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Report on Assessment of Draft Bankruptcy Law

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ABBREVIATIONS AND ACRONYMS

BELTAC	Banking, Enterprise, and Legal Technical Assistance Credit
BOM	Bank of Mongolia
BPI	Business Plus Initiative
EBRD	European Bank for Reconstruction and Development
IMF	International Monetary Fund
MOF	Ministry of Finance
MOJHA	Ministry of Justice and Home Affairs
NLI	National Legal Institute
UNCITRAL	United Nations Commission on International Trade Law
USAID	United States Agency for International Development
WB	World Bank

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EXECUTIVE SUMMARY

This report is based on interviews, review of international documents, analysis of existing bankruptcy law, and analysis and commentary on a draft bankruptcy law (the Draft Law) conducted over approximately three weeks within the context of the USAID-funded Business Plus Initiative (BPI) in Ulaanbaatar Mongolia in September 2011. The overall mission of BPI is to help Mongolia improve its credit standing relative to the rest of the world by improving access to lower interest rates, generating better allocation of resources, improving the attractiveness of investment projects, and increasing levels of domestic and foreign investments.

The BPI Workplan states:

> *The creditworthiness of Mongolia will improve if the country follows a set of strategic initiatives with the assistance provided by BPI, including: (a) Improving the ability to meet debt obligations; (b) Improving budget policy and budget formulation at the Ministry of Finance; (c) Improving public debt management by the MoF; (d) Reducing sensitivities to external economic shocks; (e) increasing the liquidity and stability of the financial markets. These and other relevant policies will strengthen the financial infrastructure and improve financial markets depth and breadth, with new financial instruments.*

Part of the effort to achieve these objectives includes assisting with the analysis and improvement of the commercial law framework, including Mongolia's bankruptcy law.

The investigation and assessment covered by this report are part of BPI's initial contribution to bankruptcy reform.

An annotated version of the Draft Law containing the comments of BPI's bankruptcy experts is available as a separate document.

SECTION I: BACKGROUND

The Role of Bankruptcy in Commerce

In the modern economy, the creation, operation, and expansion of enterprises of all kinds (non-profits, MSME's, large commercial corporations) are financed to a significant degree through borrowing and lending. A prudent lender will want to know whether she can trust the borrower to repay the loan, in effect asking, "Is the borrower able to pay it back? Does she intend to do so if at all possible?" In some countries, commercial lenders capture these trust questions with the three C's of lending: Collateral, Cash Flow, and Character.

1. Is the collateral worth at least the amount of the loan plus potential collection costs?
2. Does the borrower have sufficient discretionary income with which to make the loan payments?
3. Do I believe that the borrower has a sufficiently strong moral character or other incentive to make a good faith effort to repay the loan if at all possible?

If all goes well, the borrower will be willing and able to repay the loan.

But all does not always go well. Illness, unforeseen business problems, downturns in the economy, death, poor financial management, inadequate capitalization, and other problems lead to failed enterprises, leaving owners unable to pay their debts. The borrower defaults.

In such cases, the lender needs to be able to recover and liquidate its collateral quickly at minimal expense, in effect adding a fourth C to the troika above: Collection. Can I seize and sell the collateral if there is a default?

Knowing that some borrowers will fail and not be able to pay their loans in full, prudent lenders will ask at least two questions before going into the lending business:

1. Is the collateral, when liquidated, worth at least as much as the likely balance of the loan plus any additional expenses I incur?
2. Does the legal system provide a reliable procedure with which I can recover and sell the collateral quickly?

> "A creditor's ability to take possession of a debtor's property and to sell it to satisfy the debt is the simplest, most effective means of ensuring prompt payment. It is far more effective than the threat of an insolvency proceeding, which often requires a level of proof and a prospect of procedural delay that in all but extreme cases make the threat not credible to debtors as leverage for payment."
>
> World Bank, Principles For Effective Insolvency And Creditor Rights Systems 4 (Revised, 2005).

To provide the needed assurance for lenders, the legal system must enable lenders to obtain and enforce a judgment against a defaulting debtor that allows the lender to seize and sell the collateral within a reasonable time. Moreover, the overall economy needs the expeditious enforcement of judgments in order to return business assets (buildings, machinery, equipment, the knowledge and skills of employees, intellectual property) to productive uses.

But what if the borrower is indebted to several creditors at the same time? What if the same collateral has been pledged to more than one creditor? Should the first creditor to get a judgment be allowed to sell the collateral even though the claims of other creditors might be satisfied out of the proceeds as well?

This is the collective action problem that creditors (and potential creditors) face. If there is no solution to it, many potential lenders simply will not lend. They will not take junior positions

on collateral, and they will not make unsecured loans, because they must assume that the first creditor will get the value of all the available collateral, leaving none to cover their loans.

The absence of a viable collective debt collection system, therefore, impedes commercial development. Borrowers cannot borrow efficiently because prudent lenders will not lend unless they have a first security interest in the available collateral.

"Secured transactions play an enormously important role in a well functioning market economy. Laws governing secured credit mitigate lenders' risks of default and thereby increase the flow of capital and facilitate low-cost financing. Discrepancies and uncertainties in the legal framework governing security interests are the main reasons for the high costs and unavailability of credit, especially in developing countries." World Bank.

A properly functioning bankruptcy system solves this collective debt collection problem. It provides a process in which the claims of multiple creditors can be addressed equitably and expeditiously. In addition, it makes it possible to return otherwise dormant business assets to productivity quickly and efficiently.

If such a system is not in place, some potential lenders will not lend, some potential businesses will not be created or expanded, and the economy will not be as vibrant and healthy as it could be. Some potential entrepreneurs will not be able to start or grow a business. Potential wealth will be lost.

Summary of Some Key Impediments in Mongolian Commercial Law[1]

Mongolia has a legacy of an economy dominated by state-owned enterprises. Part of this legacy is the absence of a modern commercial legal system, of which a functioning bankruptcy system is a part.

Although some progress has been made since 1991, the following gaps still impede optimal lending:

1. There is no system for registering security interests in movable property (vehicles, machinery, intellectual property, trademarks, office equipment). The absence of this system effectively eliminates movable property as collateral for loans.
2. There is no central bureau from which lenders may obtain reliable information on the repayment histories of potential borrowers. As a result, lenders have an inadequate basis for making judgments about the third C (character) or creditworthiness of the borrower. They also have no way of getting objective information on the existence of other loans the borrower may need to repay. This makes lenders overly dependent upon personal relationships and subjective opinion.
3. The procedures for foreclosing on mortgages and obtaining judgments against defaulting debtors take 1-2 years, followed by an enforcement process that is both lengthy (2 years or more) and uncertain. Among other things, this dysfunctional legal procedure causes banks and other institutional lenders to demand significantly more collateral to secure repayment of a loan than otherwise would be the case. This leads to a sub-optimal use of assets as a funding resource.

[1] Note: The factual statements contained in this and the following sections are based in part on a small number of interviews conducted with bankruptcy trustees, lawyers, and representatives from two banks. Other information has been gleaned from reports published by the European Bank for Reconstruction and Development ("EBRD"), the World Bank, the United Nations, and the World Trade Organization.

4. The existing bankruptcy law is cumbersome, incomplete, and time-consuming. It does not meet the standards articulated by the United Nations Commission on Trade Law Legislation or those of the World Bank. Commercial lenders seldom use it. And the lack of a good bankruptcy law is a further impediment to lending by junior secured creditors, trade creditors, and other unsecured creditors.

There is almost no unsecured trade credit available in Mongolia.

Banks do not make loans secured solely by personal (movable) property.

History of Bankruptcy Law Development in Mongolia

A bankruptcy law was created in 1991, under which at least one bankruptcy case was filed.

A new law was put in place in 1997, which is still in effect ("Current Law"). Approximately 85 bankruptcy cases have been processed under this law, including one successful and a handful of attempted reorganizations. The Current Law was adopted in the same year that Mongolia became a member of the World Trade Organization.

Training

In 1999-2000, the World Bank sponsored a series of activities, including two training programs for of lawyers, judges, and accountants. The training programs were organized by World Bank BELTAC (Banking, Enterprise, and Legal Technical Assistance Credit). The first training lasted 21 days and was delivered to legal officers of banks, defense lawyers, and judges. The second training targeted entrepreneurs and lawyers and lasted 7 days.

Approximately 60-70 Mongolians participated in the trainings. Judges and even regional judges were invited. The institute of Economics hosted about 40.

The BELTAC trainings covered implementation and usage of the 1997 law. Several experts from the US came to conduct this training.

The Institute of Finance and Economics undertook a similar training, in which accountants and economists participated. Another training program in 2001 involved attorneys.

Ancillary Materials

BELTAC published a handbook for bankruptcy Trustees in 1999, which is out of print and rare. The handbook has two parts: Part 1 is a set of guidelines for trustees. Part 2 is the translation of the IMF recommendations for the system of effectively and efficiently resolving insolvency of corporate entities.

The BELTAC project together with the Ministry of Justice and the Association of Bankruptcy Trustees released a short film about bankruptcy, which was broadcast on television in 2000. The Minister of Justice may have a copy of this film.

There may be some additional materials at the Ministry of Justice from this period.

The Association of Bankruptcy Trustees

The Association of Bankruptcy Trustees was established in 1999. Until 2004, it was quite active in its scope of responsibilities. It conducted training and public education work concerning bankruptcy. The Association provided licenses of trustees in 2001. This was before the law on licensing of economic activity.

The Association of Bankruptcy Trustees has little power. It lacks proper financing, staff, and facilities. There is no legal expertise to maintain such an organization.

Because of the absence of a proper legal framework, no more licenses were issued. 11 people received licenses, mainly judges, prosecuting attorneys, legal officers of banks, and several professors. All of these people had received the World Bank training in 1999.

The law on licensing contains no provision on the licensing of trustees. But the bankruptcy law allows accountants etc. to work as bankruptcy trustees, and probably they do so. But the association has licensed only the original 11.

The bankruptcy law allows accountants, lawyers, and economists to work as bankruptcy trustees, and probably they do so. But the association has licensed only the original 11.

The Working Group is trying to develop regulations to make trustees licensed officials in the bankruptcy process.

The Association of Bankruptcy Trustees has 37 members, but because of the weak status of the association, most are not active in the association work. Most have direct employment elsewhere.

One becomes a member by submitting a written request to join, and that will probably be sufficient provided the applicant can demonstrate the necessary professional credentials (law license, accountant).

