

LEGAL ANALYSIS OF THE IMPLEMENTATION OF UMBRELLA CLAUSES PRINCIPLE IN BILATERAL INVESTMENT TREATIES IN INDONESIA

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ABSTRACT

Developing countries have the need for capital to build their country. One way to get capital is to open foreign investment in the country. Implementation of the opening of foreign capital investment is done by making international agreements between countries. This is done to attract foreign investors to enter the country. One of the countries that make foreign investment is Indonesia. Indonesia made Bilateral Investment treaties as one of the international agreements to make foreign investment to enter and invest in Indonesia. One of the clauses inherent in bilateral investment treaties is the umbrella clause. Umbrella clause is used to protect foreign investors who enter the country against the rules that can harm these investors. This paper seeks to analyse the origin and foundation of the existence of Bilateral Investment Treaties in Indonesian laws and regulations, the implementation and the consequences of umbrella clauses in legal context, and practical application run by a special investment-related agency, the Investment Coordinating Board in carrying out bilateral investment in the context of the umbrella clause. The study results reveal important changes in Indonesia's orientation, through recent regulatory legislation, in an effort to more open to foreign investment, and to protect it.

Keywords: Foreign Investment, Bilateral Investment Treaties, Umbrella Clause.

INTRODUCTION

The welfare which produced from the occupation in Indonesia has become a very important thing for the government to do. The importance of this welfare is set forth in the preamble of the 1945 Constitution which is included in the preamble that the objective of the Unitary State of the Republic of Indonesia is to protect the entire Indonesian nation and the whole of Indonesian people, to promote the common interests and prosperity, to educate the life of the nation, freedom, eternal peace and social justice (Ghofur & Susilo, 2017). Many efforts have been made by the government in order to increase the welfare for occupation of shelter and live in the territory of the Unitary State of the Republic of Indonesia as an Indonesian citizen.

These have been done in Indonesia as a country that embraces the principle of welfare state. In the doctrine of welfare states, it is disclosed that the State guarantees the well-being of every inhabitant so that the State seeks to keep the population secure for welfare. One of the most important things in improving the welfare in Indonesia is by implementing development in the economic field. According to the Indonesian Central Bureau of Statistics, *“in the third quarter of 2017, the national economic growth in Indonesia reached 5.06 percent, where this growth is higher than the first and second quarter of 2017 of 5.01 percent.”* One aspect affecting this economic growth is the national income and employment opportunities gained by citizens. This national income can be used for development so that no more villages are left behind and gain a national progress.

The many job opportunities are also very influential on economic growth, where the No. of job opportunities for the community can reduce the unemployment rate in the community itself. Adding employment opportunities is done by opening the widest investment. This capital investment is basically divided into two kinds: direct and indirect investment. While direct investment is according to Komarudin (1983) interpreted as efforts to control ownership by an entity in a business in another country, indirect investment is defined by Suny (1976) as an investment by buying stocks/bonds in a company in such amounts, so it is not sufficient to provide control over the company to foreign investors. Direct investment or also known as foreign direct investment is divided into two parts, namely foreign investment and domestic investment. According to Article 1 (3) of Law No. 27 of 2007 on Investment, foreign investment *“is an activity of investing to conduct business in the territory of the Republic of Indonesia by foreign investors, whether using the foreign capital completely or in association with the domestic investor.”* In article 1 point 2 of the Law, *“it is said that domestic investment is an activity of investing to conduct business in the territory of the Republic of Indonesia by domestic investors by using domestic capital.”* The implementation of foreign investment is often done by mutual interests. The reciprocity here means that an entrepreneur from Indonesia is allowed to expand business abroad, but the entrepreneur shall also have the right to engage in business activities in Indonesia. In order to ensure that the implementation of foreign investments is operational and not mutually disadvantageous, Indonesia has several international agreements relating to investment. The international agreement on investment is divided into bilateral investment agreements as well as multiple treaties, in which Indonesia signed such kind of treaties with several countries. In the bilateral investment treaties agreement there is a class called the umbrella clauses. The principle of lateral investment agreements. This bilateral investment agreement is referred to as bilateral investment umbrella clauses is made so that host country does not issue a policy that can harm foreign investors in the country. There are several cases in which the Indonesian government is being sued by foreign investors because according to foreign investors, the policies made by the Indonesian government are harming them (Virginia, 2007). By investigating such umbrella clauses, this research seeks to analyse the origin and foundation of the existence of Bilateral Investment Treaties (BIT) in Indonesian laws and regulations, the implementation and the consequences of umbrella clauses in legal context, and practical application run by a special investment-related agency, the Investment Coordinating Board (Badan Koordinasi Penanaman Modal/BKPM) in carrying out bilateral investment in the context of the umbrella clause.

