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## Revising Bilateral Investment Treaties as a New Tendency in Foreign Investment Law: India and Indonesia in the Focus

Caslav Pejovic  
*Kyushu University, Japan, pejovic@law.kyushu-u.ac.jp*

Juliartha Nugrahaeny Pardede  
*The Embassy of Indonesia in the United Kingdom*

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# REVISING BILATERAL INVESTMENT TREATIES AS A NEW TENDENCY IN FOREIGN INVESTMENT LAW: INDIA AND INDONESIA IN THE FOCUS

Caslav Pejovic\* and Juliartha Nugrahaeny Pardede\*\*

\* Kyushu University, Japan

\*\* The Embassy of Indonesia in the United Kingdom

Correspondence: pejovic@law.kyushu-u.ac.jp

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## Abstract

*In the second half of 20th century the central theme of foreign investment debates was on balancing conflicting interests between developed and developing countries. As one of the most visible signs of this tendency is the process of revising bilateral investment treaties (BITs). This paper has focus on two countries, India and Indonesia. These two countries have been selected not only because of their size and importance for foreign investors, but also because of important reforms regarding BITs undertaken by these two countries that have attracted worldwide attention, particularly in other developing countries. These two countries have taken different routes, but motivated by similar concerns and objectives, and represent some of the most striking examples of the new tendency towards revision of BITs. The key issue that will be explored in this text is: What can be expected from this process of revising BITs and do the new BITs model provide for a good balance between the interests of host states and foreign investors? This is the core issue of foreign investment law, from the perspective of developing countries, which raises several further questions: How to design foreign investment law so that foreign investment can be attracted without impairing the interests of the host states? Is that possible at all, and what would be the good balance that developing countries should aim at? And, the central issue of this paper is: Do new BITs models contribute to these objectives of developing countries?*

**Keywords** : BIT, foreign investment, Indonesia

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## I. INTRODUCTION

In the second half of 20th century the central theme of foreign investment debates was on balancing conflicting interests between developed and developing countries. After the differences in protection of foreign investment diminished with greater protection granted by the developing countries, the foreign investment debates have shifted into a different direction. One of the topics that attracted attention relates to conflicting interests of host states and foreign investors. This is a private-public debate, though still having elements of developed-developing nations divide, since private investors typically come from developed nations, while host countries are often developing nations.

As one of the most visible signs of this tendency is the process of revising

bilateral investment treaties (BITs). According to the UNCTAD World Investment Report (2019), the number of terminations of international investment agreements terminated by the States continues to rise. By the end of 2018, the total number of effective terminations reached 309 (61% having occurred since 2010).<sup>1</sup>

In principle, BIT should be able to benefit both parties, based on the principle of reciprocity, equality and non-intervention in international law. However, in practice BITs have often favored the investors at expense of the host states which led to dissatisfaction and complaints in many developing countries. BITs often provided for disproportionate protection of investors and deprived the host states of some of the fundamental rights, such as protection of health, environment and national treasures. In a number of lawsuits, large amounts of compensation for damages were imposed against developing countries. As result, a number of developing countries has undertaken a comprehensive revision of BITs aimed at changing the balance of these treaties in favor of the host states.

This paper has focus on two countries, India and Indonesia. These two countries have been selected not only because of their size and importance for foreign investors, but also because of important reforms regarding BITs undertaken by these two countries that have attracted worldwide attention, particularly in other developing countries. These two countries have taken different routes, but motivated by similar concerns and objectives, and represent some of the most striking examples of the new tendency towards revision of BITs.

The key issue that will be explored in this text is: What can be expected from this process of revising BITs and do the new BITs model provide for a good balance between the interests of host states and foreign investors? This is the core issue of foreign investment law, from the perspective of developing countries, which raises several further questions: How to design foreign investment law so that foreign investment can be attracted without impairing the interests of the host states? Is that possible at all, and what would be the good balance that developing countries should aim at? And, the central issue of this paper is: Do new BITs models contribute to these objectives of developing countries?

After introducing the background of changes in India and Indonesia, the paper will discuss some of the key provisions of the respective BIT models, such as definition of investment, most favoured nation (MFN), fair and equi-

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<sup>1</sup> UNCTAD, *World Investment Report 2019* (New York and Geneva: UNCTAD, 2019), available at [https://unctad.org/en/PublicationsLibrary/wir2019\\_en.pdf](https://unctad.org/en/PublicationsLibrary/wir2019_en.pdf), accessed June 9, 2020, 100.

table treatment (FET); investor state dispute settlement (ISDS). The objective is not to provide a comprehensive and detailed analyses of these new BIT models, but the scope is limited to these several clauses that should serve as illustration of the new BIT trends. For each part, the paper discusses the current formulation for these provisions in the BIT models to examine how these two countries have addressed these issues and whether there are some similarities and differences in their approaches.

