

The Ambiguity of Implementation of Full Protection and Security Principle in Indonesia Investment Law

Eka An Aqimuddin, Frency Siska

Faculty of law

Universitas Islam Bandung

Bandung, Indonesia

eka.aqimuddin@unisba.ac.id, frency,siska@unisba.ac.id

Abstract—Regarding international investment law, protection against foreign investment is a fundamental principle. The principle of protection is meant to attract foreign investors to increase state revenues. Full Protection and Security or FPS is one of protection principle that cover physical and non-physical protection to the investor. Indonesia already stipulated FPS in Law No. 25 Year 2007 on Investment and bilateral investment treaties. However, the scope of FPS provided on those regulations is ambiguous and there is no further explanation further by government. This research uses legal normative methodology. It means that authors not only to gather norms about FPS in Indonesia investment law but also to point out in which ambiguity of FPS implementation can be solved. The objectives of this research are to examine implementation and possible effects from FPS principle regulation in Indonesia law. This research concludes, that ambiguity on FPS regulation in Indonesia law will rise positive and negative effect. It will give policy space on investment for Indonesia in case of emergency and protection on national interest as positive side but in case of investment dispute in international forum it will be negative because it can broaden the term of FPS principle.

Keywords—foreign investment; full protection security; Indonesia

I. INTRODUCTION

Foreign direct investment or FDI is one of the instruments of State to increase GDP. In the case of Indonesia, several studies indicated that FDI indeed give economic advantages so as to successfully increase the GDP [1]. Data from the United Nations Conference on Trade and Development (UNCTAD), States that Indonesia is one of the destination country of the investment [2]. Based on the record of the Capital Investment Coordinating Agency (BKPM), the value of FDI since the 2012-2017 increased from Rp 51.5 trillion – IDR 109.8 trillion. [3].

The FDI usually arranged in the form of bilateral investment treaties (BIT) or multilateral. Its common to stipulates the principle of the protection in investment treaties. One of those protection which is the Full Protection and Security. In previous studies and arbitral awards, there are two forms of protection afforded by virtue of the FPS, namely physical and legal protection. Its mean in the exercise of investment activities in the host country, the investor is fully protected either physically and legal.

Indonesia's investment law, which are Law No. 25/2007 on Investment and Indonesia BIT's, stipulate FPS to protect FDI. However, there lack of harmony between those regulations. Based on the background, this article like to examine implementation of FPS in Indonesia law context. Thus, the effect that possible arise from those regulations to Indonesia.

II. METHOD

This research uses legal normative methodology. It means that authors not only to gather norms about FPS in Indonesia investment law but also to point out in which ambiguity of FPS implementation can be solved.

III. RESULTS AND DISCUSSION

A. Definition of FPS

Collin [4] giving definition FPS as a standard of protection for foreign investments that provides security against physical damage that may occur to a foreign investors' property arising from war or civil unrest in the host state." Initially, FPS was mean to protect investor assets from arbitrary actions by host states. However, definition of FPS has broadened include legal security protection. This broader interpretation than affirm by some treaties like Energy Charter Treaty and judicial decision [5].

The Oxford English Dictionary, gives definition of "protection" and "security" as synonymous which means an action or condition that must be protected from threats or risks in the form of physical, legal, or financial depending on the context of the event. Based on the grammatical interpretation, it is not surprising that several arbitral awards related to the application of the FPS principle interpret is not only limited to physical but also legal protection [6].

Based on the above mention, in the context of international investment law, the definition of FPS is not singular. FPS can be interpreted as a form of physical and legal protection that must be guaranteed by host states. In practice, to avoid a broad interpretation of the FPS, the agreement regarding investment usually stipulate restriction on the limits of the FPS. For example, North American Free Trade Agreement (NAFTA), restrict the meaning of the standard of FPS to the international minimum standard required by customary international law [5].

The consequence of limiting the definition is that if there is a dispute between host state and investor, the arbitral tribunal cannot carry out a broad interpretation.

In some treaties, formulation of FPS often use in same phrase with Fair and Equitable Treatment (FET). However, some arbitral tribunals have found that those principles are distinguishable [7]. FET requires the host State to desist from behavior that appears unfair and inequitable. By contrast, full protection and security requires the State actively to provide a framework that protects the investment from adverse interference [5].

B. Formulation of FPS in Investment Treaties

According to Malik [7] most common expression of FPS principle is in the form of "full protection and security." However, different variants are also found, such as "constant protection and security," "protection and security" or "physical protection and security." [8]. This formulation also came up in bilateral investment treaties between Indonesia and several states [9].

