UNVEILING THE LEGAL VEIL OF CONGLOMERATE-OWNED COMPANIES

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ABSTRACT

Objective: This research seeks to comprehensively analyze the legal dimensions associated with conglomerates' management and oversight of their subsidiary companies. The study emphasizes the significance of adhering to established legal principles and frameworks in this context.

Theoretical Framework: The term “conglomerate,” as defined by the Big Indonesian Dictionary (KBBI), pertains to a prominent entrepreneur who possesses multiple companies or subsidiaries operating across diverse business sectors. These entities, while legally distinct, are consolidated into an integrated economic entity under the conglomerate's control. Conglomerates leverage their assets and existing companies to invest in other businesses through means such as establishing new entities, acquisitions, mergers, or spin-offs. This consolidation aims to achieve dividends, gain product/service control, and expand market share.

Method: This study employs a normative legal research methodology to investigate conglomerates' legal aspects. The research approach involves scrutinizing legal rules, principles, and doctrines. It adopts a statutory approach by analyzing relevant legislation and regulations pertaining to conglomerates. Additionally, a conceptual approach is utilized to explore evolving perspectives within legal sciences. The research draws on primary, secondary, and tertiary legal sources, including legislation, official records, literature, expert opinions, and legal publications.

Results and Conclusion: Conglomerates oversee distinct companies that form an integrated group, maintaining independent legal status. Professional management is upheld through separate Boards of Directors and Commissioners. Legal clarity and adherence to corporate law are emphasized to prevent liability. Amendments or new laws are needed in Indonesian Corporate Law to address conglomerate liability gaps.

Originality/Value: This research contributes to the field by offering a comprehensive exploration of the legal intricacies associated with conglomerates and their subsidiary entities. It highlights the importance of adhering to legal frameworks and principles, providing insights into potential legal reforms necessary for effective conglomerate management and control.

Keywords: company, legal veil, conglomerate.

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RESUMO

Objetivo: Este estudo procura analisar de forma abrangente as dimensões jurídicas associadas à gestão e supervisão dos conglomerados das suas filiais. O estudo enfatiza a importância da adesão aos princípios e enquadramentos legais estabelecidos neste contexto.

Estrutura Teórica: O termo “conglomerado”, como definido pelo Big Indonesian Dictionary (KBBI), pertence a um empresário proeminente que possui várias empresas ou subsidiárias que operam em diversos setores de negócios. Embora juridicamente distintas, estas entidades são consolidadas numa entidade econômica integrada sob o controlo do conglomerado. Os conglomerados alavancam os seus ativos e as empresas existentes para investirem noutras negócios através de meios como a criação de novas entidades, aquisições, fusões ou spin-offs. Essa consolidação tem como objetivo obter dividendos, obter controle de produtos/serviços e expandir a participação no mercado.

Método: Este estudo emprega uma metodologia normativa de pesquisa jurídica para investigar os aspectos jurídicos dos conglomerados. A abordagem da investigação envolve a análise minuciosa das regras, princípios e doutrinas legais. Adota uma abordagem estatutária, analisando a legislação e a regulamentação relevantes no que respeita aos conglomerados. Além disso, uma abordagem conceitual é utilizada para explorar as perspectivas em evolução dentro das ciências jurídicas. A pesquisa se baseia em fontes legais primárias, secundárias e terciárias, incluindo legislação, registros oficiais, literatura, pareceres de especialistas e publicações legais.

Resultados e Conclusão: Os conglomerados supervisionam empresas distintas que formam um grupo integrado, mantendo status legal independente. A gestão profissional é mantida através de conselhos de administração e comissários separados. A clareza jurídica e a adesão ao direito das sociedades são salientadas para evitar a responsabilidade. São necessárias alterações ou novas leis no direito das sociedades indonésio para colmatar as lacunas em matéria de responsabilidade dos conglomerados.