## II. BACKLASH AGAINST BITS AND THE REVISION MOVEMENT

There are many controversies and debates whether BITs have been meeting their objectives, and to what extent they actually contribute to attracting foreign investment. BITs have not been generally entered between developed countries, since their established legal systems protect private initiative and do not discriminate against foreign investors. Typical examples of BITs are between developed and developing countries. Developing states may have various reasons to limit their exposure to BIT claims and should be cautious when negotiating BITs. However, a number of developing countries have failed to realize how risky BITs can be and entered into the texts as proposed by the developed countries.<sup>2</sup>

While almost all states are engaged in the international investment protection structure through their BITs, an increasing number of states are not satisfied with the current regime. In the last several years there has been a movement to revise and even terminate BITs in many parts of the world, due to a number of arbitration awards by the arbitration tribunals against the host states; in a number of cases arbitration tribunals treated sovereign regulatory measures of host states as breaches of BITs. Some of these awards imposed on the host states large amounts of damages.<sup>3</sup> One of the reasons for successful claims against host states has been the vague and broad language of BITs, such as a broad interpretation of FET standard in combination with the concept of legitimate expectation.

BITs have been criticized for their alleged failure to allow countries to address their public policy concerns. A number of countries have made efforts to

<sup>2</sup> Poulsen uses the term ‘bounded rationality’ to explain the careless attitude of the governments of many developing countries that decided to sign BITs without proper assessment of the consequences they bear due to “the inflated expectations about the treaties’ economic benefits and the failure to appreciate their risks”. See, Lauge Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (Cambridge University Press, 2015).

<sup>3</sup> *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, PCA Case No. AA 227, (July 18, 2014). In this case the arbitration tribunal awarded the claimant more than \$ 1,8 billion as damages.

address these concerns by revising their BITs or renegotiating with their counterparts. As a result, there is a tendency towards drafting a new generation of BITs negotiated during the past several years. New treaties attempt to preserve sufficient policy power and regulatory flexibility for host states to pursue public welfare. New generation of BITs provides expressly for such authority of the host states, which substantially reduces the risk of claims asserting indirect expropriation. This is a part of the trend that switches the basis of claims against host states from sole effects doctrine towards police power doctrine.

A number of related issues have been given new contents, such as the issues related to protection of health and environment. Particular attention was given to the ISDS, in attempt to reduce the impact of BITs on sovereignty of the host states. There are various approaches that include termination of BITs, making decision not to enter into BITs in future,<sup>4</sup> abandoning the ISDS mechanism,<sup>5</sup> revision of BITs to incorporate public policy concerns, renegotiation, entering into new treaties without arbitration clauses; etc.<sup>6</sup>

The paper will introduce reforms of BITs undertaken by India and Indonesia, as two prominent examples of the new tendencies in this area. In line with the objective of this research, the scope will be limited to several provisions of the BITs drafted by these two countries that can serve to illustrate these new tendencies.

### III. INDIA

#### A. BACKLASH AGAINST BITS

India has been active participant in the BIT program since 1990s. In 1993 India developed its own BIT template that followed the OECD policy favouring protection of foreign investment. In 2003 India adopted its BIT model which was very similar to the contents of the India-UK BIT. Between 1994 to 2011, India had signed more than 80 BITs, and in that period there were no serious problems arising from those BITs. The situation has changed afterwards.

India launched a review of its investment treaties in mid-2012 in the wake of public outcry over arbitration claims made by a number of foreign investors. India's backlash against BITs was initiated particularly after the *White Industries v Republic of India* case in 2011.<sup>7</sup> In this case an ISDS tribunal

<sup>4</sup> For example, South Africa.

<sup>5</sup> Bolivia, Ecuador, and Venezuela have denounced the ICSID convention.

<sup>6</sup> Prabhash Ranjan, Harsha Vardhana Singh, Kevin James, Ramandeep, "India's Model Bilateral Investment Treaty: Is India Too Risk Averse?" *Brookings India IMPACT Series No. 082018*, August 2018.

<sup>7</sup> *White Industries Australia Limited v. Republic of India*, UNCITRAL, Final Award (Nov. 30, 2011)

held that India violated its obligations under the India-Australia BIT. This case arose when White Industries filed a case against India under the India-Australia BIT due to judicial delays in enforcing an arbitration award against Coal India Limited in India. White Industries argued that India had failed to provide “effective means of asserting claims and enforcing rights” to White Industries. The tribunal held India responsible for violating the effective means standard. After finding India not responsible for denial of justice, by invoking MFN standard, the tribunal imported the standard of “effective means” from the India–Kuwait BIT, which did not exist in the India–Australia BIT. The *White Industries* case represented a kind of wake-up-call for the Indian policy makers.<sup>8</sup>

In fact, this case was not the only one that raised concerns in India. According to UNCTAD, a total of 24 ISDS claims have been brought against India so far.<sup>9</sup>

These ISDS cases against India led to a fundamental rethink and review of BITs. As a consequence, India has terminated 61 of out of its 84 BITs and put all further BIT negotiations on hold.<sup>10</sup> India has served notices to 58 countries with whom existing BITs have expired expressing willingness to renegotiate a new BIT with these countries based on its Model. In another move, India has asked for joint interpretive statements (JIS) to clarify ambiguities in treaty texts, in order to avoid expansive interpretations by arbitration tribunals.<sup>11</sup>

## B. ADOPTION OF THE NEW BIT MODEL

As a result of efforts to improve its position in BITs, India adopted a Model BIT in 2016<sup>12</sup> to provide “appropriate protection to foreign investors in India” “while maintaining a balance between investor’s rights and the government’s obligations”.<sup>13</sup> The fact that model BIT acts as a template for the future BIT negotiations indicates that India intends to use the 2016 Model BIT as the basis to renegotiate its existing BITs and negotiate new BITs.<sup>14</sup>

<sup>8</sup> Prabhash Rajan, “India and Bilateral Investment Treaties—A Changing Landscape,” *ICSID Review - Foreign Investment Law Journal* 29, No. 2 (2014), 23.

