CHAPTER II

GENERAL OVERVIEW OF INVESTMENT LAW

The same as general branch of law, investment law is divided into international investment law and national law. Both laws comprise, *inter alia* definition of terms, application scope, principles, and dispute settlement. Each branch has its own applicable rules and regulations depending on the territorial-based scope. Here, this theoretical review of investment divides the chapter into two subchapters: International Investment Law and Indonesian National Law.

A. International Investment Law

In international society, investment and trade shall go hand in hand.[42] In a substitute-perspective, liberalized investment may deflect high trade barriers, on the other way, complement-perspective provides chance for FDI as a complementary trade through trade itself.[43] Consequently, the lower the trade barriers, the less the need to pursue the substitute-perspective.[44]

Discussion of investment is an integral part to its former regulation of trade. The establishment of an international organization regulatory body was deemed necessary and suggested by most states.[45] The first most affecting and well-known organization is WTO and its products of GATT 1994 and TRIMs.

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[42] Mitsuo Mitsushita …p.831.

[43] *Ibid.*

[44] *See* WTO Working Group on the Relationship between Trade and Investment, WTO Doc. WT/WGTI/W/7 of 18 September 1997 [WTO Working Group, 1997]; *Ibid*, p.832.

[45] Mitsuo Mitsushita, *ibid*, p.1.

1. History of GATT.

The history of GATT 1994 begins with the Bretton Woods Conference on economic matters in 1944. The Bretton Woods yields three pillars on economic structure: International Monetary Fund; World Bank; and International Trade Organization.

In 1946, majority of WTO State Members adopted a resolution to form an International Trade Organization [hereinafter ITO]. The negotiation were conducted within the framework of United Nation Economic and Social Council in 1945 [hereinafter UNESC 1945].[46] The negotiations over the ITO then were held in several stages during 47 years. Started in 1947 in Geneva (Austria), Havana (Cuba), via Annecy (Frace), Torquay (UK), Tokyo (Japan), Punta del Este (Uruguay), Montreal (Canada), Brussels (Belgium), and finally Marrakesh (Morrocco) in 1994.

The most congregations was Geneva meeting which held from April to November 1947. The conference elaborated "three ring circus":[47] 1) draft an ITO charter; 2) prepare schedules of tariff reductions; and 3) prepare a multilateral treaty containing general principles of trade, namely GATT.

The end result of prolonged negotiations over the adoption of ITO Charter was a dead-lock. Despite the fact that in 1948 the ITO Charter had been completed, it never entered into force. Conversely, the tariff

[46] *Ibid,* p.2.
[47] John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations*. Second Edition, 1997, MIT Press, Massachusetts, p.37.

reduction and GATT had been into force by adopting a Protocol of Provisional Application to GATT in 1948.[48]

As time goes by, in 1986 – 1994, Uruguay Round as GATT negotiating round were established in response to the suggestion from Professor Jackson.[49] Uruguay Round culminated the creation of an enormous new international body so called WTO.

The WTO came into being on 1 January 1995[50] promoting the package of agreements that opened for signature at Marrakesh on 15 April 1994. The WTO Agreement incorporates with the GATT as it concluded in 1994. GATT 1994 covers GATT 1947, excluding the Protocol of Provisional Application as amended by all legal instruments that entered into force on 1 January 1995.

2. TRIMs.

Trade-Related Investment Measures [TRIMs] is a WTO Agreement applied to investment measures related to trade in goods. As it is a result from an Uruguay Round Agreement, it has strong connection to GATT 1994.[51]

Article 2.1 TRIMs provides an *Illustrative List*. The list are examples of measures that are inconsistent with Art III (national

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[48] *See* Protocol of Provisional Application to the General Agreement on Tariffs and Trade, 30 October 1947, 55 U.N.T.S. p.308. [Provisional Application to the GATT 1947].

