

# LEGAL PROTECTION FOR MINORITY SHAREHOLDERS AGAINST SHARE DILUTION IN A PRIVATE COMPANY

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## Abstract

The loss of shareholders' rights to obtain a preemptive offer on newly issued shares results in share dilution for the company's shareholders. The logical consequence of this becomes increasingly complex when the diluted shares fall below 10%, as it weakens their position in the General Meeting of Shareholders (GMS) and results in the loss of the right to file a derivative lawsuit or submit a petition for the examination of the company to the District Court in the event that the company suffers losses. The purpose of this research is to analyze the legal protection of minority shareholders against share dilution in Private Companies and the ideal legal regulation concerning the protection of minority shareholders against share dilution in Private Companies. This study employs a normative legal research method. The research findings indicate that the implementation of legal protection that can be undertaken includes, first, that minority shareholders have the right to sell their shares if they do not agree with corporate actions that are detrimental to shareholders within the scope of amendments to the articles of association; and second, the right to file a lawsuit against the company on the grounds of having been treated unfairly. The ideal legal arrangement in this regard is a legal reformulation, which includes the repeal of Article 43 paragraph (3) of the Company Law, so that the preemptive right remains attached to every shareholder in the event of the issuance of new shares. In addition, reformulation of Article 97 paragraph (6) and Article 138 paragraph (3) letter a of the Company Law is also proposed, in the form of eliminating the minimum 10% share ownership requirement related to the right to file a derivative lawsuit and a petition for a company examination to the District Court.

**Keywords:** *Private Company, Minority Shareholder, Dilution*

## 1. INTRODUCTION

The rapid development of economic and trade activities in Indonesia has created a need for business entities capable of encompassing all aspects of commercial operations. The existence of the Limited Liability Company as a legal entity established under Law Number 40 of 2007 concerning Limited Liability Companies (Company Law) in conjunction with Law Number 6 of 2023 on the Stipulation of Government Regulation in Lieu of Law Number 2 of 2022 on Job Creation as Law (Job Creation Law), is currently considered sufficient to accommodate the continuity of business activities on both national and international scales.

In terms of its types, the Company Law classifies two (2) forms of companies. First, a Limited Liability Company (*Perseroan Terbatas*) in the sense of a company as a capital partnership that conducts business activities with an authorized capital entirely divided into shares, referred to in this study as a Private Company (*Perseroan Tertutup*). Second, a Public Company (*Perseroan Terbuka*), which refers to a company owned by at least 300 (three hundred) shareholders and having a minimum paid-up capital of IDR 3,000,000,000 (three billion rupiah), as stipulated in Article 1 point 22 of Law Number 8 of 1995 concerning

Capital Markets. The distinction between these types of companies can be simply identified from their naming conventions, as regulated under Article 16 paragraphs (2) and (3) of the Company Law, which states that the name of a company must be preceded by the phrase '*Perseroan Terbatas*' or abbreviated as "PT". For a Public Company, the name must still be preceded by '*Perseroan Terbatas*', but must also be followed by the abbreviation "Tbk" at the end of the company's name.

A Private Company (*Perseroan*) is a type of Limited Liability Company that serves as a legal entity in the form of a capital partnership, established based on an agreement. The main characteristic of a Private Company is that it is founded by a minimum of two (2) individuals who generally have familial ties or personal interests in managing the business, and it is not intended to raise capital from or sell its shares to the public through the stock exchange. A fundamental principle that must be fulfilled in a company is the allocation of a certain number of shares to each founder. This gives rise to the commonly used terms 'majority shareholder' (referring to those holding a larger quantity of shares) and 'minority shareholder' (referring to those holding a smaller quantity of shares), where each shareholder's liability is limited to the number of shares they own.

In practice, minority shareholders do not possess optimal power or bargaining position, in fact, they tend to be in a marginal position regarding decision-making within the company through the General Meeting of Shareholders. This situation is factually based on the decision-making mechanism in the company, which is oriented towards the percentage of share ownership held by each shareholder, resulting in majority shareholders having a significantly advantageous position compared to minority shareholders.

