

HARAGUCHI INTERNATIONAL LAW OFFICE

KDX Toranomom Building 9th F,
4-3, Toranomom 1-chome, Minato-ku,
Tokyo 105-0001, JAPAN
Phone: 81(3)6205-4404
Fax: 81(3)6205-4405
E-mail: kharaguchi@haraguchi-law.com

Offshore Loan to Mongolian Company

January 21, 2014

Haraguchi International Law Office
Kaoru Haraguchi

I. Loan Agreement

1. Language, Governing Law and Jurisdiction

Under the laws of Mongolia, a loan agreement can be written in any language, and the governing law and jurisdictional court (Tokyo District Court, Seoul District Court etc.) can be specified by the parties. However, neither Japan nor Korea guarantees the acceptance of judgment by Mongolian court at its domestic court. Therefore, judgment by Japanese or Korean court cannot be executed in Mongolia.

Nonetheless, Mongolia, Japan and Korea are all contracting state of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards¹ (“New York Arbitration Convention”), therefore the arbitral award obtained in Japan or Korea can be executed in Mongolia. In such case, it is necessary to include appropriate articles concerning arbitration in the loan agreement.

2. Maximum Interest Rate

Laws of Mongolia do not specify the maximum interest rate. However, extremely high interest rate can be lowered by courts at the request of the debtor (Article 282(2) of the Mongolian Civil Code).

3. Certified Copy of Commercial Registration and Articles of Incorporation

The Company Act and Corporate Registration Act of Mongolia stipulate commercial registration system, and certified copy of commercial registration can be easily obtained through permission of the company. Under the Company Act of Mongolia, creation of articles of incorporation is obligated upon the establishment of company. All Mongolian companies are obliged to renew their articles of incorporation in accordance with new edition of the Company act adopted in 2011. Articles of

¹ New York Arbitration Convention requires courts of contracting states to give effect to private agreements to arbitrate and to recognize and enforce arbitration awards made in other contracting states.

incorporation shall include the basic matters of company such as shareholders meeting or board of directors meeting.

4. Transfer of Debt, Reasons to Lose Benefit of Time, and Delinquent Charge

Under the laws of Mongolia, it is possible to transfer debts, which can be perfected by notifying the transfer. Reasons to lose benefit of time can be specified by a contract. Delinquent charge can be also specified by a contract, but over 50% of interest cannot be demanded under the Civil Code of Mongolia (Article 232(4) of the Civil Code of Mongolia).

II. Compliance

1. Regulation Concerning Offshore Loan

No regulation applies when a foreign company makes a loan to Mongolian company or individual. However, if the company makes a loan with currencies rather than tugrik, which is the only legal tender in Mongolia, the lender shall register at the Bank of Mongolia ex-post facto under the Foreign Currency Regulation Law of Mongolia.

2. Regulation Concerning Exclusion of Gang Group

There is no regulation concerning exclusion of gang group in Mongolia.

III. Corporate Dominance Relationship

1. Legal Requirements of Shareholders Meeting

In Mongolia, a company shall hold shareholders meeting annually. Shareholders meeting is called by a representative director based on a resolution of board of directors meeting. The convocation notice shall include the date and time of the meeting, agenda, availability of vote by power of attorney, due date of submission of power of attorney etc.

Resolution of shareholders meeting needs to be made with a majority of shareholders present and votes by a majority of present shareholders. As for the issues of great importance, the heavier requirements are stipulated with respect to a quorum and adoption of the resolution.

2. Consent of Shareholders Concerning Merger and Acquisition, Transfer of Business, and Disposal of Important Assets

Under Article 62 of the Company Act of Mongolia, the below matters requires a resolution of shareholders meeting.

- a) Amendment to the articles of incorporation
- b) Reorganization by corporate combination, merger and acquisition, corporate divestiture etc.
- c) Debt equity swap
- d) Liquidation of company and appointment of liquidator
- e) Division or consolidation of shares
- f) Appointment or dismissal of a Board director
- g) Establishment of supervising agency of board
- h) Giving first option to the outstanding shareholders
- i) Agreement on major transactions
- j) Agreement on conflict-of-interest transactions
- k) Agreement on purchase of treasury stock which comply with the Company Code of Mongolia
- l) Agreement on the amount of salary or compensation of directors, or agreement on the amount stipulated in the Articles of Incorporation.

