

# THE URGENCY OF INTERNATIONAL INVESTMENT AGREEMENTS (IIA) AND INVESTOR-STATE DISPUTE SETTLEMENT (ISDS) FOR INDONESIA

Sefriani

Faculty of Law, Universitas Islam Indonesia, Yogyakarta - Indonesia

E-mail: sefriani@uii.ac.id

## Abstract

*In recent years, there has been an increasing number of claims through investor state dispute settlement (ISDS) proposed by foreign investors to the host states. This has prompted some states review their international investment agreements (IIA) and their ISDS clauses. Indonesia has terminated many of its Bilateral Investment Treaties (BIT) as well. The problem will discuss are the urgency of IIA and ISDS for Indonesia, and what kind of IIA and ISDS format that Indonesia should make to balance the state's and foreign investor's interest. The analysis results conclude that the existence of IIA and ISDS remains urgent for Indonesia, but it takes changes in terms of format like the new models made by many other host states. They involve redefinition of multi-interpretative terms and the exhaustion of local remedies. In addition, the non-automatic and mutual agreement ISDS arbitration which excludes the MFN clause should also provide the state's flexibility to protect the people's prosperity through non-discriminating regulations.*

*Keywords: international investment agreement; investor-state investment dispute; foreign investment*

## Abstrak

Beberapa tahun belakangan ini terjadi lonjakan gugatan di forum investor state dispute settlement (ISDS) yang diajukan investor asing kepada host state. Hal ini memicu banyak negara meninjau ulang perjanjian investasi internasional (PII)-nya berikut klausul ISDS-nya. Indonesiapun melakukan pengakhiran banyak Bilateral investment Treaty-nya. Rumusan masalah adalah Bagaimana urgensi PII dan ISDS bagi Indonesia? Format PII dan ISDS seperti apakah yang seharusnya dibuat Indonesia untuk menjaga keseimbangan perlindungan kepentingan negara dengan kepentingan investor asing? Hasil Analisa menyimpulkan bahwa Keberadaan PII dan ISDS tetap urgen bagi Indonesia, namun dengan perubahan format yang dapat merujuk model baru yang dibuat banyak host state lain seperti pendefinisi-an ulang istilah yang multi tafsir, kewajiban exhaustion of local remedies; Penunjukan arbitrase ISDS dengan kesepakatan Bersama, tidak memasukkan klausul MFN, juga memberikan fleksibilitas negara untuk melindungi kesejahteraan masyarakatnya melalui peraturan yang tidak diskriminatif.

Kata kunci: perjanjian investasi internasional, investor-state investment dispute, investasi asing

## Introduction

During 2011-2016, the number of claims through Investor State Dispute Settlement (ISDS) mechanism encountered by Indonesian government increased. It can be seen in the table year 1920-2009 (19 years) there were only 6 cases whereas during 2011-2016 (5 years) 5 cases were found. Several recorded cases were Ravat Ali Rizvi case, Churchill Mining and Planet Mining case, Newmont Nusantara BV case, Indian Metals and Ferro Alloys Ltd (IMFA) case, and Oleovest Pte. Ltd case.

**Table 1.** The cases investigated through the Investor State Dispute Settlement (ISDS)

Year	International Arbitration Cases
1990	Amco Asia Corporation v RI
1999	Himpurna California Energy Ltd. V PT. PLN
1999	Patuha Prower Ltd. V. PT. PLN
2000	Karaha Bodas LLC v. PT. Pertamina and PT. PLN
2007	Cemex Asia Holding Ltd. V RI
2009	PT. Newmont Nusa Tenggara v RI
2009	Pemprov Kaltim v PT. Kaltim Pri-ma Coal

2011	Rafat Ali Rizvi v RI
2011	Hesham Talaat M. Al-Warraq v RI
2012	Churchill Mining and Planet Mi-ning Pty Ltd. V RI
2015	Indian Metals and Ferro Alloys Ltd. (IMFA) v RI
2016	Oleovest Ltd. V RI

