CHAPTER I

INTRODUCTION

1.1 Background

A Bilateral Investment Treaty ("**BIT**") is a written agreement concluded between two states to protect and promote investments made by qualifying investors and nationals of each contracting state in the other's jurisdiction.[1] BITs establish the minimum standards of treatment and protection for foreign investors and investments.[2] Noting that every BIT provides a different scope of protection for their investors and investments, the general framework is to protect investments from unfair or inequitable conduct, unlawful expropriation, discriminatory treatment or arbitrary conduct by the host state.[3] Furthermore, BITs also contain an Investor State Dispute Settlement ("**ISDS**") provision which provides investors with a recourse to a forum such as international arbitration, to resolve a dispute that occurs in the event the host states violate any of their rights.[4]

More specifically, an ISDS clause permits foreign investors to challenge the government of the host state for compensation in international arbitration proceedings in the event of non-compliance with *any* of the treaty provisions.[5] The

[1] UNCTAD, "Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking," New York and Geneva: United Nations, 2007, p.1 ("**UNCTAD 2007**"); The US-China Business Council, "Bilateral Investment Treaties: What they are and why they matter", 2014; "International Investment Law Research Guide", Georgetown University, 2019, http://guides.ll.georgetown.edu/c.php?g=371540&p=2511784, Accessed on 15 September 2019.
[2] Matthew Porterfield, "An International Common Law of Investor Rights?", University of Pennsylvania Journal of International Economic Law, Vol.27:Issue 1, p.80.
[3] UNCTAD 2007, *Op.Cit.,* p.1; David Price, "Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment?", Asian Journal of International Law, Vol 7: Issue 1, 2016, p.126 ("**Price**").
[4] "International Investment Law Research Guide", Georgetown University, 2019, http://guides.ll.georgetown.edu/c.php?g=371540&p=2511784, Accessed on 15 September 2019.
[5] UNCTAD 2007, *Op.Cit.,* p.100.

rationale as to why most BITs include ISDS clauses is because without such clause, many investors would face no meaningful remedy in arbitrary and unfair treatment by host states.[6] For instance, before the inclusion of ISDS clauses within BITs, investors would have to bring disputes before the local court of the host state and may have not received a fair trial.[7] This is why the ISDS clause was initially designed to depoliticize investment disputes and to create a specific forum for investors to be provided with a fair hearing before an independent tribunal.[8] However, the implementation of this ISDS mechanism has raised issues for the host states and the public interest as the ISDS usually involves the enforcement of private rights in matters relating to public interest.[9] For instance, Philip Morris International Inc. ("**Philip Morris**"), a tobacco company, pursued arbitration against Australia[10] and Uruguay[11] for implementing strict tobacco control legislations involving health-motivation. Philip Morris claimed that the states breached the investment treaty standards, *i.e.*, fair and equitable treatment and expropriation. Margaret Chan, former Director-General of the World Health Organization, stated that "in my view, something is fundamentally wrong in this

[6] "Frequently asked questions about investor-state dispute settlement", 2017, https://www.nortonrosefulbright.com/en/knowledge/publications/8014c6b7/frequently-asked-questions-about-investor-state-dispute-settlement, Accessed on 15 September 2019.
[7] Geraldo Vidigal and Beatriz Stevens, "Brazil's New Model of Dispute Settlement for Investment: Return to the Past or Alternative for the Future?", Journal of World & Trade 19, Vol 19: Issue 3, 2018, p.478.
[8] UNCTAD, "Reform of Investor-State Dispute Settlement: In search of a roadmap", No.2, 26 June 2013, p.2.
[9] George Foster, "Striking a Balance Between Investor Protections and National Sovereignty: The Relevance of Local Remedies in Investment Treaty Arbitration", 49 Columbia Journal of Transnational Law 201, 2011, p.247; Tim Samples, "Winning and Losing in Investor-State Dispute Settlement", American Business Law Journal, Vol 56: Issue 1, 26 February, 2019.
[10] *Philip Morris Asia Limited v. The Commonwealth of Australia,* PCA Case No.2012-12, Award, July 8, 2017 ("**Philip Morris v. Australia**").
[11] *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay,* ICSID Case No.ARB/10/7, Award, 8 July, 2016 ("**Philip Morris v. Uruguay**").

world when a corporation can challenge government policies introduced to protect the public from a product that kills."[12]