<sup>9</sup> UNCTAD, “Investor – State Dispute Settlement: Review of Developments in 2017,” *IIA Issues Note*, iss. 2 (June, 2018), [https://unctad.org/en/PublicationsLibrary/diaepcbinf2018d2\\_en.pdf](https://unctad.org/en/PublicationsLibrary/diaepcbinf2018d2_en.pdf), accessed June 9, 2020.

<sup>10</sup> UNCTAD, “International Investment Agreements”, UNCTAD, <https://investmentpolicy.unctad.org/international-investment-agreements/countries/96/india>, last assessed on June 9, 2020.

<sup>11</sup> Ranjan, Singh, James, Ramandeep, “India’s Model Bilateral Investment Treaty,” 10.

<sup>12</sup> The government of India adopted the final text of Model BIT on January 14, 2016 after consultative process and issuance of the draft model BIT to public in March 2015.

<sup>13</sup> India Department of Economic Affairs, “Model Text for the Indian Bilateral Investment Treaty 2016,” India DEA, accessed June 9, 2020, [http://www.dea.gov.in/sites/default/files/ModelBIT\\_Annex\\_0.pdf](http://www.dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf).

<sup>14</sup> Rajan “Investment Protection and Host State’s Right to Regulate in the Indian Model Bilateral Investment Treaty Lessons for Asian Countries,” in *Asia’s Changing International Investment Regime* Julien Chaisse et al., eds. (Singapore: Springer, 2017), 48.

India's new Model BIT is a major departure from its earlier framework as it incorporates significant changes in its attempt to safeguard the interests of the host state. As it will be shown, many provisions in the Model BIT can be seen as a response to the claims made against India.

Several provisions of the BIT Model can serve as illustration of Indian efforts to improve its position in BITS: the Model BIT contains a narrow definition of investment, an extremely narrow FET-type provision, MFN clause is omitted, while the ISDS is subjected to a major revision.

### C. DEFINITION OF INVESTMENT

The definition of investment in the Model BIT has moved away from a broad asset-based definition of investment to an enterprise-based definition where an enterprise is taken together with its assets. Art 1.4 of the Indian Model BIT provides:

*“‘Investment’ means an enterprise constituted, organised and operated in good faith by an investor in accordance with the law of the party in whose territory the investment is made, taken together with the assets of the enterprise, has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the party in whose territory the investment is made. An enterprise may possess the following assets: (a) shares, stocks and other forms of equity instruments of the enterprise or in another enterprise; (b) a debt instrument or security of another enterprise; (c) a loan to another enterprise (i) where the enterprise is an affiliate of the investor, or (ii) where the original maturity of the loan is at least three years.”*

According to Article 1.4, “investment means an enterprise that has been constituted, organised, and operated in good faith by an investor in accordance with the domestic laws of the country.” Article 1.4 also provides a non-exhaustive list of assets that an enterprise may possess. It further provides that the enterprise must satisfy certain characteristics of investment such as commitment of capital and other resources, certain duration, the expectation of gain or profit, and the assumption of risk and significance for the development of the country where the investment is made.” This provision is in line with criteria developed by the *Salini* test.<sup>15</sup>

The Model BIT specifies the meaning of the juridical person imposing as requirement that only an enterprise that is legally constituted in India can bring

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<sup>15</sup> *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4.

a BIT claim.<sup>16</sup> Such company should have substantial business operations in the member state. Indian Model fails to contain an express “denial of benefits” clause by which the host state can deny the benefits of the treaty, including ISDS, in order to avoid treaty shopping by “mailbox companies”. However, the references to “substantial business activities in the territory of that Party” and that company is “directly owned or controlled by a natural person of that Party” (which make part of definition of investor) are sufficiently clear to exclude “mailbox companies”, unless they are owned or controlled by a national of an investor State.<sup>17</sup>

The portfolio investment is expressly excluded from the definition.<sup>18</sup> The same applies to debt securities, loans issued by a government or given to the government or government-owned or controlled enterprise, pre-operational expenditures, claims arising from commercial contracts, intangible rights such as goodwill, brand value, order or judgment sought or entered in any judicial or administrative or arbitral proceedings in the form of exclusionary provisions, etc.<sup>19</sup> This just adds to the impression that the definition of investment is aimed at reducing the risk of claims by foreign investors by narrowing the scope of investments protected under the BIT.

