Creating A Balance in Bilateral Investment Treaty: A Perspective from Indonesia

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Abstract
The previous movement of Government of Indonesia (GOI) to terminate its expiring Bilateral Investment Treaties (BITs) with many countries does not mean like the end point of rigorous policy. It then leaves a question mark about the legal standing after the concession and how the government establishes a new model to create a balance in BIT. This research is conducted to, firstly, analyze the legal position of government and foreign investor in a terminated BIT. Furthermore, it will discuss how the government can take benefit through learning experience from the previous mistakes in old BITs and the latest development in international investment law. Finally, this study focuses how a balance on BIT can be achieved for both host state and foreign investor. The result of this study shows that the government did not breach any international law procedure in particular by fathoming Vienna Convention on the Law and Treaties and protection for the investor is not diminish immediately due to the existence of survival clause. Further investigation identifies that to obtain a greater benefit following the termination, GOI should develop better balanced provisions in its next BIT model. This effort can be done by taking care of principle of extraterritorial obligation, full protection and security clause, indirect expropriation, and regulatory measure clause, and most importantly how to deal with dispute settlement.

INTRODUCTION

Indonesia, the 4th largest population country in the world, plays an essential role in the world of international economy. Not only because its huge numbers of people, but also this country has an enormous diversity of natural sources. In fact, the precious of spices attracted many foreign people to come and to do business since 17th century in this archipelago nation. As Bilateral Investment Treaty (BIT) become a common practice after the second world war, Indonesia also took part in this framework (Miles, 2013). Indonesia enacted its foreign direct investment law with Law No. 1 in 1967 to embody investment regulation following the flourishing of investment activities throughout the world. One year later, Indonesia made its first BIT with Netherland which is its former colonizer. Accordingly, several BITs had concluded as well within one decade with Germany (1968), Belgium (1970), France (1973), Switzerland (1974) and United Kingdom (1976) (“Indonesia Sudah Menghentikan 18 BITs ,” 2015).

In 2016, the time that many BITs have been terminated, Indonesia moved from ranking 14 in 2014 to position number 9 in 2016 on the prospective host economies for 2016-2018 (UNCTAD, 2016). This figure has made Indonesia to be the number 1 in Southeast Asia region,
just to delineate how crucial Indonesia in the international investment arena. In a real inflow statistic, Indonesia was at number 6 with $16 billion in regional Asia whereby made Indonesia also the second in Southeast Asia after Singapore (UNCTAD, 2016). Indonesia top ten investors are coming from diverse countries and continents around the world, including Asia, Europe, UK, and the USA. Meanwhile, in outflows figure, Indonesia was at 10 with $ 6 billion whereby position number 4 in Southeast Asia after Singapore, Malaysia, and Thailand. These bunch data in investment world activity inevitably delivered Indonesia as one of the significant players in international trade and investment in 2016. Subsequently, it made Indonesia policies in this area adequately impart effects on other countries and businesses.

In March 2014, Indonesia drew attention to the world after announced its intention to terminate more than 60 BITs (Ruff & Golsong, 2014). This announcement comes alongside with the controversy plan to end BIT with The Netherlands which will be expiring on 1 July 2015. This BIT already lasts for 20 years after the agreement had signed into force in 1995 due to the replacement of previous first BIT in 1968. However, in practice, the first BIT that terminated since the project began, was with Egypt in November 2014. The controversial plan testified in 2015, whereby Indonesia ended 8 BITs including the big player countries like China, France, Italy and The Netherlands. Next year after that, other 10 BITs also had been terminated in 2016 which BITs with India, Singapore, and Switzerland were amongst the lists. In total, since 2014, Indonesia already closed 19 BITs with its other trade nation partners (“HR Standard and Investor Liability in the New Model of Indonesian BITs,” 2015).