IV. Preservation

1. Requirements to create security or pledge over shares

The Company Code of Mongolia does not clearly stipulate security or pledge over shares. Even if the company issues a certificate of share, delivery of the certificate does not ensure the efficacy of security or pledge over shares (Article 146(2) of the Company Act of Japan), and possession of the certificate does not perfect the share pledge (Article 147(2) and (3) of the Company Act of Japan). In addition, laws of Mongolia do not stipulate the system which allows the pledgee to register its name, address and the subject shares of the pledge (Article 148 of the Civil Code of Japan).

Former practice was that share pledge agreement was filed at the registration office, share transfer agreement and shareholder-right, duty transfer agreement were concluded, and the transfer of shares was registered upon the enforcement of the share pledge by a court decision. However, due to the lack of clear provision, the registration office recently tends to refuse the filing of share pledge agreement.

Mongolian companies are categorized into public company and closed company. Articles of incorporation of closed company often include the names of shareholders. In such case, transfer of shares as a result of enforcement of security over shares requires the amendment to the Articles of Incorporation of the company. Without such resolution, registration of the transfer of shares cannot be accepted.

When a company creates a collateral sharing agreement or share pledge agreement with respect to international loans, laws of foreign countries rather than Mongolia are usually specified as a governing law. Recently, laws of Hong Kong are specified as governing law in an international loan transaction in which we were involved as lawyer of the creditor. Under the International private law of Mongolia, it is valid to specify laws of foreign countries rather than Mongolia as governing law of a collateral sharing agreement or share pledge agreement. Hypothecs regarding a real estate located in Mongolian territory shall be under exclusive jurisdictions of Mongolian laws and courts.

2. Regulation on foreign company which intends to create security over shares of Mongolian company / Regulation on foreign company which intends to enforce or dispose security over shares of Mongolian company

Mongolian Parliament enacted the New Law on Regulation of Foreign Investment in Business Entities Operating in Sectors of Strategic Importance (“SFI Law”) in order to prohibit Chinese state-owned companies from purchasing important foreign company which holds the right to mine Oyu Tolgoi. SFI Law stipulates strict rules regarding foreign investment in business entities operating in sectors of strategic importance such as mining sector, finance and banking sector, and media, information and communication sector.

Under the SFI Law, acquisition of shares of the companies in sectors of strategic importance requires a permission of Mongolian government. Acquiring such permission took a long time, and the requirements were not clear. Based on the referral we made, acquisition of share includes the creation of security over share by way of assignment or share pledge. Therefore, the permission of Mongolian government is required not upon the execution but upon the creation of security or pledge.

As such regulation dampened the foreign investment towards Mongolia, Mongolian government enacted the New Investment Law in September 2013 and abolished the SFI Law (Articles 1 and 2 of the Act on Abolishment of the SFI Law). The New Investment Law was enacted as of November 1, 2013 (Article 24(1) of the New Investment Law), and a foreign company which intends to create a security over shares of Mongolian bank is no longer required to obtain permission from the Government. In case where a company acquires over 5% of shares of Mongolian bank as a result of enforcement of share pledge, however, prior permission from the Bank of Mongolia is required under the Banking Law of Mongolia.

3. Personal joint and several guarantee by representative director

When a foreign company makes a representative director of the Mongolian borrower as a personal joint and several guarantor of the debts held by the Mongolian borrower, it is not required to create a consideration with respect to the guarantee agreement. Creation of deed and registration at the registration office are not required, either. However, the guarantee agreement shall be created in writing, and the maximum amount of the guarantee needs to be specified (Article 459 of the Civil Code of Mongolia).

V. Default

1. Definition and Type of Bankruptcy

According to Article 62 of the Civil Procedure Code of Mongolia, the debtor whose debts exceed the assets is allowed to file a petition for bankruptcy or liquidation by presenting the evidence of excessive liability, or file a petition for corporate revitalization or regeneration by submitting corporate revitalization or regeneration plan.