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Protection of Investment to Real Estate in Mongolia based on Japan-Mongolia EPA

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I. Introduction

Mongolia is a natural resource-rich country, which achieved more than 10% economic growth annually from 2010. However, due to rising resource nationalism and restriction on foreign investments, recent economic growth is slowing down (12.3 % in 2012, 11.6% in 2013 and 7.8% in 2014). And recession of Chinese economy might threaten Mongolian economy, which is the most important trading party for Mongolia (86.3 % of total export amount is to China).

In order to tackle this circumstances, Mongolia signed “Japan-Mongolia Economic Partnership Agreement” (“EPA”) on February 20, 2015. Currently both countries are under procedure to implement the EPA domestically.

This EPA aims at enhancing partnership between Japan and Mongolia by developing trading and investment environment, especially in mineral resources and real estate. This memo attempts to compare the EPA with “Agreement between Japan and Mongolia concerning the Promotion and Protection of Investment” executed on March 2002 (“Investment Agreement”), and clarify how the Japanese companies who invest to real estate in Mongolia may be protected.

II. Land use right for business entity with foreign investment

Ownership of land in Mongolia is in principal limited to the government of Mongolia due to its historical and political situation (Article 102.1 of the Civil Code and Article 5.1 of the Land Law and Article 6.2 of Constitution of Mongolia). Land ownership right is admitted to only Mongolian citizens in some part (Article 1 and 3.1.2 of the Law on Allocation of Land to Mongolian Citizens for Ownership). Although Land Law stipulates 3 types of rights to own, possess and use of land (Articles 3.1.3 and 3.1.4 of the Land

Law), only land use right is admitted to foreigner or business entity with foreign investment. The duration of the land use right available for the Japanese company is normally limited within 5 years.

Although the Japanese company may obtain the land use right of less than 60 years duration under the Foreign Investment Law of Mongolia enacted in July 1993, the Foreign Investment Law of Mongolia was abolished on November 1, 2013 and new Investment Law became effective on the same day. The non-tax promotion for foreign investors, including the extension of the duration of the land use right up to 60 years under Article 12.1.1 of the new law was to be in force upon the revision of the Land Law but the law has not yet revised (the revision of the Land Law is very sensitive issue for the people of Mongolia). As the result, the new foreign investment law has not yet implemented since November 1, 2013.

III. Unfair Restriction of land use right in Mongolia

Based on the above land legal framework in Mongolia, Japanese company who wants to invest in the real estate in Mongolia first needs to obtain the land use right from the Mongolian government. The company then owns the building on the land and lease or sell it. In Ulaanbaatar city (“UB City”), it is necessary to get the approval from Citizen Representation Committee first and then enter into the land use right agreement with the UB City government.

However, UB City sometimes requests the Japanese investor to shorten the duration of land use right without legitimate reasons.

Suppose a Japanese company entered into the land use right agreement with UB City to be terminated in 2030 under the Foreign Investment Law of Mongolia supported by a political party for foreign investment. In 2013, another political party for resource nationalism and against foreign investment won the election. The Foreign Investment Law was abolished in 2013 and the new law has not been implemented, and riots occurred in UB City due to surging real estate prices. Following the abolishment of Foreign Investment Law and riots, mayor of UB City announces that the land use right shall expire in 2019. In this case, the issue is whether Japanese company may claim objection against this.

IV. Counterplan for the invasion of land use right

1. Prelude

In such situation, Japanese company may contend with Mongolian government at international investment arbitration.

2. Filing of international investment arbitration

Investors of either contracting party have right to file arbitration based on the Investment Agreement (Article 10.2 of the Investment Agreement). Only investors under the Investment Agreement can receive protection such as protection for expropriation of investment assets (Article 5.2 of the Investment Agreement) or application of most favored nation clause (Article 3.1 of the Investment Agreement).