Government of Indonesia (GOI) has the explanation for the reasons to terminate many BITs as previously described (“What Is Going on with Indonesia’s Bilateral Investment Treaties?,” 2016). First, Indonesia has a different position and interest today compared to the time where the BIT agreements have signed. Furthermore, the provisions itself are not relevant anymore and thus, need to be altered to adjust current perspective. Second, many regulations in the BITs reduced the ability of Government of Indonesia (GOI) to protect its national interest regarding critical issues such as environmental and domestic economy protection. Finally, the Investor-State Dispute Settlement (ISDS) has been used unfairly whereby International Lawyers were encouraging investors to pull GOI into International Centre for Settlement Investment Dispute (ICSID). Subsequently, investors preferred to push the dispute to ICSID scheme rather than using Court Justice within Indonesia and investor home state. In addition to above arguments, it is also clear that the development of international investment law has awaken the contracting parties of BITs. It is found lately that their provisions on BITs created many unclear, inadequate, and controversial rules such as Fair and Equitable Treatment (FET), Full Protection and Security (FPS), expropriation, and sunset clauses. Those lacking rules trigger the emergence of many disputes between foreign investor and host states, including Indonesia.

Nowadays, several questions remained, was this termination allowed in international law. Will it give a bad instead of good impact? What happens next with Indonesian BIT. Can a new model BIT provide a balance between host state and foreign investor? These issues will be elaborated within this paper by using the approach of juridical normative study. The main data on this study is collected from several BITs that have been terminated by Indonesia. In addition, regulation in international law, be it customary international law, Vienna convention on the law of treaties and other international investment agreements such as TPP, CETA and NAFTA are also utilized as research materials. To assist in finding the conclusion of the study, this research paper is arranged into two major parts. The first part will discuss the consequences of Termination of BITs by Indonesia from its legal and impact aspect. It will analyze the legal standing of the government as a host state and investor rights in their investment. Afterward, the evidence of impact resulted from the termination will be provided by examining the
potential benefits that Indonesia can be spotting and compare it with the negative impact on the process. The second part will deliver a deeper analysis on what was wrong with BITs in Indonesia, so they needed to be terminated. It will explore and examine important provision that affects the sovereignty of the state and the space for a regulatory measure. Finally, this paper would attempt to offer some recommendations for Indonesia new BIT Model to construct a better provision regarding finding a balance between national interest and investor protection.

RESULT AND DISCUSSION

The Legal and Impact Aspect of BIT Termination by Indonesia

Regarding GOI massive termination of BITs, there are some consequences that The GOI will encounter. It can be assumed that there will be some political or legal impacts because the nature of BIT is a strong commitment between two countries since the first discussion until the execution stage. From the perspective of international investment regulation, it is recommended to respect the protection of investment despite the BITs have been terminated (Peinhardt & Wellhausen, 2016). In International Law context, the principle of *Pacta Sunt Servanda* stipulated a contract or an agreement between two or more sides should be respected as a law for the contracting parties (Dixon, McCorquodale, & Williams, 2016). Despite there ought to be some political effect after the process of termination, this research is merely focusing on the legal aspect to analyze if there is a contractual breach or unlawful activity behind the termination. There are several recognized regulations to methodize Foreign Direct Investment such as OECD Guideline for Multinational Enterprises, World Bank Guideline on the Treatment of Foreign Direct Investment, and Vienna Convention on the law and treaties. The framework of bilateral investment agreement termination is not sufficiently regulated but to be found only at Vienna Convention.

Based on Vienna Convention, cessation of a bilateral treaty is possible and allowed (United Nations, 2005). Furthermore, in Article 59 of this Convention stated that a treaty could be terminated by two ways. It can be with the confirmation of the treaty itself or at any time as long as both countries agree. In the case of GOI termination act, these two elements are fulfilled due to BIT clause on termination. For example, in a BIT with Netherland, there is a termination clause in Article 15 that stated the treaty would be automatically renewed for another ten years if there is no notification to not extend prior one year before agreement expiry date. This provision explicitly conveyed about termination conformity procedure (element 1). Accordingly, the second element can be found implicitly in the “agreement” of both sides to complete the treaty if one contracting party send a notice prior one year to the expiry date. With this understanding, GOI action to terminate its BITs is legally accurate due to Vienna Convention regulation and the provision of BIT itself. Thereby, there are no legal breach and legal consequences that GOI will encounter following its act to complete BITs with many countries.

