

# Legal impacts from the bankruptcy of subsidiary company to holding company as the corporate guarantor

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**Abstract.** The existence of competition in business fields demands entrepreneurs to develop strategies to make their company able to compete with other company. One of the ways is by establishing company group in the form of holding company and subsidiary company. In the development of the business, a company will need funding as their capital. This capital will be obtained from internal or external parties resulting debts or account receivable to the creditor. It creates a risk of bad debts in the future. Therefore, creditor will commonly require a guarantee, called as corporate guarantee. In this case, holding company can become a corporate guarantor. Nevertheless, it is still going to create problem to the legal impact of holding company as the guarantor in case if the subsidiaries experience bankruptcy.

This research aims to explore and analyze the legal impact from subsidiary company's bankruptcy to holding company as the corporate guarantor. This research used socio-legal approach. That is to say, this research reviews norms of law by doing literature research to get the secondary data and fields study to obtain the primary data regarding the legal impact of the bankruptcy of subsidiary company to holding company as the guarantor. The methods of collecting the data were by literature studies and interview. The interview was done to the informants, like judge and experts of corporate law and guarantee. The technique of data validity used triangulation of sources or methods. The used theory and concept was for the analysis of loan agreement, bankruptcy, corporate guarantee, and group company.

**Keyword:** Legal Impact, Holding Company, Subsidiary Company, Corporate Guarantee, Bankruptcy

## 1. Introduction

Rapid development in business results in a consequence of strict competition in business fields; thereby, it demands businessmen to do many attempts that their company can compete with other companies. One of the attempts is by creating a group company, since it is deemed as the added value through the synergy from the companies and the attempts to achieve competitive excellence to other companies [1]. According to Black's Law Dictionary, conglomerate group company means "a corporation that owns unrelated enterprises in wide variety of industry". "Group company is the order between companies or partnerships which juridically becomes independent subjects of law or separate legal entity although it is formed as economic unity." [2] Generally, the company will be called as a group if there are two or more companies which is bonded one another through shareholding. A group company consists of holding company and subsidiary company. Group company as the development of corporate law in Limited Liability Company Act (UUPT) has not get juridical acknowledgement; somehow, this Law gives the legitimacy of group company's establishment. Company is given legitimacy to get or have the stock in other company. The construction of group company causes duality of legal entities to holding company and subsidiary company. In the one hand, subsidiary company is deemed as an independent legal subject under the Law of Limited Liability Company. In the other hand, group company is deemed as the unity of economy. Holding company played the role as central hear which controls and coordinates subsidiary company in an economic unity to support the business.



The construction of law sees subsidiary company as the separate legal entity and juridically independent from holding company making this company has to take the responsibility of bankruptcy or loss by itself. Nonetheless, holding company will be responsible for legal problems experienced by subsidiary company under these parameters[1]:

- 1) Holding company is assigning agreement which is done by subsidiary company to the third party.
- 2) Holding company plays the role as corporate guarantor for the agreement of subsidiary company to creditor.
- 3) Holding company conducts action against the law affecting loss to the third party of subsidiary company.

In beginning the business development, a company, including group company, will need funding as its capital. This capital is obtained from internal or external body or other party. In this case, the funding from other party will result debts or account receivable to creditor. This thing causes the risk of bad debts or unpaid account receivable in the future. Thus, the creditor needs guarantee, which is particularly known as individual guarantee or staging (*borgtocht*).

Article 1820 of the Civil Code says that staging is an agreement where the third party, to the interest of the creditor, binds themselves to fulfill the bond of debtor when they do not fulfill guarantee. Individual guarantee is divided into two parts, personal guarantee and corporate guarantee. Personal guarantee is the staging of debts done by individual, while corporate guarantee is the staging of guarantee to certain company.

In a group company, holding company can become a corporate guarantor. Practically, subsidiary company as the debtor in doing loan agreement with the creditor invites holding company as the guarantor of the debts, since holding company is deemed as prospective company and has enough assets which ensures the guarantee to creditor upon the payment of debts or account receivable.[3] It will cause problems in case if subsidiary company experience bankruptcy.

