

Beyond Salomon in Asean Context: Director Liability, Lifting Corporate Veil and Insolvent Trading in Malaysia and Indonesia

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DOI: <https://doi.org/10.47772/IJRISS.2026.100400129>

Received: 25 March 2026; Accepted: 31 March 2026; Published: 30 April 2026

ABSTRACT

The article establishes a comparative and doctrinal analysis of director liability in insolvency in both Malaysia and Indonesia, using the United Kingdom as a reference point jurisdiction. It asserts that Malaysian law is not yet inclusive in its approach since it continues to rely upon a regime based on fraud to determine liability pursuant to section 540 of the Companies Act 2016, whereas the Indonesian law is conceptually open-ended and relies on fault and negligence found in Law No. 40 of 2007 and Law No. 37 of 2004. Both systems do not control the grey area between legitimate commercial judgment and misjudgment of risk-taking in the near vicinity of insolvency. Based on the wrongful trading regime in the United Kingdom in section 214 of the Insolvency Act 1986, this article postulates the introduction of objective standard of the liability in an ASEAN-oriented system. This kind of reform would improve the protection of creditors, increase the level of doctrinal coherence and bring regional standards of corporate governance to parity with international best practices.

Keywords: Separate Legal Entity, Director Liability, Fraudulent Trading.

INTRODUCTION

The modern company law is built on the doctrine of separate legal personality, which was developed in *Salomon v A Salomon & Co Ltd* [1897] AC 22. The doctrine ensures that the company is a separate juridical person to ensure limited liability, capital formation, and risk allocation are made possible. Its further use in insolvency situations, however, creates a basic conflict between corporate liberty and creditor safeguarding.

The article argues that the law of Malaysia and Indonesia does not appropriately govern the behaviour of directors in the financial distress zone. In Malaysia, the liability specified in section 540 of the Companies Act 2016 is limited to cases of fraudulent trading, which leaves a broad range of negligent or careless actions out. By contrast, in Indonesian law liability is grounded on fault and negligence in Articles 97 and 104 of the Law No. 40 of 2007, but does not specify a consistent doctrine upon which such liability is formed.

The main argument that is put forward is that both jurisdictions cannot deal with the intermediate level of conduct between a bona fide business judgment and fraudulent misconduct. This regulatory loophole compromises the protection of creditors and corporate responsibility. In comparison, the wrongful trading regime in the United Kingdom provides a more balanced and useful approach with an objective criterion of what directors knew or should have known.

This article takes a doctrinal and comparative approach. It examines both statutory and judicial reasoning and scholarly critique to assess the sufficiency of both jurisdictions. It finally suggests that a harmonised ASEAN framework be adopted with objective liability and safe harbour protection standards

LITERATURE REVIEW: AN ANALYTICAL SYNTHESIS

Separate legal personality has also been conceptualised widely as a device of entity shielding, which makes it possible to divide corporate resources between personal claims (Hansmann and Kraakman, 2000). Although this structure is efficient in the economy, it has been criticised as enabling opportunistic behaviour especially in insolvency cases where directors can externalize risk to creditors (Armour, 2001).

In the past, judicial processes like veil lifting have been used to deal with such abuses. The jurisprudence however is inconsistent and conceptually limited. In the United Kingdom, the Supreme court in *Prest v Petrodel Resources Ltd* [2013] UKSC 34 made a distinction between concealment and evasion, and only veil piercing in the context of wilful avoidance of the law. This method has been criticised by academic commentators who believe it is too restrictive and uncertain in its doctrines (Payne, 2013), making it less effective as a regulatory instrument.

Academic argument has moved more and more towards the position of the responsibility of directors in insolvency. According to Keay (2014), the fiduciary responsibilities of the directors change once insolvency is approaching to include creditors that become the residual risk takers. The same principle is depicted in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250, in which the court acknowledged the importance of creditor interests in financially troubled firms.