Level of Professional Expertise in Bankruptcy Law and Practice

Overall the knowledge of the bankruptcy system is low. For example, judges do not have an understanding of economic activity. In practice, most proceedings end with liquidation.

Sometimes there are companies that have been inoperable for 5-10 years and only after 5-10 years does someone open a bankruptcy case. It is almost meaningless to pursue it at this point. And the bankruptcy trustees have little interest in handling such cases because there is no value in the estate.

Bias toward Liquidation Rather Than Reorganization

Most judges approach the case from the perspective of providing an immediate payout to creditors and, therefore, have a bias toward liquidation. Some interviewees believe, however, that it often would be much more useful to have the entity continue in business.

The Current Law contains no clear procedure on how to propose or manage a reorganization. Only a handful of reorganizations have been attempted.

Priorities among Claims

Parties to a bankruptcy case are treated inequitably, and this creates discrepancies. In a liquidation under the Current Law, administrative fees and expenses are paid before secured claims. Then secured creditors are paid from the proceeds of the sale of their collateral.

But the civil code provides that damages must be paid first and then the claims of the creditors. For that reason, according to one interviewee, the secured creditors have little interest in filing bankruptcy cases.

The civil code supersedes the bankruptcy law. Several interviewees expressed the view that the new bankruptcy law should provide a separate procedure for bankruptcy proceedings in terms of prioritizing the claims of creditors.

Protection of Estate Assets

Under the Current Law, the debtor is not held accountable for the protection of estate assets following the filing of the bankruptcy petition. There is no preliminary procedure for protecting the assets. [The Draft Law attempts to address this problem in several articles and a chapter on conservatorship.]

Under the Current Law, the trustees have the power and authority to protect the assets, but they are unable to exercise this power in practice because of the expense of such activities. For example, moribund companies have no resources to pay for such protection. The source of financing such expense is unclear. For example, it is unclear how a trustee would pay for a guard.

Efforts to Reform the Bankruptcy Law

In 2002, the Ministry of Justice convened a Working Group to begin the process of revising the Current Law. The composition of this Working Group has changed several times in the subsequent 9 years, with each new group producing its own version of a draft law. The current Working Group has been working on the Draft Law for about one and one-half years.

The current Working Group consists of the following people:

1. G. Bayasgalan – the state secretary of the Ministry of Justice and Home Affairs (MOJHA)
2. C. Colmon – the chief of the legal policy department (MOJHA)
3. B. Undrah – the judge of the Supreme Court
4. T. Jambaajamc – the securities inspector of the Financial Regulatory Commission (FRC)
5. E. Ulambayar – the senior supervision inspector of the Bank of Mongolia (BOM)
6. T. Delgerhüü – the official of the legal department (BOM)
7. J. Mayzorig – the chief of the internal supervision department at the State Agency of General Registration
8. S. Ölziybayar – the deputy chief of the capital city's court decision enforcement agency
9. D. Undral – the executive director of the National Association of Bankruptcy Trustees and officer of Xac Bank.
10. J. Oyuntungalag – the official of the legal policy department (MOJHA). Mrs. Oyuntungalag is the recording secretary.

The Draft Law consists of 144 articles in 15 chapters. It is discussed in Part II of this report.

> "The legal framework for secured lending should address the fundamental features and elements for the creation, recognition, and enforcement of security interests in all types of assets—movable and immovable, tangible and intangible—including inventories, receivables, proceeds, and future property and, on a global basis, including both possessory and non-possessory interests." World Bank

SECTION II: ANALYSIS OF DRAFT LAW

This section evaluates the draft bankruptcy law in light of

a) international standards on its solvency legislation in transition economies (UNCITRAL, World Bank),
b) knowledge about other aspects of the commercial law in Mongolia, and
c) comments by people interviewed in connection with preparing this report.

UNCITRAL Standards

In 2004, the United Nations Commission on International Trade Law (UNCITRAL) published a comprehensive legislative guide on insolvency laws, intended to serve as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations.[2]

The following table sets forth the UNCITRAL's list of substantive standards for an insolvency law and matches provisions in the Draft Law to those standards, providing an opinion about the adequacy of the relevant article in the Draft Law and suggesting a proposed course of action for addressing perceived deficiencies.

> "[Insolvency] systems should aspire to: (i) integrate with a country's broader legal and commercial systems; (ii) maximize the value of a firm's assets and recoveries by creditors; (iii) provide for the efficient liquidation of both nonviable businesses and businesses whose liquidation is likely to produce a greater return to creditors and reorganization of viable businesses; (iv) strike a careful balance between liquidation and reorganization, allowing for easy conversion of proceedings from one proceeding to another; (v) provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors; (vi) provide for timely, efficient, and impartial resolution of insolvencies; (vii) prevent the improper use of the insolvency system; (viii) prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgments; (ix) provide a transparent procedure that contains, and consistently applies, clear risk allocation rules and incentives for gathering and dispensing information; (x) recognize existing creditor rights and respect the priority of claims with a predictable and established process; and (xi) establish a framework for cross-border insolvencies, with recognition of foreign proceedings."
>
> World Bank, Principles For Effective Insolvency And Creditor Rights Systems 6 (Revised, 2005).

[2] A copy of the UNCITRAL Legislative Guide on Insolvency Law is available at the UNCITRAL website: http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html.

Table of UNCITRAL Standards and Draft Law

UNCITRAL Standard	Draft Law	Adequacy of Draft	Proposed Action
Who may be a debtor (U-20a)	Article 3	Adequate (but cross-border insolvency should be a separate chapter)	Create cross-border insolvency chapter
Type of proceeding that may be commenced (U-20b)	Article 1.1 and implicit in articles dealing with reorganization and liquidation	There should be an article or clause that states the types of proceedings explicitly	Draft article to be inserted in ____
When proceeding may be commenced (grounds for) (U-20b)	Article 5	Adequate	No action
Who may initiate a bankruptcy case (U-20b)	Article 7, Article 40	Adequate	No action
Whether criteria for initiating case should differ depending on who initiates it (U-20b)	Not addressed	This does not seem to be a problem.	No action
Extent of debtor control over assets (U-20c)	See Article 68 and Article 70 [In chapter on conservatorship]	Inadequate. [Implies but does not state that management retains control unless the Temporary Trustee requests removal.] The problem here is that the management and the trustee may be in conflict over the operation of the business. It is not clear who wins.	Draft article for insertion earlier in law stating that management retains operational control of the business unless temporary trustee requests removal.
Identification of assets of bankruptcy estate (U-20d)	Article 18	Adequate	No action
Automatic stay (U-20e)	Article 81-82	Taken together, both articles are mostly adequate. There is no provision for lifting the stay, however.	Add an article spelling out the conditions under which a creditor may request and receive relief from the stay.
Executory contracts (U-20f)	Article 23.1.4	Inadequate	Draft executory contract provision
Set off rights (U-20g)	Not addressed	Inadequate	Add article dealing with setoff rights.
Powers of trustee to use or dispose of assets (U-20h)	Article 23.1.1-23.1.2; 23.1.10	Adequate	No action
Powers of trustee to avoid fraudulent	Articles 23-24	Adequate	No action

conveyances (U-20i)			
Powers of trustee to avoid preferential transfers (U-20i)	Uncertain. The catchall provision in 77.1.6 may cover this as may be the case with 77.5	Could be improved	Draft article on avoidability of preferential transfers that makes this provision clearer. Change “six months” to 180 days.
Conditions on plans of reorganization (U-20j)	Article 8.1.2 (cf. Article 71, 75.2). Chapter Eight, Article 84	Adequate	No action
Rights and obligations of debtor (U-20k)	Article 41 (duty to initiate BK case) [Note Art. 42 creates liability of management for failure to discharge duties of debtor] Article 54 (duty to cooperate) Article 68 [in chapter seven on conservatorship]	Adequate	No action
Duties and functions of trustee (U-20l)	Chapter Four, Article 23-24	Adequate	No action
Functions of creditors and creditors committee (U-20m)	Chapter Two, Article 13, Article 16	Adequate	No action
Costs and expenses of insolvency proceedings (U-20n)	Article 96.3	Adequate but could be improved.	No action
Prioritization of claims (U-20o)	Article 93	Inadequate. The language is not clear and may change substantive legal rights. Also, there is a conflict with provisions in the Civil Code.	This needs to be given greater clarity and harmonized with the Civil Code, which sets different priorities
Distribution of liquidation proceeds (U-20p)	Chapter Eleven	Sufficient	No action
Discharge or dissolution of debtor (U-20q)	Article 116.5; Article 117; Article 129 (discharge of individuals) Article 117 seems to eliminate the fresh start for legal entities and allows creditors to pursue claims against the debtor after the case is closed.	The provisions affecting legal entities need clarification.	Revise as needed to clarify status of legal entities

Conclusion of the proceedings (U-20r)	Chapters Ten and Eleven of the draft law address the conclusion of the proceedings.	Adequate	No Action

World Bank/IMF Principles for Effective Insolvency and Creditor Rights Systems

In 2005, the World Bank in cooperation with the International Monetary Fund published a revised version of its Principles for Effective Insolvency and Creditor Rights Systems.[3] Since their initial publication in 2001, the Principles have served as the basis for ROSC (Reports on Standards and Codes) studies on insolvency systems in 24 countries. A ROSC for Mongolia's bankruptcy law is being prepared but has not yet been made public.[4]

World Bank Objective	Mongolia Legal Framework	Proposed Action
	C1 Key Objectives and Policies	
Integrate with country's broader legal and commercial systems	Only partially. Conflict between Civil Code and Draft Law concerning priorities among claims. Need registry for movable property. Need credit information agency.	Encourage adoption of law on registration of security interest in movable property. Encourage adoption of credit information agency law. Draft and propose legislation to harmonize Draft Law with Civil Code with respect to claim priorities.
Maximize value of debtor's assets and creditors' recoveries.	Unclear how well Draft Law will work in this regard.	Draft three sample cases and take them through hypothetical bankruptcy draft law.
Provide efficient liquidation for nonviable businesses and those with greater breakup value than cash flow value.	The draft law appears to enable the efficient liquidation. However, it is uncertain whether it provides the appropriate mechanisms for analyzing breakup value versus cash flow value.	Use the three sample cases to conduct hypothetical analysis.
Strike balance between liquidation and reorganization, allowing for easy conversion of proceedings.	Article 84.1 of the draft law addresses the conversion.	Draft language to provide for conversion between liquidation and reorganization.
Provide for equitable treatment of similarly situated	The Draft Law is less explicit on this point than it might be.	Draft language creating classes of creditors and providing for

[3] A copy is available on the Global Insolvency Law Database: http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTICE/EXTGILD/0,,contentMDK:22095859~menuPK:64873783~pagePK:4789622~piPK:64873779~theSitePK:5807555,00.html.