In Article 1 section 1 Act Number 37 year 2004 regarding bankruptcy and the delay of debts payment, it is mentioned that bankruptcy is a general confiscation to all wealth bankruptcy of debtor which arrangement and settlement is done by curator under the order of supervisory judge as what its written in the Law. In case of bankruptcy to subsidiary company from group company, the problem will raise to legal impacts for holding company as the guarantor of subsidiary company's debts. Therefore, the problems of this research are: How is the position of holding company who becomes the guarantor of debts to subsidiary company? and . What are the legal impacts to holding company as corporate guarantor in case of debtor's bankruptcy?

## 2. Methodology

This research used socio-legal method by reviewing legal norms from literature research to obtain secondary data and fields study to obtain primary data regarding the legal impacts of bankruptcy of subsidiary company to holding company as the guarantor. The methods of collecting data were by literature studies and interview. Interview was done to informants, like judge and experts of corporate law. The technique of data validity was done by triangulation of sources or methods. The validity of the data was tested by triangulation. The used theory and concept was for the analysis of loan agreement, bankruptcy, corporate guarantee, and group company.

*Concept of Group Company.* Group company is the unity or composition of company which is juridically independent one another creating economic unity subjected to holding company as the central leader.[1]. The stakeholders of Group company includes: 1) Holding company as the central head which plays the role of controlling and coordinating its subsidiary company[4], 2) Subsidiary company is a company which has specific relation to other company due to more than 50% of its

shares is owned by its holding company; more than 50% of its voice in General Meeting is controlled by its holding company; and/or the control of the company, the appointment and dismissal of its direction and commissioner is influenced by holding company (Elucidation of Article 29 of Number 1 Year 1995 regarding Limited Liability Company Act). In the new Law regarding Limited Liability company (Number 40 Year 2007 Act), this definition does not exist.

*Concept of Personal Guarantee (Borgtocht).* Guarantee is functioned to secure creditor's account receivable. Based on Article 1131 of Civil Codes, every material owned by debtor will be the guarantee of all debtor's binds. Every person is responsible to their debts (principle of schuld and haftung)[5]. This principle is very fair, in accordance to the principle of trust in the law of the contract, which is any person who gives a debt to someone believes that the debtor will fulfill his achievements in the future. Everyone is also obliged to fulfill commitment a moral principle by the legislators upheld as legal norms.[6] One of the guarantees is personal guarantee. Article 1820 of Civil Codes states that personal guarantee is an agreement where a third party for the creditor's behalf bind themselves to fulfill debtor's bind in case if debtor cannot fulfill it. Personal Guarantee is divided into two, Personal Guarantee and Corporate Guarantee

*Concept of Bankruptcy.* Bankruptcy causes all binds of debtor after the verdicts of bankrupt cannot be paid again from bankrupt property, except if the binds benefit the property (Article 25 of Bankruptcy Act). The demands regarding rights or responsibilities related to bankrupt property should be proposed by or to curator. For the agreement of feedback done before the bankruptcy which has not or partly fulfilled (article 36 (section 1-5) of Bankruptcy Act), been then mandated to curator for the execution of agreement. If it is not agreed by the curator, the supervisory judge will decide. If there is no any answer, the agreement will be complete and be able to sue for compensation and which will determine the concurrent creditor (article 36 section (3) of Bankruptcy Act). If the curator is agreed, there should be a guarantee of agreement. The agreement cannot be applied to debtor who does not do the agreed action.[7]

### **3. Findings**

#### *3.1. The position of Holding Company as the Guarantor for the Debts of Subsidiary company*

Group company in Act Number 40 Year 2007 or Act Number 1 Year 1995 has no specific regulation. Based on the definition of group company, holding and subsidiary companies are juridically independent, but, economically, they are united to the head of holding company as the central leader. Holding company and subsidiary company are limited liability companies.

Limited Liability Company (LLC) is a legal entity of capital union, established based on agreement, doing business with basic capital which is divided in the shares and fulfills the requirement stated in the law along with its execution of rules. Legal relationship between holding and subsidiary company happens due to the ownership of shares to subsidiary company by holding company that holding company becomes the major shareholders of subsidiary company. Limited Liability Company (LLC) still defends the juridical acknowledgment of legal entity status of holding company and subsidiary as the independent legal subject. Juridically, holding company and subsidiary company are deemed as independent legal subjects who have rights to execute their legal action.

