Indonesia’s Perspective on Review of International Investment Agreements

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1. Introduction
Following the contemporary discourse surrounding International Investment Agreements (IIAs), Indonesia is currently undergoing a thorough review of its 64 Bilateral Investment Treaties (BITs) as well as 5 Investment Chapters under various free trade agreements.¹ The review envisages a critical evaluation of the impact of existing IIAs on the Indonesian national economy and formulation of a new approach towards IIAs, which will be fine-tuned in favor of its interest in pursuing national development goals. Within this context, Mrs. Retno Marsudi, the Minister for Foreign Affairs of the Republic of Indonesia, specifically emphasized in her Annual Press Statement that economic diplomacy carried out by Indonesia will also aim at creating a new regime for investment agreements between Indonesia and other countries.² This policy brief tries to share the Indonesian experience in undertaking such an intention.

For this purpose, this brief will flesh out the rationales of the review. It will also explain how the review process is being undertaken and the challenges faced during the review process. The brief will also attempt to present a set of critical outlooks to some outstanding issues that appear during the review.

2. Rationales of the Review
The rationales for the review conducted by Indonesia are essentially similar to the rationales for reviews undertaken by other countries.

First, the review has been undertaken to strike a balance between investor protection and national sovereignty as indicated by Mrs. Retno Marsudi in her opening remarks at the Regional Interactive Meeting on the Development of Investment Treaty Models hosted by the Ministry of Foreign Affairs of the Republic of Indonesia, International Institute for Sustainable Development (IISD) and United Nations Conference on Trade and Development (UNCTAD).³

Second, most provisions of the existing IIA are outdated as they grant extensively broad protections and rights for foreign investors, leaving the host state with little to no policy space to implement its own development goals. Indonesia also believes that the current regime of IIAs does not grant sufficient space for sustainable development. Therefore, a general modernization is needed to update the existing outdated IIAs in order to preserve the right for states to exercise their regulatory and policy space.⁴

Third, one of Indonesia’s greatest concerns regarding IIAs is the provision on the Investor-State Dispute Settlement (ISDS), which has increased Indonesia’s exposure to investor claims in international arbitration. To Indonesia, ISDS provisions seem to be problematic and their benefits are far from clear. They also create uneven playing fields between national and foreign corporations. It is expected that the inclusion of ISDS provisions will be a highly contentious issue in the ratification process.

To date, Indonesia has been involved in at least 6 ISDS cases. In comparison to other Association of South-East Asian Nations (ASEAN) countries, Indonesia has the highest number of international arbitration cases.⁵ The decision to undertake the review was particularly encouraged by a billion-dollar lawsuit by the UK-listed Churchill Mining and a frivolous claim arising from a bail-out following the collapse of a private bank (Rafat Ali Rizvi vs. Indonesia).⁶ Due to this reason, the then-President of the Republic of Indonesia, Mr. Susilo Bambang Yudhoyono, stressed that the Government will not let those multinational companies do as they please with their international back-up and put pressure on developing countries such as Indonesia.⁷

Similarly, Jan Knoerich and Axel Berger in their seminal work Friends or Foes? Interactions Between Indonesia’s International Investment Agreements and National Investment Law held that, because the ISDS clause is being invoked by foreign investors with increased frequency, IIAs are beginning to have serious repercussions for developing countries, particularly for Indonesia.⁸

Fourth, the provisions in IIAs may potentially override national legislation. Moreover, the decisions of international arbitration may possibly supersede the decision of domestic courts. These two considerations are well-founded considering that the current IIA regime has sometimes appeared to be superior to national law, which will raise questions of the law applicable for either the investors or

* This new policy brief series focuses on investment, including international investment agreements (IIAs), and experiences of developing countries.
Indonesia’s Perspective on Review of International Investment Agreements

the Host States.9

From the aforementioned rationales of the review, it can safely be assumed that Indonesia has not lost faith in IIAs in general. Indonesia merely intends to modernize and to renegotiate its IIAs with a view to providing greater capacity to regulate in the public interest. For that purpose, excessive benefits to foreign investors that may prejudice Indonesia’s policy space need to be re-examined. The new investment regime should aim at fostering investments that do not only reap benefits for the Host State but also contribute to the overall development of that particular Host State. Such review process also includes the need to place procedural and substantive restraints on foreign investors from lodging international claims against Indonesia.

