EXTENSION OF PARENT COMPANY'S LIABILITY AGAINST THIRD PARTIES OF SUBSIDIARY COMPANY

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Abstract

A parent company's liability for their subsidiary's third-party injury, which arises from its own instruction, is a major issue in the law on corporate groups. The 'separate legal entity', 'limited liability', and 'limited liability within limited liability' principles in a pyramidal corporate group construction are the causal factors of this legal complication.

Abstrak

Tanggung jawab induk perusahaan terhadap kerugian pihak ketiga dari anak perusahaan yang menjalankan instruksi induk perusahaan menjadi permasalahan hukum utama pada perusahaan kelompok. Tiga penyebab permasalahan tanggung jawab hukum dalam perusahan kelompok disebabkan oleh berlakunya prinsip separate legal entity, limited liability, maupun limited liability dalam limited liability pada konstruksi kelompok piramida.

Keyword: *parent company's liability, limited liability.*

A. Introduction

Corporate groups have significantly dominated businesses in Indonesia. Recent developments have shown that corporate groups have become a favorable form of enterprise for entrepreneurs in Indonesia. The amount of revenue generated by top ten corporate groups in Indonesia had contributed 9.27% of Indonesia's 2010 GDP,[1] as provided in Table 1.

This rapid growth of corporate groups is influenced by various factors, *inter alia*, the establishment of added-values through synergies of companys,[2] strive of companies to establish competitive advantage against one and another,[3] long-term use of funds,[4] or statutory provisions directing the formations of corporate groups.

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1 Based on prices at that time, Indonesia's GDP in 2010 reached IDR 6,422.9 trillions or around USD 700 billions. See: BPS-Statistics Indonesia, 2011, *BPS Strategic Data*, BPS, Jakarta, p. 15. Meanwhile, the amount of profits generated by top 10 corporate groups in Indonesia in 2010 was US$64.9 billions. Globe Asia, August 2011.

2 Djalil, "Strategi dan Kebijakan Pemberdayaan Badan Usaha Milik Negara (Strategies and Policies on the Empowerment of State-owned Enterprises)", *www.setneg.go.id*, retrieved on 9 February 2009. In the establishment of added values, state-owned enterprises are encouraged to form a holding company consisting of various state-owned enterprises.

3 An example of this strive is the vision of Semen Gresik Group towards national cement industries contained in the Decision of the Supreme Court on the dispute between PT Semen Gresik (Persero) Tbk., and PT Semen Padang.

4 Rudi Prasetya, 1995, *Kedudukan Mandiri Perseroan Terbatas: Disertai dengan Ulasan Menurut UU No. 1 Tahun 1995 tentang Perseroan*, Citra Aditya Bakti, Bandung, p. 66.

Table 1.
Corporate Groups with Highest Revenue in Indonesia

No	Groups	Revenue	
1	Jardine/Astra International	$12.80	billions
2	Salim Group	$11	billions
3	Wilmar International	$7.40	billions
4	Sinar Mas Group	$6	billions
5	Djarum Group	$5.80	billions
6	Philips Morris International	$4.80	billions
7	Bakrie Group	$4.60	billions
8	Lippo Group	$4.60	billions
9	Gudang Garam Group	$4.40	billions
10	Raja Garuda Mas	$3.50	billions

Source: Globe Asia, August 2011.

In his research on the developments of conglomeration in Indonesia, Lassare[5] postulated that almost all corporate groups were formed by trading entities. In line with the increasing scale and scope of their businesses, corporate groups had become more complex in structure,[6] some take forms as a pyramidal construction in which grandchild or lower-tier companies are the members of the group.

The existence of corporate groups in Indonesia is yet to justify the need of legal recognition of corporate group *vis-à-vis* other types of business entities.[7] The terminology of corporate group is currently associated only with a single economic entity.[8] Conversely, the Limited Liability Company Act (hereinafter, LLCA)[9] and other statutes still uphold the legal recognition of a parent company (hereinafter, parent) and its subsidiary company (hereinafter, subsidiary) as separate legal entities.[10]

As such, the insertion of a subsidiary, being a limited liability company, into a corporate group will create contradiction between the juridical aspects and business realities. A subsidiary possesses its own independence in performing legal conducts. Conversely, a corporate group, being a single economic entity, implies the economic dependence of a subsidiary, as the management of a subsidiary is wholly or partly directed to achieve the group's interests.

The differences between legal and factual facts of corporate groups have resulted in a tension between legal independence and economic unity. This condition leads to the emergence of loopholes within the

5 Lasserre, 1993, *The Coming of Age of Indonesian-Chinese Conglomerates*, Insead Euro-Asia Centre.

6 Tom Hadden, 1983, *The Control of Corporate Groups*, Institute of Advanced Legal Studies University of London, London, pp. 9-12.

7 Rudi Prasetya opined that both the Commercial Code and Act Number 1 of 1995 on Limited Liability Company do not govern on the term "concern". He also opined that the law on corporate groups is more proper to be enacted separately. Rudi Prasetya, 1996, *Op.cit.*, p. 66.

8 The term "group" does not refer to a legal entity, but rather a single economic unit of companies within a corporate group construction.

9 In this article, LLCA shall refer to Act Number 40 of 2007 and Act Number 1 of 1995. The LLCA has provided legal recognition of a parent and subsidiary as separate legal entities. However, it does not provided legal recognition of a corporate group as legal entity.