[4] There is a Corporate Governance ROSC on Mongolia, which contains the following statement about its current (1997) bankruptcy regime: "*The insolvency system does not involve excessive delays, however, when assessed against international standards applicable to insolvency, the Mongolian Bankruptcy Law is in "low compliance"*. More specifically, while the insolvency system defines the rights of different classes of creditors, and generally provides creditors with a constructive role in restructuring decisions, the legal and regulatory requirements for formal restructuring and liquidation are considered expensive, time intensive, and generally inefficient for creditors. This is also reflected in Mongolia's ranking in World Bank's Doing Business indicator ―closing a business‖, where in 2009 it ranked 108th." (citations omitted). Web address: http://www.worldbank.org/ifa/rosc_cg_mongolia_09.pdf.

creditors.		equitable treatment.
Provide for timely, efficient, and impartial resolution of insolvencies.	Uncertain how well the Draft Law will work in this regard.	Run scenario with each of the three hypothetical cases.
Prevent the improper use of the insolvency system.	The Draft Law contains provisions designed to achieve this goal. It is unclear how well they work.	Test this using hypothetical scenarios.
Prevent premature dismemberment of debtor's assets by individual creditors seeking quick judgments.	The automatic stay provisions and conservatorship provisions of the draft law are designed to achieve this end. However, because the automatic stay the night at Joe and conservatorship has been ordered, it is conceivable that aggressive creditors could seize assets between the time of the filing of the case and the order for conservatorship.	Test this with a hypothetical scenario.
Provide a transparent procedure, containing and consistently applying clear risk allocation rules and incentives for gathering and dispensing information.	Is unclear how well the Draft Law does this.	Test this using hypothetical scenarios.
Recognize existing creditor rights and respect the priority of claims with predictable and established process.	The reported conflict between the priority provisions of the Civil Code and those of the existing bankruptcy law do not appear to have been eliminated in the Draft Law.	Draft proposed language to solve this problem.
Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.	The Draft Law contains no cross-border insolvency law.	Add cross-border insolvency law to the Draft Law.
C2 Process: Notification and Information		
Afford timely and proper notice to interested parties concerning matters that affect their rights. This should include procedures for public review.	The Draft Law does not address the public rights, the timing of the review, or the question of whether bankruptcy proceedings or state pending appellate review.	Draft provisions providing for appellate review and addressing the issues of a stay pending appeal as well as the finality of sales of the State property in appeals.
Require a debtor to disclose relevant information pertaining to its business and financial affairs in detail sufficient to enable the court, creditors, and affected parties to reasonably evaluate the prospects for reorganization.	The Draft Law appears to do this.	No action necessary.
Provide for the retention of professional experts to investigate, evaluate, or	23.1.5 of the draft law empowers the trustee to retain additional professional experts.	No action necessary

develop information that is essential to key decision-making.		
	Eligibility	
Insolvency law should apply to all enterprises and corporate entities.	Article 3 of the draft law states that the law applies to all enterprises and corporate entities except those dealing with public assets which will be regulated by separate laws.	No action necessary
	Applicability and Accessibility	
Access should be efficient and cost-effective.	This appears to be the case.	No action.
Both debtors and creditors should be able to file a bankruptcy case.	This is the case under the Draft Law	No action.
Commencement criteria and presumptions about insolvency should be clearly defined, with the liquidity test as the preferred test.	Although some of the language in the Draft Law could be clearer, on the whole, the criteria are well defined. Liquidity is the test.	No action.
Debtors should have easy access to the insolvency system.	This is the case under the Draft Law.	No action.
If a creditor initiates the case, the debtor should receive prompt notice and an opportunity to respond, with a prompt decision by the court.	This is the case under the Draft Law.	No action.
	Provisional Measures and Effects of Commencement	
Provisional relief measures should be available before ruling on bankruptcy to protect assets.	This is the case under the Draft Law. It might help to add explicit language creating the right of one or more creditors to request protective measures.	No action.
Commencement of insolvency proceedings should automatically prohibit unauthorized disposition of debtor's assets.	This is the case under the Draft Law.	No action.
The automatic stay should be as wide and all-encompassing as possible.	This is largely the case under the Draft Law.	No action.
The automatic stay should be in effect in liquidation proceedings as well as reorganizations.	This is the case under the Draft Law.	No action.
There should be an opportunity for relief from the stay in appropriate circumstances.	The Draft Law contains no provision for relief from stay.	Draft provision setting forth procedure for relief from the automatic stay.

Governance		
Management		
In liquidation proceedings, management should be replaced by trustee. Control of the estate should be surrendered immediately.	According to Article 68 of the draft law, the management will not be removed, but will be severely restricted in powers and duties.	
In creditor-initiated cases, an interim trustee with limited functions should be appointed to monitor the business.	This is the case under the Draft Law.	No action.
In reorganization, the law should provide that trustee has exclusive control of debtor's assets or that governance responsibilities remain with management or that an impartial and independent representative undertakes supervision of management.	According to Articles 76 and 77 of the draft law, the trustee has the control of a debtor's assets.	
Creditors and the Creditors' Committee		
The role, rights, and governance of creditors should be clearly defined.	This is the case under the Draft Law.	No action.
Creditors' interests should be protected by appropriate means.	This is the case under the Draft Law.	No action.
Where a committee is established, its duties and functions, and the rules for the committee's membership, quorum and voting, and the conduct of meetings should all be specified by the law.	The Draft Law does not do all of this.	Draft language to provide the specificity required by this standard.
The committee should be consulted on non-routine matters and have the ability to be heard on key decisions.	This is the case under the Draft Law.	No action.
In reorganizations, creditors should be entitled to participate in the selection of the trustee.	This is the case under the Draft Law.	No action.

SECTION III: RECOMMENDATIONS

A. Recommendations for Immediate Action

1. Enact the proposed law on registration of movable property.
2. Create a Credit Information Agency through which any potential creditor (bank, supplier, contractor, etc.) or investor can obtain accurate information about the credit history of a potential borrower.
3. Revise the Draft Law on Bankruptcy ("the Draft Law") to make the changes suggested in this report, including the following critical amendments:
   a. Clearly state priorities among types of claims, making sure not to change substantive rights and harmonizing the Bankruptcy Law with the Civil Code.
   b. Add a cross-border insolvency law.
   c. Include a procedure for lifting the automatic stay.
   d. Clarify preferential transfer provisions.
4. Develop mid- and long-term strategies for creating a functioning bankruptcy system that includes
   a. a professional infrastructure (judges, lawyers, accountants, appraisers, auctioneers, turnaround specialists, bankers) with expertise and experience in reorganizing and liquidating distressed business properties, an education and licensing system for professional trustees,
   b. a code of conduct for everyone exercising fiduciary responsibilities vis a vis the bankruptcy estate,
   c. a training and continuing education program for bankruptcy professionals, and
   d. a system for assigning bankruptcy cases to trained judges only, looking toward the eventual creation of a commercial court.

B. Recommendations for Mid- and Long-term Development

1. Hire a high-level Mongolian lawyer/accountant, preferably with bankruptcy experience, to head up the multi-year effort of developing the bankruptcy system.
2. Write a Trustee's Manual that reflects the revised bankruptcy law and other aspects of the new bankruptcy regime.
3. Write a Bankruptcy Bench Book for judges.
4. Write a Creditors' Manual as a guide for creditors in bankruptcy cases and a resource for potential lenders, suppliers, and investors.
5. Create a database of information on bankruptcy cases that collects at least the following data: date of filing, nature of debtor, number and types of creditors, total liabilities, total asset value, cost of bankruptcy, percentage of recovery of unsecured claims, type of case (reorganization or liquidation), and length of time from filing to payment of claims.
6. Use UNCITRAL Legislative Guide and World Bank/IMF ROSC template as benchmark resources for assessment of development and amendments to bankruptcy law, law on secured transactions, other related laws, and the operation of the system.
7. Train trustees, appraisers, and other bankruptcy professionals in the use of the BPM software for assessing the potential economic viability of a business entity.

ANNEXES

ANNEXES

The appendixes contain the following resources of potential value for revising the Draft Law as well as for understanding the context of the effort to improve the commercial law system.

A. Timeline of Events in Draft Law

B. Summaries of Selected Bankruptcy Cases Under Existing Law

C. Draft Cross-Border Insolvency Law

D. Draft Code of Conduct for Trustees

E. Essay on Imprisoned Capital

F. Selected Interview Notes

C. Links to Resources on Insolvency

D. Annotated Bibliography

ANNEX A: TIMELINE OF EVENTS IN DRAFT LAW

<table>
<tr><th>Day</th><th colspan="3">Procedure</th></tr>
<tr><td>1</td><td colspan="3">The debtor is insolvent.</td></tr>
<tr><td rowspan="3">90</td><td rowspan="3">Creditors may file claims with the court against the debtor after three months (5.2).</td><td>90</td><td>The judge refuses to accept the claim (45.1).</td></tr>
<tr><td>100</td><td>The creditor may appeal the refusal of the court (46.5).</td></tr>
<tr><td>115</td><td>The court rules on the appeal (46.6).</td></tr>
<tr><td>95</td><td>The judge issues an order on the commencement of the bankruptcy case (47.1).</td><td>102</td><td>The court shall commence a bankruptcy case and appoint a trustee within seven days in case of a simplified procedure (142.2).</td></tr>
<tr><td>180</td><td colspan="3">The maximum time allotted for the court to commence the bankruptcy case (58.1).</td></tr>
<tr><td>125</td><td colspan="3">Court hearing to review the grounds for the claims against the debtor (48.2).</td></tr>
<tr><td>139</td><td colspan="3">The debtor shall within fourteen days have the right to provide explanations (50.1)</td></tr>
<tr><td></td><td colspan="3">The court shall issue an order to impose conservatorship and appoints the temporary trustee (53.1).</td></tr>
<tr><td></td><td colspan="3">The first meeting of the creditors shall convene on the day of the judge’s order (73.1).</td></tr>
<tr><td></td><td colspan="3">The temporary trustee shall assess the activities of the debtor and present the findings to the meeting of creditors and the debtor within one month since the appointment (25.1).</td></tr>
<tr><td></td><td colspan="3">The temporary trustee shall deliver to the court within seven days the minutes and decision from the first meeting of creditors regarding the debtor’s bankruptcy and distribution or recapitalization.</td></tr>
<tr><td>142</td><td colspan="3">The debtor’s executive management shall transfer all documents, seals, and property to the trustee within three days following the appointment of the trustee.</td></tr>
<tr><td>149</td><td colspan="3">The temporary trustee shall publish the announcement regarding the period for creditors to submit their claims within seven days since the imposition of conservatorship (69.1).</td></tr>
<tr><td>163</td><td colspan="3">The temporary trustee shall notify the known creditors regarding the imposition of conservatorship within fourteen days since the publication (69.2).</td></tr>
<tr><td>173</td><td colspan="3">The debtor’s executive management shall inform the employees and the founders regarding the imposition of the conservatorship within ten days since such imposition (69.3).</td></tr>
<tr><td>233</td><td colspan="3">The creditors may issue their demands to the debtor in order to participate in the first meeting of creditors within sixty days since receiving the notification on conservatorship (72.1).</td></tr>
<tr><td colspan="4">Reorganization</td></tr>
<tr><td></td><td colspan="3">The court shall issue a decision on the debtor’s recapitalization based on the decision of the meeting of creditors and appoint the trustee (83.1).</td></tr>
<tr><td>30</td><td colspan="3">The trustee shall produce a plan on the recapitalization plan and present it to the meeting of creditors within one month since the appointment (86.1).</td></tr>
</table>

