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Navigating Foreign Investment in Indonesia: Legal Risks, Obligations, and Policy Shifts Amid the Capital Relocation and New Administration

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The impending inflow of foreign direct investment (FDI) into Indonesia raises the prospect of potential claims for investment treaty arbitration by foreign investors. Such claims are based on breaches of the legal obligations undertaken by Indonesia as the host State and contained in the investment treaties that Indonesia has entered into.

There are at least three things to bear in mind for Indonesian SOEs and government agencies:

- In the context of investment treaty arbitration, the actions and conduct of SOEs or government-linked entities may be attributable to the State. This is because the State acts through its various agencies/entities and accordingly the State may be held responsible for the actions of such agencies / entities.
- Even after a bilateral investment treaty (or 'BIT') has been terminated, a host State can still be liable for breaches of obligations in the terminated BIT by virtue of "Sunset Clauses". The effect of "Sunset Clauses" is that foreign investors can sue the host State in relation to investments made during the period while the treaty was in force, usually up to a period of 10 to 20 years post-termination.
- Transparency is a key feature for some of the modern BITs. This means that the nature of the dispute, identity of parties and the arbitral award may be disclosed to the public at large.

Background

Indonesia is reported to have attracted more than US$47 billion[1] in foreign direct investments (FDI) in 2023. Given the Indonesian government's ambitious project to move the capital city from Jakarta (in Java) to Nusantara (in East Kalimantan) by 2045[2] and the continuation and expansion of the downstream policy[3], this figure is set to increase dramatically over the next few years.

The newly elected president, Prabowo Subianto, has also set an ambitious target for foreign investment, aiming to increase it to Rp1,900 trillion[4]. This goal builds on the continuation of Jokowi's policies. However, Prabowo also plans to introduce new policies that, while not directly related to foreign investment, could significantly impact Indonesia's overall financial stability. For instance, his proposed lunch program has raised concerns among investors about potential fiscal loosening under the new administration[5]. If such fiscal relaxation were to occur, it could lead to the cancellation of government projects aimed at budget conservation, which might prompt FDI investors to claim breaches by Indonesia of its international obligations. In light of this, the government must navigate the transition from the Jokowi administration to the Prabowo administration with caution.

[1] https://www.reuters.com/markets/asia/indonesia-sees-fdi-worth-47-bln-2023-investment-ministry-2024-01-24/
[2] https://www.antaranews.com/berita/3743721/mewujudkan-sdm-indonesia-emas-2045-melalui-pembangunan-ikn-nusantara
[3] https://www.cnbcindonesia.com/news/20240816183443-4-563886/investasi-di-era-prabowo-ditargetkan-naik-jadi-rp-1900-t
[4] https://www.cnbcindonesia.com/news/20240816183443-4-563886/investasi-di-era-prabowo-ditargetkan-naik-jadi-rp-1900-t
[5] https://www.reuters.com/world/asia-pacific/prabowos-free-meal-plan-stirs-investor-fears-about-indonesias-finances-2024-07-07/

In this context, Indonesia has many investment protection treaties – 29 BITs and 19 Treaties with Investor-State Dispute Settlement (ISDS) provisions in force as of September 2023.[6] Such investment treaties permit foreign investors to commence arbitration proceedings (under ICSID or otherwise) against Indonesia to seek redress for infringement of their property rights.

While Indonesia recently decided in 2014 to terminate and renegotiate some of its BITs (e.g., Indonesia - Netherlands BIT 1994),[7] Indonesia's obligations under such treaties as a host state survive termination for the next 10 to 20 years by virtue of "sunset" clauses. It is therefore crucial for government agencies and SOEs to be aware of the legal risks and obligations involved in this complex legal landscape.

Scope of Indonesia's Legal Obligations to Foreign Investors

Unlike commercial arbitration, a host State's legal obligations to foreign investors are usually contained in an investment agreement or treaty and supplemented by customary international law and general principles of international law[8] and are not based on the contractual principles belonging to a certain country. Such substantive treaty protections are offered by States to foreign investors in order to attract foreign investment. For example, if a mining concession previously granted to a foreign investor has been unilaterally revoked or terminated arbitrarily without compensation, the foreign investor may commence a claim in expropriation against the State if there is an applicable investment treaty which grants such protection to the foreign investor.