[49] John H. Jackson, RESTRUCTURING THE GATT SYSTEM, 1990, p.38 – 41; Professor John Jackson is a professor at Michigan and Georgetown. He has influenced generations of trade lawyers, officials and negotiators with work about the WTO and particularly its Dispute Settlement System

[50] *See* Amelia Porges, *The Marrakesh Agreement Establishing the World Trade Organization*, in THE WORLD TRADE ORGANIZATION, T.P. Stewart ed., 1996, p.63; Mitsuo Matshushita…p.833.

[51] TRIMs, art. 1.

treatment) or Article XI (prohibition on quotas) of GATT 1994. The illustrative lists covers: local content requirements; export performance requirements; and trade balancing requirements; foreign exchange balancing requirements; restrictions on an enterprise's export or sale for export of products.

The TRIMs obliges the WTO Members to: (a) notify the measures covered by its disciplines; (b) ensure standstill during a transition period, at the end of which; and (c) eliminate all measure judged inconsistent with the TRIMs disciplines.[52]

All WTO Members are obliged to eliminate the WTO-inconsistent measure within certain period of time notified to the Council on Trade in Goods (CTG). Based on article 5.2 TRIMs there are three different transition periods based on the level of development of the WTO Members. The developed country Members were required to eliminate their WTO-inconsistent measures by January 1, 1997. Developing country Members were required to eliminate their WTO-inconsistent measures by January 1, 2000. Last-developed country Members were required to eliminate their WTO-inconsistent measures by January 1, 2002.

3. Definition of Investor and Investment.

Definition of both terms "investor" and "investment" are often the issue of strong bargaining process between the negotiating parties in IIAs. The definition should be seen as part of agreement's normative contents,

[52] Mitsuo Mitsushita, *op-cit,* p.839.

since they determine the extent and scope of application of other provisions. Practically, the definition of terms are made on a case-by-case basis. Based on article 31(1) Vienna Convention on the Law of Treaties (VCLT) 1969[53], the interpretation of definition requires to refer first in its ordinary meaning as the manifestation of negotiators intent and purpose over the agreements.[54]

a. Investor.

In defining the term “investor”, the issue arises on: what type of persons or entities included as “investor”. There are two types of person included under the definition of “investor”: natural persons and legal persons or juridical entities. Commonly, the term “investor” is substituted by “nationals” to define natural persons, and “companies” to defined legal entities.[55]

Neither TRIMs nor GATT 1994 defines the term “investor”, “national”, “natural person” and “juridical person”. The definition might be found in the Convention on the International Centre for Settlement of Investment Disputes [hereinafter the ICSID Convention][56], precisely article 25(1) of the ICSID Convention states:

> “The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment between a Contracting State […] and **a national** of another Contracting State […]”

[53] Adopted on 22 May 1969 and entered into force on 27 January 1980.

[54] UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD). *Scope and Definition*. 2011, UNCTAD Series on Issues in International Investment Agreement II, p. 7. [UNCTAD, Scope and Definition].

[55] *Ibid.*

[56] Entered into force on October 14, 1966.

Article 25(2) of the ICSID Convention defines "national of another Contracting States" as:

> (a) **any natural person** who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and
> (b) **any juridical person** which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

The convention requires one of the disputing parties, in this context, investor should be different from the State Party to the dispute.

In respect to "natural person", the Convention requires persons to establish that they had the nationality of a Contracting State on two different dates: the date at which the parties consented to ICSID's jurisdiction and the date of the registration of the request for arbitration.

Some BITs provide a single definition of "national" which applies to both parties, but some other BITs offer two definitions: one related to one Contracting Party and the other related to the second

Contracting Party.[57] The latter BITs type has been practiced such as in **Finland-Egypt BIT**[58] and **US-Uruguay BIT.**[59]

A somewhat different definition is stated in **Germany-Israel BIT.**[60] Article 1(3)(b) of the BIT define the term "nationals" with respect to Israel as "Israeli nationals being permanent residents of Israel." In **Canada-Argentina BIT**[61] and **Energy Charter Treaty**[62]**,** the criterion of permanent residence is used as an alternative to nationality. The BIT provides that the term "investor" means "any natural person possessing the citizenship of or permanently residing in a Contracting Party in accordance with its laws."