#### D. MFN CLAUSE

India’s model BIT omits the MFN clause. This can be seen as a response to the *White Industries* case (and other pending claims). In that case, White Industries Australia Limited invoked the MFN clause from the India-Australia BIT to benefit from the more favourable rights of investors provided for in the India-Kuwait BIT, so that it was able to invoke the right to be provided an effective means of asserting claims and enforcing rights. This case revealed the risks deriving from the MFN clause for the host states.

The exclusion of MFN is aimed to prevent such cases of “treaty shopping”, whereby foreign investors take advantage of provisions in other BITs by “borrowing” them through the MFN clause. The absence of an MFN provi-

<sup>16</sup> Art. 1.3 provides: enterprise means: (i) any legal entity constituted, organized and operated in compliance with the law of a party, including any company, corporation, limited liability partnership or a joint venture; and (ii) a branch of any such entity established in the territory of a party in accordance with its law and carrying out business activities there

<sup>17</sup> Art. 1.5 provides: “investor” means a natural or juridical person of a Party, other than a branch or representative office, that has made an investment in the territory of the other Party; For the purposes of this definition, a “juridical person” means: (a) a legal entity that is constituted, organised and operated under the law of that Party and that **has substantial business activities** in the territory of that Party; or (b) a legal entity that is constituted, organised and operated under the laws of that Party and that **is directly or indirectly owned or controlled by a natural person** of that Party or by a legal entity mentioned under subclause (a) herein.

<sup>18</sup> Art. 1.4(i).

<sup>19</sup> Art. 1.4 (ii)-(viii).



sion switches the balance towards host state's interests.

## E. FAIR AND EQUITABLE TREATMENT

In line with the concerns regarding the FET standard, the new Model BIT has substantially reduced the scope of the FET clause. The Model BIT does not completely exclude the FET standard. Article 3(1) imposes the obligation on the parties to refrain from “denial of justice in any judicial or administrative proceedings; or breach of fundamental due process.” The denial of justice represents a part of the FET standard, so that it is not completely excluded by the Indian Model BIT; its scope is just narrowed down. The Model BIT also prohibits “manifestly abusive treatment, such as coercion, duress and harassment.”<sup>20</sup>

One possible reason for this limitation of FET is that India intended to avoid the risk of the concept of legitimate expectations, which many tribunals have held to be a part of the FET provision. Exclusion of the legitimate expectations means that the foreign investor shall have no remedy even when India creates reasonable and justifiable expectations through its conduct or by giving assurances (which an investor then relies upon to invest), even when India fails to comply with those assurances.

After foreign investors sued India under different BITs, India realised that broad and vague investment protection standards can be interpreted in manners that give precedence to investment protection over the host state's right to regulate. Exclusion of the FET provision narrows down the scope of protection available to foreign investors. India clearly intended by this approach to avoid the risk that measures adopted for public policy concerns are challenged by foreign investors as violation of BIT's FET provision.

## F. SETTLEMENT OF DISPUTES

The Indian Model BIT retains the ISDS mechanism to settle disputes with foreign investors, but it adds a number of conditions that an investor needs to meet before accessing ISDS.

The new Model BIT qualifies the consent to ISDS by requiring that a foreign investor should first exhaust local remedies at least for a period of five years before commencing international arbitration.<sup>21</sup> The five years under the Model BIT are to be counted from the date when the foreign investor first acquired “knowledge of the measure in question and the resulting loss or damage to the investment” or when the investor should have first acquired such

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<sup>20</sup> Art. 3.1(iv).

<sup>21</sup> Article 15.1 and 15.2.

knowledge.<sup>22</sup>

The other critical element related to exhaustion of local remedies is that the foreign investor should submit the dispute to the local court within one year from the date on which the investor acquired the knowledge or should have acquired the knowledge about the measure.<sup>23</sup>

The requirement to exhaust local remedies shall not be applicable “if the investor can demonstrate that there are no available domestic legal remedies capable of reasonably providing any relief in respect of the same measure”.<sup>24</sup> The requirement to exhaust local remedies has the advantage of reducing the scope of an ISDS claim being brought against India. Nonetheless, timely and effective settlement of disputes is one of the major concerns for foreign investors in India. The rationale for the rather long five-years period might be that the Indian judiciary is heavily backlogged and operates slowly, so that a five-year period was considered as “reasonable in the Indian context”.<sup>25</sup> Even if so, the requirement that a foreign investor must first exhaust local remedies for a period of five years seems excessive and unfair to foreign investors. The example of recent BIT with Brazil which omits the ISDS provision from the Indian Model BIT and contains more simple provisions on dispute prevention procedure (article 18) and arbitration (article 19) indicate that India may have to give up its ISDS mechanism, particularly in BITs with large countries.<sup>26</sup>

The adoption of the Model BIT with the ISDS mechanism shows that India has rejected the extreme option exercised by countries like South Africa to walk out of the system. India wants to be a part of the system but with different terms of engagement. Consequently, India has changed the scope and content of certain key provisions in the Model BIT to limit challenges to its actions.

## IV. INDONESIA

### A. BACKGROUND OF BACKLASH

Indonesia has a rather long BIT history. BITs concluded in the early years of Indonesia’s development<sup>27</sup>, were aiming to attract foreign investors grant-

<sup>22</sup> Article 15.2

<sup>23</sup> Article 15.1.

