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A Worldwide Review
Third Edition

Edited by
Alexander Loos



the global voice of
the legal profession®

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International Bar Association

The Global Voice of the Legal Profession



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the legal profession®

The International Bar Association (IBA), established in 1947, is the world's leading organisation of international legal practitioners, bar associations and law societies. The IBA influences the development of international law reform and shapes the future of the legal profession throughout the world.

It has a membership of over 55,000 individual lawyers and 206 bar associations and law societies spanning all continents. It has considerable expertise in providing assistance to the global legal community as well as being a source of distinguished legal commentators for international news outlets.

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The IBA GEI will become the leading voice and authority on global HR issues by virtue of having a number of the world's leading labour and employment practitioners in its ranks, and the support and resource of the world's largest association of international lawyers.

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Mongolia

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I NATIONAL BASICS

From 1924 until 1990, Mongolia was a socialist country and a member of the Soviet bloc. This ended in 1990, when the government of Mongolia elected to embrace a participatory democracy in the wake of peaceful protests by a broad spectrum of society. Since that time, the country did not receive much international attention. This changed in October 2009, when the government of Mongolia entered into an investment agreement with Rio Tinto and Ivanhoe Mines for the development of the Oyu Tolgoi copper reserves. The project brought Mongolia and its ample mineral reserves to the world's attention.

The legal system is modelled after the civil law system of continental Europe. Most Mongolian laws have been enacted since the 1990 democratic revolution, and as of January 2016, the Parliament of Mongolia has enacted nearly 560 statutes governing various aspects of business and social life in the country. The source for all Mongolian law is the Constitution, which was enacted in 1992. Mongolian constitutional courts consider whether legislative enactments or regulatory measures comport with the requirements of the Constitution.

Following the democratic revolution, the government permitted the establishment of private business enterprises in early 1991. The Company Law of Mongolia, revised by the Parliament on 6 October 2011 (the 'Company Law'), is the primary legislation that regulates the establishment, registration, and organization of Mongolian companies as well as their administrative, supervisory and financial structure.

The enactment of the revised Company Law was an important step towards the government's aim of bringing Mongolian corporate governance standards closer to those found in more developed jurisdictions. The law broadly regulates various aspects – from reorganization to obligations of shareholders – of companies operating in Mongolia and recognizes two types of companies: limited liability companies and joint stock companies.

The charter of a company is its main constituent document setting out the powers and limitations of a board of directors of the company ('Board').

The Company Law states that a charter must contain provisions which specify:

- the full name of the company;
- the location of the company's offices;
- the number of company shares and preferred shares, if any;
- the number of the members of the Board, if any;
- the authority to conduct meetings of the shareholders, the Board and the supervisory board;
- the business scope of the company; and
- any other matters relevant to the operation of the company.

The Legal Entity Registration Office of the National Registration and Statistical Office ('LERO') is in charge of business registration.

It is possible to register dual-language versions of the charter in Mongolian and a foreign language. The foreign-language version may prevail over the Mongolian version should there be a discrepancy between the two language versions.

There is considerable flexibility in drafting the terms of a charter and enumerating the powers of the shareholders and the Board. This flexibility relates to the Mongolian legal system's commitment to the freedom of contract. The World Bank Group's *Ease of Doing Business 2016 Index* ranks Mongolia at 56 out of 189 economies in the world.¹

[A] Three-Tiered Corporate Governance System

Mongolian companies have a three-tiered structure for corporate governance. These tiers consist of: (1) the shareholders; (2) the Board; and (3) the executive management.

The Company Law stipulates that the shareholders exercise the supreme authority of a company. During shareholders' meetings, the shareholders exercise the power to *inter alia*:

- revise the current charter of the company or adopt a new charter;
- approve the company's reorganization;
- convert company debt into shares or bonds; reissue shares and determine the number of the same;
- alter the form of the company's incorporation;
- liquidate the company and appoint a liquidation committee;
- divide or combine shares;
- elect members of the Board;
- elect or discontinue members of the supervisory board;

1. <http://www.doingbusiness.org/reports/global-reports/~ /media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB16-Chapters/DB16-Country-Tables.pdf> (Accessed on 30 January 2016).

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- undertake a pre-emptive purchase of shares;
 - determine the conditions for the purchase of shares;
 - approve reports submitted by the Board or the supervisory board;
 - approve major transactions;
 - approve conflict of interest transactions;
 - determine the salaries and benefits of Board members; and
 - any other matters set out in the charter of the company.

