

Comparative gap analysis: Indonesia's current obligations under international investment agreements (IIAs) vs. the obligations under the investment chapter of the Trans Pacific Partnership Agreement (TPP)

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## I. Introduction

The Trans Pacific Partnership (TPP) is a trade agreement concluded and signed by 12 Pacific Rim countries and is set to frame the rules of trade and investment in the Pacific region. Currently, Indonesia is not a member of the TPP Agreement but the Government of Indonesia (GoI) has shown an interest in exploring the possibility of becoming a member and therefore wishes to understand the effects of eventually joining the TPP. One of the key issues of specific interest is, how the TPP would affect international obligations already undertaken by Indonesia under its international investment agreements (IIAs), including its potential accountability under investor-State dispute settlement (ISDS).

To date, Indonesia has negotiated more than 71 IIAs, however only 38 of them have entered into force. This note focuses on legal comparative analysis between the investment chapter of the TPP and Indonesia's current obligations undertaken under its IIAs in force. In particular, this note addresses the question as to whether, if Indonesia opted to join TPP, it would have to undertake obligations that go beyond those already undertaken under the IIAs in force in the country. Further, given the potential implications of being subject to ISDS, this analysis also compares the ISDS procedures of the TPP and the IIAs of Indonesia that are already in force to determine whether or not the TPP would provide greater or lower safeguards in the event of the GoI being subject to an ISDS case.

The legal comparative analysis covers three broad categories of topics:

- (I) scope of application of the applicable treaty, determining the breadth of the coverage of its rules and disciplines,
- (II) the substantive investment protection guarantees contained in the various treaties, and
- (III) Enforcement provisions, including ISDS

The main conclusion of this comparative analysis is that, with the exception of certain particular aspects regarding performance requirements affecting the establishment of investments, the investment chapter of TPP would not entail for Indonesia any undertaking of obligations beyond those it had already assumed under other IIAs in force. In the area of obligations regarding the establishment of foreign investment into Indonesia, it should be mentioned that various ASEAN IIAs to which Indonesia is a party already include commitments, albeit some of them yet in process of implementation –like the annexes of non-conforming measures in the ASEAN-South Korea Free Trade Agreement.

Further, a comparison of the investment chapter of the TPP with all of Indonesia's IIAs in force –in particular the Bilateral Investment Treaties (BITs) – leads to a conclusion that the TPP investment chapter also contains many more safeguards on ISDS. Given the multiparty negotiation of TPP, added to the fact that many of its main signatories negotiated the text of the agreement after being subject to ISDS as responding parties themselves, explains why the TPP investment chapter is, from the perspective of Governments, a more “regulatory friendly” text than those of IIAs negotiated over the last decade.

To explain this assertion in detail, this note includes five additional sections. Section II, presents an introductory view of the purpose and nature of the different types of IIAs. Section III explains how the investment rulemaking has evolved over the last two decades, and focuses on the difference between “old generation” and “new generation” IIAs, both of which have been negotiated by Indonesia. Section IV, compares Indonesia's current ISDS obligations with the TPP through a comprehensive ISDS jurisprudence developed over a period of time. Section V focuses on the specific question as to whether

TPP entails additional obligations than the already undertaken by Indonesia in its IIAs, both with respect of substantive provisions as well as ISDS. Section VI presents the conclusions of the study. Last but not least, this note is complemented by three Annexes. Annex 1 shows in detail, topic by topic, the comparison of the legal texts of all the IIAs examined. Annex 2 summarizes Indonesia's experience in ISDS and Annex 3, includes a background note on the Systemic Investment Response Mechanism (SIRM) a tool recently developed by the WBG to assist countries to better implement IIAs, prevent ISDS and retain more investment.

## II. Differentiating between the purpose and nature of the different types of IIAs

Given that no multilateral legal framework on investment exists, to date a significant part of the legal disciplines which relate to the relationship between host States and international investors has been developed at a bilateral and regional level, that is, through Bilateral Investment Treaties (BITs) and investment chapters included in Regional Trade Agreements (RTAs).

In effect, rules establishing minimum guarantees regarding the treatment of foreign investment have existed for more than two centuries. However, BITs have been identified as the first international agreements which were exclusively focused on the treatment of foreign investment. BITs are negotiated between two states to protect and promote investments of investors of one party in the territory of the other party. These treaties date back to 1959 and traditionally have had a relatively uniform content that, with the exception of the introduction of provisions on investor-state dispute resolution in the 1960s, until recently had not changed markedly since their inception. The number of BITs negotiated worldwide increased dramatically over the last 25 years, reaching more than 3.500 by 2016.

A second group of International Investment Agreements (IIAs) consists of investment chapters included in Preferential Trade Agreements (PTAs). Over the last 15 years, the number of PTAs worldwide has been growing steadily, reaching more than 250 by the end of 2016. PTAs are negotiated usually among countries of the same region to facilitate the cross-border movement of goods, services, capital, or people. PTAs vary enormously and range from agreements that provide only for economic cooperation to agreements that create a common market. Such agreements may be bilateral, plurilateral, regional, interregional, or multilateral. They may involve states at the same or at different levels of economic development. Contrary to other areas of public international law, over the last 15 years, the negotiation of international rules and disciplines in investment has been quite responsive to changing international economic and political context. Two trends are evident in this regard.

First, investment rulemaking has responded to the deep transformation and "globalization" of the international economy. The old paradigm where investment was visualized as a substitute to trade has long been overcome. Today, the positive interaction between trade and investment is not only evident and well documented, but it has become evident that both trade and investment are complementary strategies at the hand of international enterprises to serve an increasingly competitive and globalized international market. With the dramatic growth in international trade in services and the disaggregation of production on a global scale, governments in both developed and developing countries have become increasingly aware of the key role that foreign investment plays in positioning their national economies in an interdependent world economy. Investment rulemaking over the last decade has been responsive to

such evolving international context. In particular, it is such context that explains the main distinctions between BITs and investment chapters in PTAs.

Despite minor specificities, the main distinction between most BITs and most investment chapters in PTAs tends to be the breadth of their respective underlying rationales. While the overwhelming majority of BITs contain obligations aimed at providing investment protection, the logic behind the majority of investment chapters in PTAs is not only to provide protection to investment but also to promote, as much as possible, the right of entry to foreign investment into the economy of the host country. Such evolution in the rationale of IIAs is to a great extent a side effect of the evolution of the historical context in which international investment flows have taken place over the last 50 years.

Second, another important factor shaping investment rulemaking over the last decade has been the tremendous increase in the number of investor-state dispute settlement (ISDS) cases. Provisions concerning investor-state dispute settlement have been included in BITs since the 1960s. However, the use of these provisions to institute arbitral proceedings was rare until the last decade. From 1987—when the first investor-state dispute based on a BIT was recorded under the arbitral proceedings of the International Centre for Settlement of Investment Dispute (ICSID) of the World Bank—until April 1998, only 14 BIT-related cases had been brought before ICSID, and only two awards and two other settlements had been issued.<sup>1</sup> However, since the late 1990s, the number of cases has grown enormously. The cumulative number of treaty-based cases has risen to at least 400 by the end of 2015, with 182 brought before ICSID (including ICSID’s Additional Facility) and more than 100 before other arbitration fora.<sup>2</sup>

A creative dynamic has been generated between investment negotiation and adjudication, as the latter puts into test the breadth of the concepts and obligations assumed by Contracting Parties to IIAs, which are then subject to interpretation in the context of investment disputes. In particular, over the past decade, a number of countries have concluded a “new generation” of PTAs that liberalize trade in goods and services, while also containing investment protection provisions similar to those that traditionally have appeared in BITs. This new generation of PTAs, like a “new generation” of BITs, has generated important innovations in IIA practice.

Although not yet representing the numerical majority of existing IIAs, this group of new generation agreements represents the most significant innovation in investment rulemaking over the last two decades, and it comprises most of new BIT models and investment chapters negotiated in the context of PTAs by country members of the North American Free Trade Agreement (NAFTA) and other countries in the Americas, the Asia-Pacific Rim, the Gulf Cooperation Council and North Africa.

Investment disputes, and in particular those that have arisen in the context of the implementation of NAFTA, have influenced the refinement of the provisions of this new generation of IIAs as well as the inclusion of a series of procedural and substantive innovations in these agreements.

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<sup>1</sup> International Centre for the Settlement of Investment Disputes found at [www.worldbank.org/icsid/cases](http://www.worldbank.org/icsid/cases)

<sup>2</sup> United Nations Conference on Trade and Development (UNCTAD) (2008), *Latest Developments in Investor-State Dispute Settlement*, IIA MONITOR No. 1, 2008, *International investment agreements* (Geneva: United Nations).

### III. Evolution of the IIAs negotiated by Indonesia

Table 1 below lists the different IIAs negotiated by Indonesia which have also entered into force. As explained before, from the perspective of the evolution of investment rulemaking, it is possible to distinguish between two categories of IIAs according to the time they were negotiated. On the one hand, there are those IIAs –mostly BITs- that were negotiated before the late 1990s within a “jurisprudential vacuum”, when investor-State international dispute settlement (ISDS) activism had not yet started to develop investment jurisprudence. These type of agreements are often denominated as “old generation” as opposed to “new generation” IIAs that started to be negotiated after countries began to observe the nascent jurisprudence in international investment law. Governments have paid attention as to how case law has evolved and have refined their approaches to investment rulemaking.