Furthermore, ISDS clauses have a unique aspect – any natural person or corporation that is a qualified investor within a BIT has the right to challenge a state without the need of *consent* from its residing state. In the practice of international law, an individual must exhaust local remedies in the respondent state before a claim can be espoused by the national state. Local remedies specifically mean remedies which are provided to an "injured person" before judicial courts in the respondent state.[13] The concept of exhausting local remedies is tied with the concept of consent because if the respondent state does not agree with the claim raised by the injured person, they do not have to file a case against the other state.[14] However, this concept is not recognized in positive International Investment Law ("**IIL**"). In the practice of IIL, the ISDS clause provides investors with direct access to bring disputes to arbitration without having to exhaust local remedies, *i.e.,* the investor is not required to use the state's domestic courts or even obtain the residing state's consent to submit the dispute to arbitration.[15]

As such, due to the rights provided to investors to bring disputes to arbitration through the ISDS clause whenever the investor believes there is a breach of any commitments under the BIT, governments of most States believe that this clause can constitute as an "affront to its sovereignty".[16] This is seen from the view of

[12] Dr. Margaret Chan, "Health has an Obligatory Place on Any Post-2015 Agenda", World Health Organization, Speech delivered to the 67thWorld Health Assembly, Geneva, 19 May, 2014.
[13] Kaczorowska, Alina, *Public International Law*, 4th Edition, (New York: Routledge, 2010), p. 487 ("**Kaczorowska**").
[14] *Ibid.*
[15] Price, *Op.Cit.*, p.125.
[16] Glen Warwick, Luke Carbon and Richard Kniveton, "Foreign Investment and Dispute Resolution in Indonesia", Clyde&Co Law Firm, 7 October, 2016,

some government officials, *e.g.*, the former European Commission's president, Jean-Claude Juncker described the ISDS mechanism as "secret courts that should not be allowed to have the final say,"[17] Daniel M. Donovan, former U.S. Trade Representative stated that the ISDS is a "threat to sovereignty",[18] and Hillary Clinton of the United States called the ISDS regime "a fundamentally anti-democratic process".[19] States that have widely been affected by the ISDS clause are EU Countries, South African Countries, Ecuador, India and even Indonesia.[20] The reason for such is because a major number of claims have been brought by investors against these states and the states are losing billions of dollars defending their claim.

In regard to Indonesia, after the famous Churchill Mining brought claims against Indonesia using the ISDS clause claiming for compensation of USD 1.8 billion,[21] the former President of Indonesia, Mr. Susilo Bambang Yudoyono, stated that "the Government will not allow those multinational companies to do as they please with their international back-up and put pressure on developing countries like Indonesia."[22] He further stated that multinational companies are exploiting BITs, which are meant to protect investors, to evade national regulations and

https://www.clydeco.com/insight/article/foreign-investment-and-dispute-resolution-in-indonesia, Accessed on 2 October, 2019.

[17] Marialuisa Taddia, "Unfair contests", The Law Society Gazette, 29 October, 2018, https://www.lawgazette.co.uk/features/unfair-contests/5068074.article, Accessed on 16 September, 2019 ("**Taddia**").

[18] Letter by the Congress of the United States Washington DC 20515, 11 October, 2017, https://www.citizen.org/system/files/case_documents/gop-on-isds.pdf, Accessed on 2 October, 2019.

[19] Taddia, *Op.Cit*.

[20] Alexander Beunder and Jilles Mast, "As the world meets to discuss ISDS, many fear meaningless reforms", https://longreads.tni.org/isds-many-fear-meaningless-reforms/, Accessed on 3 October, 2019.

[21] *Churchill Mining Plc v. Republic of Indonesia*, Decision on Jurisdiction, ICSID Case No. ARB/12/14 and 12/40, ¶¶9, 50 ("**Churchill Mining**").

[22] Bagus Saragih, "SBY frets over int'l arbitration*",* Jakarta Post, 29 June 2012, http://www.thejakartapost.com/news/2012/06/29/sby-frets-over-int-l-arbitration.html, Accessed on October 4, 2019.

oppress Indonesia.[23] Therefore, the Government of Indonesia announced its plan to discontinue 64 BITs containing ISDS clauses.[24] This far in 2019, 18 BITs have been discontinued by Indonesia.[25]

According to Indonesia's former Coordinating Minister for Economic Affairs, Mr. Sofyan Djalil, the main reason for Indonesia to discontinue its BITs is due to the "unsuitability and irrelevancy of the BITs with Indonesia's current development and that several arbitration disputes had been brought against Indonesia and the preliminary decisions had been unfair and contrary to Indonesia's interests."[26] Furthermore, even the head of the Capital Investment Coordinating Board (*Badan Koordinasi Penanaman Modal* or "**BKPM**") stated that "Indonesian BITs need to be reviewed for reasons including the increased number of lawsuits and amount of compensation that uses the BIT as their basis for a lawsuit, by which foreign investors submit a claim against Indonesia using an ISDS forum."[27] Other than the views of the Government of Indonesia and Ministers, Abdul Kadir Jailini, the Ambassador of Indonesia to Canada and a Permanent Representative of Indonesia to ICAO has also provided reasons as to why Indonesia has decided to discontinue its BITs. These include: (**i**) there exists no balance between the protection to investors and to national sovereignty, (**ii**) the wording of the provisions in a BIT lean more towards investors and provide extensive rights for foreign investors, (**iii**)