The dominant position held by majority shareholders has the potential to lead to the abuse of authority through the General Meeting of Shareholders (GMS) mechanism by positioning themselves as if they were the company's organs, whereas the legal norm stipulated in Article 1 point 4 of the Limited Liability Company Law clearly states that the company's organ is the GMS, not the shareholders themselves. This issue becomes even more complex when majority shareholders occupy positions on the Board of Directors, a key role within the company that has full authority to carry out all aspects of the company's activities. This situation results in an unideal company management system due to the absence of a proper system of checks and balances, causing all actions taken by the Board of Directors to be regarded as representative of the GMS decisions themselves, as a consequence of the overlap between the Board of Directors and the shareholders. Moreover, the dominance of majority shareholders in a company highly facilitates the centralization of decision-making and company policies by the majority shareholders, including the issuance of new company shares.

The issuance of new shares factually results in a reduction in the percentage of share ownership, commonly referred to as dilution, particularly when it occurs due to the circumstances regulated under Article 43 paragraph (3) of the Limited Liability Company Law.<sup>1</sup> Therefore, the absence of an obligation for the Company to offer newly issued shares

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<sup>1</sup> The issuance of shares is intended for: a. the company's employees; b. bondholders or holders of other securities that are convertible into shares, as approved by the General Meeting of Shareholders (GMS); c. reorganization and/or restructuring that has been approved by the GMS.

to all existing shareholders inevitably results in share dilution. In such a situation, minority shareholders are the most affected party, as the decreasing number of shares they hold further weakens their position within the company—especially if their shareholding falls below 10% of the total outstanding shares. A shareholder's right to acquire newly issued shares before they are offered to others is known as a preemptive right.<sup>2</sup> With the implementation of the preemptive right, shareholders are granted the option to purchase newly issued shares by the Company, thereby maintaining their percentage of share ownership and avoiding the dilution of their existing shares.

The losses suffered by minority shareholders as a result of dilution often become a legal issue that leads to disputes in court, whether due to the perception that the dilution was caused by the bad faith of majority shareholders who abused their power through the General Meeting of Shareholders (GMS), or due to the company's continuous losses resulting from poor management practices, which in turn force the company to issue new shares. This reality can be observed through case examples such as the Supreme Court Decision at the Judicial Review level Number 118 PK/Pdt/2017, in which the Plaintiff, as a minority shareholder holding 10% of shares in PT TH Indo Plantations, experienced a dilution of share ownership to 5% as a result of the issuance of new shares. A similar case is found in the Supreme Court Decision at the Judicial Review level Number 741 PK/Pdt/2009, where the Plaintiff, who initially held 50% of shares in PT Gusher Tarakan, experienced a dilution to 2.3% following the issuance of new shares.

Referring to the aforementioned case examples, it is evident that even though the shareholders who experienced dilution pursued legal remedies through the court, in practice, the court still rendered decisions stating that the issuance of new shares is a lawful action under the Limited Liability Company Law, and that share dilution is a risk arising from such issuance. Accordingly, the judicial process cannot be considered an effective means of providing legal protection for minority shareholders in relation to share dilution within the company.

Minority shareholders hold a position as capital contributors essential to the company's business continuity and, therefore, must be granted reasonable legal protection particularly with regard to the integrity of their share ownership, to prevent dilution resulting from the issuance of new shares, especially when such shares are issued to third parties. The exception provided under Article 43 paragraph (3) of the Limited Liability Company Law, which allows the company not to offer newly issued shares to existing shareholders, may potentially undermine the rights of minority shareholders to receive legal protection for the preservation of their shareholding.

This regulation differs significantly when compared to Malaysian corporate law as stipulated in the Law of Malaysia Act 777, Companies Act 2016 (CA 2016). This can be seen in Section 85 of CA 2016, which provides that:

- (1) Subject to the constitution, where a company issues shares which rank equally to existing shares as to voting or distribution rights, those shares shall first be offered to the holders of

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<sup>2</sup> Munir Fuady, *Pembiayaan Perusahaan Masa Kini* (Bandung: PT Citra Aditya Bakti, 1997), 105.

existing shares in a manner which would, if the offer were accepted, maintain the relative voting and distribution rights of those shareholders.

- (2) An offer under subsection (1) shall be made to the holders of existing shares in a notice specifying the number of shares offered and the time frame of the offer within which the offer, if not accepted, is deemed to be declined.
- (3) If the offer is not accepted after the expiry of the period specified in the notice under subsection (2), the directors may dispose those shares in such manner as the directors think most beneficial to the company.