3. Steps Taken

The review process is undertaken through 3 steps, namely the discontinuation of existing IIAs, reassessing the provision of the existing IIAs and developing a new treaty model of IIA. In pursuing those steps, the Government of the Republic of Indonesia also invites academicians, international/national lawyers, non-governmental organizations, UNCTAD and experts from various countries and agencies to contribute their perspectives. Indonesia also undertakes an intensive engagement with business sectors in the process.

The first step taken by Indonesia is to discontinue its existing IIAs, which as of the date of the writing of this brief has reached 17 out of 64 IIAs.10 It is important to underline that this discontinuation process is done gradually by means of discontinuing IIAs that are due to expire according to the requirement period set in the termination clause of the IIA, or commonly known as the ripe period.11 Another option in this discontinuation process is to do so immediately if the IIA authorizes either Party to end the agreement at any time.

This gradual approach is taken in order to avoid any unwanted political implications and bilateral backlash that might potentially undermine Indonesia’s position. Indonesia believes that by ending the agreement “by-the-book” according to the provisions set in the agreement, which was of course agreed bilaterally, Indonesia need not be concerned about such backlash.

However, during the review process, there has been an emphatic call to look at this approach again. As the ripe periods of many IIAs concluded by Indonesia would be many years to come, such as the Indonesia-Russia IIA that will end in 2024, it has been suggested that Indonesia consider an earlier discontinuation. If its counterpart disapproves the proposal, Indonesia may just officially notify its intention to terminate the IIA upon the expiration of the period of validity of the IIA. Such notification can be submitted to the other party to the treaty, although the period of validity of such IIA still remains to be in place for a long time.

The second step that Indonesia has taken completely relates to the fact that the core gravity of the review is the reassessment of the existing provisions. Every single IIA is dissected to find the most problematic provisions such as the ‘scope’ and ‘definition of investment’, the ‘Most-Favored-Nation Treatment’ principle, ‘National Treatment’ principle, ‘Fair and Equitable Treatment’, ‘expropriation’ and ISDS. The reassessment is aimed at identifying problems and finding the most feasible solutions which will serve as the Government’s new position on IIAs. The assessment particularly looks into the extent to which those provisions provide protection to the investors and its impact to the policy space of the Government.

The third step is the development of a Treaty Model. The purpose of developing a model is to set up a guideline for Indonesian officials in negotiating and concluding investment treaties as had been done by India and South Africa with their respective models.12 Based on the review itself, new elements were added in the model to envisage a balance between investor protection and the state’s policy space with a view to promoting sustainable development principles. The model will also ensure consistency in treaty-making practice, although, on the other hand, it may create less flexibility in negotiations.

4. Challenges of IIA Review

Conducting an all-encompassing review of the whole IIA regime proves to be a very challenging endeavor. We have identified a number of challenges, which range from concerns about scaring off investors to the more technical challenge of how to further address the survival clause issue. The detailed explanation of each challenge are as follows:

Fear of scaring-off investors

One of the main challenges is to overcome the unjustified concern that the whole review and discontinuation process is scaring off investors. The Government of the Republic of Indonesia has taken this concern seriously. In the World Investment Forum 2014, Mr. Mahendra Siregar, Chairman of the Investment Coordinating Board of the Republic of Indonesia, assertively assured that the review process shall not compromise the legal certainty and protection of foreign investment. All foreign investment continues to enjoy the same level of protection under the Indonesian National Law on Investment.13

It is a matter of fact that the review process does not really affect the foreign investment inflows to Indonesia. In fact, 2014 was the year in which foreign direct investment to Indonesia hit a record high of 78.7 trillion US dollars, according to the latest data by the Indonesian Investment Coordinating Board (BKPM).14 The comparison with previous years can be seen in the table in the next page.

Balance between protection of investors and preserving policy space for states

The second challenge that comes to the fore is the question on whether the review and reassessment will be able to achieve the right balance between investment protection and the furtherance of public interest. To this end, we need to recognize what the real balance should look like.
In principle, it might be possible to strike the balance between the two interests. Yet, it is indeed a complicated task as the interest of investor protection and policy preservation seem to be irreconcilable.

The temptation to include broadly drafted clauses on public policy exceptions is very obvious among the policymakers. They maintain that the incorporation of a set of robust clauses that may effectively serve as important tools to safeguard public policy interest would provide additional comfort to the Government.

