

LEGAL PROTECTION FOR THE BOARD OF DIRECTORS OF REGIONAL GOVERNMENT-OWNED ENTERPRISES MAKING INVESTMENTS WITH THIRD PARTIES THROUGH THE APPLICATION OF THE BUSINESS JUDGMENT RULE DOCTRINE

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Abstract

This study aims to examine whether the business judgment rule doctrine can be applied to protect the directors of Regional Government-Owned Enterprises (RGE) who engage in investment collaborations with third parties when the RGEs incurs losses. The type of research employed is normative legal research, utilizing a conceptual approach and a case approach. The study is explanatory in nature and relies on secondary data, with primary legal sources including the Limited Liability Company Law and Government Regulation No. 54 of 2017, analyzed qualitatively. In performing their duties to manage RGEs, directors are often blamed and accused of criminal corruption due to the perceived losses suffered by the RGEs as a result of their actions. Therefore, directors in managing RGEs must act in good faith and responsibly, paying careful and diligent attention to the company. They are personally accountable for any company losses if they are found guilty of or negligent in performing their duties. However, directors who perform their duties appropriately and can demonstrate that the losses incurred by the RGEs were not due to their fault or negligence can be exempted from liability for such losses through the application of the business judgment rule doctrine.

Keywords: Legal Protection, Board of Directors, Regional Government-Owned Enterprises (BUMD), Investment, Business Judgment Rule Doctrine.

1. Introduction

Regional governments play a crucial role in increasing locally generated revenue (LGR) by establishing Regional Government-Owned Enterprises (RGE). This is mandated under Article 331 of Law No. 23 of 2014 on Regional Governance, which authorizes regions to establish RGOEs through regional regulations.

The establishment of RGEs serves to support regional development and improve the welfare of local communities. Purwadi (2002) emphasizes that RGEs play a critical role in fostering regional prosperity by contributing to LGR, whether through dividends or taxes. Strengthening the role and contributions of RGEs is one way to address the challenges of increasing LGR. On a broader scale, the role of regional enterprises (RGEs) in the regional economy can be assessed through their value-added contribution to regional gross domestic product and their capacity to absorb labor.

Based on Article 331(3) UUPD in conjunction with Article 4(3) of Government Regulation No. 54 of 2017 (PPBUMD), regional governments may establish RGEs in the form of either public regional enterprises or regional limited liability companies. This article focuses solely on the latter.

Article 339(1) UUPD in conjunction with Article 5(2) PPBUMD defines regional limited liability companies as RGEs whose capital is divided into shares, with at least 51% of the shares owned by a single region.

According to Rustian Kamaludin (2000), RGEs have multiple functions, including: a. implementing government policies in regional economic and development sectors; b. generating funds for regional development financing; c. encouraging public participation in entrepreneurship; d. providing goods and services to meet public needs; and e. acting as pioneers in activities and businesses less attractive to the private sector.

The juridical objectives of RGEs, as stipulated in Article 7 PPBUMD, include: a. contributing to regional economic development; b. delivering public utility services by providing quality goods and/or services aligned with regional characteristics and potential, adhering to good corporate governance principles; and c. generating profit. Article 7(7)(a) of Law No. 40 of 2007 on Limited Liability Companies (UUPT) mandates that RGEs be established as limited liability companies (Persero). Article 339(2) UUPD further stipulates that once formalized through regional regulations, their legal entity formation

must comply with UUPT provisions. Thus, RGE establishment must adhere to UUPT.

Although RGEs symbolize regional government involvement in economic development, they often become financial burdens instead of revenue sources (Setiawan dkk., 2008). Purwadi (2002) identifies 13 common challenges faced by RGEs, which hinder their optimal contribution to PAD and the regional economy: a. excessive bureaucratic interference; b. outdated machinery and equipment; c. weak capitalization; d. non-productive assets, such as idle land and buildings, increasing overhead costs; e. generally low employee skills; f. inadequate legal foundations inconsistent with current conditions; g. weak marketing strategies; h. private sector competition producing similar goods; i. ineffectiveness of supervisory bodies; j. unfavorable debt-to-equity ratios, leading to high financial risks; k. obligations to allocate part of the profits; l. maintenance of unprofitable RGEs; and m. establishment of economically unfeasible RGEs for public service purposes, leading to inefficiency and losses.