	The debtor's executive management shall transfer all documents, accounting, seals and assets to the trustee within three days since the appointment of the trustee (85.1.3).
	The trustee shall present a report to the meeting of creditors regarding the implementation of the recapitalization plan and propose to declare the restoration of solvency, request the extension of the recapitalization or announce the bankruptcy of the debtor (88.1-88.3).
	The meeting of creditors shall issue a decision on the restoration of solvency, extension of the recapitalization or announcement of the bankruptcy (88.4).
365	The recapitalization shall proceed in no more than twelve months and may be extended by no more than six months (83.2).
370	The trustee shall submit the decision from the meeting of creditors to the court (89.1).
	The court shall issue a decision on the solvency of the debtor and settlements with creditors or on the announcement of the debtor's bankruptcy (89.4).
550	The period or settlements with creditors shall not be more than six months (89.4.1).
	The trustee shall submit a report on the settlements with creditors to the court and the court shall announce the restoration of the debtor's solvency (89.6).
Liquidation	
	The court shall declare the bankruptcy of the debtor and initiate the distribution activity (100.1).
60	The period for the creditors to submit their claims (101.1.6).
	The trustee shall audit the assets of the debtor and conduct an assessment presenting the results to the meeting of creditors (103.1).
	The trustee shall submit the distribution plan adopted by the meeting of creditors to the court for approval (107.1).
	The court shall approve the distribution plan within ten days (107.1).
	The final distribution shall occur within one month since its public announcement (114.3).
365	The distribution activity shall proceed in no more than one year and may be extended by six months (100.2).
	The court shall close the bankruptcy case proceedings where the final distribution is complete (116.1).
365	The creditors who do not obtain the income from the final distribution within twelve months shall be considered as having surrendered their demands (115.2).

Timeline for Bankruptcy of Individuals

Day	Procedure
	The debtor, creditor or authorized institution may submit a request on the individual bankruptcy (120.1).
90	The court shall approve the debt restructuring plan for the debtor. This shall suspend the bankruptcy case for three months (121.2).
	The court shall close the bankruptcy case where the debtor implements the debt restructuring plan (121.5).
Bankruptcy	
	The court shall declare the debtor bankrupt and initiate the distribution activity (124.5).

60	The maximum period for the creditors to submit their claims after the decision of the court (125.2).
	The court decision enforcement official shall organize the activity on selling the debtor's assets (126.1).
	The citizen is cleared of the debts once the settlements with the creditors are complete (129.1).

Timeline for the Simplified Procedure

Day	Procedure
7	The court shall commence a bankruptcy case and appoint a trustee within seven days since receiving the request on the bankruptcy case commencement (142.2).
	The court shall declare the debtor bankrupt and initiate the liquidation activity as specified in the law (142.3).

ANNEX B: SUMMARIES OF SELECTED BANKRUPTCY CASES UNDER EXISTING LAW

Case no. BZD-420
Respondent: "Hua Hai Barilga Bayguulamj" LLC.
Creditors: the Capital City Tax Agency, General All Chinese Construction Company.
Reason: the failure to pay the obligations amounting to more than ten percent of its equity.
Resolution: Bankruptcy, liquidation and removal from the state registry.
Duration: January 28th, 2002 – May 10th, 2006.
======
Case no. SBD-21
Respondent: "Torgon Zam Daatgal" LLC.
Creditors: the Capital City Tax Agency, Central Palace of Culture and insured persons.
Reason: insolvency.
Resolution: declaration of insolvency, bankruptcy, liquidation and distribution of assets.
Duration: April 18th, 2005 – February 14th, 2006.
======
Case no. HUD-300
Respondent: "Chinbay" LLC engaging in leather waste management.
Creditors: None despite the announcement.
Reason: Insolvency and debts amounting to 182 646 675 MNT.
Resolution: Declaration of insolvency, no recapitalization, liquidation and removal from the state registry.
Duration: March 17th, 2006 – May 1st, 2006.
======
Case no. SBD-270
Respondent: "Onim" LLC (Mongolian-Chinese joint company).
Creditors: the capital city tax agency.
Reason: customers terminated contracts resulting in the inability of "Onim" to operate further. 155 399 000 MNT is owed to creditors. The company stopped production in 2004.
Resolution: declaration of insolvency, bankruptcy and liquidation.
Duration: February 28th, 2006 – May 17th, 2006.
======
Case no. BGD-335
Respondent: "Deywuu" LLC.
Creditors: the capital city tax agency.
Reason: the respondent requested to declare the bankruptcy. Mismanagement, poor accounting and supervision caused the debt of 36,000.000 MNT to the tax agency.
Resolution: the creditor and debtor did not request recapitalization. There are no assets belonging to the company. The court decided to annul the debt, bankrupt and liquidate the company.
Duration: October 26th, 2004 – March 16th, 2006.
======
Case no. BGD-808
Respondent: "Ulaan Üzem" LLC.
Creditors: none.
Reason: the company formed in 1996 and amassed debts in 1997. Some debts were settled by the sale of the company assets. In 1997, the company was ordered for liquidation but due to the outstanding debt to the capital city tax agency of 1,927.300 MNT the company was still

existent. The company requests a declaration of bankruptcy, liquidation and removal from the state registry.
Resolution: Bankruptcy, liquidation and removal from the state registry.
Duration: April 13th, 2004 – June 29th, 2005

ANNEX C: DRAFT CROSS-BORDER INSOLVENCY CHAPTER[5]

Article 143. Scope and Purpose

(1) This Chapter provides mechanisms for dealing with cases of cross-border insolvency.

(2) The purpose of this Chapter is to promote:

a. Cooperation between the courts and other competent authorities of Mongolia and foreign States involved in cases of cross-border insolvency;

b. Legal protections of investment; and

c. Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor.

Article 144. Application. This Chapter applies where:

(a) Assistance is sought in Mongolia by a foreign court or a foreign representative in connection with a foreign proceeding; or

(b) Assistance is sought in a foreign State in connection with a proceeding under this law; or

(c) A foreign proceeding and a proceeding under this law in respect of the same debtor are taking place concurrently; or

(d) Creditors or other interested persons in a foreign State have an interest in requesting the commencement of, or participating in, a proceeding under this law.

Article 145. Definitions and Meanings

In this chapter the following definitions and meanings apply:

(a) **Foreign proceeding** means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of rehabilitation or bankruptcy;

(b) **Foreign representative** means a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the rehabilitation or the bankruptcy of the debtor's assets or affairs or to act as a representative of the foreign proceeding;

(c) **Foreign court** means a judicial or other authority competent to control or supervise a foreign proceeding.

Article 146. International obligations. To the extent that this Chapter conflicts with an obligation of Mongolia arising out of any treaty or other form of agreement to which it is a party with one or more other States, the requirements of the treaty or agreement prevail.

Article 147. Authorization of Administrator. An Administrator under this law is authorized to act in a foreign State on behalf of a proceeding under this law, as permitted by the applicable foreign law.

Article 148. Public Policy Exception. Nothing in this Chapter prevents the court from refusing to take an action governed by this law if the action would be manifestly contrary to the public policy of Mongolia.

[5] Adapted from the Model Cross-Border Insolvency Law in the UNCITRAL Guide to Insolvency Law.

Article 149. Application for Recognition

(1) A foreign representative may apply to the supreme court of Mongolia for recognition of the foreign proceeding in which the foreign representative has been appointed.

(2) An application for recognition shall be accompanied by:

a. copy of the decision commencing the foreign proceeding and appointing the foreign representative, certified in accordance with the requirements of applicable laws; or

b. A certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or

c. In the absence of evidence referred to in sub articles (a) and (b), any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative.

(3) An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.

Article 150. Determination of Application

(1) Subject to article __, a foreign proceeding shall be recognized by the supreme court of Mongolia if:

a. The foreign proceeding is a proceeding within the meaning of article __;

b. The foreign representative applying for recognition is a person or body within the meaning of article ___;

c. The application meets the requirements of article ___; and

d. no other requirements set by the legislation of Mongolia for recognition of foreign court decisions are being violated.

(2) An application for recognition of a foreign proceeding shall be decided upon at the earliest possible time, but in any event within 30 days.

(3) A decision of the supreme court of Mongolia to recognize a foreign proceeding may be modified or terminated if it is shown that the grounds for granting it were fully or partially lacking or have ceased to exist.

Article 151. Duty to Inform

From the time of filing the application for recognition of the foreign proceeding, the foreign representative shall inform the supreme court of Mongolia promptly of:

(a) Any substantial change in the status of the recognized foreign proceeding or the status of the foreign representative's appointment; and

(b) Any other foreign proceeding regarding the same debtor that becomes known to the foreign representative.

Article 152. Interim Relief

(1) From the time of filing an application for recognition until the application is decided upon, the relevant district (city) court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, make temporary protection orders under Chapter 4 of this law.

(2) The relief granted under this article terminates when the application for recognition is decided upon.