However, concerns were expressed about the possible abuse of such public policy clauses as they give too much power to the state. Business sectors may perceive that the existence of such clauses will potentially defeat the purpose of concluding IIA as an instrument in attracting higher amounts of foreign investment.

Nevertheless, this concern has also been questioned on the basis of two strands of arguments. First, the assumption that IIA will increase foreign direct investment inflow in many countries, including in Indonesia, is empirically disputed. Therefore, the existence of such clauses should not correlate with foreign direct investment. Second, the public policy clauses may be formulated in such a way to prevent their arbitrary invocation. Then, the real challenge would be how to draft such clauses in setting out legitimate regulations of the activities of the foreign investors without permitting unreasonable or unjustified treatment.

**Investment chapters under Free Trade Agreements (FTAs) or Economic Partnership Agreements (EPAs)**

Another challenge is the problem of investment chapters under FTAs or EPAs. Given the legal nature of investment chapters, they are essentially IIAs; they should be therefore subject to the review process. Nonetheless, the review process of the investment chapters could not be conducted in the same manner as in the case of bilateral IIAs. As the FTAs or EPAs consist of various chapters, which are integrated into a single undertaking instrument, a specific discontinuation of the investment chapter is not legally possible unless it is done altogether with all chapters of those FTAs or EPAs. Article 44 (1) of the Vienna Convention on the Law of Treaties clearly provides that a right of a state to denounce or withdraw from a treaty may be exercised only with respect to the whole treaty unless the treaty provides or the Parties otherwise agree.

It is true that all chapters of FTAs or EPAs can be technically terminated altogether in accordance with their termination clauses. The problem does not, however, lie in the technical context. Discontinuing the whole chapters of FTAs or EPAs will certainly require much more extensive consideration of wider bilateral relations as it may lead to more complicated implications. Consequently, so far, not much can be done with respect to investment chapters of FTAs or EPAs.

The lesson we can learn from this challenge is that the issue of terminating FTAs or EPAs should be wisely dealt with during negotiations. It is recommended that FTAs or EPAs include a clause allowing partial termination of a chapter, particularly the investment chapter.

**Survival clause**

One of the most interesting notion in reviewing and discontinuing IIAs is that the IIA will not necessarily cease to have any effect to the existing investments even after they have been discontinued, due to a provision...
Indonesia’s Perspective on Review of International Investment Agreements

commonly known as the ‘survival clause’. This clause allows foreign investors, who have had their investments made or acquired prior to the date of termination, to enjoy prolonged protection for a certain amount of time (usually 10 – 15 years) even after the treaty has been terminated.

The clause has posed substantial challenge during the review process. It means that all possible legal risk posed by the discontinued IIAs will remain intact despite the fact that the treaty is not in force anymore. Thus, the question of the survival clause needs to be assessed and revised with a view to shortening the time period of such a clause. Also, particular consideration on different survival clause durations for different sectors of investment needs to be taken.

**Challenge of drafting a treaty model**

The review process envisages development of an IIA model which will serve as a basis for future IIAs negotiations. The model will provide clearer guidelines in order to maintain coherence between IIAs. According to Jonathan Bonnitcha, the existence of a treaty model will substantially diminish the number of inconsistencies between existing IIAs.15 That being said, once a treaty model is in place, it will provide Indonesia with a strong and consolidated initial negotiating text that will prove useful in future negotiations.

Apart from the obvious advantages of having such treaty model at our disposal, there are also a couple of potential disadvantages to this process. Firstly, due to the vast amount of stakeholders involved in drafting the model, a model will take a long time to develop. Secondly, by having a basic text, we are somehow reducing our flexibility in negotiations. Different counterparts will require different elements in their intended IIAs and a treaty model will somehow limit their options, which will arguably hamper or slow down the negotiation to a certain degree. Hence, the ultimate challenge is not that of developing a well-drafted treaty model, but how to actually defend the text in negotiation.

In addressing this challenge, Indonesia is now considering developing a set of basic elements of a position that would be translated by an illustrative model treaty. Therefore, the illustrative model treaty in one way or another can be modified during negotiation, bearing in mind that some fundamental principles shall be strictly upheld and are off-limits to any kind of compromise.

5. **Most Outstanding Issues**

The review process undertaken by Indonesia has addressed almost all common provisions included in IIAs. Yet, the most outstanding issue in the review process is the ISDS. In spite of this, excluding ISDS provisions altogether might not be a wise approach. Therefore, Indonesia considers limiting the scope of application of the ISDS provision. The limitation would be substantive and procedural in nature.