In relation to the mining sector in Indonesia, a key question is whether the Indonesian government's policy to mandate downstream processing of mining products, which may cause mining companies—including foreign investors—to suffer a period of profit loss due to the prohibition on exporting raw mining products and the requirement to invest in smelting facilities, could be considered a violation of a BIT.

Ultimately, the scope and extent of Indonesia's legal obligations to foreign investors is wholly dependent on the treaty or treaties which applies to a particular investment and investors of a particular nationality. For instance, investors who are nationals of Singapore will be granted protection under the Indonesia - Singapore BIT (2018), while Qatari investors will be covered under the Indonesia - Qatar BIT (2000).

Some of the more common substantive obligations found in most, if not all, investment treaties are as follows:

1. **Expropriation without prompt, adequate and effective compensation:** A host State cannot, directly or indirectly, seize or substantially deprive of the economic benefit of a foreign investor's investment without prompt, adequate and effective compensation. The legality of expropriation also usually depends on factors such as whether the expropriation is for a public purpose, whether it is discriminatory vis-à-vis the investor, and whether it is done in accordance with due process principles.
2. **Fair and Equitable Treatment (FET):** A host State should treat a foreign investor's investments fairly and equitably, and such treatment may include notions such as legitimate expectations, transparency, predictability, consistency and denial of justice.
3. **Full Protection & Security:** A host State should take reasonable steps to provide full protection and security for the foreign investor's investments. While the protection granted is usually physical in nature (e.g., precautions to ensure that a factory is not destroyed in a military operation), it may also extend to intangible protection such as by way of legislation.
4. **National Treatment:** A host State is obliged to treat a foreign investor in a manner which is no less favourable than how a local investor from the host State is treated;
5. **Most-Favoured-Nation (MFN) Treatment:** A host State is obliged to treat a foreign investor in a manner which is no less favourable than foreign investors from any other state.
6. **Prohibition against Unreasonable, Arbitrary or Discriminatory Measures:** A host State should not take unreasonable, arbitrary or discriminatory measures against the investments of a foreign investor. This is usually a fact specific enquiry, and its application may vary depending on the phraseology of the treaty clause in question.

[6] https://investmentpolicy.unctad.org/international-investment-agreements/countries/97/indonesia
[7] https://www.ft.com/content/3755c1b2-b4e2-11e3-af92-00144feabdc0
[8] Dolzer, Kreibaum & Schreuer, "Principles of International Investment Law", 3rd ed OUP 2022, p22-23

7. **Umbrella Clause:** A host State should uphold any obligation it has assumed with regards to specific investments made within its territory by investors. Due to the vague nature of the clause, some tribunals have found that "any obligation" extends to contracts entered into with the foreign investor, such that contractual breaches are effectively transformed into treaty violations. As such, umbrella clauses have been gradually phased out and are rare in the more modern BITs.

While most investment treaties will contain some or all of the abovementioned obligations, the exact scope of an obligation may differ from treaty to treaty. This is because during treaty negotiations contracting States may have different views as to how an obligation should be structured, and therefore each treaty is "tailor-made" to the contracting parties involved. As such, the key in ascertaining the scope of Indonesia's legal obligations is to identify the applicable investment treaty.

Regarding the concern about the government's policies in the mining sector, if the government prohibits the export of raw mining products and requires significant investment in smelting facilities, the policy could be seen as unfairly altering the regulatory landscape, imposing unexpected burdens on foreign investors. This could potentially be viewed as a violation of the FET standard. Additionally, if these measures effectively deprive investors of the use and economic benefit of their investments without adequate compensation, they could be considered indirect expropriation, violating the expropriation clause typically included in BITs. Similarly, policies that lead to fiscal loosening could also be perceived as breaching these principles, particularly if they undermine investor confidence and stability, further impacting the investment environment.

Aside from identifying the applicable investment treaty, there are at least three concepts relevant to Indonesian SOEs, government-linked entities and agencies:

1. Attribution of the Actions of State-Owned Enterprises & Government Agencies to the State

"Attribution is the process whereby international law determines that a particular conduct is to be regarded as activity of a State which is capable of leading to State responsibility"[9]. The question of attribution frequently arises in the context of SOEs and government-linked entities. While an SOE or government-linked entity is a separate and distinct legal entity from the State, it is generally accepted under international investment law that the international wrongful acts of a SOE or government-linked entity may in certain instances be attributable to the State.[10] For example, Articles 5 and 8 of the International Law Commission's Articles on Responsibility of States for International Wrongful Acts[11] (ARISWA) have been often cited by arbitral tribunals as guidance, and tribunals have frequently applied this concept to SOEs (e.g., Maffezini v Spain, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction dated 25 January 2000 at [79]).