It is also a major concern toward investor’s rights after the completion of BIT as Investor is used to legally protected by a treaty for the concern of risk in foreign investment (Sornarajah, 2021). A BIT is deemed as a device or mechanism to attract inward investment of investor by offering host state’s commitment in accordance with property rights (Rose-Ackerman & Tobin, 2005). Moreover, BIT sets to define the minimum standard of behavior towards the investor to reduce the risk of expropriation or regulatory measure (Kerner, 2009). Furthermore, the nature purpose of BIT is undeniably to ensure adequate or, in some occasions, full protection for the investment of investor. In many BITs, investment protection clauses such as Most Favoured Nation (MFN), National Treatment (NT), Indirect Expropriation (IE), Full Protection and Security (FPS), sunset/survival clause or even, umbrella clause become an
international standard and widely adopted by many countries to govern their BIT. Concerning the termination of BITs regards to investment, there is a clause that called as Sunset/ Survival Clause. This provision, which evolved from Customary International Law, allows protecting the investment of investor notwithstanding the BIT which invokes the clause is no longer survive (Trakman & Ranieri, 2013). That is why this clause called as survival clause due to the term of its existence to protect the investor from the feasibility of harm effect after the termination. This provision is standard in many BITs, including in Indonesia BITs. For example, the BIT between Indonesia and China in Article 13 gives Investor protection for the next ten years after BITs termination. Moreover, the provision in Article 13 clearly conveyed that in respect to the previous agreement, all the provisions are still in force (from article 1-12) until the next ten years after the date of termination. By that, investor rights exist to perform its investment in Indonesia and GOI has no obligation to deprive investor right during the time of survival clause.

As stated previously, the reason of Indonesia to terminate its BIT is in general to establish new legal standing in the state-investor relationship. There are different interest and perspective today compared to several decades ago in term of investment activity in Indonesia. In the past, Indonesia’s policies on foreign direct investment were influenced by the corrupt regime and the need for elevating economy from hazardous crisis. These two factors made Indonesia’s position in BIT became weak, and thus, many provisions in BITs inflict a financial loss and more vulnerable position in making policy. For instance, in the extractive industry with several foreign enterprises, Indonesia share in profit was relatively tiny, and in decades, the GOI was unable to change that. Nowadays, with the better condition in economy and politic, GOI demanded a better position to fix the legal concept of making BIT with other countries by terminated all BITs and create a new model BIT at the same time. It is also bolstered by the recent development in International Investment Law whereby protection of investment activity for both host state and investor becomes equal rather solely outweighs investor as happened in the previous decades due to the consequences of Race-to-the-bottom phenomenon (Miles, 2013).

However, the action to end BITs to re-construct the regulation has faced some obstacles. Previous case in water source management in Jakarta, the capital city of Indonesia, showed that the end of BIT was not effective in the short-term due to overlapping and confrontation of regulation. The case started with the prosecution to revoke Law Number 07/2004 regard to the privatization of water management related to a contract that has been made with foreign investor (“Indonesia Sudah Menghentikan 18 BITs ,” 2015). Eventually, the constitutional court in Indonesia made decision to cancel the regulation and ordered the water management to be restored to Local Government of Jakarta. In response to the award of the court of constitutional, the local government unwilling to perform due to its contract with a foreign investor. To terminate the contract with the investor will mean the local government can be sued to arbitration tribunal by investor related to the contractual breach. With the provision of survival clause, the investor still has strong position even though the BIT already collapsed. Tribunal decision on this matter showed from several cases, where the tribunal agreed on many occasions that the domestic law is not the valid reason for a breach of international investment agreement. Therefore, in the short term, around 10-20 years, the termination of BITs will not help to fix the vulnerable position of GOI to regulate in its territory against the power of investor. In this period, ironically, the decision of the highest court in GOI is helpless against expired BITs.

Meanwhile, In the long term, especially after the end of survival clause and new model BIT is successfully implemented, Indonesia is believed to take the real benefit of it. All BITs produce the potential to establish a good balance between the protection of national interest
and the obligation to protect the investment of the investor. Thereby, the greater purpose of Foreign Direct Investment (FDI) to bring substantial benefit for both developing country and the world economy will triumph through the expansion of international trade (Dolzer & Schreuer, 2012). At the time when host state can increase the level of its capital and economic growth, the investor may also obtain benefits such as lower cost in the production and further profit by expanding the business into new market (Miles, 2013). However, it should be noted that the empirical statistic of the impact of foreign direct investment is, unfortunately, inconsistent because researchers have different result due to method’s disparity (Yackee, 2010).

