

# EXPERT GUIDE

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## LITIGATION & DISPUTE RESOLUTION



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## Bilateral Investment Treaties: Indonesia at the Crossroads

By Karen Mills

A bit over a year ago Indonesia set the arbitration community chattering after announcing that she would not renew her Bilateral Investment Treaty (BIT) with the Netherlands, indicating also that she would not renew any of her other BITs. Indonesia has signed 64 BITs, of which 47 have entered into force.

### ***What was behind this announcement and how is it likely to play out in the near future?***

Nobody should have been surprised. The popularity of BITs has been waning for some time. The first BIT (Germany/Pakistan) was entered into in 1959 and for the next 30 years such treaties enjoyed a slow increase, with numbers shooting up rapidly between the early 1990's and 2009. But since that time, with the increase of investor-state arbitral tribunals interpreting the provisions more and more broadly, states began to realise the consequences of what they had got themselves into and the number of new treaties has been decreasing

considerably. For example, while there were 83 BITs signed throughout the world in 2008, and 108 in 2009, only 29 BITs were signed in 2014, none of which have gone into effect. As of mid-2015 only 11 BITs were signed, with none in effect.<sup>1</sup>



A number of major economies are backing off, or have avoided them altogether. Brazil, for example, signed BITs with 14 states between 1995 and 1999, and one (with Mexico) in May of this year, 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.

In fact, at least over the last 10 years, Indonesia has been successful in either settling with, or staving off, investors who have sought to use investment treaties for their benefit. Aside from settling an arbitration

brought by the Dutch subsidiary of a U.S. mining giant<sup>2</sup> under the Dutch/Indonesian BIT even before a tribunal had been constituted, the state 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). Actually, neither of those cases should have been brought in the first place, but the respective tribunals interpreted the scope and jurisdictional provisions of both treaties beyond what had ever been intended, or even contemplated, when these treaties were executed.

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.

Over the past 10 years or so there has been a strong, growing dissatisfaction with the way investor-state arbitration has been applied. Many nations have found their sovereign power and authority to regulate their own economies overridden by decisions of private tribunals favouring the sanctity of contractual agreements with investors. An example is the recent Bank Century cases in which, although Indonesia eventually was successful, the tribunals did their utmost to exert jurisdiction, and authority, over Indonesia in ways Indonesia had never agreed to.

The ramifications of the OIC case promise to have broad detrimental effect upon many, if not all, of the signatory states to the OIC Agreement. The signatory states had specifically agreed that they did not intend to give right of arbitration to investors absent a separate arbitration agreement, but the tribunal decided to follow current trends to have such disputes decided by arbitration,

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ignoring the intention of the OIC members. Thankfully the case was finally dismissed on its merits but the seriously flawed decision on jurisdiction is likely to have continuing fallout on other OIC member states.<sup>3</sup>

### **The Way Forward**

As mentioned above, Indonesia announced her intention to terminate and/or not extend all of the existing BITs. So far only the Netherlands has been notified directly of the termination. Will the others follow? During the past year, a number of studies have been undertaken to try to determine the best way forward. In that interim the entire government has changed, so that most of the decision makers are new to their positions. No ultimate decision has as yet been declared, however it appears that the intention will be to offer at least some treaty partners the option whether to revise, or enter into new, more acceptable, treaties, or terminate altogether.

But the message is clear, not only in Indonesia but in an accelerating portion of the world: if the system is

not fixed it will expire. BITs must be redesigned to address the problems that have arisen in their present form.

### ***Problems encountered by Indonesia, and by extension other states, in the ISDS system and suggested solutions***

1. Problem: First of all, it should be noted that, with few exceptions, these 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.

2. Problem: BITs are too often interpreted to give treaty protection to parties to whom the state did not intend it to extend. 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 a recent case. Such overreaching is undoubtedly one reason for Indonesia's desire to terminate its 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.

3. Problem: 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.

4. Problem: 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.

5. Problem: Most favoured 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.

6. Problem: 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.

7. Problem: “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.

8. Problem: 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.

9. Problem: 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. In fact Indonesia had several years earlier brought arbitration, under contract, against the same group for its defaults, and prevailed.

3. We would suggest that it would be wise for the OIC membership to execute an addendum to their Investment Agreement clarifying that the arbitral mechanism is intended for state-to-state disputes only, as the original language apparently was not made sufficiently clear to prevent misinterpretation by an avid tribunal.

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