Although the FPS formulation is different in each agreement, its means shall refer to the FPS provisions based on international investment law. The difference in the use of the term does not mean creating a new principle in international investment law, it is only a reactional case.

C. FPS in Indonesia Investment Law

Knorich and Berger [9] separate development of FDI regulation in Indonesia into three stages. First phase, they referred as "oil boom era" (1970-early 1980s); second, liberalization era (mid-1980s to 2003); third, consolidation era (2003-present). Different opinion on development of FDI in Indonesia also stated by Lindblad [10] He classified the development into three phases, which are:

- 1966–82: economic rehabilitation and windfall gains from the oil boom during the first half of the Soeharto administration.
- 1983–97: structural change in the economy and continued rapid growth during the second half of the Soeharto administration.
- 1998–2015: the 1997–98 Asian financial crisis and its aftermath, and demonstrated resilience during the 2008 global financial crisis under a succession of post-Soeharto administrations.

Both articles above mentioned seem agreed to count the first stage of FDI development in Indonesia starts from 1966, in which the factual regime in Indonesia was changed from Soekarno to Soeharto. However, before enactment of Law No.1/1967, Indonesia already have law that stipulate foreign investment, namely Law No. 78/1958 but it deemed as a dead letter [10].

On the first stage, Indonesia enacted new investment law which separate between Foreign Investment (Law No. 1/1967) and Domestic Investment (Law No. 6/1968). These laws defined a legal framework for investors, but restrictions on foreign investment were substantial. For example, foreign

investments were treated differently than domestic investments in areas such as the establishment of investments, which is why two separate laws were put in place. [9]. Law No.1/1967 was enacted in Soeharto's New Order Government that radically changed the FDI climate. Lindblad [10] said that Law No.1/1967 was liberal in nature which part of the deal under which IMF bailed out bankrupt Indonesia. He added, the first stage was characterized by investment on exploitation on natural resources. No wonder if the first major contract FDI granted under the Law No.1/1967 went to Freeport Sulphur for mining in West Papua.

The second stage was signed by changed pattern of FDI inflow. Previously, FDI was concentrate in natural resources sector but after oil prices decline in 1982-1983 Indonesia shift orientation to more open up FDI for manufacture sector [10]. In 1986, Indonesia start to shift from positive list into a negative list scheme as a way to control FDI in which what sectors were prohibited for FDI. Equity ownership liberalize up to 100 per cent in 1994 and Indonesia BIT's programed also rise significantly during this stage [9].

In 1997-1998, whole Asia was struck by financial crisis including Indonesia. The banking sector was down and substantial's volumes of private capital flowed out of country. FDI inflows declined by \$1.3 billion in 1998. Lindblad [10] paraphrased out this era as third stage of FDI development in Indonesia. He added, unstable political situation and legal uncertainty during this era makes foreign investors to adopt a wait and see attitude. Three successors after Soeharto's fall did not give significant outcome to attract back foreign investors. In era of Susilo Bambang Yudhoyono presidency (2004-2009), improvement on economics was rising which indicates by real per capita GDP grew at more than 4% annually. To attract more foreign investors, the government announced its intention to radically reform FDI sector by combining legislation on domestic and foreign investment [10]. On 27 April 2007, Indonesia signed Law No. 25/2007 on Investment to replace the old 1967 & 1968 law. In international level, Indonesia became involved in the ASEAN process of investment liberalization and pursued more elaborate bilateral agreements, such as the EPA with Japan [9].

To complement Law No.25/2007, Indonesia BIT's were having significant effects to restore foreign investors' confidence. One of feature that urgent ruled on BIT's were protection to foreign investors. Both regulations stipulate FPS principle as a key feature to give transparency and legal certainty

According to article 2 paragraph 2 Indonesia Model of BIT Indonesia, state that, "Investments of investors of either Contracting ... and shall enjoy adequate protection and security... Term used by Indonesia is "adequate protection and security" This is unusual term if compare to rule of FPS in international investment agreements, that usually use terms "full protection and security" or "constant protection and security". Although the Indonesian BIT model uses the different term, in practice the use of the principle is also similar. According to Knorich and A. Berger, variations in the use of the principle of protection in Indonesian BIT are the result of negotiations [9].

Based on grammatical, objectives and historical interpretation, the use of the phrase "adequate protection and security" can be interpreted as granting protection, both physical and non-physical, to foreign investment in Indonesia. Thus, based on international law, Indonesia has an obligation to implement it. However, in the model of Indonesia's BIT's, it is necessary to emphasize in detail the scope of the application of the FPS principle so that it does not cause ambiguity. Because in the absence of certainty, it will provide a large space for arbitration forums to provide a broad interpretation in the event of an investment dispute.