The BIT Regime in Indonesia: Before and After Termination

In general, we understand that as an instrument of agreement between parties, BIT must provide a balance between both sides’ interest. In the past, the protection of investment was fruitful and seemed override the right of host states in certain extent. Investors have enjoyed many protections for their investment in a state including, but not limited to, non-discrimination, non-expropriation, FET, FPS, survival clauses. While host states provided that protection and could be held liable if a breach occurs, they had arguably limited space to enforce their rights.

The rough idea how previous BITs can bring harm effect to Indonesia is the way BIT’s regulation made state has limited power to regulate and protect its national interest. This assumption evokes because every change in state policy that may damage the enjoy on investment will be considered as a deprivation of investor right. For instance, the introducing of new law number 04 of 2009 on Mineral and Coal Mining to maximize the local content in mineral and coal mining in Indonesia became an object for violation of BIT brought by investor called Nusa Tenggara (“Investment Dispute Settlement: Nusa Tenggara v. Indonesia,” 2014). The case pointed out that, according to Nusa Tenggara as a claimant, the ban of the mineral export is not in line with the contract both between GOI-Newmont Nusa Tenggara and GOI-The Netherlands. Meanwhile, GOI stubbornly has taken this policy to improve the local processing facilities and increase the value-added revenue on mineral activity in Indonesian soil. The case delineates that the right of investor is extremely superior to bring an action against a state, while a state has no right to do the equal thing. In fact, the government receives a restriction to develop its policy.

The new model BIT that GOI will imply in the future should take concern of the legal standing of the state. GOI, as a state, must have a guarantee to freely regulate new policy without being sued of harming the investor rights. There must be a balance between the freedom of GOI to develop its policies and the rights of an investor to enjoy its investment. In addition to this, the new model BIT should have what called as “Principle Extraterritorial Obligation” (“HR Standard and Investor Liability in the New Model of Indonesian BITs,” 2015). This principle basically encourages the investor to have liability in the home country. Subsequently, it gives a chance for the state to sue investor if the activity of investor brings or have the potential to inflict a loss on the country. Since there is no chance for GOI to neglect the ICSID mechanism because Indonesia is the member of ICSID Convention, the right of GOI to be able to sue investor in a provision of a treaty is even more crucial. This right allows the balance status between GOI and investor, thus can actualize the same benefit for both sides. Although using ICSID mechanism as a dispute settlement in Indonesia BITs became a must, GOI, however, needs to push amicable negotiation and the national court at the first place. This provision is in line with World Bank Guideline on the Treatment of FDI regulation which can be found in Part V about Settlement. It said that there are three ways to deal with settling disputes; amicable negotiation, ad-hoc or institutional arbitral and through ICSID. In
Indonesia case, the use of ICSID mechanism has to be as minimum as possible, and only as the last effort. Moreover, amicable negotiation and the use of national court needs to be the first and the primary option in the way to settle the dispute.

What was wrong with Indonesia’s previous BITs is the proportion to use amicable negotiation and national court is ponderable less than the use of ICSID mechanism. For example, the BIT with The Netherland which found at Article 9 stated that the dispute would be settled “if possible’ with amicable negotiation (Investment Policy Hub UNCTAD, n.d.). The word “if possible” in law terminology is less encouraging and shows that there is little willingness to strive seriously. In the same article, the measure to use arbitration tribunal is even higher and implicitly stated as the main dispute settlement. BIT between Indonesia and The UK was even worst where in Article 7 on dispute settlement only regulate to settle the conflict through ICSID (UNCTAD, n.d.-b). A dispute settlement through international arbitration, particularly ICSID usually only bring one winner, spread negative image and of course there is a cost (Reed, Paulsson, & Blackaby, 2011). The use of more amicable settlement is not only preventing both sides from a loss but also produce a conducive atmosphere for both contracting parties and countries as well.

GOI must notice the implication of Full Protection and Security Clause as it is possibly become one of dispute object. The term of “full protection” has the potential to be ambiguous and vague understanding that investor can interpret it in a different way. Taking an example of a case involving AMPAL-American Israel Corps against Egypt. The ICSID Tribunal accept the claimant argumentation using “Full Protection and Security” clause. Subsequently, it delivers bigger pressure to state as ICSID decided that the fight against terrorism is one of state duty to protect an investment and the BITs become an insurance policy for combating terrorism (Howse, 2017). The absolute Full Protection and Security should be avoided in the future whereby it is a dangerous clause in the perspective of state protection like Indonesia has with The UK in Article 3 of BIT (UNCTAD, n.d.-b). The article indicated that investor should enjoy full protection and security whereby state must ensure the management, maintenance, and use of investor in its investment.