Article 153. Effects of Recognition

(1) Upon recognition of a foreign proceeding the provisions of Articles __ and __ of this law apply in respect to the debtor and its assets

(2) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended except in the normal conduct of the business of the debtor.

Article 154. Further Relief upon Recognition

(1) Upon recognition of a foreign proceeding where necessary to protect the assets of the debtor or the interests of the creditors, the relevant district (city) court may, at the request of the foreign representative, grant any appropriate further relief, including:

(a) Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;

(b) Entrusting the administration or realization of all or part of the debtor's assets located in Mongolia to the foreign representative or an office holder designated by the court.

(2) Upon recognition of a foreign proceeding the relevant district (city) court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in Mongolia to the foreign representative or an office holder designated by the court, provided that the court is satisfied that the interests of creditors in Mongolia are adequately protected.

Article 155. Intervention

Upon recognition of a foreign proceeding, the foreign representative may, provided the requirements of the law of this State are met, intervene in any proceedings in which the debtor is a party including proceedings under this law.

Article 156. Cooperation between courts

(1) In matters referred to in article ___, the court shall cooperate to the maximum extent possible with foreign courts or foreign representatives, either directly or through an office holder.

(2) The court is entitled to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives.

Article 157. Cooperation between Administrators. In matters referred to in article ___, an office holder shall, in the exercise of its functions and subject to the supervision of the court, cooperate to the maximum extent possible with foreign courts or foreign representatives.

Article 158. Forms of cooperation. Cooperation referred to in articles ___ and ___ may be implemented by any appropriate means, including:

(1) Appointment of a person or body to act at the direction of the court;

(2) Communication of information by any means considered appropriate by the court;

(3) Coordination of the administration and supervision of the debtor's assets and affairs;

(4) Approval or implementation by courts of agreements concerning the coordination of proceedings; and

(5) Coordination of concurrent proceedings regarding the same debtor.

Article 159. Concurrent Proceedings

After recognition of a foreign proceeding, a proceeding under this law may be commenced only if the debtor has assets in Mongolia and the effects of that proceeding shall be restricted to the assets of the debtor that are located in Mongolia

Article 160. Rule of Payment in Concurrent Proceedings.

Without affecting the claim of a secured creditor, a creditor who has received part payment in respect of its claim in a proceeding pursuant to a law relating to insolvency in a foreign State may not receive a payment for the same claim in a proceeding under this law regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received.

ANNEX D: DRAFT CODE OF CONDUCT FOR TRUSTEES

Preamble

A bankruptcy trustee is a licensed professional who has accepted the responsibility of administering a bankruptcy estate. As part of that responsibility, a bankruptcy trustee assures that creditors of a bankrupt debtor are paid the largest percentage possible on their claims from sale of the debtor's assets or the reorganization of the debtor's business. The bankruptcy trustee is also responsible for dealing with the judge of the bankruptcy court and all parties in interest in the bankruptcy estate with respect to the bankruptcy proceeding and the assets of the bankruptcy estate.

From the professional status and general responsibilities of a bankruptcy trustee, several principles and individual rules of behavior follow. The principles articulate the trustee's duty of loyalty, duty of care, and duty of respect—all of which exist by virtue of the trustee's status. The rules articulate requirements of behavior to which every bankruptcy trustee must conform.

The rules are divided into seven sections: (1) Personal and Professional Integrity, (2) Fiduciary Duty, (3) Exercise of Care in Performing the Work of a Trustee, (4) , Independent Judgment, (5) Interactions with Others, (6) Continuing Education, and (7) Obligations to the Profession. The classification is for convenience and should not be given any weight when interpreting the meaning or import of any particular rule.

In this Code of Conduct the phrase "administer the bankruptcy estate" shall include all work that the trustee does in carrying out his or her duties as a trustee including (without limitation) attending court hearings, meeting with individual creditors, the Assembly of Creditors, or the Creditors' Board, conducting negotiations with potential buyers of estate property, working with other professionals in regard to the bankruptcy estate, operating the debtor's business, maintaining books and records, and distributing estate assets to parties who have established a legitimate claim against those assets.

Principles

1. In administering the bankruptcy estate, every bankruptcy trustee owes a duty of undivided loyalty (also called a fiduciary duty) to the bankruptcy estate and the legitimate interests of all interested parties.
2. In administering the bankruptcy estate, every bankruptcy trustee owes a duty of care to the bankruptcy estate and the legitimate interests of all interested parties.
3. A bankruptcy trustee must treat all persons with whom he comes into contact in the course of administering a bankruptcy estate or participating in bankruptcy proceedings with complete respect.

Rules Governing Behavior

Personal and Professional Integrity

1. Bankruptcy trustees shall conduct themselves with moral rectitude at all times.
2. Bankruptcy trustees shall not engage in any form of deceit of the court, any party in interest in a bankruptcy proceeding, or of any party with whom he or she is dealing in the course of administering a bankruptcy estate.

3. Bankruptcy trustees shall not assist, advise, or encourage any person to engage in any conduct that the trustee knows or should know is illegal or dishonest with respect to the bankruptcy estate or bankruptcy proceeding.
4. Bankruptcy trustees shall not sign any document, including a letter, report, statement, representation, or financial statement or associate themselves with such a document that they know or reasonably should know is false or misleading. Any disclaimer of responsibility set out therein has no effect.
5. Bankruptcy trustees shall avoid the appearance of impropriety in the performance of the duties of the office of trustee.

Duty of Loyalty

6. Bankruptcy trustees shall fulfill the highest standards of loyalty toward the bankruptcy estate and the bankruptcy proceeding.
7. A bankruptcy trustees shall not accept appointment as a trustee in any case when, as a result of his current or prior engagements, work, property interests, or other relationships he or she might reasonably be considered to have interests that conflict with those of the bankruptcy estate, the bankruptcy proceeding, or the impartial and disinterested administration of the bankruptcy estate.
8. A bankruptcy trustee shall not engage in any conduct or enter into any relationship as a result of which he or she might reasonably be considered to have interests that conflict with those of the bankruptcy estate, the bankruptcy proceeding, or the impartial and disinterested administration of the bankruptcy estate.
9. A bankruptcy trustee shall act to further the interests of the bankruptcy estate and the bankruptcy proceeding even if doing so is detrimental to the bankruptcy trustee's own interests.
10. Bankruptcy trustees shall not use any information that is obtained in the course of administering the estate for their own benefit or that of any third party.
11. Bankruptcy trustees shall not, directly or indirectly, purchase, lease, or otherwise use or control any property of any bankruptcy estate (including estates for which they are not the trustee) for their personal benefit or that of any third party.
12. Whenever bankruptcy trustees are selling or otherwise disposing of property of the bankruptcy estate, they shall not, directly or indirectly, sell it to any of their employees, relatives, or business associates, any other trustee or any employee, relative, or business associate of any other trustee, or any other person not engaging in arms-length negotiations with respect to the property.
13. Bankruptcy trustees shall not engage in any business or occupation that would compromise their ability to administer the bankruptcy estate or that would jeopardize their integrity, independence, or competence.
14. Bankruptcy trustees shall not transfer the administration of a bankruptcy estate to another bankruptcy trustee, partner, co-owner, or employee of his company or a company of another bankruptcy trustee, or any other third party engaged by the bankruptcy trustee in exchange for any consideration of any kind.

Exercise of Care in Performing the Work of a Trustee,

15. Bankruptcy trustees shall administer the bankruptcy estate competently, with due diligence, and in accordance with the best standards of the profession.

16. Bankruptcy trustees shall take care to perform their obligations in a timely manner and without delay.
17. Bankruptcy trustees shall maintain separate checking accounts for each bankruptcy estate they administer and shall never, under any circumstances, commingle the funds of a bankruptcy estate with their own funds, whether in a checking account or otherwise, or use them even temporarily for the trustee's own benefit.
18. When administering a bankruptcy estate, bankruptcy trustees shall exercise due care to assure that the actions of their agents and employees or of any person hired on a contract basis are carried out in accordance with the same professional standards and in conformance with the same code of conduct that bankruptcy trustees themselves are required to follow.
19. The bankruptcy trustee shall preserve and administer assets entrusted to him in accordance with the bankruptcy law and other applicable regulations and professional standards.
20. Except as otherwise required by law, bankruptcy trustees shall not disclose any information that is not otherwise public concerning the business or affairs of a debtor to any person not having a right to such information by virtue of that person's status as a judge or a party in interest to the bankruptcy proceeding.
21. Except as otherwise required by law, bankruptcy trustees shall not disclose confidential information of the debtor to anyone other than the judge on a confidential basis or a member of the Board of Creditors who has signed a non-disclosure order under penalty of sanctions in the event of violation. In no event, may a bankruptcy trustee disclose confidential information of the debtor to a competitor or agent of a competitor of the debtor.

Independent Judgment

22. Bankruptcy trustees shall not engage in any conduct or enter into any relationship as a result of which he or she might reasonably be considered to have interests that conflict with those of the bankruptcy estate, the bankruptcy proceeding, or the impartial and disinterested administration of the bankruptcy estate.
23. When administering the bankruptcy estate, bankruptcy trustees shall avoid any influence, interest, or relationship that could reasonably be seen to impair their professional judgment.
24. Bankruptcy trustees shall not, directly or indirectly, pay a commission, compensation, fee, or other benefit to a third party in order to obtain a professional engagement. Neither may bankruptcy trustees accept such a commission, compensation, fee, or other benefit from a third party for referring work relating to a professional engagement.

Interactions with Others

25. In administering the bankruptcy estate, a bankruptcy trustee shall act with honesty and impartiality and shall provide full and accurate information to all parties in interest as required by the Bankruptcy Law.
26. In administering the bankruptcy estate, a bankruptcy trustee shall treat the judge, all parties in interest, and any other person with whom he or she interacts with courtesy and respect.

27. In communicating with third parties such as journalists, government officials, or potential purchasers of estate assets, bankruptcy trustees shall diligently protect confidential information and make only such statements as are in the interests of the bankruptcy estate and parties in interest. While administering a bankruptcy estate, bankruptcy trustees shall not give speeches in which they discuss the bankruptcy proceeding or the estate.

Continuing Education

28. Bankruptcy trustees shall take care to maintain their knowledge of practices, skills, legal developments, and changes in the bankruptcy law at a level at least equivalent to that of a person newly admitted to the profession.
29. Bankruptcy trustees shall participate in the minimum number of continuing education courses, seminars, and activities required for membership in the Trustees Association.

