Pacific Rim Investment Treaty Practice: Regional Considerations - Reflective or Reactionary? Indonesia's Approaches to International Investment Agreements and Recommendations for the Future
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ABSTRACT

Indonesia is in the process of discontinuing its old Bilateral Investment Treaties (BITs) by letting them lapse, with a view of renegotiating new and better ones. This is mainly because the old ones were concluded when the investment policy landscape was very different. Nevertheless, this discontinuation has raised considerable concerns among foreign investors, as some of them may not be covered by International Investment Agreements (IIAs). Meanwhile, these protections can be decisive for them to invest in developing countries perceived to have a less developed Rule of Law, such as Indonesia.

Although the government has stated that it is considering replacing the current BITs with a model BIT, concerns will continue to prevail because such new BITs might take longer to conclude, and it is unclear what sort of protection those BITs will provide. Some commentators have suggested that new investors can structure themselves so they can enjoy protections under other multilateral treaty arrangements that Indonesia still has, such as the ASEAN Comprehensive Investment Agreement (ACIA). In addition, investors can request the inclusion of the ISDS mechanism in the concession contracts that they enter into with the government. In fact, they can also invoke protection and investor-state arbitration through the Indonesian Investment Law No. 25 of 2007, though the latter is subject to the consent of the government which ultimately could nullify the efficacy of such a provision.

This paper will examine how Indonesia may reflectively conceptualize its new model BIT. We will contextualize Indonesia’s investment policies and the recent cases those were brought against it, then we will provide a general overview of the current Indonesia’s BITs and analyze whether a better drafted BIT will actually resolve some of the issues that led to investor-state arbitration including the problems associated with controlling regional authorities. Finally, we will suggest ways for Indonesia to move forward with its investment policies, including in creating certain alternative mechanisms to deal with potential investor-state disputes.
I. Introduction

On 26 March 2014, the Financial Times published a report titled “Indonesia to terminate more than 60 bilateral investment treaties”. This has since triggered mixed reactions from academics and the business community around the world. There has been speculation that this is a knee-jerk reaction of the government which has recently faced several investor-state arbitration cases. This action reminds us of the actions of several other governments who have terminated BITs or denounced the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) in order to reduce their legal exposures to international claims before arbitral tribunals.

In contrast to these approaches, statements from Indonesian government officials suggest that they are going through a review of its Bilateral Investment Treaties (BITs) by letting the old ones lapse so that new and better ones can be renegotiated. This is mainly because the old ones were concluded when the investment policy landscape was very different.

As a context, Indonesia is a major market with a population of more than 240 million. It has significant natural resources sector which in 2013, contributed to one-fourth of its GDP. Indonesia has become the largest producer of rubber, the largest exporter of palm oil and the

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4 Ben Bland and Shawn Donnan, “Indonesia to terminate more than 60 bilateral investment treaties”, Financial Times (26 March 2014) online: Financial Times <http://www.ft.com/cms/s/0/3755c1b2-b4e2-11e3-af92-00144feabdc0.html#axzz35Qatebp7>.
5 Rafat Ali Rizvi v. Republic of Indonesia, ICSID Case No. ARB/11/13, Award on Jurisdiction, 16 July 2013 [Rafat Ali v. Indonesia]; Churchill Mining PLC, ICSID Case No. ARB/12/14, Decision on Jurisdiction, 24 Feb 2014 [Churchill Mining v. Indonesia]; Planet Mining Pty Ltd v. Indonesia, ICSID Case No. ARB/12/40, Decision on Jurisdiction, 24 Feb 2014 [Planet Mining v. Indonesia].
8 Mahendra Siregar (Chairman of the Indonesian Investment Coordinating Board), Keynote Speech, National Seminar on Settlement of Investment Disputes: Indonesia, ASEAN, and International, held by Djokosoetono Research Centre, Faculty of Law, University of Indonesia, 5 June 2014. Several internal meetings have been held by government institutions in Indonesia to draft their new model BIT.
second largest exporter of thermal coal in the world.\textsuperscript{10} While there have been arguments that Indonesia does not need IIAs because investment will come in due to its natural resources as could be seen in Brazil, the government officials seem conscious that the Brazilian example does not reveal the counterfactuals,\textsuperscript{11} that is Brazil potentially could have received even more FDI, had it had IIAs. For this reason, the government does not intend to only discontinue its BITs but intends to actively renegotiate them.

The first treaty that the government seeks to discontinue is the Netherlands-Indonesia BIT.\textsuperscript{12} Indonesian government officials prefer to use the term “discontinue” rather than “termination” because they consider that eventually new BITs will replace the discontinued BITs in contradistinction to the examples in some South American and African states. However, as could be seen in Article XV of the Netherlands-Indonesia BIT, the term termination is often found in the BITs:

1. … It shall remain in force for a period of ten years and shall continue to be in force thereafter for another period of ten years and so forth unless denounced in writing by either Contracting Party one year before its expiration.
2. In respect of investments made prior to the date of termination of the present Agreement, the foregoing Articles shall continue to be effective for a further period of fifteen years from the date of termination of the present Agreement.
3. …

Based on the provision, Indonesia is allowed to unilaterally discontinue the BIT, provided it gives an advanced notice in writing to the Netherlands. Historically, the BIT entered into force on 1 July 1995 and has been automatically renewed in 2005. Therefore, it will remain valid until 1 July 2015. As regards to its intention to discontinue this BIT, Indonesia has conducted the required procedure by providing a written notice to the Netherlands in 2014.\textsuperscript{13}

Notably, Article XV(2) of the BIT contains the so-called ‘survival clause’.\textsuperscript{14} This clause obliges the state parties to the BIT to continue granting investment protection to all investments made by investors of both countries prior to the termination date of the BIT—1 July 2015—for another period of fifteen years up to 1 July 2030. However, investments made after 1 July 2015 will not be protected under the BIT.