The evolution in investment rulemaking in “new generation” of IIAs can be summarized in five fundamental trends: (i) evolution from solely regulating investment protection toward providing guarantees regarding the entry and establishment of investments, (ii) greater precision in the definition of the term “investment”; (iii) clarification of the meaning and scope of certain key investment protection standards such as “fair and equitable treatment” and “indirect expropriation”, (iv) inclusion of clauses clarifying that investment protection cannot be promoted at the expense of certain key public policy objectives, such as health, safety or the environment, (v) promotion of greater transparency and (vi) innovations ISDS procedures themselves.

<b>TABLE No.1 - Indonesia: IIAs in force</b>	
<b><i>Plurilateral Investment Agreements (PIAs)</i></b>	<b><i>Date of entry into force</i></b>
1. ASEAN Investment Agreement (ACIA)	29/03/2012
2. ASEAN-China Investment Agreement (ACFTA)	01/01/2010
3. Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference	23/09/1986
4. Indonesia-Japan EPA	01/07/2008
<b><i>Free Trade Agreements (FTAs)</i></b>	<b><i>Date of entry into force</i></b>
5. ASEAN-Australia-New Zealand (AANZFTA)	01/01/2010
6. ASEAN-Korea (AKFTA)	01/09/2009
<b><i>Bilateral Investment Treaties (BITs)</i></b>	<b><i>Date of entry into force</i></b>
7. Indonesia-Argentina	01/03/2001
8. Indonesia- Australia	29/07/1993
9. Indonesia- Bangladesh	22/04/1999
10. Indonesia- Belgium-Luxembourg	17/06/1972

11. Indonesia- Cuba	29/09/1999
12. Indonesia- Czech Republic	21/06/1999
13. Indonesia- Denmark	15/10/2009
14. Indonesia- Finland	02/08/2008
15. Indonesia- Germany	02/06/2007
16. Indonesia- Iran	28/03/2009
17. Indonesia- Jordan	09/02/1999
18. Indonesia- Korea (South)	10/03/1994
19. Indonesia- Kyrgyz Republic	23/04/1997
20. Indonesia- Mauritius	28/03/2000
21. Indonesia- Mongolia	13/04/1999
22. Indonesia- Morocco	21/03/2002
23. Indonesia- Mozambique	25/07/2000
24. Indonesia- Pakistan	03/12/1996
25. Indonesia- Poland	01/07/1993
26. Indonesia- Russian Federation	15/10/2009
27. Indonesia- Saudi Arabia	05/07/2004
28. Indonesia- Singapore	21/06/2006
29. Indonesia- Spain	18/12/1996
30. Indonesia- Sri Lanka	21/07/1997
31. Indonesia- Sweden	18/02/1993
32. Indonesia- Syria	20/02/2000
33. Indonesia- Thailand	05/11/1998
34. Indonesia- Tunisia	12/09/1992
35. Indonesia- Ukraine	22/06/1997
36. Indonesia- United Kingdom	24/03/1977
37. Indonesia- Uzbekistan	27/04/1997
38. Indonesia- Venezuela	23/03/2003

The rules contained in the agreements set out in the table above represent the normative ‘floor’ established by Indonesia’s existing IIAs. Following the six trends mentioned above, this section examines how this floor differs from the TPP disciplines by focusing on the following elements: (i) investment protection and liberalization; (ii) delimitation of the scope of the definition of investment; (iii) clarification of the meaning of several key obligations; (iv) coexistence of investment protection and public policy objectives; and (v) promotion of greater transparency. The overall objective of this legal analysis is to better understand the differences between the agreements and identify any gaps in relation to international goodpractice as reflected in the most recent “new generation” agreements, but also possible implementation gaps Indonesia may need to overcome. Section II will focus on the evolution of ISDS in TPP explaining how this agreement in fact provides certain safeguards that old generation IIAs negotiated by Indonesia do not provide.

#### a. Investment protection and liberalization

The new generation of IIAs provide not only for investment protection but also for gradual investment liberalization. This liberalization approach is explained as follows: IIAs follow the “non-discrimination” principles by granting to covered foreign investors national treatment and most favored nation treatment,

with respect to the right of establishment in the host State. This right of establishment is generally qualified by a provision that allows the parties to the agreement to specify sectors or activities of the economy in which the right does not apply, the so-called negative list approach.<sup>3</sup> Such restricted sectors or activities of the economy are listed under annexes that form an integral part of the agreement. Annex I on “non-conforming measures” of the TPP lists existing laws and regulations that are inconsistent with certain obligations of the agreement (basically the obligations on non-discrimination and performance requirements). In this regard, each Party accepts an obligation not to make those measures more restrictive in the future. Annex II, also known as Annex on “future measures” lists sectors or policy areas where Parties retain full discretion to introduce new measures (including more restrictive) inconsistent with the previously mentioned obligations of the agreement.

In the TPP, the Parties adopted a negative-list approach regarding the right of foreign investors to establish their investments into the host country. This means that Parties agreed not to discriminate against the entry of foreign investors except in the sectors listed in the list of reservations incorporated Annexes I and II of the Agreement. The twelve TPP member States have already submitted their Annex I and Annex II.

Under TPP Annex I, each signatory country listed non-conforming specific measures at the central and/or regional level where the obligations of national treatment/performance requirements/senior management and board of directors do not apply. Examples of such sectors vary from country to country but include: manufacturing, marine capture fisheries, patent and trademark agent services, some professional services, legal services, real estate services based on a fee or contract basis, communications services, education services, private healthcare facilities and services allied health services, utilities, transport services, distribution services, construction and related engineering services, freight road transportation services, wholesale and distribution services, and oil and gas.

In Annex II, they listed non-conforming measures at the local and/or regional level with respect to national treatment/performance requirements/senior management and board of directors. For example, these include: land and real estate, oil and gas, explosive and weapons, betting and gambling, non-medical utilization of atomic energy, cultural services, wholesales and distribution services, sewage and sanitation, air transport services, taxi services, legal services, and social services.

Providing non-discrimination to foreign investors through a negative list approach would not be totally new for Indonesia. Indeed, several Indonesia’s PTAs tend to follow the negative list approach such as the ASEAN Comprehensive Investment Agreement (ACIA) and the PTAs between ASEAN, Australia and New Zealand (AANZFTA) and the ASEAN-South Korea FA (AKFTA). However, in the last two PTAs, the obligation to prepare the list of reservations is subject to a working program.

#### b. Delimitation of the scope of the definition of investment

The interpretation of the scope of investment over the last decade has proved to be a sensitive issue, since after some ISDS cases the definition of investment of the “old generation” IIAs –covering “every asset” owned or controlled by an investor was perceived as too imprecise by certain governments. There are various approaches in defining what falls within a covered “investment” under IIAs.

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<sup>3</sup> One approach to the identification of measures that are subject to the terms of an agreement is a negative list: all items are affected except those that are explicitly listed. This is a less restrictive approach than the positive list.

The first approach, the more traditional broad asset based definition, is usually non-exhaustive and often described as “every kind of asset,” or “any kind of asset” (regardless of its use, nature or features) owned or controlled by a covered investor. This approach of defining investment is widely used. In fact, it can be found in the majority of BITs negotiated by Indonesia. A second approach in defining investment is the so-called “closed-list”. This approach does not contain a conceptual chapeau to define the term investment, but rather consists of an ample but exhaustive list of tangible and intangible assets (e.g. enterprise, equity security, debt security, loan, interest that entitles the owner to share in income or profits to the enterprise, real estate or other property and any related property rights, and claims to money).<sup>4</sup>

Because countries wanted to include clarifications and additional language to make the definition of investment in IIAs even more precise, new generation IIAs use a third approach, and incorporate a definition of investment covering, in principle, every asset that an investor owns and controls but adds the qualification that such assets must have the “characteristics of an investment”.<sup>5</sup> This approach is complemented by a negative list of assets that are explicitly excluded from the category of covered investments under the agreement.<sup>6</sup>

While Indonesia’s BITs and most of its FTAs (e.g. Indonesia-Sweden BIT, Indonesia-United Kingdom BIT, ACIA and AANZFTA) use the broad asset-based definition, some recent Indonesian IIAs such as the AKFTA and ASEAN-India Investment Agreement (not yet in force) use the third approach covering every asset and including the test on the qualification that such asset must have the characteristics of an investment (i.e. commitment of capital, expectation of gain or profit, or assumption of risk). Following this more conservative approach, the TPP investment chapter also uses the same formula to define what constitutes an “investment” and what forms it take in order for it to be covered by the agreement.

### c. Main investment protection guarantees

Indonesia’s IIAs, provide the basic and fundamental investment protections in a similar manner to the TPP’s Investment Chapter. These core guarantees include, among others, disciplines on non-discrimination (national treatment and most favored nation treatment); ‘minimum standard of treatment’ for investments in accordance with customary international law principles; expropriation subject to public purpose, due process, and prompt, adequate and fully realizable and transferable compensation; prohibition on ‘performance requirements’ such as local content; free transfer of funds related to an investment --subject to exceptions in order to ensure that governments retain the flexibility to manage volatile capital flows in the context of a balance of payments crisis or the threat thereof, or to protect the integrity and stability of the financial system--; and freedom to appoint senior management positions of any nationality.

