CHAPTER II
LITERATURE REVIEW

A. Conceptual Framework

1. Overview of Business Organisation Models

One of the most important factors to consider when establishing a business is the business organisation model that the owner would use to establish his or her business. It is crucial because the model of business organisation chosen could determine the extent of liability the business would have.

a. Overview of Business Organisation Models in Indonesia

The business organisation models in Indonesia could be classified into two categories, legal entity form and non-legal entity form.[30] The difference between these two categories is that the legal entity form is a creature of the law, whereas the non-legal entity form is not. Legal entity form of business organisation models consists of limited liability company (*perseroan terbatas*), foundation (*yayasan*), and cooperative (*koperasi*), while non-legal entity form of business organisation models consists of sole proprietorship (*perseroan perseorangan*), partnership (*persekutuan perdata*), firm (*firma*), and limited partnership (*persekutuan komanditer* or *commanditarie vennootschap*).[31] These models will be further explained below.

1) Legal Entity Form of Business Organisation Models

One of the characteristics of a business organisation model in a legal entity form is that there is a separation between the assets of the owners and the assets of the business organisation model, hence the owners could only be held liable to the extent of their assets in the business organisation model.[32] As mentioned above,

[30] Yohana, "Tanggung Jawab Hukum atas Bentuk Usaha Badan Hukum dan bentuk Usaha Non Badan Hukum", *Jurnal Mercatoria* 8, no. 1 (June 2015): p. 48.
[31] Ibid.
[32] Ibid.

the legal entity form of business organisation models includes limited liability company, foundation, and cooperative, which will be explained briefly below.

a) Limited Liability Company (*perseroan terbatas*)

2007 Limited Liability Companies Law defined limited liability company as a legal entity, which is composed of an authorised capital that is divided into shares and is established in accordance to a contract with the purpose to carry out business activities and which has fulfilled the requirements specified the 2007 Limited Liability Companies Law.

b) Foundation (*yayasan*)

Foundation is defined, in Law of the Republic of Indonesia Number 16 of the Year 2001 concerning Foundations (hereinafter referred to as "Foundations Law"), as a legal entity that does not consist of any member and has assets that are set aside to be used to achieved specific objectives in the social, religious, and humanitarian sectors.

c) Cooperative (*koperasi*)

Article 33 paragraph (1) of the 1945 Constitution of the Republic of Indonesia as amended by the First Amendment of 1999, the Second Amendment of 2000, the Third Amendment of 2001, and the Fourth Amendment of 2002 (hereinafter referred to as "1945 Constitution"), stated that:

"The economy shall be organised as a common endeavour based upon the principles of the family system."

Cooperative carries out its activities based on the principles of cooperative, which include the family system mentioned in the Article 33 paragraph (1) of the 1945 Constitution.[33] As defined in Law of the Republic of Indonesia Number 25 of the Year 1992 concerning Cooperatives (hereinafter referred to as "1992 Cooperatives

[33] Ibid.

Law"), Cooperative consists of individuals or other cooperatives, whereby the nature of its members is voluntary and transparent.

2) Non-legal Entity Form of Business Organisation Models

This form of business organisation models is mostly based on the concept of partnership, such as firm and limited partnership, which are regulated in the Indonesian Commercial Code.[34] These models of business organisation are fundamentally based on contract.[35] On the other hand, sole proprietorship is different from both firm and limited partnership as it is considered private business, which is established and owned by the sole proprietor.[36] The most apparent difference between legal entity form of business organisation models and those of the non-legal entity form is the liability of the models. Unlike legal entity form of business organisation models, non-legal entity form has unlimited liability, which means that the owners' personal assets could be used to cover damages the business suffers.

a) Sole Proprietorship (*Perseroan Perseorangan*)

Sole proprietorship is one of the most basic form of business organisation models in Indonesia as it is owned by one single individual. Usually, sole proprietorship is established by someone who has little capital, limited quantity of goods, or simple production technology.[37] It could also have a legal form based on its business fields, for instance, industry, commerce, or service.[38]

b) Partnership (*Persekutuan Perdata*)

Partnership consists of two or more partners, who usually have the same profession and desire to establish a business together.[39] Article 1618 of the Indonesian Civil Code defined partnership as a contract, whereby two or more people are bound to offer something into the partnership with the purpose to share

[34] Ibid, p. 50.
[35] Ibid.
[36] Ibid.
[37] Ibid.
[38] Ibid.
[39] Ibid, p. 51.

the profits earned. As contract is the foundation of a partnership, it would consequently have to fulfilled the requirements of a legally binding contract, which according to Article 1321 of the Indonesia Civil Code are as follow:

(1) The agreement of the parties

A contract consists of consensualism principle, which means mutual assent or meeting of the minds. Consesualism principle refers to the foundation of the formation of a contract when there is a mutual assent.[40] Therefore, a contract is considered valid only when the parties involved have agreed to the details stated in the contract. Similarly, the parties involved in a partnership must have agreed to all the details in the agreement to create a partnership. Fundamentally, a contract began with an offer from one of the parties, whereby when the other parties accept the offer, they would be considered as agreeing with the offer. Consequently, consensualism principle exists when one of the parties accepts the other parties' offer.

(2) The capacity of the parties to bound themselves

Article 1330 of the Indonesian Civil Law defined a person who lacks capacity as a person who is not considered an adult, who is under curatele or custody, a woman who is not married. Article 330 paragraph (1) of the Indonesian Civil Code defined a person who is not considered as an adult yet as someone who is under the age of 21 and has never been married before. On the other hand, according to Article 29 of the Indonesian Civil Code, a man under the age of 18 and a woman under the age of 15 are forbidden to commit themselves into a marriage. This is further supported by Article 7 paragraph (1) of Law of the Republic of Indonesia Number 1 of the Year 1974 on Marriage (hereinafter referred to as "1974 Marriage Law"), which stated that marriage is only allowed if the groom and bride are already 19 years old and 16 years old respectively. The age limitation imposed by the Indonesian Civil Code and the 1974 Marriage Law is extremely important as a person who is bound in marriage is regarded as an adult, hence has the capacity to enter into

