

# Implementation of Alter Ego Shareholders and Their Responsibilities According to the 'Piercing the Corporate Veil' Doctrine in Indonesia

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The application of the piercing the corporate veil doctrine can be carried out in cases, such as fraud, inadequate capital, failure to fulfill the formality of company establishment, and abuse of authority within the company as a result of the dominance of one or more shareholders (alter ego). The method used in this paper is a normative juridical approach by comparing the common law system with civil law, and in addition this writing also approaches the legal synchronisation, both vertically and horizontally, to the responsibilities of shareholders in the company. Data obtained is through library research. The results found that the principle of accountability of shareholders in the company a conflict of legal norms occurred. On the one hand the legal norms regulated in Article 3 paragraph (1) of Law Number 40 Year 2007, concerning Limited Liability Companies, stipulates that limited liability companies are only responsible for the limited capital included in the company. On the other hand, it requires shareholders not only to be responsible for the amount of shares owned but can be responsible for exceeding their shares as regulated in Article 3 paragraph (2). In addition to the conflicting legal norms, there is also a blurring of norms in the Limited Liability Company Law, concerning alter ego criteria related to the pooling of shareholders and company profits, or there is no separation of wealth between shareholders and corporate entities. Furthermore, in the Law on Limited Liability Companies in Indonesia, there is also a legal vacuum to apply the piercing doctrine of the corporate veil to hold the shareholders accountable for which the consequences of such acts lead to acts against the law.

**Key words:** *Shareholders, Alter Ego, Piercing the Corporate Veil.*

## Introduction

A Limited Liability Company means that "shareholders of a corporation are not personally liable for debts incurred or torts committed by the firm." (Stephen, 2002) Therefore the Limited Liability Company is metaphorically referred to as a corporate veil as a separate legal subject (separate legal personality ) whose purpose is to protect shareholders. (Posner & Scott, 1980). This is in line with the doctrine of the separate legal personality of a company (Nasution, 2016) which confirms that, between a company and its shareholders, there is a veil of separation. This means that there is the principle of limited liability of shareholders in the company. (Anderson *et al*, 1995) That thinking is generally based on the opinion that "a corporation may exist and act as an entity or legal unit separate and apart from its shareholders." (Cox et al., 1997). The doctrine of a separate legal personality of a company must be understood not to absolutely protect shareholders from personal liability. Because the responsibility of shareholders can change into the condition of piercing the corporate veil according to the doctrine of piercing the corporate veil, (Bendremer, 2005) that is the responsibility of shareholders personally, due to the actions of companies influenced by shareholders. (Miller, 1995) This can occur if shareholders become alter ego, where the existence of shareholders becomes part of the company and considers it their own. (Thompson, 1991). The condition of piercing the corporate veil occurs, if the company is used by shareholders to commit fraud by making the company an alter ego of shareholders. (Leigh, 1965) The application of the piercing doctrine of the corporate veil and alter ego requires strong and deep thinking, so as not to get into obstacles in its application.

In the context of corporate law in Indonesia related to the legal regulation of the principle of alter ego and piercing the corporate veil in Law Number 40 of 2007 concerning Limited Liability Companies, is basically the result of foreign legal transplants (legal transplants, legal borrowing or legal adoption) (Watson, 1974) which in its application in Indonesia experiences obstacles and conflicts of the legal system to hold shareholders accountable for acts against the law committed by the company, due to the influence of shareholders based on the principle of alter ego and piercing the corporate veil.

The political system of law in Indonesia is dominated by the civil law system from the Dutch colonial legacy which has entrenched the legal system in Indonesia primarily to hold people accountable for acts against the law. Civil law is a codified law. (Cruz, 2010) This is in line with Kahn-Freund's (1974) opinion that the success of transplantation depends mainly on the associated political system, while Legrand (1997a; 1997b) and Seidman (1994) have the view that law as a construct is culturally formed and cannot be grafted into other cultures. (Werner, 2016)

## Literature Review

### *Limited Liability Companies in Law*

Indonesia regulates Limited Liability Companies in Law No. 40 of 2007. This law regulates the responsibilities of shareholders in carrying out company activities, but in its regulations it seems inconsistent, so that there is a blurring of legal norms regarding shareholder responsibility, including: First, shareholder responsibility is the determination of the limitation of shareholders' personal liability for company obligations. That is, when the company is unable to fulfill its obligations, shareholders are only responsible for the amount of capital that is included in the company. This is based on the doctrine of separate legal personality of a company. Second, the doctrine of piercing the corporate veil means that shareholders are responsible for personal property.

