A GUIDE TO BOARD OF DIRECTORS

IN JOINT-STOCK COMPANIES OF KYRGYZ REPUBLIC

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CONTENTS

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INTRODUCTION

In the contemporary world, the role and value of a board of directors in companies increase day by day. Many companies which were previously fully managed by their owners are now entering the new stage of their business development requiring new approaches to direction and control. Companies having a board of directors in their structure reassume its significance and opportunities for enhancing their efficiency and performance. International financial institutions conducting surveys of corporate governance in companies give special consideration to their board of directors in terms of its independence, coordination and efficiency.

It is obvious that not every company needs a board of directors. For example, there are many small and medium-sized enterprises that can effectively operate without it. But any emerging company will eventually enter the stage when the increase in the scale of operations, number of employees and amount of assets can give rise to certain management issues for its operating owners, which, in turn, can lead to a slowdown in its growth. However, non-operating owners may also need help from professional practitioners to provide supervision over senior management (CEO or executive board) and to set long-term strategic direction for the company's daily operations. Members of the board of directors may include not only financial or legal experts but also technical experts specializing in a particular field of activity pursued by the company, such as engineers, architects, technicians, programmers, etc. It is encouraged that apart from the professional qualifications and personal qualities, the members of the board should be able to act independently and in the interest of the company and all of its owners rather than for the benefit of individual owners and/or groups of owners whom they represent.

As a rule, the most typical functions of the board of directors include: supervision over senior management; development of strategic plans; oversight over internal control and risk management; representation and protection of owners in matters related to strategic management of the company. Thus, the board of directors is not only an intermediate corporate organ but also a link between managers and owners (shareholders), a guarantor of good and transparent governance and a key element of the effective organizational structure of the company.

This guide provides an overview of the main requirements under Kyrgyz law for the board of directors as one of the governing bodies in joint-stock companies. Issues covered in this guide include board of directors' operating procedures, functions, eligibility criteria, liability, etc.

The information provided in this guide is not detailed or conclusive due to its limited scope and is based solely on the analysis of the current laws of the Kyrgyz Republic (the «Kyrgyz Law») effective December 21, 2015. This guide is intended primarily for members of the board of directors, senior management (sole or collective executive bodies), shareholders and other interested parties.

This guide has been developed by Kalikova & Associates lawyers: Magomed Saaduev, Ruslan Sulaimanov and Meerim Talantbek kyzy. We appreciate the comments provided by IFC Central Asia Corporate Governance Project. This guide is available online through Kalikova & Associates' website at: **www.k-a.kg**.

1. Operating procedures of the board of directors

This guide is based solely on the following legal acts: Civil Code of the Kyrgyz Republic, Part I of May 8, 1996 №15 (last amended July 30, 2015) and Part II of January 5, 1998 №2 (last amended July 24, 2015) (the «**Civil Code**»); Joint-Stock Companies Act of the Kyrgyz Republic of March 27, 2003 № 64 (last amended May 22, 2015) (the «**Companies Act**»); Bankruptcy (Insolvency) Act of the Kyrgyz Republic of October 15, 1997 № 74 (last amended April 20, 2015) (the «**Bankruptcy Act**»); Criminal Code of the Kyrgyz Republic of October 1, 1997 (last amended July 28, 2015) (the «**Criminal Code**»); Code of Administrative Liability of the Kyrgyz Republic of August 4, 1998 (last amended August 3, 2015) (the «**Administrative Code**»).

Under the Companies Act, a joint-stock company (the «**Company**») having more than 50 (fifty) shareholders must have a board of directors (the **"Board of Directors"**) as one of its governing bodies.

1.1. General

The Board of Directors provides overal direction to the company except for the matters falling within the exclusive competence of the General Meeting of Shareholders. The Board of Directors of the Company must have an odd number of members not fewer than 3 (three) and not greater than 11 (eleven) as specified in the charter or resolution of the General Meeting of Shareholders.

