PIERCING THE CORPORATE VEIL: A COMPARATIVE STUDY OF THE DOCTRINE UNDER AMERICAN AND INDONESIAN LAWS*

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Abstract

Even though the doctrine of piercing the corporate veil has been recognized and regulated in Act No. 40 of 2007 on Limited Liability Company, in practice the principle is yet to be implemented. It is certainly a huge disappointment since the doctrine itself has been enacted in Indonesia since 1995 and the abandonment of its enforcement inevitably results in the creditors' under-compensation. Having learned the situation, I am compelled to examine the implementation of veil piercing in the U.S- where it is believed to be the birth country of the doctrine and compare it with the one that applies in Indonesia in order to find out the distinc-

Abstrak

Meskipun doktrin piercing the corporate veil telah diakui dan diatur dalam Undang-Undang Nomor 40 Tahun 2007 tentang Perseroan Terbatas, dalam praktiknya prinsip hukum ini masih belum diimplementasikan. Kondisi ini sangat disayangkan mengingat doktrin tersebut telah diterapkan di Indonesia sejak 1995 dan ketiadaberlakuannya mengakibatkan para kreditur tidak dapat memperoleh kompensasi. Berdasatrkan situasi itu, penulis akan mengkaji penerapan veil-piercing di Amerika Serikat sebagaimana diperaya sebagai negara lahirnya doktrin ini dan membandingkannya dengan kondisi di Indonesia untuk menge-

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tions of its implementation in both countries. In my research, I found that both countries see veil-piercing as a doctrine which disregards the principle of limited liability, hence making corporate shareholders and managers personally liable for fulfilling corporate obligations. The two countries differ however, in their qualifications to pierce the veil.

tahui perbedaan di kedua negara tersebut. Dalam penelitian penulis, penulis menemukan bahwa kedua negara sama-sama memandang veil-piercing sebagai doktrin yang mengesampingkan prinsip pertanggungjawaban terbatas, sehingga para pemegang saham dan manajer perusahaandipertanggungjawabkan secara pribadi atas tindakan korporasi. Namun kedua negara tersebut ternyata berbeda dalam penentuan kualifikasi untuk menyingkap tabir perseroan.

Keywords: *piercing the corporate veil, company law, corporate governance.*

A. Introduction

When Indonesia was struck by financial crisis which caused the collapse of our national economy, politics, and security in 1997, it became clear that existing laws and regulations governing business practices were unfit for the society. In subsequence, the 2004 OECD Principles of

Corporate Governance which introduces *corporate governance* was deemed necessary to improve Indonesia's situation. Unfortunately, the Act No. 1 of 1995 on Limited Liability Company was not up to par with the *corporate governance* standards. For instance, the Act had given no acknowledgement of the social and environmental responsibility nor did it offer any means to monitor the enforcement of the Limited Liability Act.

The incongruity of Act No. 1 of 1995 with the spirit of *corporate governance* cumulated with the rapid progress of economy and science in the globalization era and people's increasing demand of a more efficient and legally certain incorporation procedure later led to the emergence of Act No. 40 of

2007 as a new decree concerning the Limited Liability Company.

This decree later proved to be the change to Indonesian's company laws with its fresher and improved provisions. However, it is noteworthy that the change did not affect any legal theories, philosophies, and doctrines already existed in the former act—such as the principles of *piercing the corporate veil*, *fiduciary duty*, *standard of care*, *self dealing transaction*, *business judgment rule*, *derivate action*. (Widiyono, 2005)

One of the principles recognized by both the Act No. 1 of 1995 and Act No. 40 of 2007 is the concept of *piercing the corporate veil*, which is stated in Article 3 of both laws. It is the legal principle of lifting the company's limited liability which causes the shareholders to be personally held liable for the company's obligation. Unfortunately, it has never been put into practice in this country. Cases of bad business venture were more often ruled solely by the criminal law without realizing that the *veil-piercing* could also be used to protect the victims' rights.

Back in 2006, PT Lapindo Brantas—an Indonesian oil and gas exploration company—was sued for allegedly not equipping the well bore with safety steel casing during its drilling process, thus triggering a natural gas and mud eruption. The outburst was very massive that heavy mud filled the area where the drilling had taken place—Porong, Sidoarjo in East Java—resulting in the submersion and destruction of the district's local highways and villages.

Furthermore, in 2008, a financial institution—Century Bank—fell into a financial crisis, making the bank and its affiliate—PT Antaboga Delta Sekuritas—unable to return the customer's money. Though The Supreme Court had sentenced Robert Tantular to nine years in prison for the violation of banking law by interfering in the bank's operations and embezzlement (Rayda, 2010), up until now, the customers of Antaboga have not yet received their savings.