[40] M. Muhtarom, "Asas-asas Hukum Perjanjian: Suatu Landasan dalam Pembuatan Kontrak", *SUHUF* 26, no. 1 (May 2014): p. 51.

a contract although that person is still under 21 years old.[41] Moreover, Article 220 paragraph (2) of the Indonesian Civil Code also explained that divorce does not relieve someone's status as an adult, even though he or she at the time of the divorce is still under the age of 21. However, a person who is not yet considered as an adult could, nevertheless, enter into a contract as long as they are represented by their parents or their guardian.[42] A person is also considered lacking capacity if he or she is under curatele. Article 433 paragraph (1) of the Indonesian Civil Code explained that a person who is under curatele might be mentally incompetent, deranged or emotionally unstable, despite still having the capability to think rationally to a certain extent. Besides that, a woman who is bound in a marriage also used to be regarded as lacking capacity and under curatele. However, the Circular Letter of the Supreme Court of the Republic of Indonesia Number 3 of the Year 1963 ruled that a woman who is already married is no longer considered lacking capability, hence she could be bound in a legal relationship, such as entering into a contract, without the having to as for permission from her husband, unless concerning the marital properties.

(3) The existence of a consideration

Consideration could be categorised into an act or the essence of the contract. Article 1234 of the Indonesian Civil Code divided an act into three, which are the act to give something, the act to do something, and the act to not do something whereas Article 1333 of the Indonesia Civil Law explained that a contract ought to have an essence in the form of an object, which type and quantity could be determined or counted. However, according to Prof. Drs. S. Wojowasito, the word *zaak*, which is used in the Indonesian Civil Law could be defined as an article in the form of an object, a business of a corporation, a dispute, an issue, an obligation or something unimportant.[43]

---

[41] Tan Thong Kie, *Studi Notariat & Serba-serbi Praktek Notaris* (Jakarta: PT Ichtiar Baru Van Hoeve, 2013), p. 129.
[42] Ibid.
[43] Hasanuddin Rahman, *Contract Drafting Seri Keterampilan Merancang Kontrak Bisnis* (Bandung: PT Citra Aditya Bakti, 2003), p. 11.

(4) The legality of a cause

Article 1336 of the Indonesia Civil Law stated that, if a cause or a purpose is not mentioned, but there is in fact a legal cause then the contract is considered valid. Harjan Rusli explained that the Article 1336 of the Indonesian Civil Law is the underlying basis to considered a contract, which does not state the purpose of its creation of the contracts that do not state the purpose, valid.[44] It is further supported by Subekti, who stated that the cause referred to in Article 1336 of the Indonesian Civil Code is none other than the contents of the contract.[45] Therefore, the cause mentioned above does not refer to the reason the two or more people created a binding contract, instead it refers to the contents of the contract created. Hence, the fourth requirement of a legally binding contract refers to the contents of the contract, which do not violate the law.

The four requirements explained above could be divided into two categories, subjective requirement and objective requirement. A subjective requirement is a requirement that correlate with the parties involved or the subjects of the contract itself, whereas an objective requirement applies to the object of the contract.[46] In the case whereby the objective requirements of a contract are not fulfilled, the contract would be legally null and void, thus the contract could be regarded as never have existed before because the parties' purpose of making a contract is in vain.[47] On the other hand, in the case whereby the subjective requirements of a contract are not met, the contract could be annulled by one of the parties or be voidable, hence the contract is still binding for all the parties, unless the court nullified the contract.[48]

c) Firm (*Firma*)

According to Article 17 of the Indonesian Commercial Code, the charter of a firm generally regulate that the managers could act in the name of the firm. Article

[44] Hardijan Rusli, *Hukum Perjanjian Indonesia dan Common Law* (Bandung: PT Citra Aditya Bakti, 1998), p. 102.
[45] Subekti, *Aneka Perjanjian* (Bandung: Alumni, 1984), pg. 19.
[46] Hasanuddin Rahman, op. cit, p. 8.
[47] Ibid.
[48] Ibid.

18 further explained that, if the firm's charter does not specifically mention the regulation above, then any partners of the firm could represent the firm as long as it is for the firm's interests. However, control of the firm is in the hand of all the partners as they are the ones who decided and solved problems through discussion based on the regulations stated in the firm's charter.[49]

d) Limited Partnership (*Persekutuan Komanditer* or *Commanditarie Vennootschap*)

In limited partnership, partners could be divided into two types, which are silent partners and complementary partners. Silent partners, also called passive partners, refer to the partners who only provided money, products, or manpower and do not meddle into the management or control of the limited partnership.[50] Therefore, silent partners only received profits from the business and their liability is limited to the investment they provide.[51]

Contrarily, complementary partners, also called active partners, refer to the partners who manage the operations of the limited liability.[52] In addition, complimentary partners have unlimited liability, unlike silent partners, which means that their personal assets could be subjected to cover the business' debts.[53]

b. Overview of Business Organisation Models in US

In the US, the models of business organisation are categorised into five types; sole proprietorships, partnerships, limited partnerships, limited liability companies, and corporations.[54]

1) Sole Proprietorships

A sole proprietorship model of a business organisation is probably the most basic and the easiest model to create and dissolve. Since this model of business

[49] Yohana, op. cit.
[50] Ibid.
[51] Ibid.
[52] Ibid.
[53] Ibid.
[54] Neal R. Bevans, *Business Organizations and Corporate Law* (New York: Thomson Delmar Learning, 2007), p. 3.

organisation is run by one person, it is usually considered an alter ego of the owner.[55] This also means that as the sole owner of the business, he or she has unlimited freedom to run the business as there would be no shareholders of partners to answer to or to consider, hence leaving the proprietor to make all the decisions they see as necessary and beneficial for the business.[56] However, this also means that the sole proprietor would have to bear all the losses the business suffers and be held liable for any torts the business might face.[57] Furthermore, the losses that the business suffer would have to be covered from the personal assets of the owner as there are not limitation to the owner's liability.[58] Therefore, even though the owner could enjoy as much freedom as they want in terms of running the business, they would also have to bear for any losses the business suffers with their own personal assets. The biggest disadvantage of sole proprietorship is probably the personal liability of the owner. As there is no separation between the sole proprietor and the business, the sole proprietor could be held liable for any business venture. In short, the sole proprietor could be sued for torts and must pay for losses the business suffers.

