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INVESTMENT DISPUTES AND INTERNATIONAL ARBITRATION – THE SAGA CONTINUES[1][2][3][4][5]

INTRODUCTION

A draft Government Regulation has recently been circulated, for discussion, which is intended to address the thorny issue of resolution of disputes between investors and GoI.

The draft Government Regulation deals with both domestic investment and foreign investment disputes involving GoI. However, the emotional and unfortunate history of past disputes between foreign investors and GoI means it is inevitable that the potential implications of the draft Government Regulation, for foreign investor disputes with GoI, will attract the greatest attention.

GoI's proposals for dealing with investment disputes are particularly relevant to investors in the local mining industry where some of the most high profile and intractable disputes with investors have arisen to date and still remain outstanding in many cases. Foreign investors in the local construction, energy and O&G industries should, however, also take careful note of these proposals given the long term and highly capital intensive nature of typical investment projects in these industries.

On a superficial reading of the draft Government Regulation and ignoring other relevant developments, the proposals might almost look reasonable. Unfortunately, however, a more detailed study of the draft Government Regulation and taking into account other relevant developments suggest that the proposals are really just intended to protect the interests of GoI by ensuring GoI can, except in very limited circumstances, avoid international arbitration of disputes with foreign investors if it does not expressly agree to such international arbitration on a case by case basis. The likelihood of GoI ever agreeing to international arbitration is, of course, wholly non-existent in the case of any individual dispute with a foreign investor.

In this article, the writer will review the draft proposals for resolution of disputes with investors and explain why many of these proposals do not, in their current form, even begin to address the well-founded concerns of investors with respect to having their disputes, with GoI, resolved by the Indonesian courts.

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[5] This article first appeared in the August-September 2016 edition of Coal Asia Magazine.

BACKGROUND

GoI's implacable opposition to international arbitration of disputes with foreign investors is a long running phenomenon that is, invariably, couched in highly charged, emotional terms such as "attacks on Indonesian sovereignty" and foreign multinationals "ganging up on" and "conspiring against" developing/newly industrialized countries such as Indonesia.

This opposition, on the part of GoI, to international arbitration of disputes with foreign investors, is despite the fact that Indonesia is party to numerous, freely negotiated (i) contracts of work ("**CoWs**") and coal contracts of work ("**CCoWs**") and (ii) bi-lateral investment treaties with other countries ("**BITs**") which, usually if not always, provide for international arbitration of disputes. Indonesia is also a signatory to the 1966 Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("**ICSID Convention**") which provides for the settlement of investment disputes at the International Centre for Settlement of Investment Disputes ("I**CSID**") in Washington DC.

Since 2009, GoI has been endeavoring to force large mining companies to renegotiate their CoWs/CCoWs in a way that would eventually see large mining companies receive special mining licenses ("**IUPKs**") in place of their existing CoWs/CCoWs. Unlike CoWs/CCoWs, IUPKs do **not** come with any right to international arbitration of disputes with GoI.

In early 2014, GoI (i) informed The Netherlands that its BIT with Indonesia would be terminated from July 2015 and (ii) indicated that it would, at the earliest possible opportunity, terminate/not renew **all** of its sixty two BITs with other countries including Australia, China, France, Germany, India, Singapore, South Korea and the United Kingdom.

Readers interested in knowing more about the history of GoI's opposition to resolution of disputes with foreign investors, by way of international arbitration, are referred to various previous articles by the writer including (i) "*Churchill Mining International Arbitration – The GoI Reaction*", Coal Asia Magazine, August – September 2012, (ii) "*No More Bi-Lateral Investment Treaties – Has The Queen of Hearts Made a Comeback?*", Coal Asia Magazine, April – May 2014 and (iii) "*CoW/CCoW Renegotiations and International Arbitration – A Tale of 2 (Very Different) Cities*", Coal Asia Magazine, August – September 2014.

Against the above background, readers should have little difficulty in understanding that the recently circulated draft of Government Regulation re Investor – State Investment Dispute Resolution ("**Draft ISIDR Regulation**") is just the latest move in and a continuation of a long running strategy by GoI to insulate itself, as much as possible, from international arbitration of disputes with foreign investors.

COMMENTARY

1. **Overview of Draft ISIDR Regulation**: The Draft ISIDR Regulation purports to set out a comprehensive legal framework for resolving investment related disputes, regardless of industry, between investors (whether domestic or foreign) and GoI.