The performance of RGEs significantly depends on the directors who manage the company. Article 92(1) and (2) UUPT emphasizes that directors must manage the company's affairs responsibly and in alignment with corporate objectives. Additionally, directors are empowered to make policy decisions deemed appropriate within the limits of the UUPT and the company's articles of association.

Directors play a crucial role in sustaining and advancing RGEs to ensure competitiveness, sustainability, and quality. Achieving these goals requires directors to make informed decisions and take calculated business risks. According to the "high risk, high return" principle, higher risks are associated with greater potential returns (S.M. Ulfa & I.N. Suarmanayasa, 2023). However, in practice, RGE directors often face criminal liability for losses, despite exercising prudence and due diligence. For example, the director of *PT Bintan Inti Sukses* (PT BIS) was prosecuted for financial losses arising from third-party investment agreements, despite adhering to prudent business practices (Wildayanti & Kasjim Salenda, 2022).

However, in practice, when an RGE incurs losses, these losses are often attributed to the board of directors, who may even face criminal liability for alleged financial harm to the state. This occurs despite the fact that the directors have applied the principle of prudence, including requiring third-party business partners to provide guarantees as

collateral for investment cooperation. An illustrative case of this is the decision by the Tanjung Pinang District Court in Case Number 16/Pdt.G/2021/PN Tpg. In this case, R, the Director of PT Bintan Inti Sukses (PT BIS), an RGE of Bintan Regency, served from 2015 to 2018 and entered into a business collaboration with a third-party investor for the purpose of expanding the business of PT BIS. This collaboration involved the following:

1. A business partnership with CV Multi Coco Organik for the marketing of coconut husk fiber (cocopeat), formalized under Cooperation Agreement Deed No. 7, dated January 27, 2016, with an amendment in Deed No. 8, dated January 6, 2017, executed before Notary MN, SH, in Tanjung Pinang. In this arrangement, PT BIS provided an investment of IDR 1,500,000,000 (one billion five hundred million rupiah) to CV Multi Coco Organik. In return, the third party (CV Multi Coco Organik) provided collateral as well as a power of sale, as stipulated in the agreement with the Director of PT BIS. The collateral consisted of:
 - a. A parcel of land with ownership rights, No. 95/Penjuru, dated February 25, 2011, located in Riau Province, Indragiri Hilir Regency, Kateman District, Penjuru Village, covering an area of 5,598 m², registered under the name AIP.
 - b. A parcel of land with ownership rights, located in the Riau Islands Province, Teluk Bintan District, Penage Village, covering an area of 20,000 m², based on a Land Control Transfer Certificate dated March 6, 2008, with the following registration numbers: 102/SKGR/DPNG/2008, dated March 10, 2008; 592/SKPPT/III, dated March 19, 2008; 127/G-1/BG/2003, dated April 8, 2003; and 593/SKT/51, dated May 13, 2003.
 - c. A parcel of land with ownership rights, located in the Riau Islands Province, Bintan Regency, Teluk Bintan District, Penage Village, covering an area of 20,000 m², based on a Land Control Transfer Certificate dated September 15, 2004, acknowledged by the Head of Penage Village, with the following registration numbers: 150/GR/2004, dated October 20, 2004; and the Sub-district Head of Teluk Bintan, with registration number 592.2/SKPPT/164, dated March 28, 2004, as well as Registration Number: 126/G/1/BG/2003, dated April 8, 2003, and Registration Number 593/SKt/52, dated May 13, 2003.

The initial business partnership proceeded smoothly, and the third party (CV Multi

Coco Organik) was making timely payments on the loan. However, over time, the third party (CV Multi Coco Organik) became negligent in fulfilling its obligations, leading to an outstanding debt of IDR 700,000,000 (seven hundred million rupiah).