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<sup>4</sup> E.g. Article 96, Agreement Between Japan and the United Mexican States for the Strengthening of the Economic Partnership, Sep. 17, 2004 found at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2696>

<sup>5</sup> For this purpose, ICSID practice refer to the “characteristics of an investment” as “the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk”.

<sup>6</sup> E.g. Article 10.1, Free Trade Agreement between the Government of the Republic of Korea and the Government of the Republic of Chile, Feb. 15, 2003 found at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2646>

Most of these IIAs, including the TPP also incorporate the so-called ‘denial of benefits’ clause. Under the TPP, Parties are allowed to deny benefits to shell companies owned by persons of that Party or a non-Party that establishes in another TPP country in order to take advantage of treaty rights but without establishing substantial business activities in that country. The TPP Member States may also deny such benefits if extending investment protections to that investment or investor would circumvent or violate measures prohibiting transactions with that investor, e.g. as a result of economic sanctions.

New generation investment agreements have experienced the revision of the wording of various substantive obligations in order to clarify the meaning of such provisions, in particular those dealing with absolute standards of protection, such as the international minimum standard of treatment and expropriation. It could be argued that the motivations behind the inclusion of these clarification clauses are to “correct” any particular trend in the jurisprudential interpretation of certain provisions and to provide important guidance for future cases. Another role of such clarifying provisions may be that they serve as a signal for civil society to counteract the alleged perception that ISDS included in IIAs may have a “regulatory chill” over the States’ authority to regulate.<sup>7</sup> In the following sections we will consider how the investor guarantees included in a sample of Indonesia’s IIAs vary and how they compare to guarantees provided through TPP.

#### **i. National treatment**

The national treatment provision is a core investment protection principle that grants foreign investors treatment no less favorable than that accorded to national (domestic) investors. It is one of the two main elements of non-discrimination and aims to create a level playing field between foreign and domestic investors (the other element being most-favored nation). Many BITs negotiated by Indonesia do not include a national treatment obligation. However, all of the investment chapters included in PTAs do. For instance, Article 5 of ACIA states as follows:

**Article 5 - National Treatment**

1. Each Member State shall accord to investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.
2. Each Member State shall accord to investments of investors of any other Member State treatment no less favourable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the admission, establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments.

In this regard, this obligation undertaken by Indonesia in the context of ACIA is practically the same that TPP would entail regarding national treatment. TPP includes, however, a specific clause to explain for

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<sup>7</sup> ECHANDI ROBERTO, *Bilateral Investment Treaties and Investment Provisions in Regional Trade Agreements: Recent Developments in Investment Rulemaking. Arbitration under International Investment Agreements: A Guide to the Key Issues* 3-37 (2010)

further clarity that in the case of countries with federal systems of government the national treatment obligation entails assuming the obligation to provide the best in state treatment to the foreign investor.

#### **ii. Most-favored nation treatment (MFN)**

The purpose of an MFN clause is to prevent discrimination among foreign investors. It constitutes the second element of non-discrimination. As a host country signs more agreements, this helps to harmonize the level of protection accorded to foreign investors. Indonesia's BITs include an MFN clause, as do investment chapters in its regional IIAs. The language and drafting in Indonesia's agreements follows the international standard drafting, for example in the Germany-Indonesia BIT stating that "*Neither Contracting Party shall subject investors of the other Contracting Party, as regards their activity in connection with investments in its territory, to treatment less favorable than it accords to its own investors or to investors of any third State.*" Indonesia's analyzed BITs and FTAs provide a MFN exclusion for existing FTAs, customs unions, common markets or monetary union or similar agreements and for international agreements relating to taxation, which is also standard international practice, but do not make it clear that MFN does not apply to ISDS.

Certain IIAs include an express clarification that MFN provisions do not apply to dispute settlement procedures (see, for example: Canada Model BIT or U.S. Model BIT). This language has been included as a result of certain arbitral awards using the MFN clause to grant "more favorable" procedural benefits to investors than those found in the applicable treaty, like for example reducing the number of months an investor has to wait before submitting a dispute to arbitration. This is also the case in ACIA, which states that the MFN clause, for greater certainty, "*shall not apply to investor-State dispute settlement procedures that are available in other agreements to which Member States are party.*" The TPP follows this more conservative approach and expressly provides that MFN treatment does not encompass ISDS procedures.

#### **iii. Minimum standard of treatment**

Most investment treaties include a provision on minimum standard of treatment that requires the host State to treat foreign investors in accordance with an absolute minimum level of protection. The minimum standard of treatment is in fact a bundle of other principles provided in customary international law. One of those standards is "fair and equitable" treatment (FET). Typically, FET requires host states to act with good faith, to protect foreign investors against denial of justice, and against arbitrary and abusive treatment. It is a very powerful instrument to strengthen investor confidence and, one could argue, to improve the rule of law in a given host economy.

All IIAs negotiated by Indonesia contain the FET standard, some with a clearer and more specific language than others. Indonesia's BITs tend to contain very general language, which may lead to disputes attempting to interpret its content, for example the Indonesia-Spain BIT which states that "*Each party shall guarantee in its territory fair and equitable treatment for the investments made by investors of the other Party*", the Indonesia-Morocco BIT uses similar language stating that "*investments of investors of either Contracting Party shall at all times be accorded fair and equitable treatment and subject to the strictly necessary measures to maintain the public order shall enjoy adequate protection and security in the territory of the Contracting Party.*"

The new approach has been included by Indonesia in more recent IIAs, defining the contents of the granted standard of treatment, for example, Article 11(2) of ACIA states: "*For greater certainty: (a) 'fair*

*and equitable treatment' requires each Member State not to deny justice in any legal or administrative proceedings in accordance with the principles of due process (...)"*

ACIA and TPP are very similar in this regard and both incorporate clarifications of the meaning and scope of FET and "full protection and security". ACIA, for instance clarifies that (a) FET requires member states "not to deny justice in any legal or administrative proceedings in accordance with the principle of due process" and (b) full protection and security requires each Member State to take such measures as may be reasonably necessary to ensure the protection and security of the covered investments".

The TPP represents another attempt by States to further clarify even more the breadth and scope of this standard of protection in order to delimit its scope and prevent claims potentially affecting the regulatory capacity of host States. TPP states in very similar terms that: "(a) 'fair and equitable treatment' includes the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and (b) that 'full protection and security' requires each Party to "provide the level of police protection required under customary international law."

Additionally, the TPP states that the minimum standard of treatment should be interpreted in accordance to Customary International Law. This practice has appeared in recent treaties, especially in those negotiated by the United States and is intended to limit the practice of interpreting that the FET provisions provide a greater standard of treatment than that awarded by Customary International Law. In certain cases, based on treaty language which does not limit interpretation to the Customary International Law Standard, additional elements have been incorporated which are less deferential to government actions (see for example, Occidental Exploration & Prod. Co. v. Republic of Ecuador, Final Award, paras. 180-92 (July 1, 2004).

Further, the TPP more precisely describes the situations that may be considered a breach of the minimum standard of treatment provision. The TPP provides that a government action inconsistent with an investor's expectations or the reduction or refusal of a subsidy do NOT automatically constitute a breach to the minimum standard of protection. This is an attempt to limit the potential liability of the host TPP State under the minimum standard of treatment. In this regard, the TPP investment chapter has a more deferential approach towards domestic policy than old generation IIAs with general clauses in fact gave investors and arbitration tribunals a significant leeway to determine whether a State complied with this standard of treatment.

#### **iv. Expropriation and compensation**

The TPP continues and strengthens the trend of recent "new generation agreements" of promoting greater clarification and precision on some key investment provisions in order to safeguard more policy space for host governments. Regarding indirect expropriation, the TPP, in its Annex 9-B, continues the practice that, except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives do not constitute indirect expropriation.

This diverts from the trend of the majority of IIAs negotiated by Indonesia, which do not clarify in detail what indirect expropriation is and thus delegate in arbitration tribunals the possibility to fill this vacuum. Only some IIAs negotiated by Indonesia include a more detailed text in Annexes with safeguarding language against broad interpretations of the expropriation provision. For example, the AANZFTA contains

an Annex clarifying that the determination of an indirect expropriation “requires a case by case, fact-based inquiry that considers, among other factors [...] the economic impact of the government action [...]; the character of the government action, including its objective and whether the action is disproportionate to the public purpose [...].”

**v. Currency convertibility and transfer**

All PTAs and BITs negotiated by Indonesia incorporate a guarantee of currency convertibility and transfer. What differs is the degree of detail for exceptions to the main obligation. In this regard, TPP (Art 9.9) and ACIA (Art 13) both incorporate what can be considered a “state-of-the art” transfer guarantee. Both agreements provide for freedom of transfer, without delay, in freely usable currency, at prevailing market rate of exchange. They also both include a long list of funds and transfers that are covered by the guarantee. The lists are almost identical; the ACIA list has one item not in the TPP list (remuneration of personnel) while TPP has one item (returns in kind) that is not in the ACIA list.