It only happens in Indonesia. Generally, there is increasing number of claims toward the host states through ISDS mechanism.<sup>1</sup> The claims value is bombastic and the claim material is a state policy to protect public basic principles which creates a suggestion for Indonesia government to disagree the ISDS mechanism in any International Investment Agreement (IIA), even to withdraw from the International Centre for Settlement of Investment Disputes (ICSID).<sup>2</sup> According to Susan D. Frank, there is a legitimacy crisis in ISDS by some inconsistent decisions.<sup>3</sup> The matter above results in termination and review of several International Investment Agreement (IIA) especially Bilateral Investment Treaty (BIT) in Indonesia.<sup>4</sup>

Below is official report by BPKM (Indonesia Investment Coordinating Board) in 2013-2016. There were 67 BIT. In detail, there were 20 unjustified BIT, terminated 25 BIT, and the rest 22 are still applied and reviewed for its sustainability.<sup>5</sup> The first BIT stopped was the BIT with Dutch that were effectively applied since 1 July 2015.

The government policy to terminate and review the BIT gains many supports. It is because the more commitment numbers in IIA, the more potentials to be claimed in ISDS. It might

occur when the policy to protect national interest is considered inappropriate with the agreed Indonesian commitment in IIA.

**Figure 1.** Official report by Indonesia Investment Coordinating Board in 2013-2016



In contrast, IIA existence and its ISDS clause is still believed as an urgent matter to attract foreign investment. It is because Indonesia still have limited capital, technology and human resources to conduct national development. Hence, this article will discuss: what is the urgency of IIA and ISDS for Indonesia?; And what kind of IIA and ISDS model Indonesia should make to keep state interest protection and foreign investor interest balance?

## Discussion

### IIA and ISDS Urgency for Indonesia

IIA gained its popularity after the World War II. At that time, the IIA aimed to give protection guarantee from nationalization and discrimination by the host state especially new independent state.<sup>6</sup> The first IIA was German - Pakistan BIT in 1959. Then many European and American states followed to make BIT with developing country as the place to set the investment. In this era, the protection was less

<sup>1</sup> James D. Fry, Odysseas G. Repousis, "Towards a new World for Investor -State Arbitration Through Transparency," *N.Y.U. J. Int'l L. & Pol.*, Vol. 48 No. 795, spring 2016, p. 801.

<sup>2</sup> Hikmahanto J, "Indonesia Should Withdraw from the ICSID!," *The Jakarta Post*, 2 April 2014.

<sup>3</sup> Susan D. Franck, "The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions," *Fordham L. Rev.* Vol. 75 Issue 4, 2005, p. 1522.

<sup>4</sup> Yacob Rihwanto, "Bilateral Investment Treaties dan Penyelesaian Arbitrase Internasional (Studi Kasus Pencabutan Izin Kuasa Pertambangan Churchill Mining)," *Lex Renaissance*, No. 1 Vol. 1, January 2016, p. 109.

<sup>5</sup> Badan Koordinasi Penanaman Modal, "Perkembangan Perjanjian Peningkatan dan Perlindungan Penanaman Modal (P4M) dan Prioritas Penyelesaian P4M antara Indonesia-Negara Mitra", *Paper-materi presentasi invest in remarkable Indonesia*, Jakarta, July 19<sup>th</sup> 2016, p. 3.

<sup>6</sup> Howard Mann, "Reconceptualizing International Investment Law: Its Role In Sustainable Development", *Lewis & Clark Law Review*, Vol. 17 No. 2, summer 2106, p.14.

and ISDS mechanism had not yet known.<sup>7</sup> ICSID convention in 1965 became the foundation of ISDS emergence. In '90s until 2007, the number of IIA increased significantly, not only bilateral but also regional and multilateral such as Asean Comprehensive Investments Agreement (ACIA), Comprehensive Economic Partnership Agreement (CEPA), Regional Comprehensive Economic Partnership (RCEP), Trans Pacific Partnership (TPP), Free Trade Agreement (FTA), Transatlantic Trade and Investment Partnership (TTIP). In addition, other multilateral agreements are TRIMs, *North American Free Trade Area* (NAFTA, 1992, and *APEC Non-Binding Investment Principles* (1994)<sup>8</sup>

IIA contains minimum standards of investment protection which must be given by the host state:<sup>9</sup> *first*, an equal and fair treatment or a treatment with no discrimination from any investment types whether it is domestic or foreign; *second*, a full protection and security containing state obligation to give compensation upon the corporation loss due to war, armed conflict, revolution, state emergency, riot or rebellion. This protection is usually in form of compensation or recovery; *third*, a protection from any action or nationalization and an obligation to give compensation; *fourth*, mechanism of dispute settlement which aligns the investor and the state level known as "*Investor-State Dispute Settlement* (ISDS).