<sup>24</sup> Article 15.4.

<sup>25</sup> Grant Hanessian and Kabir Duggal, “The Final 2015 Indian Model BIT: Is This the Change the World Wishes to See?” *ICSID Review* 32, no. 1 (2017), 222.

<sup>26</sup> India – Brazil BIT was signed on January 25, 2020, See UNCTAD, Investment Policy Hub, accessed on June 9, 2020, <https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/5912/download>.

<sup>27</sup> Indonesian first BIT was signed in 1968 with Denmark See: UNCTAD “Investment Policy Hub,” [ac-](#)

ing them a broad protection and rights while limiting the government's policy power.<sup>28</sup> Indonesia has concluded so far 72 BITs.<sup>29</sup>

Problems deriving from BITs have gradually changed the stance of Indonesia. Indonesia has been involved in a number of ISDS cases with a number of different foreign investors, including the *Churchill Mining and Planet Mining*,<sup>30</sup> *Newmont*,<sup>31</sup> and the latest one is the *Indian Metal and Ferro Alloys*.<sup>32</sup> As consequence there was a raising frustration fueled by the view that Indonesia was considered as "a place to play, not a player".<sup>33</sup>

In reaction to such unfavourable awards, Indonesia has terminated its 30 BITs and now is in the stage of reviewing its remaining BITs with the view to improve the balance between the investor protection and the national interests of Indonesia. With the previous experience of being exposed in international arbitration tribunals, the Indonesian government tries to achieve its economic development goals, but with some modification in its BITs.

During the review of its BITs process, it has been acknowledged that some features of the existing BITs potentially expose to serious risks the Indonesian national interests. In order to achieve the objective of reviewing its BIT, the Indonesian government has attempted to identify such provisions in its BITs in order to come up with the new model of BITs that will secure the national interests of Indonesia and still attract the foreign investments.

## B. CONTENTS OF THE INDONESIAN BITS

After the reviewing process, the Indonesian government decided to continue the renegotiation of its BITs. The most recent agreement concluded by the Indonesian government is the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) which was signed on 9 March

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cessed on June 9, 2020, <https://investmentpolicy.unctad.org/international-investment-agreements/countries/97/indonesia>.

<sup>28</sup> Jan Knörich and Axel Berger, "Friends or Foes? Interactions between Indonesia's International Investment Agreements and National Investment Law," German Development Institutes Studies (2014), 3-6.

<sup>29</sup> UNCTAD, "Investment Policy Hub: Indonesia," UNCTAD, accessed June 10, 2020, <https://investmentpolicy.unctad.org/international-investment-agreements/countries/97/indonesia>.

<sup>30</sup> *Churchill Mining PLC and Planet Mining Pty Ltd v. Republic Indonesia*, ICSID Case No. ARB/12/14 and 12/40 award on 29 November 2016.

<sup>31</sup> *Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia*, ICSID Case No. ARB/14/15.

<sup>32</sup> Ayomi Amindoni, "The Indian Mining Co. Sues Indonesia for \$581 Million," The Jakarta Post, November 18, 2015, accessed 23 October 2016, <http://www.thejakartapost.com/news/2015/11/18/indian-mining-co-sues-indonesia-581-million.html>.

<sup>33</sup> RSIS, "Indonesia's Bilateral Investment Treaties: Modernizing for the 21 Century," RSIS, accessed June 10, 2020, <https://www.rsis.edu.sg/rsis-publication/rsis/indonesias-bilateral-investment-treaties-modernising-for-the-21st-century/>.

2019. This agreement also includes the Investment Chapter.<sup>34</sup>

In the investment chapter of IA-CEPA, Indonesia and Australia try to balance the protection granted to investors and their investments with safeguards to preserve the right of the government to regulate in the public interest. The purpose of having the investment chapter in the IA-CEPA is to protect the investment of both countries and at the same time to maintain the policy power of the two governments and the right to regulate for public interest.

Being the most recent concluded investment agreement, the IA-CEPA can be used as illustration to analyze the new Indonesian approach to BITs. The focus here will be on several provisions of the IA-CEPA related to definition of investors, standards of treatment, as well as the ISDS mechanism.

### C. DEFINITION OF INVESTMENT

In the past, the Indonesian government had been exposed to the claims by investors of a third party that used the treaty shopping mechanism by establishing a mailbox company.<sup>35</sup> To avoid such risk, the IA-CEPA has made a clear distinction between an investor of a Party and investor of a non-Party, as follows:

*“investor of a Party means a Party, or a natural person of a Party or an enterprise of a Party, that seeks to make, is making, or has made an investment in the territory of the other Party; and investor of a non-Party means, with respect to a Party, an investor that seeks to make, is making, or has made an investment in the territory of that Party, that is not an investor of the other Party.”*<sup>36</sup>

The above definition indicates that an investor of a Party is the one who has a real economic activity and excludes any investor from third parties from right to gain protection under the IA-CEPA.

As an effort to improve the safety net for the Indonesian government, the Investment Chapter in the IA-CEPA has provision on denial of benefits as stipulated in Article 14.13.<sup>37</sup> Under the denial of benefits provision, the Indo-

<sup>34</sup> Chapter 14: Investment, <https://dfat.gov.au/trade/agreements/not-yet-in-force/iacepa/iacepa-text/Pages/iacepa-chapter-14-investment.aspx> (last assessed on June 10, 2020).

