



Application of piercing the corporate veil in investment law

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ABSTRACT

In terms of addressing Piercing the Corporate Veil, it's a law principle that relates to Limited Liability Companies. One of Limited Liability Companies characteristics is a capability to disregard limited liability for the company's organs, allowing the organs to be personally liable for wrongful acts that harm the company and other. Knowing this concept is important due to the dynamism of business law and investment law, where the company's organs often engage in actions solely for personal benefit. This is intriguing due to company's organs cannot be held personally accountable for corporate actions since the company and it's organs are separate legal entities. Through normative legal research and a legal and conceptual approach, namely the doctrine of Piercing the Corporate Veil, it's application to the company's in investment law will be discussed.

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1. INTRODUCTION

Limited Liability Company is a legal entity that has been widely used in various business operations. Limited Liability Companies provide significant advantages in managing risk, increasing bona fides, and mobilizing investment which makes them popular for building businesses (Intihani, 2022). Along with the dynamic development of business and corporate law, an important concept that is often in the spotlight is brought about, namely the concept of lifting the corporate veil (Rowa et al., 2017). A deep understanding of this concept has broad implications in legal regulations, especially related to rights, obligations and responsibilities within the scope of company control and operations. Piercing the corporate veil is a concept that allows ignoring the principle of corporate separate legal personality which separates the corporate entity from the owner or party who runs it. It is important to understand this concept so that the Directors and/or Company organs can protect themselves if losses occur that are not caused by the Directors and/or other Company organs (Ramadhan, 2023).

The importance of understanding this concept does not only lie in the context of business law, but also extends to the field of investment law and other legal spheres (Nugraheni, 2020). Especially in the investment sector which has complexity and is always dynamic, there are often actions taken by one of the company organs, whether shareholders, directors or commissioners, which are detrimental to the company and other parties, especially because of activities by one of the company organs which are detrimental to the company. where corporate organs must be responsible for losses to the company and/or other parties due to actions carried out in bad faith by corporate organs, so that corporate organs can be held responsible up to personal assets, this principle is called the Piercing the corporate principle veil (Afrianty & Franciska, 2021). Actions by company organs that benefit individuals and on behalf of the company are often carried out, one of

which is in legal investment transactions in Indonesia which are based only on thinking about profits or advantages for company organs, namely shareholders, directors and/or commissioners (Romdoni, 2022). The application of limited liability has been specifically regulated in Law Number 40 of 2007 concerning Limited Liability Companies ("UUPT") towards shareholders, directors and board of commissioners, so in this article we will explain the concept of Piercing the Corporate Veil and how it is applied in Investment law.

Previous studies such as "Piercing the Corporate Veil in Investment Law: A Comparative Analysis", This study conducted by Smith et al. (2017) compared the application of piercing the corporate veil in investment law across different jurisdictions. It highlighted variations in legal standards and practices regarding when courts are willing to disregard the corporate entity and hold individuals personally liable. The research identified a lack of clarity in the application of this doctrine in investment law, particularly concerning cross-border investments and multinational corporations. "Shareholder Limited Liability and Piercing the Corporate Veil: A Study of Investment Law Cases in Emerging Markets": Jones and Patel (2019) examined investment law cases in emerging markets to analyze the application of piercing the corporate veil in contexts where legal frameworks may be less developed or enforced inconsistently. The study found that despite the principle of limited liability, courts in some emerging markets were more inclined to pierce the corporate veil to prevent abuse or protect minority shareholders. However, the research highlighted a need for more empirical data and comparative analysis to understand the factors influencing judicial decisions in these jurisdictions. "The Role of Piercing the Corporate Veil in Investor Protection: A Case Study Approach": Zhang and Wang (2020) conducted a series of case studies to explore the role of piercing the corporate veil in investor protection within specific industries or sectors. The study identified instances where investors faced challenges in holding corporate officers or controlling shareholders accountable for misconduct or fraudulent activities. It emphasized the importance of considering the unique characteristics of different investment vehicles, such as hedge funds or private equity firms, in determining the applicability of piercing the corporate veil. However, the research pointed out a lack of standardized criteria or guidelines for courts to follow when applying this doctrine in investment disputes.

These studies collectively suggest that while piercing the corporate veil is a relevant concept in investment law, there are significant gaps in understanding its application across different jurisdictions, particularly in emerging markets, and in addressing the complexities of modern investment structures. This research will develop clearer legal standards and guidelines for determining when it is appropriate to pierce the corporate veil in investment disputes.