2) Partnerships

Partnership is considered a contractual agreement between two or more parties with the purpose to conduct a business, thus the principles of contract law are applied when forming a partnership.[59] Partnership could be divided into two different types, general partnership and limited partnership.[60] General partnership could be distinguished from limited partnership by looking at the possibility of the partners to lose their personal assets in order to cover the losses suffered.[61] There are evident advantages that partnership has as compared to sole proprietorship, such as there are more than one person that managed and operated the business, hence

[55] Ibid.
[56] Ibid, p. 46.
[57] Ibid.
[58] Ibid.
[59] Ibid, p. 70.
[60] Ibid.
[61] Ibid.

lessening the burden of the owners.[62] Nonetheless, partnership also has its drawbacks, such as more limitations to the control of the business.[63]

a) Requirements of Partnerships

As the law considers partnership to be, first and foremost, a contract, the parties involved would have to fulfil the requirements of a legally binding contract, which includes[64]:

(1) Mutual Assent[65] or Meeting of the Minds

For a contract to be legally binding, there must be a mutual assent to the details of the contract between all the parties involved.[66] Ergo, when a dispute arises regarding the agreement, the court would always first consider the intent of the parties involved when the agreement was created.[67] Should the intent of all parties is clear, then the court would most likely to upheld that an agreement exists between the parties and should the intent of the parties involved is not clear, then the court would probably rule that there is no agreement between all parties.

(2) Capacity

Capacity refers to the ability of the parties involved in a contract to not only understand the terms of the contract, but also the legal obligations they are subjected to.[68] A person is regarded as lacking in capacity if they are under the influence of either alcohol or drugs, mentally incompetent, still considered as a child or are under the age of 18.[69] Consequently, people who are considered lacking the capacity could not enter into a contract.

---

[62] Ibid.
[63] Ibid.
[64] Ibid.
[65] Mutual assent is the meeting of the minds of the parties to the contract; a general agreement as to the details of the arrangement between the contracting parties.
[66] Ibid.
[67] Ibid.
[68] Ibid, p. 71.
[69] Ibid.

(3) Consideration

Consideration refers to the bargained-for exchange in a contract.[70] It is one of the requirements in a contract, which demand that both parties have something of value to offer to the other parties.[71]

(4) Legality

A partnership that is formed with the purpose to conduct an illegal business in legally void.[72] Legality is a requirement that must be fulfilled by any contract as provided that it is not fulfilled then the court would have to enforce the terms of a partnership agreement despite the fact that the partnership exists for illegal purposes.[73]

b) Types of Partnerships

There are two most popular and basic classifications of partnerships, which are general partnership and limited partnership. These two types of partnerships differ in the rights and obligations of the partners.

(1) General Partnership

General partnership is an agreement to carry out a business between two or more people, whereby all parties involved are liable for torts and debts that may occur during the partnership.[74] Such liability could also be referred to as joint and several liability, which means that the partners are liable for the actions of one another, hence the partners' personal assets may be subjected to judgements when the partnership suffers losses or suffers from bankruptcy.[75] This classification of partnerships can also be formed in different types, such as a two-person partnership and a multilevel partnership, while still maintaining the basic components of partnerships.[76]

---

[70] Ibid.
[71] Ibid.
[72] Ibid, p. 72.
[73] Ibid.
[74] Ibid, p. 73.
[75] Ibid, p. 87.
[76] Ibid, p. 73

(2) Limited Partnership

Limited partnership is created by the state law, thus providing the parties with a limited liability, which could protect their assets from being subjected to.[77] This type of limited partnership will be explained further below.

3) Limited Partnerships

Limited partnership combines the concept of a partnership and the concept of limited liability. Therefore, limited partnership could be defined as a business model that could protect the personal assets of the partners by using the concept of limited liability.[78] The concept of limited liability itself is a legal concept that, when applied in the context of business, refers to the protection of an investor's assets by limiting the losses to the extent of the shares owned by the investor.[79] Unlike sole proprietorships and general partnerships, business owners or partners in limited partnership do not have to worry over liability issues as they could enjoy the concept of limited liability, which protects their personal assets from being subjected to by a judgement and thus more likely to attract investors to invest in the business.

The structure in limited liability consists of general partners and limited partners. General partners have the same role as well as liability as partners in general partnership, although they play the role of business management.[80] On the other hand, limited partners are partners who do not have a say in the management of the business, yet they enjoy the limited liability offered by limited partnership model.[81] It is heavily emphasised in limited partnership model that the extent of the limited partners' is the investment the place in the business.

4) Limited Liability Companies

One of the relatively recent invention of the business model is the limited liability company, which is very similar to limited partnership but they poses the

[77] Ibid.
[78] Ibid, p. 4.
[79] Ibid.
[80] Ibid, p. 96.
[81] Ibid.

legal protections of a corporation.[82] In limited partnership, limited partners are able to enjoy the limited liability offered by this business model, thus investors are aware that they losses are limited to the amount of their investment. However, only limited partners have limited liability whereas general partners still face unlimited liability in limited partnership. Therefore, limited liability company exists as a vehicle to avoid the downside of limited partnership, which is the liability of the general partners. Under the arrangement of a limited liability company, none of the owners would have to bear unlimited liability that could make them lost their personal assets, hence minimising the risk of loss of the managers[83] of limited liability company.[84]

c. Overview of Business Organisation Models in UK

The business organisation models in the UK fundamentally are classified into two, partnerships and companies.