This provision indicates that any new shares to be issued by the company, whether classified as shares with voting rights or distribution rights, must first be offered to existing shareholders in order to preserve their voting and distribution rights. If the shareholders do not accept the offer within the prescribed time period, the offer is deemed to have been declined, thereby allowing the directors to dispose of the shares in any manner they consider most beneficial to the company.

Further examination of the provisions regulated in the CA 2016 reveals that the author did not find any regulations concerning exceptions to the offering of new shares to be issued by the company, unlike those stipulated in the Limited Liability Company Law. In this regard, the author considers that the provisions on the offering of new shares in the CA 2016 provide greater legal protection compared to the Limited Liability Company Law, because the absence of any exception removing shareholders' preemptive rights to be offered new shares first indicates that the CA 2016 has minimized the occurrence of internal conflicts among shareholders related to the issuance of new shares.

In relation to the above matters, this study will focus on two issues: first, the legal protection of minority shareholders against share dilution in Private Companies; and second, the ideal legal regulation concerning the protection of minority shareholders against share dilution in Private Companies.

## 2. RESEARCH METHODS

The type of research used in this study is normative legal research, which examines law as a set of norms or rules applicable in society and serves as a reference for individual behavior. These applicable legal norms include positive written law created by legislative bodies (such as the constitution, codifications, statutes, government regulations, and so forth), written legal norms established by judicial institutions (judge-made law), as well as written legal norms created by interested parties (contracts, legal documents, legal reports, legal notes, and draft laws).<sup>3</sup>

The approaches used in this study are the statute approach, case approach, and conceptual approach in order to obtain information to address the legal issues at hand. These approaches are based on primary and secondary legal materials, and data analysis is conducted using the inductive method.

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<sup>3</sup> Abdulkadir Muhammad, *Hukum dan Penelitian Hukum* (Bandung: PT Citra Aditya Bakti, 2004), 52.

### 3. ANALYSIS AND DISCUSSION

#### 3.1. Legal Protection for Minority Shareholders Against Share Dilution in Private Companies

A company as a legal entity means that the company is a legal subject that can be vested with rights and obligations, similar to a natural person. The company serves as a means of cooperation among shareholders. As stated by Wirjono Projodikoro, a legal entity is a body that, besides natural persons, can act within the law and possesses rights, obligations, and legal interests towards other persons and/or entities.<sup>4</sup> Furthermore, Sri Soedewi Masjchoen Sofwan states that a legal entity is a collection of people who together establish a body or association, along with a collection of assets that are set apart for a specific purpose.<sup>5</sup>

The company's business activities can only be carried out if it has separated assets and a specific purpose that has been stipulated in the articles of association. These separated assets take the form of funds used to finance all of the company's business activities. According to the Explanation of Article 41 paragraph (1) of the Limited Liability Company Law, these funds are referred to as capital, which is divided into three forms: authorized capital, issued capital, and paid-up capital.

The existence of capital is a very important factor as part of the continuity and development of the company. Additionally, capital serves as a means to generate profits from the company's business activities, which is the primary objective of establishing the company. With the profits obtained, each shareholder can receive dividends proportionate to the number of shares they hold in the company.

The scope of shareholder responsibility as regulated in Article 3 paragraph (1) of the Limited Liability Company Law includes three aspects: being responsible for what has been paid up, not being liable for the company's losses beyond the value of the shares owned, and not being personally liable for obligations incurred on behalf of the company. Furthermore, regarding share ownership, Article 84 paragraph (1) of the Limited Liability Company Law stipulates that each issued share carries one voting right (one share, one vote), unless otherwise specified in the articles of association.

The Limited Liability Company Law does not provide a clear definition of who can be called a majority shareholder or a minority shareholder. However, referring to Black's Law Dictionary, a majority shareholder is defined as "a shareholder who owns or controls more than half the corporation's stock", whereas a minority shareholder is defined as "a shareholder who owns less than half the total shares outstanding and thus cannot control the corporation's management or singlehandedly elect directors".<sup>6</sup>

Shares, as movable property, confer proprietary rights to each owner, where these rights can be upheld against anyone.<sup>7</sup> The attachment of ownership rights to shares

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<sup>4</sup> Wirjono Projodikoro, *Hukum Perkumpulan, Perseroan dan Koperasi di Indonesia* (Jakarta: Dian Rakyat, 1985), 9.

