

The Business Judgement Rule in Indonesia: Insights for corporate governance <sup>P1</sup>

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### I. Introduction

In today's business world, market dynamics can shift quickly, leaving even the best-laid plans vulnerable. Amidst this uncertainty, the Business Judgment Rule (the “**BJR**”) doctrine emerges as a protective measure for directors against potential legal liabilities, while also acting as a guiding principle for making sound and informed decisions, key to sustaining corporate stability and progress.

The BJR operates on the understanding that directors will act with due care, in good faith and by placing the corporation's interests above their own. This rule provides a safety net, ensuring directors are not personally liable for their business decisions if they are made with due care and good intentions. By reducing fear of personal consequences, the BJR encourages directors to make sound decisions necessary for the company's success, fostering an environment of calculated risk-taking for corporate benefit.

### II. Historical context and legal foundations

The BJR originates from the common law legal system and is rooted from the doctrine of fiduciary duty, which refers to the responsibilities of corporate directors. This doctrine is applicable when a director has met their fiduciary responsibilities, specifically adhering to the principles of duty of care and skill.

By adhering to these duties, directors may be exempt from personal liability for any errors that occur in decision-making. However, penal liability may be imposed on directors if there is a breach of fiduciary duty, as directors are considered as fiduciaries of the company.

Historically, the BJR was created to balance directors' freedom to make independent decisions with the need for accountability. By trusting directors' judgment, the rule sets standards for thoughtful governance, encouraging directors to optimise strategies for better outcomes while recognising their strategic instincts.

### III. Application and importance in corporate governance

Beyond serving as a defence mechanism for the company's directors, the BJR acts as a compass, guiding them to make thoughtful, informed decisions.

Considering that each decision has the potential to significantly impact an organisation, a director must be guided by the norms contained in the BJR when making decisions. These include upholding the principle of due care, acting in good faith, focusing solely on the corporation's best interests, and adhering to the provisions of the articles of associations, as well as the applicable laws and regulations.

If directors could be held personally liable for all business losses without any guidelines for action or a means of defence, they might hesitate to make important business decisions, which could hinder business growth and harm economic progress. The BJR empowers directors to focus on long-term success rather than just immediate gains, encouraging sustainable excellence in corporate governance.

### IV. The regulatory framework in Indonesia

In Indonesia, the key provisions underlying the Indonesian "BJR" is found in Article 92, paragraph (2) of Law No. 40 of 2007 on the Company Law, as amended by Law No. 6 of 2023 on the Enactment of Government Regulation in Lieu of Law No. 2 of 2022 on Job Creation (the "**Company Law**"). This article states that the board of directors is authorised to undertake management in line with policies it considers appropriate within the limits determined by the Company Law and/or the articles of association. The elucidation of this article further stipulates that the policies considered appropriate are those based on expertise, available opportunities and common practice for similar business practice.

The implementation of the BJR is further regulated under Article 97 of the Company Law, which stipulates that directors are responsible for the management of a limited liability company, which must be carried out by each member of the board of directors with good faith and full responsibility. Furthermore, each member of the board of directors is personally fully responsible for the company's losses if they are at fault or negligent in carrying out the management duties. However, a director cannot be held accountable for such losses if they can prove that:

- the loss is not due to their fault or negligence;
- they have carried out management in good faith and due care for the interest of and in accordance with the aims and objectives of the company;
- they do not have a conflict of interest, either directly or indirectly, over the management actions that resulted in the loss; and
- they have taken measures to prevent the loss from arising or continuing.

These four conditions essentially form the basis for applying the BJR, as a defence mechanism for directors of a limited liability company in Indonesia. However, to invoke the BJR as a defence mechanism, directors must meet these criteria cumulatively. Importantly, the BJR does not protect against cases involving elements of fraud, conflict of interest, unlawful acts and intentional misconduct, as emphasised by key judicial decision (e.g., Supreme Court Decision No. 121 K/Pid.Sus/2020). This highlights the importance of maintaining integrity and accountability, promoting higher governance standards aligned with global practices.

## V. Challenges in the consistent application of the BJR

Despite its significance, the consistent application of the BJR in Indonesian businesses faces multiple challenges due to the lack of uniform understanding among law enforcers. Although Article 97, paragraph (5) of the Company Law provides conditions for the application of the BJR, it does not explain the criteria for fulfilling each of the conditions mentioned earlier.

In such cases, the law is often determined and interpreted based on the facts revealed during trials, leading to varied interpretations. This reduces the effectiveness of the BJR compared to its implementation in common law jurisdictions.

## VI. Enhancing regulatory clarity and corporate practice

To ensure greater consistency in BJR application, clear regulations are essential. Legislation should provide precise criteria defining good faith, diligent conduct and permissible risks. Industry bodies and legal experts should lead efforts to interpret these rules and disseminate knowledge, enhancing understanding among business stakeholders and law enforcers. Additionally, collaboration between regulators and business stakeholders can further refine practices, developing a shared framework that supports innovation while adhering to legal standards.

Additionally, refining corporate governance through targeted training and education helps directors manage legal uncertainties. As directors learn to leverage their legal protections under the BJR, businesses can confidently pursue growth while staying compliant, transforming theoretical guidelines into practical successes. This alignment strengthens directors' ability to harmonise strategies with their fiduciary duties, fostering a transparent and accountable business environment. Continuous education ensures that directors are not only aware of their responsibilities but are also equipped to handle complexities within the legal landscape adeptly.

## VII. Practical approaches for business decisions

Businesses can adopt various strategies to effectively align the decision-making process with the BJR's principles, including:

- conducting regular updates and training for directors and senior management on legal compliance and BJR principles. This increases their capability to align corporate strategies with changing legal requirements;
- developing comprehensive internal corporate policy guidelines that emphasise informed decision-making, due diligence and good faith;
- improving transparency by enhancing communication channels within the organisation for effective decision-making;
- establishing a dual oversight mechanism for high-risk decisions, such as requiring approval from the Board of Commissioners (BOC) and/or the General Meeting of Shareholders (GMS) for specific corporate actions;
- obtaining external evaluations, recommendations, opinions and/or reviews prior to executing high-risk corporate actions, which may include insights from external lawyers, financial advisors and/or tax consultants; and
- coordinating with pertinent government stakeholders (e.g., attorney general, *Badan Pemeriksa Keuangan/BPK*), including specific regulatory and supervisory agencies, by participating in discussion and consultation forums, particularly when dealing with high-risk corporate actions.

These practices not only boost directors' confidence in their governance roles but also enhance organisational resilience and adaptability in rapidly changing markets. By translating regulatory insights into strategic action, directors can drive growth even amidst uncertainties, ensuring a resilient business model. Additionally, fostering a culture of transparency and accountability within the organisation not only strengthens compliance but also drives long-term success, encouraging a forward-thinking approach to business decisions.

## **VIII. Conclusion**

The BJR is a cornerstone of sound corporate governance in Indonesia. It empowers directors to make responsible decisions while protecting them from personal liability when acting in good faith and prioritising corporate interests. This framework allows directors to navigate complex business landscapes with reduced personal risk, supporting paths toward success and competitiveness. As the BJR evolves within Indonesia's legal framework, aligning its application with international standards is crucial for long-term corporate growth and prosperity. Integrating the BJR with robust governance practices forms a solid foundation for sustainable business development in Indonesia and beyond, ensuring that directors can lead confidently and effectively in a demanding and dynamic business world. By continually refining these practices and maintaining alignment with global trends, Indonesian companies can position themselves as leaders in corporate governance.

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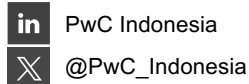
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