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[23] *Ibid*; Ben Bland and Shawn Donnan, "Indonesia to terminate more than 60 bilateral investment treaties", Financial Times, 26 March, 2014, https://www.ft.com/content/3755c1b2-b4e2-11e3-af92-00144feabdc0, Accessed on October 4, 2019 ("**Bland and Donnan**").
[24] *Ibid.*
[25] "Indonesia terminated 18 BITs", Indonesia for Global Justice, 24 March, 2015, https://igj.or.id/indonesia-terminated-18-bits/, Accessed on September 16, 2019.
[26] "What is going on with Indonesia's Bilateral Investment Treaties?", Global Business Guide Indonesia, 13 June, 2016, http://www.gbgindonesia.com/en/main/legal_updates/what_is_going_on_with_indonesia_s_bilateral_investment_treaties.php, Accessed on October 4, 2019.
[27] Badan Koordinasi Penanaman Modal, "Review P4M Indonesia-Negara Mitra", Jakarta, 2015, p.3.

the problems arising from ISDS clauses have increased Indonesia's exposure to investor lawsuit in ICSID and (**iv**) the clauses of the BITs overrides national laws.[28]

To date, there are 7 known cases that have been brought by investors challenging Indonesia with claims for huge amounts of compensation for damages[29] and a large number of threats brought by foreign investors against Indonesia. The threats are considered so powerful to the extent that they can eliminate the actually need of bringing a lawsuit. Especially for a developing country like Indonesia, which struggles with many mining contracts, a mere threat of an ISDS claim would immediately trigger something.[30] Assessing all the threats that Indonesia has faced from foreign investors throughout the years, the Author has concluded that a majority arises from the mining sector.[31] An important point to note from these threats that has been a huge concern to the Government of Indonesia is that these threats interferes with the government's right to regulate.

For instance, in 2002, Indonesia put a ban on the practice of open-pit mining in protected forests for the purposes of evading environmental damage.[32] After the implementation of the law, a group of foreign-owned mining companies had threatened to file a case to international arbitration by way of the ISDS clause.[33] Due to such, the Indonesian House of Representatives and Ministry of Forestry

[28] Abdulkadir Jailani, "Indonesia's perspective on Investment Agreement Review", Investment Policy Brief, 1 July, 2015.
[29] Price, *Op.Cit.*
[30] Vincent Lingga, "COMMENTARY: Freeport's threat of arbitration simply a ploy to block mining reform", The Jakarta Post, 23 February, 2017, https://www.thejakartapost.com/academia/2017/02/23/commentary-freeports-threat-of-arbitration-simply-a-ploy-to-block-mining-reform.html, Accessed on October 11, 2019.
[31] "Lembar Fakta Ancaman Perjanjian TPP", Indonesia for Global Justice, 2013.
[32] "Mining in protected forests – government gives way to mining industry pressure," Down to Earth No.61, May 2004, https://www.downtoearth-indonesia.org/story/mining-protected-forests-government-gives-way-mining-industry-pressure, Accessed on October 22, 2019.
[33] *Ibid.*

agreed to change the forest designation on the locations of the listed company from "protected" to "production" forests,[34] *i.e.*, exempting 13 foreign investors from the ban.[35]

This case may set as an example of an investor abusing their rights. Abuse of rights is deemed to occur when a party exercises a right in a manner that benefits them but causes a loss to the counterparty – being unjustifiably disproportionate.[36] Furthermore, the opinions of different governments have perceived that bringing claims or threats against a state's enactment of regulations using the ISDS clause may constitute as an exploitation of their rights which may be concluded to being an abuse.[37]

In this vein, the Author of this thesis will define whether the exploitation of an ISDS clause can constitute as an abuse of rights. Along with analyzing such, the author will further provide alternative approaches for Indonesia to adopt to the

[34] Forest areas in Indonesia are divided into three functional zones: conservation, production and protected forests; Art.7, Law No.24 of 1992 concerning Spatial Use Management ("**Law No.24/1992**").

