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Legal Liability of Parent Company on Subsidiary's Bankruptcy in Indonesia

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Abstract: This paper aims to know legal liability of parent company on subsidiaries's bankruptcy in holding company. In holding company, parent company automatically controls the operation of subsidiaries. Parent company and subsidiaries stand independently and have their own by law as a regulation to comply with in respective companies. Subsidiary is legally responsible itself for doing its business activity. However, parent company has legal relation to subsidiary when parent company binds itself to an agreement entered into by the company and third party. Parent company is not responsible for legal deed done by subsidiary. Parent company can be accountable for any action taken by its subsidiary in an economic unity. When bankruptcy occurs in subsidiary, parent company should be responsible for the subsidiary's legal deed in the case of Parent Company contributes to and signs the agreement entered into by the subsidiary and the third party in loan agreement between subsidiary as debtor and creditor. Parent company can have responsibility in the case of it acts as *corporate Guarantee* for loan agreement entered into by subsidiary between subsidiary as debtor and creditor. When the parent company becomes corporate guarantee, parent company is also responsible for debt-loan taken by the subsidiary.

Keywords: *Holding Company, Parent and Subsidiary Company, Legal Liability, Bankruptcy.*

I. INTRODUCTION

Nowadays, the global economy develops very dynamically; it is triggered, among others, by the presence of globalization giving the businesspersons the broader opportunity of improving trading volume by means of expanding their business to international market (Andi Fahmi, 2009).

Group company or so called conglomeration always becomes an interesting topic, as the group company's uncontrolled growth and development can result in monopoly over a business network. On the other hand, group company is considered as necessary to speed up a state's economic development. The relation occurring between companies constituting the members of group can be defined as the one between legal entities existing in a group; entity in the form of Limited incorporation. Such the relation can occur, among others, due to much or little ownership interrelation. It is a close interrelation between one and another in both business operating policy and in the term of financial management and organizational relation. In other words, a company under one central leadership or collective leadership is managed with the same style and pattern (Emmy Simanjuntak, 1997).

The attempt of developing a company's business or marketing can be taken by establishing subsidiary in a region. Sometimes a company's business has been large so that it should be split by its business categorization. However, it is also necessary for the split business to be independent Limited Incorporation under the same ownership to operate in the presence of centralized controller in certain limits. The split companies along with other companies likely existing earlier are under the same owner or at least have specific relation, owned and commanded by an independent company, and the owner (commanding) company is called *holding company*, *parent company* or *controlling company* (Munir Fuadi, 2008).

Sometimes a company's business has been so large and expansive that the company itself should be split by its business categorization. However, it is a necessary for the split businesses to be independent Limited Incorporation under the same ownership to operate in the presence of centralized controller in certain limits. The split companies along with other companies likely existing earlier are under the same owner or at least have specific relation, owned and commanded by an independent company. This owner company is called holding company or parent company (Emmy Simanjuntak, 1997).

A Holding company has legal relation to its subsidiary. In addition, Holding company has responsibility for its subsidiary when the subsidiary is stated as bankrupt. The presence of responsible party, particularly in the case of a subsidiary's bankruptcy, is very important. Parent company should also be responsible for the subsidiary stated as bankrupt when parent company becomes corporate guarantee. This responsibility for bankruptcy is intended to prevent the loss from occurring in the third party as creditor, and to resolve immediately the problem occurring in subsidiary, as the longer resolution process will harm the subsidiary's business activity, impacting on the parent company's fundamental economy in its financial statement.

II. METHODOLOGY

This study was a normative law research using statute approach. This article aimed to find out the legal relation of Holding company to and its responsibility for subsidiary. The source and type of law material used consisted of primary law material including legislation, particularly related to limited incorporation, Law Number 40 of 2007 about Limited Incorporation and Law Number 37 of 2004 about Bankruptcy and Loan Repayment Obligation Postponement. It also consisted of secondary law material, including the one related and relevant to primary law material source, such as books and journals related to limited incorporation, particularly concerning holding company.

III. LITERATURE REVIEW

In the era of globalization, holding companies have become a popular and advantageous way of doing business. Their numerous benefits have motivated many businesses to direct their strategy towards creating holding structures (Dominik Gajewsk, 2012).