Article 201 **NAFTA** defines national as "natural person who is a citizen or permanent resident of a Party." Similar definition is also found in **Canada Model FIPA.**[63] Nonetheless, in the absence of treaty regulation, "effective" nationality principle of the individual applies. [64]

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[57] ORGANIZATION FOR ECONOMIC AND DEVELOPMENT (OECD), *International Investment Law: Understanding Concepts and Tracking Innovations*, 2008, p.13. [OECD, Concepts and Tracking Innovations].

[58] Finland-Egypt BIT, entered into force on 5 February 2005. The BIT provides that the term "national" means *"a)* In respect of Finland, an individual who is a citizen of Finland according to Finnish law; *b)* In respect of Egypt, an individual who is a citizen of Egypt according to Egyptian Law."

[59] US-Uruguay BIT, entered into force on 1 November 2006. The BIT provides that the term "national" means: "*a)* For the United States, a natural person who is a national of the United States as defined in Title III of the Immigration and Nationality Act; *b)* For Uruguay, a natural person possessing the citizenship of Uruguay, in accordance with its laws."

[60] Germany-Israel BIT, signed on 24 June 1974, not entered into force yet.

[61] Canada-Argentina BIT, entered into force on 29 April 1993.

[62] Energy Charter Treaty entry into force on 16 April 1998; *See* article 1(7)(a)(i). [ECT].

[63] *Ibid,* article 1, p.6.

[64] R. Dolzer and M. Stevens, *Bilateral Investment Treaties,* 1995. Martinus Nijhoff Publishers, The Hague/Boston/London, 1995.

Unlike the "juridical person", the ICSID Convention requires person to establish that they had the nationality of a Contracting State only on the date when the parties consented to ICSID's jurisdiction.[65] The definition allows the local company established in the host state by the foreign investor considered as a national of another Contracting State.[66] Therefore, local subsidiary may have recourse to be available before ICSID arbitration.

In respect of the juridical person, **Energy Charter Treaty** provides in article 1(7)(a)(ii) the definition of investor as company or other organization organized in accordance to the law applicable in that Contracting Party. Similar definition is also found in **draft MAI** as "A legal person or any other entity constituted or organized under the applicable law of a Contracting Party […]."

In determining corporate nationality, the requirements of article 25(2)(b) ICSID Convention shall be met, one of them is the "foreign control" element. **A. Broches** explained that the purpose of control test

16. *Ibid,* p.34; *See* the 1991 BIT between Israel and Romania which in its Protocol provides that: "With respect to physical persons – an individual who possesses both Israeli and Romanian citizenship who invests in Israel shall be considered as Romanian investors, under Israeli law in force, for the purposes of this Agreement."

[65] OECD, Concept and Tracking Innovations, p.28.

[66] *See* Holiday Inns v. Morocco; Klöckner v. Cameroon; Amco Asia v. Indonesia; Vacuum Salt v. Ghana; Aucoven v. Venezuela; Soabi v. Senegal.

under article 25(2)(b) is to expand the jurisdiction of ICSID.[67] Similar approach is also taken in **Energy Charter Treaty,[68] draft MAI.[69]**

The question of the nationality of judicial person had been presented in some cases, *inter alia*, ***MINE v. Guinea,***[70] ***Amco v. Indonesia,***[71] ***Klöckner v. Cameroon,***[72] ***AMT v. Zaire***[73] and ***Banro v. Democratic Republic of Congo.***[74]

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[67] A. Broches, "*The Convention on the Settlement of Investment Disputes between States and Nationals of Other States"*, 1972, Recueil des Cours de l'Académie de Droit International, 331, p.358-9 and 361.

[68] ECT, article 26(7) provides: "An Investor other than a natural person which has the nationality of a Contracting Party to the dispute on the date of the consent in writing referred to in paragraph (4) and which, before a dispute between it and that Contracting Party arises**, is controlled by Investors of another Contacting Party**, shall for the purpose of Article 25(2)(b) of the ICSID Convention be treated as a 'national of another Contracting State' […]."