1) Partnerships

The UK's Partnership Act 1980 Section 1 paragraph (1) defines partnership as the relationship between two or more people to carry out a business with the purpose of making a profit, hence it is a voluntary unincorporated association. The legislation in the UK divided partnership into three types, which are ordinary or general partnership, limited partnership, and limited liability partnership.

a) Ordinary or General Partnership

The main characteristic of ordinary or general partnership is that it is nor created by the state as its creation is based on the agreement between the partners to carry out a business together according to what they have agreed upon in the agreement.[85] Another main characteristic of partnership is that all of the partners are jointly liable for the debts and obligations of the partnership, which is regulated

[82] Ibid, p. 127.
[83] Managers refer to the people responsible for the day-to-day operation of a limited liability company whilst the people who invest in a limited liability company are referred to as members.
[84] Ibid, p. 128.
[85] David Ricardo Sotomunte Mujica, "Partnership and Companies a Comparative Approach to UK Business Organisations", *REVIST@ e-Mercatoria* 3, no. 2 (2004): p. 7.

by the capital each partner invested and their involvement in the administration of the partnership.[86]

Furthermore, there are no requirements for the minimum capital placed at the time of the creation of the partnership.[87] In fact, partnership could be established without any capital at all[88] as Section 9 of the Partnership Act 1890 stated that the assets of the partners will always be affected for the debts and obligations occurred during the partnership as long as they remain unsatisfied.

b) Limited Partnership

Limited partnership is defined in the Limited Partnerships Act 1907, whereby the definition is similar to the definition of partnership in general, yet the only difference is the existence of two different types of partners, which are general and limited partners.[89] General partners' duties are to manage the operation of the business and thus there is no limit to their liability while the liability of limited partners amounts to their contribution to the business, such as their work or skills.[90] However, limited partners are not allowed to participate in the operations of the business and if they do participate, then they would be considered as liable as the general partners.[91]

c) Limited Liability Partnership

Limited liability partnership could also be referred to as incorporation partnership, whereby it has all the characteristics of a general partnership while also possesses a separate legal personality and limited liability for the members.[92] Therefore, limited liability partnership is considered as a legal person that could be held liable for its acts and debts.[93]

---

[86] Ibid.
[87] Ibid.
[88] Ibid.
[89] Ibid, p. 8.
[90] Ibid.
[91] Ibid.
[92] Ibid, p. 9.
[93] Ibid.

2) Companies

There are three main elements of a company according to Companies Act 2006, which are the limited and unlimited liability of the members, the way the company's capital is represented, and whether the company is public or private. Therefore, these characteristics could be categorised as follow:

a) Limited and unlimited companies

Based on Part 1 Section 3 of the Companies Act 2006, the terminology limited and unlimited companies refer to the liability of the company's members towards any acts or debts of the company. Paragraph (1) explained that, the liability of the company's members is limited by the constitution if it is a limited company, whereas paragraph (4) explained that a company is an unlimited company if there is no limit to the liability of its members.

b) Limited liability by shares or guarantee

Part 1 Section 3 of the Companies Act 2006 also explained the limited liability by shares and by guarantee. Paragraph (2) stated that the company is limited by shares if the liability of its members is limited by the amount of shares they have, while Paragraph (3) explained that the company is limited by guarantee if the liability of its members is limited by the amount the members contribute to the assets of the company. Hence, the difference between limited liability by shares of by guarantee is the amount and when they would have to pay. For instance, the members of a company limited by guarantee would have to pay the fixed amount as its winding up whereas the members of a company limited by shares would only have to pay the amount of their shares at the moment they became members.[94]

c) Public or private companies

According to Part 1 Section 4 Paragraph (1) and (2) of the Companies Act 2006, a public company is a company limited by shares or guarantee and have a share capital, whereby it is stated in its incorporation certificate that it is a public company whilst a private company is not a public company. A public company would have to be registered as one and so its memorandum of association would have to state that it is a public company, thus if a company

[94] Ibid, p. 4-5.

is not specifically registered as a public company then it would be considered as a private company.[95]

2. Overview of the Concept of Corporation

a. Overview of the Concept of Corporation in Indonesia

The form of corporation is the most common and the most used form of business in Indonesia as it is a capital association and an independent legal entity.[96] In Indonesia, corporation is known as *Perseroan Terbatas* (hereinafter referred to as "PT"), which is adapted from Dutch Commercial Code *Naamloze Vennootschap*, which also means corporation and which for a period of time the term had also been used in Indonesia.[97] In fact, the corporation form adapted by Indonesia and Netherland originated from France, known as *Societe Anonyme* in French, which literally means a company without name.[98] Article 36 of the Indonesia Commercial Code explained that corporation or PT does not use the name of one or all of its members, but it adopted its name from the purpose of the company itself.[99] The purposes and objectives of the corporation referred to should not contradict the legislation, public order, and ethics.[100]

1) Corporate as An Artificial Person

The concept of corporate as a legal entity brings forth the existence of corporate as a separate legal subject from its shareholders, hence a corporate needs its Directors as its representatives because unlike human beings, a corporate is an artificial person, thus it needs to be represented by human beings.[101] Article 98 paragraph (1) of the 2007 Limited Liability Companies Law regulated that the

---

[95] Ibid, p. 5.
[96] I. G. Rai Widjaya, S.H., M.A., *Hukum Perusahaan: Khusus Pemahaman atas Undang-undang Nonor 1 Tahun 1995 Perseroan Terbatas Belaku (Efektif) sejak 7 Maret 1996* (Indonesia: Kesaint Blanc, 2000), p. 1.
[97] Ibid.
[98] Ibid.
[99] Ibid.
[100] Ibid, p. 3.
[101] Nike K. Rumokoy, "Pertanggungjawaban Perseroan selaku Badan Hukum dalam Kaitannya dengan Gugatan atas Perseroan (dengan Undang-undang Nomor 40 Tahun 2007 tentang Perseroan Terbatas sebagai Acuan Pembahasan)", *Jurnal Hukum Unsrat* XIX, no. 2 (Januari-Maret 2011): p. 15.

Directors could represent the corporate inside or outside the court. Therefore, the Board of Directors is one of the important organs of a corporate.