2. A business collaboration with CV Safina Air Cond Services, as outlined in the Cooperation Agreement Deed No. 178/L/2016, dated March 1, 2016, executed before Notary MN, S.H., a Notary in Tanjungpinang. Under this agreement, CV Safina Air Cond Services was tasked with carrying out the air conditioning, supply, and installation of AC units and ventilation systems for the Cassia Condotel Bintan project. For the capital contribution to finance this project, PT. BIS provided a sum of IDR 700,000,000 (seven hundred million rupiah) to CV Safina Air Cond Services. In return, CV Safina Air Cond Services offered the following collateral:
 - a. A motorcycle with License Plate Number: BP 2513 TU, Honda Brand, Type NC11B3C A/T, manufactured in 2010.
 - b. A motorcycle with License Plate Number: BP 4275 TV, Yamaha Brand, Type 28D (MIO/ALI 115S) A/T, manufactured in 2010.

As per the agreement, if the collateral was deemed insufficient, CV Safina Air Cond Services would add more collateral. To date, CV Safina Air Cond Services has repaid IDR 448,000,000 (four hundred forty-eight million rupiah) of the capital, leaving a balance of IDR 252,000,000 (two hundred fifty-two million rupiah).

3. A business collaboration with PT. Chantika, which operates in the transportation of water from Sekupang Batam to the Fuel Terminal (TBBM) Pulau Sambu. This cooperation agreement is documented in the Agreement Deed No. 6, dated June 10, 2017, executed before Notary MN, S.H., in Tanjung Pinang. In this business agreement, PT. BIS contributed a capital of IDR 210,000,000 (two hundred ten million rupiah). In exchange, PT. Chantika provided collateral in the form of motor vehicles as security for PT. BIS, which included:
 - a. A vehicle with License Plate Number: BP 1023 YD, Toyota Brand, Type AVANZA 1.3 GA/T, manufactured in 2009.
 - b. A vehicle with License Plate Number: BP 1064 ZF, Toyota Brand, Type Corona AT190, manufactured in 1997.

4. A business collaboration for the purchase and marketing of meat from ranjungan crabs with Al Baik Group (Mr. MZ), which is documented in the Financing Cooperation Agreement Deed, Notary MN, S.H., Deed No. 4, dated September 9, 2017. In this business agreement, PT. BIS provided a loan of IDR 1,500,000,000 (one billion five hundred million rupiah). In return, Al Baik Group provided collateral consisting of 3 (three) vehicle ownership certificates (BPKB) for four-wheeled vehicles and 1 (one) land certificate. By 2018, PT. BIS's capital was fully reimbursed. The collaborations undertaken by the Director of PT. BIS with the third parties are a demonstration of the director's responsibility to manage the company in the best interests of the company, in accordance with the company's objectives, and with due diligence and good faith in carrying out the company's administrative duties for the benefit and business of the company. In this regard, the Director of PT. BIS (Regional Government-Owned Enterprise of Bintan Regency) has carried out the company's objectives as outlined in Article 3 of the Amendment Deed No. 18, dated August 23, 2007, which specifies that the purpose of establishing the company is to engage in businesses such as construction, general trade, industry, mining, agriculture, tourism, and services. This purpose was carried out as reflected in the Corporate Work Plan and Budget (RKAP) for 2016 and 2017, which was presented at the General Shareholders Meeting. However, the Director of PT. BIS (RGE of Bintan Regency) was still held accountable for damages and faced criminal liability for allegedly causing financial loss to the state.

Director of PT. BIS (Regional Government-Owned Enterprise of Bintan Regency) should not be held liable. A director is the most competent party to manage and make decisions regarding the company's business, and therefore, no one else has the authority to decide on the business affairs of the company. Even the court is prohibited from offering a "second guess" or alternative opinion on the business decisions made by the director. (Sartika Nanda Lestari, 2015).

2. Research Method

This study employs a normative legal research methodology with a conceptual and case approach. According to I Made Pasek Diantha (2017), normative legal research focuses on examining law from an internal perspective, with the primary object of study

being legal norms. Soerjono Soekanto and Sri Mamudji (2003) further define normative legal research as the investigation of secondary data or literature materials.

The conceptual approach is used because the study is based on the analysis of existing legal rules (Ramlan et al., 2023). As Bahder Johan (2008) explains, the conceptual approach involves researching legal concepts. The case approach, however, is utilized to explore the application of legal norms or principles in practice. Although the cases studied are empirical, they offer valuable insights into the impact of legal norms and serve as input for legal analysis (Johnny Ibrahim, 2011).