Wrongful trading is a major development in the doctrine of this subject. The section 214 of the insolvency act 1986 provides that the directors should not proceed with the business when they are aware or should have been aware that there was no reasonable prospect of avoiding insolvent liquidation. In *Re Produce Marketing Consortium Ltd (No 2)* [1989] BCLC 520, the court used objective standard thus expanding the liability past fraudulent basis to negligent decision making.

Academic commentary in Malaysia has always pointed out the weaknesses of the current regime of fraud. According to Zainal and Rahman (2020), section 540 does not address reckless trading behaviour, thus, providing a regulatory gap. In Indonesia, though there are wider statutory provisions that create liability, scholars observe that there are no definitive doctrinal guidelines to guide on the topic of fault and negligence, which leads to varying judicial decisions (Butt, 2012).

This literature shows that there is a common issue; the current legal processes do not sufficiently control the actions of directors during insolvency. This paper expands on this observation by coming up with a comparative framework to address and balance these shortcomings.

Doctrinal Analysis: Malaysia

Malaysian company law exhibits a good sense of following the doctrine of separate legal personality and courts are unwilling to deviate out of this doctrine unless there is some exceptional condition. The Federal Court in *Aspatra Sdn Bhd v Bank Bumiputra Malaysia Bhd* [1988] 1 MLJ 97 stated that the veil lifting should only be done in instances of fraud or sham. This limiting principle has been repeatedly reiterated in other cases like *Gurbachan Singh Bagawan Singh v Vellasamy Pennusamy* [2015] MLRA 107.

Section 540 of the Companies Act 2016 holds liabilities when one conducts business with the intention of defrauding creditors. This clause gives a subjective standard of dishonesty in that they must prove intent to defraud. The court made it clear in *Re William C Leitch Bros Ltd* [1932] 2 Ch 71 that commercial misjudgement alone could not be used to prove liability.

This doctrine opens a big gap in regulations. Directors that keep trading under a condition of financial distress are not obligated to liability in case no evidence of fraudulent intent can be proved. The high evidentiary burden

on plaintiffs has been evidenced by Malaysian case law such as *ARL Associates Sdn Bhd v Bank Kerjasama Rakyat Malaysia Bhd* [2013] MLRA 370].

The Malaysian framework is, therefore, normatively under inclusive in that it does not control careless or reckless trading conduct that can be detrimental to creditors.

Doctrinal Analysis: Indonesia

The Indonesian law embraces a wider statutory approach to the liability of the directors. Article 97(3) of the Law No. 40 of 2007 states that the directors are personally liable to the company losses as a result of fault or negligence. Article 104 expands liability to the cases when the insolvency occurs due to such misconduct.

Nonetheless, the statutory framework does not have a well-defined standard of fault and negligence. The jurisprudence in Indonesia has failed to establish a uniform doctrinal test and this has brought about inconsistency in judicial decisions. The examples of *PT Asuransi Jiwasraya* and *PT Bank Century Tbk* demonstrate the readiness of the judicial system to hold the perpetrators liable in case of mismanagement, but they do not give a clear understanding of the culpability threshold.

This leads to a regime that is likely to over-deter. In cases of commercial uncertainty, the directors can be liable to the decisions that they make in good faith. This problem is further put in perspective by the lack of safe harbour provisions.

Comparative Doctrinal Framework

Jurisdiction	Legal Basis	Standard of Liability	Doctrinal Character
Malaysia	s 540 CA 2016	Fraud (subjective)	Under-inclusive
Indonesia	Arts 97 & 104 Law 40/2007	Fault / Negligence (unclear)	Over-expansive
United Kingdom	s 214 IA 1986	Objective (knew or ought to know)	Balanced

As shown in the comparative analysis, Malaysia and Indonesia are two sides of the extremes of regulatory design. The United Kingdom makes a compromise solution in the wrongful trading regime, which captures careless behaviour without eliminating room on legitimate business judgment.

