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Judicial Review of the Director's Action that Violated the Reserved Matter Stipulated Under the Company Article of Association

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ABSTRACT

This academic article provides a comprehensive analysis of the legal liability faced by directors who violate reserved matter clauses in a company's articles of association. The study primarily focuses on the provisions stipulated under the Law No. 40 of 2007 regarding Limited Liability Companies.

Directors, as authorized representatives of the company, wield substantial powers. However, the authority of the Board of Directors may be restricted in cases where specific matters are designated as reserved matters. These reserved matters, if violated, can lead to potential lawsuits filed by shareholders or third parties.

Using a normative juridical approach, this research investigates the liability incurred by directors who exceed their authorized scope by contravening reserved matter provisions. It thoroughly examines the legal framework established by the Law No. 40 of 2007 and scrutinizes the relevant clauses within a company's articles of association.

The article highlights the potential consequences that directors may face for violating reserved matter provisions. It emphasizes the crucial role of directors in ensuring compliance with the authorized limits prescribed by both law and the company's articles of association. By understanding the legal implications of such violations, directors and stakeholders can effectively mitigate risks and uphold the integrity and stability of limited liability companies.

The findings of this analysis contribute to a better understanding of the legal responsibilities of directors and the importance of their adherence to reserved matter provisions. It serves as a valuable resource for legal practitioners, academics, and corporate professionals seeking insights into the legal framework surrounding the liability of directors in limited liability companies.

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I. INTRODUCTION

(A) Background

As human beings, every person needs to fulfill their living needs. In order to fulfilled their needs, each person has different ways, whether it's through working or building a business. In carrying out a business, people can engage in various forms of business endeavors. In Indonesia, according to Article 9 paragraph (5) Regulation of The Investment Coordinating Board Of The Republic of Indonesia on Guidelines And Procedures for Risk-Based Business Licensing Services and Investment Facilities Number 4 Of 2021, the business entities can be in the following forms:

1. limited liability company or *perseroan terbatas*;
2. limited partnership or *persekutuan komanditer (commanditaire vennotschap)*;
3. firm partnership or *persekutuan firma (venootschap onder firma)*;
4. civil partnership or *persekutuan perdata*;
5. cooperatives or *koperasi*;
6. foundation or *yayasan*;
7. public companies or *perusahaan umum*;
8. regional public companies or *perusahaan umum daerah*;
9. other state-owned legal entities or *badan hukum lainnya yang dimiliki oleh negara*; and
10. broadcasting agencies or *lembaga penyiaran*.

According to data from the Central Statistics Agency in Indonesia, there are 206,605 business entities in Indonesia.³ One of the popular forms of business entities in Indonesia today is a limited liability company. Limited liability companies in Indonesia are regulated by the Indonesian company act i.e. Law No. 40 of 2007 concerning Limited Liability Companies (“**Law 40/2007**”). One characteristic of a limited liability company is the separation of assets between the legal entity and the shareholders’ personal assets. In a limited liability company, there is an Articles of Association. The Articles of Association essentially...

Within a limited liability company, there are organs that are crucial parts of the limited liability company as follows:

³ Badan Pusat Statistik, *Jumlah Perusahaan menurut provinsi (Unit), 2019-2021*, (May, 30, 2023, 16.00), <https://www.bps.go.id/indicator/170/440/1/jumlah-perusahaan-menurut-provinsi.html>

1. General Meeting of Shareholders;
2. Board of Directors; and
3. Board of Commissioners

In carrying out their activities, each organ of the limited liability company must adhere to the provisions and conditions agreed upon by the shareholders in the Articles of Association. If the organs of the limited liability company fail to act in accordance with the provisions of the Articles of Association, their actions may potentially harm the company.

In a company, the board of directors is one of the organs that play a crucial role, as they represent the company. When discussing violations of the provisions of the Articles of Association, the board of directors as the crucial organ, has the highest potential for committing violations of the Articles of Association.