Both TPP and ACIA allow a member state to prevent or delay a transfer in very specific circumstances (such as bankruptcy or criminal offence) and provide that these exceptional measures are subject to requirements of equity, non-discrimination and good faith application. It is worth noting that TPP contains a balance of payments obligation in its general exceptions chapter (chapter 29). This may provide additional policy space to restrict transfers in situations of balance of payments difficulties.

**vi. Performance requirements**

One area in which the TPP may entail some areas of innovation for Indonesia, if it wishes to join, is the area of performance requirements. The TPP assures international companies that they will not be required to meet “performance requirements” such as local content or technology-transfer/technology-localization mandates.” Even though local content requirements (LCRs) are already prohibited under the Trade-Related Investment Measures (TRIMs) Agreement of the World Trade Organization, those rules and disciplines only cover those performance requirements affecting trade in goods –not in services—and thus, some performance requirements have nonetheless been used around the world in recent years.<sup>8</sup>

The TPP provision restricts countries’ ability to impose obligations, such as LCRs and export requirements, as a condition for investment entry. Up to this point, all of Indonesia’s FTAs with the exception of the ACFTA restrict the use of performance requirements,<sup>9</sup> most of them provide no further limitations than those contained in the TRIMs Agreement. Agreements such as ACIA suggests that parties might further review the performance requirement provision and include more detailed obligations in the future. The only exception to this trend in the Japan-Indonesia Economic Partnership Agreement (EPA). This PTA, just like TPP, goes beyond the TRIMs limitations, and also applies to performance requirements for services.

Article 63 of the EPA between Indonesia and Japan shows that Indonesia already has undertaken commitments on performance requirements beyond TRIMs. However, the commitment on performance requirements in the investment chapter of TPP has a more detailed language that may entail additional commitments, albeit subject to more specific reservations.

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<sup>8</sup> See CIMINO-ISAACS, HUFBAUER, and SCHOTT (2014).

<sup>9</sup> ACIA, for instance, prohibits performance requirements, export requirements and trade balancing requirements.

## **Article 63 (EPA Indonesia-Japan)**

### **Prohibition of Performance Requirements**

1. Neither Party shall impose or enforce any of the following requirements, in connection with investment activities in its Area of an investor of the other Party:

- a) to export a given level or percentage of goods or services;
- b) to achieve a given level or percentage of domestic content;
- c) to purchase, use or accord a preference to goods produced or services provided in its Area, or to purchase goods or services from natural or legal persons or any other entity in its Area;
- d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with investments of the investor;
- e) to restrict sales of goods or services in its area that investments of the investor produce or provide by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
- f) to appoint, as executives or members of board of directors, individuals of any particular nationality;
- g) to locate the headquarters of the investor for a specific region or the world market in its Area;
- h) to achieve a given level or value of research and development in its Area; or
- i) to supply to a specific region or the world market exclusively from its Area, one or more of the goods that the investor produces or the services that the investor provides.

2. Paragraph 1 does not preclude either Party from conditioning the receipt or continued receipt of an advantage, in connection with investment activities in its Area of an investor of the other Party, on compliance with any of the requirements set forth in subparagraphs 1 (g) through (i).

#### **d. Balance between investment protection and public policy regulation**

In addition to the core protection guarantees already mentioned previously, new generation BITs and investment chapters in PTAs address a broader scope of issues, including the reinforcement of the protection of public policy objectives, e.g. health, safety, cultural identity, the environment, and the promotion of internationally recognized labor rights. These clauses aimed at clarifying that the investment

promotion and liberalization objectives of IIAs must not be pursued at the expense of these other key public policy objectives.<sup>10</sup> Some IIAs have included general treaty exceptions while others have opted for positive language in order to strengthen commitments of the contracting parties to safeguard certain values, some have combined both. These normative developments seem to respond to the intention of host states to address the concerns of labor unions and environmental non-governmental organizations regarding international investment agreements.

The new Indonesian IIAs typically include a section on exceptions, prohibiting the prevention of measures aimed at public welfare objectives. The ACIA, for example, explicitly names protection of the environment in its exceptions. It also has an Annex (Annex 2: Expropriation and Compensation) that provide criteria to help judges and arbitrators determine on a case by case basis which action of the host government constitutes indirect expropriation and what does not. As the tests for indirect expropriation in ACIA are relatively difficult to meet, it can be considered that ACIA preserves more flexibility for Indonesia and other ASEAN member States than other IIA's. ACIA and AANZFTA both include a similar provision specifying that measures based on legitimate public welfare objectives such as protection of public health, safety and the environment may not be considered indirect expropriations. This detailed approach is not found in the Indonesian BIT with Germany and UK, where there is a broad coverage of the general provisions of expropriation with no detailed explanation of the specific exceptions or protection measures that the GOI can take in protecting environment, health, culture and safety etc. Therefore, it leaves the field open for the tribunal to make the interpretation of whether there was an indirect expropriation and if it was in the interest of the public welfare.

Following this same logic, the TPP includes an explicit provision stating that Parties have the right to adopt, maintain and enforce any measure otherwise consistent with the Investment Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives.<sup>11</sup> Further, TPP includes a series of additional clauses to safeguard the capacity of the States to regulate. For example, article 9.16 states that:

*“Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives.”*

#### e. Promotion of greater transparency

The traditional notion of promoting transparency obligations in IIAs were tied to the publication of laws and regulations. In addition to this obligation, new generation IIAs substantially modify the content and impact of transparency obligations as the new approach focuses on the process of investment rulemaking affecting investments. Thus, the new generation of IIAs uses transparency as a tool to enable interested

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<sup>10</sup> ECHANDI, *Supra*

<sup>11</sup> The TPP also innovates in including a Corporate Social Responsibility clause. This provision encourages enterprises operating in a Party's territory or subject to its jurisdiction to voluntarily incorporate into their internal policies those internationally recognized standards, guidelines, and principles of corporate social responsibility that have been endorsed by that Party.

parties or stakeholders to participate in the process of investment related rulemaking<sup>12</sup>. Some IIAs go one step further in the application of transparency obligations by extending its scope of application for draft bills and regulations<sup>13</sup>. In this regard the contracting parties are required to publish in advance any proposed measures of application that has a tendency to affect investments and thereby providing the interested persons and the other party a reasonable opportunity to comment on such proposed measures. This obligation is not only applicable to the contracting parties with respect to investors of the other contracting party but also between each contracting party and its own citizens.

Indonesian IIAs follow a multi-dimensional approach. While Indonesia's BIT commitments with UK and Germany do not contain provisions on transparency obligations, its later commitments with Finland on its BIT; FTAs with New Zealand, Australia (AANZFTA), and regional integration through the ACIA contain provisions on transparency obligations. The transparency provisions on these IIAs are fairly similar requiring each party to ensure that publication of all relevant laws and regulations affecting investments covered under the respective agreements, and to publish any proposed measure it would adopt and notify all interested parties about proposed changes and provide sufficient opportunity to comment on such proposals. In addition to this stance, these IIAs also guarantee that the investors have the right to review any administrative rulings under the IIAs and in doing so they are also provided a reasonable opportunity to defend their position and to appeal or further review such decision as provided in their domestic laws. These provisions are largely similar with the position found in the ACIA, but the ACIA does not provide for review or appeal of administrative rulings.

The TPP parties adopted a transparency clause approach<sup>14</sup> which is marginally different from the approach Indonesia has taken on its IIAs. While the transparency clause in the TPP provides that all parties ensure publication of laws, regulations and procedures covered under that agreement, it also extends this provision to any proposed measure and provides opportunity for the interested parties to comment on such measures before they are adopted and finalized. The key difference lies in the breadth of coverage of transparency issues. With regard to this, the TPP requires the parties to publish any proposed regulations in an official journal 60 days (or another time that provides sufficient time for interested parties to evaluate the proposed regulation) prior to the date on which the comments from the interested parties are due. Further any comments provided by the interested parties must be considered and any significant modification made in relevance to such comments received, must be promptly published in an official website or an online journal.

In addition to the above, the position adopted by the TPP parties is largely similar to the IIAs of Indonesia with its counterparts. For instance, in TTP the parties are required to maintain a judicial, quasi-judicial or administrative tribunals to independently review any administrative actions concerning any matter covered under the scope of the agreement. In addition, the TTP parties must provide a reasonable opportunity to the parties to the proceeding to support or defend their position and to receive a decision based on the evidence or relevant record submitted. Further, the emphasis of TPP on regulatory

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<sup>12</sup> ECHANDI, Supra

<sup>13</sup> E.g. Agreement between Canada and \_\_\_\_\_ for the Promotion and Protection of Investments art. 19, 2004 found at <http://www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf>

<sup>14</sup> Trans Pacific Partnership, Ch. 26, Feb. 4 2016 found at <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text>

transparency is evidenced by the inclusion of a specific chapter on regulatory coherence (see specific section on this subject in this note), which also develops the basic obligations on transparency included in the investment chapter.

#### IV. ISDS clauses in Indonesia's IIAs and the TPP

Most old generation IIAs include very limited and general provisions on ISDS. Their content is often limited to specifying the different arbitration venues available to the foreign investor, the procedures for appointing arbitrators, and the obligation imposed on the contracting parties to consider arbitration awards as final and binding. Numerous procedural aspects of arbitration are not regulated in the IIAs themselves but rather the contracting parties frequently refer to existing arbitration rules (e.g. the International Centre for Settlement of Investment Disputes (ICSID), and the United Nations Commission on International Trade Law (UNCITRAL)). Recently, a new generation IIAs have addressed ISDS in more detail, providing greater guidance, both to the disputing parties and tribunals, with respect to arbitration procedures and strengthening the rule orientation and transparency of these adjudication mechanisms.