This research is explanatory in nature, aiming to clarify and test a theory or hypothesis. Abdulkadir Muhammad (2004) defines explanatory legal research as research that seeks to explain and test a theory or hypothesis in order to either support or refute the findings of previous research. The data used in this study is secondary, primarily consisting of primary legal sources, such as Law No. 40 of 2007 on Limited Liability Companies and Government Regulation No. 54 of 2017 on Regional Government-Owned Enterprises. This data is analyzed using qualitative methods, with conclusions drawn and presented in relation to the legal protection of directors through the application of the business judgment rule doctrine.

3. Results and Discussion

1. The Business Judgment Rule Doctrine in Indonesian Company Law

The Business Judgment Rule (BJR) originates from common law systems and is deeply rooted in the doctrine of fiduciary duty, which governs the obligations of company directors. This rule emerged as a consequence of the director's fulfillment of their fiduciary duties, particularly the duty of skill and care. As such, if a director follows this principle but later makes an erroneous decision, they cannot be held personally liable for the consequences of that decision (Hendra Setiawan Boen, 2008).

Asep Mulyana (2008) defines the Business Judgment Rule as a principle that shields company directors from legal liability for decisions that may lead to financial loss, provided these decisions were made in good faith, with the proper purpose, sound reasoning, and due care. The rule arises from the director's adherence to their fiduciary duties, which includes exercising the duty of skill and care (Hendra Setiawan Boen, 2008).

Carlos Andres Laguado Giraldo and Maria Paula Diaz Cacon (2005) further explain that the Business Judgment Rule protects corporate officers from personal liability as long as they act in good faith, with reasonable care, and within their legal authority. The rule allows a director's decisions to be scrutinized by the court only if it is demonstrated that their duties were violated—particularly in cases involving bad faith, self-interest transactions, or decisions made without adequate information.

In a similar vein, Busyra Azheri (Hamzar Nodi, 2024) characterizes the Business Judgment Rule as a legal doctrine that safeguards the directors and commissioners of a limited liability company (LLC) when making business decisions. This doctrine acknowledges that directors are entrusted with the authority and responsibility to make business decisions, and they will not be held personally accountable for those decisions, provided they are made in good faith, based on available information, and comply with legal requirements.

In Indonesia, the Business Judgment Rule is enshrined within the Limited Liability Company Law (UUPT), serving as a protective mechanism for directors and commissioners. The legal framework for this rule can be found in Article 97, paragraph (5) of the UUPT, which stipulates that a director cannot be held liable for company losses if they can demonstrate the following: (a) the losses were not caused by their fault or negligence; (b) the actions were taken in good faith, with due care, and in the best interest of the company; (c) no direct or indirect conflict of interest existed in the actions taken; and (d) measures were taken to prevent the company from facing insolvency.

The provisions of Article 97, paragraph (5) of the UUPT reflect the essence of the Business Judgment Rule, as they ensure that directors are protected and exempt from personal liability for decisions made in good faith and with the necessary caution, even if those decisions lead to financial loss (Asep Mulyana, 2008).

The requirements set out in Article 97, paragraph (5) of the UUPT regarding the conduct of directors align with the principles of the Business Judgment Rule, ensuring that directors' decisions are evaluated in terms of both process and substance. The Delaware Supreme Court has used specific cases to illustrate that the Business Judgment Rule entails both procedural and substantive considerations in assessing the legality of directors' decisions (Gunawan Widjaja, 2008).

As noted by Busyra Azheri, in order for the Business Judgment Rule to apply, certain conditions must be met. These conditions include (Hamzar Nodi, 2024):

- (1) Good Faith: The decision must be made with a genuine intent to serve the best interests of the company.
- (2) Adequate Information: The decision must be based on the available information at the time, deemed sufficient and relevant for the decision-making process.
- (3) Legality: The decision must not violate applicable laws or regulations.
- (4) Rational Consideration: The decision must be the result of thoughtful and reasoned deliberation.
- (5) No Conflict of Interest: The director must not have any personal interest in the decision made.