<sup>5</sup> Sri Soedewi Masjchoen Sofwan, *Hukum Perdata: Hukum Benda* (Yogyakarta: Liberty, 1981), 29.

<sup>6</sup> Bryan A. Garner, *Black's Law Dictionary*, 8th ed. (Minnesota: Thomson-West, 1999), 1408.

<sup>7</sup> See the Explanation of Article 60 paragraph (1) of the Limited Liability Company Law.

carries the legal consequence that the existence of a shareholder in a company must receive legal protection. Therefore, the focus is not on the number of shares owned, but rather on their status as a legal subject and shareholder.

Regulations concerning legal protection for shareholders in a company are an urgent matter, especially in Closed Companies, particularly when there are significant differences in ownership percentages among the shareholders. This is influenced by the characteristics of Closed Companies, as stated by M. Yahya Harahap, which include: a. Shareholders are limited to people who know each other or only limited to those with family ties and closed to outsiders; b. The company's shares as stipulated in the articles of association are few in number and the parties eligible to be shareholders have been determined; or c. The shares are only registered shares (*aandeel op naam*) held by certain limited persons.<sup>8</sup>

These characteristics can serve as indicators that Closed Companies are more vulnerable to conflicts of interest compared to Public Companies or Open Companies. This is because the owners or shareholders of Closed Companies are limited and predetermined, leading to a situation where majority shareholders have full control over all aspects of the company.

The general trigger for conflicts is the disharmony in the relationship between majority and minority shareholders, caused by differences in decision-making at the General Meeting of Shareholders (GMS) or actions taken by majority shareholders who tend to maintain their dominance through management or the GMS, actions which are often considered detrimental to the interests of minority shareholders.

The weak position of minority shareholders serves as a benchmark for the urgency of providing them with legal protection, as the General Meeting of Shareholders (GMS) is the only forum available for minority shareholders to advocate their interests, while final decisions in the GMS are determined by majority votes. Unfair decision-making in the GMS against minority shareholders has become an inherent legal issue, even though normatively the majority vote system is the most democratic method in accordance with the one share one vote principle regulated in Article 84 paragraph (1) of the Limited Liability Company Law. For illustration, a party owning 25% of the shares holds the same voting position as one owning 10% of the shares, but these voting rights differ significantly from those of a shareholder owning 65% of the shares. This condition clearly becomes unfair in decision-making, considering that the minority shareholders' votes will have no influence in the GMS once the majority shareholders have determined a decision.

Every company always aims to grow and develop, which is characterized by increasing sales year after year. To support the increase in sales, the company needs to add its assets. A shortage of funds to finance the increase in assets is generally first covered by retained earnings. However, if the required funds exceed the retained earnings, the company has no choice but to raise external funds in the form of new debt

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<sup>8</sup> M. Yahya Harahap, *Hukum Perseroan Terbatas* (Jakarta: Sinar Grafika, 2016), 38–39.

and/or issuing new shares.<sup>9</sup> Regarding the issuance of new shares for capital increase, Article 43 paragraph (1) of the Limited Liability Company Law emphasizes the obligation to offer new shares first to each existing shareholder in proportion to their share ownership within the same classification. However, referring to the provision of Article 43 paragraph (3) of the Limited Liability Company Law, the issuance of new shares that does not require a prior offer to existing shareholders includes, among others, shares that: a. are intended for the company's employees.<sup>10</sup> b. Intended for bondholders or other securities that can be converted into shares, issued with the approval of the General Meeting of Shareholders (GMS). c. Carried out in the context of a reorganization and/or restructuring that has been approved by the GMS.<sup>11</sup>

The issuance of new shares in a Company is part of a corporate action, a term frequently used in the capital market environment. However, the meaning of corporate action is not limited to the scope of the capital market alone but can also be used to describe any actions and/or certain acts related to a Limited Liability Company. Corporate action can be defined as a management action that can change the fundamental condition of a company.<sup>12</sup> A corporate action is an action taken by a company that is sufficiently material in nature, such that it has the potential to affect the value of the company's shares.<sup>13</sup>