ISDS is minimum standard which must exist in IIA. ISDS is not an agreement which is directly made between host state and investor. Instead, it is made by home state with the host state embodied in IIA.<sup>10</sup> ISDS aims to be an effective mechanism of dispute settlement that

does not cause any conflict between the states.<sup>11</sup>

However, ISDS is perceived to undermine the democratic norm, violate personal rights and public rights that develop in domestic context, and destroy the state sovereignty. According to this party, the domestic court should be the proper institution to rule the public, environmental, security, safety and social interests rather than ISDS court.<sup>12</sup>

This reminds us of the Calvo doctrine in 19th century which prioritizes the host state sovereignty and refuses the home state intervention in dispute settlement between investor with host state.<sup>13</sup> Another criticism to ISDS is the risk of many claims proposed by investor to the host state with its value reaching out US \$ 1 billion. Besides, the case high expense can be charged to host state even in case of their winning.

Furthermore, there has been a perception that ISDS is the determinant factor of the Foreign direct investment (FDI) entry. Nevertheless, some research show different result that it is not.<sup>14</sup> The increased policy transparency, market access, removal of Investment Negative List, license simplification, and regulation certainty are considered more important. ISDS is not the initial determinant of important investment, but it becomes important as the last attempt if the relation between states gets worse.<sup>15</sup>

The criticism toward ISDS is getting wider since the withdrawal of several South American countries such as Bolivia, Ecuador and Venezuela from ICSID forum. It is a reaction of many

<sup>7</sup> *Ibid*

<sup>8</sup> Eka Husnul Hidayati, et.al. "Akibat Penghentian Bilateral Investment Treaty (BIT) Indonesia-Belanda yang dilakukan secara sepihak oleh Indonesia", *USU Law Journal*, Vol. 5 No. 2, April 2017, p.138.

<sup>9</sup> Rachmi Hertanti and Rika Febriani, 2014, *Bilateral Investment treaty (BITs) Negara VS Korporasi, Seri Buku Panduan Memahami BITs: Perjanjian Perlindungan Investasi Internasional dan Gugatan Investor Melawan Indonesia*", Jakarta: Indonesia for Global Justice, p. 5.

<sup>10</sup> Rachel wellhausen, "Recend Trends in Investor State Dispute Settlement", *Journal of International Dispute Settlement*, University of Texas in Austin, December 2015, p.2

<sup>11</sup> Martina A. Weiss, et. al, 2015, *International Investment Agreement (IIAS)*, Washington: Congressional Research Service, p. 22.

<sup>12</sup> Effrey T. Cook, "The Evolution of Investment-State Dispute Resolution in NAFTA and CAFTA; Wild West to World Order", *Pepp. L. Rev.*, Vol. 34 Issue 4, 2007, p.1089

<sup>13</sup> *Ibid*

<sup>14</sup> J.W Yackee, "Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence", *Virginia Journal of International Law*, Vol. 51, 2010, p. 114.

<sup>15</sup> Michael Nolan, "Challenge to the Credibility of the Investor state arbitration system", *Am. U. Bus. L. Rev.* Vol. 5 No. 429, 2015, p. 432.

claims toward their policies conducted by the investor in ICSID forum.<sup>16</sup>

It is inferred from the explanation above that indeed there are many pros and cons towards the IIA and ISDS existence for the host state. Yet as long as Indonesia is still in need of foreign capital then the IIA and ISDS existence is still urgent, in the context of Indonesia. The other Indonesia's competitor states that also need the foreign investment are facilitating or providing IIA and ISDS as well. IIA and ISDS are the instrument of international law which tied two parties up, either the investor or the state. The IIA and ISDS existence secure the foreign investor since they will obtain the protection assurance of their investment in Indonesia from the arbitrary nationalization action, discrimination, and other unfair treatments. Even so, IIA and ISDS need a particular format, not like the current one that is investor-biased and disadvantaging Indonesian business. Even Indonesian investors abroad also need such protection guarantee from their host states.