On Law No. 25/2007, principles of FDI were stipulated in several articles which are:

- Article 4, paragraph 2, letter b states that government "guarantee ... business security for investors from the process of obtaining establishment permits to the expiration of investment".
- Article 6 Paragraph 1 giving guarantee to provide equal treatment to all investors originating from any country that carries out investment activities in Indonesia in accordance with the Indonesia law.
- Article 7 stipulates about protection that the government will not nationalize investment ownership except by law. If this is done, compensation will be given in accordance with applicable regulations.
- Article 8 states that government guarantee to protect transfer of fund in accordance with domestic legislation.
- Article 30 paragraph 1 states that the Government and / or local government guarantees business security and certainty for the implementation of investment.

Based on the aforementioned provisions, the phrase "adequate protection and security" does not appear as is the case in Indonesia's BIT's. The phrases used in the Investment Law only "guarantee the business certainty and security" as stipulated in Article 4 paragraph 2 letter b and Article 30 paragraph 1. In the explanation section also not further elaborated. Based on the interpretation of Jan Knorich and Axel Berger [10] the unclear form of protection for foreign investment will provide room space for Indonesia to make policies related to the application of the FPS principle.

In our opinion, the analysis from Knorich and Berger is incomplete, they do not explain the impact of the open policy space to the Indonesia government. At least, there are two effects that can be caused due to the lack of clarity of the interpretation of the phrase "guarantee the business certainty and security". First, positive impact. In this case, authors agreed with the analysis of Knorich and Berger that by not being explicitly stipulated the government could interpret the principle in a limited or narrow manner. For example, in emergency situation, government only provided physical protection under the pretext of protecting national interests or public order. However, in international level, limited interpretation only for physical protection did not restrict investors against the interpretation if dispute arise.

Second, negative impact. If there is an investment dispute related to the application of the FPS principle and brought to a foreign arbitration forum, then the interpretation of the application of the FPS principle can have the potential to expand, which includes non-physical protection so that the government will be held accountable.

In addition, with no further explanation of the form of protection in the phrase "business security", it provides a legal uncertainty. This obviously contradicts one of the aims and objectives of Law No.25/2007. Therefore, it is important for the government to clarify the scope of the application of the principle of protection in investment law.

IV. CONCLUSION

Based on the discussion above, the authors conclude that FPS protection is a common standard in international investment law. FPS includes physical and non-physical protection to investors. FPS arrangements in Indonesian law are stipulated in Law No.25/2007 and Indonesia BIT's. Both regulations use different phrases to rule FPS. In addition, no FPS interpretation in the two regulations will have a positive and negative impact. The positive impact is that Indonesia has a policy space to interpret according to national interests. At the international level, this ambiguity will provide broad space for foreign arbitration to interpret which might harm Indonesia's interests if there raise investment dispute. Therefore, the government must provide a definition and scope of the FPS so that it provides legal certainty.

ACKNOWLEDGMENT

This article is fully funded by Faculty of Law, Universitas Islam Bandung (UNISBA), Bandung, Indonesia. Therefore, authors would like to express deepest gratitude to faculty for supportive attitude.

REFERENCES

- [1] H. Hill, *Foreign Investment and Industrialization in Indonesia*. Oxford: Oxford University Press, 1988.
- [2] UNCTAD, "World Investment Review," 2017.
- [3] BKPM, "Investment Report," 2017.
- [4] D. Collins, "Applying the Full Protection and Security Standard of Protection to Digital Investments", *Journal of World Investment and Trade*, vol. 12, pp. 1, 2011.
- [5] C. Schreuer, "Full Protection Security," *Journal of International Dispute Settlement*, vol. 1, pp. 1, 2010.
- [6] *Oxford English Dictionary*
- [7] M. Malik, "The Full Protection and Security Standard Comes of Age: Yet another challenge for state in investment treaty arbitration," *IISD Best Practice*, pp. 11, 2011.
- [8] G.K. Foster, "Recovering "Protection and Security": The Treaty Standard's Obscure Origins, Forgotten Meaning and Key Current Significance," *Vanderbilt Journal of Transnational Law*, vol. 45, pp. 1097-1098, 2012.
- [9] J. Knorich and A. Berger, "Friends or Foes? Interaction Between Indonesia's Investment Agreements and National Investment Law," *The German Development Institute/DIE*, 2014,
- [10] J.T. Lindbland, "Foreign Direct Investment in Indonesia: Fifty Years of Discourse," *Bulletin of Indonesian Economic Studies*, vol. 51, no. 2, 2015.