In practice, share dilution has become a legal issue that requires serious attention, especially when it occurs as a result of the majority shareholder's abuse of dominant position. Based on real-life situations, it is evident that majority shareholders often hold a dominant position. One example is the case of PT TH Indo Plantations in the Supreme Court Decision at the Reconsideration Level No. 118 PK/Pdt/2017. In this case, it was found that the dilution of shares experienced by PT Primasakti Rizki Pertiwi, a minority shareholder holding 10%, which was reduced to 5% of the total 324,000,000 (three hundred twenty-four million) shares, resulted from the abuse of dominant position by the majority shareholder, PT TH Indopalms SDN BHD, which held 90% of the company's shares. The majority shareholder unilaterally made a decision through the GMS to issue new shares as a conversion of the company's debt to PT TH Indo Industries SDN BHD.

The GMS decision resulted in the loss of the preemptive right for PT Primasakti Rizki Pertiwi, preventing it from maintaining its shareholding proportion in PT TH Indo Plantations. Although the share dilution was also experienced by PT TH Indopalms SDN BHD, decreasing from 90% to 45%, the number of shares it retained still allowed it to maintain a bargaining position in the GMS against PT TH Indo Industries SDN

<sup>9</sup> Handono Mardiyanto, *Intisari Manajemen Keuangan: Teori, Soal dan Jawaban* (Jakarta: Grasindo, 2009), 78.

<sup>10</sup> See the Explanation of Article 43 paragraph (3) letter a of the Limited Liability Company Law, which states that shares intended for the company's employees include shares issued under the company's Employee Stock Option Program (ESOP) along with all the rights and obligations attached to them.

<sup>11</sup> See the Explanation of Article 43 paragraph (3) letter c of the Limited Liability Company Law, which states that reorganization and/or restructuring refers to mergers, consolidations, acquisitions, debt settlements, or spin-offs.

<sup>12</sup> Tjiptono Darmadji and Hendy M. Fakhrudin, *Pasar Modal di Indonesia* (Jakarta: Salemba Empat, 2011), 139.

<sup>13</sup> Nor Hadi, *Pasar Modal Acuan Teoritis dan Praktis Investasi di Instrumen Keuangan Pasar Modal* (Yogyakarta: Graha Ilmu, 2013), 177.

BHD, the new shareholder to whom the company issued shares. Moreover, the entry of PT TH Indo Industries SDN BHD as the new majority shareholder holding 50% of the company's shares poses a relatively low risk of power abuse, considering that it is affiliated with PT TH Indopalms SDN BHD under the same corporate group. This situation further marginalizes the position of PT Primasakti Rizki Pertiwi as a 5% shareholder in the company.

The above case illustrates that a share dilution reducing ownership to below 10% of the company's total shares can significantly impact the shareholder's rights and interests. Among these are the loss of the right to represent the company in filing a lawsuit against the board of directors for acts of negligence or misconduct that have caused losses to the company (derivative suit), as regulated in Article 97 paragraph (6) of the Limited Liability Company Law, and the loss of the right to conduct an investigation or inquiry (right of inquiry) into the company, the board of directors, and/or the board of commissioners for unlawful actions that harm the company itself, the shareholders, or third parties, as stipulated in Article 138 paragraph (3) letter a of the Limited Liability Company Law.

Minority shareholders whose shares have been diluted to below 10% of the company's total shares are essentially placed in a disadvantaged position, as the only remaining rights they retain are the right to receive dividends, as regulated in Article 71 of the Limited Liability Company Law, and the right to vote in the General Meeting of Shareholders (GMS), as stipulated in Article 84 paragraph (1) of the same law. However, these rights are not fully guaranteed to be realized, especially if the company continues to suffer losses in which case dividends will not be distributed. Likewise, the voting rights of minority shareholders in the GMS will have no significant impact if their votes oppose those of the majority shareholders.