Some consider a holding company a company that holds shares of other companies in amounts sufficient to

influence the decisions of these companies (Solarz, 1992). Others consider a holding company one that is controlled by another entity, regardless of the method of control (Warchoł, 2001)

Holding companies aimed to identify the reasons for companies grouping, identify the impacts and determine the correlation between the level of association and the performance of the companies. The information necessary was obtained through a questionnaire enquiry and interviews as well as by analyzing the financial statements and other documents describing the relationships between the companies in question. The interviews confirmed the main benefits of a holding company, improved cash flow management. The most frequent cash flow management tools include loan agreements, internal factoring, dividend payment in favor of the holder, using of transfer price, and cash pooling with the subsidiaries' cash concentrated in a joint account and transferred from active companies to those with a temporary deficit (David Ficbauer, 2014).

In a holding company the price policy is within a head company competence. Thus, neither heads of definite gas station, nor branch or subsidiary management has an opportunity to adjust a realization price when external factors are changed independently (Artem I. Krivtsov, 2016). Holding companies are basically valued by their liquidation value, which is corrected to take into account taxes payable and managerial quality (Pablo Fernandez, 2007).

IV. ANALYSIS AND DISCUSSION

A. The legal relation of Holding Company to its subsidiary

Holding company is also called *parent company*, or *controlling company*. Munir Fuadi defines holding company as a company aiming to have share in one or more other companies and/or to govern one or more other companies (Munir Fuadi, 1999).

Komarudin in his book entitled *Ekonomi Perusahaan dan Manajemen* defines holding company as an enterprise established aiming to master most shares of the enterprise it will influence (Komarudin, 1982).

Holding company, according to Ray August, is the one owned by one or some parent companies in charge of supervising, coordinating, and controlling its subsidiaries' business activity (Sulistiowati, 2010).

Basically, Law Number 40 of 2007 about Limited Incorporation, as the fundamental rule of limited incorporation does not govern clearly the bond legal relation between parent company and subsidiary. However, the rapid growth of group company number in Indonesia is affected by the motive of achieving competitive advantage surpassing other companies, long-term motive of utilizing the fund collected optimally, or instruction of legislation encouraging the establishment of group company (Sulistiowati, 2010).

Considering such the motives, businesspersons make group company the superior area chosen in developing their business. However, the existence of group company itself has not been legitimized completely in Indonesia, in the term of status and position between parent company and subsidiary; it is because there is no clear definition of group company and no concrete provision governing firmly the right and obligation of parent company and subsidiary. Essentially, any legal entity born on the behalf of incorporation will be subjected and will comply with Law Number 40 of 2007 about Limited Incorporation.

Belonging to a company in group company construction, a company should be subjected to and should comply with such the regulation. For that reason, referring to Limited Incorporation Law of 2007, it can be concluded that the law does not legitimize specifically the form of legal relation between subsidiary and parent company, recalling that no article explains the definition of group company. However, group company is interpreted to be the companies independent in juridical manner in a strong arrangement between one and another, while viewed from economic perspective it is considered as one unity under central leadership (Emmy Pangaribuan, 1994).

In Indonesia, the regulation about limited incorporation governed in Law Number 40 of 2007 about limited incorporation holds on the principle of separate legal entity, in which there is no authority separation between shareholder and the incorporation and the shareholder's responsibility is as much as the capital it invests in the company, and shareholder may not intervene with the board of directors as the assumer of shareholder's mandate in the term of company management as the policies made by the board of directors is absolutely the constitutional right belonging to the board of directors to operate the incorporation according to its purpose and objective.

The incorporation doing legal deed is obligatorily subjected to the enacted rule, in which the action of entering into an agreement is governed in articles 1313-1319 of civil code about agreement, articles 1320-1337 about the legitimate condition of agreement, and articles 1338-1341 about the consequence of agreement (M. Yahya Harahap, 2011). Therefore, in the case of subsidiary is established by parent company in the form of separate legal entity, legal entity takeover, or new legal entity establishment, it should be subjected to the rules governing the legal relation. As such, the right and obligation resulting from the legal relation between parent company and subsidiary can be automatically seen. However, the problem is that there is no clear regulation about the relation between right and obligation in group company construction leading to the inappropriate implementation of mandate of each article contained in the regulation related to group company, Law Number 40 of 2007 about Limited Incorporation, in which the law only gives the companies the opportunity of establishing subsidiary but does not explain the relationship between right and obligation of interrelated companies. It is because the concept of group company is currently not in legal domain, but in the reality of integrated business of companies under the parent company's control. It leads to the establishment of group company as the plural form in juridical manner, but one unity in economic perspective, in which it breaks the provision of incorporation as a separate legal entity, according to the rule of law. The juridical recognition of the independency of parent company and subsidiary results in the complicated legal problem related to group company, concerning the parent company's ownership over its subsidiary, the board of directors' placement in subsidiary, and voicing contract in Shareholder General Meeting (Sulistiowati, 2010).