In theory, both aforementioned cases could be pierced. Yet in reality, the actors were convicted using other provisions which is directed into under-compensation for the victims. According to Dr. Sulistiowati, S.H., M. Hum., up until now

there have been no precedents that made on the basis of *piercing the corporate veil*. It shows that the level of implementation of *veil-piercing* doctrine in Indonesia is dangerously low, which is disappointing since the limited liability company law itself has recognized the principle.

The abandonment of *piercing the corporate veil* in Indonesia has led me to a question whether the same condition happens in the U.S. whose commercial laws are deemed to be more innovative and have influenced legal system on business practices in many countries around the world. Furthermore, as it is believed that the implementation of this principle differs in every country, hence this particular article would like to compare the enforcement of *veil-piercing* principle in the U.S. and Indonesia.

B. Characteristics of Limited Liability Company

Corporations had been expanding its power in the 19th century but had its giant leap when Ronald Reagan took office in 1980. Government's controls over corporations were pretty much eliminated, creating freedom for corporations to do basically what they wanted with minimal government oversight. With that, the amount of investment skyrocketed, a plethora of corporations were created, and mega-mergers became an instant fad. This condition later on resulted in the large number of corporate groups in America. (Drutman)

Before observing the *piercing* doctrine, an understanding of the limited liability company/ corporation's characteristics is crucial. Although the exact definition of corporation varies depending on each country's legal system, its characteristics remain universal. The distinctive attributes of a limited liability company are:

1. Legal personality

As a legal matter, a company is an entity that is entirely separated from the people who own it and work for it. It has the rights and obligations of a natural person as well as a different identity and funds from its members.

2. Limited liability

The limited liability doctrine is derived from the perception of a corporation as an independent legal person. It holds that shareholders of a corporation are not personally liable for corporate obliga-

tions and thus puts at risk only the amount of money that they have invested in buying the shares.

3. Transferability of shares

One of the great advantages of the corporate form is that the shares are freely transferable. When there is an absence of special contractual restrictions, shareholder of the company is free to sell the shares to anybody at any price. A transfer of stock has no effect on the company, except that there is a new voter of those shares. (Bainbridge, 2002)

While the aforesaid characteristics may have attributed to today's prevailing trend of corporation as a form of business organization, they also create drawbacks that shall never be undermined. The limited liability doctrine, for instance, although is believed to be very beneficial by making shareholders not personally liable towards the corporation's debts or obligations, thus will encourage the investment for the risk has been minimized, can potentially serve as a means for the shareholders to evade from fulfilling their obligations to the victims of misconduct in corporate activities.

Having learned the potential hazard posed by the doctrine, *veil piercing* thus plays an important role to ensure that corporate shareholders cannot use the limited liability principle in ways that are inconsistent with public interest.

C. Veil Piercing under U.S. Law

Up until now, *veil piercing* remains as one of the frequently debated legal concepts among scholars and judges. In the U.S., there are still no stringent rules when it comes to pierce the veil, similar to what Benjamin Cardozo, a former New York Court of Appeals Judge once observed[1] and seen from the cases below:

- *Radaszewski v. Contrux, Inc.; Dan Leslie Satterfield; Telecom-corporation*, 891 F.2d 672

Konrad Radaszewski suffered a permanent brain injury when a truck driven by Dan Leslie Satterfield, an employee of Contrux, Inc., struck him by the side of a road in Independence, Missouri. As Contrux had been declared bankrupt,

[1] Judge Benjamin Cardozo once stated in the case of Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y.1926) that *veil piercing* was a doctrine "enveloped in the mists of metaphor".

Radaszewski's guardian then sued Telecom as the parent company. The tribunal set a three-prong test in order to *pierce the veil*:

1. The party seeking to prove that two corporations are not separate entities must show control by one corporation over the other;
2. Such control must have been used to commit fraud, wrong, a violation of a statutory or other legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights;
3. *The control and breach of duty must have proximately caused the injury of which plaintiff complains.*

- *Kinney Shoe Corp. v. Polan*, 939 F.2d 209 (4th Circ. 1991)

Plaintiff Kinney sought to recover money owed on a sublease between Kinney and Industrial Realty Company. The court ruled in favor of Kinney, making Polan as the sole shareholder of the company, personally liable for Industrial's rent payment. The court based its verdict on the satisfaction of a two-prong test:

1. *The unity of interest and ownership is such that the separate personalities of the corporation and the individual shareholder no longer exist;*
2. *An equitable result would occur if the acts are treated as those of the corporation alone.*