[69] Draft of Multilateral Agreement on Investment [MAI Draft], "*Standing of the Investment*: An enterprise constituted or organised under the law of a Contracting Party but which, from the time of the events giving rise to the dispute until its submission for resolution under paragraph 2.c. was an investment of an investor of another Contracting Party, shall, for purposes of disputes concerning that investment, be considered 'an investor of another Contracting Party' under this article and a 'national of another Contacting State' for purposes of Article 25(2)(b) of the ICSID Convention regarding a dispute not submitted for resolution by the investor **which owns or controls it**".

[70] UNCTAD, Scope and Definition, p.35.

[71] *Amco Asia Corporation, Pan American Development Ltd. and P.t. Amco Indonesia* v. *The Republic of Indonesia*, Decision on Jurisdiction, ICSID case No. ARB/81/1, 25 September, 1 ICSID reports.

[72] *Klöckner* v. *Cameroon* , Award, ICSID case No. ARB/81/2, 21 October 1983, 2 ICSID Reports.

[73] *American Manufacturing & Trading (AMT)* v. *Zaire,* Award, ICSID Case No. ARB/93/1, 21 February 1997.

[74] *Banro* v. *Democratic Republic of Congo,* Award, 1 September 2000, (2003)17 ICSID Rev-FILJ 382.

b. Investment (Foreign Direct Investment).

Since mid-nineteenth century, the growing international economic relations affects the subject protection of varied types of assets.[75] By the late-twentieth century, since much FDI was taken into account by most developed states, the protection of assets then became an increasing concern in international society.

As time goes by, the practices of FDI through IIAs and BITs have increased among states. With respect to the FDI, each Agreement defines the term "investment" differently based on the parties' interest. Therefore, there is no single absolute definition of "investment". The meaning of the term is varied depend on the object and purpose of investment instruments.[76]

In regards to the broad definition of the term "investment", OECD Code of Liberalisation of Capital Movements provides a main representative example.[77] Based on this Code, there are at least four combinations of elements to demonstrate the existence of "investment" in a "direct" character:[78]

1) There should be a contribution.
2) This contribution should be in capital.
3) It should allow the establishment of durable relations between the investor and the enterprise.

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[75] UNCTAD, Scope and Definition, p.8.

[76] D. Carreau, P. Juillard, *Droit international économique* (3e édition, Dalloz, Paris, 2007), 403 : "La difficulté que l'on rencontre, lorsque l'on veut proposer une définition de l'investissement international, vient de la multiplicité des conceptions en cette matière – cette multiplicité des conceptions, en définitive, ne reflétant que la prolifération des sources" as cited in UNCTAD, Scope and Definition, p.46.

[77] See *www.oecd.org/dataoecd/10/62/4844455.pdf*; UNCTAD, Scope and Definition, p.48.

[78] OECD, Concept and Tracking Innovations, p.45.

4) The investor should be in a position to exercise a real influence on the management of the company where it had invested.

OECD Benchmark Definition of Foreign Direct Investment [hereinafter Benchmark Definition] sets the similar standard for FDI, as follows:[79]

> "Direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise resident in an economy other than that of the investor (the direct investment enterprise). The motivation of the direct investor is a *strategic long-term relationship* between the direct investment and the enterprise which allows a *significant degree of influence* by the direct investor in the management of the direct investment enterprise. The *lasting interest'* is evidenced where the director investor owns at least 10 per cent of the voting power of the direct investment enterprise"

Most IIAs and BITs and some trade agreements include a broad definition of investment as "every kind of asset" then followed by an illustrative but (usually) non-exhaustive list of covered assets.

Article 1(6) of **Energy Charter Treaty** defines investment as "every kind of asset" and refers to "any investment associated with an economic activity in the energy sector." A slightly different in NAFTA[80] and Canadian Model FIPA[81] where the definition of investment is combined with specific exclusions.

This broad-asset definition may rise a danger gradual extension. Some various restrictions on a wide approach should be presented into the definition and scope clause. For example, IIAs or

[79] OECD Benchmark Definition of Foreign Investment (Draft) – 4th Edition, DAF/INV/STAT(2006)2/REV. 3, 2007.