Originalidade/valor: Esta investigação contribui para o campo, oferecendo uma exploração abrangente das complexidades jurídicas associadas aos conglomerados e suas entidades subsidiárias. Sublinha a importância de aderir a quadros jurídicos e princípios, proporcionando uma visão clara das potenciais reformas jurídicas necessárias para uma gestão e controlo eficazes dos conglomerados.

Palavras-chave: empresa, véu legal, conglomerado.

1 INTRODUCTION

The presence of conglomerates in the Indonesian economic system has become an undeniable reality today. This reality extends beyond the economic sphere and encompasses various social, political, and cultural aspects. Consequently, the existence of conglomerates generates diverse and often contradictory responses (Yulfasni, 1995).

Since the 1970s, the development of conglomerate business groups in Indonesia has led to a prevailing trend and an essential business requirement: the establishment of holding companies. These holding companies, also known as parent companies or
controlling companies, serve the purpose of owning shares in one or more companies and/or managing multiple companies. Typically, a holding company operates in various business fields, although not exclusively (Fuady, 2004).

In practice, a conglomerate is the ultimate capital owner or major shareholder of all companies within the group, even if the shareholding is legally structured through subsidiaries. This means that the legal entities owning shares in these business entities are ultimately linked to a specific individual or group referred to as the conglomerate. While the companies within the group retain their separate legal entities, possessing independent rights, obligations, and assets distinct from their shareholders, they remain subject to the principles of corporate law. Therefore, it is crucial to evaluate the extent of control exercised by shareholders or conglomerates over the companies within the group based on corporate law principles. With this background in mind, this research aims to analyze the legal aspects of conglomerates in managing and controlling the companies they own.

2 THEORETICAL FRAMEWORK

According to the Big Indonesian Dictionary (KBBI), a conglomerate is defined as a prominent entrepreneur who owns multiple companies or subsidiaries engaged in various business sectors. The conglomerate’s control extends to diverse industries such as mining (gold, coal), transportation (shipping, sea, air, land), oil palm plantations, rubber, fisheries, financial services, toll roads, telecommunications, malls, and more. This control consolidates these entities into a cohesive economic unit.

Conglomerates utilize their assets, wealth, and existing companies to invest in other businesses through methods such as establishing new companies, acquisitions, mergers, or spin-offs. These investments aim to acquire dividends, gain control over products and/or services, or expand market share in companies not yet owned. Over time, these investments accumulate in various companies, which are then consolidated under the control of capital owners known as conglomerates.

The companies owned by conglomerates are commonly referred to as business groups, corporate groups, or corporations. Sulistiowati defines a group company as a combination or arrangement of legally independent companies closely related to each other, forming an economic unit under the leadership of a holding company (Sulistiowati, 2010).

Although the conglomerate incorporates each company as an independent entity
with limited liability, adhering to the principles of corporate law, the legal status of a company as a separate entity is essential. This status ensures that the principle of limited liability applies to the shareholders of the company (Sulistiowati, 2010). The simplest form of business recognized by the Indonesian Civil Code is a civil partnership (maatschaap), which can evolve into more complex forms such as a multinational group of companies. In such groups, the capital owner or conglomerate, along with their family, manages the entire company directly or indirectly. However, these developments have not been fully addressed in positive legal regulations in Indonesia. Consequently, legal actions taken by conglomerates have not been adequately regulated by the applicable laws. The positive law in Indonesia mainly regulates legal actions involving shareholders, the Board of Commissioners, and the Board of Directors of limited liability companies, as outlined in Law No. 40 of 2007 concerning Limited Liability Companies (UUPT).

3 METHODOLOGY

This research employs the normative legal research method, which involves the process of examining legal rules, principles, and doctrines to address the legal issues at hand (Marzuki, 2017). Specifically, this study adopts a normative juridical legal research approach, which focuses on analyzing positive legal provisions and legal principles (Hadjon, 1997).