Although the termination of old BITs can be a starting step for Indonesia to renegotiate its new BITs, the government should consider about the applicability of survival clause which will continue the old regime’s applicability for quite a long period of time, as well as the concern of

\begin{itemize}
  \item Indonesian Investment Coordination Board (BKPM), Facts of Indonesia: Natural Resources, online: <http://www2.bkpm.go.id/contents/general/7/natural-resources>.
  \item Siregar, supra note 8.
  \item Agreement between the Government of the Republic of Indonesia and the Government of the Kingdom of the Netherlands on Promotion and Protection of Investment, signed on 6 April 1994.
\end{itemize}
new investors who are not entitled to any protection until a new BIT has been concluded. We will analyze these scenarios and their legal implications.

Aside from these technicalities, Indonesia needs to come up with a new and better model BIT that can be used to replace the old ones. We will first explore whether the previous cases that Indonesia had faced before investor-state arbitration tribunals can provide inputs to the model BIT. Further, we will also analyze the issues that have been facing Indonesia with regard to its investment policies and investor-state arbitrations. We will also suggest the policies for Indonesia to consider, as well as options to deal with relevant issues that it is facing. We will also explore options for investors who are facing this policy change.

II. Lessons from Jurisprudence for Indonesia’s Model BIT

Indonesia has been a party in at least six investor-state arbitration disputes before the International Centre for the Settlement of Investment Disputes (ICSID) as could be seen in Table 1. This involvement has increased only recently, and it has not lost many cases nor it had to pay relatively substantial amount of compensation to the investors. We will now analyze the cases and explore whether there are lessons that can be learned for the purpose of formulating Indonesia’s new BITs to ensure that these new BITs strike a balance between investment protection and preservation of the government’s policy space.

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A. Dealing with Expropriation

Indonesia was found to have unlawfully expropriated investment in one case. In *Amco Asia v. Indonesia*, the investor entered into a Lease and Management Agreement with an Indonesian company linked to the government to manage a hotel/office complex in Indonesia. After about 12 years, the Indonesian company (under the guidance of the Indonesian government and army leadership) forcibly took over the management of the hotel, and the government revoked the investor’s license to engage in business ventures in Indonesia, PT Amco Indonesia and its parent companies submitted the dispute to ICSID and claimed compensation for damages because of the unlawful taking and the termination of the license. The first tribunal award in 1984 found that Indonesia’s actions breached international law and awarded damages. This award was then annulled by the Annulment Committee because the tribunal had failed to state the reasons for its findings on some issues, such as the calculation of the shortfall of the investor’s investment of its initial license. The dispute was then resubmitted to ICSID with essentially the same claims, and the tribunal found that the takeover of the hotel and the revocation of PT Amco’s license were internationally wrongful acts attributable to Indonesia and awarded damages.

This result should not be seen as problematic. If the government seeks to conduct expropriation, it should at least fulfill the requirements for lawful expropriation under a contract or a treaty, including providing compensation to the investors. The case was brought under the concession contract between PT Amco and the government. Since the government has many similar concession contracts with various companies—especially in the oil and gas and mining sectors, it should ensure that its measures do not violate such contracts. This is also true in the case of expropriation of foreign investments protected under IIAs. In general, avoiding an unlawful direct expropriation is relatively easy.

The latest case registered before ICSID against Indonesia dealt with a potential claim of indirect expropriation. In *Newmont v. Indonesia*, the investor brought a claim against the government’s regulation banning any export of raw minerals. Nevertheless, there is possibility to export, subject to the prevailing progressive taxes, if the mining companies (some are also the exporters) commit to building smelters to process the minerals domestically before being

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17 *Ibid.*, paras. 126-130
22 *Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia*, ICSID Case No. ARB/14/15, registered on 15 July 2014 [*Newmont v. Indonesia*].
23 Law No. 4 of 2009 concerning Minerals and Coal; Government Regulation No. 23 of 2010 concerning the Implementation of Minerals and Coal Mining Business Activities.
exported.\textsuperscript{24} Newmont had been trying to negotiate with the government, but it was not successful. Newmont decided to stop its mining operations\textsuperscript{25} and finally brought the dispute to ICSID. Prior to this case, Newmont had a commercial arbitration case with the government of Indonesia regarding the divestment requirement in the concession contract, in which the arbitrators decided against Newmont.\textsuperscript{26} However, in August 2014, after agreeing to renegotiate with the government, Newmont withdrew its filing before ICSID.\textsuperscript{27}

In \textit{Newmont v. Indonesia},\textsuperscript{28} one can witness clearly Indonesia’s attempt of shifting its policy from getting investment mostly in the extractive industry/ export of raw materials to getting investment that conducts higher value added activities in the country. While the measure seems to be capable of achieving the goal, it affects foreign investors in this sector and have triggered such a reaction. Indeed, the Indonesian Chamber of Commerce and Industry has requested the new government to review this ban as it turns out that all the supporting infrastructures are not yet available to support the proposed push towards a refinery industry, e.g. electricity, as well as the refinery facilities.\textsuperscript{29}

There have been comments in Indonesia that the case reflects how IIAs limit the policy space and encroach the sovereignty of Indonesia.\textsuperscript{30} If the government believes that there are certain policy considerations that can justify its action, then these could be reflected in their model BIT.

In this regard, where the BIT does not provide for such an exception, the government should have considered other strategies to attract such investment of higher value added nature, e.g. strengthening the rule of law in Indonesia, including by retaining its IIAs. In fact, some economists have shown direct correlations between the presence of IIAs and higher premiums paid by foreign investors from essentially similar investments.\textsuperscript{31} UNCTAD argues that this reflect the potential contribution of IIAs to coherence, transparency, predictability and stability.