In inserting protection and security clause, there are two safe ways. First, by modifying the word of 'full' into 'adequate'. Indonesia already has this kind of clause from its previous BIT with China in Article 2 with the use of “adequate protection and security” phrase (UNCTAD, n.d.-a). The last way to regulate full protection and security clause is with an additional annotation. It usually appears as “for greater certainty, ….” phrase to give some limitation on a provision. India adopted this technique in its recent BIT model of 2015 in article 3 on Treatment of Investment (UNCTAD, 2015).

Other essential things to be added in the next model of Indonesia’s BITs are several fundamental issues that never include in previous BITs which are:

1) Provision for creating good corporate governance

This including provision about the principle of good corporate governance, both state-investor obligations in fighting corruption, corporate social responsibility, and accountability of investor. These requirements ensure the investment project will not bring any damage to the country such as scandal or fraud (Enron, Parmalat, Worldcom, etc.). There might be a debate whether this specific kind of provisions should be included in BIT or not since the nature of BIT is more like a general agreement between two countries. The contra side would illustrate how recent Corporate Social Responsibility (CSR) framework already regulated the obligation of enterprises to promote sustainability business development such as from the EU Commission Strategy 2011, OECD Guideline for Multinational Enterprises, and United Nation
Guiding Principle on Business and Human Rights. In contrast, it could be argued that while the application of those CSR regulation remains voluntary, it is insufficient to grant the protection of social and corporate responsibility conducted by enterprises ("Open-Ended Intergovernmental Working Group on Transnational Corporations and Other Business Enterprises with Respect to Human Rights," 2014). Therefore, the necessity to writing the language of corporate sustainable development in BIT is still essential to guarantee the protection from malicious or mismanage investment activity.

2) A minimum standard for the protection of human rights, labor, and environment

A good example for this is from USA BIT Model 2012 in Article 12 (Investment and Environment) Article 13 (Investment and Labor) and BIT USA-Rwanda in Article 13 (Investment and Labor); and

3. A guarantee of health, public moral, and security protection

BIT between China and Canada already has this provision in Article 15 on Health, Safety, and Environmental Measures.

Concerning point number (2) and (3) above, it should be noticed that the designated provisions must be aligned with other primary clauses such as Indirect Expropriation and Regulatory Measure. There ought to be an evident language in the BIT to the nexus between those terms connect each other. In simple words, how far is the regulatory measure taken by the government to protect environment, health, and safety can be tolerated from the judgment and cause of indirect expropriation allegation. Drafting these provisions carefully is extremely fundamental to avoid a broader interpretation that can be used by international arbitration should the dispute arise.

CONCLUSION

The Government of Indonesia (GOI) felt that many provisions in previous BITs have placed a weak position for GOI so investors could quickly push GOI into International Centre for Settlement Investment Dispute (ICSID). Therefore, the GOI cancelled to renew or let its BITs with other countries expired started since 2014. GOI action in terminated its BITs is legally accurate due to Vienna Convention regulation and the provision of BIT itself. However, the presence of survival clause in many BITs has allowed the protection on the investment of investor notwithstanding the BIT itself is no longer in-forced. In the short term, around 10-20 years, the termination of BITs seems ineffective. Nevertheless, In the long term, especially after the end of survival clause and final new model BIT is successfully drafted, there is a chance to invoke a splendid balance between the protection of national interest and the obligation to protect the investment of the investor. Lesson learned from previous experiences has taught us that GOI, as a state, must have a guarantee to freely regulate new policy without being sued of harming the investor rights. Therefore, new model BIT should have ‘principle extraterritorial obligation’ which encourages the investors to have liability in the home country. New model BIT must incorporate few essential provisions including amicable solution in dispute settlement and encouraging the use of domestic court in the first place. GOI should also pay attention to the implication of Full Protection and Security Clause, Provision for creating good corporate governance, a minimum standard for the protection of human rights, labor, and environment and a guarantee of health, public moral, and security protection.

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