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Analysis of the Doctrine of *Ultra Vires* and its Prevention Efforts Against the Actions of the Board of Directors in Limited Liability Companies

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ABSTRACT
The issue of abuse of authority by company directors often occurs in companies in Indonesia. Deviations that exceed the authority of the board of directors are known as *Ultra Virus.* As a result of these deviations, it has the potential to cause losses to stakeholders such as shareholders, the wider community, company partners and even the company itself. In the Limited Liability Company Law, *ultra virus* acts can be held accountable to the Board of Directors personally, but the problem is, how the directors can fulfill the demands of the injured parties while their assets have been transferred or have been exhausted. In this writing the author uses a normative juridical approach. The result of this study is that the actions of directors who have *ultra viruses have the* potential to harm many parties, therefore so that these actions are not repeated there needs to be a strict supervision mechanism, because so far, the supervision has only been carried out by commissioners. Internal supervision by commissioners is deemed not optimal, so it is necessary to establish by the government an institution in charge of overseeing the performance of directors in the company.

1. INTRODUCTION

In Indonesia, there are many choices of company models to carry out various business activities, including companies in the form of legal entities, for example, cooperatives, foundations and limited liability companies. Or other forms of companies that are not incorporated such as CV, Firma, individual companies and trading businesses. It's just that in companies that are not incorporated, active company officers can be held accountable up to their personal property if the business being run is detrimental or has obligations to third parties exceeding the company's assets. In short, entrepreneurs who run unincorporated companies are unlimitedly liable for actions and agreements made for and on behalf of the unincorporated company. Whereas in companies that are incorporated there is a distinction of responsibility for actions taken by company organs such as directors, commissioners and shareholders[1] . As long as each of them acts in accordance with their authority as stipulated in the company's Articles of Association and according to the limited liability company law,

[1] Moechthar, Oemar. *Techniques for making deeds of legal entities and business entities in Indonesia*. Airlangga University Press, 2020. Page 3

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the legal acts of the company's organs of capacity and responsibility are for and on behalf of the company .[2]

In principle, a person cannot be held liable for the actions of another person, unless the other person commits an act under his guardianship, or the person is under his supervision and/or works as his laborer/employee.[3] . Liability for the actions of others occurs in the event that they cause harm to a third party, so that the third party can claim compensation for the actions of others who are under their guardianship/supervision. Likewise, in a limited liability company, it is not possible for the shareholders to be held liable for the acts committed by the directors or commissioners of the company as long as the actions of the directors or commissioners of the company are not against the law and do not violate the provisions in its articles of association and the shareholders do not commit acts that cause the company to suffer losses due to the bad faith of the shareholders themselves.

The limited liability company as an independent entity is considered an independent legal subject regardless of its members. According to Yahya Harahap, corporate law in Indonesia adheres to the principle of *limited liability* and *separate entity*, namely the company is separate and distinct from its owner, in this case separate from shareholders *(separate and distinct from owner)*[4] *.* According to Munir Fuady, the duty of the board of directors is as a *fiduciary of duty. The* doctrine *of fiduciary of duty* comes from the *common law* legal system which teaches that between the board of directors and the company has a *fiduciary* relationship*. The* Board of Directors only acts as a *sprang trustee* or agent solely who has the obligation to serve fully or as well as possible to the company. Directors are required to have a *duty of care and skill,* good faith, loyalty, and honesty towards their company with a *high* degree*.*[5]

The separation of personal quality and the quality of the company in the responsibility for acts committed by directors for and on behalf of the company can be a loophole that is very likely to be utilized by directors not to be personally responsible, even though when acting for and on behalf of the company the directors have personal interests (*conflict of interest)*. So that company organs such as directors, commissioners and shareholders can escape personal responsibility. In the example case of ***PT First Anugerah Karya Wisata, the*** directors were only prosecuted and decided by the court in the form of criminal liability for fraud and laundering of customer money.[6] The concrete form of *Ultra virus* is in the form of offering unlicensed entity products so that the actions of the directors violate existing norms, including exceeding their authority, also go unnoticed. Most law enforcers focus on the criminal acts of directors[7] .