RESEARCH METHODOLOGY

This research follows a doctrinal approach with the help of comparative law. It analyses legal statutes, judicial and legal commentary in Malaysia, Indonesia, and the United Kingdom. The comparative approach is a functional approach to assess the regulation of director liability in insolvency by each of the jurisdictions, with the emphasis on the liability thresholds, judicial intervention, and creditors protection.

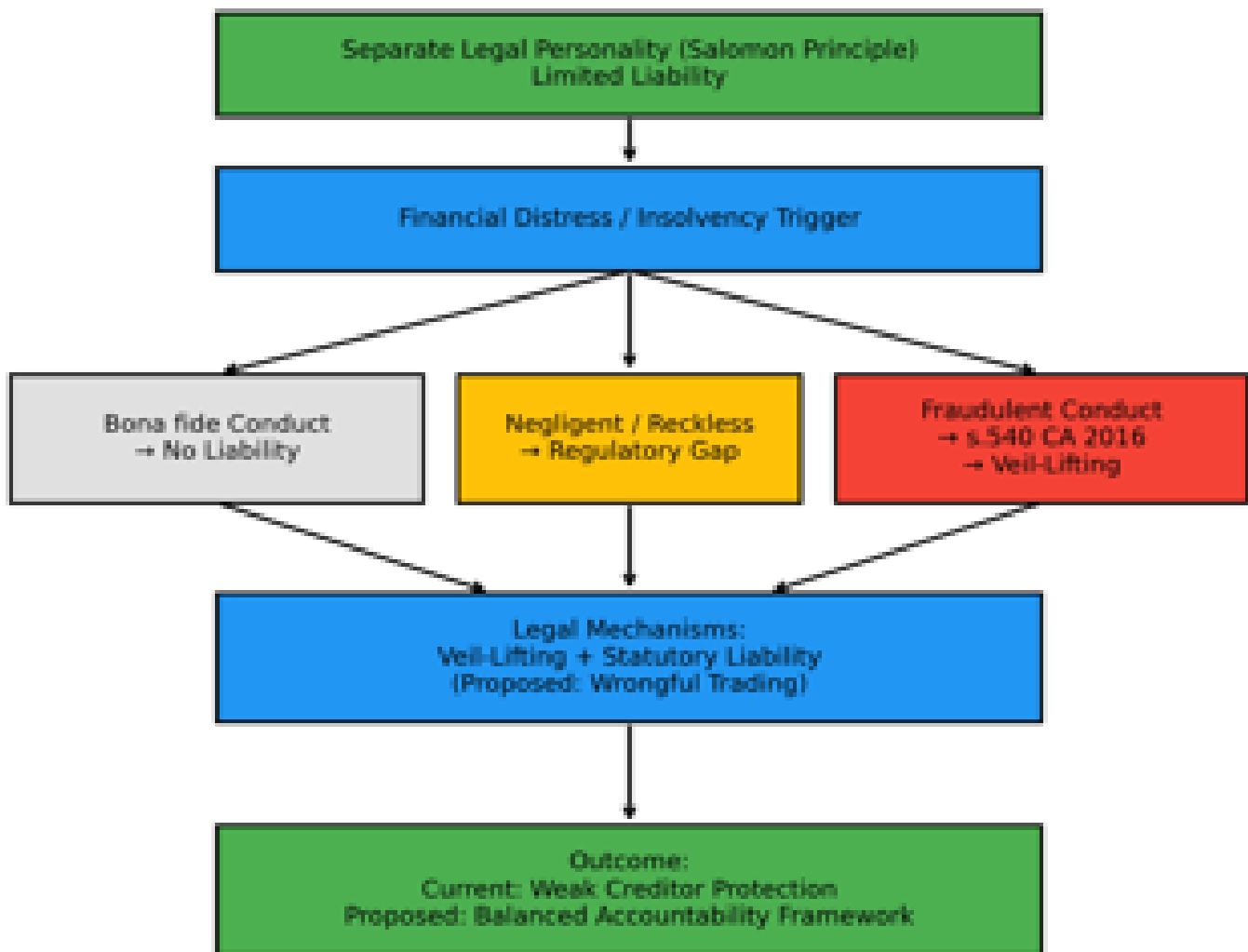
Conceptual Framework

This article constructs a combined conceptual framework on three interacting constructs: separate legal personality, director behaviour in financial distress and liability mechanisms. The framework indicates that there is a regulatory loophole between legitimate business judgment and fraudulent malpractice. It shows that good regulation should not only be fraud but also negligent and reckless behaviour.