Bilateral Investment Treaties in Indonesian Laws and Regulations

Capital investment is something that happens in every region in all countries around the world. Competition in the business world is getting higher, including in this case is investment. Implementation of investment should not be detrimental either to investors or to host country as a recipient of investment. In the relations between countries related to investment, the state entered into cooperation agreements with investors who will make an investment. In the investment agreement there are often articles that also protect investors. According to United Nations Conference on Trade and Development/UNCTAD (1995), there are eight bilateral and multilateral agreements that usually apply to investments, namely Provisions on Capital Movement (PCM), Provisions on Foreign Borrowing (PFB), Double Taxation Treaties (DTT), and Insurances Guarantees in The Multilateral Investment Guarantee Agency (MIGA), Washington Convention on the Settlement of Investment Disputes (WCSID), the Preferential Trade Agreement (PTA), and Bilateral Investment Treaties (BIT) (Situmorang, 2011). BIT is defined as an agreement that protects investor's investments from one country in another territory by providing clear substantive rules governing the host country's treatment of investments and by establishing a dispute resolution mechanism that can be applied to allegations violation of the rules (Sheehan, 2006). BIT is a realization of the relationship between countries that both want to promote economic activity in each country, given the investment can simply be understood as one of the forms of efforts to enhance economic activity that many done by countries in modern era. BIT has become a universal tool for documenting foreign investment relations, to allow and protect foreign investment. This agreement, according to Connolly (2012), defines the scope and definition of foreign investment, including investors and investments covered by the agreement (scope of application). Simply put, by the sense of BIT mentioned above, it can be concluded that BIT is indeed an international agreement. In legal terminology, the use of the term '*treaty*' to name the investment agreement shows how BIT is actually an international agreement (Parthiana, 2002).

In Indonesia, the regulation concerning foreign investment is previously regulated in Law No. 1 of 1967 concerning Foreign Investment as amended by Law No. 11 of 1970 concerning Amendment and Supplement to Law No. 1 of 1967 concerning Foreign Investment and Law No. 6 of 1968 concerning Domestic Investment as amended by Law No. 12 of 1970 regarding Amendment and Supplement of Law No. 6 of 1968 concerning Domestic Investment due to the contemporary rapid development. Furthermore, with the assumption that law is deemed to be no longer compatible with the need for accelerated economic development and national law, the law was changed to Law no. 25 of 2007 about Investment. The law brings together arrangements on foreign investors and domestic investors. In other words, there is no difference in the provision between foreign investment and domestic investment. This investment law is intended to provide legal certainty, with the amendment being intended to increase freedom within the laws governing investment (Sembiring, 2010). Here, Indonesia also attempt to enhance the national competitiveness a as a host country with taking the principle of equal rights in accepting foreign investment. As an implementation of the principle of national treatment and as a main destination of investment, Indonesia brings the theme of non-discrimination in the Trade Related Investment Treaties for the implementation of foreign investment in Indonesia. In Law No. 25 of

2007 on Investment, it is possible to have an agreement between the government and a private foreign-owned enterprise. This is one that can underlie where bilateral agreements between Indonesia and other countries can be used to support investment in Indonesia.

The Investment Coordinating Board (Badan Koordinasi Penanaman Modal/BKPM) as the national special agency in coordinating investment, on Bilateral Investment Treaties issued the Investment Improvement and Protection Agreement (Perjanjian Promosi dan Proteksi atas Penanaman Modal Asing/P4M). This is needed as in 2015 Indonesia has signed about 67 bilateral investment treaties. Bilateral Investment Treaty (BIT) is one form of cooperation agreement between countries in the field of economy, especially investment, which has been made by many countries in the world. This kind of treaty is an investment agreement signed by two countries and binds the rights and obligations in facilitating the entry of investment in each country. Hertanti and Febriani (2014) state that this agreement stipulates the standards of investment protection that must be carried out by the host country, such as:

1. Equal and fair treatment or no discrimination of any kind of foreign and domestic investment.
2. Full protection and security which contains the obligation of States to provide compensation for losses suffered by corporations due to war, armed conflict, revolution, State emergency, riot, or rebellion, in which usually this protection is in the form of compensation or recovery.
3. Protection from expropriation or nationalization measures and requires compensation of compensation.
4. Dispute settlement mechanism, which aligns between the investor level with the state or known as "*Investor-State Dispute Settlement (ISDS)*".

Umbrella Clause as One of the Elements in the Implementation of Bilateral Investment Treaties

There are several forms of Bilateral Investment Treaties applicable in the world. Different enactments in the implementation of BIT in the world can be drawn into some similarities. According to Wong (2006), "*this fact can be seen from the similarity of structure and content of each state BIT which generally regulates four substances namely:*"

1. Conditions for the admission of foreign investors to the host State.
2. Standards of treatment of foreign investors.
3. Protections against expropriation.
4. Methods for resolving investment disputes.