In this Investment Agreement, “Investors” means, in relation to one contracting party, (1) physical persons possessing the nationality of that contracting party (Article 1 (5) of the Investment Agreement), or (2) corporation, partnerships, companies and associations constituted under the applicable laws and regulations of one contracting party and having their seat within its territory (Article 1 (4) of the Investment Agreement). Also, “Investments” comprises every kind of assets including shares of the company (Article 1 (1) (a)).

If Japanese company establishes its subsidiary in Mongolia as company limited by shares, the parental Japanese company meets the definition of the “Investors” under the Investment Agreement, and the shares of the Mongolian subsidiary as “Investments”.

As a result, the Japanese company can file arbitration and get protection under the Investment Agreement.

3. Problem of the Investment Agreement (lack of fair and equitable treatment clause)

A. Prelude

However, the Investment Agreement did not provide fair and equitable treatment clause, thus the protection of Japanese company which invests to Mongolia was unstable.

B. Fair and equitable treatment

Fair and equitable treatment means investment host-nation shall give fair and equitable treatment for investment goods received from investment home country such as subsidiary located to host-nation or assets.

Fair and equitable treatment clause has been set forth in many bilateral investment treaties or investment chapter of free trade agreement. Japan adopted it for few bilateral investment treaty or free trade agreement, and there is no fair and equitable treatment clause in the Investment Agreement.

C. Necessity to protect investors by fair and equitable treatment clause

However, it is important to impose fair and equitable treatment duty to Mongolian government, as in many arbitral awards, protection of legitimate expectation of investor has been considered to be component of fair and equitable treatment. Legitimate expectation arises from action of contracting state or condition provided from the investment host-nation¹. Especially, contract conditions provided upon investment create legitimate expectation under certain conditions².

Generally, expectation of one party on proper implementation of contractual obligation will not be protected by International law. In other words, many arbitral awards concluded that breach of contract between investor and investment-host nation does not violate fair and equitable treatment obligation as the breach has only contractual nature³. It can be breach of fair and equitable treatment duty, however, if contract violation by investment-host nation was done as exercise of sovereign power⁴.

Japanese investor develops their business plan in Mongolia depending on the size and terms of land use right set forth upon the execution of land use right agreement. Thus, if UB City declines in size of object domain for land use right or shortening of contractual terms without consent of investor, it goes against with legitimate expectation of investor and it turns out to be breach of fair and equitable treatment duty.

The restriction of land use right by UB City is not mere non-performance of contract. Needless to say, legislation of Foreign Investment Law relates to sovereign power of Mongolian government, and abolishment of the law is based on resource nationalism in Mongolia. Moreover, there is no reasonable grounds for changing duration of land use right. As a result, it contradicts to expectation of Japanese company. Therefore, the treatment by UB City corresponds to breach of fair and equitable treatment duty of Mongolian government.

However, the Investment Agreement did not provide this clause.

D. Introduction of fair and equitable treatment clause

Therefore, the EPA has provided that each party nation shall provide treatment in accordance with international law, including fair and equitable treatment and full protection and security (Article 10.5 (1) of EPA). It could be said that the introduction of this clause would improve the position of Japanese investors.

¹ Syotaro Hamamoto, Protection of legitimate expectation of investors: Mixture of Treaty and General Principal of Laws,14 RIETI Discussion Paper Series, 2014 n.14-J-002, at 6.

² Id. at 11.

³ Id. at 11.

⁴ Id. at 12.

V. Other provisions regarding protection of Japanese company

1. Prelude

EPA stipulates “investment” in chapter 10, which also aims at enhancement of real estate investments. Followings are major changes from the Investment Agreement.

2. Establishment of National Treatment and Most-Favored-Nation Treatment in the Admission of Investment

Under this EPA, each party nation shall provide national treatment and most-favored treatment to investors with respect to investment activities in (Article 10.3 and 10.4 of EPA). National treatment refers to assuring beneficial treatments to investor equivalent to those which are given to domestic investors. Most-favored-nation treatment refers to assuring beneficial treatments to investor equivalent to those which are given to investors of third party nations.

The “Investment Activities” means establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposal of an investment (Article 10.2 (e) of EPA), which covers broad activities regarding investment.