The gap between negligence and fraud should be demonstrated by arrows downward which point out the regulatory lack.

Arrows below should show the gap between negligence and fraud, which highlighting the regulatory deficiency.

Figure 1. Conceptual framework



FINDINGS AND DISCUSSIONS

The Malaysian legislation is very compliant with the orthodoxy of doctrine. As in *Aspatra Sdn Bhd v Bank Bumiputra Malaysia Bhd*, the Federal Court reiterated that veil lifting should be exceptional. Such a restrictive practice is reinstated in *Gurbachan Singh Bagawan Singh v Vellasamy Pennusamy* and *Ong Leong Chiou v Keller (M) Sdn Bhd* where a court had to find clear cases of fraud or impropriety to authorize the corporate veil to be pierced.

In the meantime, a narrow liability regime is represented in Section 540 of the Companies Act 2016. Liability as in *Re William C Leitch Bros Ltd*, must be shown as a dishonest intent. The Malaysian case of *ARL Associates Sdn Bhd v Bank Kerjasama Rakyat Malaysia Bhd* and *Tradewinds Properties Sdn Bhd v Zulkiflee A Bakar* confirm the heavy evidentiary burden on behalf of the plaintiff, in order to have the corporate veil pierced.

Indonesian law, on the contrary, is more statutory. Article 97 of the law No. 40 of 2007 subject's negligence liabilities whereas Article 104 subjects the directors to insolvency due to misconduct of directors. The *PT Asuransi Jiwasraya Case* and the *PT Bank Century Tbk Case* are some of the cases that demonstrate the willingness of the judiciary to hold individuals liable due to mismanagement.

Malaysia is under regulated and Indonesia is over expanding comparatively. The United Kingdom offers a moderate approach in terms of wrongful trading provisions, which encapsulate careless behaviour without having to prove presence of fraud.

Policy Implications

The comparative results have a huge implication on the corporate governance and insolvency regulation in ASEAN. As much as the Malaysian model encourages certainty, it does not do enough to discourage irresponsible trading thus lowering the creditor confidence and integrity of the market. The Indonesian law, despite being stronger in protecting creditors, brings about uncertainty because it is broad and inconsistent in its application of the liability of fault whereby failure to save the interest of the director when making attempts to save the company is not always consistent.

Policy wise, wrongful trading regime would be a needed compromise point. Such a regime must include an objective criterion that depends on what directors knew or should have known prior to decision being made on the trading decision. Thus, they will be able to capture careless and reckless actions without subjecting them to unnecessary liability due to making sound business decisions. Such a strategy would harmonize ASEAN jurisdictions with the best practices in the world without affecting the flexibility of entrepreneurship.

Moreover, the legislative change must be used to define when the responsibilities of directors to the shareholders would be replaced by the responsibilities to the creditors to minimise the uncertainty and increase accountability. Safe harbour provisions must also be included in the regulatory frameworks to safeguard directors who act in good faith.

On the regional level, insolvency laws in ASEAN would be harmonised to facilitate regional investment and legal certainty. The coherent strategy towards director liability would also empower the corporate governance system in the region and make it more competitive in the global economy.

The identified gaps in both jurisdictions require the reform of the doctrines. In Malaysia, a wrongful trading provision should be introduced as it would fill the regulatory gap that exists by creating liability in objective terms as opposed to subjective intent. When reforming in Indonesia, it should aim at defining the meaning of fault and the concept of safe harbour.