New generations IIAs have incorporated various innovative provisions derived from the experiences on investment disputes directed to foster four general objectives: (a) provide greater control by the contracting parties over arbitration procedures; (b) promote the principle of judicial economy in investment-related disputes; (c) ensure consistency among arbitral awards; and (d) promote greater legitimacy of ISDS within civil society.<sup>15</sup> Thus new generation IIAs in fact provide greater safeguards than old generation BITs regarding the use of ISDS against governments. The next sections will address in detail each of these patterns reviewing Indonesia's selection of IIAs, including the TPP.

##### a. Greater control of the contracting parties over arbitration procedures

The rationale behind this trend is to limit the degree of discretion arbitral tribunals have in deciding how to conduct the arbitration proceedings, making the process more predictable. In doing so, new generation of IIAs increase the level of detail of procedural aspects of ISDS in order to clarify in advance certain issues that otherwise would have to be decided by arbitral tribunals. Old generation IIAs provide that ISDS procedures apply to disputes arising "in connection with", "arising out", "with respect to", "concerning" or "related to" an investment. These formulation might be sufficiently broad to include disputes not involving an alleged violation of the IIA.

New generation of IIAs –like TPP- include an ISDS clause requires more than an alleged breach of an obligation in the IIA for the ISDS mechanism to be activated. This approach also requires that the investor has incurred a loss or damage as a result of the violation. The requirements of this approach are threefold: (i) a claim of a breach of an obligation under the IIA; (ii) the existence of a loss or damage for the investor; and (iii) a causal link between the two. This approach reinforces the notion that arbitral procedures are mainly geared to addressing conflicts related to property rights.

Although some of Indonesia's IIAs include a well-developed clause on ISDS, we see from the IIAs that the scope of application of the ISDS clause is relatively broad by including any dispute that has incurred loss or damage arising out of an alleged breach of any rights conferred by the agreement with respect to a covered investment (e.g. ASEAN-China FTA, Indonesia-Germany BIT, AANZFTA).

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<sup>15</sup> ECHANDI, *Supra*

New generation agreements also include other types of provisions aiming at providing the Member States more prerogatives to prevent too much judicial activism by arbitration tribunals. For instance, some agreements include safeguards as the following:

- (i) Procedures in certain situations –such as regarding tax matters, or interpretation of certain Annexes -- to force the investor to wait for an agreement of the Contracting Parties to determine whether a violation to the Agreement has in fact occurred. If the defending government invokes this mechanism, the ISDS proceedings are suspended. If the Contracting Parties agree on the interpretation of the agreement, the ISDS case can no longer continue.
- (ii) Procedures to enable the Contracting Parties agree on the interpretation of a particular clause of the Agreement, making such interpretation binding for arbitration tribunals.

The majority of the IIAs negotiated by Indonesia do not contain these safeguards. The only partial exception is ACIA which contains one such mechanism for taxation matters –but not for the rest. The most sophisticated example in this regard in TPP which will be further explained in Section IV below.

#### b. Promotion of judicial economy

ISDS proceedings entail a significant amount of time and resources. Investment procedures not only expose host governments to the risk of lost investment, but also to reputational damages and significant costs of litigation and arbitral awards. In order to minimize the risk, new generation IIAs include procedural innovations that may be instrumental in fostering the principle of judicial economy in ISDS procedures. These mechanisms include:

- (i) the possibility to consolidate separate claims having a question of law or fact in common and arising out of the same events or circumstances;
- (ii) preventing a particular investment dispute from being addressed in more than one adjudication forum at the same time; and
- (iii) avoiding frivolous claims.

Indonesia's BITs entered into prior to the 2000s do not include these provisions. Rather they provide a basic framework for ISDS and call for an amicable settlement of the dispute and if resolution is not obtained by such means, allowing the parties to submit the dispute to a competent court or arbitration in ICSID.

Regarding parallel procedures, Indonesian IIAs has taken different approaches: (i) request a waiver of the investor's right to initiate or continue any proceedings before the courts of administrative tribunals of either Party, or other settlement procedures (e.g. ACIA), and (ii) once the investor has submitted the dispute to their respective competent courts or administrative tribunals or to one of the alternative arbitration procedures, the choice of the procedure is final (e.g. in the ASEAN-China Investment Agreement and AKFTA). In this regard, TPP provides an additional safeguard than other IIAs and requires the claimant to submit with the notice of arbitration a written waiver of any right to initiate or continue before any court or administrative tribunal under the law of a Party, or any other dispute settlement procedures, any proceedings with respect to any measure alleged as a claim under the TPP.

Further, the TPP includes a mechanism for host states of expedited review and dismissal of frivolous or otherwise unmeritorious claims and claims the tribunal is not empowered to resolve. None of Indonesia's

previous IIAs under review incorporates the mechanism to avoid frivolous claims. In this regard, TPP would represent a significant innovation for Indonesia in providing greater safeguards in the use of ISDS.

### c. Consistency among arbitral awards

New generation IIAs have been negotiated in the context of a significant increase in investor-state disputes. These disputes have yielded awards that have not always been consistent, and in some cases, have rendered controversial legal interpretations of the terms of the investment agreements and of international law in general.<sup>16</sup> To respond to this situation, new generation IIAs have included innovative provisions to foster a consistent and sound development of jurisprudence through (i) more detail provisions on several key substantive issues (as discussed above in the case of indirect expropriation and minimum standard of treatment); and (ii) the proposal that arbitral awards be subject to appeal.

Although none of Indonesia's IIAs, provide for an appeal mechanism, some other agreements such as the recently concluded EU-Canada Comprehensive Trade and Economic Agreement (CETA) incorporates a two-stage ISDS mechanism, by establishing an investment tribunal and introducing an Appellate review mechanism.

### d. Promotion of legitimacy of investor-state arbitration within civil society

In response to concerns that arose over the years by some non-governmental organizations with respect to ISDS, new generation of IIAs include provisions aimed at improving the transparency of investor-state arbitration proceedings. Such rules on transparency include, for instance: the requirement of the respondent in an investment dispute to transmit to the home state and to make available to the public, certain documents, including the notice of arbitration, the memorials, the transcripts of hearings, and the awards of the tribunal; the requirement that the hearings be open to the public; and the requirement to allow parties not involved in the dispute to submit briefs and authorize arbitral tribunals to consider submissions from any member of the society, the so-called "amicus curiae".

None of the BITs negotiated by Indonesia include these provisions. Recent Indonesian "new generation" IIAs include transparency rules requiring the disputing party to make publicly available all awards and decisions made by the tribunal except when such information is specifically designated as confidential (as noted in the AANZFTA and AKFTA etc.). The TPP, following the trend of new generation IIAs, incorporates rules of transparency of arbitral proceedings (arbitration hearings and documents open and available to the public), amicus curiae submissions and non-disputing party submissions. The Indonesian BITs do not include this standard, as they contain a standard version of the ISDS clauses typically found in the previous generation BITs often conferring power of interpretation to the tribunal to decide on these issues.

## V. Does TPP go beyond the level of commitments undertaken by Indonesia in its IIAs?

As stated in the introduction to this note, after a comparative legal analysis of the obligations undertaken by Indonesia both in its BITs and new generation IIAs, the investment chapter of TPP seems to provide Indonesia with more significant policy space and safeguards against frivolous ISDS claims. Indeed, taking as a basis the published text of the investment chapter of TPP, the latter represents a more sophisticated treaty incorporating much more detailed language delimiting the scope of the substantive obligations and incorporating a series reservations and exceptions to these commitments. Further, TPP contains much

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<sup>16</sup> ECHANDI, *Supra*

more detailed provisions including a series of safeguards against potential abuse of ISDS by investors or broad interpretations by the arbitration tribunals going beyond the original intention of the parties.

A complete comparison of the different provisions has been included in the Annex to this note. In this section, a summary of the analysis is presented, making a difference on three key areas: (i) scope of application of the obligations, (ii) main substantive protection provisions and (iii) ISDS safeguards.

<b>Table No. 2 - Scope of application of the treaty</b>			
	<b>BITs</b>	<b>New Generation PTAs</b>	<b>TPP</b>
<b>Definition of investment</b>	Very broad, asset-based definition. Includes public debt.	Qualified asset-based definition. Includes public debt.	Qualified asset-based definition, complemented by more detailed clarifying footnotes and annexes with respect to public debt
<b>Definition of investor</b>	Any company constituted under the laws of the host country is an investor.	Same as BITs, but include denial of benefits clauses	Same as PTAs, but include more detailed denial of benefits clauses
<b>Application in time</b>	Some BITs can apply after denunciation for 10 + years for existing investments	Treaty can be withdrawn upon a fixed notification period.	Treaty can be withdrawn upon a notice of 6 months. No part of the agreement will remain in force thereafter.
<b>Pre or post establishment application</b>	Applies only to investments admitted according to domestic laws	Nondiscrimination (National Treatment and MFN) – subject to reservations- applies to the establishment, acquisition, operation and expansion of an investment. ASEAN-CHINA investment agreement does not grant national treatment in pre-establishment phase. In AANZFTA further discussions between the parties will take place on the application of Most Favored Nation (MFN) treatment.	

