Juridical Review of Derivative Suits Against Board of Directors to Enforce The Company's Rights

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Abstract. Limited Liability Company is a corporate structure to conduct business with its capital divided into the number of shares, and the ownership will be determined by the contribution of shareholders. A consequence of a share-based ownership structure is the establishment of majority and minority shareholders. The board of directors plays a crucial role in determining the ratio of majority to minority shareholders. A company's directors, by virtue of their position of power, can act as its representatives and pursue legal action against wrongdoers. The firm may not have the legal standing to sue its directors if the board of directors themselves make a mistake that costs the business money and the majority of shareholders approve of their behavior. If the company's rights are violated, especially by the board of directors, a minority shareholder may be able to restore them through extraordinary legal measures according to "Article 97, paragraph (6) of Law Number 40 of 2007 concerning Limited Liability Companies. When directors or commissioners commit misbehavior that causes financial loss to the firm, minority shareholders have the right to initiate legal procedures against them as representatives of the company". This is called derivative action. So, in essence, *derivative action* aims to protect the interests of the company, and indirectly protect the interests of minority shareholders. Minority shareholders can take extraordinary action through the court so that the company's rights are not harmed, for example the directors use company funds for personal interests. A derivative lawsuit is an abnormal lawsuit because in most cases, it is the directors who act as representatives of the company and not the shareholders. However, even though this derivative lawsuit is filed by a minority shareholder, the compensation will be given to the Company. This is because the minority shareholder acts as a representative of the Company. Therefore, derivative lawsuits provide practical benefits and purposes both for managerial accountability, as well as a means of compensation for the company and resolution of internal corporate conflicts. The concept of derivative action is a significant advancement

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in corporate law, designed to curtail the misuse of authority by directors or commissioners, often controlled by majority shareholders. This study employs normative legal research methodology, which involves collection of data through literature studies, such as scholarly books, legislation, and relevant data accessed through the internet pertinent to this inquiry. This study's findings show that when directors fail to fulfill their duties, shareholders, particularly minority shareholders, can protect the company's interests through derivative action. Given that directors represent the firm on a daily basis, it is improbable that they would initiate actions against other directors who engage in misconduct. In this context, the notion of derivative action gives minority owners the authority to initiate exceptional legal proceedings to restore or safeguard the company's rights.

Keywords: Derivative Action, Directors, Limited Liability Company.

1 Introduction

1.1 Background

Derivative action is a mechanism employed by shareholders, particularly minority shareholders, to assert the company's rights when directors breach their duties, as it is nearly unfeasible for directors representing the company to initiate action against fellow directors who perpetrate such violations.

Derivative action must strike a balance between facilitating effective recovery for shareholders and allowing the board of directors to make decisions impartially and without shareholder intervention. This is founded on the notion that shareholders ought not to participate in corporate management. Additionally, the notion of derivative action may influence corporate governance by serving as a disincentive to board members who engage in misconduct or fraudulent activities.

In a derivative action, shareholders sue on the company's behalf in an effort to get the board of directors to pay for their mistakes that hurt the business. The case is initiated because the corporation lacks the purpose to litigate or reclaim its rights for certain reasons. The notion of derivative action gives minority shareholders the authority to initiate exceptional legal proceedings to restore or protect the company's rights [1].

The concept of derivative action was initially defined in "Law Number 1 of 1995 concerning Limited Liability Companies in Indonesian corporate law. Once again, the concept of derivative action is defined under provisions of the most recent restricted liability company Law, which governs Limited Liability Companies (Law 40 of 2007)". Nevertheless, these two statutes do not directly reference the terms derivative action or derivative lawsuit [1].

Derivative lawsuits may be initiated by shareholders possessing a minimum of 10% of the business's shares against board members whose mistakes or incompetence result in financial damages to the company [3]. The only requirement specified in Article 97 of the 2007 Company Law is a minimum shareholding limit of 10%. Thus, ownership of 10% of shares is the only procedural requirement that must be fulfilled by minority shareholders. Before a shareholder files a derivative lawsuit, the shareholder must request the company to take action against the directors who have made mistakes that result in losses to the company. If the request is rejected by the company, the shareholder can file a derivative lawsuit against the directors who committed the wrongdoing. Law No. 40 of 2007 on Limited Liability Companies also contains no other requirements that must be fulfilled by minority shareholders to be able to act on behalf of or represent the company. It is recommended that the Law No. 40 of 2007 should create or add other requirements that must be fulfilled by minority shareholders to be able to act on behalf of or represent the company. Moreover, for minority shareholders, it is not easy to obtain evidence of the elements of fault or negligence of members of the board of directors, as well as elements of company losses before the examination in court. In addition, there is also no clarity that the directors concerned must be sued in a court whose jurisdiction covers the personal domicile of the directors or must be sued in a court whose jurisdiction covers the legal domicile of the company.