### The Model of IIA and ISDS for Indonesia

Indonesian action in terminating and reviewing IIA and ISDS is already precise. World's trend also shows the same causes. Many states have modified their IIA to protect more their host state's sovereignty comprehensively, to minimize the misuse the ISDS risk and to give more state's autonomy in pursuing its people prosperity.<sup>17</sup> Several new IIA models done by some host states can be a reference to arrange the new IIA and ISDS format of for Indonesia.

The first model is India. India's action in revising their BIT is triggered by their defeat in a case of *White Industries Australia Limited v. Republic of India*, in UNCITRAL forum. The India's new BIT model is redefining the definition of investment, investor and enterprise based on

the investment law applied in India, as well as obliging investor using the exhaustion of local remedies at least 5 years before using ISDS.<sup>18</sup>

Local remedies doctrine was known in 1970s-1980s, but then it was forgotten. An arbitration clause like ICSID is interpreted as an obligation dismantling of local remedies. A few part of IIA is still required obligation of exhaustion local remedies by approximately 18 months of time limitation.<sup>19</sup> It is actually unfair if we look on how in ISDS, the solving of such case takes more than 4 years in average.<sup>20</sup> The benefit gained by obliging the exhaustion of local remedies employment in IIA is to push the national law to improve the law system and its justice; to ease ISDS in giving qualified decision because arbitrary ISDS can learn the national law through national court's decision; to set the investor equally to the citizen, without any privilege; and to help clarify as well as integrate the role of domestic court and ISDS arbitration.

India's new BIT model does not contain MFN conditions. In addition, it forbids treaty shopping as well. Although this model is more host-state friendly, it still provides investor's protection. India is still actively integrating with the global economy and negotiating IIA which gives India autonomy and protection towards the claims potentials through ISDS<sup>21</sup>

The second IIA model is given by Canada which was triggered by the case of *Lone Pine Resources Inc. v. The Government of Canada*. Canada was prosecuted by Lone Pine Resources because An Act to limit oil and gas activities launched by Quebec. The licenses of exploration in St. Lawrence River was called off including Lone Pine Resources' license.<sup>22</sup> The Quebec's action was intended to protect the environment around the river.<sup>23</sup> In response to this case, Canada stated that this action was legally a sovereign state action without any discrimination. It aims to protect St. Lawrence Ri-

<sup>16</sup> Christoph Schreuer, "Denunciation of the ICSID Convention and Consent to Arbitration", in Michael Waibel, Et. All. (eds), *The Backlash against Investment Arbitration*, Kluwer Law International, March 2010 *The Backlash against Investment Arbitration*, p. 354,

<sup>17</sup> Nikesh Patel, "An Emerging Trend in International Trade: A shift to safeguard against ISDS abuses and protect host state sovereignty", *Minnesota Journal of International Law, Minn. J. Int'l L.* Vol. 26 No. 273, winter 2017, p. 273

<sup>18</sup> *Ibid.*

<sup>19</sup> Matthew C. Porterfield, 2015, "Exhaustion of Local Remedies in Investor State Dispute Settlement: An Idea Whose Time has Come, *Yale J. Intl. L. Online*, Vol. 41 No. 1, fall 2015, p. 4.