[2] Handayani, Otih. "Legal Protection of Activity Organizer Services for Business Sustainability of Activity Organizer Services Company." *Krtha Bhayangkara* Volume 12 Number 2 Year 2018. pp. 154-168

[3] Irianto, F. Criminal Law Liability of Hospitals as Health Service Corporations. *Sol Justicia*, *4*(2), 2021 pp. 163-174.

[4] M Yahya Harahap in Siti Hafsah Isfardiana, *Responsibility of Limited Liability Companies in Violation of Fiduciary Duty*, Padjajaran Journal of Legal Sciences, Volume 2 Number 1 Year 2015 Page. 169.

[5] Munir Fuady in Siti Hafsah Isfardiana, *Responsibility of Limited Liability Companies in Violation of Fiduciary Duty*, Padjajaran Journal of Legal Sciences, Volume 2 Number 1 Year 2015 Page. 170

[6] https://www.bbc.com/indonesia/indonesia-50451607 (accessed on February 23, 2021).

[7] https://www.kompas.com/tren/read/2019/11/17/060000565/first-travel-awal-berdiri-lakukan-penipuan-hingga-akhirnya-tumbang?page=all (accessed on February 23, 2021)

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The existence of the doctrine of *piercing the corporate veil,* allows *piercing* the veil of separation of the actions of the company's organs for and on behalf of the company into personal responsibility for the company's organs who abuse their authority and act outside the provisions of its articles of association (*ultra vires),* or the directors utilize the company for personal gain, act carelessly so as to cause the company's assets to be insufficient to pay obligations to third parties or harm the company.

Piercing the corporate veil and *ultra vires* theory can indeed reveal the veil of liability of the company's organs, especially the directors to the directors' personal property. The actions of the directors that were originally for and on behalf of the company then changed, so that they could be held accountable to their personal property, if the directors were proven to have committed illegal acts and had bad faith in running the company. However, it takes time and a long process to uncover the *ultra vires* actions of the directors. Meanwhile, it could be that the personal assets belonging to the directors have been transferred or have been exhausted. As a result, the parties who hold the directors personally responsible still do not get compensation for the *ultra vires* actions of the directors. All seems to be in vain. In fact, it is likely that many have been harmed, including the company they lead, shareholders, creditors or partners of the company. For this reason, there needs to be a good and strict supervision system that allows preventive efforts or prevention of directors' actions that exceed their authority (*ultra vires)* which harm many parties. The Limited Liability Company Law strictly regulates this *ultra vires* doctrine. However, until now, abuse of authority by the board of directors still often occurs even though in practice the board of directors has been supervised by the commissioners in their daily activities. Then how to prevent the board of directors from abusing their authority that exceeds the limits and violates the Articles of Association of the Company. The loophole will appear when there is an action that can benefit the directors personally, while there is no supervision. There are many loopholes in the actions of the company's directors in carrying out their duties and authorities, for example an insurance company, when money is raised through premiums paid by customers, the directors can rotate *money* in the *money market.* Management can be carried out in business aspects that are minimal risk and in accordance with the provisions in the articles of association, for example in the articles of association the company is only allowed to use funds for deposits, bonds or shares, but *ultra viruses* can occur when the directors buy real assets such as hotels, other business properties outside those that have been limitatively regulated in the articles of association. Furthermore, the results of business management can be disguised and used for personal interests. So here prevention efforts are needed against *ultra vires* that harm the Company and or third parties. Prevention efforts are more useful to reduce greater losses and protect the interests of all parties rather than waiting for the doctrine of *piercing the corporate veil to be* applied. this is because it is very difficult to prove. That the board of directors committed *ultra virus* acts was only discovered after the company suffered losses in several financial statements, or there were obligations to third parties that were not carried out. Only then is the performance of the board of directors examined. To prove the abuse of authority of the board of directors to the detriment of the company, it is carried out by a professional independent audit which takes a long time, while the directors have the opportunity to change or disguise their actions as if they do not violate the articles