2. **Legal Justification**: The claimed legal justification for the Draft ISIDR Regulation is Article 32 of Law No. 25 of 2007 re Investment ("**IL**") which provides that:

(a) where an investment dispute arises between GoI and an investor, the parties shall first endeavor to settle the dispute amicably;

(b) where it is not possible to settle an investment dispute amicably, the dispute may be settled through arbitration or alternative dispute resolution or by a court of law in accordance with the relevant laws and regulations;

(c) where an investment dispute arises between GoI and a domestic investor, the parties may go to arbitration for settlement based on agreement between the parties but, if dispute settlement through arbitration cannot be agreed on, then the dispute shall be settled by a court of law; and

(d) **where an investment dispute arises between GoI and a foreign investor, the parties shall settle the dispute through international arbitration that must be agreed on by the parties** ("**IL Article 32**").

GoI's dilemma is that the BITs and many existing contracts to which GoI is party (**eg**, CoWs/CCoWs) provide for international arbitration and, therefore, mean that GoI is deemed to have agreed to international arbitration of disputes as contemplated by IL Article 32. This is, most definitely, **not** where GoI wants to be.

The Draft ISIDR Regulation states that is simply intended to "*provide legal certainty and business certainty for investors*". Once they understand what is in the Draft ISIDR Regulation, however, many investors may be actually quite happy to "pass" on GoI's "generous offer" to provide them with "*legal certainty and business certainty"* unless (i) the Draft ISIDR Regulation is substantially revised before its finalized and issued and (ii) becomes part of a comprehensive overhaul of the Indonesian court system.

3. **Relevant Investors**: The Draft ISIDR Regulation applies to disputes between GoI and investors which carry out investment in Indonesia (Draft ISIDR Regulation Article 2(1)) **subject to various exceptions** including most importantly:

(a) foreign investors with investments in Indonesia, **which investments are carried out by an entity owned and controlled by the foreign investors but incorporated in a third-party state (i.e., not the home country of the foreign investors), which entity does not have any substantial business operations in its state of incorporation ("Jurisdiction of Convenience Exception")**; and

(b) foreign investors with investments in Indonesia, which investments are carried out by legal entities owned and controlled by domestic investors ("**Nominee Exception**") (Draft ISIDR Regulation Article 3(a) and (b)).

The Jurisdiction of Convenience Exception is clearly intended to deny the very limited rights offered by the Draft ISIDR Regulation to foreign investors who structure their investments in Indonesia through a particular offshore jurisdiction selected solely because it has existing treaties with Indonesia that offer better protection or other more favorable treatment to foreign investors than do the existing treaties between the home countries of foreign investors and Indonesia.

The Jurisdiction of Convenience Exception has major implications for foreign investors which have traditionally viewed Singapore as their preferred offshore jurisdiction, when it comes to Indonesian investments, because of Singapore's favorable tax treaty with Indonesia and/or, more recently, because of the Australia, ASEAN, New Zealand, Free Trade Agreement ("**AANZFT Agreement**") to which both Indonesia and Singapore are party. Many foreign investors, which set up special purpose vehicles in Singapore, have no substantial investments in Singapore.

The Nominee Exception effectively excludes, from the scope of the Draft ISIDR Regulation, foreign investors which use nominee arrangements in order to invest in sectors of the Indonesian economy otherwise closed to foreign investment or to avoid/evade compliance with the foreign ownership limitations applicable to certain sectors of the Indonesian economy. The Nominee Exception is clearly intended to discourage the use of nominee arrangements which continue to exist, in surprising numbers, notwithstanding the fundamental legal problems with the same.

As the Draft ISIDR Regulation, in its current form, offers so little real benefit to foreign investors, foreign investors caught by either the Jurisdiction of Convenience Exception or the Nominee Exception may actually be no worse off or, indeed, even better off as a consequence of being excluded from its coverage. This obvious irony has, no doubt, been entirely lost on the bureaucrats responsible for the Draft ISIDR Regulation.

4. **Compulsory Amicable Settlement Discussions**: Any investment dispute must be the subject of amicable settlement discussions between GoI and the relevant investor for a period of not less than sixty days (Draft ISIDR Regulation Article 4(1)).

