



## MONGOLIA'S LEGAL FRAMEWORK ON COAL BED METHANE

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### 1. INTRODUCTION

On 1 July 2014, the Parliament of Mongolia adopted the revised *Petroleum Law* ("**Petroleum Law**") providing the legal basis for prospecting, exploration and exploitation of unconventional oil and gas for the first time in Mongolia.

The Petroleum Law identifies coal bed methane gas, defined as gas accumulated in coal during the process of carbonization, as one form of unconventional oil.

Another law relating to the petroleum sector is the *Law of Mongolia on Petroleum Products*, enacted on 1 July 2005 ("**Petroleum Products Law**") which regulates the import, production, trade, transportation, storage of petroleum products (i.e. all types of fuel products, special liquids, combustible gas, lubricating materials, bitumen, black oil and other products that are produced through the refining of petroleum and other chemical compounds), and ensuring the safety of these activities.

On 19 June 2015, the Parliament of Mongolia also adopted amendments to the *Energy Law of Mongolia*, enacted on 1 February 2001 ("**Energy Law**"), which among others identified methane gas as a source of energy.

With the adoption of the revised Petroleum Law and the amendments to the Energy Law, the key legal basis for prospecting, exploration and exploitation of methane gas and the use of methane gas for energy purposes were established.

In addition to these laws, the Parliament of Mongolia and the Government of Mongolia adopted several policies and programs which recognise the importance of development of the

methane gas industry and express commitment to undertake research and studies, support necessary infrastructure and develop appropriate rules and standards. Further, a number of technical rules and regulations relevant to unconventional oil also apply to methane gas.

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### 2. REGULATORY BODIES

There are a several regulatory bodies involved in various aspects of methane gas development.

The Ministry of Mining and Heavy Industry ("**MMHI**") and the Mineral Resources and Petroleum Authority of Mongolia ("**MRPAM**") are the two primary regulators of the petroleum sector.

The MMHI oversees policy-related matters and issues petroleum licences.

MRPAM is the main implementing agency responsible for matters such as concluding production sharing agreements (as authorised by the MMHI and the Cabinet) ("**PSA**"), approval of annual plans and budgets, monitoring and evaluating the operations of license holders and the supervision of payment of fees.

Under the Petroleum Products Law, MMHI and MRPAM oversee matters relating to the import, production, trade, transportation and storage of petroleum products together with relevant government authorities such as the Professional Inspection Agency.

Once methane gas is extracted, and if it is to be used for domestic energy purposes, the matter would fall under the jurisdiction of the Ministry of Energy (“**MoE**”) and the Energy Regulatory Commission of Mongolia (“**ERC**”).

Overall, the MoE oversees methane gas development when extracted methane gas is used as an energy source and supplied to consumers through pipelines or other means. The ERC grants licenses to generate, transmit, and distribute energy and is responsible for tariff regulation for the energy sector.

### 3. REGULATIONS UNDER THE PETROLEUM LAW

#### 3.1 Background

The Petroleum Law provides a regulatory framework for both conventional and unconventional oil and gas but does not provide specific regulations on methane gas. Thus, the general regulations applicable to all conventional and unconventional oil and gas apply to methane gas.

The Petroleum Law provides that unconventional petroleum existing in subsoil or on surface in its natural state shall be the property of the state and the state shall exercise its ownership rights by means of issuing unconventional petroleum exploration and exploitation licenses.

The Petroleum Law identifies three types of petroleum-related activities: (i) prospecting, (ii) exploration and (iii) exploitation.

Prospecting is defined as "*geological, geochemical and geophysical research conducted in order to determine the prospects of oil and unconventional oil in a certain area*". The law provides that drilling can be carried out during unconventional oil prospecting. Prospecting is not a licensed activity, however the Petroleum Law provides that a legal entity wishing to conduct prospecting must submit a request to MRPAM, which, in turn, should respond within 30 days of the submission of the request. The Petroleum Law provides that a prospecting agreement may have a term of no more than three years.