10 One of these regulations is 2006 Regulation of the Central Bank on Single Presence Policy, which governs the existence of Holding Company Bank; and Article 13 paragraph (2) of Act Number 22 of 2001 on Oil and Gas, which encourages establishment of corporate groups for companys having more than one oil and gas blocks.

law on corporate groups which may lead to opportunistic attitudes and abuse of law by a parent.

Opportunistic attitude of a parent in taking advantages out of loopholes within the law can be made explicit in the following examples:[11]

1. a parent may perform expansion of high-risk business activities using its subsidiaries.[12] When losses occur, such subsidiary would be liable for such losses, whereas the parent, being a shareholder of that company, would be granted a limited liability. Furthermore, if the implementing entity is an indirect subsidiary, the parent would be entitled for double limited liabilities.
2. a parent may utilize part of its subsidiary's loan from third parties to finance operational expenses of other subsidiary without the creditors being informed of such conduct.
3. a parent may transfer part of its insolvent subsidiary's assets to other subsidiary, without the minority shareholders and creditors of the insolvent subsidiary. When the subsidiary is finally declared bankrupt, the ownership of such assets has been transferred to other subsidiaries. This results in third parties not being able to claim those assets for repayment of the loan made by the bankrupt subsidiary.

Such abuses of corporate groups would result in losses suffered by third parties,[13] specifically when the factual control of a parent over its subsidiary has reduced the degree of economic independence of the latter. Economic dependence of a subsidiary would arise when the economic interests of such subsidiary are directed at supporting the interests of the parent or the group.

On the contrary, the acknowledgment of parent and subsidiary as independent legal entities resulted in both the parent and subsidiary may perform their own legal conducts. As such, the parent, being the shareholder of the subsidiary, would be protected by a limited liability against the inability of the subsidiary to settle its affairs with third parties, namely limited to the shareholding percentage on that subsidiary.

The contradiction of economic dependence and legal independence of a subsidiary has created a legal issue concerning the liability of a parent against third party of its subsidiary suffering losses as a result of the subsidiary performing orders or instructions from its parent. As a single economic unit, a corporate group may create vulnerability of third parties of a subsidiary, being member of the group. These parties, which include employees, creditors, and minority shareholders, may

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[11] Sulistiowati, 2010, *Aspek Hukum dan Realitas Bisnis Perusahaan Grup di Indonesia*, Erlangga, Jakarta.

[12] Easterbrook and Fischel opined that a moral hazard may arise within a corporate group construction, namely: if the limited liability principle is to be applied strictly, then a parent may form a subsidiary with minimum capital and to perform risky business. In a worst-case scenario, the subsidiary may go bankrupt, leaving its creditors unpaid. It follows that the parent may form another subsidiary with similar management and business. The unbalance condition of costs and benefits will create incentives for burdening the society resulted from performing risky businesses. Frank Easterbrook and Daniel Fischel, "Limited Liability and the Corporation", *University of Chicago Law Review*, Vol. 52, No. 89, 1985, p. 111.

[13] In this case, third parties include minority shareholders, creditors, and employees of a subsidiary.

suffer losses when the subsidiary performs instructions from its parent.

The issue on parent's liability against third parties of its subsidiary has occurred in the lawsuit filed by employees of PT Inti Fasindo International against the parent, PT Great River International concerning the non-fulfillment of employee's rights by the latter, in which case evidence of subsidiary's dependence, such as it performing its parent's instructions, had not justified the annulment of the parent's limited liability.[14] The Board of Judges of the Labor Court who examined the case ruled out that interventions made by the parent did not nullify the legal recognition of the subsidiary as a separate legal entity to its parent and thus may perform its own legal conducts, including being brought before the court by its employees.

The non-existence of legislations governing specifically on corporate groups has obviously benefited a parent. It is not liable for any legal conducts performed by its subsidiary, as the latter is a separate legal entity. In this regard, the law should provide protection for third parties suffering losses resulted from a subsidiary performing instructions from its parent. As such, this article attempts at solving the issue concerning parent's liability against third parties of its subsidiary performing its instructions. This will serve as a breakthrough within the law, which will prevent the existence of domination without liability.

B. Legal Issue concerning Parent's Liability within a Corporate Group

A parent's liability within a corporate group has become one of the major issues in the laws on corporate groups.[15] This issue arises as a result of contradiction between legal aspects and business realities of a corporate group. However, this contradiction has become natural for corporate groups as business law itself has not governed specifically on such groups, whereas business realities show that a corporate group forms an economic unity amongst members of the group.

The parent-subsidiary relationship has granted a parent's authority to act as the central management of the group. A parent will determine the common objectives of the group. Then, such parent will control and coordinate its subsidiaries, and creates an economic unity. In this regard, the burdening of liability to a parent on its subsidiaries is obstructed by the application of limited liability principle, which the parent, being the shareholder of its subsidiary, is entitled to.

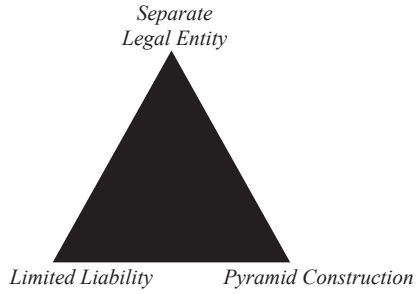

Figure l. Triangle of Liability Issues within a Corporate Group

[14] HukumOnline, "Nasib Karyawan Great River Semakin Tidak Jelas", *www.hukumonline.com*, retrieved on 9 February 2009.