National treatment and most-favored-nation treatment was also provided under the Investment Agreement, but only latter one “in respect of the matters relating to the admission of investment”, and both of them “in respect of investments, returns and business activities in connection with the investment” (Article 2.2 and 3 of Investment Agreement).

This EPA assures both treatments broadly with respect to “investment activities”, which means that national treatment is assured in the process of admission of investment.

3. Umbrella clause

Under Article 10.5 (2) of EPA, each party nation shall observe any written obligation it may have entered. This clause is called umbrella clause, under which investors may regard contractual duty owed by nation as that of treaty, thus it may rely on dispute resolution procedure provided in investment treaty.

Under this clause, Japanese company who acquired land use right by agreement with UB City is entitled to rely on dispute settlement procedure under the treaty.

4. Banning of Performance Requirement

Under Article 10.7 of EPA, neither party nation shall impose or enforce requirements listed in said article.

In the overseas investment, some host nations require specific treatments to investors, such as export restrictions and technology transfer. These are called performance requirement. Host nations take this option in order to restore benefits to its companies or people, while it distorts cross-border trading and investment. Thus BIT bans these treatments. The Investment Agreement also banned performance requirement such as local procurement (Article 15 of the Investment Agreement). This EPA covers broader performance requirements to be banned. Moreover, this EPA bans performance requirement with respect to license contract (Article 10.7 (k)).

5. ISDS Clause

This EPA provides ISDS (Investor State Dispute Settlement) Clause (Article 10.13), which is upgraded from Article 10 of the Investment Agreement.

Under this clause, Japanese investors may choose to use either judicial procedure in Mongolia or international investment dispute resolution procedure. It was questioned whether former one is effective, thus the EPA enables protection of Japanese investors substantially.

VI. Conclusion

As above, the EPA provides effective provisions for protection of investors compared with the Investment Agreement. The effectuation of the EPA is strongly expected.

However, in order to effectuate the EPA, legislation procedure in both Japan and Mongolia is necessary. Especially, it is said that Mongolian side has difficulty in proceeding this. We strongly hope that Mongolian government recognizes that the EPA would enhance Mongolian economy, and to complete the domestic legislation procedure to effectuate the EPA.

(Over)

Appendix Comparative Table

Name (Issue Date)		Agreement between Japan and Mongolia concerning the Promotion and Protection of Investment (2002. 3)	Japan-Mongolia Economic Partnership Agreement (Signed on 2015. 2)
Definition of "Investment"		Every kind of investment assets	Every kind of investment assets
National Treatment	Admission of Investment	×	○
	After the Admission	○	○
Most-Favored -Nation Treatment	Admission of Investment	○	○
	After the Admission	○	○
Banning of Performance Requirement		Δ (4) (Only after the admission)	○ (10)
	- Export Restriction	○	○
	- Procurement of Raw Materials	○	○
	- Procurement of Parts and Services	○	○
	- Balance of Exports with Imports	○	○
	- Requirement of Exports	×	○
	- Restriction on Domestic Sale	×	○
	- Nationality of Executives	×	○
	- Hiring Host Country Citizen	×	○
	- Place of Head Office	×	○
	- Research and Development	×	×
	- Technology Transfer	×	× (Including license clause)
- Exclusive Distributorship	×	○	
Negative List		×	○
Fair and Equitable Treatment		Δ (limited to "most constant protection and security")	○
Umbrella Clause		×	○
Expropriation and Compensation		○	○
NT&MFN regarding Compensation under		○	○

Riot		
Freedom of Remittance	○	○
Treatment in Immigration Application of Investors	○	●
Transparency (Disclosure of Legislation)	○	●
Obligation to Make Efforts of Holding Public Comment Procedures	×	●
Obligation to Make Efforts of Preventing Corruption	×	●
Dispute Settlement (Between Nation and Investor)	○	○
Dispute Settlement (Between Nations)	○	●
Joint Committee	△	○
Others	NT shall not be applied to registration of air craft and acquisition of ship	
Note: Mark “●” means it is provided in other chapters		