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Key Adjustments Proposed by the Draft Insolvency Law of Mongolia

The Parliament of Mongolia has passed a policy document regarding “the General Directory to Improve and Update the Regulations of Mongolia until 2024” in 2021 through its resolution No.12. According to this policy document, it is pursued to revise the Bankruptcy Law of Mongolia (hereafter referred to as the “**Current Law**”), which was initially passed in 1997 and still in effect, amongst many other laws and regulations within 2021.

A draft of the Revised Bankruptcy Law was initially prepared in 2019 and was modified upon public hearings amongst the public, experts, lawyers, and judges. Subsequently, the revised draft law was renamed to the Insolvency Law (hereafter referred to as the “**Draft Law**”). Currently, the Draft Law is at the stage of another public hearing and has not yet been introduced to the Parliament of Mongolia for approval.

Purpose of the Draft Law

The Draft Law is aimed at having a great positive impact on decreasing potential risks of investors or lenders and stabilizing the financial system by improving the legal background of financial infrastructure.¹

Introduction

The Draft Law was prepared based on the Bankruptcy Code of the UNCITRAL Model Law on Insolvency of 2004.² Its purpose is to clarify and regulate relations about the determination of insolvency of a legal entity, court process in insolvency proceedings, commencement of insolvency proceedings, claim reliefs and their satisfaction, appointment and release of a trustee and his/her authority, creditors’ meeting and its power, mediation, restructuring and refinancing an insolvent legal entity, and liquidation.³

Key adjustments proposed by the Draft Law

1. Scope of the Draft Law:

Due to the specific characteristics of the banking system, and insurance and non-banking financial institutions, their insolvency matter is regulated by their specific law, while the general insolvency issue is regulated by this law.⁴ The Civil Procedure Law remains to regulate relations that are left unregulated by this law.

Furthermore, this law has replaced the terminology of “defendant” which was defined under the Current Law with “debtor”.

¹ The Concept of the Draft Law;

² *Id.*

³ The Introduction of the Draft Law;

⁴ *Id.*

2. *Insolvency test:*

The Current Law	The Draft Law
To determine insolvency of a legal entity, the Current Law takes into account when the legal entity is unable to pay its debts which equal to more than 10% of the value of its assets as they fall due according to the law or contract. ⁵	The Draft Law has replaced the Current Law's test with the most prevalent forms of corporate distress assessment applicable internationally which is a combination of the cash flow and the balance sheet tests. ⁶ According to the Draft Law, a legal entity is insolvent when it is unable to pay its debts for more than 6 consecutive months as they fall due under the law or contract; or if its reported liabilities exceed 50% of the book value of its assets as listed on the conventional balance sheet. ⁷

3. *A creditor's claim:*

The Current Law did not specify the procedure of verification of creditors' claims and it led to a negative practice where creditors could unreasonably increase the value of their claims. To prevent from such negative practice, the Draft Law specifies the procedure for submission, verification, and satisfaction of a claim.⁸

№	The ranking of claims which is not specified under the Current Law is regulated by Article 32.5 of the Civil Code as follows. If assets of a legal entity being liquidated are not sufficient to pay off the debts, they must be distributed to its creditors on a pro-rata basis which is proportional to the debt due.	The Draft Law specifies the ranking of claims as follows. If the distributable assets of a legal entity being liquidated are not sufficient to pay off the debts, they must be distributed to its creditors of the same rank on a pro-rata basis. ⁹
1	payments to eliminate harm done to the life and health of others, tax payments, and other payments ordered by the court decision;	payments to eliminate harm done to the life and health of others and the environment can be compulsorily enforced independently;
2	operation costs incurred by a trustee, liquidation committee, and other similar parties within the given authority;	costs of insolvency proceedings;
3	claims incurred under agreements or arrangements which are executed during the refinancing of a defendant in the mid of bankruptcy proceedings;	

⁵ The Current Law, Article 4.1;

⁶ The Introduction of the Draft Law;

⁷ The Draft Law, Article 22.1;

⁸ The Introduction of the Draft Law;

⁹ The Draft Law, Article 84.1;

4	indemnification of a mandatory savings insurance plan;	
5	savings deposit;	
6	salary of employees employed under the employment contract;	salary, benefit, social insurance, health insurance, and other additional payments agreed under the employment contract and collective agreement;
7		other payments incurred after start of insolvency proceedings to refinance and/or restructure the debtor;
8		secured claims;
9		unsecured claims
10		unpaid part of the secured claim due to a difference in the value of a pledge;
11		lower-ranking claims ¹⁰ ; *** The lower-ranking claims may be satisfied if the court decision approving the start of an insolvency case permits such lower ranking claims. The lower-ranking claim means an obligation without a bargained for exchange; costs incurred by creditors while participating in the insolvency proceedings; and loans granted by the shareholders or similar claims.
12		after satisfying the claims or debts mentioned above, the leftover must be distributed in proportion to the shareholders' shareholding. ¹¹
13	payments to the others as defined under the laws.	

4. Trustee requirements:

A trustee is not required to be licensed under the Current Law. On the contrary, the Draft Law requires a trustee, which can be either an individual or a legal entity, to be licensed from the Ministry of Justice and Homeland Affairs. Also, in order to enhance the credibility and accountability of trustees, the Draft Law enables the courts to refuse to appoint or release a trustee if there is any suspicion of conflict of interest.