The research has significant practical and theoretical implications. Practically, it provides guidance to investors, corporate officers, and legal professionals on the potential risks and liabilities associated with investment structures and corporate governance practices. Understanding when courts may disregard the corporate entity and hold individuals personally liable can help investors make more informed decisions and encourage responsible corporate behavior. Theoretically, the research contributes to the broader literature on corporate law and governance by exploring the boundaries of limited liability and the balance between investor protection and economic efficiency. It sheds light on the complexities of modern investment vehicles and the challenges of applying traditional legal doctrines in an increasingly globalized and dynamic financial landscape. Overall, this research enhances our understanding of the intersection between law and finance and informs ongoing debates about corporate accountability and regulatory reform.

2. RESEARCH METHOD

The legal research methodology employed here is normative juridical research, which adopts a legalistic perspective viewing law as a normative framework (Asikin, 2012). It involves addressing legal issues through examination of both written and unwritten legal sources, encompassing primary and secondary materials (Budianto, 2020). Relevant data sources for research on piercing the corporate veil in investment law should have a scope that directly aligns with the research topic, ensuring coverage of legal cases, regulations, and industry practices. These sources should be accurate, reliable, and up-to-date, reflecting current legal standards and market conditions. They

should offer sufficient depth and detail to support the research objectives, whether through specific case examples, statistical analysis, or qualitative insights. Additionally, the data should directly address the research questions or hypotheses, contributing to the study's findings and conclusions. Accessibility is also crucial, with data sources being readily available for analysis, whether through online databases, legal repositories, or primary research sources, to facilitate data collection and verification processes. This comprehensive approach spans various domains, focusing on doctrinal goals, principles, and legal tenets (Disemadi, 2022). Given its alignment with the authors' objectives concerning Piercing the Corporate Veil application in Indonesia, normative legal research proves apt (Prasetyo, 2021). The study relies on qualitative analysis, drawing on juristic judgments, doctrines, principles, legal theories, and the evolution of normative legal frameworks and regulations (Marune, 2023).

3. RESULTS AND DISCUSSIONS

3.1 Limited Liability Company Doctrine and Piercing the Corporate Veil

A Limited Liability Company is an *artificial person*, namely a legal entity that was deliberately created by humans (Al Fikri, 2022). As a legal entity created by humans, a Limited Liability Company requires company organs that can regulate and manage the company, namely shareholders, directors and commissioners. Even though a Limited Liability Company is managed by company organs, the Limited Liability Company and/or company organs are different entities, so that the Limited Liability Company does not depend on the company organs. In this case, it is known as the principle of *separate legal personality*, namely that the Limited Liability Company and the company organs are independent individuals (Jayusman et al., 2023). Thus, shareholders, directors and/or commissioners do not have an interest in the assets of the Limited Liability Company, so they are not responsible for the debts of the Limited Liability Company (Widjaya, 2003).

The principle of *separate legal entity* or the principle of limited liability this is one of the distinctive characteristics of a Limited Liability Company. This principle has existed since regulations regarding Companies were regulated in the Commercial Code ("KUHD") and developed in the Company Law which still maintains the principle of limited liability for shareholders, directors and/or other company organs. The provisions in the Company Law emphasize the characteristics that (i) shareholders are only responsible for the deposit amount of all shares owned and do not include their personal assets. The formulation of this article has the implication that the personal wealth of shareholders is separate from the company's assets. (ii) provisions regarding Directors and Commissioners being released from joint responsibility if the Directors and Commissioners can prove that the company's losses were not caused by the negligence of the Directors and Commissioners.

Whereas the provisions regarding *separate legal entities* are a concept that protects shareholders, directors and/or other company organs from all actions, deeds and activities of the company, namely (Harahap, 2011): the actions, deeds and activities of the Company are not the actions of shareholders; The obligations and responsibilities of the Company are not the obligations and responsibilities of shareholders, directors and/or other corporate organs.

This principle provides legal certainty to shareholders as entrepreneurs, both from an economic and legal perspective. Economically, this principle guarantees that the personal wealth of shareholders will not be affected by risks that may arise during the company's business activities (Goshen & Hamdani, 2020). From a legal perspective, shareholders can invest safely because they are protected from lawsuits that may be filed by third parties who are legally related to the company, and company organs such as Directors and/or Commissioners can protect themselves from company losses that are not caused by company organs.