These rights and responsibility are given, apart from the rights, responsibility, and wealth of the founder or shareholders, or all administrators.[4]. As an independent legal entity, holding company or subsidiary company has their own rights and responsibilities. Besides, between holding company and subsidiary company also have separate wealth in juridical or shareholding terms.

Holding company which plays the roles of shareholder of subsidiary company will affect certain impacts, including:

- 1) Holding company has the authority to control subsidiary company through general meeting mechanism of subsidiary company.
- 2) Holding company has the responsibility to place direction and/or commissioner member of holding company to also work in the same place in subsidiary company.

Based on the impact of shareholding in subsidiary company by holding company, holding company has huge roles in controlling subsidiary company. Subsidiary company, in executing their business, needs funds to get their target. The need of funding can be obtained from internal or external sources. The external sources come from the third party. To get the funding, subsidiary company does loan agreement with the third party. The creditor in doing the loan agreement requires the guarantee to secure the risk of unpaid account receivable, including the personal guarantee. Personal guarantee is the guarantee given by the third party to creditor, and the third party guarantees back to the loan of debtor if they cannot fulfill their responsibility. There are 2 kinds of personal guarantee: personal guarantee with personal guarantor, and corporate guarantee with corporate guarantor.

In doing the agreement, subsidiary company usually invites holding company as the guarantor. By the existence of holding company as the guarantor of subsidiary company, this guarantee is included as corporate guarantee. Corporate guarantee is staging given by company to guarantee the repayment of debt from debtor to creditor.[3]. Ever since loan agreement and the warranty agreement is made, automatically, the rights and responsibilities are also given to the involved stakeholder. The guarantor has the responsibility to pay the debt of debtor to creditor if there is a bankruptcy. It is in line to Article 1820 of Civil Codes stating that staging is the agreement where the third party for the creditor's behalf, bind themselves to fill debtor's bind if the debtor does not fill the bind.

From this article, it can be concluded that the guarantor is not only individual, but also legal entity as legal subject. Thus, holding company is basically the guarantor of subsidiary company. According to Munir Fuady, in company guarantee, the guarantor is a company.[8] Holding company is the guarantor of subsidiary company's debt to creditor, or becoming the corporate guarantor. In this case, there are several factors should be concerned, including:

1. Is the legal entity can act as the guarantor based on its article of association?
2. Who, based on the article of association, is entitled the authorized legal entity as the guarantor? If there is not any firm provision to that, general principle will be used that the ones who are able to represent legal entity are the ones who are able to do the general legal action, like direction with or without the agreement of other organ of legal entity, like commissioner, depend on the article of association of related legal entity.

The existence of holding company as the guarantor in the agreement between subsidiary company and the third party can cause legal impact for holding company as the guarantor from subsidiary company in the loan agreement. Holding company as the guarantor from subsidiary company has the responsibility to pay the debts of debtor to creditor if the debtor experiences default. Thus, holding company also becomes the debtor in staging agreement. Holding company which acts as the guarantor of subsidiary company is responsible to pay after the first debtor's debts was default and its properties have been confiscated and auctioned but the result is proven unable to pay the debts, or the debtor was default with no property. Besides, as the consequence of its position as debtor, as the guarantor of subsidiary company, it can be bankrupted by the creditor.

Based on this explanation, the legal connection between holding company and subsidiary company is merely between shareholder and subsidiary company. The position of company as the shareholder can be changed to become the guarantor and debtor if the subsidiary company breaching the contract and its assets is not enough to pay the debts, making the assets of holding company becomes the guarantee of debts made by subsidiary company.

### 3.2. *Legal Impact of Holding Company as Corporate Guarantor from the Bankruptcy of Subsidiary Company*

Subsidiary company which has done binding or agreement with the third party is basically unable to involve holding company to the accomplishment or default of subsidiary company from every legal action done by subsidiary company.