\textsuperscript{24} Regulation of the Minister of Energy and Mineral Resources No. 1 of 2014 concerning Increasing Mineral Value-Added through Processing and Refining of Minerals Domestically.
\textsuperscript{26} \textit{Republic of Indonesia v. PT Newmont Nusa Tenggara}, 2009, UNCITRAL Arbitration (award is not publicly available).
\textsuperscript{28} \textit{Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia}, ICSID Case No. ARB/14/15, registered on 15 July 2014 [Newmont v. Indonesia].
\textsuperscript{29} Maria Rosari, “KADIN requests mineral export ban to be reviewed (KADIN minta larangan ekspor mineral dikaji ulang), Antaranews: 30 August 2014, \url{http://www.antaranews.com/berita/450998/kadin-minta-larangan-ekspor-mineral-dikaji-ulang}.
\textsuperscript{31} Srividya Jandhyala and Robert J. Weiner, “\textit{Institutions sans frontières: International agreements and foreign investment}”, Journal of International Business Studies (2014) 45, 650. Jandhyala and Weiner examine data for sale of petroleum assets in 45 countries and find that MNEs pay significantly higher amounts for those protected by IIAs than similar but unprotected assets; UNCTAD, \textit{The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries} (Geneva: United Nations Publication, 2009), 24-26.
of the investment frameworks of host countries.\textsuperscript{32} Foreign investors will be more attracted to invest

\textbf{B. Tensions between Central and Regional Governments}

\textit{Cemex Asia v. Indonesia, Churchill Mining v. Indonesia, Planet Mining v. Indonesia}, and to a certain extent, \textit{East Kalimantan v. PT KPC} reflect the difficulty that the central government often faces when dealing with the regional government or other organs of the government. This problem becomes greater with the \textit{desentralisasi} system as elaborated below. While this is a constitutional pathology, the central government could be stricter in dealing with the regional governments because eventually it will be liable for the latter’s actions as they are organs of the government.\textsuperscript{33} In the cases where the central government is aware of a conflict that is arising due to actions of the regional government, it should proceed to negotiate with the affected parties to resolve the conflict before it elevates into a full-scale dispute.

\textit{1. Cemex v. Indonesia}

In \textit{Cemex v. Indonesia},\textsuperscript{34} the investor acquired shares in the state-controlled PT Semen Gresik (PT SG) and held an option to buy a 51% stake by 2001. However, the investor could not exercise this option because of the local opposition to a foreign-takeover.\textsuperscript{35} After the negotiations with the government stalled, in January 2004, Cemex submitted the dispute to ICSID for breach of contract and \textit{de-facto} expropriation under the 1987 ASEAN Agreement for the Promotion and Protection of Investments. However, before proceedings were conducted, a settlement was agreed by the parties and recorded at their request in the form of an award (Award embodying the parties’ settlement agreement was rendered on February 23, 2007, pursuant to Arbitration Rule 43(2)).

\textit{2. East Kalimantan v. PT Kaltim Prima Coal (PT KPC)}

In \textit{East Kalimantan v. PT KPC},\textsuperscript{36} the regional government of East Kalimantan (GPEK) filed a claim against the investor in relation to the divestment requirement imposed by the concession contract entered into by PT Kaltim Prima Coal (PT KPC—the investor) as GPEK wanted to acquire the shares in PT KPC. Eventually, a divestment was done, but other Indonesian entities and a foreign investor acquired the shares. GPEK decided to bring this case to ICSID to enforce divestment to GPEK based on the dispute settlement provision in the concession contract. The tribunal found that it lacked jurisdiction because the requirements under Article 25 of the ICSID Convention were not met as GPEK failed to show that it was designated as a constituent division

\textsuperscript{32} Ibid., UNCTAD.
\textsuperscript{34} \textit{Cemex Asia Holdings Ltd v. Republic of Indonesia}, ICSID Case No. ARB/04/3 [Cemex Asia].
\textsuperscript{36} Government of the Province of East Kalimantan v. PT Kaltim Prima Coal, Rio Tinto Plc, BP Plc, Pacific Resources Investments Ltd, BP International Ltd, Sangatta Holdings Ltd, Kalimantan Coal Ltd, ICSID Case No. ARB/07/03, Award on Jurisdiction, 28 December 2009 [East Kalimantan v. PT Kaltim Prima Coal].
of the Government. \(^{37}\) This was one of the few cases where a regional government acted against investors and the only one that we know which attempted to do it at ICSID. Nonetheless existing BITs seem to be lacking of substantive provisions under which states can bring claims against the investors.

### 3. Churchill Mining v. Indonesia and Planet Mining v. Indonesia (ongoing)

The cases of *Churchill Mining v. Indonesia* \(^{38}\) and *Planet Mining v. Indonesia* \(^{39}\) share the same facts, except that they are two different investors—Churchill Mining and Planet Mining (a wholly-owned subsidiary of Churchill Mining). These investors brought their claims under two different Bilateral Investment Treaties—the Indonesia-UK BIT and the Indonesia-Australia BIT. Both investors collectively invested in an Indonesian company, PT Indonesian Coal Development (PT ICD) with the purpose of conducting exploration and exploitation of coal in East Kutai, Indonesia. \(^{40}\) However, PT ICD only had licenses for general mining and supporting services, thus it entered into various cooperation agreements, investors’ agreements and pledge of shares agreements with the Ridlatama Group which had the exploration and exploitation licenses of the East Kutai Coal Project (EKCP). \(^{41}\) In fact, some exploration licenses for the EKCP had been issued to other companies, and some overlapped with the licenses of the Ridlatama Group in the EKCP. \(^{42}\) In 2010, the Regent of East Kutai decided to revoke the licenses of Ridlatama Group due to the overlapping and forgery allegations. \(^{43}\) For this reason, Churchill Mining and Planet Mining decided to bring the disputes to ICSID.