Another factor worth considering is the host country's political stability, economic, industrial and administrative policy frameworks, economic benefits from initial investment or an increase in on-going investment, and new incentive packages or investment management options. In practice, unless host country can provide a secure profit-making capital to foreign investors, then bilateral treaty alone will not attract investors (Reading, 1992). The issue of the political situation in host country is very interesting to discuss. Investors in this case will not be willing to invest if they are not supported by legal certainty in the implementation of capital investment (Salacuse & Sullivan, 2005). Implementation of this investment can be a problem in the event of frequent change of policy within host country or political situation within an uncertain condition in host country (Chalamish, 2009). The government within the host country can easily change the regulations on foreign investment in the country after the investment

process. Changes in this regulation are often done unfairly to foreign investment actors in their country. This injustice occurs either to individual investors or to their business entities. Thus, investor objections to the host country's domestic legal system can be bridged. Here comes a class called the umbrella clause. In this umbrella clause a State is required to provide a legal umbrella to foreign investment when there is a change to the foreign investment policy in the country. Umbrella clauses can be interpreted as the policy of host country where in the implementation, there is a firmness and commitment from host country where bilateral agreements which is in this case is bilateral investment treaties, are under a legal umbrella that can protect from investors on a contractual relationship (Schreuer, 2004). Mann (1982) also was of the view that the umbrella clause in the BITS protects the investor against a mere breach of contract:

“This is a provision of particular importance in that it protects the investor against any interference with his contractual rights, from a mere breach of contract or a legislative or administrative act, and independently of the question whether or not the interference amounts to expropriation. The variation of the terms of a contract or license by any of the terms, for instance, by non-payment, the dissolution of the company with which the investor may have contracted and the transfer of its assets (with or without the liabilities) -these and similar acts the treaties render wrongful” (Mann, 1982).

New Foreign Investment Regulation Issued By BKPM

In Indonesia, the agreement using umbrella clause is based on the similarity of structure and content of each state which generally regulates four substances regarding to Law No. 13/2017 that replaces the old regulation in Investment and effective on 2 January 2018 on the conditions for the admission of foreign investors to Indonesia. The regulation No. 13/2017 further regulates two types of business licenses for foreign investment companies, namely the temporary business license and permanent business license. The former is valid for one year. This license will be issued to foreign investment companies that are unable to fulfil the investment requirements set by BKPM. This temporary business license can be extended one time for maximum one year again. The permanent business license is valid for as long as the company remains operational. This license will be issued to foreign business entities that have already complied with BKPM's investment requirements. The business license is valid as long as the company operates, unless the relevant regulations provide otherwise. The Regulation No. 13/2017 only allows a foreign investment company that has not yet fulfilled any of the following large-scale requirements to apply for a year for temporary business license¹ (www.indonesia-investments.com):

1. Has net assets of more than Rp. 10 billion, excluding land and buildings, based on the latest financial statements.
2. Has annual revenue of more than Rp. 50 billion based on the latest financial statements.

Recently, there is a regulation on the standards of treatment of foreign investors issued by BKPM, i.e. the Regulation No. 13 of 2017 regarding Guidelines and Procedures for Investment Licensing and Facilities (13/2017 Regulation). Moreover, the protections against expropriation can be conducted by registration of capital investment. The Regulation No. 13/2017 now

introduces a new type of license. The Registration of Capital Investment only applies to foreign investment companies that fulfil one of the below criteria² (www.bakermckenzie.com):

1. Businesses that need time for construction activities.
2. Businesses that are entitled to investment facilities.
3. Businesses that have medium to high potential of environmental pollution.
4. Businesses related to national defence, natural resources management, energy and infrastructure.
5. Other businesses as determined by specific regulations.

Lastly, in the methods for resolving investment disputes, there are two dispute settlement provisions in BITs (Haikal & Ji, 2017):

1. Between an investor contracting state (country to country).
2. Between Investor state disputes.

Furthermore, if the dispute cannot be settled through consensus within the period, it shall be submitted to the judicial processes provided or international arbitration or conciliation. These are several dispute settlements in BITs with the general trend is to give investors a choice of the arbitral mechanism through institutions such as The International Centre for Settlement Dispute, and United Nations on International Trade Law (UNCITRAL), The International Chamber of Commerce, International Court of Justice, and other regional arbitration centre.

CONCLUSION

Developing countries require foreign investment to finance their state budget. In conducting investment investors also see the security aspect offered by host country. Various things are seen from a host country by the investors. One of the most important things to consider is policy. This policy is seen from changes in regulations in the implementation of investment. The country of foreign investment undertakes a bilateral investment treaty to host country in which one of its clauses is to ensure the implementation of capital in the investment to remain unchanged in accordance with domestic policy changes concerning foreign investment i.e. umbrella clause.

ENDNOTE

1. <https://www.bakermckenzie.com/en/insight/publications/2017/12/bkpm-new-regulation-for-the-implementation>.
2. <https://www.indonesia-investments.com/business/business-columns/new-foreign-investment-regulation-issued-by-bkpm/item8540?>

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