As Table No.2 summarizes, Indonesia has had already treaties with a broad scope of application. Although BITs only apply to investments established in Indonesia according to its legislation, the definition of investment is significantly broad and may lead to cover all kinds of “assets” owned or controlled by an investor. New generation PTAs - like ACIA, or the Japan-Indonesia EPA -- do have a broader scope than BITs in the sense that they apply both to the investor seeking to invest in Indonesia as well as to investment established in the country. However, the definition of investment is qualified and does not cover any asset,

but only those with the characteristics of an investment, like commitment of capital, duration in time and assumption of risk. TPP follows the same logic of the PTAs already signed by Indonesia, but includes a series of additional clarifications not yet included in Indonesia’s PTAs regarding specific caveats restricting even more the definition of investment, including an Annex clarifying the conditions in which public debt will be considered as an investment.

A similar trend can be found regarding the definition of investor and application in time of the agreement. Here the BITs already signed by Indonesia entail broader commitments than new generation PTAs and TPP.

<b>Table No. 3 - Main Substantive investment protection provisions</b>			
	<b>BITs</b>	<b>New Generation PTAs</b>	<b>TPP</b>
<b>National Treatment</b>	Some do not have it. Those that do provide unqualified national treatment	Subject to “like circumstances” and reservations	Subject to “like circumstances” and reservations.  Clarification of best “in State treatment” included.
<b>Most Favored-Nation Treatment</b>	Unqualified, do not clarify if it applies to ISDS	Subject to “like circumstances” and reservations. Some clarify that do not apply to ISDS	Subject to “like circumstances” and reservations.  Does not apply to ISDS
<b>Minimum Standard of Treatment: Fair and Equitable Treatment and Full Protection and Security</b>	General, unqualified language.	More specific language, clarifying the concepts understood to be protected under fair and equitable treatment (such as due process) and/or limiting the scope to customary international law	Very specific language, clarifying that it only provides standard according to customary international law and defines each term
<b>Expropriation</b>	General unqualified language for indirect expropriation	More specific language. Some include annex with guidelines to determine indirect expropriation.	Very specific language, clarifying that it only provides standard according to customary international law and defines guidelines for determination of indirect expropriation. Clarifies that obligation is not intended to prevent

			regulatory powers of the State.
<b>Transfers</b>	General language. Some include balance of payments exception. Some BITs only protect outbound transfers	More specific language, includes some exceptions, including balance of payments exception and protects both outbound and inbound transfers.	Very specific language includes exceptions plus balance of payments exception.
<b>Performance Requirements</b>	Do not contain obligation. TRIMS applies by default	EPA with Japan includes TRIMS + obligations applicable to services	Very specific TRIMS+ language, additional obligations applicable to services but subject to reservations and exceptions
<b>Compensation for Strife</b>	Basic language. No obligation to compensate except national treatment in case the State opts to do so to its own investors. Obligation to compensate in cases of undue requisition of property by armed forces.		
<b>Umbrella clauses</b>	Included	Not included	Not included
<b>Transparency</b>	Not included	Some PTAs include clauses.	Very detailed clauses.
<b>Exceptions and Reservations</b>	Only exceptions: regional integration and double taxation for MFN.  No reservations.	Exceptions and Reservations	Exceptions and Reservations

Table No.3 above shows that all BITs, PTAs and TPPs contain obligations regarding the same matters, however, the distinction lies in the level of detail and reach of each of the obligations affecting the treatment and protection to covered investments. As stated before, it is in this area where the impact of ISDS on investment rulemaking is more evident, as BITs tend to use very short and yet broad language to refer to the investment protections granted to investors. This trend has enabled investors to prepare claims with arguments supporting expansive interpretations of the IIAs, and at the same time, has also forced arbitration tribunals to interpret those general provisions in concrete situations.

New generation PTAs and TPP in particular represent the trend by which governments have attempted to clarify the investment protection clauses not only to prevent broad claims by investors, but also to limit opportunities for arbitration tribunals to be creative and interpret the IIAs by themselves. Thus, TPP includes a series of safeguards and clarifying clauses that are normally not included in most of the IIAs negotiated by Indonesia. For instance, the inclusion of the “like circumstances” clause in national

treatment and MFN which enables States to have regulation that may have a different impact over foreign investors and yet may be tolerated provided that there is rational policy objective that is not the nationality of the investors. Another example is the clarification of the Minimum Standard of Treatment and Expropriation clauses where contrary to BITs, TPP limits the scope of the provision to the standards under customary international law –which require a degree of arbitrariness to generate liability. Further TPP makes it clear that none of these clauses intend to limit the regulatory powers of the State and that a simple negative impact of regulation over the investor does not constitute in itself a violation of these obligations by the host State. All of these safeguards are not included in Indonesia’s BITs. The same trend can be observed regarding the other investment protection guarantees.

Performance requirements is the only area where TPP may entail additional commitments to existing IIAs signed by Indonesia. Although the EPA with Japan also includes TRIMS plus commitments that among other aspects apply to investment in services, TPP includes more specific provisions which may entail more disciplines in this field. However, it should be noted that TPP also includes more reservations and exceptions than the EPA text in this regard. The manner in which Indonesia would deal with this would require specific negotiations with Indonesian authorities.

<b>Table No. 4 - Investor-State Dispute Settlement Procedures</b>			
	<b>BITs</b>	<b>New Generation PTAs</b>	<b>TPP</b>
<b>Scope of procedures</b>	Very broad, no need for alleged breach, or damage or causal link to invoke ISDS	More specific, breach and damage required to invoke ISDS.	More specific, breach, damage and causal link among the two required to invoke ISDS
<b>Mechanism against frivolous claims</b>	None	ACIA, AANZFTA contain mechanism.	Very detailed mechanism included
<b>Mechanisms to prevent arbitration tribunals to decide on certain matters</b>	None	Mechanism included in ACIA for tax matters.	Mechanism included for tax matters, interpretation of annexes, and prudential measures
<b>Mechanisms for binding interpretations by the Parties over the tribunals</b>	None	Included	Included

<b>Explicit provision for the Parties to bring counterclaims against investors</b>	None	None	Included
<b>Exclusions from ISDS for pre-establishment claims and certain types of claims (tobacco)</b>	None	None	Included
<b>Transparency of proceedings</b>	None	Included	Included
<b>Possibility for civil society to submit amicus curiae</b>	None	None	Provided
<b>Possibility for the other Parties to participate in ISDS</b>	None	None	Provided
<b>Rules of Conduct for Arbitrators</b>	None	Not in the text	Explicit reference included in text
<b>Binding nature of awards and enforcement</b>	Referred to ICSID or New York Convention		
<b>Possibility to establish an Appeal Mechanism</b>	None	None	Included

Table No.4 shows that one of the areas where TPP goes beyond existing IIAs negotiated by Indonesia is in the inclusion of much more detailed ISDS provisions aimed at enabling Governments have more safeguards against potential abuse by investors of these enforcement mechanisms. As Table No. 4 above demonstrates, TPP makes it more difficult for investors to submit claims than BITs, includes mechanisms to screen frivolous claims, prevents arbitration tribunals from deciding on certain sensitive matters which are reserved to government themselves, introduces mechanisms to enable governments to generate binding interpretations of the agreement, enables other governments besides the defendant to participate in ISDS proceedings –to defend policy space-, provides exclusions of ISDS and so on. Clearly, TPP is an example of a policy of member States towards safeguarding their capacity to regulate and shield themselves from potential challenges under ISDS. These safeguards are not included in most of the IIAs currently in force in Indonesia.

## VI. Conclusion

The main conclusion of this comparative analysis is that, with the exception of certain particular aspects regarding performance requirements affecting the establishment of investments, the investment chapter of TPP would not entail for Indonesia any undertaking of obligations beyond those it has already assumed under other IIAs in force. In the area of obligations regarding the establishment of foreign investment into Indonesia, it should be mentioned that various ASEAN IIAs to which Indonesia is a party already include commitments, albeit some of them yet in process of implementation –like the annexes of non-conforming measures in the ASEAN-South Korea Free Trade Agreement.

Further, a comparison of the investment chapter of TPP with all the IIAs in force Indonesia –in particular those Bilateral Investment Treaties (BITs) – leads to conclude that the TPP investment chapter also contains many more safeguards on ISDS. Given the multiparty negotiation of TPP, added to the fact that many of its main signatories negotiated the text of the agreement after being subject to ISDS as responding parties themselves, explains why the TPP investment chapter is, from the perspective of Governments, a more “regulatory friendly” text than those of IIAs negotiated over the last decade.

The fact that TPP may not entail significant additional obligations for Indonesia in the hypothetical situation it opted to accede to this agreement does not mean that the country should not undertake serious efforts to prepare for TPP negotiation and to better implement existing IIAs. Preparation for TPP negotiation would be essential for Indonesia given the level of granularity of the reservations and exceptions that TPP members can make. Thus, in case of negotiation, it would be paramount for Indonesia to undertake a detailed analysis of its own investment related legislation to determine areas to safeguard or otherwise reform depending on the policy objectives of the government.

