INDONESIA

Indonesia and beyond: Investment Treaties and Arbitrations. Can the problems be solved before the system dies out?

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The first Bilateral Investment Treaty was entered into between Germany and Pakistan in 1959, but it was not until thirty years later that the popularity of such treaties began to reach a peak, with numbers shooting up rapidly between the early 1990's and 2009, when such treaties began to be regularly used by investors to bring arbitration against host states. Unfortunately the trend was for arbitral tribunals to interpret the provisions of such BITs, which one has to admit were often not sufficiently clear, more and more broadly, causing states to begin to realise the consequences of what they had got themselves into, with a consequent considerable decrease in the number of new treaties entered into thereafter. For example, while there were 83 BITs signed throughout the world in 2008, and 108 in 2009, only 22 BITs were signed in 2015, only four of which have gone into effect; 30 in 2016, of which only two are in effect, and, as of September, 2017, only 5 have been signed, of which only one is already in effect.[1]

The situation as it stands today:

As mentioned, it is almost certain that the flagging enthusiasm for such treaties stems from the outcome of so many investor-state arbitrations, which have highlighted the restrictions now being imposed upon the sovereign rights of independent states to regulate their own economies.

Indonesia is not immune to this discomfort and, as of a few years ago, has commenced a policy of terminating a number of its BITs. In the past few years Indonesia has terminated its treaties with 25 other states, including three of her major investors: the Netherlands, China and Singapore,[2] as well as those with France, Germany, Norway, India, Switzerland, Malaysia, Pakistan, Vietnam, Egypt, Argentina and a dozen other countries.

In all, between 1968 and 2011 Indonesia signed BITs with 65 states, leaving 40 not yet terminated. However, only 26 of these have come into, and now remain, in force.

A number of other major economies are backing off as well. Brazil, for example, signed BITs with 14 states between 1995 and 1999, and six more in 2015, but none of these have entered into force. Other countries, such as Argentina, Ecuador, Venezuela, India and Australia have also indicated their reticence to continue to embrace the system. Thus Indonesia is not the only state considering to what extent it wishes to continue its participation.

> INDONESIA IS NOT THE ONLY STATE BACKING OFF FROM THE BIT SYSTEM. IF NOT PROPERLY ADDRESSED, WE MAY SOON SEE NO MORE BITS NOR INVESTOR-STATE ARBITRATIONS.

Why the Backlash?

Surely this backlash reaction is, at least in part, due to a growing international dissatisfaction with the way investor-state arbitrations are being applied. Many nations have found their sovereign power and authority to regulate their own economies overridden by decisions of private tribunals favoring the sanctity of contractual agreements with investors. This is exacerbated by the tendency of many Tribunals to find and exert jurisdiction, and authority, over host states in ways such states had never agreed to subject themselves. This is certainly the basis for Indonesia's current policy of resiling from so many BITs.

The dispute resolution provisions of the early BITs called for either submission to the International Court of Justice or private arbitration, but only for disputes between the state parties themselves. There was no right given to investors to bring arbitration against the host state. Investors could avail themselves only of the host state's courts. Any arbitration by an investor would have to be pursued by his home state on his behalf. Only in the 1980's did

treaties begin to include provisions giving investors the right to bring arbitration against a host state directly. Many states, Indonesia included, find that this situation has got out of hand.

Indonesia's experience in Investor-State Arbitrations:

Actually, at least over the last fifteen years, Indonesia has been fairly successful in either settling with, or staving off, investors who have sought to use investment treaties for their own benefit. Aside from settling an arbitration brought by the Dutch subsidiary of a U.S. mining giant under the Dutch/Indonesian BIT even before a tribunal had been constituted, Indonesia has prevailed in arbitrations brought under the BIT with the United Kingdom and a multilateral treaty among 55 Islamic States, the Investment Agreement of the Organisation of Islamic Conference (OIC). In fact, none of those cases should have been brought in the first place, but the respective tribunals interpreted the scope and jurisdictional provisions of these treaties beyond what had ever been intended, or even contemplated, when such treaties were executed.