On a regional basis, a harmonised ASEAN system would create legal risks and ease investment across borders. The ideal structure should include several criterion as follows: director liability objective criteria, obvious reasons why the responsibilities transferred to creditors and safe harbour provisions of good faith decision making.

CONCLUSION

This paper has established that, despite the doctrine of separate legal personality still being a major organising concept of company law in both Malaysia and Indonesia, its use in insolvency context reveals serious structural and doctrinal constraints. The comparative analysis shows that neither of the jurisdiction has come up with a sufficiently coherent and effective framework to govern the conduct of directors in times of financial distress. In Malaysia, the still existing liability regime under the fraud based liability regime in the Companies Act 2016, Section 540, leaves a significant gap in regulation because the liability can only be evoked when a dishonest intent has been proven. This high evidentiary test, which is regularly upheld by the judiciary including *Aspatra Sdn Bhd v Bank Bumiputra Malaysia Bhd* and *Gurbachan Singh Bagawan Singh v Vellasamy Pennusamy*, practically exempts a broad range of negligent and reckless actions of examination. Consequently, the directors that keep trading in the face of impending insolvency can escape personal liability even though they can cause significant damages to the creditors.

The Indonesian legal system, in its turn, follows a broader approach by holding directors liable in case of fault and negligence in accordance with the Articles 97 and 104 of the Law No. 40 of 2007. The case of *PT Asuransi Jiwasraya Case* and *PT Bank Century Tbk Case* in the judicial ruling indicates that there is more readiness to sue the directors on the account of mismanagement and violation of fiduciary duties. Although this method is better at protecting creditors, it also creates some uncertainty in doctrine since it lacks clearly prescribed criteria by which one can calculate the existence of fault and absence of a systematic framework that can be used to determine the difference between acceptable business judgment and actionable misconduct. Indonesian law is

therefore at the risk of over deterrence that may discourage good decision making in the responsible entrepreneurship.

The overall observation made out of this research is that the two jurisdictions lack an adequate regulation of the middle ground of director conduct which lies between bona fide commercial judgment and fraudulent conduct. This regulatory loophole is especially prominent in insolvency issues. In cases where the decision made by directors has far reaching consequences on the interest of creditors and market stability. It can be seen that a more balanced approach can be achieved by adopting an objective standard that is founded on what directors knew or should have known at the time in question by the comparative reference of the wrongful trading regime in the United Kingdom that is found in Section 214 of the Insolvency Act 1986. This type of structure does a good job of covering negligent and reckless behaviour and still covering directors acting in good faith to the healthiness survival of the company.

In line with this, this paper develops the discussion that a harmonised ASEAN oriented model of director liability must be established with the aim of ensuring that a balance between the under regulation of liability and over-expansion of liability is achieved. In the case of Malaysia, this requires the introduction of wrongful trading provision which compliments the current regime of fraud based with objective standards of liability. In the case of Indonesia, the issue that should be reformed is to refine and clarify the statutory definition of fault so that the liability is to be imposed in a principled and predictable way. The change in the role of directors towards creditors as insolvency approaches in both jurisdictions should also be clearly reflected in the legislative reform to match legal doctrine with commercial reality.

In a larger policy context, the harmonisation of the framework used would add to the creation of a stronger and more coherent corporate governmental regime in ASEAN. It would increase the confidence of creditors, minimize opportunistic behaviour and encourage directors to take responsible risks. Besides, this harmonisation would promote cross border investment and economic integration since legal certainty and consistency across jurisdictions would increase.

To sum up, the doctrine of separate legal personality still plays a vital economic role even today, but it is no longer viable to apply it without qualifications in insolvency situations. This requires a re-calibrated law system and objective criteria of liability, explicit statutory obligations and an orderly attitude towards director responsibility to make corporate law commercially viable and normatively fair. Through these changes, Malaysia and Indonesia can advance to a more balanced and modern insolvency regime that is consistent with the international best practices and responds to the needs of the ASEAN economic environment.

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