1.2. Elections

Members of the Board of Directors are elected by the General Meeting of Shareholders of the Company for a term of 3 (three) years in a manner prescribed by the Companies Act or the charter of the Company. If the term of office of the current members has expired but the new members have not been elected, the Board of Directors will serve until the new members are elected. Under the Companies Act, the members of the Board may be re-elected an unlimited number of times.

New appointments to the Board of Directors are made by electing the entire Board if the remaining directors constitute less than half of the total membership.

The General Meeting of Shareholders can elect the Board of Directors by cumulative voting only[1].

1.3. Meetings

Regular meetings of the Board of Directors can be held as the need arises, but not less than once in every quarter. The procedure for calling and holding regular meetings of the Board of Directors is set out in the charter or internal regulations of the Company. If so provided in the charter of the Company, the Board of Directors can take action without a meeting.

The meeting of the Board of Directors may be called by the chairman of the Board on his own initiative or at the request of:

- any member(s) of the Board of Directors of the Company;

- audit committee or auditor of the Company;

- executive body of the Company or other persons specified in the charter of the Company;

- securities market regulatory authority of the KR, in cases involving violation of securities laws of the KR.

A quorum for the transaction of business at any meeting of the Board of Directors must be established by the charter of the Company and must not be less than half of the total number of elected members of the Board of the Company.

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1 With cumulative voting, each shareholder is entitled to a total number of votes equal to the number of Board members to be elected multiplied by the number of voting shares a shareholder owns. The shareholder can cast all of these votes for one candidate or split them among several nominees for director. In any election of directors, the candidates receiving the highest number of affirmative votes are elected.

1.4. Action

At all meetings of the Board of Directors, the act of a majority of the total number of the members of the Board elected by the General Meeting of Shareholders, is the act of the Board of Directors, unless otherwise provided by the Companies Act, charter or internal regulations of the Company setting forth the procedure for calling and holding the meetings of the Board of Directors. Each member of the Board of Directors of the Company is entitled to one vote on each matter submitted to a vote at a meeting of the Board of Directors.

Members of the Board of Directors of the Company may not delegate their voting power to other members of the Board.

If so provided in the charter of the Company, the chairman of the Board of Directors may have a second or casting vote in the event of an equality of votes being cast on one matter.

1.5. Formal record of action

A written record of the actions taken at the meeting of the Board of Directors of the Company must be completed within 10 days from the date of such meeting and should state the following:

- place and time of the meeting;
- agenda of the meeting;
- list of persons present at the meeting;
- matters submitted to a vote and voting results;
- actions taken by the Board of Directors.

A written record must be signed by the chairman and secretary of the meeting who are responsible for the accuracy of the data set out therein.

1.6. Removal

By the resolution of the General Meeting of Shareholders, any director or the entire Board of Directors may be removed before the expiration of their term of office[2].

If the number of members of the Board of Directors of the Company becomes less than half of the number of members specified in the charter of the Company, the Company must call a special meeting of shareholders to elect the new Board of Directors of the Company. The remaining members of the Board of Directors can only take actions relating to the calling and preparing of a special meeting of shareholders.

2 Directors appointed to the Board of Directors to replace disqualified directors can serve until the expiration of the term of the entire Board of Directors.

2. Eligibility criteria for members of the board of directors

The Companies Act does not specify eligibility criteria for members of the Board of Directors except that it prohibits directors from simultaneously serving as members of the audit committee or auditors of the Company.

Members of the Board of Directors need not be shareholders of the Company; requirements for candidates to the Board of Directors of the Company can be set out in the charter or internal regulations of the Company approved by its General Meeting of Shareholders. Also, in practice, members of the Board do not serve in executive positions since the executive body is appointed by the Board of Directors and accountable thereto.

3. Functions (competence) of the board of directors

Functions (competence) of the members of the Board of Directors of the Company are mainly set out in Articles 53, 54, and 69 of the Companies Act, and in the charter and/or other internal regulations of the Company[3].