Furthermore, in carrying out its obligations, Directors of a corporate must always prioritise the interests of the corporate and correspond to the purposes and objectives of the corporate as stated in Article 92 paragraph (1) of the 2007 Limited Liability Companies Law.

b. Overview of the Concept of Corporation in US

According to Hayden and Bodie, corporation is an entity created by the law, whereby it has a legal personality with the rights to enter into a contract, acquire and dispose a property, as well as suffer from liability for torts.[102] Corporation is also created with the purpose to represent individuals for business and other similar purposes. The fact that corporation is created by the law thus having its own legal personality and status, means that it would continue to exist even though there are changes to the individuals involved as long as there is someone who could act on its behalf.[103]

1) Elements of A Corporation[104]

A corporation that is legally constituted will have several basic elements, such as:

a) having a perpetual existence, whereby a corporation could exist indefinitely unless terminated by the people who created it;

b) having the ability to sue and be sued, whereby a corporation can hire solicitors to file a suit against an individual or another corporation for any violations. Likewise, a corporation can also be sued and when the suit filed against it is successful, then its assets could be seized to satisfy the judgement. However, only the corporate's assets would be subjected to seizure while the personal assets of the shareholders would be protected by the limited liability of a corporation;

[102] Grant M. Hayden and Matthew T. Bodie, "The Uncorporation and the Unraveling of "Nexus of Contracts" Theory", *Michigan Law Review* 109, no. 6 (2011): p. 1127.
[103] Ibid.
[104] Ibid, p. 159-160.

c) being able to own properties, whereby because a corporation is created by the law and it has a separate legal personality from the people who created it as explained above, a corporation is able to own properties in its own name; and

d) possessing articles of incorporation[105] and being able to create corporate bylaws, which are established to regulate and to control the day-to-day operations of the corporation as well as to create policies for issues such as contract negotiations, employee requirements and funds disbursal.

c. Overview of the Concept of Corporation in UK

A company is created through the process known as incorporation, whereby as a result of incorporation, a company gains a separate legal personality and became an independent legal person distinct from its owners and members.[106] There were three mechanism of incorporation that existed in UK, which were companies incorporated by the Crown, companies incorporated by Parliament though passing an Act, and companies incorporated by Registration with a public official under the Companies Act 1985.[107]

1) Companies Incorporated by the Crown

The grant of a Royal Charter was one of the mechanisms by which companies were incorporated. Historically, royal charters were used by the state to incorporate municipal corporations, which then extended to domestic trading companies.[108] Companies incorporated through this mechanism were usually private companies, which were established by the capital from the members, managed by the directors and had royal charter granted to them.[109]

2) Companies Incorporated by the Parliament

Companies incorporated by parliament though the passing of a general act were most of the time formed for public purposes, such as post offices, bank,

[105] Articles of incorporation refers to the document that frames the creation, organisation, day-today operation, sale of assets, identity of registered agent, and dissolution of a corporation.
[106] David Ricardo Sotomunte Mujica, op.cit, p. 1.
[107] Ibid.
[108] Ibid, p. 2.
[109] Ibid.

historic buildings, and museum.[110] In addition, there was also another type of act passed by the parliament to incorporate companies, which was a private act that is petitioned by the owner of a company with a special commercial interest.[111]

3) Companies Incorporated by Registration with a public official

It was very difficult and it still is for common business people to obtain a royal charter or a parliament act in order to incorporate a company.[112] Furthermore, there were also problems in the case of court procedures against unincorporated joint stock companies.[113] Consequently, the Parliament passed the Joint Stock Companies Act 1844, which created the Office Registrar for Joint Stock Companies and the procedure to incorporated companies before the registrar.[114]

3. Overview of the Concept of Corporate Liability

a. Overview of the Concept of Corporate Liability in Indonesia

As it was explained above that a corporate was established through the articles of incorporation and it became a legal entity when its articles of incorporation were endorsed by the Minister of Justice of the Republic of Indonesia.[115] As the result of the endorsement, which makes the corporation a legal entity, the liability of the shareholders became limited.[116] This means that the shareholders of the corporate could not be held personally liable for the acts done in the name of the corporate and could only be held liable to the extent of the amount of shares they held.

According to Article 23 of the 2007 Limited Liability Companies Law, the articles of incorporation of a corporate as well as its amendments need to be approved or to received announcement from the Ministry of Justice for it to be effective. As long as the corporate's articles of incorporation and its amendments

[110] Ibid.
[111] Ibid.
[112] Ibid.
[113] Ibid.
[114] Ibid.
[115] I. G. Rai Widjaya, S.H., M.A., op. cit, p. 11.
[116] Ibid.

have not received approval nor announcement from the Ministry of Justice, then the Directors of the corporate would be liable for all acts done in the name of the corporate in a joint responsibility.[117] Based on the explanation above, it could be concluded that as long as the corporate's articles of incorporation has been endorsed by the Ministry of Justice, the corporate would obtained a separate legal entity similar to that of a real person.

As a corporate becomes an independent legal entity, it gains its own rights and responsibilities and its existence does not rely on the existence of its owners not its Board of Directors and Board of Commissioners, hence the change in the board does not affect the existence of the corporate as a *persona standi in judicio*[118].[119] To elaborate further, a corporate could be accounted for contractually (*contractuele aansprakelijkheid*) when it breached a contract or not contractually (*buitencontractuele aansprakelijkheid*) when it committed an act against the law.[120] Article 1365 of the Indonesian Civil Code further explained that every act committed against the law that brings damages to other people, held the person, who is responsible for their mistakes that cause the damages, to compensate the damages. In addition, a corporate as a legal entity could also be held liable according to the Criminal Law (*strafrechtelijke aanspraktilijkheid*).[121]

1) *Ultra Vires* According to the 2007 Limited Liability Companies Law

Ultra vires refers to the actions of the corporate under the condition that it lacks the capacity to carry out those actions because those actions are beyond the purposes and objectives of the corporate.[122] *Ultra vires* actions are essentially considered null and void, hence they do not bind the corporate.[123] However, it is

---

[117] Ibid.
[118] *Persona standi in judicio* is a right which a person has generally, to sue or defend action. Standing or character enabling a person to appear in a lawsuit is *persona standi in judicio*. *Persona standi* is essential for a person to vindicate his or her right. Generally, every person has got the right to file suit seeking relief for infringement of his or her right. However, that right can be deprived by operation of law. A person is not entitled to sue or defend until the removal of any disability which law imposed on him. But title to sue is a legal interest which a party must obtain to initiate particular action.
[119] Nike K. Rumokoy, op. cit, p. 13-14.
[120] Ibid, p. 14.
[121] Ibid.
[122] Ibid, p. 15.
[123] Ibid.