General meetings of shareholders are convened by the Board (or in its absence by the executive management). A quorum is established if shareholders holding more than 50% of all voting rights are in attendance. A resolution is passed if supported by a simple majority of shareholders with voting rights save for the first six matters above which require an overwhelming majority (two-thirds of voting shareholders). Extraordinary meetings may be held if called by the Board or shareholders holding 10% or more of the voting rights of the company.

The Board exercises the power to administer and operate the company at all other times within the framework of powers granted to it by the charter. The Company Law requires joint stock companies to have a Board, while it is possible for a limited liability company not to have a Board.

As set out in the charter, the Board's powers include:

- preparing the company's business plan;
- convening shareholders' meetings;
- presenting matters for discussion at shareholders' meetings;
- determining the market price of the assets of the company;
- appointing or removing the executive management of the company and determining their powers;
- entering into employment agreements with the executive management;
- appointing the auditor and determining its scope of activities;
- compiling reports on the company's annual business activities and financial reports;
- determining the issue of dividends;
- approving rules relating to the Board and the executive management, as well as cooperate governance matters; and
- drafting decisions for shareholders' meetings regarding the company's reorganization and implementing the decisions adopted at shareholders' meetings.

Members of the Board are legally obligated to act in the best interests of the company and are subject to a penalty for failure to do so. Members of the Board are not permitted to participate in decisions on matters where they have a conflict of interest.

Unless the charter stipulates otherwise, the Board holds monthly meetings. Extraordinary meetings of the board can take place if necessary. A quorum is established if two-thirds or more of directors are present.

The board renders its decisions in the form of resolutions by at least two-thirds of the directors attending the meeting. If the vote of the directors is split, the chairman of the Board has a casting vote unless such provision has been excluded in the charter.

[B] Chairman/Chief Executive Officer

In majority of the cases, Mongolian companies are run via the executive body rather than a board, and customarily through an Executive Director.

Unless otherwise stated in the charter, the Board elects its chairman by a simple majority vote. The chairman is responsible for organizing the activities of the Board and chairing its meetings.

An Executive Director is responsible for the day-to-day operations of the company. The Board (or in its absence, the shareholders) appoints the Executive Director who enters into service agreement that has been approved by the shareholders. The Executive Director represents the company and carries out his or her duties within the scope of authority granted by the Board. If preferred, the charter can divide the responsibilities of the Executive Director among several members of an executive management body. The Executive Director may be a member of a board, but not its chairperson.

The Executive Director may act on behalf of the company without a power of attorney within the limits of his or her authority. Details of the Executive Director should be registered with the LERO of Mongolia.

[C] Board Structure

The Company Law requires that a director must be a natural person with legal capacity. Such natural person does not need to be a shareholder of the company. There is no other specific requirement for a natural person holding the position of a director, except for the directors of companies operating in regulated sectors (banks or non-banking financial institutions). In those cases, the director must satisfy criteria demonstrating a professional qualification and a complete absence of criminal conduct.

Under the Company Law and other related legislation, certain entities must have independent board members ('IBM'). Joint stock companies and state-owned companies must have boards of not less than nine members, and one-third of these must be independent. If these companies do not appoint IBMs, the board shall not be able to exercise its rights.

[D] Directors' Elections

The Company Law states that the number of the directors of the board needs to be set out in the charter but otherwise leaves the precise number to the discretion of the shareholders. However, in the case of a joint stock (i.e., listed) company, there is a mandatory requirement that the Board consist of no less than nine members.

Unless the charter otherwise so provides, a director of a limited liability company is elected on the basis of the number of votes by the shareholders in attendance at a general shareholders' meeting. On the other hand, a director of a listed company is elected by a cumulative voting method. Under this method, a shareholder may vote for one member or may divide its vote between two or more candidates on a pro rata basis.

[E] Directors' Term of Appointment

Unless otherwise stated in the company's charter, the term of appointment for a director is one year, but this may be extended. If a director becomes incapacitated or dies, a replacement can be appointed for the remainder of the term until a new director is elected.

[F] Delegation

While Mongolian law does not expressly forbid the directors of a company from delegating their powers to third parties, it is an unsettled area of law whether such delegation constitutes a breach of a director's duties. The conservative view is that such delegation is questionable at best and unenforceable at worst.