<sup>20</sup> *Ibid.*, p. 11.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

ver and cannot be considered as an arbitration, unfair or inequitable measure.<sup>24</sup>

In 2015, IIA of Canada and the European Commission (CETA) gave a flexibility to make legitimate policy, recognition on the importance of international security, democracy, and human right in order to improve the trading and international economy cooperation. CETA made sure that investor's protection must not ignore the importance of protecting country's sovereignty.<sup>25</sup>

The third model is what Australia has. Similarly to Canada's case, Australia was prosecuted by Phillip Morris to UNCITRAL because their Tobacco Plain Packaging Act 2011 was considered violating the regulation on Article 2 (2) and Article 6 on the Hong Kong-Australia Bilateral Investment Treaty (1993)<sup>26</sup> about "fair and equitable treatment" and the indirect expropriation of investments without adequate compensation. Australia refused all prosecution from Phillip Morris and stated that the purpose of The Tobacco Plain Packaging Act 2011 was to protect people's health. Although they won, Australia still launched more than fifty million dollars for the court fee.<sup>27</sup> Learning from this case, CHAFTA tried to make several changes on IIA and ISDS process in their will to protect host state's right in arranging society's prosperity legitimately through non-discriminating regulation.

The Philip Morris Asia Ltd. v. Australia case inspired and influenced the Trans-Pacific Partnership (TPP) arrangement. In this case, although there are still many controversies which make many parties shout to many states to not take parts in this agreement, TPP has done several changes related to the direct expropriation and indirect expropriation definition, especially related to state's right to protect public interests.<sup>28</sup>

The new BIT model is also set by New Zealand that made IIA without ISDS clause. It aims to decrease the investor's claim risk to

ISDS. For New Zealand, the litigation risk can be managed through substantive conditions in the investment agreement.<sup>29</sup> Even so, this practice got many criticism because the state's commitment in IIA without containing ISDS is doubted. How it is possible for IIA to promise the investor mutually substantive treatment without giving them rights to access international arbitration. It is the same as not providing law protection from host state's behavior which might be opportunistic.<sup>30</sup>

The alternative offered by the author is by fixing the BIT by improving ISDS clause which is not automatically applied. Yet, it is going to be determined later in a separated arbitration agreement after the dispute appears based on all parties' deal. Besides, in Indonesia's new BIT model, it is going to be better if the exhaustion local remedies is applied 5 years before it is brought to ICSID forum. This aims to give a chance for Indonesian court to handle it.

## Conclusion

The IIA and ISDS existence is still urgent for Indonesia due to the need of foreign investment related to the limit of Indonesian capability in the terms of capital, technology, and human resources. IIA and ISDS are going to give protection guarantee, law certainty and justice to the investor. The current IIA and ISDS need reformulation which gives balance towards host state's interest as well as investor's personal interest.

Indonesia's new IIA and ISDS model can refer to similar the other host states' instrument, especially India, as the same developing countries. Indonesia's new BIT should reformulate the terms which are given a very open definition and can be interpreted widely this whole time, as well as applying obligation of exhaustion of local remedies. Furthermore, the pointing of ISDS arbitration must be taken with mutual consent (not automatically), no fake MFN clauses, and give host state nation's flex-

<sup>24</sup> Nikesh Patel, *op.cit.*, p. 290.

<sup>25</sup> *Ibid.*, p. 292.

<sup>26</sup> Michael Nolan, "Challenge to the Credibility of the Investor state arbitration system", *Am. U. Bus. L. Rev.*, Vol. 5 No. 429, 2015, p.430

<sup>27</sup> Nikesh Patel, *op.cit.*, p. 296.

<sup>28</sup> *Ibid*

<sup>29</sup> Amokura Kawharu, Luke Nottage, "Models for Investment Treaties in the Asia Pacific region: An Underview", *Ariz. J. Int'l & Comp. L.*, Vol. 34 No. 461, 2017, p. 477.

<sup>30</sup> Jason Webb Yackee, 2 "Do States Bragain over Investor State Dispute Settlement? Or Toward Greater Colaboration in the Study of Biateral Investment Treaties", *Santa Clara J. Int'l L.*, Vol. 12 No. 277, 2013, p. 287.

ibility to protect the society's prosperity through non-discriminating regulations to get society's prosperity, health, safety, environment, public moral, and public order. Indonesia needs to review and make a new IIA and ISDS format model which balances the investor's and host state's interests.