To penetrate into independent responsibility of a legal entity, particularly the responsibility of subsidiary, parent company can be accountable for its subsidiary's business; in this case personal contracts can be entered into as well. It is made, for example, to guaranty its subsidiary's loan by means of developing corporate guarantee, personal guarantee, or limited guarantee (Gatot Supramono, 2007).

Individual incorporations have their independent right and obligation, their own asset and loan, and limited liability

not assuming the incorporation's loan and loan repayment beyond the capital deposited. Incorporation law uses legal principle about juridical independence of subsidiary or affiliated company when entire incorporation is owned by other incorporation and integrated into a complex multi-businesses network (Sulistiowati, 2010).

Holding company as the parent company automatically controls its subsidiary's operation. Parent company and subsidiary stand independently, and have their own bylaw, to which they should be subjected. Subsidiary is legally responsible for its own activity.

Parent company's control over its subsidiary refers to the actualization of parent company's authority through policy or instruction to direct the subsidiary's business activity in encouraging the group company's economic interest (Sulistiowati, 2010).

Parent company's ownership over its subsidiary's share in significant number authorizes it to act as the central leader controlling subsidiaries as the whole management. One function of parent company's shareholding over its subsidiary is *zeggenschapsfunctie. Zeggenschapsfunctie* of subsidiary's shareholding give the parent company the voting right to control subsidiary through a variety of controlling mechanism existing, like shareholder general meeting to support the *beleggingsfunctie* of group company construction as an economic unity (Sulistiowati, 2010).

Although in juridical manner subsidiary is responsible for doing any activity and business activity itself, Parent company has legal relation to subsidiary, as parent company has an obligation to supervise and to control the operation of business activity and particularly law-related actions taken by subsidiary. Such the legal relation can be established when parent company serves as corporate guarantee against the agreement entered into by subsidiary as debtor and the creditor. In addition, when Parent Company participates in signing the agreement entered into by subsidiary and the third party, parent company has automatically bond itself to the agreement, and should comply with the agreement, so that a legal relation is indirectly established between parent company and subsidiary.

On the other hand, parent company and subsidiary have their own by law, constituting a rule to which respective companies should be subjected. Subsidiary should be responsible legally for any activities it has done.

B. Holding Company's responsibility for its subsidiary stated as bankrupt

Company, as a legal entity in the case of committing legal deed representing by a board of directors under commissioner's supervision, representatively represents the company stakeholders' interest based on fiduciary duties principle given by the stakeholders to run the company as well as possible corresponding to the objective and purpose of incorporation as governed in incorporation's bylaw. Fiduciary duties apply to board of directors in undertaking its duty in performing its function both as management and as incorporation representative (Munir Fuadi, 2002).

In operating its business, a company must have related to other parties, the third party. The company conducts buying-selling transaction, banking loan, leasing, and etc. When the transaction can run smoothly or no problem occurs, its condition will usually be safe, but otherwise, when some problem occurs, for example, the company cannot perform the agreement, responsibility will be looked for. As the one conducting transaction is a Company, the problem of responsibility is affected by its status, whether or not it has legal entity status. The difference of status affects who should be responsible for the problem (Gatot Supramono, 2007).

To penetrate into independent responsibility of a legal entity, particularly the responsibility of subsidiary, parent company can be accountable for its subsidiary's business; in this case personal contracts can be entered into as well. It is made, for example, to guaranty its subsidiary's loan by means of developing corporate guarantee, personal guarantee, or limited guarantee (Gatot Supramono, 2007).

Holding company can be asked for being accountable for the action taken by its subsidiary in an economic unity. To the process and form of holding company's accountability, *Co Policy Decider* theory is applied, in which when the holding company interferes with the management and business of subsidiary too far, just like in the centralized company group, the holding company can be considered as influencing the decision made by the subsidiary. In this case, holding company is considered as "co decider" so that certain limit is feasible to be included in order to be responsible legally through joint responsibility (Munir Fuadi, 1996).