In both cases, Indonesia argued that the tribunals did not have jurisdiction because there was no consent to submit the dispute to ICSID under the Indonesia – UK BIT and the Indonesia-Australia BIT. Indonesia claimed that the ISDS clause, “shall assent” and “shall consent” in both treaties did not contain consent to submit the dispute to ICSID. \(^{44}\) Rather, the clauses required a two-step procedure, allowing Indonesia to refuse to consent if other jurisdictional requirements were not fulfilled. \(^{45}\) Further, it also argued that the investments did not fall under the definition of investment in the BIT because of various violations of Indonesian law. \(^{46}\)

In *Churchill Mining v. Indonesia*, the tribunal found that Indonesia had given its advance consent in the BIT after observing the preparatory materials of the Indonesia-UK BIT. \(^{47}\) For this reason, the tribunal found that it had jurisdiction over the case. \(^{48}\) However, in *Planet Mining v. Indonesia*, the tribunal found that the Indonesia-Australia BIT did not contain any advance consent, but consent was given to the investor by virtue of the Indonesian Investment

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\(^{37}\) Ibid., paras. 198, 200, 218.

\(^{38}\) *Churchill Mining v. Indonesia*, supra note 5.

\(^{39}\) *Planet Mining v. Indonesia*, supra note 5.

\(^{40}\) *Churchill Mining v. Indonesia*, supra note 5, para. 16; *Planet Mining v. Indonesia*, supra note 5, para. 15.

\(^{41}\) *Churchill Mining v. Indonesia* and *Planet Mining v. Indonesia*, supra note 5, paras. 22-28.

\(^{42}\) Ibid., para. 34.

\(^{43}\) Ibid., para. 36.

\(^{44}\) *Churchill Mining v. Indonesia*, supra note 5, para. 102; *Planet Mining v. Indonesia*, supra note 5, para. 100.

\(^{45}\) *Churchill Mining v. Indonesia*, supra note 5, para. 105; *Planet Mining v. Indonesia*, supra note 5, para. 102.

\(^{46}\) Ibid., para. 77.

\(^{47}\) *Churchill Mining v. Indonesia*, supra note 5, paras. 225, 229.

\(^{48}\) Ibid., para. 230.
Coordination Board’s approval, thus the tribunal had jurisdiction over the case.\textsuperscript{49} Both of these cases are pending hearings on the merits.

\textbf{C. Dealing with frivolous claims}

In \textit{Rafat Ali v. Indonesia},\textsuperscript{50} the investor invested in Indonesia through a Bahamas-incorporated company which acquired shares in several banks in Indonesia those later on merged into Bank Century.\textsuperscript{51} It became clear during the proceedings that the investor had transferred legal ownership of his shares in the Bahamas company prior to the date of the events that gave rise to violations of the United Kingdom – Indonesia BIT (1976),\textsuperscript{52} but he claimed to have retained equitable ownership of an investment despite the transfer. He claimed the investments included the shares in the banks, as well as other loans and financing arrangements.\textsuperscript{53}

The investor’s claim was based on measures taken by Indonesia against the banks when it dealt with a potential financial crisis brought on by the 2008 Financial Crisis in the United States. However, the ICSID proceeding was limited to addressing the meaning of Article 2(1) of the BIT which required the investments to have been granted admission in accordance with the Foreign Capital Investment Law of Indonesia to be protected under the BIT. The tribunal declined jurisdiction because the investment was not granted admission as required by the BIT, and thus did not fall within the scope of the BIT.\textsuperscript{54}

While this case demonstrates that frivolous claims may be lodged against states, Indonesia can deal with this by including a provision about a special and expedited procedure to deal with such claims. For example, the Draft of the Canada – European Union Free Trade Agreement, in its investment chapter provides for two systems which “permit frivolous claims to be rejected very quickly – one where the case is manifestly unfounded, the other where the tribunal, even if facts are assumed to be correct, cannot rule in favour of the investor.”\textsuperscript{55} The provision can be formulated as follows:\textsuperscript{56}

1. The respondent may, either no later than 30 days after the constitution of a tribunal pursuant to Article x- (Constitution of Tribunal) and in any event before the first session of the Tribunal, file an objection that a claim is manifestly without legal merit.

... 

3. The Tribunal, after giving the disputing parties an opportunity to present their observations on the objection, shall, at its first session or promptly thereafter, issue a decision or award on the objection, stating the grounds therefor. In the event that the objection is received after the first session of the Tribunal, the Tribunal shall issue such decision or award as soon as possible, and no later than 120 days after the objection was filed.

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\textsuperscript{49} Planet Mining v. Indonesia, \textit{supra} note 5, para. 215.

\textsuperscript{50} Rafat Ali v. Indonesia, \textit{supra} note 5.

\textsuperscript{51} \textit{Ibid.}, paras. 36-37.

\textsuperscript{52} \textit{Ibid.}, para. 38.

\textsuperscript{53} \textit{Ibid.}, para. 40.

\textsuperscript{54} \textit{Ibid.}, paras. 196-198.

\textsuperscript{55} European Commission, “Investment Provisions in the EU-Canada free trade agreement (CETA)”, 3 December 2013, \url{http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf}.

\textsuperscript{56} Draft CETA as of 4 February 2014 is on file with the authors.
III. Recent policies and problems with regard to Foreign Investments

From 2011 – 2014, four investor claims have been lodged against Indonesia for various measures. These cases are still ongoing. All these cases arose from problems Indonesia is facing with managing foreign investments, including 1) the desentralisasi system and 2) uncoordinated policies.

A. Desentralisasi system

The fall of Soeharto, a former President of Indonesia, in 1998 marked a new era for the country. This also led to the change of governance, from a very centralized system to a decentralized one. Prior to this system, the central government took full control of all sectors.