1.2 Formulation of the problem

In light of the foregoing context, the following is the problem statement:

1. What are the legal regulations regarding derivative lawsuits?
2. What are the legal remedies for minority shareholders who suffer losses due to errors or negligence of directors based on the Limited Liability Company Law?

1.3 Research purposes

Based on the problem's formulation stated above, the aims to be attained in this study are:

1. To find out what the rules are for derivative lawsuits under the Limited Liability Company Law (No. 40 of 2007).
2. In line with "Law No. 40 of 2007 regarding Limited Liability Companies", to determine the legal recourse available to minority shareholders that have suffered losses as a result of the directors' errors or negligence.

1.4 Benefits of research

Apart from the objectives mentioned above, it is expected that this writing can provide both theoretical contributions to the legal discipline studied by researchers and to legal practitioners.

2 Literature Review

The theoretical framework constitutes a set of ideas or viewpoints, theories, or theses posited by the author about a specific situation or issue, serving as a comparative reference for the reader, who may either concur or dissent, thereby providing external input. Kaelan MS asserts that the theoretical foundation in research comprises the operational and research base. The theoretical foundation of research is strategic, which means it provides the realization of research implementation [4]. Theory provides an important position to summarize and understand problems better. Things that initially seemed scattered and independent can be put together and shown to be related to each other in a meaningful way. Theories provide explanations by organizing and systematizing the problems they discuss [5].

In accordance with the articles of incorporation, the Company's governing body, the Board of Directors, is entrusted with the authority and full responsibility to oversee the management of the Company in accordance with its goals and to act as its representative in legal matters. In executing its responsibilities in administering the Company, the Board of Directors sometimes commits errors or exhibits neglect, either intentionally or unintentionally, which ultimately results in losses for the Company. A Board of Directors member who is found to have deliberately inflicted losses on the Company is considered to have behaved in bad faith in the execution of their responsibilities and may be held accountable. Shareholders who suffer losses as a result of mistakes or carelessness on the part of the Board of Directors have recourse under the Private Company Law, specifically through the filing of lawsuits, as specified in Article 61, section (1) and Article 97, paragraph (6).

The law is intrinsically linked to justice, with the perspective that legislation must be integrated with justice to possess genuine significance, since its objective is to foster a feeling of justice throughout society. Every enacted law necessitates a pursuit of justice; thus, legislation without of justice becomes ineffectual and loses its societal value. Law is objective and universally applicable, but justice is inherently subjective, making the amalgamation of law and justice impractical. That is simple. Regardless of the challenges, this action is vital for the integrity of the state and the court, since fundamental legal rights are acknowledged by the judiciary [6].

Minority shareholders constitute a segment of shareholders with little equity in the firm, hence their status is in a weak position when faced with the position of majority shareholders. Therefore, to provide a sense of justice to minority shareholders, especially when it comes to the directors made mistakes or negligence, either intentionally or unintentionally, which ultimately resulted in losses for the Even though the majority of shareholders backed the company and its directors' actions, minority shareholders might nevertheless sue for derivative claims under the company with limited liability Law.

3 Result and Discussion

3.1 Legal Arrangement of Derivative Claims

3.1.1 Understanding Derivative Suits

Derivative Rights denote the privileges conferred to minority shareholders to commence legal proceedings against directors or commissioners on the corporation's behalf (derivative action). Bryan Stenfield defines derivative action as "A legal proceeding commenced by a shareholder against a company to assert a corporate right possessed by the organization has chosen not to pursue for various reasons [7]. The objective of this action is to safeguard against shareholder exploitation by the company, its directors, officials, and controlling shareholders, while ensuring corporate responsibility. Foss v. Harbottle (1843) 67 ER 189 was the first instance of a derivative action in English law. Many considered this verdict to be a watershed moment in the history of derivative action cases because of how extraordinary it was [8]. The decision in this case became the basis for regulating and protecting shareholder rights which apply not only in England, but also in British colonial countries (leading English precedent), which then became a reference for making similar regulations in countries with different laws to England.