However, attribution in the context of SOEs is by no means settled or conclusive. Unlike State organs which are clearly governmental in nature (e.g., the police force or national armed forces of the State)[12], SOEs straddle the public-private divide. In certain cases, the Tribunal will look at whether the conduct of the SOE is "governmental in nature" (meaning whether it in fact exercises governmental authority)[13], the degree of State control over the particular action[14], or if the conduct can be carried out by private individuals (Maffezini v Spain, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction dated 25 January 2000 at [80]). As such, while SOEs' conduct generally cannot be attributed to the State, much will depend on the context, the applicable treaty, and the parties in question.

Under Indonesian law, SOEs have a dual role: they operate commercially while also fulfilling public service obligations[15]. Given this dual role, certain actions taken by an SOE could potentially be viewed as State actions. This interpretation is supported by Article 66(1) of the Law No. 19 of 2003 on SOEs, which allows the government to assign specific tasks to SOEs to fulfil public service

[9] Dolzer (ibid n5) p313
[10] Albert Badia, 'Chapter 6: Attribution of Conducts of State-Owned Enterprises Based on Control by the State', in Crina Baltag, ICSID Convention after 50 Years: Unsettled Issues, (© Kluwer Law International; Kluwer Law International 2016), pp. 189 – 208
[11] https://legal.un.org/ilc/texts/instruments/english/draft_articles/9_6_2001.pdf
[12] Art 4, ARISWA would apply; see also Dolzer p315
[13] Art 5, ARISWA would apply; see also Dolzer p315
[14] Art 8, ARISWA would apply; see also Dolzer p315
[15] Art. 2 (1), Law No. 19 of 2003 on SOEs.

obligations. For example, PT Perusahaan Listrik Negara (Persero), operating in the electricity sector, and PT Pos Indonesia (Persero), operating in the postal services sector, are tasked with such responsibilities. These entities must exercise caution in their interactions with foreign investors to avoid potential violations of the State's obligations under BITs.

This is especially crucial when an SOE engages in agreements with foreign investors. Tribunals have previously ruled that breaches of contract can constitute a violation of a State's obligation under BITs, particularly under the Umbrella Clause (SGS v Philippines, ICSID Case No. ARB/01/8, Award on Jurisdiction dated 29 January 2004 at [117] and [128]) and the FET Clause (Mondev v USA, ICSID Case No. ARB(AF)/99/2, Award of the Tribunal, at [134]. It should be noted, however, that a simple breach of contract would not amount to a breach of a State's obligation under a BIT, in that the Tribunal found that the determining factor is whether the State has acted in an official, governmental capacity.

Thus, Indonesian SOEs must ensure that their conduct towards foreign investors aligns with Indonesia's obligations under BITs. By understanding and adhering to the legal requirements prescribed in BITs, they can better navigate the complex legal landscape and mitigate the risk of being implicated in disputes that could result in State liability. These considerations are essential for safeguarding Indonesia's interests in the international context.

2. Sunset Clauses

Between 2014 and 2017, Indonesia terminated a great number of its BITs, but may nevertheless be liable to treaty obligations under these BITs for the next 10 to 15 years. This is because most investment treaties and BITs contain a "sunset clause", whereby investments made when the treaty is in force would still be protected by the treaty for a fixed period of time, post-termination of the BIT. Such a clause is meant to protect investors who, unfortunately, have relied on the BIT to make an investment, only to have the BIT terminated after inception of the investment.