   No one can, of course, reasonably object to compulsory amicable settlement discussions for a limited period. The reality, though, is that, whether compulsory or not, a first attempt at settlement discussions is a "given" in any investment dispute with GoI. No rational investor is going to commence legal proceedings, of any type, against GoI without, first, trying to negotiate a reasonable settlement and thereby avoid the need for expensive, time consuming and ultimately uncertain legal proceedings. Legal proceedings, especially international arbitration, against GoI is effectively a strategy of last resort (and, indeed, an exit strategy for most foreign investors) in the case of every investment dispute.

5. **Failure of Amicable Settlement Discussions**: In the event that the amicable settlement discussions fail to resolve the investment dispute, "*investors may choose*" dispute resolution by:

   (a) arbitration;

   (b) alternative dispute resolution; or

   (c) court proceedings (Draft ISIDR Regulation Article 4(3)).

   As will become readily apparent to readers from what follows, the promised "right" of investors to "choose" the applicable dispute resolution mechanism is actually much more limited than it might otherwise seem from Draft ISIDR Regulation Article 4(3) alone and, indeed, is substantially non-existent in many cases.

6. **Arbitration**: Any arbitration of an investment dispute between GoI and a domestic investor is to be by way of local arbitration while any arbitration of an investment dispute between GoI and a foreign investor is to be by way of international arbitration (Draft ISIDR Regulation Article 5(1)).

   Dispute resolution by way of arbitration must, however, be carried out "**in accordance with agreement between the parties**" (Draft ISIDR Regulation Article 5(2)). In other words, **GoI** (as well as the investor) **must expressly agree to arbitration before it is possible to have the dispute** resolved by arbitration.

   If GoI does **not** agree to arbitration (which one must reasonably assume will always be the case in disputes with foreign investors given GoI's past vociferous opposition to international arbitration), then the investors' only choices are alternative dispute resolution (**i.e.**, mediation) or the courts (**i.e.**, local Indonesian court proceedings).

   In the event that an investor opts for mediation but it is not possible to arrive at a mediated settlement with GoI (**i.e.,** a settlement acceptable to both the investor and GoI), then local Indonesian court proceedings become the only alternative.

   Contrary to first appearances, the Draft ISIDR Regulation really only commits GoI to mediation where (i) GoI has not previously agreed to arbitration, (ii) GoI refuses now to consent to arbitration and (iii) the hapless investor opts for mediation in a final endeavor to avoid local court proceedings. Mediation, though, does **not** guarantee any resolution of the investment dispute as a mediation induced settlement is entirely voluntary.

   Given the Draft ISIDR Regulation provides for compulsory discussion, over at least sixty days and as the first step in resolving any investment dispute with GoI, the writer questions how likely it is that subsequent meditation will be successful when the compulsory discussion process did not result in any settlement. As GoI will surely be in a much stronger position than the investor, in any resulting local court proceedings, this would seem to create a seriously, negative disincentive for GoI to make many concessions to the investor during the mediation.

7. **Agreement of GoI – Domestic Investor Disputes**: In the case of an investment dispute between GoI and a domestic investor, GoI's agreement to arbitration may be in the form of:

   (a) an existing contract between GoI and the relevant domestic investor which expressly provides for arbitration; or

   (b) in the absence of any such existing contract, written approval of/consent to arbitration by/from GoI, such approval/consent to be obtained (if at all) through written application, by the domestic investor, to BKPM ((Draft ISIDR Regulation Article 6).

8. **Agreement of GoI – Foreign Investor Disputes**: In the case of an investment dispute between GoI and a foreign investor, GoI's agreement to arbitration may be in the form of:

   (a) an existing BIT, regional or multilateral treaty between the relevant foreign investor's state and GoI, which BIT, regional or multilateral treaty expressly provides for international arbitration;

(b) an existing contract between GoI and the relevant foreign investor which expressly provides for arbitration; or

(c) in the absence of any such existing treaty or contract, written approval of/consent to arbitration by/from GoI, such approval/consent to be obtained (if at all) through written application, by the foregoing investor, to BKPM ((Draft ISIDR Regulation Article 7(1), (3) and (4)).

In the event only, that GoI has already consented to international arbitration, the relevant foreign investor may commence international arbitration of the dispute in accordance with (i) the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, (ii) the ICSID Additional Facility Rules, (iii) the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules or (iv) any other arbitration procedures agreed between the foreign investor and GoI (Draft ISIDR Regulation Article 7(2) and (3)).