[15] Blumberg considers this as "one of the major problems in company law". Blumberg, "The Corporate Entity in an Era of Multinational Corporations", *Delaware Journal of Corporate Law*, Vol. 15, 1990, p. 288.

Three issues concerning a parent's liability within a corporate group, as pictured in figure 1, are as follows:

1. the insertion of a subsidiary into a corporate group construction does not nullify the acknowledgment of such company as a separate legal company, and therefore, companies within the group are still considered as independent legal entities. A parent is not liable for legal conducts performed by its subsidiaries, even when its control over its subsidiaries resulted in economic dependence of such subsidiaries;
2. as shareholder of its subsidiaries, a parent is granted a protection in form of limited liability against its subsidiaries' inability in settling their affairs with third parties; and
3. within a corporate group with pyramid construction, a parent will possess a limited liability within limited liability against its grand-subsidiaries' inability to settle their affairs with third parties. The more tiers of subsidiaries, the more limited liabilities a parent will possess.

Within a corporate group construction, a parent does not have to take form of a limited liability company. The legal entity status of a subsidiary is a logical option chosen by the ultimate shareholder, namely the parent, in order to obtain benefits from such status. It is also beneficial for a parent to possess limited liability over its subsidiaries. As such, a parent would only be liable for as much as the amount of its shareholding in a subsidiary.

The position of a parent as shareholder and central management of its subsidiaries bring into evident that a parent possesses a different economic role than an individual shareholder in a limited liability corporation. Nevertheless, company law does not differentiate the two types of shareholders. Thus, a parent would also be protected by the limited liability principle. All in all, this position of a parent does not nullify its entitlement of limited liability over its subsidiaries.

C. The Relationship between a Parent and Subsidiary within a Corporate Group

The company law has legitimated the factual conditions of corporate groups by allowing a company to obtain or acquire other companys' shares[16] through establishment of subsidiaries, shares acquisition, joint venture agreements, or spin off.

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[16] History have told that the establishments of corporate groups in the United States were marked by the revolution on business organizations through the allowance of a company to obtain or acquire other companies' shares. The need to increase investment values and the response against pressures on businesses at that time have encouraged the enactment of such provisions. See: Blumberg, 1986, *The American of Company Law*. This dramatic change was initiated from 1888 to 1893 in New Jersey, where a law was enacted to allow a company to obtain or acquire other companies' shares. In other words, the New Jersey Statute had allowed the formation of holding companies. See: Blumberg, "The Transformation Of Modern Corporation Law: The Law Of Corporate Groups", *The Connecticut Law Review*, Vol. 37, 2005. Within the next developments, more US states adopted this law, resulted in the creations of large-scaled businesses through company acquisitions. This law authorizing the inter-company stock ownership has became a turning point for business developments in the US. See: Alfred Dupont Chandler, 1962, *Strategy and Structure: Chapters in the History of the Industrial Enterprise*, M.I.T. Press, Cambridge.

A substantial shareholding of a parent in its subsidiaries entitles the former a voting right in the General Meeting of Shareholders (GMS) of the subsidiary. Such manner of shareholding also grants a parent to appoint members of the Board of Directors and/or Board of Commissioners of the subsidiary, and transfers the control of the subsidiary to other companies upon an agreement. Generally, the ownership of shares of a company on another company would create a parent-subsidiary relationship. This relationship would then establish a corporate group construction.

A parent-subsidiary relationship establishes an authority of the parent to control and coordinate business activities of its subsidiary in order to support the common objectives of the corporate group as an economic unity. An issue arises when the company law upholds the legal independency of both the parent and subsidiary, whereas the formation of a corporate group is meant to create an economic unity. This leads to a tension between legal independency and economic unity.

The tension between legal independence and economic unity has led to the emergence of a paradox between the legal independence of a parent and its subsidiaries, and the economic dependence of a subsidiary. The legal independence of a parent and its subsidiaries resulted in the former not being liable against legal conducts performed by the latter. Conversely, the economic dependence of a subsidiary resulted in the management of such subsidiary not for the sole purpose of achieving its interests.

Furthermore, the tension between legal independence and economic unity often creates different perceptions on how to treat a parent and its subsidiaries within a corporate group. This condition can be observed in the case concerning Syndication Bank's request of bankruptcy declaration against PT Ometraco Corporation and its subsidiary, PT Ometraco Multi Artha. In this case, PT Ometraco Corporation acts as debtor and Corporate guarantor in a loan agreement concluded by PT Ometraco Multi Artha with the Syndication Bank. By virtue of a Roll-Over Facility Agreement, PT Ometraco Corporation and PT Ometraco Multi Artha altogether constitutes a corporate group. The Commercial Court eventually rejected the plaintiff's request; as such request was filed through two separate lawsuits.

Judges of the Commercial Court ruled that the inter-dependence established between PT Ometraco Corporation and PT Ometraco Multi Artha through the conclusion of a syndication-loan agreement render both companies of being in an economic unity. The Court disregarded the separate-legal-entity status of both companies, which would result in the request filed through two separate lawsuits. With regards to the decision, the Supreme Court nullified the Commercial Court's rejection, ruling that Government Regulation in Lieu of Law Number 1 of 1998 does not confer that lawsuits against a corporate group should be filed in one lawsuit. As a result, the Syndication Bank was permitted to sue both companies separately, insofar as the requirements for request for bankruptcy declaration were fulfilled.