It all started in 1999 when the Parliament passed Law No. 22 of 1999 concerning Regional Government. It was then followed by the second amendment to the Indonesian Constitution (UUD 1945) which provides the following in its Article 18 (2):

2. Regional governments at provincial, regent, and city level manage and govern themselves, governance matters according to the autonomy principles and assisting tasks.

These efforts were perceived as the only way to prevent disintegration of the nation as regions of Indonesia felt that the central government had not paid enough attention to their development.

Desentralisasi is the delegation of authority from the central government to regional governments to govern and regulate within the system of the unitary state of Indonesia. Under this system, the authority is delegated in at least 31 different areas, including education, youth and sports, health, public works, environment, housing, investment, small and medium enterprises, population, labor and transmigration, women empowerment, family planning, transportation, communication and information, land ownership, rural empowerment, maritime and fisheries, agriculture, plantation, forestry, mining, tourism and culture, industry, and trade. Further, Article 10(3) of Law No. 32/2004 provides the list of areas which fall under the sole authority of the central government, including foreign policy, defense, security, judicial, monetary and fiscal, and religion.

The system is intended to allow the regional governments to accelerate the improvement of the welfare of the society and the enhancement of regional competitiveness. Desentralisasi is meant to increase the efficiency of public services, the effectiveness of governance, and the promotion of democracy. Although it has good goals, the implementation of desentralisasi has been problematic, among others, the issuance of conflicting policies and regulations by the

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57 Rafat Ali v. Indonesia, Churchill Mining v. Indonesia and Planet Mining v. Indonesia, supra note 5; Newmont v. Indonesia, supra note 28.
59 Law No. 32/2004, supra note 58, Articles 13 and 14.
central government and the regional governments.\textsuperscript{61} This is partly because of the lack of capacity (human resources) in the regional governments, as well as the lack of coordination between the central and regional governments.\textsuperscript{62} This has also caused problems to foreign investors because the regional governments issued policies and regulations affecting them, including approval or termination of business licenses after the issuance of in-principle approval by the central government.

Conflicting policies between the central and regional governments also occurs in many other countries in the world. In \textit{Metalclad v. Mexico}, the investor relied on the representation of the Mexican federal government that no other permits were required for its operation. However, the regional government required municipal construction permits and refused to allow the operation of the hazardous waste landfill.\textsuperscript{63} The tribunal found this amounted to violation of the obligation of the government to provide fair and equitable treatment to the investor.\textsuperscript{64}

It appears that the same thing may be argued against Indonesia in \textit{Churchill v. Indonesia} and \textit{Planet Mining v. Indonesia}, after the decision of the regional authority to revoke the licenses of the investors’ partner companies.\textsuperscript{65}

In most cases, the regional governments failed to issue regulations those are in harmony with the regulations issued by the central government. In 2013 alone, the Supreme Court decided 86 cases of regulatory judicial review.\textsuperscript{66} Although it is possible to bring such conflicting regulations to the Supreme Court of the Republic of Indonesia,\textsuperscript{67} the process is time-consuming and resolution can take up to six years. This is certainly not ideal for foreign investors.

While some academics in Indonesia have suggested that withdrawing from the ICSID Convention would resolve this problem,\textsuperscript{68} we disagree. Under the IIAs, the central government will always be held responsible for all actions of the regional governments, regardless whether they are party to the ICSID Convention. Article 4(1) of the ILC Articles, which is a customary rule,\textsuperscript{69} provides:70

The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the

\textsuperscript{61} Direktorat Otonomi Daerah (Bappenas), Kajian Perumusan Arah Kebijakan Jangka Menengah Bidang Revitalisasi Proses Desentralisasi dan Otonomi Daerah Tahun 2010-2014 (Badan Perencanaan dan Pembangunan Nasional, 2009), IV-74.
\textsuperscript{62} \textit{Ibid.}, IV-80 - IV-85
\textsuperscript{63} \textit{Metalclad Corporation v. Mexico}, ICSID Case No.ARB(AF)/97/1, Award, 30 August 2000 [\textit{Metalclad v. Mexico}], paras. 86-89.
\textsuperscript{64} \textit{Ibid.}, paras. 100-101.
\textsuperscript{65} \textit{Churchill Mining v. Indonesia}, supra note 5, paras. 35-37.
\textsuperscript{66} Supreme Court of Indonesia, \textit{Annual Report 2013} (Jakarta: Supreme Court, 2013), 17, 41.
\textsuperscript{67} Law No. 48 of 2009 concerning Judicial Authority (Kekuasaan Kehakiman), Article 20(2)(b); Regulation of the Supreme Court No. 1 of 2011 concerning Right to Conduct Material Review.
\textsuperscript{68} Hikmahanto Juwana, “Indonesia should withdraw from the ICSID”, Jakarta Post: 2 April 2014.
\textsuperscript{70} ILC Articles, \textit{supra} note 33.
organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State (emphasis added).

Many BITs and IIAs also include a clause such as:

(f) “measures” means any measure of a Member State, whether in the form of laws, regulations, rules, procedures, decisions, and administrative actions or practice, adopted or maintained by:
   i. central, regional or local government or authorities; or
   ii. non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities;71

The central government should find a mechanism to make desentralisasi work better. For this reason, it is important for the governments at both levels to better coordinate on policies. One way to encourage coordination between the central, regional and foreign investors may be to include a clause in a BIT stating that in certain specified areas, approval of foreign investments have to be obtained from both the central and regional governments so that the investments will be protected under the BIT. This requires Indonesia to strengthen its governance system and encourages every stakeholder to be on the same page.

B. Lack of Human Resources and Coordination

By June 2013, Indonesia was a party to more than 60 BITs.72 It is critical for the government to understand the commitments that they have made under these agreements. In this regard, the government needs to build its capacity, not only the capacity to litigate in investor-state arbitration cases, but also the capacity at all levels to appreciate the legal ramifications of regulations affecting investments.