Under Kyrgyz Law, the Board of Directors has exclusive competence over the following matters:

- Approval of strategic goals and policies of the Company and oversight over their implementation by the executive body;

- Approval of internal regulations of the Company, amendments and supplements thereto (except regulations of the Board of Directors and the Auditing Committee);

- Approval of major transactions (involving assets with a value equivalent to minimum 20% and maximum 50% of the book value of the Company's assets, unless otherwise provided by its charter);

- Election of the executive body and approval of its compensation;

- Election of the CEO, in the case of the collective executive body;

- Approval of early resignation or removal of the executive body;

- Recommendation to the General Meeting of Shareholders as to the amount and mode of payment of dividends;

- Recommendation to the General Meeting of Shareholders as to the reorganization of the Company or creation of its branch or representative offices;

3 For example, the regulations of the Board of Directors approved by the General Meeting of Shareholders.

- Election of the independent auditor and approval of his compensation;

- Recommendation to the General Meeting of Shareholders as to the amount, conditions and procedure for increasing or reducing the number of outstanding shares;

- Preparation of materials for consideration by the General Meeting of Shareholders;

- Oversight over implementation of resolution of the General Meetings of Shareholders;

- Election of the secretary of the Company;

- Approval of the resolution to issue bonds not convertible into shares and other securities with the total par value equivalent to 50% of the book value of the company's assets as of the date of such resolution;

- Prior approval of the Company's annual report (at least 30 days before the date of the annual General Meeting of Shareholders).

The matters falling within the exclusive competence of the Board of Directors may not be delegated to other governing bodies of the Company (except approval of interested-party transactions where interested parties represent more than half of all members of the Board of Directors of the Company, in which case, the relevant resolutions must be approved by the General Meeting of Shareholders)[4].

4 In joint-stock companies not having a board of directors, the matters falling within the exclusive competence of the board of directors can be delegated to the general meeting of shareholders or the executive body as provided by their charter, unless otherwise provided by the Companies Act.

4. Requirements for transactions involving directors

The Companies Act sets out a number of requirements for interest-party transactions. Thus, a director is treated as having an interest in a transaction, if he and/or his close relatives and/or affiliated person(s):

- are involved in such transaction as a party or representative or intermediary;

- own over 20% of the voting shares (interests, units) of a legal entity involved in a transaction as a party or representative or intermediary;

- are officers of a legal entity involved in a transaction as a party or representative or intermediary.

Members of the Board of Directors having an interest in a transaction must provide the following information to the Board of Directors, Audit Committee (Auditor) and independent auditor of the Company[5]:

- information about the legal entities in which they own solely or jointly with their affiliated person(s) over 20% of the voting shares (interests, units);

- information about the legal entities in which they hold executive positions;

- information about a proposed transaction (conditions and type of transaction, material facts relating to type and degree of interest therein) between the Company and an individual or legal entity whose director or other persons affiliated with the director may be treated as having an interest (the "Interested-Party Transaction") under the Companies Act.

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5 An open company must disclose information about the interested-party transaction within 5 days from the date of such transaction by making public announcement in mass media and notifying the Securities Market Regulatory Authority about such transaction, including conditions and type of transaction, material facts related to type and degree of interest therein. Such information must be also included in the quarterly and annual reports of the Company prepared by it under Kyrgyz Law.

An interested-party transaction can be approved by the Board of Directors of the Company by a majority vote of non-interested directors. If more than half of all members of the Board of Directors of the Company are interested parties, such transaction must be approved by the General Meeting of Shareholders. An interested-party transaction not meeting the requirements set out in the Companies Act may be declared invalid by court order[6].

6 An interested party bears liability to the Company and shareholders to the extent of damages caused thereby and must indemnify the Company and shareholders for damages inflicted thereto by an interested-party transaction and return all amounts received thereunder to the Company. If there are several interested parties, they will be held severally and jointly liable to the Company. The officers of the Company who approved an interested-party transaction not meeting the requirements set out in the Companies Act bear liability to the Company and shareholders to the extent of damages inflicted by such transaction.