Better implementation of existing IIAs is another area where Indonesia could consider focusing its efforts. Up to date, Indonesia has been subject to six ISDS cases –see Annex 2 attached to this note. In addition to the shortcomings regarding time and cost of invoking investor-State dispute settlement regimes, from a systemic perspective, there is a more important negative consequence which should not be overlooked. Increased litigation undermines the development of long-term harmonious relationships between foreign investors and host States. Such outcome is in fact contrary to one of the key objectives that IIAs should promote, that is, to contribute towards the creation of an investment climate favoring the growth of investment inflows. As explained in Annex 3 to this note, this latter point is more than a philosophical one, and has very concrete practical implications, in particular for emerging economies like Indonesia. Among other functions, IIAs should be used to respond to the real social need of finding effective ways to enable investors and host States to address their problems in an efficient manner, without necessarily incurring in the costs associated with litigation.

## Annex 2: Summary: ISDS Experience of Indonesia

Up to date, Indonesia has been involved in six ISDS cases which are shown in Table 5 below:

<b>Table 5: Indonesia's ISDS cases<sup>17</sup></b>		
<b>Case Name and Number</b>	<b>IIA</b>	<b>Outcome</b>
Amco Asia Corporation and others v. Republic of Indonesia, ICSID Case No. ARB/81/1	Contract	Dismissed for lack of jurisdiction
Cemex Asia Holdings Ltd v. Republic of Indonesia, ICSID Case No. ARB/04/3	Contract, ASEAN Treaty 1987	Settled
Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia, ICSID Case No. ARB/12/14 and 12/40_	Australia-Indonesia BIT; Indonesia-United Kingdom BIT	Pending
Hesham T. M. Al Warraq v. Republic of Indonesia, UNCITRAL	Organisation of Islamic Cooperation Investment Agreement -	Partially in favor of Indonesian State and partially in favor of the investor. No damages awarded.
Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia, ICSID Case No. ARB/14/15	Indonesia-Netherlands BIT	Withdrawn
Rafat Ali Rizvi v. Republic of Indonesia, ICSID Case No. ARB/11/13	Indonesia-United Kingdom BIT	Dismissed for lack of jurisdiction

Of these six cases, only one has been decided on the merits (Hesham T.M. Al Warraq v. Indonesia), two were dismissed for lack of jurisdiction (Amco Asia v. Indonesia and Rafat ali Rizvi v. Indonesia) and one of them is still outstanding (Churchill Mining v. Indonesia). In “Hesham T.M. Al Warraq v. Indonesia”, which was based on the Organisation of Islamic Cooperation Investment Agreement, the investor claimed the nationalization of his stake in an Indonesian bank due to a bail out performed by the Republic of Indonesia’s Deposit Insurance Agency (“LPS”). Due to this action the investor claimed that his invested was expropriated, a violation of the fair and equitable treatment standard and responsibility of the Indonesian state for failing to provide full protection and security. The tribunal found that there was no expropriation of the investment and no failure to provide full protection and security, however the state did breach the obligation to provide fair and equitable treatment. In spite of finding a violation, the

<sup>17</sup> ICSID; italaw.com

tribunal awarded no damages to the investor given that it found that the investor had breached the investment agreement by committing acts contrary to the public interest.

In *Rafat Ali Rizvi v. Indonesia*, a British investor used the Indonesia-UK BIT to also claim the expropriation of his investment and the breach of the fair and equitable treatment clause due to the bailout measures implemented in Bank Century, a local Indonesian bank. In this case, the tribunal found it lacked jurisdiction since there was not an investment given that Mr. Rizvi's investment had not been admitted in accordance to Indonesian law, a requirement under the Indonesia-UK BIT.

The *Amco v. Indonesia* case was initially decided in favor of the investor, the case used a contractual agreement between a consortium of companies (claimants) for the building and management of a hotel complex. They claimed that the investment had been expropriated because Indonesia seized the investment in an armed military action and then unjustifiably cancelled the investment license. Initially, the arbitral tribunal found in favor of the investors, however Indonesia sought the annulment of the award because the arbitral tribunal failed to consider the merits of all the grounds justifying the revocation of the license and failed to state the reasons justifying its award. The award was indeed annulled by an ad hoc ICSID tribunal and in the new analysis of the case the tribunal found that it lacked jurisdiction to rule on the dispute.

The above cases show that Indonesia has experience in handling ISDS cases, both at UNCITRAL and ICSID. It also shows that Indonesia has had relative success in defending itself against ISDS claims, having either settled or obtained the dismissal of most of its cases. Even in the only case it was found in breach of an investment guarantee, it was not found liable for damages. However, despite these developments it is important to stress that resolving a grievance, as opposed to defending a legal dispute, tends to be a better outcome both for the investor and the State. Thus, a key area for further work to be considered by Indonesia would be how to use IIAs in a more constructive manner, different from ISDS –see Annex 3 of this note.

## Annex 3: Background Note on Systemic Investment Response Mechanism

### *Context*<sup>18</sup>

- *Retaining existing investment is as important as attracting new investment - reinvested earnings make up as much as a third of FDI flows in developing countries and as much as two fifths of all FDI income.*
- *Investors are concerned about inadequate protection, especially adverse regulatory changes, breach of contract and transfer and convertibility restrictions; these areas are also identified as the principal political risks facing investors in developing countries.*
- *Investor protection (including from non-transparent government conduct) is important for investors; the absence of protection can lead to withdrawal of existing investments, or cancellation of new investments.*
- *Inadequate protection is costly for governments; investor-state disputes can average \$10.4 million in damages per arbitration case and \$3 million per case in legal and administrative costs.*

### I. *The case for having a Systemic Investment Response Mechanism*

Improvement in the legal framework (“de jure”), in particular in investor protection guarantees -- protection against expropriation and breach of contract, ability to convert and transfer currency overseas, lack of transparency, arbitrary government action and discrimination -- which are closely linked to investor perceptions of political risk, can greatly improve investor confidence. Yet the biggest challenge faced by investors is the lack of implementation of laws (“de facto”), regulations and contracts. Surveys conducted by the WBG have indicated that investors often withdraw their investment or cancel expansion plans due to investor protection issues. Further, the lack of implementation often ultimately culminates into disputes between investors and host countries. These not only expose host governments to the risk of lost investment, but also to reputational damages and significant costs of litigation and arbitral awards (an average of \$3 million in administrative costs and \$10.4 million in damages per arbitration case). A mechanism ensuring legal and regulatory compliance across government agencies and promoting effective problem solving for investors would help prevent investor grievances from escalating into disputes by identifying them in a timely manner and attempt to resolve them early. This would result in a more transparent and consistent investment climate and would help address foreign investors’ main investor protection concerns.

### II. *Setting up a Systemic Investment Response Mechanism*

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<sup>18</sup> All data are from MIGA, World Investment and Political Risk 2013.

The Trade and Competitiveness Global Practice of the WBG offers assistance to counties in setting up a Systemic Investment Response Mechanism (SIRM). SIRM helps governments better manage critical investor grievances/problems. Critical investor grievances/problems are those which can cause investors to withdraw investment (or cancel expansion plans), or to sue governments for violation of investor protection guarantees such as expropriation, restrictions on ability to transfer currency, lack of transparency and arbitrary government action, breach of contract or discrimination. To support the functioning of SIRM, or even as a stand-alone tool, the WBG also provides support in designing and implementing an Investor Tracking System, which is an ICT tool to help governments track and monitor investor grievances and progress in resolving them (see example of Bosnia and Herzegovina below).

SIRM essentially provides the minimum institutional infrastructure that enables governments to identify, track and manage grievances arising between investors and public agencies as early as possible. Reforms are undertaken to enable a designated Lead Agency within the government to manage and implement SIRM. SIRM ensures that the government responds to investor grievances in a suitable manner and in accordance with the country's international investment agreements, laws and regulations. The Lead Agency is equipped with adequate legal training and authority to serve as a 'secretariat' of SIRM, facilitating the use of international and domestic investment law as a tool to persuade public agencies that generate investor grievances to consider whether their actions are in fact in conformity with the applicable investment frameworks well before those grievance escalate into a dispute. It should be noted that investor aftercare is much broader than SIRM in that the latter is focused on identifying, tracking and managing grievances arising from lack of implementation of investor protection guarantees. In this sense, SIRM can be said to be a more focused subset of Investor Aftercare.

From a transparency perspective, SIRM helps identify specific cases of violation transparency obligations (i.e. through individual investor complaints), the tangible amount of investment impacted by the violation, any other impact on the investor due to the violation. It enables governments to provide an effective and timely response to resolve a specific case. While a single investor's complaint helps identify prevalent instances of lack of transparency, the proposed solution under the SIRM would typically involve a systemic improvement.

### III. *Features of a Systemic Investment Response Mechanism*

There is no ideal 'best practice' SIRM. However many countries have started to establish their own versions of dispute prevention and general aftercare systems, which provide the following valuable good practice elements for designing SIRM:

- **Lead Agency:**

There should be a government agency with power and attributions conferred by law and/or regulations, which is responsible for implementing SIRM. The Lead Agency may be an existing government ministry/agency, or may need to be newly created. In particular, the Lead Agency should be able to obtain information from relevant government agencies that interact with investors/cause grievances and provide a channel for information sharing among government ministries/agencies. The Lead Agency can be established at a sectoral, sub-national or a national level, depending on the political-economy and requirements of the country. Countries like Korea have been able to appoint a fairly independent national Lead Agency, appointed directly by the

president; other countries such as Bosnia and Herzegovina have relied on a collaborative system involving multiple agencies at sub-national levels. In Mongolia, the government has chosen to have a top down approach involving the setting-up of a centralized Lead Agency. Annex A provides greater details on the Korea model.