GoI has been extremely industrious, since early 2014, in doing everything it can to ensure that there will, as soon as possible, be **no** BITs for it to have to worry about. Research by the writer's staff has revealed that, in fact, twenty one BITs have been terminated/not renewed by GoI since April 2014. These long standing BITs were with (i) The Netherlands, (ii) Bulgaria, (iii) Italy, (iv) Malaysia; (v) Egypt, (vii) Slovakia, (vii) Spain, (viii) China, (ix) Kyrgyztan, (x) Laos, (xi) France, (xii) Cambodia, (xiii) India, (xiv) Norway, (xv) Romania, (xvi) Turkey, (xvii) Vietnam, (xviii) Hungary, (xix) Singapore, (xx) Pakistan and (xxi) Germany. Quite an impressive, albeit worrying, tally in such a short period of time!! The only reason the remaining forty one BITs have not yet been terminated/not renewed is that the relevant renewal dates have not been reached. No one should doubt, however, the remaining forty one BITs are very much the last members of a soon to be "extinct species".

While most BITs have so-called "sunset" provisions that seek to protect **existing** foreign investments only, for an extended period after the relevant BIT comes to an end, clearly GoI's intention is to eventually eliminate all BIT based, international arbitration relief for foreign investors. Further, the "sunset" provisions only protect **existing** investments in Indonesia by parties from countries which had a BIT with Indonesia at the time the investment was initially made. The "sunset" provisions do **nothing** to protect **new investments** made by foreign parties after the relevant BITs come to an end and even if those foreign parties already have existing investments in Indonesia.

It must be acknowledged that Indonesia is party to a very limited number of regional and multi-lateral treaties which provide for arbitration of investment disputes although not necessarily on as favorable terms, for foreign investors, as the BITs. Once such example is the AANZFT Agreement. This, of course, will be a source of some comfort for foreign investors from Australia, ASEAN and New Zealand. Needless to say, however, it will be a source of absolutely **no** comfort whatsoever for foreign investors from other countries who previously had BIT protection but are not covered by the AANZFT Agreement or any other similar regional and multi-lateral treaties to which Indonesia is a party.

If GoI has its way, there will also soon be **no** CoWs/CCoWs left with their "inconvenient" provision for international arbitration of contract disputes with GoI. The April draft of Indonesia's proposed new Mining Law expressly provides that all CoWs/CCoWs must be converted into IUPKs (without any international arbitration resolution of disputes) not later

than twelve months after the proposed new Mining Law comes into force. Although the Draft ISIDR Regulation applies to all investor contracts with GoI in all industries, rather than just to CoWs/CCoWs in the mining industry, anyone following the Indonesian popular press, over the past few years, can surely not have failed to notice GoI's preoccupation (not to say obsession) with the CoWs/CCoWs which, almost certainly, are the largest body of existing contracts between investors and GoI, regardless of industry, providing for international arbitration of disputes.

9. **Applications for GoI Approval/Consent**: GoI has ninety working days to respond to applications, from either domestic investors or foreign investors, for GoI approval of/consent to investment dispute resolution by arbitration (Draft ISIDR Regulation Article 9(1) and (2)).

In the event GoI rejects an investor application for GoI approval of/consent, to investment dispute resolution by arbitration, the investment dispute must be resolved through court proceedings in Indonesia (Draft ISIDR Regulation Article 9(4)).

In the event that GoI fails to respond to an investor application within the prescribed ninety working day period, GoI approval of/consent, to investment dispute resolution by arbitration, is deemed to have been granted (Draft ISIDR Regulation Article 10).

Given the uniformly hostile reaction of GoI, over many years, to the prospect of being subjected to international arbitration by foreign investors, the writer **cannot** think of even one situation where it is in the least likely that GoI would ever approve a foreign investor's application for GoI approval of/consent to investment dispute resolution by international arbitration. It should also go without saying that GoI is **never** going to intentionally fail to respond to a foreign investor application within the prescribed ninety working day period.

10. **Ongoing Court Proceedings**: Investment disputes that are currently being examined/heard by a District Court or a State Administrative Court cannot be settled using arbitration (Draft ISIDR Regulation Article 12).