**Substantive limitations**

The definition of investment is very essential as it will determine the scope of the protection rendered under the IIA. A narrower definition of investment will also narrow down the possible number of cases brought via the ISDS mechanism. Therefore, the review has led Indonesia to reform its position into a more limiting definition (a combination between an asset-based and enterprise-based approach which targets particular investments). Portfolio investment is certainly excluded from the definition. The “Salini Test” characteristic of investment has been considered to be part of the definition. By doing so, not all investments may enjoy benefits under an IIA unless such investments also contribute to national development of the host state.16

Furthermore, the current scope of the National Treatment (NT) clause also needs to be reduced. The NT clause in existing IIAs by Indonesia extends to the pre-establishment phase. Therefore, the clause will apply not only to investors who are already operating in Indonesia (post-establishment treatment) but also potential investors seeking to make investments. This kind of NT clause creates the so-called pre-establishment right (right to establishment). It gives potential foreign investors the right to enter Indonesia and make investments in any sector on the same terms applicable to domestic investors.17 The clause provides both protection and liberalization undertaking. Having said that, the review process suggests that the NT clause should only cover the post – establishment phase. It is also suggested that liberalization is better regulated through national law and not through investment treaties. This new approach to the NT clause also considers excluding special treatment in favor of domestic small/medium enterprises, measures affecting certain sectors related to development needs, particularly natural resources and sectors which possess close ties to national security.

Likewise, restricting the scope of Most-Favored-Nation (MFN) clause is also necessary for limiting the possible application of ISDS. The MFN clause in existing IIAs to which Indonesia is party seems to be too broad, as it potentially allows a foreign investor to invoke provisions of any treaty other than the one concluded between the Home State of the investor and Indonesia. This classic principle has been substantially modified to fit Indonesia’s current stance on IIAs. Some of the important exclusions incorporated in the new MFN clause are, namely:

- pre-establishment measures;
- any existing or future regional FTAs and EPAs;
- existing and future IIAs;
- ISDS provisions; and
- any preferential system for any least-developed countries.

The inclusion of the clause on Fair and Equitable Treatment (FET) has brought about a high degree of unpredictability, particularly with respect to ISDS. In that regard,
the FET clause has been numerous and successfully used by investors as a basis of their claim against states. The FET clause was initially introduced to provide a just and equal treatment to foreign investors as if they were domestic investors. However, due to its over-extensive application, there has been a number of uncertainties and legal risks associated with FET. One of the most worrying concerns is the tendency for arbitral tribunals to interpret FET broadly in favor of foreign investors, particularly with respect to the notion of “legitimate expectation”.

The review process undertaken by Indonesia found that a vague and broad wording of the FET obligation carries risk of overreach in the application of the principle. This has led Indonesia to craft a new provision to replace FET, namely Standard Treatment, which simply shifts the focus from investor rights to protection from denial of justice. In this newly formulated provision, assurances were made regarding the fact that investors shall not be subjected to denial of justice in criminal, civil or administrative proceedings. To augment this treatment, Indonesia also provides police protection from any physical harm to the investors and/or investment.

As far as expropriation is concerned, Indonesia still maintains the clause of expropriation. In that regard, a distinction is made between direct expropriation, and indirect expropriation, which is entirely excluded.

Direct expropriation shall only be made for the purpose of public interest and carried out with due process of law and followed by prompt and adequate compensation. Yet, the issue of indirect expropriation seems to be very problematic as investors may have the liberty to assume that any regulatory action taken by the Host State that diminishes the economic value of an investment is a form of expropriation.

Such an approach potentially reduces the Host State’s authority and policy space to implement development-oriented measures and/or policies. Within its new approach to IIAs, Indonesia plans to exclude in whole the provision on indirect expropriation. This also means that any measures that have effect or consequences that amount to expropriation shall be excluded from the clause of direct expropriation. This is done to preserve a greater degree of regulatory space for Indonesia to pursue its development goals without facing legal risk of challenges through the ISDS mechanism.