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of association or deviate from the provisions of the law. The actions of the directors to abuse the mandate of the GMS and Articles of Association that exceed the limits of authority, whether based on the *Ultra Virus* doctrine or the doctrine of *piercing the corporate veil,* mostly always intersect with crime. So that the mechanism is very difficult for the company or the affected party to prove. Meanwhile, law enforcers, both investigators and public prosecutors, always focus on the perpetrator. Evidence only concerns matters related to unlawful acts and those that fulfill the offense in criminal law. Meanwhile, the company or victim must parse and prove which actions can be attributed to the doctrine of *ultra virus* and *piercing the corporate veil.*

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2. RESULTS AND DISCUSSION

2.1. Overview of the Doctrine of Ultra Vires

Ultra vires comes from Latin which in English is translated as *"beyond the power"* or in Indonesian as beyond the authority. The academic understanding, for example, was written by Timothy Endicott, "*ultra vires means beyond (the agency's) legal powers*". Defined by Frank Mack as: "*The term ultra vires in its proper sense, denotes some act or transaction on the part of the corporation which although not unlawfull or contrary to public policy if done or executed by an individual, is get beyond the legitimate powers of the corporation as they are defined by the statute under which it is formed, or which are applicable, or by its charter or incorporation papers".*[8]

Ultra vires is an act that is beyond the ability to act (not included in the purpose and objectives of a limited liability company in other words, *ultra vires* means that certain actions are essentially legal (in relation to other parties) but are apparently beyond the ability to act of the company's directors as stipulated in the company's articles of association or are outside the scope of the company's purpose and objectives.[9]

The company as a legal entity means that the company is a legal subject, so that the company can be burdened with rights and obligations like humans in general. As a legal entity, the company has its own wealth which is separate from the wealth of its management.[10] The limited liability company law expressly and explicitly regulates that violations of duties that result in losses to the company, can make the director liable to civil, even criminal charges. A director can be personally sued and charged under criminal law if he or she does any of the following: [11]

a) The director acted imprudently or *recklessly* or without calculation *(reckless)*;
b) Being *intentionally dishonest*;

[8] See Johny Ibrahim, The *Doctrine of Ultra Vires and the Consequences of Its Application to Private* Legal *Entities*, Journal of Legal Dynamics, Vol. 11 No. 2 Year 2011 Page. 244

[9] Kurniawan, *Directors' Liability in the Bankruptcy of a Limited Liability Company based on the Limited Liability Company Law*, Mimbar Hukum, Volume 24 Number 2 June 2012, pp. 218-219

[10] Kurniawan, *Responsibility of Limited Liability Company Shareholders According to Positive Law*, Mimbar Hukum Volume 26 Number 1 February 2014 Page. 71.

[11] Yafet Y. W. Rissy, The Doctrine of Piercing the Corporate Veil: Provisions and Their Application in the UK, Australia and IndonesiaReflection of Law, Volume 4 Number 1 Year 2019. Page. 8

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c) *Failing to* perform their duties in good faith in the best interests of the company and its worthy objectives;
d) Use his/her position as a director dishonestly and *recklessly*, directly or indirectly, so that he/she or another party gains an advantage or causes a loss to the company;
e) Use information obtained by him/her as a director dishonestly and *recklessly,* directly or indirectly, which enables him/her or another party to gain an advantage or cause a loss to the company.

From the five points above, a director can be held personally liable. Even the demands of the injured parties are only in the form of compensation claims to the directors personally, not to the company, because of *ultra vires*. The company can only be sued if the actions of the directors are *intra vires,* this is the important point of the doctrine of *ultra vires*. With this doctrine, it is hoped that the directors will act carefully and measuredly, not recklessly to bind the company and act in accordance with the articles of association of the company's bylaws, let alone utilize the company for the purpose of releasing responsibility.

2.2. Prevention of Ultra Vires Directors

Until now, deviations made by the directors of limited liability companies in carrying out their duties still often occur. These deviations are certainly very high risk, where the risks that may be experienced by the company due to the *ultra vires* actions of the directors are losses for investors and creditors, then the invalidity of the legal actions of the directors even to the provision of criminal sanctions, of course this can reduce public trust and stakeholders.

