Indonesia Gives Notice: Foreign Investors to Lose Treaty Protection

On March 23, 2014, Indonesian Vice President Boediono confirmed that Indonesia will not renew its Bilateral Investment Treaty (“BIT”) with the Netherlands, set to expire next year on July 1, 2015. As a possible harbinger of things to come, the Dutch Embassy in Jakarta also reports the Indonesian government “has mentioned” it intends to terminate its remaining investment treaties, some 66 in total. This is in line with a recent move by some developing States to terminate or renegotiate investment treaties, which some view as providing greater protection to foreign investors than benefit to the State.

For foreign investors in Indonesia and those who are planning to invest in Indonesia, it is time to take stock of whether new or different steps should be taken to protect those investments against sovereign risk. For investments currently protected under the Indonesia-Netherlands BIT, the immediate impact of Indonesia’s announcement is limited because protection under the BIT for existing investors and investments continues for 15 years following its termination, that is, until 2030. However, any investors considering structuring (or restructuring) an investment through a Dutch entity investing in Indonesia must act before July 1, 2015, or the investments will not qualify for protection.

Foreign investors in Indonesia also should consider the investment protections afforded by other bilateral investment treaties, as well as multilateral investment treaties and free trade agreements to which Indonesia is a party, such as the Association of Southeast Asian Nations (“ASEAN”) and the Investment Agreement of the Organisation of the Islamic Conference (“OIC”), given the suggestion that Indonesia may be terminating its other BITs. While Indonesia is reported to be considering termination of its other BITs, there are no indications as of yet that Indonesia intends to withdraw from multilateral treaties.

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Importance of Investment Treaties for Managing Risk

Investment treaties provide qualifying investors with the means to manage the sovereign risk associated with foreign investments in host States. They can be bilateral (such as the Indonesia-Netherlands BIT) or multilateral (such as ASEAN), and establish standards of treatment and protection for qualifying investors and investments. While the scope of the protections differs by treaty – sometimes significantly – they generally protect foreign investments from unlawful expropriation, unfair or inequitable conduct, discriminatory treatment, and arbitrary conduct by the host State.

In addition to these substantive protections, most investment treaties confer individual investors with standing to enforce the treaty directly against the host State through international arbitration, often under the auspices of the International Center for the Settlement of Investment Disputes (“ICSID”) or under the United Nations Commission on International Trade Law (“UNCITRAL”) Rules, whether or not a contractual relationship between the investor and the State exists.

The number of BITs has grown exponentially in the last decade, totaling approximately 3,000 BITs in force in 2014. Indonesia is a party to 67 BITs, including the United Kingdom, Switzerland, Spain, China, France and Germany.

The Indonesia-Netherlands BIT

The Netherlands signed the first investment treaty with Indonesia in 1968, and the current BIT between the States has been in force since July 1, 1995. Within the gamut of investment treaties, the Indonesia-Netherlands BIT provides a broad range of substantive protections including Indonesia’s obligation to provide foreign investors fair and equitable treatment prohibiting “unreasonable or discriminatory” measures, according full protection and security, treating investors the same as other domestic and foreign investors, as well as prohibiting unlawful expropriation. The BIT also includes an umbrella clause, obliging Indonesia to “observe any obligation it may have entered into with regard to investments of nationals of [the Netherlands]”, and a guarantee of the ability to transfer any freely convertible currency payments relating to an

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investment without restriction or delay. In addition, the Indonesia-Netherlands BIT allows investors to directly submit a dispute against the State parties before ICSID.

**Is Indonesia’s Action an Omen of Things to Come?**

Accompanied by indications that Indonesia intends to terminate its remaining BITs, Indonesia may be following in the footsteps of Venezuela, which terminated its BIT with the Netherlands in 2008 in the face of a series of threatened investment actions and then withdrew entirely from the ICSID Convention. ⁴

There is speculation that Indonesia’s actions are in response to a number of recent cases brought by foreign investors, and more specifically to a decision in the ICSID case *Churchill Mining and Planet Mining v. Indonesia* earlier this year, in which the tribunal found it had jurisdiction to hear claims brought under the UK-Indonesia and Australia-Indonesia BITs for the alleged expropriation of a coal project in Borneo. ⁵ In that case, claimants seek over US$1 billion in damages. Indonesia argued that the ICSID tribunal did not have jurisdiction over the claim, since the investments were not “admitted” by the government, as Indonesia argues is required under its BITs. ⁶

In addition to the cases brought by Churchill Mining and Planet Mining, Indonesia is currently defending a third ICSID action for alleged breaches of an investment treaty, ⁷ and according to publicly available sources, is defending against claims by investors in other fora. ⁸

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⁵ *Churchill Mining and Planet Mining v. Republic of Indonesia*, ICSID Case No. ARB/12/40 and 12/14, Decision on Jurisdiction, (Feb. 24, 2014).