The recent export ban of raw minerals is perhaps the example of this. The issuance of the obligation to domestically process and refine raw materials prior to exportation can be traced back to 2009, namely in Article 103 of Law No. 4 of 2009 on Mineral and Coal Mining. However, the Government Regulation that regulates the implementation was not issued until 2010,73 with the most amendment in 2014.74 Even after the issuance, Article 96 of the Regulation did not provide the technical details on the implementation. Instead, it stated that the value added activities for minerals and coal mining will be regulated further in a Regulation of the Minister. The Regulation of the Minister No. 1 of 2014 on Increasing Value Added of Minerals through Domestic Minerals Processing and Refinery was finally released only in 2014, resulting in concerns being voiced by Freeport, Newmont,75 and the players in the industry, among others that the supporting infrastructure was not yet available.76

71 ACIA, supra note 3, Article 4(f) (emphasis added).
73 Government Regulation No. 23 of 2010 on Implementation of Mineral and Coal Mining Business Activities (GR No. 23/2010), Article 93.
74 Government Regulation No. 1 of 2014 on Second Amendment to GR No. 23/2010 on Implementation of Mineral and Coal Mining Business Activities.
76 Rosari, supra note 29.
We do not take a position on whether the measure is lawful. However, we recognize that the government should have policy space to regulate matters in its territory. Nonetheless, in doing so, the government should make its policy goals clear and have conducted an assessment of the legitimacy and the legality of the measure, including the mechanism to implement its measure. Sometimes, it is the way things are done rather than what is done which aggravates the conflict.

Intra-ministerial coordination within the country is equally important to ensure that all relevant ministries are aware of the measure and its full implementation mechanism. In this instance, press reports suggest that the implementation of the export ban seems to not be sufficiently coordinated among ministries. Instead, some reporters have suggested that the Ministry of Trade has taken a wait-and-see approach, rather than actively coordinating with the other ministries, such as the Ministry of Finance (in charge of issuing the regulation about the export tax) and the Ministry of Energy and Mineral Resources (which issued the implementing regulation of the export ban).77

IV. Policy Recommendations

A. Recommendations for the Government

1. Discontinuing the BITs

From the procedural perspective, there are three possible ways for the government to discontinue its existing BITs: 1) terminating the lapsing old BIT unilaterally by way of notification and renegotiating a new one (done for the Indonesia-Netherlands BIT), 2) terminating the old BITs consensually with the other party and renegotiating a new BIT, or 3) renegotiating the old BIT with a view of amending the clauses to clarify them further.

With option 1, although the old BIT is terminated, the regime will continue to apply to investments made prior to the date of termination according to the terms mentioned in the survival clause. On the other hand, option 2 may end immediately the application of the old regime, including its survival clause if the other party agrees. Then a new BIT can be negotiated. For option 3, the new regime will operate immediately after the parties reach an agreement, and the old regime will cease as the survival clause will not kick in as the process does not involve termination of the BIT.

We note that options 2 and 3 and can be taken only if Indonesia already has its model BIT. At the same time, their success fully depends on the consent of the other party to Indonesia’s proposal. Without such consent, Indonesia cannot change the terms in its BITs. This is different compared to option 1 where the old BIT will be terminated, thus it puts some pressure on the other party to come to the negotiation table to formulate the replacement.

The Indonesian government’s BIT review is timely. The clauses in Indonesia’s existing BITs lack clarity and this can potentially lead to difficulties for tribunals in interpreting the provisions. For example, investor-state arbitral tribunals often look at the purpose of the agreement. Unfortunately, the purpose of a BIT is often not clearly mentioned, and different tribunals have often identified different purposes. Some tribunals have simply read the purpose of BITs as “to encourage and protect investment”. Such a liberal reading of the purpose may lead to a situation where all uncertainties should be resolved in favor of investors. However, this is not really the only objective of a BIT. Other tribunals found the purpose of a BIT is “to promote greater economic cooperation”. This purpose is more nuanced and allows the tribunals to take into account the ongoing regulatory interests of host states and weigh it against the objective of protecting investments. The tribunal in Saluka v. Czech Republic noted this by stating that:

The protection of foreign investments is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties’ economic relations. That in turn calls for a balanced approach to the interpretation … since an interpretation which exaggerates the protection … to foreign investments may serve to dissuade host states from admitting foreign investments and so undermine … the overall aim of extending and intensifying … mutual economic relations.

The opportunity provided by the lapsing old BITs is also one that merits deep consideration of the need to provide policy space for the government, the importance of signaling to foreign investors that Indonesia welcomes such investments and the importance of protecting Indonesian investors investing abroad.84

There are several provisions that Indonesia could also look at clarifying and refining so as to ensure that the balance is properly set. However, it is not the objective of this paper to focus on those specific issues. This will be done in a future paper. Instead, we choose to focus on the broader issue raised by several Indonesian academics as elaborated below.

2. Retaining the ISDS v. Denouncing the ICSID Convention?

Juwana in his article in the Jakarta Post (2 April 2014) suggests that Indonesia should withdraw from the ICSID Convention based on criticisms targeted against the ISDS mechanisms in general. We have sought to address some of these criticisms in our response in the Jakarta Post.
Post by analyzing ICSID as one of several ISDS mechanisms available. We also attempted to distinguish the ICSID Convention and IIAs.

Substantively, the ICSID Convention does not regulate about treatments of states to foreign investors. Therefore, an investor cannot bring a case to ICSID just by virtue of the Convention or claiming violation of the convention, except if it is a claim of violation of the procedural provisions of the Convention or of the Arbitration Rules that may lead to annulment of an award.