As the adage in the medical world states, "prevention is better than cure" this also needs to be applied in the prevention of *ultra vires* directors. The application of the doctrine of *ultra vires* in Indonesian law must be carried out strictly, it is intended that the economic system in Indonesia can be built with a strong foundation. So it is necessary to make efforts for prevention to minimize the company as the driving force of the economy to experience losses and bankruptcy.

Usually, the company's articles of association clearly contain the purpose and objectives of the limited liability company. So that the GMS also acts in accordance with its functions and objectives to develop and run a healthy limited liability company. In addition, with regard to the duties and authority of the board of directors, the articles of association also stipulate that the board of directors is fully responsible for carrying out its duties in accordance with the aims and objectives of the limited liability company. Regarding statutory restrictions on the authority of members of the board of directors, it can be found in CHAPTER VII of the Limited Liability Company Law. Meanwhile, the authority of the board of directors itself in relation to the doctrine of *ultra vires* is contained in Article 2 and Article 92 paragraph (1) of the Limited Liability Company Law, namely: "the board of directors carries out the management of the Company for the benefit of the Company and in accordance with the aims and objectives of the company, not contrary to laws and regulations, public order and decency". in Article 92 paragraph (2) reads: "The Board of Directors is authorized to carry out the management as referred to in paragraph (1) in

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accordance with policies deemed appropriate, within the limits set forth in this law and/or the articles of association".[12]

Likewise, the authority of the Board of Commissioners is contained in Article 108 paragraph (2) of the Limited Liability Company Law which states: "supervision and provision of advice as referred to in paragraph (1) shall be carried out for the benefit of the company and in accordance with the purposes and objectives of the Company. From the authority possessed by the limited liability company organ normatively, it can be seen that the purpose and objectives and activities of the limited liability company are important, this is also very clear if the limited liability company will make changes to the purpose and objectives and business activities must obtain ministerial approval, which must first make a deed of amendment to the Notary. As stipulated in Article 21 of the Law on Limited Liability Companies[13] .

In practice, the implementation of duties and authorities, directors and commissioners act for the benefit of the company. All legal actions related to the interests of the company are binding on the company as well as all costs incurred as a result of the implementation of these duties and responsibilities are borne by the company from the company's assets, not the personal assets of the directors and commissioners. The relationship between the legal entity of the company and the directors and commissioners is a *fiduciary duty* relationship. In carrying out duties and authorities for the benefit of the company, it must be carried out in good faith and with prudence so as not to harm the interests of the company. Directors are personally liable if the company's losses are caused by their errors or omissions committed in *bad faith*. So that if there is a *financial* loss, then the payment of the loss uses the personal assets of the directors, not the assets of the company[14] .

According to the Articles of Association and the law, commissioners have the function of supervising the performance of the company's board of directors. The commissioners can check the books, reprimand the directors, give instructions, and even if necessary dismiss the directors by organizing a GMS to make a decision whether the directors will be dismissed or not.[15] Therefore, one of the efforts to prevent *ultra vires* directors is to maximize the supervisory system of commissioners in limited liability companies. Commissioners are appointed by the GMS and serve as the eyes and ears of shareholders, so the position of commissioners is very urgent. For this reason, the appointed commissioners must have good integrity and credibility. Ideally, commissioners who are appointed are not just to fulfill the formality requirements, but are truly tested for credibility. This is because the weakness of the commissioners so far is the psychological state and authority where their position only acts as a supervisor and is not responsible for operating the company. As a result, the

[12] Dwi Suryahartati, The *Doctrine of Ultra Vires (Perspective of Law Number 40 Year 2007 on Limited Liability Companies)*, Inovtif, Volume 6 Number 7 in 2013 pp. 120-121

[13] Ibid, Dwi Suryahartati, p. 121

[14] Hasnati, etc, Separation of Limited Liability Company Wealth from the Wealth of Shareholders, Board of Commissioners and Board of Directors. *Journal of encyclopedias.org. Volume 1. Number 1 February 2019*, pp. 53-54.