**Procedural limitation**

Imposing procedural limitations is a useful way to minimize legal risk of ISDS. In most IIAs, the Host States have already given their consent that an investor may bring any dispute against the Host State to international arbitration without requiring further consent from the Host State. It is also the case in Indonesia’s IIAs. This approach has become a grave concern for Indonesia as it will pose great legal risk to the country. As a solution to this legal risk, Indonesia considers introducing separate consent requirement before an investor could bring a matter to international arbitration. Therefore, an investor may bring a case to international arbitration if the investor and the Host State have expressed their consent to settle the case through the arbitration. A special agreement to settle a dispute through international arbitration would be required on a case per case basis. This approach would be expected to cut down the number of ISDS claims in international arbitration. At the same time, it will also promote settlement of investor – State disputes through the domestic courts or alternative dispute resolutions.

### 6. Conclusion

Indonesia’s review of its IIAs was mainly triggered by the increased exposure to investor claims in international arbitration. The review itself has been manifested in several steps such as IIA discontinuation, reassessment of existing provisions and the development of a new IIA model. The effort has met several challenges, including on whether the review will scare off investors, how to strike the balance between protection to investors and policy space preservation, problems of investment chapters in FTAs or EPAs, survival clauses and the development of a new model of IIA. The review process focuses on how to limit the scope of application of ISDS provisions. In light of this, substantive and procedural limitations are envisaged. As far as the substantive limitations are concerned, there are at least five pertinent issues related to the definition of investment, national treatment, MFN, FET and indirect expropriation. For procedural limitations, the new IIAs by Indonesia will require a special agreement between the investor and Indonesia for bringing a case to international arbitration. This review is a dynamic process and not a one-off event. Constructive input and suggestions from every stakeholder, including business sectors, and in-depth analysis are still highly needed to further fine-tune Indonesia’s new approach which will be crystallized in the new treaty model.

### End notes:

1. Indonesia-Japan Economic Partnership Agreement, ASEAN-Australia-New Zealand Free Trade Agreement, ASEAN-China Agreement on Investment, ASEAN-Korea Free Trade Agreement and ASEAN Comprehensive Investment Agreement.
Indonesia’s Perspective on Review of International Investment Agreements

2 Indonesia has the highest number of ISDS cases among ASEAN member states, which amount to six cases to date. The Philippines comes in second place among ASEAN member states with three recorded cases. See http://www.italaw.com/search/site/indonesia?f[0]=im_field_case_type%3A1090 and http://www.italaw.com/search/site/philippines?f[0]=im_field_case_type%3A1090.
3 In the Rafat Ali Rizvi v. Indonesia case, the issue of frivolous claim came to surface. The claim which rose under the Indonesia-UK IIA made by the investor was deemed frivolous, or not having legal merit, by the International Centre for Settlement of Investment Disputes (ICSID) Panel.
6 Ibid, page 78.
7 So far Indonesia has discontinued BITs with the Netherlands, Bulgaria, Italy, Malaysia, Slovakia, Spain, Kyrgyzstan, China, Laos, France, Egypt, Hungary, Cambodia, Norway, Romania, Turkey, Vietnam.
8 Ripe period refers to the period in which the IIA is eligible to be discontinued/terminated. One example is Article XIII(2) of the Indonesia-Chile IIA: This agreement shall remain in force for a period of ten years. Thereafter it shall remain in force indefinitely unless one of the Contracting Parties gives one year’s written notice of termination through diplomatic channels. From this provision it is clear that the ‘ripe period’ is in effect after 10 years.
15 FET is the most frequently invoked clause in investment disputes. According to UNCTAD, in 2013, of the seven decisions finding states liable, five decisions found a violation of the FET provision. At least five decisions rendered in 2013 awarded compensation to the investor, including an award of USD 935 million plus interest, the second highest known award in history. See United Nations Conference on Trade and Development, “Recent Developments in Investor-State Dispute Settlement”, IIA Issues Note No. 1, April 2014, Page 10, available at http://unctad.org/en/publicationslibrary/webdiaepcb2014_d3_en.pdf.
17 Indirect expropriation in principle is measures that a state takes to regulate economic activities within its territory, even where such regulation is not directly targeted at an investment. In this case, the legal title to the investment is not affected. See Suzy H. Nikiema, “Best Practices, Indirect Expropriation”, IISD Best Practices Series, March 2012, page 1. Available at http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf.
18 One example of this automatic consent can be found in Article VIII(2) of the Indonesia–Cambodia BIT: If such a dispute cannot be settled within a period of six months from the date of a written notification either party requested amicable settlement, the dispute shall, at the request of the investor concerned, be submitted either to the judicial procedures provided by the Contracting Party concerned or to international arbitration or conciliation.