"Law Number 1 of 1995 concerning Limited Liability Companies limited liability enterprises in Indonesian company law initially defined the concept of derivative action. The new private company the Law, specifically Law Number 40 of 2007, which addresses Limited Liability Companies, reiterates the principle of derivative action in its provisional form". Nonetheless, these two statutes do not directly reference the words derivative action or derivative lawsuit [8].

The popular terms either "derivative action" or "derivative suit". In Indonesia it is often referred to as "derivative lawsuit". The term "derivative action" comes from 2 (two) words, namely the word "derivative" and the word "action". The word "derivative" comes from the word "derive" which means "to receive from" or "to get from" (in Indonesia "to get from"), so the term "derivative" means "that which is obtained from". Meanwhile, the word "action" (or the word "suit") as a legal term means "lawsuit". The word "derivative action" refers to a claim that arises from another source. The corporation itself is a distinct entity in this instance, while the shareholders, who are also the task force for him, are the ones pursuing the action. In a derivative action, shareholders sue on the company's behalf in an effort to get the board of directors to pay for their mistakes that have hurt the business. The case is initiated because the corporation lacks the purpose to litigate or reclaim its rights for certain reasons. Under the doctrine of derivative action, minority shareholders can restore or safeguard the company's rights by launching extraordinary legal processes [1].

3.1.2 Legal Regulation Regarding Derivative Suits

Derivative action is a mechanism employed by shareholders, particularly minority shareholders, to uphold the company's rights when directors breach their duties, as it is nearly unfeasible for directors, who represent the company on a daily basis, to initiate action against fellow directors who perpetrate such violations. The notion of derivative action need to strike a balance between facilitating effective recovery for shareholders and allowing directors the autonomy to make decisions without undue intervention from shareholders. This is founded on the notion that shareholders ought not to engage in corporate management. Consequently, derivative action serves as a means to sustain investor or shareholder trust.

The 2007 Limited Liability Company Law allows minority shareholders to sue the company's directors or commissioners in a derivative action if the directors' or commissioners' acts cause financial harm to the firm. The derivative litigation seeks to safeguard the interests of the corporation while indirectly protecting the interests of minority shareholders. Derivative lawsuits represent a significant advancement in corporate law designed to mitigate the misuse of power by directors or commissioners, who are often influenced by majority shareholders.

Article97, paragraph(6) of the Company Law of 2007 is the sole statute that governs regulations pertaining to derivative litigation involving company directors. Article 97 of the 2007 statute on companies stipulates just a basic share ownership barrier of 10%, which is insufficient in comparison to the expanding idea of derivative transactions in common law countries as well as civil law countries.

These regulations do not include additional prerequisites that the plaintiff shareholder must satisfy to act on behalf of or represent the corporation. Consequently, possession of at least 10% of shares is the only procedural need that the plaintiff shareholders must satisfy. The presence of mistake or carelessness by board members, with the element of loss, constitutes a significant need and is integral to the case's subject matter, which is sometimes difficult to substantiate prior to the trial. Moreover, the stipulation mandating directors to initiate legal action against a board member suspected of inflicting financial harm to the corporation is not addressed under the Limited Liability corporation Law [1]. This matter is crucial to regulate, as it prevents conceptual conflicts between derivative claims and the proper plaintiff principle. The proper plaintiff principle asserts that only the company or its authorized representatives, specifically the directors, can initiate a lawsuit on behalf of the company. Article 98 paragraph (1) of the 2007 a limited liability company Law states that company directors must represent the company in all judicial and extrajudicial matters. This principle is in line with the concept of standing in litigation, which is widely recognized in Indonesian business law and civil law jurisdictions.

The requirement that a court determine whether the shareholders' legal status as plaintiffs meets the necessary conditions is not imposed by “Law No. 1 of 1995 or Law No. 40 of 2007” pertaining to Limited Liability Companies. Under the principle of derivative action prevalent in common law, derivative litigation may only be initiated or pursued with prior judicial approval. In the context of Indonesia, the court should first provide a judgment or interlocutory decision to ascertain the validity of the shareholder's representation of the firm in a derivative action. Furthermore, there is a lack of clarity on whether the director in issue must be sued in a court whose jurisdiction encompasses the director's personal domicile or in a court has authority over the company's legal domicile [1].