In the event of a violation of the terms and conditions of the Articles of Association that results in company losses, there should be a party that will be held responsible for the incurred loss. Therefore, the author intends to conduct research entitled “**Judicial Review of the Director’s Action that Violated the Reserved Matter Stipulated under the Company Article of Association**”

(B) Formulation of Issues

How is the liability of the director that conducts the violation of the company’s reserved matters according to Law 40/2007?

(C) Purposes of Research

Based on the formulation of the issue, the author proposes the following objective that needs to be achieved in this research:

Analyzing, and examining the director’s liability in the event of the company’s reserved matters according to Law No. 40 of 2007.

(D) Merits of Research

The author wishes that this research can provide knowledge for law students in order to have a better understanding of the director’s responsibility and function.

II. THEORETICAL BASIS

(A) Limited Liability Company

According to Article 1 paragraph (1) of Law 40/2007, a limited liability company is a legal

entity which takes the form of a capital partnership. A limited liability company is established based upon an agreement and conducting business activities using authorized capitals that are entirely divided into shares and has met the requirements set out under this Law and its implementing regulations.

As stipulated under Article 2 of Law 40/2007, a limited liability company must have objectives and purposes as well as business activities that are not contrary to provisions of laws and regulations, public order, and/or morality. A limited liability company's objectives and purposes are mentioned in the limited liability company's article of association. An article of association ("**AoA**"), is stipulated under Article 15 that shall contain at least (i) the name and domicile of the Company (ii) the objectives and purposes as well as the line of business of the Company (iii) the duration of the Company (iv) the amount of authorized capital, issued capital and paid-up capital (v) the number of shares, the classes of shares, if any, together with the number of shares for each class, the rights attached to each share, and the nominal value of each share, (vi) the title and the number of members of the Board of Directors, and the Board of Commissioners, (vii) the setting of place and procedures for holding a general meeting of shareholders (viii) the procedures for appointment, replacement, and dismissal of members of the Board of Directors and the Board of Commissioners and lastly (ix) the procedures for the use of profits and the distribution of dividends.

Other than the provision as set forth in Article 15 paragraph (1) on the minimum conditions to be stipulated under AoA above, Article 15 paragraph (2) allows the limited liability company to set other provisions to be stipulated in AoA provided that such additional provisions are not conflicted with the applicable law.

(B) Organs of a Limited Liability Company

As stipulated under Article 1 paragraph (2) of Law 40/2007, the organ organs of a limited liability company shall consist of the following:

- General Meeting of Shareholders ("**Shareholders**")

The Company Organ having the authorities not vested in the Board of Directors or the Board of Commissioners, within the limits set out under this Law and/or articles of association

- Board of Directors

An organ that is authorized and fully responsible for the management of the Company for the interests of the Company, in accordance with the purposes and objectives of the Company, and represents the Company both in and out of the court in accordance with provisions of the articles

of association

- Board of Commissioners

An organ that is in charge of carrying out oversight in general and/or in particular under the articles of association, and providing advice to the Board of Directors

Based on Article 3 paragraph (1) of Law 40/2007, The Shareholders of a Company are not personally liable over contracts made on behalf of the Company and are not liable over the losses of the Company exceeding the shares they own. Therefore, a Board of Directors which consist of a member of directors is the authorized organ to represent a limited liability company.

(C) Board of Directors

The Board of Directors is responsible for the management of the limited liability company.⁴ Every member of the Board of Directors shall be fully and personally responsible for the losses of the limited liability company if the person concerned is at fault or negligent in carrying out his/her duties.⁵

A member of the Board of Directors cannot be held responsible for the loss if he/she can prove that:

- a. the loss in question does not result from his/her fault or negligence;
- b. he/she has performed the management in good faith and with due care for the interests and in accordance with the purposes and objectives of the limited liability company;
- c. he/she has no conflict of interest, either directly or indirectly, in acts of management causing the loss;
- d. he/she has already taken measures to prevent the onset or continuation of the said loss

The Board of Directors is required to:⁶

- a. draw up the register of shareholders, the special register, the minutes of the Shareholders, and the minutes of the meeting of the Board of Directors;
- b. draw up the annual report and the financial documents of the limited liability company; and
- c. maintain all registers, minutes, and financial documents of the limited liability company as referred to in letter a and letter b above and other documents of the limited liability

⁴ Article 97 paragraph (1) of Law 40/2007

⁵ Article 97 paragraph (3) of Law 40/2007

⁶ Article 100 paragraph (1) of Law 40/2007

company.