[15] Hasnati, etc, Separation of Limited Liability Company Wealth from the Wealth of Shareholders, Board of Commissioners and Board of Directors. *Journal of encyclopedias.org. Volume 1. Number 1 February 2019*, Page. 53.

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commissioners only supervise as necessary against the directors who are given the authority to run the company, this has led to the weakening of the commissioners' performance in supervision. If an error is made by the board of directors or the board of directors commits an *ultra vires* act, the responsibility is only borne by the directors, but the commissioners as supervisors are not held responsible, under the pretext that the actions of the directors violate the rules and are beyond the control of the commissioners. Of course it is very irrational, when those who are supervised are sanctioned or sued civilly, while the commissioners as supervisors are not. For this reason, good synergy between commissioners and directors is needed. By not cornering each other or shifting responsibilities.

In addition to commissioners, the performance of directors in the company is also supervised by the government, it's just that the government in supervising the performance of directors of limited liability companies cannot be used as a benchmark [16] . Because government supervision is passive. The form of government supervision is carried out in many sectoral institutions, so it will be difficult to supervise and prevent *ultra vires.* For example, supervision of annual reports, tax-related financial reports and investment reports related to national and foreign investments. The form of the report is not a supervision of the performance of the board of directors. It is only administrative in nature or what is known as *Good Corporate Governance (GCG).* So there needs to be an effort from the government to create a healthy business climate with effective supervision. The hope is that the directors work in accordance with procedures and laws and regulations. In the author's opinion, the government needs to make preventive efforts by conducting periodic performance audits more strictly, for example at least quarterly or one semester, not just accepting financial or tax reports, let alone annual reports. Even though the report has been audited by a public accountant. However, it is still very possible for reports to be manipulated. Meanwhile, if the government audits directly, this will be very good in controlling and supervising directors.

The next prevention model that can be pursued is to make a statement and guarantee letter for directors. This at least provides a psychological effect so that the directors in carrying out their duties do their best. The statement is set out in a letter authorized by the authorities, for example the Ministry of Law and Human Rights together with the ratification of the registered GMS decision. The statement letter also attaches a guarantee for directors who will carry out their duties as management of a limited liability company in the form of certain assets that can be used by the company and third parties if the directors commit *ultra vires* acts that cause losses to the company and third parties.

Specifically regarding the transfer of immovable assets, the board of directors can usually do so provided that they have the approval of the commissioners. However, for immovable assets and engagements with third parties do not require the approval of the commissioners. Therefore, to control each other in the articles of association, it is necessary to expressly regulate, the implementation of the transfer and purchase of assets with a

[16] Azizah, J., & Erinos, N. R. (2020). The Effect of the Board of Commissioners, Audit Committee, and Sharia Supervisory Board on Islamic Banking Performance. *Journal of Accounting Exploration*, *2* (1), pp. 2554-2569.

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certain nominal value must be carried out jointly. It cannot be done only by one of the directors.

5. CONCLUSION

The Board of Directors of a Limited Liability Company ideally works based on the articles of association and is also obliged to comply with the laws and regulations, with the hope that the company's objectives can be achieved properly. However, in practice, there are many irregularities committed by the directors of the company, such as selling and buying assets without seeing the benefits for the company, doing actions that harm the company with the intention of obtaining personal gain, carrying out business activities that are not in accordance with the articles of association, this kind of action can be said to be *ultra vires.* To prevent directors from committing *ultra vires,* efforts need to be made, among others:

a. Optimization of supervision by the company's commissioners
b. Active government oversight and regular audits
c. Make a statement and guarantee
d. Restrictive implementation of duties with a collegial collective.

In conclusion, this research suggest to strengthen the system of monitoring the performance of directors in limited liability companies, so that they do not exceed their authority, the Government needs to establish an institution in charge of monitoring the performance of the company's directors. This is aimed at preventing irresponsible directors.

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