

Company Law (Revised)

June 2012

On 6 October 2011, the Parliament of Mongolia, the State Great Khural, adopted significant revisions to the Company Law of Mongolia (the "Revised Company Law" or "RCL"). The RCL came into effect on 21 November 2011, when the former Company Law ceased to be effective.

The key features of the Revised Company Law are:

- broadening of the personal liability of governing persons
- introduction of administrative sanctions for non-compliance
- stricter corporate governance rules
- changes in "major" and "conflict of interest" transactions provisions
- abolition of minimum capital requirements for companies
- introduction of closed joint venture companies

The enactment of the RCL is a step towards the government's aim of bringing Mongolian corporate governance standards closer to those found in more developed jurisdictions. Nevertheless, the law remains under-developed by comparison. The lack of precision in the drafting will cause some uncertainty until market norms emerge, and it introduces some unexpected pitfalls that have the potential to deter rather than encourage trade and investment.

The RCL requires that all companies amend their charters before 1 July 2012 in order to reflect the changes introduced. Whilst the coming into force of the RCL technically rendered any offending provisions of existing company charters automatically ineffective, the RCL provides that companies have until 1 July 2012 to amend their charters and submit them to the State Registry. *Accordingly, it is important to have your company charter reviewed and revised as soon as possible in order to be compliant with the new law.*

1. Personal liability of governing persons

Under Mongolian law, the personal liability of governing persons such as directors and the executive management was already relatively onerous compared to most developed jurisdictions? The duties and responsibilities of governing persons are broadly stipulated. The RCL contains what will be some further concerns for international investors since it not only widens the definition of governing persons, it also extends the scope of the duties and liabilities of such governing persons. Most importantly,

governing persons may now be held personally liable for failure to comply with their disclosure obligations (see further in paragraph 2 below).

2. Increased disclosure obligations

A governing person must disclose and submit a list of his/her affiliated persons to the company secretary within 10 days of his/her appointment as a governing person and thereafter notify the company of any changes within 10 days of such change.

Upon becoming a shareholder, a shareholder must give notice to the share registrar of its name, address and the number of securities it holds, thereafter must give notice of any additions or changes. A shareholder must also give notice to the company within 3 business days following the date that (a) another shareholder becomes an affiliated person of such shareholder or (b) jointly with its affiliated persons becomes an owner of a block of five percent or more of the company's shares. The definition of "affiliated persons" has been broadened so as to include employees, shareholders and sister companies.

3. Administrative sanctions for non-compliance

The RCL prescribes fines for non-compliance, including failure to comply with the various reporting, notification, registration and information disclosure requirements set out in the RCL. Fines can be levied on the companies themselves, the shareholders, and governing persons. Fines range from MNT 702,000 (c.US\$528) to MNT 5,616,000 (c.US\$4,222).

4. Stricter corporate governance rules

The RCL retains relatively light-touch corporate governance regulations for limited liability companies, but there are some changes that will need to be reflected in company charters. In particular, all companies, regardless of type, must hold their annual general shareholders' meetings within 4 months of the end of the fiscal year and must now discuss the previous year's financial results at this meeting. Failure to comply with this requirement results in an automatic freezing of the authority of the board and renders any transactions concluded in the intervening period void. This obviously has the consequence of penalizing innocent contracting counterparties. It is therefore essential that companies' hold their annual general meetings by 30 April or as soon as possible thereafter and those they check that their commercial counterparties have done so. Other changes that will need to be reflected in an updated company charter include changes to the procedure for calling shareholders' meetings and abolition of the requirement to have a supervisory board.

5. Changes in major and conflict of interest transactions

The "major" and "conflict of interest" transaction provisions of the old Company Law were notoriously confusing and the RCL does little to improve the situation.

Under the old Company Law, a major (i.e. over 25% of total asset value) transaction to be entered into by a company was subject to unanimous approval of the company board. If the board failed to approve the transaction unanimously, the major transaction could be approved by a majority of shareholders. A conflict of interest transaction was subject to approval of a majority of non-conflicted board members of the company and then the approval of a shareholders' meeting.

In 2007, in an effort to clarify the approval requirements under the old Company Law, the Supreme Court issued an interpretation which seemed to suggest that both major and conflict of interest transactions were subject to approval of both shareholders and the board.

The RCL did not introduce many changes in the approval requirements of major or conflict of interest transactions, and the above-mentioned Supreme Court interpretation is presumed to still be in effect. However, the RCL did clearly introduce a requirement that major and conflict of interest transactions be disclosed in a company's annual report.

Based on the Supreme Court interpretation, the cautious approach is to obtain the approval of both the board of directors and shareholders. However, in our view, a limited liability company with less than 10 shareholders should be able to use certain carve-outs to avoid engaging the statutory procedures in relation to carefully structured transactions.

6. Changes to minimum capital requirements

The RCL abolishes the minimum capital requirements for most companies, save for those operating in certain sectors and for business entities with foreign investment. Further, the RCL redefines share capital as the product of "all issued common and preference shares multiplied by their par value", and specifically excludes treasury shares from this definition. If this change in the definition alters a company's share capital as stated in its current charter, the charter must be amended to reflect the revised share capital amount.