<sup>35</sup> *Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia* case illustrates the risks posed by BITs and potential abuses by foreign investors. Nusa Tenggara Partnership B.V. had seat in Amsterdam with zero employees, a typical case of “mailbox company” and it appeared as claimant against Indonesia on the basis of the Netherlands – Indonesia BIT: *Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia*, ICSID Case No. ARB/14/15.

<sup>36</sup> Article 14.1: Investment, *ibid.*

<sup>37</sup> Article 14.13: Denial of Benefits

A Party may deny the benefits of this Chapter:

nesian government will enjoy the protection against any investor of the non-Party who tries to get protection from the Agreement. To achieve that goal, the Indonesian and Australian governments have already defined the kind of investor that can enjoy protection of investment, *inter alia* the investor who has substantial business activities in the territory of the Parties.

#### D. STANDARDS OF TREATMENT

The IA-CEPA contains the provision of National Treatment (Article 14.4), Most-Favoured Nation Treatment (Article 14.5) and Minimum Standard of Treatment (Article 14.7).

The Article 14.4 on National Treatment states as follows:

*“1. Each Party shall accord to investors of the other Party treatment no less favourable than it accords, in like circumstances,<sup>9</sup> to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.*

*Each Party shall accord to covered investments treatment no less favourable than it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.*

*For greater certainty, the treatment to be accorded by a Party under paragraphs 1 and 2 means, with respect to a regional level of government, treatment no less favourable than the most favourable treatment accorded in like circumstances, by that regional level of government to investors, and to investments of investors, of the Party of which it forms a part.”*

The objective of this Article is to assure that foreign investor will be given a treatment which the host country gives to its own investors. Article 14.7

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- a. to an investor of the other Party that is an enterprise of the other Party and to investments of that investor if:
    - i. persons of a non-Party or the denying Party own or control the enterprise; and
    - ii. the enterprise has no substantial business activities in the territory of the other Party;
  - b. to an investor of the other Party that is an enterprise of the other Party and to investments of that investor if:
    - i. persons of a non-Party own or control the enterprise; and
    - ii. the denying Party adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments; or
  - c. to an investor of the other Party if a person of a non-Party owns or controls the enterprise and the denying Party does not maintain diplomatic relations with that non-Party.

specifies that the provision applies when the “like circumstances” exist. The “like circumstances” provision will set a parameter whether the foreign investor is in a comparable setting with the domestic investor, and whether the treatment accorded to the foreign investor is not less favourable than the treatment accorded to a domestic investor.

In Article 14.5, the provision on MFN states the following:

*“1. Each Party shall accord to investors of the other Party treatment no less favourable than it accords, in like circumstances, to investors and their investments of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.*

*Each Party shall accord to covered investments treatment no less favourable than it accords, in like circumstances, to investments in its territory of investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.*

*2. For greater certainty, the treatment referred to in this Article shall not encompass international dispute resolution procedures or mechanisms, such as those included in Section B (Investor-State Dispute Settlement).”*

The MFN provision remains the standard norm of the investment treaty that Indonesia previously had. The above provision obliges the host state to treat foreign investor in a way that is no less favorable than another investor from a third country. The MFN provision allows investor to import another Indonesia’s investment treaty to obtain a more generous protection. However, the IA-CEPA also provides that the MFN clause shall not cover the procedures or mechanism of the dispute resolution. Nevertheless, in the IA-CEPA, there are numerous safeguard provisions that can be used to minimize the risk of being exposed to claims under the ISDS mechanism.

The Minimum Standard Treatment in Article 14.7 states that:

*“1. Each Party shall accord to covered investments fair and equitable treatment and full protection and security.*

*For greater certainty:*

*“fair and equitable treatment” requires each Party to not deny justice in any legal or administrative proceedings;*

*«full protection and security» requires each Party to take such measures*

*as may be reasonably necessary to ensure the protection and security of the covered investment; and*

*the concepts of «fair and equitable treatment» and «full protection and security» do not require treatment in addition to or beyond that which is required under the customary international law minimum standard of treatment,<sup>14</sup> and do not create additional substantive rights.*

*3. A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.*

*4. For greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result."*

The term of "fair and equitable treatment" has expressed the denial of justice as an assurance to protect the foreign investor that the principle of due process and transparency will be upheld. The provision in paragraph (4) protects the government's right to regulate, although this may not be in line with the investor's legitimate expectations. The aim of this provision is to limit the discretionary power of arbitration tribunal to use a broad interpretation of FET standard.

## E. ISDS MECHANISM

One of the Indonesia's biggest concerns is the Investor-State Dispute Settlement (ISDS) clause. Such a clause has become a standard provision in many BITs, yet it puts a high pressure on the host states to comply with the commitments. According to the ISDS clause, foreign investors may sue the host states in the arbitration forum in case of non-compliance with the provisions of the BITs by treating a breach of contract between the host state and investor as a breach of BIT. The government of Indonesia is of the view that the ISDS in the previous BITs was not fair, in particular because it limited the policy power of Indonesia in term of the right to regulate issues that are of its national interests, such as protection of the health and environment.