## References

- Badan Koordinasi Penanaman Modal. "Perkembangan Perjanjian Peningkatan dan Perlindungan Penanaman Modal (P4M) dan Prioritas Penyelesaian P4M antara Indonesia-Negara Mitra". *Paper*. Materi Presentasi Invest in Remarkable Indonesia. Jakarta. July 19, 2016;
- Cook, Jeffrey T. "The Evolution of Investment State Dispute Resolution in NAFTA and SAFTA: Wild West to World Order". *Pepp. L. Rev.* Vol. 34 No. 1085. 2007. Pp.1085-1106;
- Franck, Susan D. "The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions", *Fordham L. Rev.* Vol. 73 No. 1521, 2005, Pp.1521-1625;
- Fry, James D. Odysseas G Repousis. "Towards A New World for Investor -State Arbitration Through Transparency". *N.Y.U. J. Int'l L. & Pol.* Vol. 48. Spring 2016. p. 795-865;
- Hertanti, Rahmi and Rika Febriani, 2014, *Bilateral Investment treaty (BITs) Negara VS Korporasi, Seri Buku Panduan Memahami BITs: Perjanjian Perlindungan Investasi Internasional dan Gugatan Investor Melawan Indonesia*". Provided on [http://igj.or.id/wp-content/uploads/2015/08/MODUL-BITs\\_Indonesia.pdf](http://igj.or.id/wp-content/uploads/2015/08/MODUL-BITs_Indonesia.pdf) Retrieved on December 20, 2017 in Indonesia for Global Justice;
- Hidayati, Eka Husnul et.al. "Akibat Penghentian Bilateral Investment Treaty (BIT) Indonesia-Belanda yang dilakukan secara sepihak oleh Indonesia", *USU Law Journal*, Vol. 5 No. 2. April 2017. Pp. 134-157;
- Juwono, Hikmahanto. "Indonesia Should Withdraw from the ICSID". *The Jakarta Post*. April 2, 2014;
- Kawharu, Amokura and Luke Nottage. 2017. "Models for Investment Treaties in the Asia Pacific region: An Underview. *Ariz. J. Int'l & Comp. L.* Vol. 34. 2017. p. 461-525;
- Mann, Howard, "Reconceptualizing International Investment Law: Its Role In Sustainable Development", *Lewis & Clark Law Review*, Vol.17-2, Summer 2016, Pp. 14-39;
- Nolan, Michael. "Challenge to the Credibility of the Investor state arbitration system". *Am. U. Bus. L. Rev.* Vol. 5 No. 429. 2015. Pp. 429-444;
- Patel, Nikesh, "An Emerging Trend in International Trade: A shift to safeguard against ISDS abuses and protect host state sovereignty". *Minnesota Journal of International Law*. Vol. 26. Winter 2017, Pp. 273-302;
- Porterfield, Matthew C. "Exhaustion of Local Remedies in Investor State Dispute Settlement: An Idea Whose Time has Come", *Yale J. Intl. L. Onlinefall*. Vol. 41. 2015. Pp. 1-12;
- Rihwanto, Yacob. "Bilateral *Investment Treaties* dan Penyelesaian Arbitrase Internasional (Studi Kasus Pencabutan Izin Kuasa Pertambangan Churchill Mining)". *Lex Renaissance*. Vol. 1 No. 1. January 2016. Pp.107 - 125;
- Schreuer, Christoph. "*Denunciation of the ICSID Convention and Consent to Arbitration*". *The Backlash against Investment Arbitration* in Michael Waibel. et. all (eds). 2010. *The Backlash against Investment Arbitration: Perceptions and Reality*. Pp. 353-368.
- Weiss, Martina A. Et. Al. 2015. *International Investment Agreement (IIAS)*. Washington: Congressional Research Service;
- Wellhausen, Rachel L." Recend Trends in Investor State Dispute Settlement". *Journal of International Dispute Settlement*. December 2016. Pp. 1-19. DOI: 10.1093/jnlids/idv038;
- Yackee, Jason Webb. "Do States Bragain over Investor State Dispute Settlement? Or Toward Greater Colaboration in the Study of Bilateral Investment Treaties". *Santa Clara J. Int'l L.* Vol. 12. 2013. Pp.277-300;
- Yackee, Jason Webb. "Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence". *Virginia Journal of International Law*. Vol. 51. 2010. Pp. 110-141.