The Business Judgment Rule has been incorporated into Indonesian positive law through the Limited Liability Company Law (UUPT). The legal regulation of this principle is crucial for at least three reasons (Diky Anandya, et al., 2023; Aurelio Gurrea Martinez, 2018):

- (1) Preventive Measure for Companies: It ensures that the decision-making processes at the director level are conducted properly, thereby reducing the risk of mismanagement or improper decisions.
- (2) Encouragement for Directors to Make Bold Decisions: By providing legal protection under the Business Judgment Rule, directors are encouraged to make decisions that align with the company's objectives without the fear of legal repercussions, particularly when such decisions might result in company losses.

Guidance for Law Enforcement Authorities: It serves as a framework for law enforcement to identify potential criminal actions. This is crucial in avoiding wrongful legal actions due to misunderstandings of corporate decision-making processes. The Business Judgment Rule helps prevent the judiciary from second-guessing business decisions, as courts are not equipped to evaluate business decisions with the same expertise as company directors. If judicial review of the rule is conducted, it risks retrospective judgment (hindsight bias) and may create institutional issues for the courts.

2. The Business Judgment Rule in Providing Legal Protection for Directors

The concept of legal protection is inherently tied to the responsibility of individuals in fulfilling their obligations. In this case, it pertains to the directors of regional-owned enterprises (RGEs), who are tasked with performing their duties to the best of their ability in order to protect their legal rights.

In carrying out their roles, directors are bound by a fiduciary duty to the company, based on trust. Therefore, directors must operate under the principle that their tasks and positions are derived from two fundamental principles: the trust vested in them (fiduciary duty) and actions guided by skill and care (duty of skill and care). These principles require directors to act with good faith, caution, and solely in the best interests of the company (Chatamarrasjid Ais, 2001).

In relation to the vital and strategic role of directors in managing a BUMD, Article 97(1) of the Limited Liability Company Law (UUPT) explicitly mandates that directors are responsible for managing the company. Further, Article 97(3) stresses that each director is personally liable for the company's losses if they fail to fulfill their duties in accordance with the law. In the case of a multi-member board of directors, Article 97(4) provides that liability for such losses is joint and several among the directors.

However, Article 97(5) offers an exemption from responsibility for directors if they can prove four conditions:

- (a) The loss was not due to their fault or negligence.
- (b) The management was performed with good faith and due diligence.
- (c) There was no conflict of interest in the decision-making process.
- (d) Actions were taken to prevent or mitigate the loss.

When directors are able to meet these four conditions, they are relieved of liability for the company's losses. This provision acts as a legal shield, protecting directors when they execute their duties in good faith, with skill, care, and prudence (Raffles, 2020).

In contrast, if the conditions are not met, the director remains accountable for the company's management. The first condition, regarding loss, is not limited to errors but also includes negligence, as civil law principles require individuals to avoid both mistakes and negligence. The Indonesian Civil Code (KUH Perdata) stipulates that responsibility arises not only from error but also from negligence.

When losses occur, it is crucial to have legal protection for directors to prevent excessive liability. Although the legal personality of a limited liability company shields directors from personal responsibility for the company's obligations, directors are not entirely immune from responsibility for the business risks they take (Freddy Haris, 2005). It must be proven that the decisions and policies made by the directors align with principles such as good faith, caution, professionalism, risk mitigation, and are not made for personal gain or the benefit of other parties.

Determining whether a director acted in good faith is not always straightforward. In contract law, good faith is interpreted as "honesty" and "propriety." Honesty is subjective, residing in the heart, while propriety is based on the circumstances surrounding the legal relationship, which is objective (Muhammad Arifin, 2018).

Negligence occurs when directors fail to adequately consider potential risks or, despite knowing the risks, take no preventive action. A director is considered negligent if they make decisions without evaluating potential risks or if they are aware of an impending risk yet ignore it. If a company's losses are due to errors or negligence by the directors, their reliance on the Business Judgment Rule for legal protection weakens.

In terms of the risk's nature, Riagel and Miller (Prasetio, 2014) categorize economic risks into two types: speculative risk and pure risk. Speculative risks involve both the possibility of profit and loss, while pure risks are certain to result in a loss. If directors are aware that a risk is purely negative, they violate the principles of good faith and caution. In such cases, directors may be found negligent in their duties and held personally accountable. Conversely, if directors can demonstrate that a decision was based on a speculative risk, they may still be entitled to legal protection under Article 97(5) of the UUPT (Wildayanti & Kasjim Salenda, 2022).