difficult to determine when actions of the corporate could be considered as *ultra vires* pertaining to the purposes and objectives of the corporate. There is often a need to interpret the purposes and objectives of the corporate in a reasonable cause, which means in accordance to the norms. For instance, the jurisprudence from several cases upheld that actions that are considered as *ultra vires* actions could still bind the corporate, given it was proven that the third party, whom the corporate did transaction with, acted in good faith and had acted with reasonable care.[124]

For some actions, the Board of Directors must have the consent from the General Meeting of Shareholders (hereinafter referred to as "GMS") or the Board of Commissioners, whereby the legality of the Board of Directors' actions is bound to the approval mentioned.[125]

b. Overview of the Concept of Corporate Liability in US

As it was discussed above, a corporate is an independent legal entity and has a separate legal personality, which means that it could be considered as an artificial person, hence liable for actions carried out on behalf of it civilly or criminally. Moreover, it was also mentioned above that the duties of the corporate's directors are different from the duties of its shareholders, hence the corporate's directors could be held civilly liable to the corporation if they breached their duties.[126] This shows that the personal assets of the directors could be subjected to cover any economic injuries the corporate suffers as a result of the negligence of the directors. The court has agreed and upheld that the directors of a corporate must exercise ordinary care and diligence when carrying out their duties as well as act in good faith and in the corporate's best interests, otherwise they could be held liable for gross negligence.[127]

1) Business Judgement Rule

The business judgement rule is a rule, which creates presumption that directors of a corporate carry out their duties in good faith and in the best interest

[124] Ibid.
[125] Ibid, p. 16.
[126] Neal R. Bevans, op.cit, p. 264.
[127] Ibid.

of the corporate, even if their decisions result in economic loss for the corporate.[128] This is based on the fact that the court has reasoned that the directors should be the best judges to the situations and circumstances at that time since they were well acquainted with the facts and the financial situation of their company, hence they should be acting in the best interest of the company.[129] However, it is undeniable that what might seem as the most favourable negotiation conditions of that time could not be as attractive as they were months or years later, thus it is justifiable to assume that at that time the directors had acted in good faith in accordance with their corporate duties.[130] Therefore, the business judgement rule acts as a prevention for the shareholders to bring actions against the directors when they are not as familiar with the situations and conditions at that time as the directors, thus unable to evaluate the factors objectively.[131]

2) *Ultra Vires* Actions

Ultra vires literally means beyond the power, hence when the directors of a corporate carry out an act deemed as *ultra vires*, then the business judgement rule explained above would not be able to protect them.[132] For example, a business with the purpose of function as a nonprofit business is not allowed to carry out activities that would bring them profit. However, a corporate might be allowed to carry out certain actions that directors are not allowed to because they do not have the power to do so. In fact, directors would need to be authorised by the corporate charter to be able to carry out certain actions.[133]

c. Overview of the Concept of Corporate Liability in UK

A corporate is considered as having the legal capacity to operate as a business vehicle, hence it would have to face potential liability such as tortious and criminal liability.[134]

---

[128] Ibid, p. 266.
[129] Ibid.
[130] Ibid.
[131] Ibid.
[132] Ibid, p. 271.
[133] Ibid.
[134] Russell Hinchy and Peter McDermott, *Company Law* (Australia: Pearson Education Australia, 2009), p. 93.

1) Tortious Liability

A company is vicariously liable for the tortious conduct, such as negligence, fraud, and defamation of its employees and agents.[135] This is based on the fact that these employees and agents are the directing mind and will of the company.[136] For instance, directors and senior executive officers are the directing mind and will of the company in respect to management decisions, while company secretaries are the directing mind and will of the company in respect to administrative decisions. Therefore, a company might be primarily liable for the tortious conduct of its directors, senior executive officers, and secretaries.

2) Criminal Liability

Through the directing mind and will of the employees and officers, such as the directors, senior executive officers, and secretaries, a company could also be primarily liable for a criminal offence.[137] The Criminal Code Act 1995 codifies the general principles of criminal responsibility under the laws of the Commonwealth and also applies to criminal offences committed by both individuals and corporations.[138] As such, the Criminal Code Act 1995 also regulated regarding physical elements, fault elements other than negligence, negligence, intervening conduct or event, and even manslaughter committed by the members or by the corporate itself.

4. Overview of the Concept of Group Company

According to Emmy Pangaribuan, a group company is a combination or an arrangement of companies, whereby each of them is an independent legal entity, which are tightly related to one another so that they create an economic unity that complies under the governance of the holding company as a central control.[139]

---

[135] Ibid, p. 104.
[136] Ibid, p. 105.
[137] Ibid, p. 106.
[138] Ibid, p. 107-110.
[139] Miranda Chairunnisa et al, "Pertanggungjawaban Perusahaan Induk Terhadap Perusahaan Anak dalam Hal Terjadinya Pencemaran dan/atau Kerusakan Lingkungan Hidup", *USU Law Journal* 2, no. 2 (November 2013): p. 32.

Group company is usually created when a company wants to widen its sector by forming subsidiaries for a certain sector of business, whether in the country or abroad.[140] Moreover, the economic reason for the creation of a group company could not be separated from the fact that there are business interests or corporate strategy on the business sector the group company is venturing into.[141]

A group company in general consists of a holding company and one or more than one subsidiary. Holding company or parent company is the central governance, which controls and coordinates the subsidiaries in an economic unity.[142] The central governance of the holding company shows the possibility to carry out rights and directions, which are deciding in nature.[143] Therefore, with the authority of the holding company that acts as a central governance, which collectively controls its subsidiaries as a management unit, the holding company is considered as performing its function as a holding company.