The above case has shown how the Commercial Court and Supreme Court have

different perceptions regarding the status of a parent and its subsidiaries within a corporate group construction. The roll over facility agreement between PT Ometraco Corporation and its subsidiary PT Ometraco Multi Artha was meant to achieve the objectives of the group as an economic unity. Therefore, the Commercial Court held that the complaint filed by the Syndication Bank should be filed in one lawsuit. Conversely, the Supreme Court held that PT Ometraco Corporation and its subsidiary PT Ometraco Multi Artha are separate legal entities, and therefore the complaint filed by the Syndication Bank should be filed in two lawsuits.

D. The Legal Independence of a Parent and a Subsidiary

Until now, Indonesia is yet to have specific regulations on corporate groups. The governance of corporate groups is performed in accordance with the company status of the companys forming the group. Therefore, the relationship between a parent and its subsidiary having limited liability company status is to be conducted in accordance with the law on limited liability companies.

As the rules within the company law are intended to govern independent companys,[17] it defines a parent-subsidiary relationship as the relationship between two separate legal entities.[18] The insertion of a subsidiary into a corporate group construction does not nullify the legal independency of that subsidiary.[19] Therefore, such subsidiary has its own capacity to perform legal conducts, whereas its parent is not liable to such conducts.

The relationship of parent and subsidiary within a corporate group does not nullify their independent liabilities as separate legal entities. Therefore, basic regulations contained in the law, such as the legal status, the independency, and limited liabilities, would also be applicable to members of a corporate group.[20]

The establishment of a company generates its legal status of being an independent legal entity. This is in accordance with Article 1 point 1 of the 2007 LLCA, which confers that a limited liability company is a legal entity. According to

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17 Fundamentally, the law of companys is applicable for companys in their single and independent form. It comprises of a set of rules governing company financing and risks allocation. The establishment of a company leads to its entitlement of an independent legal status along with its entailing rights and obligations. This status further entitles a company to possess assets and liabilities, and to perform a legal conduct of its own. As it is for other legal subjects, a company has an independent capacity to act and simultaneously be liable for any consequences resulting from the performance of such act. This is commonly known as the *ubi commoda, ibi incommoda* principle. Antunes, 1994, *Liability of Corporate Groups*, Kluwer Law and Taxation Publishers, Boston.

18 Elucidation to Article 29 paragraph (1) of the 195 LLCA provides definitions of parent and subsidiary. Unfortunately, these definitions do not exist in the 2007 LLCA, which is currently enforced.

19 Within a corporate group construction, a subsidiary need not be an independent legal entity or a limited liability company. The legal independence of a subsidiary is a logical option of a parent in order to obtain benefits from its subsidiary's independence, and thus would prevent the former from being liable of the latter's legal conducts.

20 Magaisa, "Corporate Groups and Victims of Corporate Torts –Towards a new Architecture of Corporate Law in a Dynamic Marketplace", *Law, Social Justice & Global Development Journal*, 2002, p. 1.

the Black's Law Dictionary, a legal entity[21] is *an entity, other than a natural person, who has sufficient existence in legal contemplation that it can function legally, be sued or sue and make decisions through agents as in the case of Corporation*.[22] Based on that definition, a legal entity is an independent subject of law, similar to a natural person who possesses his own capacity in performing legal conducts, being sued, or files a lawsuit.

As an independent legal subject, a company possesses a legal independency in performing its own legal conducts. Any conduct performed by the company is considered solely as the conduct of that company, the yields of which is being attributed to the same company as its properties. Similarly, losses and liabilities of such company are burdened to that company.[23] The application of the separate legal entity principle on parent and subsidiary companies implies that a parent company is not liable for any conduct that has been performed by its subsidiary company. Meanwhile, as the shareholder of the subsidiary company, a parent company has a limited liability proportionate to its paid-up capital, and therefore has a limited liability against the subsidiary's inability to settle its affairs with third parties.

At earlier stages, the limited liability principle is meant for a single company, whereas the factual inter-company control is being disregarded, and even considered unlawful. This was true, as inter-company control relationship among independent legal entities is considered non-articular to be governed in the same law. A company may not have a duality of being a separate legal entity and an entity being dependent on another company.[24]

E. Economic Dependence of a Subsidiary

The control of a parent company on its subsidiary company has been the major change towards recognition of the law to current business practices. It has made significant change to the earlier conceptions of companies. Initially, the company laws prohibited control of

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21 Schilfgaarde stated that a *rechtspersoon betekent drager van rechten en plichten* (a legal entity, like a natural person, is a legal subject in possession of rights and obligations). A company can become a debtor or creditor, be parties of an agreement, and establish another company. P. van Schilfgaarde, 2001, *Van de BV en de NV*, Gouda Quint, Deventer, p. 1.

22 Bryan A. Garner (ed.), 1999, *Black's Law Dictionary*, 7 edn., West Group, St. Paul, p. 985.

23 Rudi Prasetya, *Loc.cit.*

24 Amongst the mainstreams on this matter are the company nominalism and company realism schools of thought. Iwai submitted that a company is not a legal person or even a thing, but rather a unique amalgamation of the two, as it can possess and be possessed. With regards to a company's capability to possess its own assets, this can only be possible if a legal person exists. Contradictory to a natural person that may not be possessed, a company is being possessed by its shareholders. Based on those proportions, a company is essentially an entity that performs coordinating functions based upon a complex contractual relationship between shareholders and outside parties. Furthermore, Iwai emphasized that a company is not a nexus of contracts, but rather a matter belongs to the shareholders, who are fully capable of participating as owners of the company's assets upon a contractual relationship. Duality of a company as a person or thing refers to the company's action to possess another company, vice versa. Iwai illustrated that this dualism had been occurred since 1889 when the State of New Jersey (United States) legitimated the formation of holding companies. At later stages, companys in US and other countries are allowed to acquire other company's shares.

a company on another company, as it was considered not in accordance with the basic idea of company's independence.[25]

Without any change within the corporate law concerning shareholding activities of one company on another company, the formation of a corporate group would have never existed. A parent's control is aimed at directing various business relations and activities of subsidiaries, performed by a central management. It is a factual notion derived from business realities of a corporate group. The central management is meant to control and coordinate subsidiaries in order to achieve the common goal of the group as an economic unity.