To address the legal problems in this research, multiple approaches will be utilized. The statutory approach, which considers legislation as the primary legal material, will be employed. According to Peter Mahmud Marzuki, the statutory approach involves analyzing legislation and regulations (Marzuki, 2017). Additionally, a conceptual approach will be employed to examine the clarity of concepts based on evolving perspectives and doctrines in the field of legal sciences (Hamdani & Fauzia, 2022). This conceptual approach involves exploring legal rules, principles, and doctrines related to conglomerates and their realization within applicable provisions, underpinned by a philosophical foundation.

The legal materials for this research encompass primary, secondary, and tertiary sources. Primary legal materials refer to authoritative and binding sources such as legislation, official records, or minutes relevant to the formation of legislation concerning conglomerates in Indonesia. Secondary legal materials comprise works that provide explanations and analyses of primary legal materials, including books, research findings,
scientific journals, articles, expert opinions, scholarly opinions, legal publications, newspapers, and other relevant supporting materials. Tertiary legal materials consist of sources that offer guidance and explanations of primary and secondary legal materials, such as legal encyclopedias, dictionaries, the Big Indonesian Dictionary, and various other dictionaries.

4 RESULTS AND DISCUSSION

According to Black's Law Dictionary, a conglomerate is a corporation that engages in diversified activities and controls multiple companies across various industries. Furthermore, Wibisono defines conglomerate as a business form resulting from the merger or grouping of two or more companies involved in different activities, whether vertically or horizontally (Wibisono, 1995).

From an economic perspective, the companies within a business group function as a unified entity in terms of management and operations, under the leadership of a parent company (Suciani & Setyawan, 2022). However, legally, these companies, including both the parent company and subsidiaries, are considered independent entities. Therefore, a conglomerate, business group, or conglomerate (as it is sometimes called) represents a collection of legally separate companies that are closely intertwined to form an economic unit in terms of management and ownership, with the parent company at the center.

As a conglomerate expands, it can exert significant influence and wield power akin to that of an "octopus" company capable of achieving its desired outcomes (Saleh, 1990). Vertical integration occurs when companies within the business group are interconnected in a production chain that spans from upstream to downstream activities, encompassing access to raw materials, processing of materials, and the production and marketing of finished goods by the group's member companies. Horizontal integration, on the other hand, is intended to limit competition by reducing the number of competitors. The conglomerate achieves this by engaging in diverse business activities, such as real estate, insurance, plantations, transportation, banking, and more.

The mentioned integration can weaken market mechanisms and lead to monopolistic practices. The presence of a monopoly and control over a significant market means that other companies face limitations and are overshadowed by the dominant conglomerate. The centralization of decision-making within a business group can also have negative consequences, potentially leading to the formation of trusts and cartels.
Reciprocity practices further contribute to these issues. It involves creating conditions where companies within a group or conglomerate agree to purchase each other's goods and services without considering market conditions. This limits or even eliminates market access for competitors. If this situation continues to develop, it can result in economic inequality, particularly by squeezing out small and medium-sized companies (Marcel, 1992).

The term "conglomerate" often refers to the major shareholder within a group of companies, who is typically the individual who founded the group or the name of the group itself, even if the shares are owned by the founder and their family. The conglomerate initiates and evolves the business structure from a limited liability company to a group of companies. This transformation involves intensification and expansion efforts. Intensification aims to optimize the company's potential to achieve maximum profit. The conglomerate's reform is realized through the establishment of new companies or the creation of subsidiaries by existing companies, through takeovers (acquisitions), mergers (consolidations), separations (spin-offs), and amalgamations (mergers). While these companies maintain their subjective independence, they are combined into an economic unit known as a group company, under the control of the main shareholder and owner referred to as the conglomerate or legally recognized as the ultimate shareholder. Conglomerates encompass multiple companies, each considered a separate legal entity, and while there may or may not be a holding company involved, a controlling shareholder within the conglomerate and their family can be traced across all the business entities gathered within the group company.