However, even though having said that there are no clear standards for the infliction of *veil piercing*, I can at least identify a number of arguments that justify *veil piercing*:

1. Nonconformance of incorporation requirements

When not yet meeting the incorporation requirements, its owners using their personal assets shall carry any of the corporation's settlements out. In other words, before a corporation enters a status of being a legal entity, asset partition has not yet existed. Note that veil-piercing doctrine in this context is not used in the purpose of protecting creditors, but rather as a consequence of failing to observe corporate formalities;

2. *Alter ego* and *instrumentality*

Theoretically, *alter ego* focuses on the relationship between the corporation and its shareholders while *instrumentality* refers to the affiliation between a parent

company and its subsidiary. Yet, in practice, the U.S. Courts tend to use these two theories interchange-ably.

Courts would normally pierce the corporate veil, when it is proven that there are:

1. Control. The word 'control' here does not merely refer to the majority or complete stock control, but also to a complete domination in the corporation's financing, policy-making and business practices. This domi-nation will later result in the controlled corporation having no separate mind, will, or exis-tence;
2. Such control is used to commit fraud, wrong, a violation of a statutory or other legal duty, or a dishonest and unjust act in contravention of plaintiff's le-gal rights; and
3. The control and breach of duty must proximately cause the in-jury or unjust loss complained of.[2]

Note that bringing up the issue of the control alone without proving that the financial setup of the cor-poration is only a sham and cau-ses an injustice, will never lead to a *piercing of the corporate veil*.[3]

Remember that inadequacy of payment to creditors is not suffi-cient to *pierce the corporate veil*. The argument of corporation's insolven-cy must be backed up with the fact that there is a complete domination by the shareholders and it is used to commit fraud, wrong, or as unjust act against creditors.[4]

D. Veil Piercing under Indone-sian Law

The *veil-piercing* doctrine first appeared in Article 3 of Act No. 1 of 1995 on Limited Liability Com-pany, stating:

1. *Company Shareholders are not personally liable for agreements entered into on behalf of the Company and are not liable for Company losses exceeding the nominal value of the shares in-dividually subscribed.*

[2] See, e.g., Zaist v. Olson, 227 A.2d 552, 558 (Conn.1967); Collet v. American Nat'l Stores, Inc., 708 S.W.2d 273, 284 (Mo.Ct.App.1986); *Radaszewski v. Contrux, Inc.; Dan Leslie. Sat-terfield; Telecomcorporation*, 891 F.2d 672

[3] See, e.g., Rowland v. Lepire , 99 Nev. 308, 662 P.2d 1332 (1983).

[4] See, e.g., Associated Vendors, Inc. v. Oakland Meat Co, 210 Cal.App.2d 825, 26 Cal.Rp-tr.806 (Cal.App. 1 Dist.1962).

2. *The condition above will not apply if:*
   a. *The requirements for the Company as a legal entity have not been or not fulfilled;*
   b. *Shareholder, either directly or indirectly, in bad faith, uses the Company solely for personal purposes;*
   c. *Shareholder is involved in torts committed by the Company, or*
   d. *Shareholder, either directly or indirectly, unlawfully uses the Company's assets which causes the Company assets to be inadequate to settle the Company's debts.*

Indonesia's promulgation of the *veil piercing* doctrine continues until today through its Article 3 of the Act No. 40 of 2007 on Limited Liability Company, stating the same provision as its predecessor.

Based on Verse 2, Article 3 of Act No. 40 of 2007, shareholder is personally liable of legal actions on behalf of the company when there is an ignorance of the formal incorporation procedure. Further, shareholder is subject to personal liability when there is domination that causes the company acting as shareholders' mere instrument. It has to be noted that domination alone does not suffice to pierce the veil, but needs to be supported with the existence of bad faith by the shareholders. Moreover, shareholder can also be held personally liable when he/she is proven to take a part in torts committed by the company. The term *tort* in this case refers to Article 1365 of the Civil Code which states:

> *"Every unlawful act of man which causes damage to another obliges him by whose fault it occurred to make reparation."*

Last but not least, in connection with the illegal use of company's assets, in the event of the company failing to pay its debts due to the aforementioned shareholder's act, *veil piercing* doctrine shall be applied to the case.

Based on the above explanation of Article 3, Act No. 40 of 2007 on Limited Liability Company, the Lapindo and Century cases are fine examples of commercial case that should have been pierced. Lapindo's shares are owned by Bakrie

Group through PT Energi Mega Persada. On 29 May 2006, mud began flowing from the Banjar Panji 1 well owned by Lapindo, destroying villages and the local highway in the area. If Lapindo was unable to perform its duties to the victims due to the increasingly dwindled funds, theoretically its veil could be pierced based on the ground of *Shareholder is involved in torts committed by the Company (*Article 3 Verse (2)C of the Act No. 40 of 2007 on Limited Liability Company).