Holding company as the shareholder of subsidiary company has economic position and roles different with individual shareholder in a limited liability company. In group company, holding company has the duality to become a shareholder of subsidiary company and central leader of group company. Nevertheless, corporate law does not differentiate the position of holding company with individual shareholder in certain limited liability company. There is no different treatment to holding company in a group company with a shareholder in a company causing holding company gets the protection based on two principles, company as an independent legal subject and limited liability.[8]

One of the characters of limited liability is limited liability which provides legal protection for shareholder. Holding company as the shareholder of subsidiary company also obtains legal protection with the principle of limited liability; thereby, it does not have any responsibility out of the total of shares to subsidiary company from its inability to fulfill legal responsibility to third party from subsidiary company. It means that holding company as the shareholder only has the responsibility to the extent of its share totals to subsidiary company. The capital of the company is divided to values or stock on behalf or forms. Individual or shareholder or stocks do not have the responsibility more than the total values of the shares (Articles 42, 47, 50 of Commercial Codes, etc).

Subsidiary company which conducts the binding or agreement with the third party has the responsibility to pay the debts. If the company breaches the contract or responsibility to pay the debts in the due date, subsidiary company is legally considered as default. In this case, default is an action that certain party does not fulfill the responsibility as stated in the previously assigned agreement between creditor and debtor.[9]. In the case of subsidiary company as debtor cannot fulfill its responsibility, the creditor can settle the problems of debts through bankruptcy institution. Creditor can propose the request of bankruptcy if it complies the requirement as stated in Article 2 section (1) Act Number 37 Year 2004 regarding bankruptcy and the delay of debts payment, including:

- 1) Debtor has two or more creditors,
- 2) No payment to one's debt in the due date.

The inability of paying the debts by subsidiary company as debtor should be stated to the Panel of Judges in the Commercial Court regarding the verdicts of bankruptcy. The impact of the bankruptcy is the subsidiary company as debtor before the law lost its legal rights to control and manage its wealth including its property right after the verdicts is given (Article 24 section (1), Law of bankruptcy and the delay of debts payment). In article 21 from Law of bankruptcy and the delay of debts payment, it is stated that bankruptcy copes all wealth of debtor during the statement of bankruptcy and all things obtained during the bankruptcy.

If holding company acts as the guarantor of bankrupt subsidiary company, the guarantor has the responsibility to guarantee the repayment of debts from debtor to creditor based on Article 1820 of Civil Codes. Holding company as the guarantor in the agreement between subsidiary company as debtor and the third party as creditor is based on the agreement of guarantee. Basically, as the guarantor, there are special rights given by the Law, including:[10]

- a) Rights of initiating the demand that the wealth of the debtor should be confiscated and auctioned to pay the debts of debtor to creditor, as stated in Article 1831 of Civil Codes.
- b) b.Rights to do debt-breaking as stated in Article 1837 of Civil Codes.



- c) Rights to be halted from guaranteeing if it is creditor's fault that the guarantor is hindered to do subrogation (Article 1848 and 1849 of Civil Codes).
- d) d.Rights to propose defense.[11]

Basically, guarantor has the freedom to release its special right or not. This release is related to its responsibility as well as the legal impact which should be given by holding company as the guarantor to the creditor if the subsidiary company as debtor is breaching the contract.

For holding company, as the guarantor who does not release its special rights, it can sue that the wealth of debtor should be initially confiscated and auctioned to repay its debts. Besides, holding company as the guarantor only has the responsibility to repay the unpaid debts of subsidiary company after the wealth has been confiscated or auctioned.

In case of subsidiary company as debtor experience bankruptcy, according to Law of bankruptcy and the delay of debts payment, if holding company as the guarantor does not release its special rights, the creditor cannot directly collect the debts to holding company, since it has to wait the process of bankruptcy on subsidiary company as debtor is completely finished and stated as bankrupt by Commercial Court. After the subsidiary company as debtor has been stated as bankrupt by Commercial Court, the creditor can collect the debts to holding company. In this case, if the holding company acts as the guarantor and debtor in the agreement of staging cannot fill the responsibility, it is bankrupt under the control of creditor. It means holding company as the guarantor does not release its special rights that holding company cannot be bankrupt if the debtor has not been bankrupt. It is in line to Article 1831 of Civil Codes stating that stager or the guarantor is not responsible to pay debtor's debts unless the debtor is neglectful and debtor's wealth has been confiscated and auctioned to pay its debts.