(D) Reserved Matter

In carrying out their duties as an organ of a limited liability company, the authority of the Board of Directors may be limited by certain provisions already stipulated in Law 40/2007 and the company's Articles of Association. For example, as stipulated under Article 99 paragraphs (1) and (2) of Law No. 40/2007:

- (1) A member of the Board of Directors shall not be authorized to represent the Company if:
 - a. there is an ongoing court case between the Company and the relevant member of the Board of Directors;
 - b. the relevant member of the Board of Directors has a conflict of interest with the Company.
- (2) In the event of the circumstances as referred to in paragraph (1) arise, then the ones entitled to represent the Company shall be:
 - a. other members of the Board of Directors who has no conflict of interest with the Company;
 - b. the Board of Commissioners, in the event of all members of the Board of Directors have a conflict of interest with the Company; or
 - c. nother party appointed by the RUPS in the event of all members of the Board of Directors or Board of Commissioner have a conflict of interest with the Company.

Further, according to Article 102 paragraph (1) of Law No. 40/2007, the following Board of Directors' actions must seek prior approval from the Shareholders:

- a. transfer the assets of the Company; or
- b. encumber the assets of the Company

which constitute more than 50% (fifty percent) of the total net assets of the Company in 1 (one) transaction or more, whether related to one another or not.

However, the above-mentioned reserved matter will not limit the Shareholders to stipulate other limitations or reserved matters for the Board of Directors' action.

(E) RESEARCH METHOD

The approach used in this research is the normative juridical or statutory approach. According

to Peter Mahmud Marzuki, all research related to law (legal research) is inherently normative.⁷ Therefore, the data sources utilized in this study are secondary legal sources consisting of primary legal materials, secondary legal materials, and tertiary legal materials.

In completing this research, the author utilized the following legal materials:

1. Primary legal materials, which include legislation and regulations, particularly those related to Limited Liability Companies.
2. Secondary legal materials, which complement the primary legal materials. These include legal journals, theses in the field of law, and law books.
3. Tertiary legal materials, which encompass legal magazines, articles in the field of law, as well as dictionaries and online resources.

In conducting this study, the author employed the following analytical approaches as research instruments:

1. **Statutory Approach:** This approach involves analyzing the applicable laws and regulations related to the legal issues discussed in this research.
2. **Conceptual Approach:** The author also employed a conceptual approach based on various perspectives and doctrines within the field of law, specifically pertaining to limited liability companies.

Throughout this research, the author used primary legal sources, such as relevant legislation and regulations concerning Limited Liability Companies. Secondary legal sources, including legal journals, law theses, and law books, were used to complement the primary materials. Tertiary legal sources, such as legal magazines, articles in the field of law, as well as dictionaries, and online resources, were also consulted. The author applied the statutory approach by analyzing the applicable laws and regulations while utilizing a conceptual approach rooted in legal theories and doctrines relevant to Limited Liability Companies.

III. ANALYSIS

Although in carrying out their duties as an organ of a limited liability company, the Board of Directors authorities shall be unlimited and unconditional, as stipulated under Article 98 paragraph (3) of Law No. 40/2007 unless otherwise stipulated under the Law No. 40/2007, the articles of association of the limited liability company, or Shareholders resolution, their authorization shall be limited as a reserved matter.