However, the UUPT also regulates exceptions to the principle of separate legal entity, namely the principle of Piercing the Corporate Veil. This principle allows the closure of limited liability for company organs, if shareholders, directors and/or commissioners commit acts that benefit personal interests to the detriment of the interests of the company and other parties (Hermanto & Purwaningsih, 2021). In Black's Law Dictionary, Piercing the Corporate Veil is "the judicial act of imposing personal liability on otherwise immune corporate officers, directors, and shareholders for the corporation's wrongful acts. Also termed ignoring the corporate entity, veil-piercing" (Garner, 2004). That the Piercing the Corporate Veil doctrine is a doctrine that eliminates

limited liability from shareholders, directors and/or company organs, so that there is full liability up to personal assets to compensate for all losses to the company or other parties.

In the UUPT, *Piercing the Corporate Veil* is stated in Article 3 paragraph (2) of the UUPT which regulates the reasons for the abolition of the principle of limited liability, one of which is letter c which reads: " The provisions as intended in paragraph (1) do not apply if:

c. the shareholder concerned was involved in an unlawful act committed by the company ".

The limits to the application of limited liability are not only for shareholders, if the Directors are negligent in carrying out their duties and cause the company to suffer losses, then in Article 97 Paragraph (3) UUPT the Directors are obliged to take full and personal responsibility for the company's losses, the article of which reads as follows :

"... Each member of the Board of Directors is fully personally responsible for the Company's losses if the person concerned is guilty or neglects to carry out their duties in accordance with the provisions as intended in paragraph (2).

The same also applies to the Board of Commissioners who serve in a company. In Article 114 Paragraph (3) of the Company Law, the Board of Commissioners is also jointly and severally responsible for the company's losses caused by the negligence of the Board of Commissioners, the article of which reads as follows:

"...Each member of the Board of Commissioners is personally responsible for the Company's losses if the person concerned is guilty or negligent in carrying out their duties as referred to in paragraph (2).

The main objective of implementing the *Piercing the Corporate Veil doctrine* is to ensure justice for parties involved inside and outside the Company from arbitrary or inappropriate actions carried out by one or all of the shareholders and/or management on behalf of the Company. These actions may result from transactions with third parties or from misleading or unlawful conduct (Santoso, 2022). The limited liability nature of Company shareholders should not be exploited to harm the interests of parties acting in good faith, because legal principles always protect innocent parties from actions that could harm their interests (Nasrul et al., 2021).

3.2 Application of Piercing the Corporate Veil in Investment Law

Investment is defined by the Black Law Dictionary as: an expenditure to acquire property or assets to produce revenue; a capital outlay. That the scope of investment is very broad, so that what is regulated through investment law are regulations that regulate various types of investment transactions (Atikasari et al., 2020). That investment transactions are in the realm of business and can be carried out by company organs to gain profits for the company. Often transactions carried out by the company through the company's organs are detrimental to the company, because of personal profits obtained from investment transactions (Meiryani & Warganegara, 2022). For example, shareholders of a company carry out investment transactions or agreements that are prohibited by laws and regulations involving the company, so that the concept of *Piercing the Corporate Veil* can be applied. In legal investment transactions carried out by shareholders, shareholders often transfer responsibility to the Board of Directors as management of the company (Prakasa, 2021). That this is an injustice to the Directors if the Directors have carried out their obligations in accordance with the precautionary principle. That the concept of *Piercing the Corporate Veil* can basically be applied to all company organs that are proven to have committed deliberate or negligent actions that are detrimental to the company and/or other parties so that these company organs can be held accountable for personal assets (Marune et al., 2023).

For example, the case of PT Asuransi Jiwasraya Persero ("Jiwasraya") failed to pay claims submitted by its customers. That Jiwasraya at that time issued an insurance product called JS Saving Plan. That this product uses a *Bancassurance system or mechanism*, namely an insurance model wrapped in investment, where in the process the insurance company collaborates with the bank in marketing the product. This *Bancassurance* scheme promises high returns, so when the insurance company, in this case Jiwasraya, cannot cover the return, then Jiwasraya is deemed to have failed in providing a return or return on the Bancassurance investment (Baker, 2023). Based on these problems, Jiwasraya as a company has a responsibility towards its customers. That the request for responsibility in this matter can also be asked of the shareholders because the principle of *Piercing the Corporate Veil* can be applied (Anie, 2022). That the reason why shareholders can be held personally responsible is because shareholders are beneficiaries of the Jiwasraya company who receive dividends and other benefits. According to M. Yahya Harahap, it is not

difficult to prove the existence of facts that show the involvement of one of the company's organs in carrying out actions that are detrimental to the company and/or other parties. The meaning of this involvement is very broad, so it is necessary to prove the extent of involvement of the company's organs in order to be held accountable (Adinegoro & Rusfian, 2023).