Procedurally, an investor can only bring a claim of violation of an IIA to ICSID if the IIA provides ICSID as a forum and the host state consents to it. Notably, the IIAs, and not the ICSID Convention, contain states’ consent to arbitration. While, some countries have denounced the ICSID Convention, they may retain other ISDS mechanisms under their IIAs, e.g. ad-hoc arbitration using the UNCITRAL Arbitration Rules, or the International Chamber of Commerce Rules of Arbitration. In fact, most existing BITs of Indonesia also contain more than one ISDS mechanisms.

The authors believe that Indonesia’s new BITs should continue to have ISDS mechanisms, either institutional or non-institutional arbitration. The experience of other countries suggest that the ISDS mechanisms, including ICSID arbitration, may actually contribute to better governance. In Mexico, after some measures by local authorities resulted in awards against the state, the central government thereafter would often cite these awards in negotiations with the local authorities about the need to comply with domestic and international legal obligations. This often resulted in compromises once the local authorities realized that their position could have fiscal implications for the state. In the case of recalcitrant local authorities, it may even be possible to create a mechanism where the liability for such a breach of an investment obligation is taken from the regional budget.

The ACIA and other ASEAN investment agreements negotiated with Australia/New Zealand, China and Korea—also provide for ISDS mechanisms, including resort to ICSID arbitration. They encourage the regional rule of law and require governments to comply with their international obligations not to act arbitrarily against foreign investors. In fact, certain provisions promote transparency by requiring governments, among others, to publish new laws and regulations, and to clarify the applicable approval mechanism for FDI, thereby cutting the most-often cited complaint of investors in Indonesia – that the procedure for getting required approvals is not clear.

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86 Ewing-Chow and Losari, supra note 84.
89 See supra note 7.
90 ACIA, supra note 3, Articles 21, 25(c).
91 Ibid., Annex 1.
Some foreign investors and states often view the ISDS mechanism as a fair, independent, transparent and neutral mechanism to resolve their disputes. Others completely oppose such a view and claim that it is not independent and not transparent enough. Nonetheless, in a relative sense, 1) the ISDS mechanism still make the host states accountable under BITs, 2) the provisions in the BITs protect fundamental rights of investors and ensure procedural fairness, and 3) the adjudication through the ISDS involve arbitrators who are not formally connected to the parties to the dispute. This demonstrates that the ISDS mechanism can contribute to the rule of law.

It has also been argued that the ICSID mechanism does not provide a level playing field for both domestic and foreign investors because foreign investors have recourse to both the domestic court and ICSID arbitration whereas the domestic investor only can access the local courts. This is true but this is not necessarily problematic. Foreign investors have many choices about where to invest. By providing an investor with a transnational system, ICSID reduces the concerns about the legal risks. Indeed, the Executive Directors of the International Bank for Reconstruction and Development (the World Bank), in their 1965 report on the ICSID Convention stated that, while they thought that “private capital will continue to flow to countries offering a favorable climate for attractive and sound investments, even if such countries did not become parties to the Convention […] adherence to the Convention by a country would provide additional inducement and stimulate a larger flow of private international investment into its territories”.

Based on the reasons above, Indonesia should retain the ISDS mechanism, and unless it can be demonstrated that ICSID arbitration is worse than the other arbitration mechanisms, Indonesia should not denounce the ICSID Convention.

3. Improving the Management of Investment Disputes

While ISDS should be treated as a last resort, an alternative dispute resolution mechanism has been suggested to resolve investor-state disputes. However, Echandi suggests that the ‘interest-based’ dispute resolution—a mechanism that relies on the reconciliation of the different interests

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94 Jiwuna, supra note 68.
of the parties involved in a conflict—has not been used as often because of its novelty, the private-public nature of treaty-based disputes, and the lack of clarity and evolving nature of international investment law.\(^9^6\)

For this reason, he suggests for the development of investor-state conflict management, a basis for protocols for dispute avoidance. These processes aim to address the interests of the parties involved at the early stage of the conflict to eliminate or reduce the source of dissatisfaction.\(^9^7\) The governments of Korea and Peru are leaders in this area.

In Korea, the government created the Office of the Foreign Investment Ombudsman within the Korea Trade-Investment Promotion Agency. The office is independent and only accountable to the Prime Minister. It serves as a stop for foreign investors who face difficulties or find a conflict either in taxation, investment procedures and incentives, customs and tariffs, finance, labor, insurance, visa, etc.\(^9^8\)

In Peru, the government created the International Investment Disputes State Coordination and Response System. The system requires all government agencies to cooperate and coordinate on various policies they take. One of its special features is it imposes accountability on the agency which has triggered the dispute (bearing any costs of the process and award against the State).\(^9^9\) In a way, this will become a driving factor to harness more cooperation and coordination among the different agencies.

Creating this conflict management system will be useful for Indonesia to prevent a conflict turning into a dispute before investor-state arbitration tribunals. This can be beneficial for both foreign investors and the government because the problem can be resolved faster and the investors can continue their investments in the country.

4. Capacity Building and Increasing Coordination

Indonesia should also prioritize capacity building for its officials. Then the government should create a process where these officials are tasked to review each proposed government’s measure—central or regional—that may affect foreign investors, and its compliance with Indonesia’s international obligations under its IIAs—either BITs, regional investment agreements or investment chapter in FTAs, prior to the implementation of the measure. The scrutiny over the proposed measure should continue by holding public consultation with interested parties, including investors or the society who might be impacted. During this process, the government should consider the inputs and comments provided. This can effectively help to avoid disputes or at the very least prepare the government if disputes arise as a result of a necessary measure.


\(^{97}\) Ibid., 287.


Capacity building often becomes useless if the trained officials are then transferred to a completely different division. This leaves their old posts to inexperienced or untrained officials. Therefore, the government should find a way to ensure this does not happen, for example by implementing a training program prior to the transition of the trained civil servants.