The authority of a company to control another company has led to the existence of central management and control within a corporate group, through which the interests of the member companies are directed at supporting the group's interests. However, the existence of a central management is not imperative in establishing a corporate group. The authority of a company to control another company is based on inter-company share ownership, inter-company directorship, and a control agreement.

The control of a parent on its subsidiary consequently changes the status of the latter company from being subject of control to object of control. A company is a subject of control when it possesses legal independence to perform its business in accordance with the purposes and objectives contained in its establishing documents. The transformation of a company to become an object of control is marked by the cease of institutional framework of the company as a single business unit and become an organizational instrument that is being created and managed by a multi-unit, multi-function, and multi-national company network.[26]

The regulations of various company control instruments that exist in a corporate group, such as inter-company stock ownership, inter-company agreement, and inter-company management in the company law have proven that the law has acknowledged and even supported the existence of a corporate group. Without such regulations, formation of a corporate group would have been beyond imagination.

F. Liability of a Parent within a Corporate Group Construction

As previously elaborated, the issue concerning a parent's liability against third parties of its subsidiary within a corporate group is resulted from application of the separate legal entity and limited liability principles, and as an implication of a pyramid corporate group construction in which a parent has limited liability within limited liability against grand subsidiaries' legal conducts. The dualism of a parent being shareholder and central management of the group does net render the emergence of liability of such parent against its subsidiary's legal conducts.

The issue regarding a parent's liability is resulted from the company law design

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[25] Klein, 1914, *Die wirtschaftlichen und sozialen Grundlagen des Rechts der Erwerbgesellschaften*, F.Vahlen Berlín.
[26] Antunes, *Loc.cit.*

itself, which is designed as to govern the interests of a single company. Conceptually, the company law is aimed at governing the relationship between a company and its personal shareholders.[27] Thus, the law experiences falls behind applied in a corporate group construction. Meanwhile, courts have not recognized the difference between the liability of a single company and a parent's liability against its controlled subsidiary.[28]

In Indonesia, the application of limited liability principle is governed in Article 3 paragraph (1) of the 2007 LLCA. The provision confers that a shareholder of a company may not be made liable for losses suffered by the company in an amount exceeding his shares on that company. Furthermore, the explanatory note to the article stated that the provision affirms the unique characteristic of a company, in which a shareholder would only be made liable for an amount not exceeding his amount of shares in that company. This means that a shareholder would be protected by the limited liability principle, with which it would not be made liable personally against agreements concluded by its subsidiary, and thus against any losses suffered by such subsidiary, in an amount exceeding its amount of shares in that subsidiary.

A corporate group, being an association of separate legal entities and an economic unity, has created a loophole between juridical aspects and business realities of a corporate group. Limited liability principle would be applicable, as they are all limited-liability companies. Conversely, majority share ownership, directorship, and control agreement have given a parent company the authority to be a central management and control for its subsidiary companies. This establishes the economic unity of a corporate group. Therefore, the dualism of a parent being a shareholder and central management of its subsidiary is obvious.

The separate legal entity and economic unity principles have created a tension between the upholding of company's legal independence and the factual control of a parent on its subsidiary companies resulting in a corporate group and, thus, an economic unity. This tension has become the nature of a corporate group, particularly when a corporate group is being governed using the basic company law.

The tension between the legal independence of a subsidiary company and factual control of its parent company is casuistic depending on the degree of control of the parent company, which in turn influences the degree of independence of the subsidiary company to disregard orders and instructions from its parent company. Furthermore, the degree of control of the parent company and the degree of legal independence of the subsidiary company determines the application of limited liability against the parent company concerning the inability of its subsidiary company to settle its own affairs with third parties.

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[27] Kurt A. Strasser, "Replacing Misused Limited Liability with Enterprise Analysis in Corporate Groups", *Paper,* presented at Conference on Corporate Accountability, Limited Liability, and the Future of Globalization, London, 20-21 July 2007.

[28] Blumberg, "The Law of Corporate Groups", III, 17 ff.

By virtue of legal independence of a company, the regulation of a corporate group using the single-company approach has established loopholes, particularly concerning the absence of a principle that overcomes the issue of a parent company's liability over its subsidiary company. Therefore, cases concerning corporate groups can hardly be predicted. This is also caused by the rule-exception approach used in solving cases concerning such issue.

Meanwhile, as regards where to draw the line from case laws, there has not been consistency in defining cases in which the court justifies the nullification of legal independence. Courts often disregard legal independence of member companies of a corporate group, resulting in the parent company be made liable for its subsidiary company's liabilities.

The burdening of liability against a parent on its subsidiary's debts is rather impossible, except in particular circumstances where facts concerning nullification of legal independence of a group member arise. This is based on the "rule-exception" approach. Court's analysis should be initiated by the assumption that all affiliated companies are separate legal entities, and therefore have their own liabilities before the law. Only because the occurrence of special conditions can courts disregard such assumption.