[35] Presidential Decree No.41 of 2004 concerning Forestry ("**PD No.41/2004**"); "Mining in protected forests – government gives way to mining industry pressure," Down to Earth No.61, May 2004, https://www.downtoearth-indonesia.org/story/mining-protected-forests-government-gives-way-mining-industry-pressure, Accessed on October 22, 2019.

[36] Gian Paolo Coppola and Maurizio Traverso, "Principle of good faith and abuse of rights – what are the court's powers and duties?", International Law Office, 30 March, 2010, https://www.internationallawoffice.com/Newsletters/Litigation/Italy/LCA-Studio-Legale/Principle-of-good-faith-and-abuse-of-rights-what-are-the-courts-powers-and-duties#, Accessed on November 13, 2019 ("**Coppola and Traverso**").

[37] "Canadian corporations abuse investment treaties, bully governments into environmental backtrack: study", Canadian Centre for Policy Alternatives, August 5, 2015, https://www.policyalternatives.ca/newsroom/news-releases/canadian-corporations-abuse-investment-treaties-bully-governments, Accessed on October 25, 2019; UNCTAD, "Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims", IIA Issues Note, 2, December 2010; Andrew Newcombe, "General Exceptions in International Investment Agreements", Draft Paper for the Annual WTO Conference, London, 2008, p.2; Statement by Alfred-Maurce de Zayas, Independent expert on the promotion of a democratic and equitable international order at the 70th session of the General Assembly (United Nations Human Rights).

ISDS clause in order to balance the host state's right to regulate and foreign investor's protection.

1.2 Research Questions

Based on the background discussed above, there exists two issues that will be discussed and analyzed throughout this thesis, that being:

1. Whether disputes initiated by foreign investors that intervenes with Indonesia's implementation of public policies constitutes as an abuse under International Investment Law?
2. What other alternative approaches can Indonesia adopt to the ISDS clause in order to balance the host state's right to regulate and foreign investor's protection?

1.3 Research Purpose

The purpose of this research is to provide the readers with an in-depth analysis, specifically:

1. First, to analyze whether disputes brought by foreign investors that intervenes with a state's right to regulate constitutes as an abuse of rights under International Investment Law.
2. Second, to analyze whether Indonesia can adopt alternative approaches that have been implemented by other states to the ISDS clause, instead of terminating its signed BITs in order to balance the host state's right to regulate and foreign investor's protection.

1.4 Benefits of The Research

There exist two main benefits to this research, that being – (**1**) theoretical benefits and (**2**) practical benefits.

1.4.1 Theoretical Benefits

Viewing this thesis from a theoretical perspective, it is aimed at providing theoretical knowledge and information to the government, regulators, the general public, scholars, professors, investors and students mainly on the subjects of BITs and the ISDS clause. It is mainly aimed to be used as an examination by scholars and the government to find approaches to balance Indonesia's and the investors' interests in regard to the use of the ISDS clause within signed BITs.

1.4.2 Practical Benefits

Viewing this thesis from a practical perspective, it can be used as a reference for the Government of Indonesia and investors. It can be used by the Government of Indonesia in finding a way in finding new approaches other than the ISDS clause within BITs. Furthermore, it can be used by an investor in knowing how to protect their substantive rights under a BIT before making any investments in Indonesia as well as being aware of how other approaches other than the ISDS may benefit or not benefit them.

1.5 Framework of Writing

This Thesis is divided into five main chapters along with a brief summary of each, as follows:

CHAPTER I: INTRODUCTION

The first chapter of this thesis is to provide readers with: the background of the problem, research questions, research purpose, research benefits and the framework of writing.

CHAPTER II: LITERATURE REVIEW

The second chapter of this thesis is focused on the literature review based on a theoretical and conceptual approach concerning the issues and questions presented in chapter I.

CHAPTER III: RESEARCH METHOD

The third chapter of this thesis discusses the methodology of the research in writing this thesis, the types of research, specific procedures in obtaining the research materials and the research technique used in writing this thesis.

CHAPTER IV: ANALYSIS

The fourth chapter of this thesis will be an analysis of the specific research issues. This chapter will analyze: **first**, whether the liberty provided to foreign investors to use the ISDS clause constitutes as a violation of International Investment Law and **second,** whether Indonesia can adopt alternative approaches that have been implemented by other states to the ISDS clause, instead of terminating its signed BITs.

CHAPTER V: CONCLUSION AND RECOMMENDATIONS

The fifth chapter of this thesis focuses on the overall conclusion and recommendations provided by the Author. The conclusion and the recommendations will be the final say and the suggestions from the Author in order to solve the existing problem that was researched upon for the purpose of this thesis.