⁶ *Id.* at ¶ 77 (Indonesia argues that the tribunal lacks jurisdiction because “the investment is not covered by Article 2(1) of the UK-Indonesia BIT, as it has not been granted admission in accordance with the 1967 Foreign Capital Investment Law or any law amending or replacing it.”).


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What Termination of the Indonesia-Netherlands BIT Means for Foreign Investors

For foreign investors with investments that already fall within the scope of the Indonesia-Netherlands BIT, the immediate impact of Indonesia’s termination is limited. While the termination will become effective when the BIT expires on July 1, 2015, because of the treaty’s sunset clause, its investment protections will continue for 15 additional years. As a result, foreign investors can still avail themselves of the protections under the Indonesia-Netherlands BIT until 2030, so long as the investment is made or restructured in conformity with the treaty before July 1, 2015. Any foreign investors who wish to avail themselves of the treaty’s protections must thus act promptly or they will lose its benefits.

Because it is likely Indonesia’s termination of the Indonesia-Netherlands BIT will not be an isolated event, foreign investors in Indonesia should also consult with counsel specialized in Public International Law and International Arbitration, who closely monitor and assess government conduct. This includes paying close attention to any indications from Indonesia that it intends to allow other investment treaties to expire. The timing of when Indonesia may legally terminate each treaty will differ depending on the terms of the treaty, and the protections afforded by other Indonesian treaties may expire more rapidly than those under the Indonesia-Netherlands BIT.

As backstop, foreign investors should also evaluate the possibility of structuring new investments or restructuring existing investments to benefit from multilateral investment treaties and free trade agreements to which Indonesia is a party. These multilateral treaties include the ASEAN, which protects foreign investments if the investor creates a “juridical entity” in an ASEAN member state, and the World Trade Organisation Agreement on Trade Related Investment Measures (“TRIMs”), which provides foreign investors in Indonesia with similar “national treatment” protections to those found in most BITs. Whether it makes sense to do so will depend on the individual investment, taking into account the tax ramifications of structuring through one country versus another and other aspects of the investment.

Finally, to the extent they have not already done so, foreign investors should become conversant with the protections that may be available to them under the Indonesian Investment Law and, to the extent they are able to do so, they should take steps to manage sovereign risk through

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to be settled before the Islamic International Court of Justice, and arbitration was only permissible upon Indonesia’s consent.).


transactional terms (e.g., by providing for arbitration outside of Indonesia, limiting the ability of a state-owned entity to invoke political *force majeure*, and similar clauses).

**Conclusion**

Investment treaties are powerful tools for managing sovereign risk by providing foreign investors with a means to address government actions that negatively impact the investor. Often, the existence of treaty protection can help change the conversation with the State and help pave the way towards an amicable resolution. Indonesia’s recent termination of the Indonesia-Netherlands BIT should serve as a tangible reminder to prudent foreign investors in Indonesia and elsewhere of the need to evaluate available protections as part of their investment strategy.
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About Chadbourne’s International Arbitration and Public International Law Practice

Chadbourne & Parke’s International Arbitration and Public International Law (PIL) group represents both investors and sovereigns in disputes arising under bilateral and multilateral investment treaties, free trade agreements, concession contracts, and commercial contracts. The team also advises on sovereign investment policy, constitution drafting and treaty drafting and interpretation, recognition and enforcement of arbitral awards, and the structuring of international investments to minimize political risk.

Chadbourne lawyers have a wealth of experience in all forms of arbitrations, including commercial, investor-state and WTO proceedings before panels worldwide. We represent clients in ad hoc proceedings under the UNCITRAL Rules as well as in arbitrations administered by leading institutions such as the International Chamber of Commerce (ICC), the International Centre for Dispute Resolution (ICDR) of the American Arbitration Association (AAA), the London Court of International Arbitration (LCIA), the International Centre for Settlement of Investment Disputes (ICSID) and many other regional centers around the world (such as SIAC in Singapore, HKIAC in Hong Kong and DIAC in Dubai).

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