[80] North American Free Trade Areement [NAFTA], article 1139.

[81] *Ibid,* article 1, p.4.

BITs Parties may include additional requirement that only investment made in accordance to the host states' law are entitled the protection. In this way, investment that fail to abide the law of the host country will lose the protection of the investment instruments.[82]

4. Sources of International Investment Law.

There are some International Agreements that have a binding rules towards the State Party, *inter alia*:

1) World Bank Guidelines on Foreign Investment 1992.[83]
2) Convention on Multilateral Investment Guarantee Agency (MIGA) 1985.[84]
3) Convention on the Settlement of Investment Disputes between States and Nationals of other States 1966.
4) New York Convention on Recognition and Enforcement of Foreign Arbitral Awards 1958.
5) Andean Investment Code.
6) North American Free Trade Agreement 1992.
7) Energy Charter Treaty 1994.
8) Trade-Related Investment Measures [TRIMs] Agreement.

[82] WTO Working Group, 1997, p.10.

[83] Adopted in 1992 and may be applied by members of the World Bank Group institutions to private foreign investment in their respective territories. Indonesia is a Member since 1944, then resigned in 1965, and re-join in 1967.

[84] The Convention on Multilateral Investment Guarantee Agency [MIGA] is submitted to the Board of Development on October 11, 1985, went into effect on April 12, 1988 and was amended by the Council of Governors of MIGA effective on November 14, 2010. Indonesia as a signatory Party in 1986.

9) Trade Related Aspects of Intellectual Property Rights [TRIPs] Agreement
10) General Agreement on Trade and Tariffs [GATT]
11) General Agreement on Trade in Services [GATS]
12) DOHA Declaration 2001.
13) The ASEAN Agreement on promotion and protection of Investment of 1987 as amended in 1996.
14) The framework agreement for the ASEAN Investment Agreement 1998 as amended in 2001 [the Framework Agreement].

Afterwards, there are some soft laws related to investment:

1) The Havana Charter of 1948.
2) The International Chamber of Commerce (ICC's) Drafts Guidelines for International Investment.
3) The United Nations Commission on Transnational Corporation (UNCTC's) Draft Code of Conducts on Multinational Corporation.
4) The OECD's Study and Draft on Multilateral Agreement on Investment of 1994.
5) World Bank's Guidelines on Foreign Investment of 1992.
6) UN Code of Conduct for Transnational Corporation.

5. Applicable Principles.

a. National Treatment.

Under article 2.1. TRIMs, WTO Members are prohibited to apply any investment measure inconsistent with Article III (national treatment) or Article XI GATT (prohibition of quotas). The Annex to TRIMs provides Illustrative List, the examples of measure that are inconsistent with Article III or Article XI GATT, as follows:

a) Local content requirements;
b) Export performance requirements;
c) Trade balancing requirements;
d) Foreign exchange balancing requirements;
e) Restrictions on an enterprise's export or sale for export of products.

According to GATT 1994, national treatment principle imposes an obligation of like treatment and non-discrimination between domestic and imported goods. The "like treatment" standard means that: once the "imported products" have cleared customs; and the applicable tariff or duty has been collected. The imported products shall be treated the same as domestic products.[85] National treatment has been customary since it applies in many trade agreements including GATS.[86]

Article III:1 GATT provides the application scope of national treatment as follows: (1) internal taxes and charges; (2) laws, regulations and requirements affecting the sale, transportation, distribution or use of products; and (3) internal quantitative regulations

[85] Mitsuo Matsushita… p.234.
[86] *Ibid.*

requiring the mixture, processing or use of products in specified proportions.[87]

The activities of foreign investors in their host states include a numerous operations, *inter alia* international trade in products, trade in components, know-how technology, local production and distribution, the raising of finance capital and the provision of services.[88]

In relation to FDI, national treatment is defined as a principle whereby a host states extends to foreign investors treatment that is at least as favourable as the treatment that accorded to national investors in like circumstances.[89] Foreign and domestic investors should subject to the same competitive conditions on the host states market. None of government measure should unduly favour domestic investors.[90]