Although parent company and subsidiary are two different and separate legal entities, there is an interrelationship in economic aspect and in the right and obligation of both legal entities.

Considering the independency principle of subsidiary as a legal entity, Holding company does not have legal authority to intervene with the subsidiary's management and policy. Meanwhile, the involvement of Holding Company in its subsidiary's business is possible in the following cases:

1. Through director and commissioner hired by Holding company as the shareholder, as long as not in contradiction with Holding company's bylaw.
2. Through contractual relation, and as long as not in contradiction with the company's bylaw (Munir Fuadi, 1999).

In this *Holding Company*, subsidiary can be stated as the separate legal subject, entitled to do its own legal deed, and parent company is not responsible for the legal deed the subsidiary has done. In this holding company, limited liability principle protecting parent company as the shareholder of subsidiary in order to be responsible not beyond the investment value over the subsidiary's incapability of completing its legal responsibility to the third party.

In a business activity, every company is generally inseparable from loan matter in which it is made to increase its capital business. Subsidiary must have its distinctive business activity different from the parent company's. In addition, in running its business activity, subsidiary encounters some obstacles. It is possible that subsidiary cannot repay its mature debt (loan), thereby stated as bankrupt. Subsidiary as a separate legal entity can be considered as a separate legal entity in the case of bankruptcy. Therefore, subsidiary should be subjected to the provision of Bankruptcy Law. The provision of Article 1 clause 6 of Law Number 37 of 2004 about Bankruptcy and Loan Repayment Obligation Postponement states that loan is an obligation stated or that can be stated in an amount of money in either Indonesian or foreign currency, either directly or that will occur in the future or contingent, occurring because the agreement or law that should be obeyed by Debtor and is not obeyed gives the creditor the right to get its fulfillment from Debtor's wealth.

Considering the limited liability principle, it can be stated that parent company is irresponsible for subsidiary has been stated as bankrupt; it is because parent company has

limited responsibility to subsidiary. Parent company is irresponsible for the legal deed committed by the subsidiary as a separate legal entity. Subsidiary in principle should be responsible legally for the loss the third party suffer from as a legal consequence of subsidiary implementing instruction or command of parent company. In principle, parent company's responsible in group company is only limited to how much share is invested in its subsidiary.

When a subsidiary is bankrupt, parent company should be responsible for the subsidiary's legal deed in the case of parent company participates in signing an agreement entered into by the subsidiary and the subsidiary's third party in which subsidiary serves debtor and the creditor. Parent company can also have responsibility in the case of it acts corporate guarantee over the loan agreement entered into by subsidiary as debtor and creditor. When parent company becomes as corporate guarantee, it is also responsible for the loan made by subsidiary.

CONCLUSION

1. *Holding company* as the parent company automatically controls the operation of subsidiary. Both parent company and subsidiary stand independently and have their own bylaw, to which they should be subjected. Subsidiary is legally responsible for its own business activity. But parent company has legal relation to subsidiary when it binds itself to an agreement entered into by subsidiary and third party.
2. Subsidiary is not responsible for the legal deed the subsidiary has done. The limited liability principle is enacted that protects the parent company as the subsidiary's shareholder from being responsible beyond its investment value or capability of completing its legal responsibility to the third party. Parent company can be asked for being responsible for the action its subsidiary has taken in an economic unity. When a subsidiary is bankrupt, parent company should be responsible for the subsidiary's legal deed in the case of parent company participates in signing an agreement entered into by the subsidiary and the subsidiary's third party in which subsidiary serves debtor and the creditor. Parent company can also have responsibility in the case of it acts corporate guarantee over the loan agreement entered into by subsidiary as debtor and creditor. When parent company becomes as corporate guarantee, it is also responsible for the loan made by subsidiary.

Recommendation

1. The Law Number 40 of 2007 about Limited Incorporation should be revised, as the Law has not governed clearly yet the legal relation between holding company and its subsidiary.
2. In the case of some problem occurs in subsidiary, although the subsidiary is legally responsible for its own activity, Holding company or parent company remains to help solve the subsidiary's problem in order to solve the problem more quickly, so that it will not harm the business activity of both subsidiary and holding company.

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