On the other hand, subsidiary company is a legal entity, which has an independent standing and separate from other legal entities as well as has its own rights and responsibilities as a legal entity and has its own assets separate from the assets of the shareholders, regardless whether the shareholder is a holding company or not.[144]

B. Legal Framework

1. Legal System

As a tradition, the law in every society is different from one another as it is influenced by background, history, character or behaviour, sense of law, and perspective.[145] A society that tends to be homogeneous with a single character would need a codified law through the forming of laws.[146] On the other hand, a

[140] Ibid, p. 32-33.
[141] Ibid, p. 33.
[142] Ibid.
[143] Ibid.
[144] Ibid.
[145] Syofyan Hadi, "Mengkaji Sistem Hukum Indonesia (Kajian Perbandingan dengan Sistem Hukum Lainnya)", *DiH Jurnal Ilmu Hukum* 12, no. 24 (Agustus 2016): p. 149.
[146] Ibid.

heterogeneous society's development of law tends to be through the court's judgements of case by case.[147] In a religious society, the law is mostly influenced by the values of religion, hence it has a religious character and transcendence.[148]

a. Civil Law System

Roman Law is the pioneer of the Civil Law system and even though Roman Law is the soul of the Civil Law system, the influence of the Roman Law is also very strong in the development of the common law system as the founder of the norms in Common Law system had first studied the Roman Law system or the Civil Law system.[149]

The Civil Law system uses statutes or acts as its main source of law, which are the written and codification of other sources of law.[150] However, in some countries of the Civil Law system, court's judgements have also been used as a legal source reference, although the nature of such judgements is only as accessories to what have been regulated in existing the statutes of acts.[151] The changes and development of law in the Civil Law system are quite dependant on the Parliament and this has made the laws that exist in Civil Law system countries associated with strong political elements, though at the same time becoming more theoretical, coherent, and structured.[152]

b. Common Law System

The Common Law system originated and has been adopted in England since the 16th centuries, whereby the system was developing rapidly to other countries, such as Canada, the US, and Commonwealth countries, encouraged by the geographical situation and the continuous political and social development.[153] Unlike Civil Law system, which its source of law is codified, the highest source of

---

[147] Ibid.
[148] Ibid.
[149] Farihan Aulia, Sholahuddin Al-Fatih, "Perbandingan Sistem Hukum *Common Law*, *Civil Law* dan *Islamic Law* dalam Perspektif Sejarah dan Karakteristik Berpikir", *Legality* 25, no. 1 (Maret-Agustus 2017): p. 100.
[150] Ibid.
[151] Ibid.
[152] Ibid.
[153] Ibid, p. 103.

law in Common Law system is the norms of the society that are developed further in courts and would become precedents.[154]

In addition, although the US and most Commonwealth countries inherited the tradition of the Common Law system, the American Law, for example, tend to be unique in a lot of aspects.[155] This is because during the independent revolution of the US, the legal system in the US was detached from the British legal system, hence it developed independently afterwards.[156] Therefore, the judges in the American courts would sometimes look into cases in UK, which the judges of the cases had created precedents and principles from, when there were no newer laws that replaced or overturned the old ones from the early 19th centuries.[157]

2. Indonesia 2007 Limited Liability Companies Law

The 2007 Limited Liability Companies Law regulates the limited liability of the members of a company, such as the shareholders, the directors and the commissioners in Article 3, Article 97, and Article 114 respectively. In Article 3 Paragraph (1) of the 2007 Limited Liability Companies Law, it regulates that shareholders of the company could not be held liable for the actions done on behalf of the company and if the shareholders are held liable, they are only subjected to pay as much as the amount of their shares. However, there are exceptions to the limited liability of the shareholders, which are regulated in the subsequent paragraph. The paragraph explains that the provision stated in Paragraph (1) is not applicable if the requirements of the company's status as a legal entity are not satisfied, therefore the company could be considered as carrying out its business illegally. Furthermore, it also explains that shareholders could be held liable for the company's damages, regardless of the amount of shares they own, if they exploits the company in bad faith for their personal interests, if they are involved in illegal acts committed by the company, or if they illegally use the company's assets such that the remaining assets are not enough to cover the company's debts.

---

[154] Ibid.
[155] Ibid, p. 106.
[156] Ibid.
[157] Ibid.

The limited liability of the Board of Directors is regulated in Article 97, particularly in Paragraph (3), Paragraph (4), and Paragraph (5), of the 2007 Limited Liability Companies Law. In Article 97 Paragraph (2), it is stated that the Board of Directors must act in good faith when performing their responsibilities of managing the company. Therefore, Paragraph (3) states that if the directors are at fault or in negligence when carrying out their duties, then they should be fully liable for any damages or losses as a result of their actions. Moreover, when the Board of Directors consists of two or more members, then the liability should be joint and several for each member. Similar to the exceptions of the limited liability of the shareholders, the directors could be free from any liability subjected upon them if they could prove that the damages are not caused by their fault or negligence, they have performed their management duties and responsibilities in good faith and in accordance to the purposes and objectives of the company, they do not have direct interest to the actions that caused damages to the company, and they have taken necessary actions to prevent the losses from happening, which all are stated in Article 97 Paragraph (5) of the 2007 Limited Liability Companies Law. In addition, the exceptions to the limited liability of the Board of directors would also apply in the event of insolvency, whereby as stated in Article 104 Paragraph (2), the members of the Board of Directors would be jointly and severally liable for the unpaid debts of the company if the whole assets of the company is insufficient to pay for the company's liabilities unless, as stated in the subsequent Paragraph (4), that they could prove the following:

a. the insolvency of the company is not caused by neither their fault nor negligence;
b. they have carried out their duties in good faith and in accordance to the purposes and objectives of the company with full liability for the company's interests;
c. direct conflict of interest is not present in any actions performed by them; and
d. they have taken prevention actions to avoid the insolvency.

The 2007 Limited Liability Company Law regulates the limited liability of the Board of Commissioners in the same was as that of the Board of Directors. The limited liability of the Board of Commissioners and the exceptions are regulated in

Article 114, particularly in Paragraph (3), Paragraph (4), and Paragraph (5). Furthermore, the liability of the Board of Commissioners in the event of insolvency is also stated clearly in Article 115, which is the same as the substance of Article 97 regarding the Board of Directors.