- **Information Sharing:**

Information sharing should enable the Lead Agency to coordinate the diffusion of relevant information to those agencies more likely to generate or become involved in grievances. Information sharing may involve substantive information on the contents and breadth of the obligations included in the different international investment agreements (IIAs), or informing the highest possible number of governmental departments about the existence and purpose of the Lead Agency so the latter knows who to call in case of doubt regarding the consistency of their measures/actions with IIAs, or if a conflict with a foreign investor arises. For example, in Colombia a focus area of the dispute prevention strategy is training, information sharing on IIA commitments and on what these commitments mean for a public official's daily routine and decision making. Similarly in Mexico, the Secretaries of Economic Development organized training sessions and capacity building efforts at a regional and municipal level, to create awareness of the commitments undertaken by Mexico with regard to foreign investors in IIAs.

- **Early Alert Mechanisms:**

Early alert mechanisms enable the Lead Agency to learn about the existence of a grievance as early as possible (e.g. through the private sector). In some countries representatives of the Lead Agency make regular visits to companies to gather information on existing grievances. This is the case in Korea and in Bosnia and Herzegovina. In other countries, investors need to report a grievance to the Lead Agency on their own. Some countries also use online technology tools as early alert systems. For example Peru has designed an online tool for government agencies to register grievances. Gradually, this tool will be made available to investors to enable them to register grievances.

- **Problem Solving Methods:**

SIRM should provide for problem-solving methods for the parties to seek an interest-based solution to the grievance (e.g. fact finding, obtaining third party expert opinion). In most existing models, consultation with investor and regular follow ups have been used to resolve investor grievances.

- **Political Decision Making:**

Once the problem-solving process has enabled the parties to find a solution to the grievance, it is paramount that such solution receives the approval of the adequate political authority of host State and the investor. To achieve this goal, alternatives currently being considered in various countries entail the establishment of political bodies, such as Ministerial Councils, to monitor the effective implementation of solutions agreed by the Lead Agency, which will be an administrative body. High-level political endorsement would guarantee that the measure providing a solution to the problem would be effectively implemented.

Political risk and investor protection related grievances often involve multiple levels of government and can relate to controversial government conduct. Having high level political support is thus essential for resolving such grievances. In Mongolia for example, the possibility of having a Ministerial Council under the Prime Minister's office is being explored. In Bosnia and Herzegovina, problem solving and political decision making is voluntarily done by the Lead Agency (which is a group of representatives from relevant government agencies). The sub-national government agencies are very powerful and act quite independently. The thrust for political decision making to solve investor grievances is peer pressure from other government agencies and not one "superior" agency.

- **Enforcement of decisions:**

Closely related to political decision making is the need to ensure that the consensual solution to the grievance agreed by representatives of governments and investors is not ignored or disrespected by one of the many other agencies (e.g. Ministerial Councils enforce)

#### IV. *Models of Systemic Investment Response Mechanisms*

SIRM is designed based on a country's political, economic and legal/institutional framework. The capacity of the government and resources available also determine the type of SIRM that can be designed for a country. In some countries, a centralized SIRM may be set up, while in others a sub-national approach is more fitting. In some countries majority grievances arise in a specific sector and thus governments choose to design a sectoral SIRM. Below are two examples of how different approaches to SIRM have been implemented:

##### **Bosnia and Herzegovina:**

In Bosnia and Herzegovina, initial WBG assistance was provided in helping the government provide aftercare services. The aftercare initiative gradually evolved into a more targeted and effective SIRM. Rather than pursuing a top down approach, a more organic approach was followed involving representatives of the private sector and sub-national government agencies. Bosnia and Herzegovina has a strong federal structure with sub-national entities functioning fairly independently. The Collaborative Network, which is the Lead Agency, is essentially constituted on a voluntary basis and so far does not have a single law/regulation governing it. Peer pressure from each other motivates and pushes governments to address investor grievances in an effective manner. The investment promotion agency can also submit a report on pending investor grievances to the council of ministers for their consideration.

##### **Korea:**

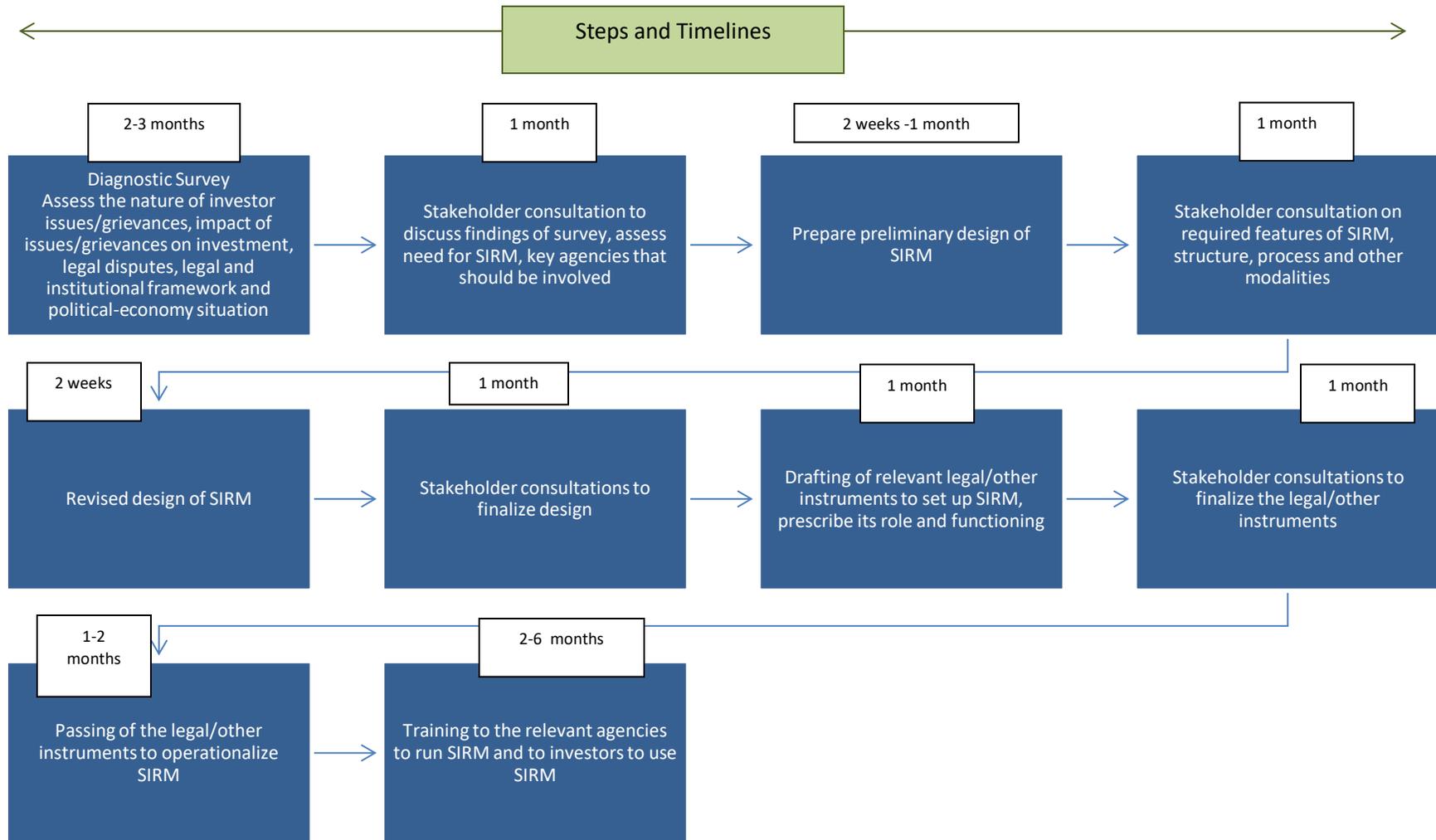
A more sophisticated model is Korea's Office of Foreign Investment Ombudsman (OFIO) that is commissioned directly by the president and heads the Investment Aftercare Division. The Investment Aftercare Division is staffed with 9 experts in the fields of taxation, labor, finance, accounting, law, construction, IT etc. The experts, also called "Home Doctors", provide foreign-invested companies one-on-one service in investigating and resolving a wide range of grievances. In the Korean model, "grievances" are very broadly defined and OFIO addresses all types of grievances, ranging from corporate

management to the living environment of foreign investors. Unlike Korea's general aftercare system, typically SIRM focuses only on key investor protection guarantees. Having a more targeted approach helps countries with more limited resources react more effectively to investor grievances. A detailed description of the Korean model is provided in Annex A.

V. *Timeline/Milestones for Setting up a Systemic Investment Response Mechanism*

The diagram below indicates typical steps and expedited timelines for setting up SIRM.

### Key Steps and Timelines (Expedited Proposal)



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