IA-CEPA does not remove the ISDS clause. Instead, the IA-CEPA clarifies the protection that the States are willing to grant to investors, procedural rules and still maintain the policy space of the governments.

An ISDS claim based on IA-CEPA may only be brought in relation to commitments under the Investment Chapter. ISDS cannot be used to enforce other provisions of the agreement. At the same time, the IA-CEPA preserves each

government's right to adopt regulatory measure in the public interest; this means, for example, that public health related government measures cannot be challenged under ISDS.

Concerning the scope of the ISDS, under Article 14.20 the parties agree that the ISDS mechanism only applies to disputes between a party and an investor of another party to the covered investment and shall not apply to investment disputes occurred before the entry into force of IA-CEPA<sup>38</sup> This approach has helped the Indonesian government to set the timeline for the ISDS mechanism which only applies to the investment dispute after the entry into force of the IA-CEPA.

Indonesia's experience with ISDS process had led to drafting the clause that provides for consultation and conciliation as stipulated in Article 14.22<sup>39</sup> and 14.23.<sup>40</sup> By having a provision that allows the disputing party to initiate a consultation and conciliation, the Indonesian government will have the opportunity to develop a layer of dispute settlement in amicable way and not allowing the dispute to proceed to the arbitration forum directly.

Based on the consultations and conciliation provisions, a party must submit a written request for a consultation to settle the dispute. If the parties

<sup>38</sup> Article 14.20

1. This Section shall apply to disputes between a Party and an investor of another Party concerning an alleged breach of an obligation of the former under Section A which causes loss or damage to the covered investment of the investor ("investment dispute").
2. This Section shall not apply to investment disputes which have occurred prior to the date of entry into force of this Agreement.
3. A natural person possessing the nationality or citizenship of a Party may not pursue a claim against that Party under this Section.

<sup>39</sup> Article 14.22: Consultations

1. In the event of an investment dispute referred to in Article 14.20, the disputing parties shall as far as possible resolve the dispute through consultation, with a view towards reaching an amicable settlement. Such consultations shall be initiated by a written request for consultations delivered by the disputing investor to the disputing Party.
2. With the objective of resolving an investment dispute through consultations, a disputing investor shall provide the disputing Party, prior to the commencement of consultations, with information regarding the legal and factual basis for the investment dispute.
3. For greater certainty, the initiation of consultations shall not be construed as recognition of the jurisdiction of the tribunal.

<sup>40</sup> Article 14.23: Conciliation

1. If the dispute cannot be resolved within 180 days from the date of receipt by the disputing Party of the written request for consultations, the disputing Party may initiate a conciliation process, which shall be mandatory for the disputing investor, with a view towards reaching an amicable settlement. Such a conciliation process shall be initiated by a written request delivered by the disputing Party to the disputing investor.
2. The conciliation process under this Article can only be initiated by a written request delivered by the disputing Party within 180 days from the date of receipt by the disputing Party of the written request for consultations.
3. Expenses incurred in relation to the conciliation process shall be borne equally by the disputing parties. Each disputing party shall bear its own legal expenses.



cannot resolve the dispute within 180 days, the respondent State may submit the claim to conciliation. Either party may submit a request for a conciliation with a goal to achieve an amicable settlement. The main point is that the process to resort to an arbitration tribunal can only be done after going through the consultation and conciliation process.

The intention of the Indonesia's government to balance the right to regulate of the government and the right of investor is stipulated in the conclusion of an alternative course in the ISDS provision. The consultation and conciliation mechanisms have become an innovative layer of protection for both government and investor. Both sides may seek for amicable dispute settlement within a certain period of time before proceeding to the arbitration proceeding. During this stage, both sides are expected to come up with a settlement.

The Indonesia's position to have the alternative course in dispute settlement can be seen as a response to the criticism that Indonesia does not have a "investor friendly environment". Instead, Indonesia is trying to maintain its policy space without weakening the protection for investor. That being said, the IA-CEPA represents also a compromise between Indonesia and Australia, particularly that both governments have shared a common concern concerning the ISDS mechanism.

The attention given to the ISDS mechanism reflects the importance given by Indonesia to this part of BITs. Regardless of whether the speculations are right or not, the reaction of Indonesia has demonstrated that the ISDS clause has indeed become the greatest concern of Indonesian government. These provisions allow Indonesia to avoid that a dispute goes directly to arbitration by providing new levels of dispute settlement mechanism. It remains to be seen the reaction of foreign investors to these new dispute settlement procedures.

## **V. CONCLUSION**

India and Indonesia have taken bold measures to improve their positions with regard to BITs. The motives and objectives are similar. Process of revision in both countries was directly affected by negative experiences with the investment arbitration claims. Both countries have taken action to change the balance in their favour and acquire a stronger regulatory power. With regard the way of revising their BITs, there are some differences but also similarities in the approaches of these two countries.