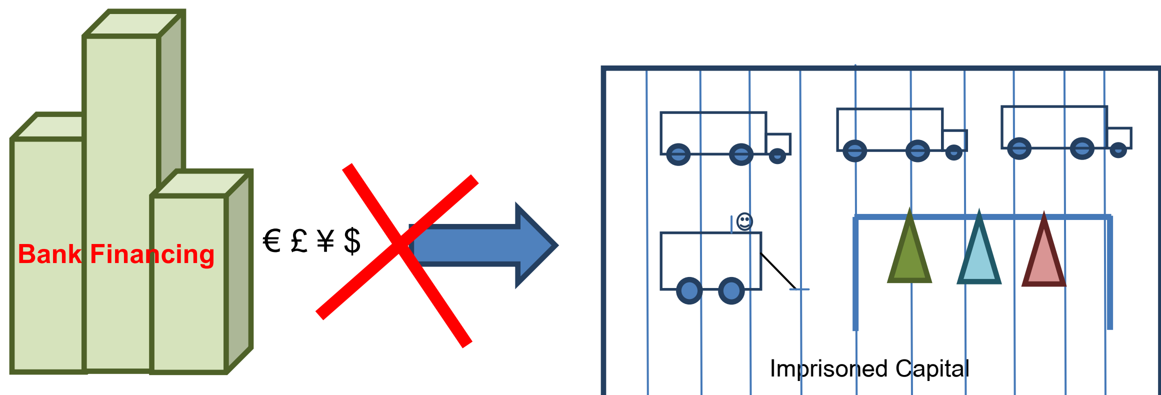
Obligations to the Profession of Bankruptcy Trustees

30. Bankruptcy trustees shall not obtain, solicit, or conduct any professional engagement that would discredit their profession or jeopardize the integrity of the bankruptcy process.
31. Bankruptcy trustees shall not, directly or indirectly, advertise in a manner that they know or should know is false, misleading, materially incomplete, or likely to include error.
32. Bankruptcy trustees shall not, directly or indirectly, advertise in a manner that unfavorably reflects on the reputation or competence of another trustee or on the integrity of the bankruptcy process.
33. Any bankruptcy trustee who has first-hand knowledge that another bankruptcy trustee has violated a rule of this code of conduct shall report that knowledge to the enforcement body.

ANNEX E: WHY IS A SYSTEM FOR REGISTERING A SECURITY INTEREST IN MOVABLE PROPERTY IMPORTANT?

There is no ability to register a security interest in personal property. As a consequence, banks do not make loans secured by personal property. (However, they do take a security interest in personal property anyway when making loans that are secured by real property.)

Because banks do not make loans secured solely by personal property, a substantial amount of asset value remains unavailable to entrepreneurs as a source of capital for business formation, operation, or expansion. (See the De Soto thesis on imprisoned capital.)



In Western-style market economies, it is possible to have your cake and eat it too. That is, you can own and use a physical asset while simultaneously turning it into money by using it as non-possessory collateral to secure repayment of a loan. In such a system, physical and intangible assets are capitalizable, making it possible to nearly double their value.

But if there is no mechanism for recording a security interest in property, it cannot be capitalized in this sense. (It can, of course, be sold, if it has commercial value; but then it is gone. Someone else has the use of it. The former owner has only the money.)

Several things are necessary for a securitization system to work. These include: title records for some kinds of property (real estate, stocks, bonds, insurance, pensions, annuities, etc.), written security agreements, and a means of notifying the world that the security agreement exists (i.e., that the property has been pledged to secure payment of a debt).[6]

Why is a means of notifying the world through a registry for security interests in movable and intangible property necessary for a system of securitization (and hence capitalization) to work? Answer: A prudent lender will not lend against property unless it has the ability to assert and prove its security interest in the property against the whole world. The lender does not have a possessory interest in the property but only an abstract, conceptual (and legal) interest. But without documentation, there is no way to prove that security interest. Others could assert a similar interest (even a prior interest) or claim that the lender was lying about the existence or extent of the security interest. There would be substantial uncertainty about the enforceability of the secured creditor's rights. And given that uncertainty, a prudent lender would not lend.

[6] With certain exceptions such as vehicles, registrable title is generally not necessary for personal property because, as a rule, the owner demonstrates ownership by possessing the property. (Possession is such a strong indication of ownership that in some countries people can obtain ownership even of real property by openly and notoriously possessing it for a sufficient length of time (say, 15 years) as if they were the owners. They can then assert ownership against the title owners in a court proceeding.)

Some people may be able to obtain loans against their personal property through an informal system of borrowing from friends, relatives, or the local Big Man. But no prudent bank will make substantial loans to businesses in this environment.

Which is precisely the situation in Mongolia with respect to personal property. Except for revolving loans to herders, banks do not rely on personal property as collateral for loans. Business owners cannot use their personal property to obtain loans for the creation, operation, or expansion of the business.

But it is not just direct loans to business owners that could be but are not being made. Once a promissory note and a security agreement have been signed, the lender can transfer both to someone else, who then has the right to enforce their terms. And such notes and agreements can be bundled together and used as collateral for larger loans. This is all part of capital formation.

In due course, the secured promise of the car dealer to pay the bank might be joined with hundreds or thousands of similar promises by other debtors, becoming part of an effort to obtain financing for a large building project, for example. In other words, the bank can borrow against or sell the security interests it has taken in the movable property of hundreds or thousands of borrowers. In this way the property of many individual businesses can serve both as the means for creating and operating the business entities themselves and also as part of the capital wealth of the country for larger activity. Capital takes on magical properties.[7]

”By unleashing the potential of physical assets in the form of credit, thereby allowing new sorts of ventures and new sorts of risk, and new sorts of sharing of risk, the development of the formal property system gave rise to that quantum leap in human welfare which we associate with the success of Western capitalism.”[8]

[7] *Cf.* Hernando de Soto, *The Mystery of Capital* (2000).
[8] Barry Smith, Searle and de Soto: The New Ontology of the Social Order at 46. (online at http://ontology.buffalo.edu/document_ontology/Searle&deSoto.pdf.)

ANNEX F: NOTES OF INTERVIEWS

Interview with Bankruptcy Trustee
9/14/2011

Interviewee has worked on 6 cases.

The court prefers to select people with specialization in trustee area, but often lawyers work as bankruptcy trustees without having this special training. Whoever does trustee work needs special training. They can be lawyers but only if they have special training.

Colleague: The American experts said that accountants should work as bankruptcy trustees, but they lack the legal education to properly protect parties and manage things from the legal point of view. But the law allows the trustee to select a team of professionals as needed to manage the case.

Interviewee: The three most important things that need to be changed in the current law:

> First, the bankruptcy trustees do not have enough time to produce a final report. The law requires the report within 20 days.
>
> Second, the law is vague about how to liquidate and close a business.
>
> Third, reorganization is unclear and not properly regulated by the current law.

Do collection activities cease with the filing of a bankruptcy case?

> There is an automatic stay under the current law.
>
> There is no procedure for lifting the automatic stay, for example to allow a foreclosure to continue.

Does the Interviewee want to share any other thoughts on what needs to be changed in the current law from her perspective as a trustee?

> In terms of the practice, the law on bankruptcy needs to be revised because it does not provide the trustee with sufficient time to conduct a proper analysis of the viability of a given business.
>
> For example, the time periods under the law are not realistic. Maybe there should be two laws on bankruptcy, one on the merits of the bankruptcy and the other on procedure.
>
> Many things are not there such as fees for trustees are not regulated.

Interview with Bank Officer and Trustee
9/14/2011

<u>Trustees Association</u>

What does it do?

> Established in 1999. Until 2004, it was quite active in its scope of responsibilities. It conducted training and public education work concerning bankruptcy. Association provided licenses of trustees in 2001. This was before the law on licensing of economic activity. Because of the absence of a proper legal framework, no more licenses were issued. 11 people received licenses, mainly judges, prosecuting attorneys, legal officers of banks, and several professors. Previously, these people had received World Bank training.

The law on licensing contains no provision on the licensing of trustees. But the bankruptcy law allows accountants etc. to work as bankruptcy trustees, and probably they do so. But the association has licensed only the original 11.

Are there any plans to establish a licensing procedure under the law on licensing?

The WG of the MOJHA is working on establishing such regulations to make trustees official, licensed people. The ABT is weak and powerless organization. It lacks proper financing, staff, and facilities. There is no legal expertise to maintain such an organization. Overall the knowledge of the system is low. For example, judges do not have an understanding of economic activity. In practice most proceedings end with liquidation.

Sometimes there are companies that have been inoperable for 5-10 years and only after 5-10 years does someone open a bankruptcy case. It is almost meaningless to pursue it at this point. And the bankruptcy trustees have little interest in handling such cases because there is no value in the estate.

There is also unequal treatment of parties to a bankruptcy case, and this creates discrepancies. There is no system of liabilities for the debtor concerning protection of assets. No preliminary procedure for protecting the assets. The law is very small. It does have the capacity to deal with this kind of problem.

Example of unequal treatment:

Restoration of the claimant's rights. Most judges approach the case from the perspective of the claimant's rights. In the ideal situation, it would be much more useful to have the business continue in business.

The current law provides that the first priority would be given to secured creditors after payment of administrative fees. [MP follows up to make sure he understood this correctly.]

But the civil code provides that damages must be paid first and then the claims of the creditors. For that reason, the secured creditors have little interest in filing bankruptcy cases. [Need to clarify what is meant by "damages."]

The civil code supersedes the bankruptcy law but the new bankruptcy law should provide a separate procedure for bankruptcy proceedings in terms of prioritizing the secured creditors.

Protection of assets:

Under current law, the trustees have the power and authority to protect the assets, but in practice it is not effective because of the expense of such activities. For example, moribund companies have no resources to pay for such protection. The source of financing such expense is unclear. If there needs to be a guard hire, it is uncertain how this will be paid for.

This has been put on the agenda at the MOJHA. The conclusion has been that the ABT as an NGO does not have enforcement powers such as those that state agencies have. It does not have an economic basis for its activities. The new draft law addresses this. Some of the powers of the ABT would be transferred to a state agency, for the time being. Suggested to delegate to the court enforcement agency or to establish a small agency for this purpose. But this is all under discussion and nothing official has been adopted.

The National Legal Institute has been researching practices in other countries. The NLI operates under the MOJHA but it is a semi-NGO.

What was the WB training? What did it consist of? Is there a curriculum?