Exploration is defined as "*geological, geochemical, geophysical activities, drilling and test extractions conducted in order to explore an oil deposit and determine the amount of its reserves*". Only an entity that has entered into a PSA with MRPAM can engage in exploration activities upon obtaining an exploration license

from MMHI. Alternatively, an exploration licence may be issued to a company that has won a bid for a reserve where MRPAM and a company conducting prospecting have not been able to conclude a PSA.

Exploitation is defined as "*extraction site development and the extraction of oil and unconventional oil*". Development includes constructing petroleum extraction facilities, transmission pipelines and infrastructure up to a delivery point, and extraction refers to all operations of extracting except for development.

Exploitation licences for unconventional petroleum are issued for a term up to 30 years and can be extended once for a period of up to five years.

The Petroleum Law provides that exploitation licences can be also issued by way of open tender in six different circumstances, such as where the exploration activities were funded by the state or where an exploration licence holder does not submit an application for an exploitation licence.

#### 3.2 Production Sharing Agreement

As mentioned, companies must first enter into a PSA prior to obtaining a license to engage in exploration of unconventional oil.

The Petroleum Law provides that a company performing prospecting must submit an application and give the primary materials and reports and information on the results of its prospecting work to MRPAM for assessment. The company must present its request to enter into a PSA within 60 days from the date of MRPAM's assessment together with the draft PSA.

MRPAM must negotiate the terms of the PSA within 60 days of receipt of the draft PSA and submit the agreed draft to the MMHI. The MMHI then reviews the draft PSA within 30 days, and if it considers the draft PSA appropriate to conclude, it must deliver its proposal to the Cabinet for review. The Cabinet then should issue a decision as to whether or not to conclude a contract within 60 days of receipt of the proposal. If the Cabinet has granted the authority to conclude PSA, MRPAM must conclude the PSA within 30 days.

As provided above, the statutory time period required for reviewing, negotiating and entering

into a PSA can take at least six months from the date of submitting a request to enter into PSA.

The Petroleum Law provides that the Government shall approve a model form of PSA on the exploration and extraction of petroleum, and as per the law, the Government approved a model production sharing agreement on 16 March 2015. Although the agreement is a “model” agreement, the contract is the de facto agreement which the MRPAM uses as base agreement with certain terms and conditions tailored to the needs of the specific project. For now, there is no specific methane gas model agreement and the model is based largely on conventional oil extraction.

### 3.3 Fees, Royalty, Cost Recovery and Production Sharing

The annual fee for an exploration license is an amount in Mongolian tugrugs equal to US\$ 3 per sq. km for the initial license term, and US\$ 8 per sq. km for any extension of the license term.

The annual fee for an exploitation license is an amount in Mongolian tugrugs equal to US\$ 100 per sq. km for the initial license term, and US\$ 200 per sq. km for any extension of the license term.

The royalty for unconventional petroleum is between 5-10 percent. The law does not specify the basis upon which the royalty will be calculated. By analogy to the provisions relating to conventional oil, it is assumed that the royalty is based on the total amount of extracted unconventional oil.

In terms of cost recovery expenses and cost oil, a contractor must bear all costs necessary for

carrying out petroleum operations. Cost recovery expenses must be verified by the National Auditing Office and recovered in the amount specified in the PSA. The law does not specify the percentage of cost oil equivalent for unconventional petroleum.

In terms of profit oil, the law provides that the amount of profit oil shall be agreed in the PSA and the amount allocated to the Government is to be determined taking into account the daily extraction volume.

There are also other financial obligations a contractor must meet such as meeting minimum exploration expenditure, providing bonuses for signing the PSA, commencing and increasing extraction, for training, and also depositing a cash amount equal to 3% of its exploration work budget for the relevant year, or 1% of its profit-bearing oil during exploitation for that year into an escrow account annually by way of a performance guarantee and for environmental rehabilitation and demobilization.

## 4. CONCLUSION

The legal basis for prospecting, exploration and extraction of methane gas is in place. However, there is a need to develop detailed rules and regulations specific to methane gas development given that the methane gas development is economically different from that of conventional and unconventional oil. For example, policies, rules and regulations addressing environmental matters, coordination and cooperation among government institutions, incentives to attract potential investors, construction and operation of related infrastructure would provide a significant boost to the development of the sector.

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