A holding company encompasses multiple companies operating in diverse business fields (Mulhadi, 2017). Gunawan and Yani (2012) define a holding company as an entity primarily engaged in investing in subsidiary companies and overseeing their management activities. According to Black's Law Dictionary, a holding company is formed to control other companies, typically focusing on stock ownership and management supervision (Black, 1990).

Although conglomerates control all their subsidiaries, including holding companies, they should still adhere to legal doctrines that govern the legal relationship between subsidiary companies and the conglomerate within the corporate group. From a formal legal perspective, each company is an independent entity. Both the parent company and subsidiaries are subject to corporate law doctrines such as the Fiduciary
Duty doctrine. Black (1990) states that “fiduciary duty refers to the duty to act for the benefit of someone else while subordinating personal interests to that of the other person, representing the highest standard of duty implied by law.”

Another perspective states that "a limited liability company is the reason for the existence (raison d'être) of the Board of Directors. Therefore, it is not wrong to say that there is a fiduciary relationship between the company and the Board of Directors, which gives rise to fiduciary duties for the Directors" (Tumbuan, 2000). Ais (2000) states that Directors should base their actions on two fundamental principles: first, the trust given to them by the company (fiduciary duty), and second, the duty of skill and care. Rai (2000) states that the duties of Directors involve managing the company and acting as its representative. Rai (2000) further divides the duties of Directors into three categories: duties based on trust and confidence (fiduciary duties); duties based on skill, care, and diligence; and duties based on statutory provisions. Thus, even though the conglomerate owns the subsidiary companies, the conglomerate should not interfere in the management affairs carried out by the Directors.

However, the Directors of conglomerate-owned companies are still obliged to comply with the legal doctrine of Self-Dealing Transactions. The policies implemented by the Directors must be conducted with honesty and professionalism, taking into account the purpose, objectives, and efforts of the company as stated in its Articles of Association. The doctrine of Corporate Opportunity states that a Director, Commissioner, or other employees of the company, as well as major shareholders, are not allowed to seize opportunities for personal gain when such actions should rightfully be carried out by the company in its business operations (Munir, 1999). Therefore, the conglomerate will assess the actions of the Directors of its subsidiary companies to ensure they align with the purpose and efforts of the company stated in its Articles of Association.

The Corporate Opportunity Doctrine requires directors to take actions that are profit-oriented while complying with the provisions stated in the company's articles of association and the relevant laws. They are expected to act professionally and consider the interests of stakeholders and shareholders. However, the Business Judgment Rule, as explained by Munir (2009), provides a limitation to this doctrine. It states that directors, commissioners, employees, or major shareholders are not allowed to seize opportunities for personal gain if those actions should be carried out by the company in its business operations.
The Doctrine of Ultra Vires and Intra Vires is relevant to determining the authority of the board of directors, which must align with the authority granted in the company's articles of association. If an action exceeds the company's capacity or goes beyond the purpose and objectives stated in the Articles of Association, it is considered "ultra vires." In the UK, an action is considered "ultra vires" only if it clearly falls outside the company's main objectives (Rai, 2000).

In this context, conglomerates are prohibited from exerting control or interference to influence directors, including those of their parent companies, to violate the aforementioned doctrines. If a conglomerate exercises control and influences directors to deviate from these doctrines, the conglomerate can be held personally liable. Therefore, conglomerates must understand that their extensive control over a company may result in personal liability, even affecting their personal assets. The notion of being a "limited" liability company cannot serve as a shield in such situations. A violation of the mentioned legal doctrines can be proven if there is evidence of the merger of the shareholder's personal wealth with the company's wealth (Inyang et al., 2023), indicating that the company is solely used as a tool by the shareholder (conglomerate) to fulfill personal goals (Ais, 2000).