5. Existing contracts or agreements:

The Current Law states that the court may modify or terminate the existing contracts or agreements which are yet to be completed or a majority of which is not completed upon a request by the

¹⁰ The Draft Law, Article 40;

¹¹ The Draft Law, Article 84.3;

№	Contracts or agreements made by the debtor	Debtor's performance
1.	Other monetary obligations except payments to eliminate harm done to the life and health of others and the environment	To be suspended.
2.	Agreement made at rates specified by the stock exchange according to a specific schedule	If the performance is required after the start of insolvency proceedings, the performance cannot be demanded, but real losses incurred due to non-performance can be obtained.
3.	Unsecured transaction to purchase a movable property	If the payment has not yet been paid and the ownership right has not been transferred after acquiring possession of the property according to the transaction, a trustee must decide whether to pay the consideration payment owed by the debtor. ¹³
4.	Movable property purchase agreement	The purchaser who has paid the payment may demand the debtor to transfer the property's ownership right if the debtor sold a property by transferring its possession at first and preserving its ownership until the price is paid in full prior to the commencement of insolvency proceedings. ¹⁴
5.	Lease of immovable property or office, or service agreements	The contractual performance by the debtor should resume if the value of the debtor's distributable assets increases as a result of such agreement. ¹⁵ Otherwise, it must be terminated.
6.	Lease agreement of immovable property or office entered into by the debtor as a lessee	A trustee may cancel the immovable property lease agreements entered into by a debtor as a lessee in accordance with the contractual termination procedure stipulated under the Civil Code regardless of the notice period required under the agreement. ¹⁶
7.	Service agreement	A trustee or the other party of the agreements may terminate the service agreement entered into by the debtor as a customer regardless of otherwise stipulated under the agreement. ¹⁷
8.	Any task agreement pertaining to the distributable assets	Such agreement is to be terminated upon the start of insolvency proceedings. ¹⁸

¹³ The Draft Law, Article 64.1;

¹⁴ The Draft Law, Article 64.3;

¹⁵ The Draft Law, Article 65.1;

¹⁶ The Draft Law, Article 66.1;

¹⁷ The Draft Law, Article 66.6;

¹⁸ The Draft Law, Article 67.1;

Termination of insolvency proceedings: upon final distribution of the distributable assets, the court orders to liquidate the debtor and terminate the insolvency proceedings. Pursuant to the court's decision, a trustee must arrange the debtor's de-registration with the tax office and the state registration authority. However, the Draft Law omitted to reflect the Current Law's regulations regarding termination or release of the debtor's obligation to the creditors upon the termination of the insolvency proceedings.

Discontinuation of insolvency proceedings: insolvency proceedings may be discontinued due to short of the distributable assets, or no basis found to start the insolvency proceedings in the first place, or with the permission of the creditors. Upon discontinuation, the equity rights are shifted back to the debtor from a trustee.

9. Restructuring and refinancing:

The Draft Law separates "refinancing" and "restructuring" as two different concepts while the Current Law only defines a concept of "refinancing". According to the Draft Law, a restructuring plan, which can be prepared by either of the parties defined under the law, must be approved by the court to start the restructuring process. A trustee is in charge of monitoring the implementation of the plan and may send its proposal to distribute the debtor's distributable assets and liquidate it if it is no longer possible to execute the plan. On the other hand, the Draft Law defines refinancing as an investment in an insolvent legal entity after the start of the insolvency proceedings. However, the details on how to attract investment or available legal remedies to the debtor are still left unclear and unregulated.

According to the Current Law, refinancing must be carried out within 2 years.²⁵ However, the Draft Law does not impose a strict time limit and sets it more flexible that the default time period for restructuring is 2 years which can be extended up to 6 months each time by the court or within the time period approved by the creditors' meeting.²⁶

Furthermore, if there is any difficulty executing the restructuring plan caused due to the sale of the distributable assets, the court may suspend the sale upon a request by the debtor or a trustee according to the Draft Law. If such suspension creates a detrimental impact on the distributable assets or the board of the creditors or the creditors' meeting gives permission, the court may order to resume the sale of distributable assets upon a trustee's request pursuant to the Draft Law.²⁷

The court may dismiss the case and terminate the debtor's obligation before the creditors and restore the debtor's operation back to normal if the restructuring plan is completed or the claims are satisfied prior to the completion of the plan.²⁸

²⁵ The Current Law, Article 25.1;

²⁶ The Draft Law, Article 104.1;

²⁷ The Draft Law, Article 106;

²⁸ The Draft Law, Article 117.3;

10. Mediation process:

The whole chapter of the Draft Law is dedicated to regulating mediation in pre-insolvency proceedings. For example, a court-appointed mediator prepares a mediation plan and the court approves the plan with the consent of the creditors; because the creditors monitor the implementation of the plan, they may request the court to terminate the mediation and start insolvency proceedings and etc.

11. Conclusion:

In general, the Draft Law omitted personal insolvency issues and could not provide sufficient legal remedies supporting the debtor's refinancing process which is conducted as part of a restructuring. It is still unclear whether obligations of the debtor and of its shareholders or members are terminated or released after the completion of insolvency proceedings depending on a type of the legal entity.