There were two trainings in 1999. Organized by WB Beltac. First targeted legal officers of banks, defenses, and judges. Lasted 21 days. Second training targeted entrepreneurs and lawyers and lasted 7 days.

There was a similar training undertaken at the Institute of Finance and Economics. Mainly accountants and economists participated in this training.

There was a similar training in 2001 that involved attorneys.

Training covered:

Facilitation of implementation and usage of 1997 law on bankruptcy. Several experts from the US came to organize this training. David ___ and others.

The Beltac published a handbook for BK Trustees in 1999. That edition is very rare. There may be some materials at the MOJHA.

Approximately 60-70 Mongolians participated in the trainings. Judges and even regional judges were invited. The institute of Economics hosted about 40.

How many members?

37 members but due to the weak status of the association, most are not active in the association work. Most have direct employment elsewhere.

How does one become a member?

Submit a written request to join and that will probably be sufficient provided you meet the professional requirement.

Does it have any official status (e.g., sanctioned by MOJHA or MOF)?

Does it provide any training?

Has it established any best practice standards or code of ethics?

There is a handbook but no code or other documents.

What else do you want to tell me about the trustees association?

Continuation of Interview on 9/15/2011

The training conducted by Beltac resulted in the publication of a trustees handbook.

Two parts. Part 1 is a set of guidelines for trustees. Part 2 is the translation of the IMF recommendations for the system of effectively and efficiently resolving insolvency of corporate entities. [Get IMF part from the resident mission of IMF.]

Beltac project and the MOJHA and the Ass'n of Bankruptcy Trustees released a short film about bankruptcy, which was broadcast on television. This was done in 2000. The film is probably in the MOJHA.

The handbook is out of print.

It is somewhat useful for lawyers and specialists who use it as a reference.

MP would like to cover two topics today:

First, the nuts and bolts of bankruptcy practice in the courts today.

Second, your thoughts on things that need to be changed in the current law and why.

<u>Procedural question</u>

Creditor wants to file a bankruptcy case against a debtor. How does it go about doing that?

The creditor files a request with the court provided it is owed at least 10% of the assets of the debtor. How does the creditor know what the debtor's assets are? This was the point of the training by the Beltac project. Now, the practice is that the creditor does not have to know this in advance. The creditor simply files his claim and then the debtor must disclose its assets, and if the claim exceeds the 10% threshold, then the case proceeds. Otherwise, the court dismisses the case.

It is not possible for multiple creditors to file a case jointly.

Is there a problem with some judges handling bankruptcy cases who do not have a good grasp of the law and economic realities? Would it be good to have only judges with special training in bankruptcy handle bankruptcy cases?

It is better to have specialized judges. Overall, judges do not have a high level of economic knowledge. It would help to have this economic sophistication. For example, a judge should be able to read and understand financial statements.

Should trustees be required to have specialized training in financial matters in order to serve as trustees?

Yes, they should have a deep understanding of financial matters.

Should trustees be licensed?

Since a lot depends on the bankruptcy trustee, the trustees should be licensed. And the Minister of Justice shares this view.

Would you like to share any thoughts on how well the draft law addresses the deficiencies in the existing law?

The draft law is not perfect. It incorporates elements from the legislation of other countries. In some ways it is better; but on the other hand it is still a draft and not finalized.

Mrs. Undral has spoken with the secretary of the Working Group and discussed convening the WG once again to review the draft. That might take place in two weeks.

How well does the bankruptcy law work with other laws and they with it?

There are some inconsistencies with other legislation. For example, the order of satisfying claims contradicts other laws. There are few mechanics for enforcement. Does not spell out the powers of trustees etc.

The new draft law needs to address these deficiencies.

Does the draft do that sufficiently? It incorporates the establishment of bankruptcy trustees, but it needs to be further improved.

Are there any unsecured creditors in bankruptcy cases other than government agencies?

No. But they think the new draft law should include claims by employees. That is not possible under the current law.

Problem with conflict between civil code and bankruptcy law on priorities of claims.

The current law on bankruptcy and the civil code have contradictory provisions on satisfying claims. Since the civil code supersedes the bankruptcy code, it is unattractive for people other than legal entities to file or pursue claims in bankruptcy.

The bankruptcy law says that secured creditors have priority and then the unsecured creditors, but the civil code says employees get paid first, then damages, then payments to the court, then trustees fees, and only then payments to secured creditors.

Another impediment to creditors in bankruptcy is the issue of stamp duties. This is a disincentive to creditors who might receive nothing out of the case. They will never get the deposit back.

This is one reason why banks are reluctant to file bankruptcy cases. It is also another reason why banks seek double and triple the value of a loan in collateral. {MP's comment: This state of affairs violates jurisprudential principles. But it also serves as an impediment to efficient lending and borrowing to finance commercial activity as well as investment. It creates a considerable uncertainty about how my secured claim will be treated in the event of a bankruptcy.]

What is the Interviewee's opinion as director of the bank's legal department on how well the current bankruptcy law works for banks?

Because banks are disenfranchised by the law in bankruptcy and civil code, banks do not view the bankruptcy law in a positive light. But if it were improved, banks would be more receptive.

In US, parties have out of court settlements. That does not happen so much here but it would be good if we could do that more. [Presumably, for the same reasons that it is good to do it in the U.S.]

Registration of security rights in movable property. How important to commercial activity would it be to fix that problem?

The Minister of Justice has produced a draft on movable property collateral. If there would be a registration process, then lending would be different. The draft law from the MOJHA includes provisions on registration as well as a central credit history agency.

Since large loans from banks are secured by real estate, registration of movable property is not so important to the banks. But with the increase in mining activity, there will be large machines coming into the country that could be pledged but can't be now since there is no registration process.

And currently banks focus too much on the value of the collateral. Ideally, the banks should be considering the potential revenue stream and the character of the debtor as well.

Interview of Former Bank Official
9/14/2011

The existing bankruptcy law was written in the late 90's. Hope you have the option to throw that law away, because it is pure garbage.

In 11 years, this bank has never used bankruptcy. Because nobody understands it. Nobody grasps the fundamental concept. If someone goes broke, the bank grabs what it can and sells it. It's a messy inconclusive process. No significant business has failed since 2000.

In Mongolian, the word "bankruptcy" means failure.

I would be shocked if there were anything like a bankruptcy trustee. In 11 years, I've never heard of one. We don't even have appraisers here.

Buildings are registered. Lien is registered. Foreclosure. Bailiff sells the building.

Defaults on loans secured by real property are rare.

Immovable property cannot be used as security because there is no way to perfect the security interest (i.e., to register it). As a result, no one tries to enforce a security interest in inventory or other personality. (They take a pro forma security interest anyway.)

Courts are terribly unsophisticated here. No commercial courts. Most judges went to law school before 1990, i.e., before the switch to private property.

It is essential to carve out some dedicated judges. Not going to educate 300 judges in commercial law. But could educate 5.

It's a primitive and political system. In the countryside the Bank always wins because we're part of the structure of the community. Here in UB we lose because we're not part of the structure. Here, whoever pays the bribes wins.

We don't make car loans because you can't rely on the courts to enforce the claim.

The enforceability of a guarantee is questionable.

The COP of the judicial reform project was a former Weil Gotschall lawyer. He concluded that this is a government of men, not laws. And he was right.

The objective [of a project such as BPI] has to be to get somewhere real, where it actually works. To get there is the real challenge. It involves getting a few judges and lawyers trained.

There's no demand for a bankruptcy law.

Deficiency judgments are almost never enforced.

We should speak with some workout loan people from the Bank.

The system could work better. The Bank doesn't have stroke with the judges in UB. They are debtor friendly. We'd like to be able to go to an impartial court.

With loans of $100,000 to $150,000 there are almost never junior secured creditors.

There is very little unsecured [trade] credit.

Trade creditors can't sue. So, they rarely extend credit.

To improve small-business formation, we need movable property registration

How long will it take to get there and what are the practical pay backs?

It's difficult for individuals to overleverage themselves. [Thus, no need for personal bankruptcy law.]

Everything else is secured by cash flows (salary, pensions, etc.).

In the countryside, lenders [including banks] threaten the extended family if there is a default.

Before 2000 there was no bank lending. Herders lent to herders etc. No defaults.

The bank is different. It represents authority. If you can beat the bank, you beat them. The same sort of fidelity you had among people is not extended to banks. [This seems to be a carryover from the socialist era when the bank was part of the government. Many people still think banks are government agencies.]

That is the reason bankers overcollateralize. The best collateral is an apartment.

Compensatory lending.

Changing the legal system [order of priority]

> Movable property registration. Can't borrow against your car or other personality. Free up capital. See de Soto.
>
> Dedicated judges. Don't know who the opposition to that would be.
>
> > The Interviewee knows a judge who agrees this.
> >
> > Head of MOJHA must bless it or it won't happen. He might have a problem with a specialized commercial court.

If you build it, they might come.

The number 3 or 4 person in the Ministry of Justice is the go-to external lawyer. Trained in Berlin and London. Litigated with the Bank from time to time.

The idea of a trustee does not exist here.

Virtually certain that the workout guy at the Bank would not have a clue about what bankruptcy is. He's not a lawyer.

The place is growing incredibly fast. It will continue to do that. It does need significant upgrades in the laws. At some point it will require a functioning bankruptcy system. It's a long process.

It's good that someone from the Mongolian Government asked for this. The question is can we make an impact in terms of getting the process started, explaining the issues, why it has to happen. Maybe the first step is a policy clarification. Then it becomes a question for USAID as to how many resources to put into this. Do we put $3 million into it or something less.

How investor friendly is Mongolian legal system?

> Zero. You would be crazy to come into this market and assume that the court system would work for you. You must have someone local (whether honest or dishonest) who can protect you.
>
> There is a long history of fleecing foreigners.
>
> No one would make a significant investment here without having an offshore arbitration clause.
>
> The BCM represents the major businesses in town.

The way the Interviewee looks at this is as a project to get something started, to assess what needs to be done. Making that inventory is all you can do. Get some sense of the lay of the land.

Interview with Lawyer and Trustee
9/15/2011

World Bank Doing Business Survey

> The law firm was established in 2003. One of the founders contributed to the survey. He is not available today. He also participated in several bankruptcy cases.
>
> The firm provides professional legal services in many areas. Cooperates with mining companies. Has a partnership with Gibson Dunn. Provides oral and written legal counsel.

Assistance with legislation. Represents clients in court in civil and administrative proceedings.