The term *tort* itself can be found in Article 1365 of the Civil Code:

1. Unlawful act. Based on the definition in the post-1919 *Arrest Hoge Raad,* tort is every deliberate act or negligence of man which violates another's right, and/or unsuitable with the actor's legal obligation, and/or goes against moral standards and appropriateness. The mud eruption in Porong, Sidoarjo has had people around the area severely affected. Twelve villages were destroyed leaving approximately 11,881 families with no homes. If Lapindo could not prove that the mud eruption in Sidoarjo was not caused by its negligence of not encasing the drilling equipment, thus the element of "unlawful act" has been met.
2. Fault. The victims will certainly face difficulties in meeting this element since the Civil Code applies the rule of *liability based on fault* and *actori incumbit probatio* (the onus of proving a fact rests upon the man) to determine the existence of fault).
   It is noteworthy however, that Article 88 of Act No. 32 of 2009 on Protection and Management of the Environment states that every person who causes serious damage to the environment will be held liable in a strictly manner (strict liability). In short, it is not necessary to prove his fault for making him responsible. Therefore, this provision of the Environment Act could be a means to prove Lapindo's fault.
2. Damage. Lapindo's negligence to encase its drilling equipment had triggered a heavy mud outburst that destroyed 12 villages, affecting 11,881 families in the area. (ARA/APO, 2012)

3. A causal relationship between act and damage. Once again, if Lapindo was unable to prove that the mudflow was the result of a natural disaster, thus it occured because of the company's negligence of not using steel casing in its drilling activity, then the qualification of this element would be met.

Having PT Antaga Delta Sekuritas as its subsidiary, PT Bank Century Tbk (BCIC) was initially the selling agent of the latter's investment product. (Wibowo, 2009) Many of the bank's clients were persuaded to put their savings into Antaboga. This persuasion was later proven to be Robert Tantular (one of the company's dominant shareholders)'s influence. Later, an investigation found that the product had never been documented in the Century's financial records nor its list of products. The bank never had any fees regarding its contribution in selling the discretionary fund. More peculiarly, a joint receipt between Century and Antaboga was initially issued for the customers payment. (YOZ, 2011) However, in late 2008, the receipt changed, excluding the Century Bank name from it. (Kurniawan, 2009) Century was also never licensed to sell the discretionary fund and that the product itself had never been approved by investment manager. In short, Antaboga investment product was a scam.

In connection with the *piercing of the corporate veil* doctrine in Article 3 of the 2007 Limited Liablity Company Law, this case could theoretically be pierced. The shareholders had been in bad faith, defrauding their clients by persuading them to put their funds in Antaboga. They were also responsible of looting the total of of Rp 1.38 trillion generated from the scam as money obtained was channeled to Robert Tantular, Anton Tantular, and Hartawan Alwi as the bank's key shareholders. (AMR, 2009)

E. Conclusion

After having analyzed the theories and applications of *veil-piercing* under the U.S. and Indonesian laws, I can conclude that both countries have the same understanding in interpreting the doctrine. Both countries view *veil-piercing* as court's action to disregard the concept of a corporation being a legal person, thus making its shareholders

and managers personally responsible for the damages caused by the corporate activities. The U.S. and Indonesia however, differ in their qualifications of enforcing the doctrine. Under American law, there are no stringent rules when it comes to pierce the veil. Although, in development, states have begun to adopt a two or three-prong test to *pierce the veil*, whereas in Indonesia, the qualifications can be found in Article 3 of Act No. 40 of 2007 on Limited Liability Company.

As for the implementation, *piercing the corporate veil* has been used in many cases in U.S. I have not found any research reporting the number of courts' decisions with the doctrine as their foundation, but it is known that from 1,600 decisions in 1991, the courts decided to pierce the veil of company in more than 40% of those cases (Thompson, 1991) and that was in 1991! Indonesia itself pales in comparison with no records of *veil piercing* since it was first introduced in 1995. It is difficult to be applied in Indonesia probably because the court has such difficulty to gain evidence that the parent company ordered its subsidiary to commit illegal acts since the order itself is mostly done informally. Moreover, political power might also be the culprit of making the courts unwilling to pierce the veil.

Last but not least, Indonesian courts are strongly encouraged to start enforcing *veil piercing* in relevant cases since law does not only talk about the punishment for unlawful acts but also as a remedy and protection for the ones injured, just like the old adage, "*Ubi Jus Ibi Remedium*", which means that for every wrong, the law provides a remedy."

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