In such circumstances, the law must be able to provide a solution so that all rights and interests of minority shareholders in the company can be protected. This aligns with the view of Sudikno Mertokusumo, who stated that legal protection is an effort regulated by law to prevent violations by unauthorized parties. Essentially, the existence of law arises when there is a conflict of human interests.<sup>14</sup>

Juridically, the implementation of legal protection for minority shareholders in the event of dilution to below 10% of the company's total shares can be carried out based on two main aspects, as follows:

1. The minority shareholder sells their shares and receives payment from the company at a fair price

The issuance of new shares and the entry of other parties as new shareholders will essentially alter the entire shareholding percentage and change the management structure of the company, which will subsequently be followed by amendments to the company's Articles of Association. In this regard, Article 62 paragraph (1) letter a of the Limited Liability Company Law grants minority shareholders the right to request the company to purchase their shares at a fair

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<sup>14</sup> Sudikno Mertokusumo, *Mengenal Hukum Suatu Pengantar* (Yogyakarta: Liberty, 1999), 31.

price if they do not approve of the company's actions, considering such actions detrimental to their interests as shareholders due to the changes made to the Articles of Association.

Although the purchase of shares by the company is limited as regulated in Article 37 paragraph (1) letter b of the Limited Liability Company Law, which states that it shall not exceed 10% of the total issued capital of the company, the provision in Article 62 paragraph (2) of the same law regulates that if the number of shares requested to be purchased by the company exceeds 10%, the remaining shares must be sold to a third party by the company. Therefore, there is no reason for the company to reject the minority shareholders' request to sell their shares. Selling the shares becomes the most feasible option if their position in the company will only increasingly disadvantage them.

2. Filing a direct lawsuit (direct action) against the Company in the district court.

The legal instrument stipulated in Article 61 paragraph (1) of the Limited Liability Company Law serves as a formula for minority shareholders to file a direct lawsuit (direct action) for losses arising from share dilution due to the issuance of new shares, which results from the loss of preemptive rights to maintain their ownership stake.

Article 61 paragraph (1) of the Limited Liability Company Law accommodates the rights of shareholders who feel aggrieved by unfair and unreasonable actions taken by the Company as a result of decisions made by the General Meeting of Shareholders (GMS), the Board of Directors, and/or the Board of Commissioners, allowing them to file a lawsuit in the District Court. In this regard, the explanation of Article 61 paragraph (1) of the Limited Liability Company Law states that the lawsuit essentially contains a request for the Company to stop the harmful actions and take certain steps to address the consequences that have arisen as well as to prevent similar actions from occurring in the future. Thus, it can be understood that the lawsuit will only be granted if it falls within this scope; in other words, the lawsuit filed by minority shareholders has a limited scope, being solely intended to stop the Company's actions, remedy the arising consequences, and prevent similar acts from happening again.

### **3.2. Ideal Legal Regulation Regarding Legal Protection for Minority Shareholders Against Share Dilution in Closed Companies**

There is empirical evidence that the current legal protections for minority shareholders provided in the Limited Liability Company Law (UU Perseroan Terbatas) are considered insufficient in delivering full justice to minority shareholders, particularly regarding the provisions set forth in Article 43 paragraph (3) of the Law. This provision results in the loss of preemptive rights over new shares issued by the Company for capital increase, causing shareholders to experience share dilution without the ability to take action to maintain their existing ownership percentage.

Capital increase in a Company is normatively regulated under Article 42 paragraph (2) of the Limited Liability Company Law, which states that such increase is only valid if carried out through a General Meeting of Shareholders (GMS) mechanism with a quorum of more than half (1/2) of the total shares with voting rights present and approved by more than half (1/2) of the total votes cast, unless a higher requirement is stipulated in the articles of association. However, the problematic issue arises in a situation where the Company has only two shareholders with an uneven composition: one shareholder holds a majority ownership of 90% of the shares, while the other is a minority shareholder owning 10% of the shares.

Regarding this matter, the enforcement of Article 42 paragraph (2) of the Limited Liability Company Law can be considered ineffective, because even if the minority shareholder who owns 10% of the shares expresses rejection or disapproval of the capital increase process at the General Meeting of Shareholders (GMS), it will certainly not affect the decision of the majority shareholder who owns 90% of the shares. This is based on the legal reasoning that Article 42 paragraph (2) of the Limited Liability Company Law only requires that the GMS decision for capital increase is valid if approved by more than half (1/2) or 50% of the votes. Therefore, in this context, it can be understood that even if the minority shareholder does not attend the GMS summons or attends but disagrees with the GMS decision, it will not affect the decision made by the majority shareholder, considering that the percentage of shares they hold already exceeds the minimum threshold regulated in Article 42 paragraph (2) of the Limited Liability Company Law.