Other than defining the relationship between a parent company and its subsidiary company, the separate legal entity principle should also be utilized to define the relationship between a subsidiary company and third parties. A subsidiary company should be made liable for its affairs with third parties. In principle, a parent company or other member companies of the group does not have direct interests on affairs conducted by a subsidiary company with third parties. As such, a parent company or other member companies of the group may not be made liable for any unsettled affair a subsidiary company may have with third parties, nor may it be entitled a right out of the relationship between a subsidiary company and third affairs.

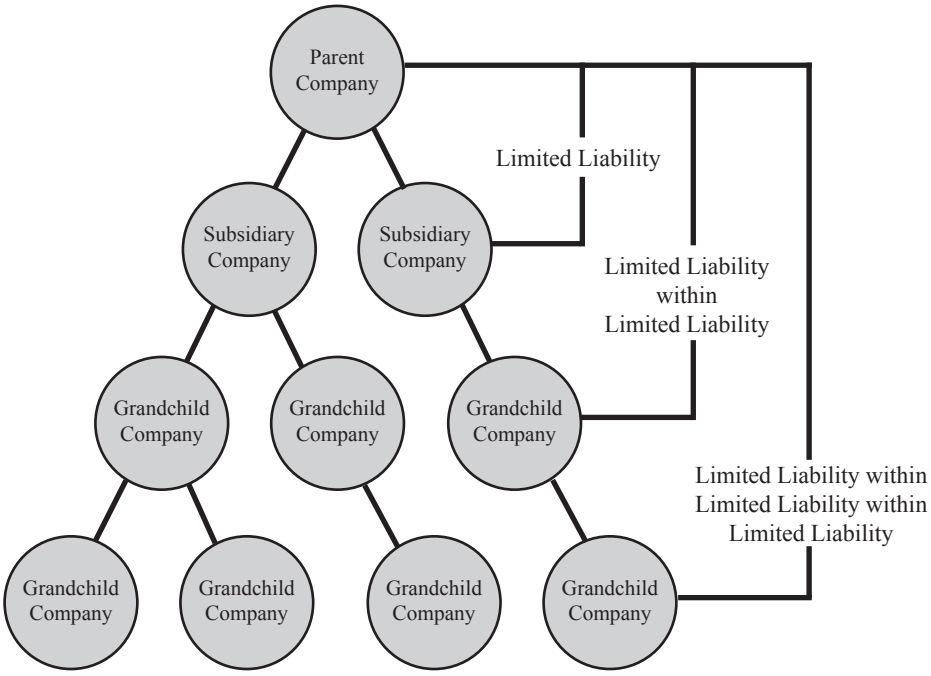
Within a corporate group construction, an issue arises when a parent company dominates the management of its subsidiary company causing the latter company being an instrument of the former corporation. Such condition puts minority shareholders, creditors, or employees of the subsidiary company in a vulnerable circumstance against the opportunistic attitude of the parent company to disregard them. As a response to this issue, several jurisdictions, primarily Germany, has governed corporate groups in details, taking into account the various legal issues within.

Furthermore, it often occurs that transactions among member companies are designed to reduce profits of minority shareholders or creditors of subsidiary companies. In other words, such third parties would incur losses from transactions conducted by the group. For example, the value-added yielded from production and distribution of assets from one member company to another may be reduced or eliminated, resulting in losses for creditors, particularly when the transferee of these assets could not present collateral.

A substantial shareholding of a parent on its subsidiary entitles the right of the parent company a voting right in the General Meeting of Shareholders (GMS) of the subsidiary. Moreover, this shareholding generates an incentive and authority of the parent to make strategic decisions and performs changes in the management in order to support the common objectives of the corporate group as an economic unity. Therefore, a clear separation between a parent and its subsidiary within a corporate group has become vague.

Liability issues have become more complicated in Indonesia, specifically when corporate group constructions tend to form a pyramid by having more than one tiers (multi-tiers). This would affect the application of limited liability of the shareholders, in the sense that shareholders would have more limited liabilities concerning torts conducted by its subsidiary. It would create limited liability within limited liability, particularly when the tort is conducted by lower-tier subsidiaries.

Figure 2.
Hierarchy of Limited Liability of Parent on its Company



Based on the above picture, the degree of limited liability of a parent can be constructed as follows:

1. a parent possesses a limited liability on torts committed by first-tier subsidiary;
2. a parent possesses a limited liability in limited liability on torts committed by second-tier subsidiary; and
3. a parent possesses a limited liability in limited liability in limited liability on torts committed by third-tier subsidiary.

This condition may lead to the emergence of opportunistic attitude of the parent towards expansions of risks to lower-tier subsidiary companies. By virtue of the separate legal entity principle, a parent would have limited liability on its subsidiary.[29]

Using the company governance approach within a single company, the limited liability principle, which is applicable to independent shareholders, is a consequence of separation of ownership and control principle. The latter principle postulates that shareholders do not have the power to prevent the company from suffering business losses. As such, had the company not being able to settle its liabilities against third parties, they may not be made liable for amounts exceeding its portion of shareholding

On the contrary, the company governance approach within a corporate group indicates the tendency to reunify ownership and control over a subsidiary company. This matches with the double role of a parent company of being a shareholder and central management and control of the subsidiary company.

Once again, the liability of a parent company on third parties' losses resulted from the subsidiary performing instructions from its parent, has become one of the major issues in the field of corporate group law. The crucial part is to determine the facts regarding degree of a parent's control on its subsidiary leading to dependency of the latter in performing the former's instructions. If a subsidiary clearly performs instructions from its parent because of which it suffers losses, then the parent may be made liable in accordance with the "piercing the corporate veil" principle.