Effective risk management is crucial, and directors must possess the skills to systematically assess and minimize potential risks. This involves carefully considering the situation, evaluating what might go wrong, and taking steps to prevent or mitigate any possible damage (Wildayanti & Kasjim Salenda, 2022).

Although the UUPT does not explicitly use the term Business Judgment Rule, several articles in the law reflect this principle. The inclusion of the Business Judgment Rule in the UUPT would provide greater legal certainty, aligning with Reinhold Zippelius'

concept of "legal orientation certainty." Legal orientation certainty requires clear procedures for law-making and the enactment of laws that are coherent and mutually reinforcing. It ensures that the public can foresee the future implications of legal rules, and it prevents the creation of contradictory regulations (Tengku Erwinsyahbana & Vivi Lia Falini Tanjung, 2017).

Key elements of legal orientation certainty include: a. Clear norms that specify what is required and prohibited; b. Legal transparency that prevents normative confusion, ensuring consistency in the actions and statements of government officials and law enforcers; c. Legal continuity that provides guidance for future behavior, reducing speculation and uncertainty among the public (Tengku Erwinsyahbana & Vivi Lia Falini Tanjung, 2017).

Managing a RGE is not always profitable. Business ventures can result in both profits and losses. Directors may make business decisions based on speculation that ultimately lead to losses for the company. However, such losses should be considered part of the normal course of business as long as decisions are made in accordance with the principles of caution, good faith, and adherence to applicable laws and internal company regulations, including the articles of association, policies, systems, and procedures (Prasetio, 2014).

According to Satjipto Rahardjo's (2003) theory of legal protection, legal protection involves efforts to safeguard an individual's interests by granting them human rights and powers to act in pursuit of those interests. In this regard, the business judgment rule doctrine provides a standard for directors' conduct in making decisions, requiring them to consider the potential consequences of their actions.

The business judgment rule grants directors the right to make business decisions, but not for personal gain or self-dealing. These decisions must be based on sufficient information, made in good faith, and with the honest belief that they serve the company's interests (Hendy Herijanto, 2014). In this way, the company assumes the risks of business, including the risk of financial loss. Consequently, directors cannot be held accountable simply due to an error in judgment or the company's losses.

As a general principle, when directors act beyond their authority or contrary to the company's articles of association, such actions are considered personal actions, not those

of the company. As a result, the company is not liable, and full responsibility lies with the directors (Rudhi Prasetya, 2011).

For this reason, it is crucial that law enforcement authorities share a common understanding of the business judgment rule to ensure clearer resolutions in cases where directors are accused of corruption. For example, as discussed earlier, directors who make business decisions for a BUMD, only to incur losses, can be convicted of criminal acts, such as corruption. However, managing a BUMD inevitably involves business risks that may lead to financial losses, as profits are not guaranteed. These risks may stem from changes in business dynamics or competition with third parties.

Thus, it is essential to distinguish between the norms of state loss and corporate loss. Law enforcement must first understand whether these two concepts are the same or different. This understanding will influence their approach to cases involving company losses in business operations, which cannot be equated with state financial loss.

4. Conclusion

RGE (Regional-Owned Enterprises) are established with the primary goal of increasing regional revenue and contributing to the prosperity of the region, enabling it to become self-sufficient and enhance the welfare of its citizens. Therefore, it is crucial for the directors of BUMD to manage these companies with full responsibility. Each director must understand what decisions are permissible and what are not, ensuring that each decision is legally sound and can be accountable in a court of law.

In Indonesia, judgment fully optimized to provide legal protection for directors, and many directors have been penalized for the business decisions they have made. This indicates that law enforcement in Indonesia often disregards. Therefore, there is a need for amendments to the UUPT (Limited Liability Company Law) to explicitly include provisions related to the business judgment rule and to incorporate the term “business judgment rule” itself. It is essential to clearly integrate the elements of the business judgment rule into the UUPT, such as ensuring that directors cannot be held liable if their business decisions are made in good faith, based on the information available at the time, in compliance with applicable laws, after careful and rational consideration, and without any personal interest in the decision.

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