

Alternative investment protection strategies for Indonesia

In this briefing, we consider the implications of Indonesia's termination of its Bilateral Investment Treaty (**BIT**) with the Netherlands (**the Netherlands BIT**) and how foreign investors might structure their investments to take advantage of certain *multilateral* investment treaties to which Indonesia is a party, notably the Association of South East Asian Nations (**ASEAN**) Comprehensive Investment Agreement (**ACIA**).

Termination of the Indonesia-Netherlands BIT

On Thursday 20 March 2014, the Netherlands Ministry of Foreign Affairs announced that Indonesia had decided to cancel the Netherlands BIT.¹ The same announcement explained that the Indonesian Government mentioned that "*it intends to terminate all of its 67 bilateral investment treaties.*"²

Indonesia is yet to confirm reports that it intends to terminate its other BITs. It may be that the Government is simply "testing the water" to see what impact the termination of the Netherlands BIT has on inbound capital flows. However, Indonesia has faced a number of treaty claims in recent years, and the decision to terminate the Netherlands BIT may well have been informed by these experiences.³ Contextually, it should

also be remembered that Indonesia is in an election cycle, and it is not unusual to see shifts in trade and foreign investment policy at such a time.

Are existing investments still protected under the Netherlands BIT?

As of 1 July 2015, the Netherlands BIT will continue to apply for a sunset period of 15 years, but only to investments made prior to that date.

Existing investments covered by the Netherlands BIT are therefore still protected, and will be for some time. However, investors who are currently protected but who have investments that will run for more than 15 years should consider other options. These covered investors may be able to restructure their investments to secure the protection of other instruments (provided they are not already in dispute with the Indonesian State).

Mining PLC under the United Kingdom-Indonesia BIT. See Churchill Mining PLC v. Republic of Indonesia. (ICSID Case No. ARB/12/14).

Key issues

- Indonesia has announced that it will terminate its bilateral investment treaty with the Netherlands as of 1 July 2015.
- It is reported that Indonesia plans to terminate all of its bilateral investment treaties.
- Investors should consider structuring their investments to acquire the protection of multilateral investment treaties to which Indonesia is a party, such as the ASEAN Comprehensive Investment Agreement.

What alternative protection can investors seek?

With the future of Indonesia's BIT programme now uncertain, Indonesia's multilateral trade and investment treaties may present a more stable and reliable investment protection framework for foreign

¹ BITs are treaties entered into between two states to promote capital flows and provide rules for the protection of covered investments.

² <http://www.minbuza.nl/en/key-topics/treaties/news/newsflashes-2014/indonesia-terminates-ibo.html>

³ The most recent treaty claim against Indonesia is that brought by Churchill

investors. The instrument we focus on in this briefing is the ACIA.⁴

The ACIA is a relatively new, multilateral investment treaty between ASEAN Member States which only came into force on 29 March 2012. The current signatories to the ACIA are Indonesia, Brunei, Singapore, Cambodia, Lao, Philippines, Malaysia, Myanmar, Thailand and Vietnam.

The ACIA – an overview

Substantive investment protections

The ACIA contains all of the substantive protections and standards of treatment normally found in a modern BIT. The rules that will be of interest to most investors are:

- **National Treatment** – under this rule, covered investors must be treated in the same way as local investors. It is, in effect, a rule against discrimination. It should be noted, however, that Member States may make reservations with respect to National Treatment, and Indonesia has done so.⁵
- **Fair and Equitable Treatment (FET)** – each ASEAN Member State undertakes to accord "fair and equitable treatment" to covered investments of ASEAN investors.⁶ In practice, the FET standard is particularly important because it can be used as a basis for resisting (or seeking compensation for the effects of)

adverse changes in the laws and regulations applicable to an investment.

- **Expropriation** – an ASEAN Member State that expropriates an investment (either directly or indirectly) is required to provide proper compensation to the affected investor.⁷ However, like many modern multilateral trade and investment treaties, the ACIA contains special rules for the qualification of a measure as an indirect (or "creeping") expropriation.⁸
- **Most Favoured Nation status (MFN)** – this rule requires that ASEAN investors are to be treated no less favourably than investors from outside the ASEAN bloc.⁹ Practically, MFN is useful because it gives covered investors a basis for importing the more favourable provisions under other investment treaties to which Indonesia is a party.

Investors must be aware that the ACIA contains general exceptions which expressly permit Member States to take measures necessary to protect certain public interests. These exceptions are set out in ACIA Article 17. While they do make the ACIA somewhat less "investor friendly" than some of Indonesia's BITs, they should not necessarily be seen as negatives. This is because these exceptions, and the other special rules described above, make the ACIA more balanced as an instrument, and thus more likely to endure as a treaty in the long term.