3.2 Legal Remedies for Minority Shareholders Who Have Been Harmed Due to Errors or Negligence of The Board of Directors

As stated in the documents of organization, the Board of Directors is responsible for overseeing the company's operations to ensure they are in line with its goals and objectives and for representing the company in external and legal affairs [9]. The Board of Directors administers the Company in the interest of the Company and in alignment with its aims and objectives." This sentence explains the duties, powers, and authority of a company's board of directors, as outlined in “Law Number 40 of 2007 concerning limited liability companies. In addition, paragraph (1) of Article 97 states: "The Board of Directors is accountable for the management of the Company as delineated in Article 92, paragraph (1)." According to Article 97, paragraph (1) and Article 92, paragraph (1), the Board of Directors is required to ensure that their actions are in line with the goals and interests of the corporation. Everything done and decided upon must be in harmony with the objectives and interests of the business. The obligations of the Board of Directors are laid out in Articles 92 and 97”. The corporation benefits from the barrier. The Board of Directors is prohibited from acting on behalf of the business or using the company for purposes that do not align with its interests or are detrimental to those interests. Directors must not favor personal interests or certain groups inside the organization [11].

A business with limited liability could incur financial losses if its board of directors is negligent or fails to adequately oversee the company's operations. Because they are the ones who put their money into the Limited Liability Company, shareholders would likewise take a financial hit if the business went bankrupt. There must be enough legal safeguards for shareholders, especially minority owners, because the Board of Directors may make mistakes or be negligent in managing this Limited Liability Company, which could cause shareholders to lose money. Minority shareholders who are underrepresented in company leadership positions can now take targeted legal action to protect their interests, thanks to the limited liability companies Law. As per the provisions outlined in “Article 97, paragraph (6) of the limited liability company Law, this necessitates bringing a derivative complaint against a Board member for negligence or misconduct, in addition to initiating legal action against the Company as per Article 61, paragraph (1) of the same law. Article 97, paragraph (6) of the Limited Liability Companies Law states”: "In the name of the Company, shareholders possessing a minimum of 1/10 (one tenth) of the total voting shares may commence legal proceedings in the district court against Board of Directors members whose errors or negligence have resulted in losses to the Company." It states that minority shareholders who intend to sue members of the Board of Directors for errors or omissions leading to losses must comply with these provisions.

The majority shareholder can protect their interests in the case that the Board of Directors makes mistakes or is negligent by going to the annual meeting of shareholders. If they can't reach a consensus, they can make decisions by majority vote, as stated in “Article 87, paragraph (2) of the Limited Liability Companies Law”. At shareholder meetings, the idea of majority voting gives power to the most powerful shareholder. The converse is also true: dominant shareholders put their interests ahead of those of minority shareholders, who are left exposed, marginalized, and even excluded. As a result of previous laws and the “Limited Liability Companies Law Number 40 of 2007”, the majority of shareholders in Indonesia may have a disproportionate amount of power. This is because, unless otherwise stated in the articles of association, each share that a company issues has the same voting power as one share [12].

Minority shareholders are among the stakeholders, alongside majority shareholders, directors, commissioners, workers, and creditors. Furthermore, alongside the main shareholders, minority owners also contribute to the company's finances (bagholders). Consequently, the question arises as to whether minority shareholders need to get legal protection to a certain degree. Minority shareholders are individuals who own a tiny proportion of shares in a firm, resulting in a relatively weak position compared to majority shareholders [13]. Therefore, to provide a sense of justice to minority shareholders, especially when it comes to the directors who are committed to mistakes or negligence, either intentionally or unintentionally, which ultimately resulted in losses for the Company and the directors' actions received support from the majority shareholders, so the minority shareholders were given the authority by the Limited Liability Companies Law to file derivative lawsuits.

In order to initiate a derivative lawsuit on the company's behalf, shareholders must take into account the following factors and conditions:

a. If the alleged wrongdoing is associated with a Board of Director's actions that can be approved by an ordinary resolution at the Annual Meeting of Shareholders, then shareholders cannot bring a derivative action case against that director;
b. The board member who breaches their fiduciary obligation is the one who consistently exerts control over the company and, in some instances, has the backing of the majority of the unbiased shareholders [14].