⁷ Peter Mahmud Marzuki, *Penelitian Hukum Kencana Prenada*. (Jakarta: Media Group, 2011) page 35

In the event that the Board of Directors conducts or carries out an action that does not in line with or violate the reserved matter provisions that are regulated under Law No. 40/2007 or the articles of association of the limited liability company, such action can be considered as *ultra vires*. *Ultra vires* is a Latin phrase that means "beyond the powers" or "exceeding the authority" granted by law.⁸ Based on the explanation from Black's Law Dictionary:⁹

“An act performed without any authority to act on subject. Acts beyond the scope of the powers of a corporation, as defined by its charter or laws of state of incorporation. The term has a broad application and includes not only acts prohibited by the charter, but acts which are in excess of powers granted and not prohibited, and generally applied either when a corporation has no power whatever to do an act, or when the corporation has the power but exercises it irregularly. Acts is ultra vires when corporation is without authority to perform it under any circumstances or for any purpose. By doctrine of ultra vires a contract made by a corporation beyond the scope of its corporate powers its unlawful. Ultra vires act of municipality is one which is beyond powers conferred upon it by law”

In relation to the above explanation on the doctrine regarding *ultra vires*, basically, *ultra vires* is describing an action that is carried out by either an individual that goes beyond to his/her limit of authority that is granted by the law and regulation.

Ultra vires action that is carried out by a member of or Board of Directors of a limited liability company may result in the potential loss to the limited liability company. Although as mentioned under Article 97 paragraph (1) of Law No.40/2007, a member of the Board of Directors cannot be held responsible for the loss of the limited liability company if he/she can prove the following:

A member of the Board of Directors cannot be held responsible for the loss if he/she can prove that:

- a. the loss in question does not result from his/her fault or negligence;
- b. he/she has performed the management in good faith and with due care for the interests and in accordance with the purposes and objectives of the limited liability company;
- c. he/she has no conflict of interest, either directly or indirectly, in acts of management causing the loss;

⁸ Agus Riyanto, *Ultra Vires dan Kewenangan Direksi*, (June, 1, 2023, 10.00), <https://business-law.binus.ac.id/2016/12/28/ultra-vires-dan-kewenangan-direksi/>

⁹ Bryan A. Garner: *Black's Law Dictionary*, 8th ed. (St. Paul, MN: Thomson West, 2004), page 1559

d. he/she has already taken measures to prevent the onset or continuation of the said loss

Ultra vires actions can be considered as bad faith actions and negligent acts. Therefore, due to the member of a Board of Directors violation of the reserved matter provisions, any third party, Shareholders, or the limited liability company claim and demand an indemnification from the relevant member of the Board of Directors.

Should the indemnification claim be demanded by the limited liability company, on behalf of the limited liability company, Shareholders representing at least 1/10 (one-tenth) of the total number of shares with voting rights may file a lawsuit through the district court toward a member of the Board of Directors who, due to his/her fault or negligence, has cause losses to the limited liability company.¹⁰ If there are still other organs e.g. other members of Board of Directors or Board of Commissioners felt that the limited liability company is experiencing losses due to the member of a Board of Directors' violation of the reserved matter provisions, they can also file a lawsuit on behalf of the Company.¹¹

IV. CONCLUSION AND SUGGESTIONS

(A) Conclusion

Any action carried out by the member of the Board of Director whether it is carried out with a good faith or a bad faith, if such action is violating the reserved matter provisions, it will be considered an action that goes beyond his/her limit of authority and will be categorized as ultra vires. Ultra vires action that causes losses either to the limited liability company or other third party may result in a potential lawsuit for the indemnification.

(B) Suggestions

Every member of the director of a limited liability company is appointed by the Shareholders with the spirit of supporting the growth of the limited liability company and also to act on behalf of the Shareholders' interest. Therefore, in carrying out his/her duties, the member of the Board of Directors should always act with good faith and in compliance with the implemented terms and conditions including but not limited to Law No. 40/2007, limited liability company's AoA, or the Shareholders' resolution.

¹⁰ Article 97 paragraph (6) of Law 40/2007

¹¹ Article 97 paragraph (7) of Law 40/2007

V. REFERENCES

Laws and Regulations

- Law No. 40 of 2007 regarding Limited Liability Companies

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