5. Duties and responsibilities of directors of troubled companies

In troubled companies, the members of the Board of Directors have the following duties and responsibilities:

- they must not interfere in the affairs of the troubled company by giving direct instructions, orders or other directives in the form of requests or recommendations to the executive body except as provided by the constituent documents of this company or Kyrgyz Law;

- they must provide necessary documents and assist the company in the matters related to the appointment of a special administrator.

When a troubled company goes bankrupt as a result of the acts or omissions of the members of its Board of Directors deliberately intended to facilitate or augment its insolvency in the interests of such members or third parties (deliberate bankruptcy), the creditors can claim compensation for damages caused by the offenders and impose other liability on the offenders in the manner provided by law.

In the above case, if the property of the troubled company is not enough to cover its obligations, the members of the Board of Directors can bear secondary liability imposed by court order.

If a court awards damages to the creditors of the troubled company against the members of the Board of Directors of this company, it will also consider disqualification of the members of the Board of Directors for the period and in the manner set out in Kyrgyz Law[7].

7 Under Article 83 of the Bankruptcy Act, chief executive officers of a troubled company can be disqualified for a period of 1 (one) to 5 (five) years for any first-time breaches and for a period of ten (10) years for any repeat breaches. The period of disqualification is determined based on the degree of guilt and the amount of damage caused to the creditors. A court may defer consideration of the disqualification case for a period of up to 3 (three) months. If during this period, the creditors are not compensated for damages, disqualification can be imposed for a maximum period of 5 (five) years. If the creditors are compensated for damages, the period of disqualification is determined based on the degree of guilt of the involved person for causing damages to the creditors.

6. General overview of civil, administrative and criminal liability of directors

6.1. General

Civil, administrative or criminal liability can be imposed on the members of the Board of Directors for breach of Kyrgyz Law.

Civil liability is imposed on directors of the Company for breach of civil law and involves the duty to compensate the Company or its creditors for any damages caused thereto by the unlawful acts or omissions of directors.

Administrative or criminal liability is imposed on directors of the Company for breach of tax, labor, securities or other laws.

6.2. Civil liability

Under Article 88.3 of the Civil Code and Articles 65.3 and 65.4 of the Companies Act, a director can be individually liable for damages caused to the Company by his acts or omissions. Where several directors are responsible for such damages, they are held jointly and severally liable to the Company.

However, directors who voted against or did not vote for the resolution that caused any damage to the Company are not held liable for such damage. Civil liability can be imposed on directors by court order at the claim of any interested party filed within 3 (three) years from the date the damage occurred.

6.3. Administrative liability

Administrative liability is imposed on directors for breach of the Administrative Code.

As a rule, administrative liability involves the duty to pay a fine expressed as a certain amount of specified rates[8]. The amount of the fine imposed on directors for commission of administrative offences provided by the Administrative Code depends on the type and gravity of the administrative offence.

The presumption of innocence applies to all administrative cases, which means that any individual or legal entity charged with an administrative offence is presumed innocent until proven guilty in the manner provided by law or by final and binding judgment of court or judge or by order of public body or official that reviewed the case within the scope of its authority. The person charged with the administrative offence does not carry the burden of proof of his innocence[9].

6.4. Criminal liability

Criminal liability can be imposed on directors of the Company for committing criminal offences provided in the Criminal Code and punishable by fines, public works, debarment, disqualification, or imprisonment. Criminal liability can be imposed on officers of the Company, including directors, only by court order.

The presumption of innocence applies to all criminal cases, which means that any individual or legal entity charged with a criminal offence is presumed innocent until proven guilty by final and binding judgment[10].

8 Under the Specified Rate Act of the KR No. 13 of January 27, 2006, specified rate is a statutory monetary rate used to calculate the amount of social payments, compensations, economic sanctions, administrative penalties and fines, other economic rates not related to salary. The amount of specified rate is approved by Parliament upon the recommendation of the Government. Under Parliamentary Resolution No.1115-III of June 15, 2006, the amount of specified rate is 100 Kyrgyz soms.

9 Article 5 of the Administrative Code.

10 Article 3.2 of the Criminal Code.

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