Although Article 61 of the Limited Liability Company Law grants the right for minority shareholders who feel aggrieved to file a lawsuit (direct action), this provision is considered ineffective and does not reflect adequate legal protection for minority shareholders. This is based on the legal reason that there is a restrictive requirement explained in the Explanation of Article 61 paragraph (1) of the Limited Liability Company Law, where the subject matter of the lawsuit is only oriented towards requesting the Company to stop the harmful actions and to take certain steps either to address the consequences that have arisen or to prevent similar actions in the future. Therefore, it can be understood that if minority shareholders file a lawsuit seeking a court order to annul the results of the GMS decision made unilaterally by the majority shareholders regarding the issuance of new shares for capital increase, the lawsuit filed is likely to be rejected by the Court.

The issuance of new shares for the purpose of increasing the Company's capital, as regulated in Article 43 of the Limited Liability Company Law, states that:

- (1) All shares issued for capital increases must first be offered to each shareholder in proportion to their share ownership for the same class of shares.
- (2) In the event that the shares to be issued for the capital increase are of a classification that has never been issued before, the right to purchase first belongs to all shareholders in proportion to the number of shares they own.
- (3) The offer referred to in paragraph (1) does not apply in the case of the issuance of shares:

- a. addressed to the employees of the Company;
  - b. addressed to bondholders or other securities convertible into shares that have been issued with the approval of the GMS; or
  - c. carried out in the context of reorganization and/or restructuring that has been approved by the GMS.
- (4) In the event that the shareholders referred to in paragraph (1) do not exercise their rights to purchase and fully pay for the shares within 14 (fourteen) days from the date of the offer, the Company may offer the remaining unsubscribed shares to third parties.

It is evident that there is an imbalance among the paragraphs, where on one hand, the regulation allocates the fulfillment of shareholders' rights to obtain a portion of the new shares to be issued by providing them the opportunity to purchase such shares within a 14 (fourteen) day period as stipulated in paragraphs (1), (2), and (4); yet on the other hand, the same regulation reduces the shareholders' rights to participate in the issuance of new shares as provided in paragraph (3).

The provision of Article 43 paragraph (3) of the Limited Liability Company Law presents significant issues in its implementation. Although it is limited by the requirement that the loss of preemptive rights must be approved by the General Meeting of Shareholders (GMS), the revocation of such rights has a clear principle when applied to the issuance of new shares for employees, which in this case does not require GMS approval. Furthermore, upon reviewing the Elucidation of Article 43 paragraph (3) of the Limited Liability Company Law, the author did not find any clear urgency or legislative intent behind the inclusion of such a provision.

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The principle of justice serves as the main premise in relation to share ownership in a company, as stipulated in Article 53 paragraph (2) of the Limited Liability Company Law, which states that every share within the same classification grants equal rights to its holder. These rights must be equally attached to both majority and minority shareholders. This characteristic is fundamentally relevant to the first principle of justice as proposed by John Rawls, namely the *greatest equal liberty principle*, which emphasizes the application of the *original position*, a condition where all individuals in society are in an equal and fair situation, with no party holding a superior position over another, thereby enabling agreements to be made on equal footing.<sup>15</sup> Thus, the

<sup>15</sup> Pan Mohamad Faiz, "Teori Keadilan John Rawls (John Rawls' Theory of Justice)," *Jurnal Konstitusi* 6, no. 1 (2009): 140, <https://dx.doi.org/10.2139/ssrn.2847573>.

preemptive right should be regarded as an absolute entitlement without specific exceptions, considering that the interests of shareholders in the company they own must be prioritized as long as such interests are not intended to harm other shareholders. Therefore, the existence of adequate and non-discriminatory legal regulations is essential, particularly in relation to the issuance of new shares.

The enforcement of the provision under Article 43 paragraph (3) of the Company Law, when viewed from the perspective of the theory of justice as proposed by John Rawls, shows that justice is the primary virtue of social institutions. Therefore, the law must be reformed if it is unjust, as every individual possesses dignity based on justice, and their freedoms and rights as human beings must be guaranteed by justice.<sup>16</sup> Thus, it can be analyzed that the loss of the right to maintain the percentage of share ownership in order to avoid dilution factually reflects that the provision of Article 43 paragraph (3) of the Company Law does not prioritize the fulfillment of justice guarantees and legal protection.