The Interviewee is a lawyer and a bankruptcy trustee. Has handled several cases.

Does not know who else participated in the Closing a Business part of the survey.

The Interviewee's participation as a trustee in bankruptcy cases

He has been a trustee in one case but also participated in devising the plans for trusteeship in three other cases.

What does "devising a plan for trusteeship" mean?

A client comes to bankruptcy and wants to have a bankruptcy case and the law firm provides studies about the ways and implications of possible bankruptcy, including the appointment of a trustee.

Are these clients creditors?

Can be either debtor or creditor, but the one case where he was a trustee, the client was a creditor.

Clarification: None of the creditors was a client of the law firm.

Description of the case in which the Interviewee was a trustee.

That case was reviewed by the regional court. The respondent was a meat company that had incurred debt. The claimants were an investor, tax authority, the social insurance agency, and another company. The meat company had not transferred the SIA commissions to the SIA.

The meat company owed money to its creditors but was unable to pay it out of cash flow. So they addressed this matter in a meeting of shareholders. So the insolvency issue arose regarding payments to creditors. The amount being discussed was 2 billion MNT plus other items.

Before the court proceeding the creditors had waited a certain amount of time to see whether the company would pay but when they saw that it would not, they initiated the bankruptcy case.

When did the Interviewee get involved in the case and what happened before that?

The Interviewee was nominated by one of the creditors.

The process is as follows: First the claimant files a claim with the court. The court reviews the claim and issues an ordinance regarding the possibility of opening the case and asks the claimant to nominate a temporary trustee. And then the temporary trustee is appointed by the court. Then there needs to be an assessment of whether the company is insolvent. This assessment is done. Then after a period of time, the court publishes an announcement in the media that the company is insolvent and claimants should file their claims. All the claimants gather at the first meeting of claimants. At the meeting, the claimants review their claims and nominate the actual trustee, who then proceeds with his duties as specified by the law, including protecting assets. The meeting of claimants issues the reorganization plan and the trustee presents the plan to the court.

Does the trustee prepare the draft plan for the creditors to approve or does someone from the creditors meeting prepare the draft? The trustee has the duty of preparing a

draft plan, but sometimes creditors propose separate plans. Several plans may be discussed and reviewed.

Another duty of the bankruptcy trustee is to resolve disputed claims with creditors.

The actual bankruptcy trustee collects funds owed to the debtor. He also restricts the powers of the management of the insolvent entity.

The claimants can decide whether to suspend the powers of the management. But they do not have the power to oust the management entirely.

Should the trustee have the power to get rid of the existing management and replace it with other management, including possibly the trustee? The Interviewee does not believe it is necessary to fire the management. The trustee should not have the power to fire the existing management.

Thoughts on the existing bankruptcy law. How should it be changed?

The Interviewee believes that the law should be considerably revised. It needs to be revised or replaced

Harmonization with the existing laws is missing. [lists several laws]

Timing. The times specified in the law do not translate into reality. They are too short for some entities to study and prepare plans.

The issue of registration and the tax authority. The tax authority must conduct an audit and determine liability. The company should be liable but it is already liquidated.

Protection of assets during temporary trustee period.

It is done mainly through the provisions of the law on court decision enforcement. According to them, the assets of the insolvent debtor are arrested, documents are placed in a locked safe.

The temporary trustee files a request with the court for an order of the court decision enforcement to protect the assets.

Time frames: A week can elapse between the filing and the appointment of the temporary trustee and a week further before the trustee requests the order protecting the assets.

Should it be shorter or is that time acceptable?

It is normal. The risk of the debtor destroying or stealing is possible, but, at the same time, the creditor may also request protection of the assets at the time the case is filed. If the period is shortened, there may not be enough time for the court to review the papers.

Has the Interviewee written anything on how the law should be revised?

The Interviewee does not know of any articles or memoranda on how the law should be revised.

There were some studies during college regarding some bankruptcy assets, but nothing representing substantial changes.

No one from the WG has contacted the Interviewee to obtain his views on the existing law or how it should be changed. Nor any other law firm to his knowledge. They heard that a WG has been established.

The Interviewee would like to have input in the bankruptcy revision and also other laws. But due to time constraints, there is sometimes no opportunity for real cohesion. The law

firm has participated in the NGO of young lawyers and presented their opinions on various laws through this organization.

There is no bar association other than the association of defense lawyers.

Would consider accepting an invitation to serve on a working group to revise the law.

Should trustees be licensed by a government or non-governmental agency?

There should not be licensing or examinations because it will create a lot of bureaucracy. Rather, the lawyers may pursue specialization in bankruptcy trusteeship.

The Interviewee would like the future law to have more cohesion with other laws.

Interview with Bank Executive and Trustee 9/15/2011

Experience as Trustee with Current BK Law

Mongolia's first law on corporate bankruptcy was passed in 1991.

In 1997 the current law of bankruptcy was adopted and is in effect now.

The Interviewee is a certified public accountant and a lawyer.

Back then, Mongolian professionals had little understanding of bankruptcy.

In 1994, the Interviewee worked on the reorganization of a state-owned enterprise. Restructuring of the debts and putting the assets of the insolvent entity in order and giving it back to the state. Ornokh (specialized in trade). It was subsequently purchased by private interests (Technic Imports). Technik Imports was then purchased by another company (NN).

The Interviewee was the bankruptcy trustee on that reorganization. It was a court proceeding. The Interviewee was appointed by the court. The judge wanted to select someone knowledgeable in accountancy and state property. The Interviewee was secretary of the privatization commission, a state agency.

That case was processed under the first bankruptcy law.

Creditors in that bankruptcy:

No secured creditors.

3 unsecured creditors.

There was no feasible collateral. The bank accepted the revenues of that company as collateral. The bank provided the loan against cash flow. The Agricultural Bank (now Han Bank) was the lender. The loan amounted to 10,000,000 MNT in 1994 money, a huge sum.

The company had assets but it accumulated a lot of debts over time. That is why the bankruptcy was

There were buildings and automobiles. The bank did not take the buildings or cars as collateral. Only the income stream.

At the time the whole system was still operating under socialist economic standards. The bank expected to get paid, but because both it and the company were owned by the state, it was not critical that it get repaid. The state would assure the continued operation of both the company and the bank (a kind of cross-subsidization).

In socialist times, the economic entities were expected to cover loan expenses by revenue. In the case of Ornokh, the company supplied products to its customers but did not get paid, which caused the company to be unable to pay its debts when due.

The reorganization of Ornokh was not part of a privatization process. But it was necessary in order to make the privatization possible. If the debts had not been restructured, no private company would have been interested in buy it.

The 1991 law.

It was less extensive than the 1997 law.

Did the 1991 law provide sufficient guidance to the court and trustee for the Ornokh reorganization?

Yes, the 1991 law was important in achieving its goals during the transition period.

The 1997 law expanded on this.

There were some deficiencies in the 1991 law. It had no provision for post-petition borrowing (recapitalization). New money was crucial to the success of the reorganization. Making valueless objects value objects. [Taking assets without value and turning them into assets with value.] The company had accumulated a considerable number of debts and after the reorganization, the debts were removed. The debts were restructured and settled, so the company no longer had any paper debts.

Clarification. The company did not borrow new money during the bankruptcy.

Was the deficiency the absence of a provision for restructuring and eliminating debts through a reorganization? Yes.

They did it anyway through the management means. What is meant by that? As the trustee, the Interviewee arranged to pay the most urgent debts of the company and in so doing was able to restructure the company.

The total sum of debts at the time was around 12,000,000 MNT in 1994 money. Only three creditors: The bank (Khan Bank), the tax authority, and the social insurance authority.

There were suppliers who demanded payment for services (electrical utilities), and these debts were paid. This was not a significant amount of debt.

The social insurance authority represented the interests of the employees. This authority paid the employees and then stepped in their shoes as a creditor in the bankruptcy.

Was this basically a negotiated reorganization in which the trustee worked out a plan with the creditors, which they accepted and the court approved?

Did the court have the authority under the 1991 law to approve the plan and cancel certain debts?

How much did the plan say would be paid to the three creditors?

The total 12,000,000 was distributed to the creditors. The creditors were paid in full.

The fees for the bankruptcy trustee were paid from the revenues of the insolvent company. There was no commission. the Interviewee received his regular salary as an employee of the state.

The entire bankruptcy lasted about three months and all creditors were paid in full at the end of the bankruptcy.

How?

He presented the papers to the court and with all the papers and balance sheet out of which the payments were made.

Where did the money come from?

The company was owed more than 12,000,000 at the time of the bankruptcy case and the trustee collected that money and paid it to the creditors.

Why wasn't the previous management able to do that?

It was mismanagement of the company that led to such a situation. The trustee took over the management of the company. The previous management was fired, but nothing else happened to them.

Other reorganization cases?

There have been other reorganization cases.

In 2000 the American experts came and conducted training for licensed bankruptcy trustees and held an examination to award the participants a license but due to the law on licensing, the licenses were not valid and it was somehow abandoned. All of the initial licensees other than the Interviewee were lawyers. The Interviewee thinks that trustees should be accountants, not lawyers.

Input on WG process

Neither the Interviewee nor other bankruptcy practitioners were invited to participate in the Working Group. He has made comments from time to time in response to questions but has not submitted anything in writing. He believes that it will not be possible to reform the law properly without the input of practitioners who know how things work in practice.

Interview of Entrepreneur with Over 10 Years Experience
9/21/2011

The impediment is time. Banks consider 2 years a long-term loan.

There is money available from a variety of areas.

The interest rate is a problem. Why 13% if there is a 99.2% re-payment rate.

Banks want some type of security. They want your real property as security. They'll take whatever you can give them.

Leasing is in its early stages here. If necessary, they the heavy boys (coercive threats) to get their loan back.

The smaller you go down to the credit unions, they're getting quite smart. The CU's do micro-lending.

The law is another battlefield. I have a claim against one of the big corporations. They do not have anything like a charter called customer charter. The courts are not in the business of protecting the parties or plaintiffs.

In my country, I would never see the judge or know who it is until the hearing. Here you meet the judge at the time the case starts. At least one of the parties will have gotten to the judge and fixed the case. Many fear that they've lost before they even start.

There is no such thing as a small claims court.

There are no established mediator or arbitration system in Mongolia.

Borrowing to expand.

Go to the bank and find out what the rate is.

Because I have money invested in the bank, I can get the loan.

You would go to a savings and loan company (Monkord)