Even though the Annual Meeting of Investors has authorized some director activities that breach fiduciary duties, minority shareholders are not always bound by these actions. Directors' actions that prioritize their own interests above the company's interests can be sued by minority shareholders. The Limited Liability Companies Law also emphasizes that in derivative action, there must be the following parties:

1. The Plaintiff, namely 1 or more shareholders who sue voluntarily
2. The Defendant is the Directors or Board of Commissioners

3. The party whose interests are represented by the plaintiff is the company [15]

Derivative rights are the entitlements conferred to minority shareholders to undertake certain measures in safeguarding or representing the firm against the activities of other corporate entities when the company's interests are jeopardized. This is a right that shareholders with at least 10% of the voting shares in the company are granted by the limited liability corporation Law. Furthermore, two derivative shareholder rights are defined by “Law Number 40 of 2007 concerning Limited Liability Companies”. These two rights are derived from:

1. “According to Article 97 paragraph (6) of Law Number 40 of 2007, shareholders who own at least 1/10 of the voting shares can sue board members in district court if their mistakes or carelessness cause the company to lose money”.
2. “Under Article 114 paragraph (6) of Law Number 40 of 2007, shareholders who own at least 1/10 of the voting shares can sue Board of Commissioners members whose mistakes or carelessness cause financial harm to the company” [16]

Derivative lawsuit is an abnormal lawsuit because in general cases, those who act as representatives of the Company are the Directors, not shareholders. However, even though this derivative lawsuit was filed by a minority shareholder, compensation will be given to the Company. This is because minority shareholders can benefit from increasing share prices because they are solely involved as representative of the company. Shareholders who suffer damages as a result of an oversight or mistake by a Board member may exercise their rights by suing the Company, as stated in Article 61, paragraph (1) of the Private Company Law. According to Article 97, paragraph 6, they can also sue the Board member who is financially liable for the losses on the company's behalf (6). As a result, when minority shareholders suffer losses because of mistakes or negligence made by board members while carrying out their management duties, they can essentially initiate one of two types of cases. There are two types of lawsuits that minority shareholders have initiated: those against the company itself (called "direct lawsuits") and those against members of the board of directors (called "derivative lawsuits") whose negligence or gross negligence caused the company to suffer losses.

One of the derivative lawsuit cases that has been filed is a case that has been decided by the Bale Bandung District Court in Decision Number 06/Pdt.G/2009/PN.BB, dated 8 May 2009 which was then strengthened with improvements by the West Java High Court in Decision Number 270/Pdt/2009/PT.BDG., dated 20 November 2009, and then strengthened by the Supreme Court of the Republic of Indonesia in Decision Number 1855K/Pdt/2010 dated 12 January 2011. (Kadir, 2017). The Plaintiffs in this case are shareholders who each own 25% of the company's shares or cumulatively the Plaintiffs own 50% of the company's shares. Therefore, from the aspect of minimum share ownership, the Plaintiffs fulfil the requirements to file a derivative lawsuit based on Article 97 paragraph (6) of Law No. 40/2007 on Limited Liability Companies. Minority shareholders acting for and on behalf of the company suing directors who are considered guilty and detrimental to the company, shows the awareness of minority shareholders to utilise the mechanism of derivative lawsuits as an effort to obtain protective justice for the interests of minority shareholders in particular and the interests of the company in general, as well as an effort to realise corrective justice to restore and stop the losses suffered by the company.

4 Conclusion

A derivative action is a mechanism employed by shareholders, particularly minority shareholders, to uphold the company's rights when directors breach their duties, as it is nearly unfeasible for directors, who manage the company daily, to initiate actions against fellow directors who perpetrate such violations. Article 97 paragraph (6) of Law No. 40/2007 on Limited Liability Companies gives minority shareholders the right to take extraordinary action through the court with the aim that the company's rights can be restored and or not harmed, especially by actions taken by the board of directors.

Derivative lawsuit is an abnormal lawsuit because in general cases, those who act as representatives of the Company are the Directors, not shareholders. However, even though this derivative lawsuit was filed by a minority shareholder, compensation will be given to the Company. This legal mechanism represents a significant advancement in corporate law, designed to prevent the misuse of power by directors or commissioners, who are typically influenced by majority shareholders.

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