In the past decades, the wording of the clauses has essentially remained the same.[91] The national treatment clauses in investment treaties use varying language. The phrases "no less favourable", "less favourable", "like circumstances" and "like situations" are widespread.[92] The national treatment clauses in any IIAs shall be interpreted within their contexts including their surrounding treaty texts.[93]

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[87] *Ibid,* p.235.
[88] *Op-cit.*
[89] *Ibid,* p.1.
[90] UNCTAD, National Treatment.p.8. The rationale may or may not extend beyond the treatment of the person to touch upon property rights and the rights of legal persons.
[91] Rudolf Dolzer…p.1.
[92] http://www.tradelawguide.com/index.asp?toc=content&id=222 acessed on 17 February 2016.
[93] *Ibid.*

In the investment agreements, national treatment comprises an economic aim unlike to the adoption in trade agreements. In the context of investment, the "likeliness of products" in article III GATT 1994 is inadequate. The "likeliness of circumstances" is rather essential to prove.

b. Most-Favoured-Nation Treatment.

Most Favoured Nation Treatment [hereinafter MFN] prohibits distinct treatment towards nationality-based foreign investors. MFN requires state conduct not to discriminate between similarly situated persons, entities, goods, services or investments of different foreign investors. The host state should grant equal competitive opportunities between investors and their investment from different states.[94]

Within the context of FDI, TRIMs does not mention specifically for the obligation of MFN treatments. Although Article I GATT 1994 covers the standard to accommodate MFN Treatment, it cannot merely be applicable to investment measures without any other binding rules to the host State.[95] Unlike national treatment principle binding under Art. III GATT, MFN binds to the states on the ground of Customary International Law [hereinafter CIL]. [96]

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[94] UNCTAD, *Most-Favoured-Nation Series*, UNCTAD/ITE/IIT/10, 1990, UNCTAD Series on issues in international investment agreements, United Nations, New York, [UNCTAD, MFN Treatment], p.8.

[95] Mitsuo Matsushita, p.206.

[96] OECD. *Commentary to the Consolidated Text of the Multilateral Agreement on Investment*, Document No. DAFFE/MAI (98)8/REV1, 1998, Paris. [OECD, 1998].

Draft Articles on Most-Favoured-Nation[97] defines MFN as:[98]

> "[…] treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable that treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State."

This clause is aimed to ensure the right of entry and establishment for the foreign investors and the conditions that apply to the pre-establishment phase of the investment. The treatment shall not different for one and another nationality-based investors and their investment.[99]

c. International Minimum Standard.

As defined by Organisation for Economic and Development [hereinafter OECD], International Minimum Standard is a norm of customary international law governing the treatment of aliens, by providing for a minimum set of principles where States, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property.[100]

This principle comes into exists as the expansion and development of Calvo Doctrine. Previously, the doctrine was declared in 1896 by Carlos Calvo (a distinguished jurist from Argentina) and

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[97] In 1970s, International Law Commission (ILC) acknowledged the importance of MFN Treatment in International Law by preparing the "Draft Articles on Most-Favoured-Nation" in 1978 [Draft Articles on MFN].

[98] Draft Articles on MFN, article 5.

[99] UNCTAD, MFN Treatment, p.14.

[100] OECD Directorate for Financial and Enterprise Affairs. *Fair and Equitable Treatment Standard in International Investment Law,* Number 2004/3, September 2004, Working Papers on International Investment [OECD, FET Standard], p.8.

was adopted by several countries in Latin America, such as United Mexican States. After 1960s and 1970s, the trends of the doctrine has changed. Latin American Countries entered into BITs that contain clause of State Responsibility Doctrines. The treaties leave behind the Calvo Doctrines.[101]

State Responsibility doctrines reflect responsibility of the host state for the protection to a foreign national or his property below a customary international minimum standard.[102] Furthermore, under American Law Institute's Restatement (Third) of Foreign Relations Law of the United States,[103] a state is also responsible if it fails to provide the remedies to foreign national for injuries suffered, regardless the infliction of those injuries.[104]

This concept of international minimum standard of treatment has been standardized in some cases before 20th century such as in L.F. Neer v. United Mexican States and Roberts v. United Mexican States.