At first sight, Draft ISIDR Regulation Article 12 appears to be simply designed to ensure finality of the investment dispute resolution process once a particular investment dispute has been submitted for consideration by the local Indonesian courts. This seemingly innocuous provision, however, actually has a lot of potential significance that would only be apparent to seasoned Indonesian litigators. It is a well-established litigation strategy, in Indonesia, for local parties to avoid/evade or at least indefinitely delay (i) compliance with foreign arbitration provisions in contracts and (ii) applications for enforcement of foreign arbitration awards by starting court proceedings in Indonesia which, notionally, are expressed as being claims in tort or claims for administrative relief when, in reality, they are concerned with substantially the same issues raised by a foreign counterparty in its arbitration claim grounded in contract or substantially the same issues resolved by the foreign arbitration panel. Indonesian courts have repeatedly shown themselves very willing to allow Indonesian parties to use this strategy to defeat the reasonable expectations of foreign parties. Left in its current form, Draft ISIDR Regulation Article 12 is extremely dangerous as it could easily be interpreted as meaning that, if **anyone** has already commenced District Court or State Administrative Court proceedings on an issue **in any way** related to the dispute between an investor and GoI, arbitration will not be allowed to proceed even if arbitration has been previously agreed to by GoI in a contract with the relevant investor or in an existing BIT, regional or multilateral treaty between the relevant

foreign investor's state and GoI. The writer can only express his surprise and wonderment at such an obvious defect finding its way into the Draft ISIDR Regulation.

SUMMARY AND CONCLUSIONS

The bureaucrats who prepared the Draft ISIDR Regulation have sought to create the impression that GoI is willing to have investment disputes resolved by arbitration and, more particularly, to have investment disputes with foreign parties resolved by international arbitration. To this end, the Draft ISIDR Regulation is expressed in terms of investors having the right to choose how any dispute with GoI will be resolved, including by arbitration if that is their preference. Once, however, the detail of the Draft ISIDR Regulation is carefully examined, it becomes apparent that, unless GoI has previously committed itself to dispute resolution by arbitration, whether in a BIT, a multilateral treaty or a contract, arbitration is only possible if GoI, in its absolute discretion, expressly approves of/consents to arbitration on a case by case basis. The carefully laid out procedures, for applying for GoI approval of/consent to investment dispute resolution by arbitration, give the impression this is merely an administrative exercise that has to be gone through in order to obtain the necessary approval/consent and that GoI will carefully and independently review each such application with an open mind. In fact, though, nothing could be further from the truth at least in the case of investment disputes with foreign parties. GoI has already, on numerous occasions, made very plain its total opposition to international arbitration of investment disputes with foreign parties. Accordingly, any application by a foreign investor to have its dispute with GoI resolved by international arbitration will, almost inevitably, be rejected out of hand by GoI. To suggest otherwise, is disingenuous and foolish.

At the same time, GoI has been doing its absolute best to ensure that, at least in respect of new investments, there will be no BITs left to provide for international arbitration of disputes. Similarly, in the case of the most high-profile and contentious contracts that GoI currently has in place with investors and which provide for international arbitration of disputes (**i.e.**, the CoWs/CCoWs), GoI is working hard to bring the same to an end as soon as possible. Accordingly and quite to the contrary of how it is presented in the Draft ISIDR Regulation, instead of special application for GoI approval/consent to arbitration being just the ultimate fallback position that will only apply in exceptional situations, this is likely to become, in many all too common situations, the only available means of pursuing arbitration against GoI, especially where disputes with foreign investors are concerned.

The most that can be said, in any positive vein, about the Draft ISIDR Regulation is that investors, which are denied arbitration of their disputes with GoI, can seek to engage GoI in mediation before having to fall back on the wholly unattractive alternative of local court proceedings if the mediation does not result in a voluntary settlement with GoI that is mutually acceptable to both the investor and GoI.

For the reasons previously explained, the Draft ISIDR Regulation does not, in its current form, adequately protect investors from or even begin to adequately address investors' entirely justified concerns about having to resolve disputes with GoI through the Indonesian courts.

The proposals contemplated by the Draft ISIDR Regulation would only be of any material value to investors if they are to be coupled with a comprehensive overhaul of the Indonesian court system. Unless and until such time as investors can be confident of the independence, integrity, professionalism and transparency of Indonesian court proceedings, no investor (far less any foreign investor) is going to have any confidence whatsoever that its dispute with GoI will be resolved by

an Indonesian court having regard only to the legal merits of the parties' respective positions. Unfortunately, there is no suggestion that the Draft ISIDR Regulation is intended to be part of any such comprehensive overhaul of the Indonesian court system.

All investors in Indonesia, whether domestic or foreign, deserve a better outcome, than that contemplated by the Draft ISIDR Regulation, when faced with a dispute with GoI.

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