## Methods

This research is a normative legal research and data are sourced from library data (library research). This research tends to use secondary data in the form of primary legal materials and secondary legal materials. Primary legal material is legislation relating to the dominance of shareholders as alter ego and its accountability according to piercing the corporate veil, for example the Limited Liability Company Law and the Banking Act. Secondary legal material is the view of legal experts, quoted from the literature that supports the framework of thought and analysis of the object of research. The secondary legal material is in the form of reading books relevant to this research, the results of scientific writing such as theses, dissertations, journals, papers, and research reports in accordance with the topic of this research study (Sadalia et al., 2017 and Erlina et al, 2018). The Tertiary Legal Materials or supporting legal materials which include material which provide instructions and explanations for primary and secondary legal materials, such as public dictionaries, legal dictionaries and scientific journals, as well as materials outside the relevant legal field and can be used to supplement the data needed in research.

## Results and Discussion

### *Results*

#### *Arrangement of Alter Ego Shareholders and Piercing the Corporate Veil in Indonesia*

The provisions contained in Act Number 40 of 2007 concerning Limited Liability Companies in particular Article 3 paragraph (1) contain the principle that between the company and shareholders there is a dividing veil. This can be described as follows: "Article 3 paragraph

(1) of the Act -Rule No. 40 of 2007 concerning Limited Liability Companies, states that the Shareholders of the Company are not personally responsible for the agreements made on behalf of the Company and are not responsible for losses of the Company in excess of shares owned. Paragraph (2), the provisions referred to in paragraph (1) do not apply if: First, the requirements of the Company as a legal entity have not been or are not fulfilled. Second, the relevant Shareholders either directly or indirectly in bad faith use the Company for personal gain. Third, the relevant Shareholders are involved in illegal acts committed by the Company. Fourth, the relevant shareholders either directly or indirectly illegally use the Company's assets, resulting in the Company's assets being insufficient to pay off the Company's debts.

The provisions of Article 3 paragraph (1) are in line with the doctrine of separate legal personality of a company. With this doctrine there is a confirmation that, between the company and the shareholders there is a veil of separation. Here it can be understood about the principle of limited liability of shareholders in the company . Based on the provisions of Article 3 paragraph (1) of the Limited Liability Company Law and the doctrine of separate legal personality of a company, it can be understood that the limited liability is a determination of the limitation of shareholders' personal liability for company obligations (Erwin et al., 2018). That is, when the company is unable to fulfill its obligations, shareholders are only responsible for the amount of capital that is included in the company.

On the one hand the Law on Limited Liability Companies accommodates the doctrine of a separate legal personality of a company, and on the other hand the Law also accommodates the doctrine of piercing the corporate veil. This means that in certain cases the limited liability of shareholders does not apply, as specified in Article 3 paragraph (2) of the Limited Liability Company Law in advance. Where the provisions of Article 3 paragraph (2) are a measure that makes shareholders to not be protected by the doctrine of separate legal personality of a company. Based on the piercing doctrine of the corporate veil, shareholders are responsible for their personal assets.

### ***Implementing of the Piercing the Corporate Veil***

The application of the piercing the corporate veil doctrine can be done in cases, such as fraud, inadequate capital, failure to fulfill the formality of a company establishment, and abuse of authority within a company as a result of the dominance of one or more shareholders. In addition, the doctrine of piercing the corporate veil may also be imposed for cases of avoiding legal obligations, violating fiduciary duties and agencies, dividends that are not paid or excessive dividend payments to shareholders, and majority shareholders use individual guarantees for themselves personally to bear obligations of the company. Another factor is regarding the distribution of company funds by dominant shareholders, for example, as can be observed from the Century Bank case. (Wiriadinata, 2012).

The Century Bank case began with the failure of the bank to fulfill the prefund clearing (interbank transactions) at Bank Indonesia on November 13, 2008. On November 21, 2008, the Governor of Bank Indonesia announced that BI through the Financial System Stability Committee (KKSK) had decided to take over Century Bank by Deposit Insurance Agency (LPS). Although Bank Indonesia realises that Bank Century's health condition is in a bad condition, LPS asks customers not to panic because the agency will guarantee all of Bank Century's liquidity needs with an allocation of funds of Rp. 1 trillion. Based on LPS data, the injection of funds that had been disbursed by the agency to Century Bank total funds disbursed was Rp. 6.77 trillion. Evidence of Bank Century's management irregularities in carrying out its operations is increasingly visible when the status of the suspect is assigned to the former President Director of Century Bank, based on the investigation of police investigators there have been violations of banking crimes.