The 2007 LLCA has provided an opportunity to apply the piercing the company veil principle, which can be used to nullify the limited liability of a parent company, as a shareholder of its subsidiary company. This provision is contained in Article 3 paragraph (2) of the 2007 LLCA, which confers that the provision contained in Article 3 paragraph (1) of the same Act does not apply insofar as:[30]

a) the requirements of being a company has not been fulfilled;
b) the relevant shareholder, without good faith, is directly or indirectly using the company for its own objectives;

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[29] Sulistiowati, "Limited Liability dalam Limited Liability pada Konstruksi Perusahaan Kelompok Piramida", *Jurnal Mimbar Hukum*, Vol. 23, No. 2, 2011.

[30] Article 3 paragraph (1) of the 2007 LLCA confers that a shareholder of a company may not be made liable for losses suffered by the company in an amount exceeding his shares on that company. Furthermore, the explanatory note to the article stated that the provision affirms the unique characteristic of a company, in which a shareholder would only be made liable for an amount not exceeding his amount of shares in that company.

c) the relevant shareholder is involved in an unlawful conduct performed by the company; or
d) the relevant shareholder is directly or indirectly, and unlawfully using the company's property causing such company being unable to settle its liabilities with third parties.

The elucidation to the article explains that in circumstances laid down in the article, there is a possibility to nullify the limited liability principle. In general, the limited liability principle may be nullified if it is proven that there is an aggregation of properties between the shareholder and the company, resulting in the company being established solely to pursue its shareholder's personal interests, such as that laid down in letter b and letter d.

Based on the above provision, the piercing the company veil principle is applicable provided that "the factual control of a parent causes the nullification of the subsidiary's legal independence." Further, it should also be proven that the parent is "without good faith, is directly or indirectly exploiting its subsidiary for its own objectives," or that the parent is "directly or indirectly, and unlawfully using its subsidiary's property causing such subsidiary being unable to settle its liabilities with third parties." In these occurrences, a parent should be made liable for losses suffered by third parties of its subsidiary.

This is particularly shown in the lawsuit filed by employees of PT Inti Fasindo International against its parent, PT Great River International. Judges of the Commercial Court ruled that legally, both companys are separated as they possessed two different Statutes of Organization. Thus, the lawsuits should have been filed separately. The judges disregarded the fact that the parent had interfered its subsidiary, causing the latter stopped operating and could not fulfill its obligations to its employees. This fact could have induced the application of the "piercing the corporate veil" principle, by which the parent would had been liable for such non-fulfillment of its subsidiary.

The rights and obligations of third parties of a corporate group, such as creditors and minority shareholders, may be affected by the fact that their debtors are being inter-dependent with other companies within a corporate group. A particular circumstance experienced by the group would further affect them in many ways. Mohr opined that such circumstance may provide positive or negative impacts for third parties.[31]

In principle, third parties' rights may not be violated by the fact that companies are being organized as a group. However, these parties usually suffered losses resulting from the economic dependence of companys being members of a group. In this regard, there is a need to provide legal protection for these third parties, such as loss compensation. Furthermore, lawmakers should determine whether the existing tort law would provide such protection, or should a new law be enacted.

Once again, the liability of a parent on third parties' losses resulted from the

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[31] Emmy Pangaribuan Simanjuntak, 1994, *Perusahaan Kelompok*, Fakultas Hukum Universitas Gadjah Mada, Yogyakarta, p. 51.

subsidiary performing instructions from its parent, has become one of the major issues in the field of corporate group law. Factually, the relationship between a parent and its subsidiary through share ownership, directorship, and control agreement could not justify the proportion that the parent's control over its subsidiary has resulted in the obligation of the subsidiary company to perform instructions from its parent company, *per se*.

Furthermore, the separate legal entity principle upheld by the company law leading to domination of parent over its subsidiary, does not justify the liability of the parent against losses suffered by third parties of its subsidiaries on the reason of economic dependence. This is true because a subsidiary is independent and being subject of law. Therefore, they can be brought before the court for torts against their third parties. This proves that domination of a parent in the managing their subsidiary does not render the parent to be liable against third parties of its subsidiaries.

A 50%+-share ownership of a subsidiary company would grant control for the parent company. However, such majority share ownership does not automatically ensure a day-to-day control and management of a subsidiary.

A control by a parent on its subsidiary is factual in order to achieve economic interests of the group. Such control has resulted in the domination of a parent on its subsidiary, causing the latter to lose its legal independency as it fully performs its parent's instructions or policies. However, such control is usually limited to strategic matters, leaving a subsidiary retains its independency in daily company management.

Furthermore, the degree of control cannot be quantified solely through share ownership, control agreement, or directorship. It should be determined factually. Thus, control, which causes the subsidiary company to lose its independence as a *persona in standi*, should be proven. This, however, is a complicated matter, as instruments measuring the quality of a factual control are necessary.

In litigation practices in the United States, the factual control of a parent company over its subsidiary company leading to losses suffered by third parties of the latter company, is proven by courts through application of the alter ego instrumentality principle, which is a specification of the piercing the corporate veil principle. Courts focuses on the existence of domination of majority shareholders and the occurrence of unfair conducts resulting from application of the separate legal entity principle. Based on Thompson's research on cases concerning applications of the piercing the corporate veil principle, courts do not need to apply the agency theory to prove the existence of unfair conducts by majority shareholders.