Indonesian law firms also need to boost up their knowledge in this area, including by being involved in more investor-state litigations. In both Rafat Ali v. Indonesia and Churchill Mining v. Indonesia, the government used local law firms to defend them. Having these firms cooperating with experienced foreign law firms to assist in the cases can help to build up the domestic capacity.

Finally, the central and regional governments, as well as all relevant ministries should increase coordination among themselves in taking measures, especially when a measure is likely to have impacts on foreign investors. This can be done by creating an online database of various regulations that a ministry or regional government is going to implement. Then, the relevant ministry or regional government may flag this to the relevant institutions at the central level for further consultation. Where necessary, they can hold a coordination meeting to discuss the measure.

**B. Recommendations for Investors**

If the government of Indonesia decides to proceed with the termination of its old BITs, investors who have invested prior to the effective date of termination need not worry because their investments will be protected by the survival clause for the period of time specified therein.

As for new investors who make investments only after the termination of the old BITs, they can structure their corporations in order to be covered by other investment agreements to which Indonesia is a party. For example, the investors can create a company in another ASEAN country (with substantive business operations) then use the company to invest in Indonesia. Conversely, Indonesian investors investing abroad can also structure their corporations to obtain protection from ASEAN IIAs. In doing this, the investors should fulfill the requirements to be covered investors and investments. For example, a Dutch investor who wishes to invest in Indonesia may seek investment protection under the ACIA by satisfying the condition of an ASEAN Investor and ‘covered investments’.

Article 3(d) of the ACIA provides that “investor” can also mean “a juridical person of a Member State that is making, or has made an investment in the territory of any other Member State”. Article 3(e) defines “juridical person” further as “any legal entity duly constituted or otherwise organized under the applicable law of a Member State, whether for profit or otherwise, and whether privately-owned or governmentally-owned, including any enterprise, corporation, trust, partnership, joint venture, sole proprietorship, association, or organization”. Notably, Article 19(a) provides further that a Member State may deny the benefits of the Agreement to:

an investor of another Member State that is a juridical person of such other Member State and to investments of such investor if an investor of a non-Member State owns or controls the juridical person and the juridical person has no substantive business operations in the territory of such other Member State;
This means that although there is a possibility to structure the company in such a way to be considered as an ASEAN Investor, and thus benefit from the ACIA, the Dutch investor must also have substantive business operations in the territory of the other ASEAN Member State other than Indonesia.

Article 4 of the ACIA provides that ‘covered investment’ means:

… an investment of an investor of any other Member State in existence as of the date of entry into force of this Agreement or established, acquired or expanded thereafter, and has been admitted according to its laws, regulations, and national policies, and where applicable, specifically approved in writing by the competent authority of a Member State.

Annex 1 provides that the investment has to be approved in writing, and footnote 1 clarifies further the procedure for approval in writing, as well as the Member States’ obligation if they require this procedure. During this process, some Member States may request details about the investors, including the ultimate owners of the company.

V. Conclusion

Indonesia is currently at a cross-road with regard to its policy on IIAs. On the one hand, as a major market with significant natural resources, Indonesia looks at Brazil which does not have any IIAs and wonders if it still needs IIAs. Yet, Indonesia is aware that the Brazilian example does not take into account the counterfactuals. Perhaps Brazil could have received even more FDI, had it had more IIAs or as stated before, perhaps the investors would have paid a premium for their investments in Brazil.

At the same time, most policymakers in Indonesia would like to see the rule of law and better governance in the country. The recent election of Joko Widodo as the President of Indonesia is seen as a consolidation of this reform. Indonesia also realizes it has a corruption problem and appears to see both domestic and international legal reform as a way to address this problem.

Indeed, even though it receives fair amount of investments, much of them are in the extractive industry. Indonesia hopes to attract more investments of higher value added nature. The recent plan of Foxconn to invest in Indonesia was lauded by the government as a step in Indonesia’s value added industrialization. Unfortunately, Foxconn decided to postpone the commencement of its investment due to the lack of clarity in the procedures to invest. With significant human capital available in Indonesia, attracting value added investments could come to pass. However, this will only happen if a stronger rule of law is established, including transparency in the application of law as shown in Foxconn’s experience.

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At the same time, the specter of looming litigation casts a chill over Indonesia’s policies. *Churchill v. Indonesia* has shaken the confidence of some policymakers in the IIA regime. The recent case of *Newmont v. Indonesia* has added to it. ¹⁰² Few civil servants would ever like to be responsible for advising governments to sign agreements which open them up to liability. The recent decision of the tribunal in *Yukos v. Russia*,¹⁰³ awarding US$50 billion against Russia based on a treaty (the Energy Charter Treaty)—signed by not ratified by Russia—must further concern Indonesia. Therefore, we believe that a decision on these issues we have talked about in this paper should be made at the highest political level, and that the decision should be one that balances the need for capital for the development of Indonesia, the need to attract value added investment into Indonesia, the need to protect Indonesian investors who are increasingly going abroad, and the need to develop good governance domestically. Understandably, there will be a risk of litigation, but Indonesia now has the opportunity to refine its agreements to ensure more policy space.

We hope that a wise approach will be taken so that Indonesia will continue to signal its support for foreign investments and good governance by developing and negotiating IIAs which benefit both the state and foreign investors by fostering the rule of law.¹⁰⁴ This will probably be a brave political position because inevitably, litigation will occur. However, Indonesia can mitigate the potential liabilities by developing a quick response feedback mechanism in the way that some scholars have suggested.¹⁰⁵ In the end, history has shown us, if anything, that fortune favors the brave.

¹⁰² *Newmont v. Indonesia*, supra note 22.
¹⁰³ *Yukos Universal Limited (Isle of Man) v. the Russian Federation*, PCA Case No. AA 227, Final Award, 18 July 2014.