### ***Determination of Piercing the Corporate Veil***

Determination of the qualification of piercing the corporate veil is seen from the following indicators: First, fraud. Second, alter ego. Third, corporate entities. Fourth, agency.

1. Fraud committed by shareholders. Here the Court will impose unlimited liability when shareholders use corporate entities to commit fraud, mislead creditors when conducting business transactions with companies, divert funds out of the company fraudulently, or otherwise commit fraudulent actions within corporate entities.
2. The alter ego or instrumentality doctrine. Both of these doctrines teach that shareholders will be subject to unlimited liability if there is a pooling of shareholders and company profits or there is no separation of wealth between shareholders and corporate entities.
3. The doctrine of enterprise entity or enterprise liability that can be used so that shareholders can be held responsible to shareholders' personal wealth. Both of these theories allow the court to expand responsibilities within a group of companies, including the relationship between the parent company and its parent companies and other groups that are affiliated with the corporate entity.

The enterprise entity doctrine states that when two or more companies conduct business as a business entity, the plaintiff may make a lawsuit outside the company's assets. Unlike the piercing theory, enterprise entity theory provides a form of horizontal responsibility - that is, access to assets of entities that are merged or affiliated and are not shareholders - as well as forms of vertical responsibility (to grab the assets of a parent company as a shareholder in a subsidiary or parent-shareholder). Although the court articulates the basis for giving responsibility to the parent company based on this theory, at least there must be a unified interest. This unification occurs when the parent company holds the control in operational activities of the subsidiary that exceeds its authority. So, the two companies in reality have

run business activities as a single company.

In addition to the above qualifications, the accountability of shareholders can also be seen from the agency principle indicators to hold shareholders accountable to personal assets as principals, when shareholders treat or use company entities as their agents. Corporations as legal entities certainly have their own legal identity. The legal identity of a corporation or company is separate from the legal identity of its shareholders, directors, and other organs. In the civil law rules, it is clearly stipulated that a corporation or legal entity concludes that the subject of civil law can carry out trading activities, can make agreements or contracts with other parties, and can sue and be prosecuted in court in civil relations. Shareholders enjoy the benefits derived from the concept of limited liability, and corporate activities take place continuously, in the sense that their existence will not change despite the addition of new members or the cessation or death of existing members. Until now, the concept of criminal liability by corporations as individuals (corporate criminal liability) is still a matter of debate. Many parties do not support the view that a pseudo corporation can commit a crime and have a criminal intent that gives birth to criminal liability.

### ***Discussion***

Based on the explanations above, it shows that the adoption of alter ego of shareholders and their responsibilities, according to the corporate veil piercing doctrine, which means that in certain cases the limited liability of shareholders does not apply, there is a conflict of law, vagueness of legal norms and a legal vacuum. For this reason, efforts are needed to be divided into 2 (two) stages, namely: First, the short term, a memorandum of understanding between the criminal justice system is needed in the framework of holding shareholders accountable for bad intentions and unlawful acts committed by shareholders as alter ego; this is intended to overcome the blurring and conflict of legal norms. Second, in the long run, a Supreme Court Regulation (PERMA) is needed that can be used as a literacy to apply the piercing the corporate veil doctrine to the responsibilities of shareholders that are unlimited. In Indonesia, although a limited liability company law can be used as a legal basis to impose criminal liability on shareholders, the Criminal Court has so far been reluctant to recognise and use these regulations. This can be seen from the few cases of corporate shareholder crime in court and of course the impact on the very few court decisions that can apply shareholder accountability by putting the alter ego and Piercing the Corporate Veil as the basis for determining shareholder misconduct. As a result, there is no reference that can serve as a precedent for the judicial environment in Indonesia.



## **Conclusion**

The implementation of shareholder alter ego and shareholder responsibility based on the Piercing the Corporate Veil principle in Indonesia, experienced a legal conflict with the existing legal system and institutionalised related accountability arising from acts against the law, so that the application of alter ego and Piercing the Corporate Veil, was very difficult to attribute to a certain form of action (actus reus or guilty act) and prove the element of mens rea (criminal intent or guilty mind) of an abstract entity such as a corporation in which there are shareholders.



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