Using the instrumentality or alter ego principle, courts may use the piercing the corporate veil principle and ruled out that a parent company is liable for its subsidiary company's conducts. In this regard, the plaintiff should be able to prove that:

1. in performing its control over its subsidiary company, a parent corporation is considering its subsidiary

company as an instrument to per-form its own interests;
2. the parent company is conducting fraudulent or wrongful conduct in controlling its subsidiary company, such as unlawful transfer of assets of the subsidiary company; and
3. the performance of control of a parent company over its subsidiary corporation has resulted in losses or bankruptcy of the subsidiary company

With regards to this matter, the German Corporate Group Law has been utilizing control agreement (in German, *beherrschungsvertrag*) as a legitimate proof of a parent's control in running an economic unity, including the authority to direct its subsidiary. This contract is concluded between a parent and its subsidiary. This type of provision can serve as deviation to the general company law.

Furthermore, the Statute of Organization generally allows a parent to direct and influence member companies of a corporate group, even when the subsidiary is suffering losses. This can be applied, provided that the parent has consistently upheld the business interests of the group; and that the parent is not endangering the juridical existence of the subsidiary.

In other words, the contractual control of a parent over its subsidiary within a corporate group should aim at fulfilling the group's interests, and that the parent does not intent to make its subsidiary insolvent.

Meanwhile, in the Netherlands, the corporate group law does not oblige a parent to be liable for its subsidiary's liabilities. However, this does not render the parent being unable to be brought before the court in the event of breach of contract by its subsidiary against third parties. Nevertheless, a breach of contract by a subsidiary may not be automatically considered as an unlawful conduct conducted by the parent, unless the following facts exist:

1. the subsidiary is breaching a contract against third parties under the influence of the parent;
2. the parent is receiving benefits from such breach of contract by the subsidiary; and
3. the parent is a company guarantor for its subsidiary's liabilities to creditors.

In order to prevent the existence of domination without liability, a parent should be made liable for losses suffered by third parties of its subsidiary resulted from the latter performing instructions or policies from the former. This should be done in the purview to establish legal certainty, justice, and benefits of the relevant parties, namely minority shareholders, creditors and employees. A proportionality principle should be submitted, by which a balance between rights and obligations of a parent should be established. A parent may order instructions to its subsidiary. However, if the performance of such instructions by the subsidiary resulting in losses for third parties, then the parent should be made liable to settle such affairs with those third parties. The reasoning behind the application of this principle is the extension of a parent's liability against third parties of its subsidiary.

This proposal is submitted using the personal liability approach recognized in Article 1367 of the Indonesian Civil Code, with which a person should be made liable for losses suffered by other parties resulting

from his or his defendant's conducts. Analogically, this can be used as to extend a parent's liability against losses suffered by third parties of its subsidiaries performing its instructions. The above provision confers that a person is not only liable for losses caused by his conducts, but also those caused by persons being his defendants, or belongings under his supervision.[32] As such, a parent, being a central management and control for the group, should be made liable for losses suffered by third parties of its subsidiary, provided that such subsidiary is performing instructions from its parent. This proportion could be a basis for courts to order a parent's liability against its subsidiary's legal conducts.

G. Conclusion

Within a corporate group, a parent possesses the dualism of being a shareholder of its subsidiary and central management of the group. Being a central management of the group, a parent is authorized to control and coordinate its subsidiaries in order to achieve the common objectives of the group as an economic unity. This unity leads to economic dependence of subsidiaries, as its business activities are in whole or in part be directed as to achieve the common objectives of the group.

The insertion of a subsidiary, being a limited liability company, into a corporate group construction does not nullify the acknowledgment of such subsidiary as a separate legal entity, and therefore, companies within the group are still considered as independent legal entities. As such, the separate legal entity principle would apply and prevent a parent from being liable against legal conducts performed by its subsidiaries. Furthermore, a parent, being a shareholder of its subsidiary, has a limited liability against unlawful conducts performed by its subsidiary. In a pyramid corporate group construction, such parent would have limited liability within limited liability against unlawful conducts per-formed by its grand subsidiaries.

The contradiction between business realities and juridical aspects of a corporate group has led to the emergence of loophole, namely a parent's opportunistic attitude to abuse the corporate group construction. In order to prevent the existence of domination without liability, a parent should be made liable for losses suffered by third parties of its subsidiary resulted from the latter performing instructions or policies from the former. This is done in order to protect third parties' interests. Such breakthrough is necessary considering the rapid growth of corporate groups in Indonesia. Factual control of a parent on its subsidiary should

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[32] Moreover, a parent or custodian is also liable for losses caused by their children, who lives with them and on whom they perform custody. This is also true for a landlord who appoints another person as his servant; a school teacher who performs instructions to his students; and a supervisor who supervises his labors (*Staatsblad* 1927-31, *jis.* 390, 421.) The above liability should be void by operations of the law, provided that such parent, custodian, landlord, teacher, or supervisor is able to exhibit that he could not prevent any conduct that would otherwise be under his liability (Indonesian Civil Code Article 299, 802, 1368 and so on; Article 1566, 1613, 1710, 1803; Indonesian Commercial Code Article 321 and so on, Article 331 and so on, Article 358a3, 373, 534 and so on; WvO. 28.)

be the basis for burdening such parent with liability against third parties of such subsidiary, who performs its parent's instructions. This should be done in the purview to establish legal certainty, justice, and benefits of the relevant parties, namely minority shareholders, creditors and employees.

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