Practice Note Community Development Agreements*, EiSourceBook, 2011.

4. Dupuy, Kendra E., *Community Development in Mining Laws, 1993-2012*, Forthcoming in the Extractive Industries and Society, 2014.

5. Environmental Resource Management Limited, *Community Development and Local Conflict: A Resource Document for Practitioners in the Extractive Sector*, April 2008.

6. Ernst & Young's Global Mining & Metals Center, *Business Risks Facing Mining and Metals 2013-2014*, 2013.

7. Farid Tadros, Kristina Svensson, *Investment Climate In Practice: Using Taxation to Enable a Fair and Thriving Mining Industry*, June 2010.

8. Frilet, Marc and Haddow, Ken, *Guiding Principles for Durable Mining Agreements in Large Mining Projects*, International Bar Association's Journal of Energy & Natural Resources Law, Volume 31, No. 4, 2013.

9. International Council on Mining & Metals, *Community Development Toolkit*, 2012.

10. International Council on Mining & Metals, *Utilizing Mining and Mineral Resources to Foster Sustainable Development of the Lao PDR*, April 2011.

11. Pike, Alexandria and Powell, Sarah, *International Comparison of Solutions to Aboriginal Rights Issues Associated with Mineral Development: Free, Prior and Informed Consent – the Canadian Context, Rocky Mountain Mineral Law Foundation*, July 2013.

12. The World Bank, prepared on behalf of the government of Mongolia, *Strategic Environmental and Social Assessment of the Mining Sector*, 2014.

13. Sustainable Development Strategies Group, *Model Mining Development Agreement – Transparency Template*, May 2012.

14. Williams, John P., *Global Trends and Tribulations in Mining Regulation*, International Bar Association's Journal of Energy & Natural Resources Law, Volume 30, No. 4, 2012.

15. The World Bank, prepared by Environmental Resources Management, *Mining Community Development Agreements – Practical Experiences and Field Studies*, June, 2010.

16. The World Bank, prepared by James Otto, *Community Development Agreement Model Regulations & Example Guidelines*, June 2010.

17. The World Bank, *Sourcebook on Mining Foundations, Trusts and Funds*, June 2010.

18. The World Bank Sustainable Energy - Oil, Gas and Mining Unit, *Mining Community Development Agreements Source Book*, March 2012.

19. The World Bank and International Finance Corporation, *Large Mines and Local Communities: Forging Partnerships, Building Sustainability*, 2002.

20. Zarsky, Lyuba and Stanley, Leonardo, *Can Extractive Industries Promote Sustainable Development? A Net Benefits Framework and a Case Study of the Marlin Mine in Guatemala*, Journal of Environmental & Development.

<u>Interviews</u>

1. Interview conducted with mining industry expert David Deisley of Nova Gold Resources Inc. on Friday, January 30, 2015.

2. Interview conducted with mining and human rights expert Stephane Brabant Herbert of the law firm Smith Freehills on February 4, 2015.

3. Interview conducted with human rights experts Lucas Gomez and Ignacio Boulin Victoria of the Argentina Southern Lights Group, Argentina on February 3, 2015.

4. Interviews conducted with international development experts Luke Danielson and Kristi Disney of the Sustainable Development Strategies Group on November 14, 2014, January 15, 2015 and January 22, 2015.

<u>Mining and Community Development Agreements</u>

1. Australia – Argyle Diamond Mine Participation Agreement: Management Plan Agreement, between Argyle Diamonds Limited and Argyle Diamond Mines Pty Limited and Traditional Owners, dated January 1, 2004.

2. Australia – Memorandum of Understanding between Rio Tinto Exploration Pty Ltd and the Northern Land Council, dated December 1, 2001.

3. Canada – Economic and Community Development Agreement between the Ktunaxa Nation Council Society and the Province of British Columbia, dated January 29, 2013.

4. Canada – Economic and Community Development Agreement between the Williams Lake Indian Band and the Province of British Columbia, dated March 6, 2013.

5. Canada – Sample Impact & Benefits Agreement prepared by Fasken Martineau.

6. Canada – The Raglan Agreement between Makivik Corporation, Qarqalik Landholding Corporation of Salluit, Northern Village Corporation of Salluit, Nunatulik Landholding Corporation of Kangiqsujuaq, Northern Village Corporation of Kangiqsujuaq and Societe Miniere Raglan du Quebec Ltee and Falconbrdige Limited, dated January 25, 1995.

7. Ghana – Ahafo Social Responsibility Agreement between the Ahafo Mine Local Community and Newmont Ghana Gold Limited, dated May 2008.

8. Ghana – Agreement on Local Employment between the Newmont Ghana Gold Limited and the Ahafo Mine Local Community, dated May 2008.

9. Liberia – Mineral Development Agreement between the Government of the Republic of Liberia, BHP Billiton (Liberia) Inc. and BGHP Billiton Iron Ore Holdings PTY LTD, dated June 4, 2010.

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14. Papua New Guinea – Standard Mining Development Agreement Template, draft prepared May 2010.

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16. Russia – Sakhalin Indigenous Minorities Development Plan prepared under the authority of the Tripartite Agreement by the Sakhalin Oblast Government, the Regional Council of Authorized Representatives and the Sakhalin Energy Investment Company Ltd., December 2010.

17. Zambia – Chambishi Mine Development Agreement between the Government of the Republic of Zambia, NFC Africa Mining PLC and China Nonferrous Metal Industry's Foreign Engineering and Construction Corporation (Group), dated June 29, 1998.

18. Zambia – Amended and Restated Development Agreement between the Government of the Republic of Zambia and Konkola Copper Mines PLC, dated 2004.

19. Zambia – Mufulira Mine, Smelter and Refinery and Nkana Mines, Concentrator and Cobalt Plant Development Agreement between the Government of the Republic of Zambia and Mopani Copper Mines PLC, dated March 31, 2000.

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