This is in line to the Constant Case Law of Indonesian Supreme Court RI No. 922 K/Pdt/1995, on 31st October 1997 stating that:

The status of principal data cannot be redirected to guarantor out of the demands to pay the debts, thus, the guarantor cannot be asked for bankruptcy, while the demand is only limited to principal debts' payment. Holding company can choose to release its special rights. Holding company as the guarantor who releases its special rights will be impacted to Article 1832 of Civil Codes stating that:

"The guarantor cannot demand to make the properties of debtor to be confiscated and sold to pay the debts:

- 1) If it has released its special rights to demand debtor's wealth confiscation and selling;
- 2) If it has bonded itself to debtor in terms of responsibility, the impacts of the binds are set under the principle stated to debts' responsibility;
- 3) If debtor can propose a defense for itself;
- 4) If debtor is bankrupt;
- 5) Under the stager ordered by the judges."

In this case, holding company is responsible to all debts payment of subsidiary company as debtor making all assets of wealth of holding company becomes the guarantee of the debts' repayment. If subsidiary company as debtor is bankrupt based on Civil Codes, and holding company as the guarantor has released its special rights, the creditor can directly collect the debts to holding company (the guarantor) without holding company's (the guarantor) demand on confiscating and selling the wealth of debtor. It can be seen in Constant Case Law of Indonesian Supreme Court RI

No.39 K/N/1999, on 2nd November 1999 to the case of bankruptcy between PT Deemte Sakti Indo against PT. Bank Kesawan. In this case, Supreme Court considers that guarantor has released its special rights, making the Creditor directly demands the guarantor to fulfill its responsibility. Since guarantor cannot do that voluntarily, Creditor/Petitioner wished that the guarantor was bankrupt, and based on the consideration of Commercial Court, the guarantor has fulfilled the requirement of bankruptcy.

Besides, holding company as the guarantor which has released its special rights will automatically has the same position to subsidiary company or debtor. It will be bankrupt by the creditor without waiting the process of bankruptcy of debtor if the guarantor does not have good intention to fulfill its responsibility. It can be seen in the Constant Case Law of Indonesian Supreme Court No. 43 K/N/1999, on 31st December 1999, in the case of bankruptcy between (1) Bank Artha Graha and (2) PT Bank Pan Indonesia, Tbk. (PT Bank Panin, Tbk.) against (1) Cheng Basuki and (2) Aven Siswoyo. In case of subsidiary company breaches the contract and holding company as the guarantor has fulfilled the responsibility of debtor (subsidiary company), it has the rights to regress towards subsidiary company. This right has two types:

- 1) Regress rights as the rights of holding company as the only guarantor since it pays the debts of subsidiary company. Article 1839 of Civil Codes says that the guarantor which has paid the debts of debtor can demand the debt again from debtor if this payment is with or without debtor's acknowledgement.
- 2) Regress due to subrogation (changing the position of creditor). Article 1840 says that the guarantor who has paid the debts is able to change its position as the creditor.

#### 4. Conclusion

In group company, holding company can become a guarantor in the debts agreement of subsidiary company to the third party (creditor). The legal connection between holding company and creditor is based on the agreement of guarantor. In this case, the position of holding company is the debtor to fulfill the responsibility of the debtor who breaches the contract.

The legal impact of holding company as corporate guarantor in the case of debtor's bankruptcy or breaching the contract. In the agreement of holding company as guarantor, it has special rights as determined by Civil Codes, including the rights of initial demand that the wealth of debtor should be confiscated and auctioned, rights to do debt-breaking, right to be halted from the guarantor position from creditor's fault to prevent the subrogation, and right of proposing defense. These rights can be released or not which will cause different legal impact. As the guarantor, in the agreement, the position of holding company can also become a debtor; thus, if it does not fulfill its responsibility, the creditor can also make it bankrupt. Holding company as the guarantor which has done its responsibility to pay the debts to debtor will have rights or regress to demand payment from the main debtor.

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