[G] Removal of Directors

A director may be removed before the expiration of his or her term by resolution of an extraordinary meeting of shareholders. However, if the board was elected by the cumulative method, all directors of the board will have to be removed at that time.

II RECENT CASES DEALING WITH DIRECTORS' LIABILITY

Given the early stage of development of Mongolia's legal system and that fact only five years have lapsed since the adoption of the revised Company Law, there have been few cases involving the question of a director's liability regarding the operations of a company.

III JUDICIAL OVERVIEW

The Mongolian judiciary consists of a three-tiered structure with courts of first instance at the district or county level, appellate courts based at the provincial level, and the Supreme Court sitting in the capital. When compared with former socialist or quasi-socialist states in Asia, Mongolian courts tend to be independent of political institutions and are comparatively active in enforcing straightforward matters, such as payment claims and the like. Nevertheless, there continue to be concerns expressed about the

potential outside influence and the impartiality of local courts. As a civil law jurisdiction, adjudicated court cases do not have a *stare decisis* effect for subsequent cases.

Thus far, Mongolian courts have not taken a leading role in defining the liabilities of directors. However, Mongolia is a participatory democracy where public opinion matters. The heightened expectations of the populace for a fair distribution of the nation's mineral wealth is likely to result in this issue being brought before the judiciary in the future and in a tightening of standards as the extractive industries ramp up operations and profits.

IV CORPORATE GOVERNANCE

In Mongolia, corporate governance is beginning to get the public's attention. However, the level of understanding of the notion of corporate governance, as we view it, is very much dependent on the sophistication and exposure of companies to international markets or investors.

The level and maturity of corporate governance is a key indicator for potential investors. It is companies that have obtained financing or equity investment, particularly from international investors, which are more likely to be familiar with corporate governance principles. It is common for potential investors to conduct financial and legal due diligence. International organizations such as ADB, EBRD and IFC all of whom are active in the Mongolian economy require certain standards of corporate governance to be met.

Corporate governance matters in Mongolia are principally governed by the Company Law, Corporate Governance Codex (adopted by the Financial Regulatory Commission), the Securities Markets Law and the Banking Law.

The Corporate Governance Codex has been drafted in accordance with the guidance and advice of international organizations such as the IFC and the World Bank. For 'A' list joint stock companies ('JSCs') on the Mongolian Stock Exchange, compliance is mandatory pursuant to Article 20.1 of Securities Market Law. Other JSCs and ordinary limited liability companies are encouraged to comply. Its aim is to develop the Mongolian economy by establishing an investment-friendly environment.

In 2013, the IFC conducted a corporate governance assessment on the top twenty companies trading on the Mongolian Stock exchange, who scored an average rating of 27.5%.

According to the 2015 Report on Corporate Governance compiled by FRC, the Corporate Governance National Commission and Luxembourg Agency for Development Cooperation, some major statistics relating to corporate governance in 2014 are as follows:

- compliance rate of corporate governance of joint stock companies – 53.4%;
- compliance rate of corporate governance at commercial banks – 65.3%;

- compliance rate of corporate governance of other regulated sectors – 52.72 %;²
and
- compliance rate of corporate governance of state-owned entities – 73.1 %

Thus it appears that corporate governance in Mongolia is improving.

V LIABILITY ISSUES

[A] Who Can Be Sued?

Chapter 10 of the Company Law imposes on ‘governing persons’ of a company an affirmative duty to act in its best interests. Article 84 of the Company Law defines ‘governing persons’ to include the members of the Board, shareholders of a limited liability company that own more than 20% of the issued shares, the executive management, the chief financial officer, the general accountant, and other senior executive officers of the company.

The Company Law states that ‘a shareholder who, alone or in conjunction with its affiliated parties, holds more than 20 per cent of a company’s shares, or who otherwise has the power to control the management of the company, shall be personally liable for any loss incurred by the company resulting from his/her/its wrongful acts’.

Furthermore, the Company Law specifically provides that governing persons may be liable for the following intentional illegal actions and omissions:

- misuse of company name for personal gain;
- provision of false information to shareholders and/or, creditors or other persons having business relations with the company;
- omission of duty to report;
- failure to store company’s documents as required by the Company Law; and
- does not produce the information specified in Company Law to the authorized persons who have the right to receive the information, or produces it with undue delay.

[B] Who Can Sue?