The revision of the provisions of Article 43 of the Company Law is a matter of primary concern for the author, namely by removing the provision of Article 43 paragraph (3) of the Company Law. As such, the legal regulation regarding the issuance of new shares under Article 43 of the Company Law would no longer include exceptions to the preemptive right of existing shareholders. The continued recognition of preemptive rights can serve as a benchmark for the fulfillment of justice and legal protection for shareholders, particularly minority shareholders. This is intended to ensure that shareholders have the option to either accept dilution of their shares or maintain the percentage of shares they already own.

The strengthening of the position of minority shareholders in a Company must also be supported by a reformulation of Article 97 paragraph (6) and Article 138 paragraph (3)(a) of the Company Law, specifically by removing the limiting requirement of owning 1/10 (one-tenth) of the total shares with voting rights. By eliminating this threshold, every shareholder with voting rights would be entitled to file a lawsuit on behalf of the Company through the district court against members of the Board of Directors whose fault or negligence has caused losses to the Company, as well as to submit a request for an investigation of the Company to the district court.

The requirement of a minimum 10% share ownership needs to be reformulated based on the legal principle that every share recorded in the shareholders register grants rights to its holder. Furthermore, eliminating the ownership threshold would help optimize the application of the *piercing the corporate veil* principle as stipulated in Article 3 paragraph (2) points (b), (c), and (d) of the Company Law. This is particularly relevant when considering instances of minority share dilution resulting from the loss of preemptive rights due to the issuance of new shares in the context of restructuring or debt-to-equity conversion for creditors. In such cases, there is a possibility of

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<sup>16</sup> John Rawls, *Teori Keadian: Dasar-Dasar filsafat Politik untuk Mewujudkan Kesejahteraan Sosial dalam Negara*, trans. Uzair Fauzan and Heru Prasetyo (Yogyakarta: Pustaka Pelajar, 2006), 4.

involvement or bad faith on the part of majority shareholders that may have contributed to the Company's failure to repay its debts.

Legal reforms regarding Article 43 paragraph (3), Article 97 paragraph (6), and Article 138 paragraph (3) letter (a) of the Company Law in the form of eliminating exceptions to the exercise of preemptive rights related to the issuance of new shares, as well as removing the minimum ownership threshold of 10% of the total shares, will result in optimal legal protection for minority shareholders when faced with dilution. By accommodating these rights, the realization of the principle of majority rules with minority protection will be better upheld by majority shareholders. Therefore, in cases where the General Meeting of Shareholders approves the issuance of new shares as a capital increase, particularly for purposes of restructuring or debt to equity conversion, the potential losses suffered by minority shareholders who are the most affected by the issuance of such new shares can be minimized as much as possible.

#### 4. CONCLUSION

The implementation of applicable legal provisions in response to share dilution, as a form of legal protection, is by filing a lawsuit against the Company based on the grounds stipulated in Article 61 paragraph (1) of the Company Law namely, that the minority shareholder has been treated unfairly due to decisions made by the General Meeting of Shareholders (GMS), the Board of Directors, and/or the Board of Commissioners. However, the existence of this right to sue does not in itself fully constitute legal protection for minority shareholders, as any lawsuit filed must comply with formal procedures prescribed by procedural law and may not automatically fulfill the objectives of the claim. Furthermore, if dilution nonetheless occurs and the minority shareholder does not agree with the dilution of their shares, then based on Article 62 paragraph (1) of the Company Law, the minority shareholder is entitled to request that the Company buy their shares at a fair price.

The reformulation of the provisions of Article 43 paragraph (3), Article 97 paragraph (6), and Article 138 paragraph (3) letter a of the Company Law is considered an ideal regulatory measure to ensure the fulfillment of justice and legal protection for minority shareholders in a Private Company in connection with the issuance of new shares. In addition, this reformulation is also intended to optimize the application of the principle of *piercing the corporate veil* as stipulated in Article 3 paragraph (2) letters b, c, and d of the Company Law.

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