How to structure investments to gain protection under the ACIA

Most investment treaties have two main "gateway requirements". First, the business seeking protection must fall within the treaty's definition of an "investor". Second, the interest that the business has (or plans to have) in the host state must fall within the treaty's definition of an "investment".

On the first requirement, in order to benefit from the investment protection offered by the ACIA, an investment must be made by a natural or legal person of an ASEAN Member State.¹⁰ However, like many multilateral treaties, the ACIA contains a "denial of benefits" rule that limits the ability of non-ASEAN investors to acquire the protection of the treaty by simply setting up a "mailbox company" in an ASEAN Member State. Under the ACIA, an ASEAN host state may deny the benefits of the treaty to an investor that has "*no substantive business operations in the territory*" of the ASEAN Member State from which it makes its investment.¹¹

In other words, non-ASEAN investors are entitled to treaty protection only if they make a real economic contribution to both their ASEAN home state and their ASEAN host state. The economic rationale is simply to attract as much capital to as many members of the ASEAN bloc as possible.

The rule is best illustrated by an example. A German company wants to make an investment in Indonesia. It has an existing Singapore subsidiary, and intends for this Singapore entity to own and operate its investment in Indonesia. The investment will only be covered by the

⁴ Indonesia has also entered into other multilateral agreements, including the Australia-New Zealand-ASEAN Free Trade Agreement (AANZFTA).

⁵ For the full list of Indonesian reservations on National Treatment, go to <http://investasean.asean.org/index.php/page/view/investment-policy-database---search>

⁶ ACIA Article 11.

⁷ ACIA Article 14.

⁸ Annex 2 of the ACIA ("Expropriation and Compensation").

⁹ ACIA Article 5(2).

¹⁰ ACIA Article 4(d).

¹¹ ACIA Article 19.

ACIA if the Singapore entity has "*substantial business operations*" in Singapore. Although the ACIA does not explain what is meant by "*substantial business operations*", based on the way that expression has been interpreted in other multilateral treaty contexts, it is likely that in order to pass the test for "*substantial business operations*" the Singapore entity would have to:

- have employees and resident managers who are based (and paid) in Singapore, and who carry out work and assignments furthering the business of the investment in Indonesia;
- be party to substantial transactions in Singapore, which are more than just transactions required to maintain the Singapore company's corporate existence. For example, the Singapore company would need to buy and sell goods and services in Singapore, and engage in the local procurement of inputs necessary for the conduct of its business; and
- pay taxes in Singapore.¹²

What investments qualify for protection under the ACIA?

The ACIA defines the term "*investment*" by reference to a list of examples, which includes:

- claims to money or to any contractual performance related to a business;

- rights under contracts, including turnkey, construction, management, production or revenue-sharing contracts;
- business concessions required to conduct economic activities including any concessions to search, cultivate, extract or exploit natural resources; and
- shares, stock, bonds and debentures.¹³

Finally, in order to be a "*covered investment*" under the ACIA, the relevant investment must also be "*admitted*" according to the laws, regulations and national policies of the host state and, where necessary, specifically approved in writing.¹⁴ These local admission requirements vary from state to state, and are sometimes complicated where Indonesia is concerned.

If an investor has an interest that falls within one or more of the categories set out above, and its investment has been admitted by the host state in accordance with the relevant local law requirements, the investment will be covered by the ACIA.

How are investment disputes under the ACIA resolved?

The ACIA provides a range of investor-state dispute resolution options, including arbitration at the International Centre for Settlement of Investment Disputes (ICSID), provided the host state is an ICISD member (which Indonesia is), and *ad hoc* arbitration under the Arbitration Rules of the UN Commission on International Trade Law. These mechanisms are critical because they allow investors to enforce their rights under the ACIA directly against the

host state, in a neutral forum that the host state does not control.

Conclusion

While the uncertainty over Indonesia's investment treaty program is a cause for concern, with proper planning foreign investors may still be able to acquire similar standards of investment protection under the ACIA, provided they meet the qualification requirements set out in the treaty. In particular, non-ASEAN investors need to make their investments in Indonesia from an ASEAN Member State in which they have "*substantial business operations*". For countries like Indonesia, multilateral instruments like the ACIA are likely to provide a more reliable investment protection framework than BITs, especially for long-term investments.

¹² These indicators of "substantial business operations" have been recognised in the context of the Energy Charter Treaty, which contains a similar denial of benefits clause to the ACIA. See S Jagusch and A Sinclair, "Denial of Advantages under Article 17(1)", in G Coop and C Ribiero (eds), *Investment Protection and the Energy Charter Treaty* (JurisNet, 2008), p. 20.

¹³ ACIA Article 4(c).

¹⁴ ACIA Article 4(a).

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