Sunset clauses are typically located within the section of the BIT providing for termination of the BIT and will usually provide a time period of between 10 to 20 years post-termination. Usually, the only condition is that the investment must be made during the time period when the treaty is in force and before notice of termination. The following is a non-exhaustive list of terminated BITs with sunset clauses which Indonesia is a party to:

List of Terminated BITs with Sunset Clauses

S/N	BIT Title	Date of Termination	Sunset Clause Period
1.	Australia - Indonesia BIT (1992)	06/08/2020	15 years
2.	Indonesia - Kyrgyzstan BIT (1995)	18/02/2018	10 years
3.	Germany - Indonesia BIT (2003)	01/06/2017	20 years
4.	Indonesia - Spain BIT (1995)	18/12/2016	10 years
5.	Indonesia - Pakistan BIT (1996)	02/12/2016	10 years
6.	Argentina - Indonesia BIT (1995)	19/10/2016	10 years
7.	Indonesia - Singapore BIT (2005)	20/06/2016	10 years
8.	India - Indonesia BIT (1999)	07/04/2016	15 years
9.	Hungary - Indonesia BIT (1992)	12/02/2016	10 years
10.	Cambodia - Indonesia BIT (1999)	07/01/2016	10 years
11.	Indonesia - Romania BIT (1997)	07/01/2016	10 years
12.	Indonesia - Turkey BIT (1997)	07/01/2016	10 years
13.	Indonesia - Viet Nam BIT (1991)	07/01/2016	15 years
14.	Indonesia - Lao People's Democratic Republic BIT (1994)	13/10/2015	10 years
15.	Indonesia - Netherlands BIT (1994)	30/06/2015	15 years
16.	Indonesia - Italy BIT (1991)	23/06/2015	10 years
17.	Indonesia - Malaysia BIT (1994)	20/06/2015	10 years
18.	China - Indonesia BIT (1994)	31/03/2015	10 years
19.	Indonesia - Slovakia BIT (1994)	28/02/2015	10 years
20.	Bulgaria - Indonesia BIT (2003)	25/01/2015	10 years
21.	Egypt - Indonesia BIT (1994)	30/11/2014	10 years
22.	Germany - Indonesia BIT (1968)	02/06/2007	20 years

Given that the above list of treaties is fairly substantial, it is critical to take note of the dates when claims under such terminated treaties may be made, and when a terminated treaty may finally be regarded as incapable of giving rise to a claim. However, it should also be noted that the protection and obligations granted under these treaties have been replaced and superseded by newer treaties. For example, the Indonesia - Singapore BIT (2018) appears to replace the Indonesia - Singapore BIT (2005), and the ASEAN Comprehensive Investment Agreement (2009) also provides investment treaty protection to ASEAN contracting States as well. As such, the termination of a treaty or the expiry of the Sunset Clause period does not necessarily mean that the particular class of foreign investor no longer has investment protection. It is therefore crucial to keep up to date with and monitor new BITs or regional treaties so as to ascertain the exact scope of Indonesia's legal obligations to foreign investors.

3. Transparency

Like international commercial arbitration, investment arbitrations can be confidential (except ICSID arbitration which allows for intervention of third parties and the publication of awards). However, given that arbitral awards can run up to quite a few billion dollars and can generate intense public interest, some recent BITs have mandatory transparency or disclosure regimes. Such clauses may require the disputing party to disclose arbitral awards or other documents involved in the proceedings. For example, Article 14.31 of Chapter 14 to the Australia-Indonesia Comprehensive Economic Partnership Agreement 2019 mandates that:

> "…*the disputing Party shall make publicly available all awards and decisions produced by the tribunal*", subject to information which the tribunal deems to be confidential.

This is in line with global efforts to improve the legitimacy of the ISDS regime, and has culminated in the 2014 United Nations Convention on Transparency in Treaty-based Investor-State Arbitration or The Mauritius Convention.[16] As such, global trends towards transparency will only accelerate and therefore States and SOEs will have to carefully consider transparency clauses in the applicable BITs/treaties and weigh its impact before considering arbitration.

Conclusion

Investment treaty arbitration and BITs are double-edged – it is used to attract foreign investors by granting investment protection and on the other hand it allows potential claims in arbitration to be commenced against the State and depletion of State resources. Such risks may grow as Indonesia engages in infrastructural and construction projects involving foreign investors. To mitigate the legal risks involved, State agencies and SOEs must be keenly aware of the legal landscape before engaging in a particular course of action. Given the manifold considerations as highlighted above, this would likely be a complex task involving a number of difficult legal issues.

[16] https://uncitral.un.org/en/texts/arbitration/conventions/transparency

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