3. US Model Business Corporation Act 2016

The Model Business Corporation Act (hereinafter referred to as "MBCA") 2016 regulates the liability of both shareholders and directors. Section 6.22 of the MBCA 2016 Paragraph (a) regulates that shareholders are not liable for the acts carried out on behalf of the corporation towards creditors, unless to pay for consideration amounted to no more than the shares they owned and if their liabilities to the company's losses are stated in an agreement. Paragraph (b) also regulates that shareholders could not be held liable except if the articles of incorporation stated otherwise or if the cause for the company's liabilities is the shareholders' own conduct or acts.

The MBCA 2016 also regulates the standards of liability for directors in Section 8.31, whereby in Paragraph (a), it is stated that the director should not be liable to the company nor the shareholders, unless it is proven that they carried out actions in bad faith, made decisions not according to the best interests of the company or decisions that are beyond their authority, lacked objectivity due to personal relationships, they acted in negligence towards the growth of the company, and to received financial benefits from third parties. However, when the other parties, who seek to hold the directors liable should bear the burden to prove that the directors' actions have caused damages to other people, hence creating causality between the directors' actions and the damages done.

4. UK Companies Act 2006

Part 10 Chapter 7 Article 232 of the Companies Act 2006 regulates the provisions protecting the directors from liability. Paragraph (1) of the Article 232 states that there should be no provisions that exempt directors from their liability, especially in connection with negligence, default, breach of duty or trust. If there are such provisions, then those provisions would be considered as void.

C. Theoretical Framework

1. Organ Theory

Otto von Gierke was the first person to put forward the organ theory, which explains that a legal entity, such as a corporate, is like a human being that is truly in a legal association.[158] Organ theory sees a legal entity as something real and not fictional.[159] According to this theory, a legal entity becomes a *verbandpersoblich keit*, which refers to an entity that forms its will by using tools or organs, such as its members or its shareholders, as its mediation.[160] Therefore, what were decided by the organs are the will of the legal entity.

2. Piercing the Corporate Veil Theory

Piercing the corporate veil theory is one of the most well-known theory in the company law not only in the legal system of Indonesia, but also in the legal system of most countries. The implementation of this theory has a main objective, which is to achieve fairness especially for a third party that has a certain legal relationship with the corporate.[161] In the studies of company law, the term piercing the corporate veil has become a doctrine or a theory that is described as a process of burdening legal responsibility to someone or to another company over acts of law done by a company offender without considering the facts that the actions were done by the company offender itself.[162] In this kind of condition, the court would ignore the corporate's status as a legal entity and the privilege of the corporate's organs to enjoy the limited liability given by the corporate's status as a legal entity by burdening the liability on the corporate's organs.[163] Hence, in such situations, the court is said to have pierced the corporate veil and the theory of piercing the

---

[158] Dyah Hapsari Prananingrum, "Telaah Terhadap Esensi Subjek Hukum: Manusia dan Badan Hukum", *Relfeksi Hukum* 8, no. 1 (2014): p. 87.
[159] Ibid.
[160] Ibid, p. 88.
[161] Munir Fuady, *Doktrin-doktrin Modern dalam Corporate Law dan Eksistensi dalam Hukum Indonesia* (Bandung: PT. Citra Aditya Bakti, 2002), p. 7.
[162] Ibid, p. 8.
[163] Ibid.

corporate veil is usually applied when there are damages or lawsuits from a third party against the corporate.[164]

There are several universal examples of cases, whereby piercing the corporate veil theory is implemented. Among them, two examples are going to be discussed further in this paper, which are the implementation of piercing the corporate theory because of acts against the law or criminal acts and in the relationship between a holding company and its subsidiary.

a. The Implementation of Piercing the Corporate Veil because of Criminal Acts

If there is any criminal element in an activity of a corporate, even though the activity is done by the corporate itself, then according to piercing the corporate veil theory, the organs of the corporate, such as the directors and the shareholders, could be held liable by the law.[165] The same condition should also apply if the corporate carried out an act against the civil or private law. For instance, a large corporate is running the business with a small capital or if the corporate is formed especially for the purpose of carrying out dangerous activities without authorised permit, such as producing explosives.[166]

b. The Implementation of Piercing the Corporate Veil in the Relationship Between A Holding Company and Its Subsidiary

Besides applied towards a sole company, piercing the corporate veil could also be applied towards a group company. According to the legal studies regarding such application towards a group company, piercing the corporate theory could be implemented based on Instrumentality Doctrine.[167] This doctrine explained that the shareholders (the holding company) could also be held liable for the acts done by its subsidiary, given the condition that one of the elements below is satisfied[168]:

1) Express agency; or
2) Estoppel; or

[164] Ibid.
[165] Ibid, p. 13.
[166] Ibid.
[167] Ibid.
[168] Ibid, p. 14.

3) Direct tort; or

4) Could be proven that there are these three elements:

a) Control over subsidiary by holding company

b) The use of control over subsidiary by holding company to commit fraud, dishonesty, or other unfair actions

c) There are damages as a result of the breach of duty from the holding company

3. Legal Development Theory

Prof. Mochtar Kusumaatmadja propelled as well as convinced that the law is not only could, but also has a role in development.[169] In other words, Mochtar emphasised the function and the role of law in development. Mochtar defined the development that he reffered to as[170]:

> *"Development in the widest context involves all aspects of the people's lives and not only from the aspect of mere economy, hence the term economy development is actually not so precise because we could not build the economy of a society without involving the development of the other aspects of the people's lives."*

The essence of development, according to Mochtar, is change and the role of law in the development is that law has to guarantee that the change would be carried out smoothly. What he meant by the change being carried out smoothly is that the urgency of order as one of the classical functions of the law is emphasised to aid development.[171] Change, which is the essence of development and order that are two of the important functions of law, is a common purpose of a developing society.[172] In addition, when law is taking a role in the development, it could not be understood as a statistic element that is always behind the change itself.[173] Instead, the law should be in front of the change to guide it, thus the role of law is not as the

[169] Atip Latipulhayat, "Mochtar Kusumaatmadja", *Padjadjaran Jurnal Ilmu Hukum* 1, no. 3 (2014): p. 628.
[170] Ibid.
[171] Ibid, p. 629.
[172] Ibid.
[173] Ibid.

follower but has to be the prime mover of development.[174] As such, Mochtar intended to use law as the society's instrument of change.

[174] Ibid.