

Mongolian Strategic Foreign Investment Law - Update May 2013

We wish to update our clients on the implementing regulations on the *Law of Mongolia on the Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance* enacted 17 May 2012 ("the SFI Law"). As previously advised, on 2 March 2013, the Government of Mongolia adopted a resolution (resolution #75/2013) in respect of regulations regarding receiving and determining applications for approval submitted by business entities operating in sectors of strategic importance (the "SFI Regulations"). The SFI Regulations were formally published on the website of Foreign Investment Regulation and Registration Department of the Ministry of Economic Development ("FIRR", formerly known as "FIFTA").¹ The SFI Regulations are intended to augment the provisions of the SFI Law.

Hogan Lovells previously circulated a newsflash based on the presumed final version of the SFI Regulations. The official and conformed version of the SFI Regulations published on FIRR's website differs from final version in some respects. We have prepared a translation of the published version of the SFI Regulations which we include with this update.

The SFI Regulations

The SFI Regulations are on the whole similar to the drafts previously circulated. The main focus of the SFI Regulations is to describe the documents required and the approval procedure under the SFI Law.

Business activities within Strategic Sectors

Under the SFI Law, three sectors are identified as having strategic importance and the Law's scope extends to foreign investment in business entities operating in such sectors ("BESIs"). However, it was unclear under the SFI Law which business activities would be included in each strategic sector.

The SFI Regulations aim to clarify this situation by providing that the scope of business activities falling within a relevant strategic sector will be determined by Article 8.2 of the Value Added Tax Law. This provision in turn refers to the Classification of All Types of Economic Activities ("Classification") as adopted by order #103 of the Minister of Finance dated 29 April 2011. The Classification follows the International Standard Industrial Classification of All Economic Activities (ISIC) (revision 4) adopted by the United Nations.

¹ http://investmongolia.com/fiftanew/images/File/Strategy_juram.pdf

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While helpful in some respects, the Classification does not fully clarify the current uncertainty. For example, under the Classification there is no "minerals sector," rather it refers to mining, extraction and refining. It is therefore not clear where certain industries would fall. For example, it remains uncertain to what extent ancillary services to the mining sector would be considered by FIRR to fall within the relevant classifications and therefore be considered strategic.

Accordingly, if investors are unsure as to whether a Mongolian company operates in a strategic sector, we advise that clarification or confirmation is sought from FIRR on a case-by-case basis.

Approval Authorities and Application Documents

The SFI Regulations state that the Ministry of Economic Development ("MED") is in charge of receiving, reviewing, making recommendations on and/or decisions for applications submitted for approval under the SFI Law.

Article 2.1 of the SFI Regulations sets out the documents to be submitted in support of an application for approval. These include forms for completion of information on the parties, specifically on foreign investors and the transaction, copies of a BESIs registration documents, certificates of registration and reference letters for the foreign investors, draft transaction documents and financial statements of the relevant parties. The forms attached to the SFI Regulations that need to be submitted in support of an application require that a foreign investor disclose details of its ultimate beneficial shareholders by way of requiring that shareholders of "affiliated parties" and "third parties" of a foreign investor be named. Given that the SFI Law provides a broad and open-ended definition of "affiliated parties" and "third parties", it may be difficult to give specifics of some shareholders whose details are not readily available to some investors, such as listed companies.

It remains the case that the Mongolian BESIs itself rather than the proposed acquirer must submit the application for approval, which is not standard in international cross-border transactions. It further raises a procedural dilemma if the acquirer is looking to incorporate a greenfield BESIs.

The SFI Regulations require a tentatively-agreed form of the underlying acquisition agreements to be submitted for approval. This requirement is unusual. It would more comport with international practice if the parties were to submit fully

executed acquisition agreements which provided for the requisite SFI Law approval to be a condition precedent for closing of the transaction. There is the risk that the documents submitted for approval may differ from those actually signed. Further, there are confidentiality concerns as well as the prospect of the MED examining and commenting on commercial terms beyond its purview.

Application and Review Procedure

Upon receipt, the MED registers submission of the application and considers whether any of the circumstances set out in Article 7.3 of the SFI Law apply, such as whether the transaction is contrary to the National Security Policy. The MED may request further documents if it considers this to be necessary. Further, the MED may obtain comments and conclusions/recommendations from other state authorities for the application, such as the Ministry of Mining for minerals, the Bank of Mongolia for banking or the Information, Technology, Post and Communications Authority for telecommunications sector. In each case, the relevant state authority must respond to the MED within 14 days.

Timing

The SFI Regulations state that the MED must formulate and deliver its opinion as whether or not to approve the transaction within 30 days of receipt. The Cabinet, in turn, must deliberate the opinion within 7 days of receipt, and make a decision within 30 days. Once the application is determined, the MED must inform the applicant BESI within 5 working days.

Sanctions for non-compliance

The SFI Regulations reiterate the sanctions for non-compliance set out in the SFI Law, stating that offending transactions will be invalid and violators shall have their business operations discontinued and licences revoked.

Conclusion and potential developments

The SFI Regulations add little detail to the SFI Law, but by publishing the forms and information to be submitted with an application, they provide a platform for making applications. Further, FIRRD has confirmed it is now receiving applications under the SFI Law.

Various government officials have indicated that a new Investment Law is under discussion, with the intention of providing a favourable and enabling regulatory framework applicable to both foreign and domestic investment. We understand that if adopted, such new Investment Law could repeal the SFI Law and the Law of Mongolia on Foreign Investment enacted in 1993, which has regulated foreign direct investment in Mongolia since its adoption. However, there is no clear timetable for submission of the draft law to

Parliament and subsequent discussion and adoption. If enacted in the form proposed, the new Investment Law could substantially change the foreign investment regime in Mongolia. We will continue to monitor the situation and will issue an update as soon as further information is available.

Anthony Woolley
Senior Associate, Ulaanbaatar
anthony.woolley@hoganlovells.com
+976 7012 8904

Solongoo Bayarsaikhan
Associate, Ulaanbaatar
solongoo.bayarsaikhan@hoganlovells.com
+976 7012 8908

Contacts

Michael Aldrich
Partner, Ulaanbaatar
michael.aldrich@hoganlovells.com
+976 7012 1020

Chris Melville
Partner, Ulaanbaatar
michael.aldrich@hoganlovells.com
+976 7012 8910