Smith, Stone & Knight v Birmingham provides several juridical criteria to determine if a subsidiary can be considered an agent of the holding company, thereby allowing the theory of Piercing the Corporate Veil to be applied to the holding company. These criteria include:

- Whether the profits are treated as profits of the holding company.
- Whether the implementation process is controlled by the holding company.
- Whether the holding company serves as the "head and brain" of the subsidiary's business.
- Whether the holding company organizes "the adventure."
- Whether profits are generated with the expertise and direction of the holding company.
- Whether the holding company consistently controls and influences the subsidiary.

The presence of a conglomerate business group often involves a holding company, which has both advantages and disadvantages (Khatoon et al., 2023). One advantage of a
holding company is that it can earn profits from its subsidiaries without directly managing them. However, a disadvantage is that the assets of the parent company and subsidiaries are isolated from potential losses experienced by any one of them. The legal relationship between holding companies and subsidiaries can vary based on their involvement in business operations, decision-making, and share ownership.

In the case of an investment holding company, its involvement with a subsidiary is solely for investment purposes, usually in the form of share ownership, without interfering in the subsidiary's management. This type of holding company is often formed due to factors such as the parent company lacking the willingness, ability, experience, or knowledge of the subsidiary's business. It can also occur when the parent company holds a minority stake in the subsidiary, allowing external capital and shares to be brought into the subsidiary. Furthermore, if the subsidiary has a business partner who is more capable and well-known in the relevant field, an investment holding company may be established (Fuady, 2004).

On the other hand, a management holding company not only holds shares but also interferes with, or at least monitors, the subsidiary's business decision-making. However, excessive involvement of the parent company in the management of the subsidiary can prevent the subsidiary from having independent professional directors. If the parent company is not able to entrust the management to professionals, it can lead to negative outcomes, such as the gradual decline or sudden failure of the conglomerate's business, especially when the business is unable to survive beyond the second or third generation.

The analysis of control conditions exercised by conglomerates, whether through shareholder agreements, charters, appointment of chairpersons and/or board members, assignment of key officials, directorial supervision, or the presence of consolidated balance sheets, indicates that holding companies or major shareholders, including conglomerates, do exert control over subsidiary companies. Holding a conglomerate accountable for managing and controlling all its companies, either directly or through group companies, would require the establishment of a legal framework defining the actions that result in liability. However, in Indonesia, the current regulation, specifically Article 3 of Law No. 40 of 2007 concerning Limited Liability Companies, only addresses direct shareholders and does not encompass the actions of conglomerates in managing and controlling their multiple ownership companies.
5 CONCLUSION

Directors of companies owned by conglomerates must uphold professionalism and independence, as they are not employees of the conglomerate and should not be mere puppets of the conglomerate. They must also adhere to the principles of corporate law. In the management and control of companies within its group, the conglomerate must comply with the legal doctrines discussed above. If a conglomerate engages in actions that violate the doctrines of corporate law, whether directly or through group companies and/or holding companies, the conglomerate should be held liable. This liability should extend to both criminal and civil matters, including personal liability that may impact the conglomerate's personal assets, given its status as a major shareholder.

However, in order to hold conglomerates accountable, it is essential to establish provisions in the applicable laws and regulations that outline the specific actions taken by conglomerates that result in liability. Currently, Indonesian Corporate Law only addresses the liability of shareholders in the first degree, as outlined in Article 3 of Law No. 40 of 2007 concerning Limited Liability Companies, and does not fully cover the liability of conglomerates. Therefore, it is imperative to promptly amend Law No. 40 of 2007 on Limited Liability Companies to regulate the control exerted by major shareholders or conglomerates. Alternatively, the introduction of a separate law specifically addressing holding companies or groups of companies, governing the legal relationship between companies within the group and the control exercised by conglomerates as major shareholders, should be considered. This regulatory enhancement aims to provide legal certainty for conglomerates in managing and controlling the companies they own, while also meeting the requirements of the government and other stakeholders.
REFERENCES