A company may sue its members of the Board. However, it is rare in Mongolia for a Board to decide to sue one of its members for violation of duties, and therefore this remedy is not effective in practice. The Company Law provides for the right of shareholders to bring such a suit on behalf of the company. Under the Company Law, a holder of 1 % or more of a company’s common shares may file a claim with a court against a Board member and executive management of the company for any loss or damage caused to the company.

2. A median of non-bank financial institute, savings and credit cooperative, audit and insurance companies.

[C] ‘De Facto’ Directors

Unlike in some other jurisdictions, there does not exist a notion of de facto or ‘shadow’ directors as opposed to de jure directors. In practice, for smaller companies, a shareholder may act as both the shareholder and the executive director, or in some cases as a go-between for the actual management team and the other shareholder(s). In terms of larger companies, these structures are generally more clear.

[D] Thresholds and Limitations/Caps of Liabilities

While the Company Law sets out provisions regarding the liability of governing persons, including directors, it does not provide for a mechanism under which members of the Board can limit their liability. In practice, such limitation of liability of the members of the Board may be implemented by including relevant language in the company’s charter, internal regulations and/or contracts with Board member(s).

[E] Joint and Several Liability

Article 84.6 of the Company Law establishes personal liability for governing persons for their unlawful actions. Article 84.8 states that in the event the company has suffered a loss as a consequence of a resolution of the Board, those Board members who voted against such resolution or who did not participate in the meeting shall be freed from liability. Article 84.9 of the Company Law also acknowledges that liability can be jointly imposed.

[F] Derivative Actions

The Company Law does not provide for procedures under which a derivative action can be taken by shareholders of a company to bring a court claim. However, as noted above, a holder of 1% or more of a company’s common shares may file a claim with the court against a governing person of the company for any loss or damage caused to the company.

[G] Class Actions

Mongolian law does not contemplate class action suits, although shareholders may combine their claims before the court at the judge’s discretion.

[H] Relevance of Bankruptcy of Corporation

The Law on Bankruptcy (*‘Bankruptcy Law’*), enacted on 20 November 1997 governs the commencement and determination of bankruptcy proceedings and the restructuring or liquidation of an insolvent business entity. Under the Bankruptcy Law, a debtor

is considered insolvent when it is unable to fulfil its obligations in the amount equal to or higher than the value of 10% of its equity by the deadline specified by law or contract. A creditor's request for starting voluntary bankruptcy proceedings needs to describe the grounds for considering the debtor to be insolvent, proposals for restructuring or liquidation, and other provisions as specified in the Civil Code. However, due in part to the fact that the legislation has not been updated, there is little precedent on bankruptcy proceedings in Mongolian commercial practice. Individual bankruptcy is not recognized under Mongolian law.

VI INDEMNIFICATION

Governing persons are liable for 'losses' arising from a violation of the Company Law. The concept of 'losses' is defined broadly under Article 227.3 of the Civil Code.

Where a person has had his or her rights violated, he or she may claim losses, including expenses incurred by such a person to restore violated rights, actual monetary losses or damage to property, as well as lost profits.

Under the Civil Code, a person who has not performed an obligation or has performed it improperly is liable when there is fault (intentional or negligent), unless another basis for liability is established in a specific law or a particular contract. This liability standard applies to acts and omissions of governing persons. Accordingly, fault includes both negligent and intentional conduct.

VII DIRECTORS' AND OFFICERS' INSURANCE

As noted above, a company's charter may limit the personal liability of directors for monetary damages related to breach of duty. In practice, it is not common for domestic companies to enter into insurance policies offered by insurance companies that provide for protection in the event of any actual or alleged error, misstatement, omission, misleading statement, or breach of duty by the directors and officers of the company. However, we note that insurances for contractual and legal liability are included in the list of voluntary insurances permitted in Mongolia adopted by the Financial Regulatory Commission.

VIII OTHER METHODS OF PROTECTION

An agreement between the governing persons and the company could attempt to contractually limit the liabilities of the governing persons, but it is not clear whether such agreement would be legally enforceable.

IX LAWYER DIRECTORSHIP

Neither the Company Law nor the Law on the Legal Status of Lawyers establish any limits on the right of lawyers to act as directors of corporations and, in fact, both Mongolian and foreign lawyers have been appointed to the boards of Mongolian companies.

X FORECAST ON FUTURE LEGISLATION DEVELOPMENT

In general, the Company Law provides a rational and comprehensive corporate governance regime. There are currently no proposals for any material change to the regime or substantial amendments to the Company Law.