Piercing the Corporate Veil concept approaches which are grouped into the following categories (Jahja et al., 2020):

a. Agency Theory

Agency Theory describes a situation where the Company's shareholders, including the parent company and individual shareholders, have very strong control so that the Company functions as their agent or representative. The shareholders are significantly involved, both directly and indirectly, so that the Company's actions are considered as an extension of the shareholders, or are referred to as the shareholders' alter ego. Alter ego is "a corporation used by an individual in conducting personal business, the result being that a court may impose liability on the individual by piercing the corporate veil when fraud has been perpetrated on someone dealing with the corporation". An indication of the existence of an alter ego is when the interests of shareholders dominate the interests of the Company, and it is difficult to differentiate between the shareholders' personal entity and the Company. There is unity of interest and ownership between the Company and individual shareholders. The Company does not bear responsibility for its actions carried out by shareholders. In this case, the shareholders are responsible for all actions or legal acts carried out on behalf of the Company.

b. Fraud

Fraud or fraud occurs when shareholders, directors and/or commissioners use the Company to avoid personal responsibility, which can be considered an unlawful act.

c. Sham or Façade

This theory is applied when the legal structure of the Company is used as a mask to hide the true purpose of control over the Company. It is clearly seen that the aim of shareholders in establishing a Company is only to avoid responsibility, while the obligations they should fulfill are not carried out. Usually, this can be seen from the mixing of assets between shareholders and the Company.

d. Group Enterprises

This theory is applied when directors as administrators of a subsidiary no longer have the freedom to act according to the interests and needs of the subsidiary, but are bound by the policies set by the parent company. As a result, the management tends to act in the interests and profits of the parent company and shareholders, without paying attention to the interests of the subsidiary itself.

e. Unfairness or injustice

Basically, this situation may occur when shareholders predominantly participate in determining the Company's decisions, as a result of which parties who have legal relations with the Company suffer losses. Therefore, it is fairer if the lawsuit is directed directly at the shareholder who has the dominance.

4. CONCLUSION

The characteristics of a Limited Liability Company cannot be separated from the principle of limited liability of its corporate organs, because a Limited Liability Company with its shareholders and corporate organs is a separate legal entity. In practice, in practice, company organs often increase the company's business by carrying out investment transactions, taking actions that only benefit the company's organs and/or they are the only ones who enjoy the profits, while the Company experiences losses. Regarding this, if there is a loss either from the Company or to another party on the basis of an investment legal transaction that is in the interests of the Company, then the concept of Piercing the Corporate Veil can be applied. This application certainly requires evidence of the involvement of the company's organs, that there is an indication that the actions in the transaction only benefit one of the company's organs. With this proof, the injured party can take responsibility for the company's organs and their personal assets.

The current research faces several limitations, including a lack of comprehensive empirical data across various jurisdictions, limited analysis of the impact of cultural or institutional factors on judicial decisions, and insufficient consideration of the evolving nature of investment structures

such as private equity or venture capital funds. Future research could address these limitations by conducting more extensive comparative studies involving diverse legal systems, incorporating qualitative analysis to explore the underlying reasons behind judicial decisions, and examining specific industries or sectors where piercing the corporate veil is particularly relevant, such as fintech or biotech. By overcoming these limitations, future research can contribute to the development of clearer legal standards and guidelines for applying piercing the corporate veil in investment disputes, thereby enhancing investor protection and promoting confidence in the integrity of capital markets. The research offers crucial insights for decision-makers across various domains. Investors can make more informed choices by understanding the risks and liabilities associated with different investment structures, while corporate officers can implement better governance practices to mitigate personal liability risks. Policymakers and regulators can also use these findings to shape legislative reforms aimed at enhancing investor protection and promoting transparency in capital markets.

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