Indonesia has been involved in only 12 investor-state arbitrations (seven of them before ICSID), two of which were settled or withdrawn before any hearings were held, and two of which were eventually dismissed for lack of jurisdiction. Of the others two are still pending, while Indonesia was successful on the merits in three, one of which was actually brought by the state, as Claimant, against a recalcitrant investor in the mining sector who refused to comply with its contractual obligation to divest a portion of its shareholding. Thus Indonesia has suffered only three Awards against her. However at least two of these cases, both relating to private power projects postponed as a result of the Economic Crisis of 1997/1998, were rife with political interference (primarily US) and other serious defects and resulted in disproportionate losses for the state. But even the cases in which Indonesia was successful on the merits had serious jurisdictional overreaches, which are at least in part the rationale for Indonesia's backing away from the BITs altogether.

The message is clear, not only in Indonesia but in an accelerating portion of the world: the ambiguous language of BITs is leaving too much leeway for misinterpretation by Tribunals, differing drastically from what was intended by states when they agreed to enter into these BITs. This must be addressed, perhaps through revision of treaty language, for if the system is not fixed it will expire. BITs must be redesigned to address the problems that have arisen in their present form.

Some of the Problems and What can be done:

a. Most BITs are entitled: "*Agreement for the Promotion and Protection of Investments*". And yet few, if any, BITs contain provisions calling for promotion. They deal only with protection. So where is the benefit to a host state to enter into such a BIT? That is a question being asked more and more as the protections become more onerous.

Solution? There should be some obligation on the home state to encourage its businesspeople to invest in its treaty partner.

b. BITs are too often interpreted to give treaty protection to parties to whom the state did not intend it to extend. For example, it has always been Indonesia's intention to restrict treaty protection to foreign investors who make application to and are approved by the government to establish what is known as a "PMA", or Indonesian foreign investment company. Although this is indicated by reference to the Foreign Investment Law in all of Indonesia's BITs, it has been misinterpreted in recent cases. This is the kind of overreaching that Indonesia is reacting to in termination of treaties.

Solution? More precise drafting as to the scope of which investors/investments are covered would be necessary for any future treaties, if any, to avoid the possibility of such misinterpretation.

c. Probably the most serious problem is that treaties are being interpreted to restrict states' sovereign right to regulate their own economy and society.

Solution? In forthcoming treaties the language must make it clear that the state must be free to regulate its economy, and to take any measures it deems necessary, as long as they are not discriminatory against the investor only. If the measures apply across-the-board and are for the benefit of the state and its populace, there can be no breach/no expropriation and no right of action.

d. Treaties have also been interpreted to give better treatment to covered investors than to state's own nationals.

Solution? This must be clarified. While most treaties make it clear the investor is to be treated no worse than domestic investors, they should also state they are not to receive better treatment either.

e. Most Favored Nation provisions have been abused to allow investors to treaty-shop.

Solution? Treaty language should state that the investor will be treated no worse, and yet not better, than domestic investors or investors from other states with which the host state does **not** maintain a separate treaty.

f. Provisions relating to protections, such as "Fair and Equitable Treatment" and "Full" or "Adequate Protection and Security" are being too broadly interpreted.

Solution? Language must be very specific that what is intended is to avoid egregious violations of human rights and due process. An action or inaction should not be a breach unless so specified, not the other way around.

g. "Umbrella clauses", stating that the host state will respect any obligation it may have entered into with regard investments from its treaty partner, are being interpreted to allow the investor to apply dispute resolution provisions of the BIT even where the investor has a contract with the state calling for another type of dispute resolution.

Solution? A BIT should clearly state that its own arbitration clause does not apply if the parties have agreed otherwise in a bi-partite agreement or other instrument.

h. There are no obligations upon the investors themselves, as they are not parties to the treaties. If they are in breach they should not be entitled to the treaty's protections. Currently they are entitled to all nature of rights without any obligations.

Solution? Language must be included requiring investors to comply with the laws and regulations of the host state in which they are operating, and have no right to bring any action if they are in breach thereof. The host state should also be entitled to counterclaim against an errant investor if the latter brings arbitration against the state.

i. The duration and termination provisions lock the states in for too long a period with very restricted ability to opt out or terminate.

Solution? More flexible termination provisions need to be added. The states should have the right to terminate or opt out at any time upon reasonable notice.

If the system is not rectified to the comfort of contracting host states, there will soon be no more investment treaties. The changes needed are not complicated. What is needed is only the will to improve.

1 Data provided in this note, as well as considerable other information can be found on the website of the United Nations Conference on Trade and Development (UNCTAD) at: http://investmentpolicyhub.unctad.org/IIA.

2 Note Indonesia has never entered into a BIT with the United States.