India's decision to adopt a new Model BIT, especially in light of the grow-

ing debate on how to reconcile investment protection with host state's right to regulate should be welcomed from the position of the Indian national interests. The examples shown in this paper demonstrate a substantial change of balance in favour of host states. The real challenge is how far India will stick to its new Model BIT and be successful in negotiating BITs with other countries based on this Model BIT. The case of Brazil-Indonesia BIT signed in 2020 raises some doubts about the effectiveness of the Indian BIT Model, at least with regard to the ISDS clause. This clause might be too "ambitious" to protect the national interests of India which may impair its effectiveness in practice.

Indonesia has taken a different approach from India by not adopting its own BIT Model. Instead, the action has been taken to revise the terms in the new BITs. The contents of these BITs have some similarity, but also differences when compared with the Indian BIT Model. For example, Indonesia has decided to retain the MFN standard, but the experience of India should serve as a warning of potential risks deriving from this standard.

When it comes to termination of BITs, as a matter of principle, revision might be better option than termination. It is better to revise an unfavourable BIT and rectify its adverse effects, instead of simply terminating. The host states should be aware of the "sunset clause" that enables BITs to continue impacting the parties even after their termination (some BITs provide for 20 years of survival period).<sup>41</sup>

One important issue that will be observed is the impact these revisions of BITs in India and Indonesia will have on foreign investment to these two countries. Main goal of BITs is to protect foreign investment rather than promote it. It can be argued that foreign investment is promoted through its protection, but there is no hard evidence that would link these two in practice.<sup>42</sup> The profit is normally the most important incentive of investors. India and Indonesia are among the top four most populous countries in the world offering great potential to investors. Investors may come to these two countries even without any BITs.<sup>43</sup> However, the importance of BITs should not be underesti-

<sup>41</sup> For example, Art. 15(2) of the Netherlands – Indonesia BIT provides for "sunset" clause of 15 years. This means that all investments made until 2015 will be protected until 2030.

<sup>42</sup> M. Sornarajah, "Review of Asian views on foreign investment law," in *Foreign Investment and Dispute Resolution Law and Practice in Asia*, Vivienne Bath and Luke Nottage, eds. (Routledge, 2011) 252.

<sup>43</sup> According to the Citizen Global Watch report from 2018 (covering both India and Indonesia), "investment flows from former BIT partner countries were more likely to increase rather than decrease after BIT termination". Available at Public Citizen, "Termination of Bilateral Investment Treaties Has Not Negatively Affected Countries' Foreign Direct Investment Inflows," Public Citizen, April 16, 2018, accessed June 9, 2020, <https://www.citizen.org/article/termination-of-bilateral-investment-treaties-has-not-negatively-affected-countries-foreign-direct-investment-inflows/>. For opposite opinion, see, Gerard P.H. Kreijen, 'The Termination of Bilateral Investment Protection Challenges for Investors' (Jakarta, 2014).

mated; there is no doubt that investors prefer to invest in countries where their interests are well protected by BITs. The key issue is that protection of foreign investors should not be at expense of the national interests of the host state; or, more precisely, the issue is how to find a fair balance between these two potentially conflicting interests.<sup>44</sup>

India and Indonesia are two important countries, and their actions regarding revision of BITs are carefully observed. Of course, each country has its priorities and interests, but learning from other countries experience provides a useful guidance. Experiences can be good and bad, and both carry weight. What is the message sent by India and Indonesia to other developing countries? Should developing countries dispense all BITs? These two countries have made bold decisions and many countries may be reluctant to take similar actions. Nevertheless, India and Indonesia have sent an important message. Maybe the time has come to consider alternatives to BITs and their eventual replacement with investor-State negotiated contracts, an idea developed by Sornarajah.<sup>45</sup> The fact is that BITs are imposing obligations only on the host country's obligations, with no similar obligations imposed on foreign investors; they are just beneficiaries of BITs even without taking part in their negotiations. That system does not seem to be fair. On the other hand, foreign investors are exposed to a number of different risks in foreign jurisdictions and they do need a protection.

Anyway, BITs are likely to be used in future, and developing countries have various reasons to limit their exposure to BIT claims; they should be cautious when negotiating BITs in order to limit BIT protection to those investors who are meant to be protected, and not more than is fair for both parties. The examples of India and Indonesia represent illustration of the the emergence of a new generation of BITs, which is aimed at contributing to a balanced treatment of foreign investment and reducing risks for the host states. The time will show whether this new approach will actually enable the host states to achieve the intended objective of maximizing the benefits of foreign investment.

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<sup>44</sup> Abdulkadir Jailani, "Indonesia's Perspective on Review of International Investment Agreement," in *Rethinking Bilateral Investment Treaties Critical Issue and Policy Choices*, Kavaljit Singh and Burghard Ilge, eds., (Amsterdam and New Delhi: Both Ends, Madhyam, Somo, 2016) 114.

<sup>45</sup> M. Sornarajah, "Review of Asian views on foreign investment law" in Vivienne Bath and Luke Nottage (eds.), *Foreign Investment and Dispute Resolution Law and Practice in Asia* (Routledge, 2011) 252. There is certainly some weight in the argument of Professor Sornarajah that investment treaties "promote predatory lawyers and arbitrators" rather than economic development of the host states.

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