In an evolving customary law, the interpretation of minimum standard has expanded to the element of fair and equitable principle. Some IIAs and BITs have adopted the fair and equitable standard as the element of international minimum standard. In NAFTA for example, in Chapter XI provides the minimum standard and the fair and equitable treatment are written in article 1105 (1):

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[101] Adriana Sanchez Mussi, *International Minimum Standard of Treatment.* p.5.
[102] UNCTAD, National Treatment, p.32.
[103] The American Law Institute. Restatement of the Law Third. *The Foreign Relations Law of the United States*. Volume 2, 1987, American Law Institute Publishers, para.711 e.
[104] Adriana Sanchez… p.6.

> "Each party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."

In the light of interpretation of the fair and equitable provision, tribunals gave different interpretation among cases. In response to the various interpretation, NAFTA Free Trade Commission (FTC) then issued a binding interpretation on July 21, 2001 as follow:

> Article 1105 (1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
>
> The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
>
> A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105 (1).

The question of international minimum standard treatment and fair and equitable treatment has been presented in Mondev International LTD v. United States of America,[105] ADF Group INc. v. United States of America,[106] The LOewen Group, Inc. and Raymond L. Loewen v. United States of America,[107] Azuric Corp v. The

[105] Mondev International LTD v. United States of America, ICSID Case No. ARB (AF)/99/2. 11 October, 2002

[106] ADF Group Inc. v. United States of America, ICSID Case No ARB (AF)/00/1, 9 January, 2003.

[107] The Loewen Group, Inc. and Raymond L. Loewen v. United States of America, ICSID case No. ARB (AF)/98/3

Argentine Republic,[108] Saluka Investment BV (The Netherlands) v. The Czech Republic.[109]

To sum up, the final question is whether the international minimum standard is equivalent to the fair and equitable treatment or they differ from each other? If the Parties to the Treaty believe that the fair and equitable standard is entirely equivalent with international minimum standard, they could easily indicate this in their investment instrument. However many cases, most investment instruments do not make an explicit link between the two standards.[110]

6. Dispute Settlement.

Foreign investors may sue the host state before an arbitral tribunal appointed when they believe that the treaty has been violated by the host state.[111] This is what makes investment treaty different from any other treaty. Most of IIAs mention that the Investor-State Dispute Settlement Mechanism [hereinafter ISDS] should make sure on how disputes between States and investors are resolved.

A few early of IIAs provide languages of access to domestic courts, and to bring claims arising under the expropriation clause. This has been practiced in Korea-Bangladesh BIT (1986).[112]

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[108] http://www.worldbank.org/icsid/cases/pdf/ARB0112_Azurix-Award-en.pdf accessed on 15 February 2016.

[109] Saluka Investments BV (The Netherlands) v. The Czech Republic provided in http://www.pcacpa.org/ENGLISH/RPC/SAL-CZ%20Partial%20Award%20170306.pdf accessed on 16 February 2016.

[110] Adriana Sanchez…p.22.

[111] https://www.iisd.org/investment/dispute/ accessed on 05 February 2016.

[112] Koread-Bangladesh BIT, article 5.1. provides: “The national or company affected shall have a right, under the law of the Contracting Party making the expropriation, to prompt review,

Another small number of treaties in 1990s include the ISDS through International Arbitration, exclusively (does not mention domestic judicial review as the dispute settlement), such as in Austria-Bolivia BIT (1997); Belgium/ Luxembourg - Cyprus BIT (1991); Belgium/ Luxembourg - Estonia BIT (1996); Belgium/ Luxembourg-Georgia BIT (1993); Belgium/ Luxembourg-Mongolia BIT (1992); Belgium/Luxembourg-Vietnam BIT (1991); France-Haiti BIT (1984); Hungary-Croatia BIT (1996); and South Africa-Iran BIT (1997).

Some other treaties provide recourse to both international arbitration and domestic court, under certain conditions. The conditions might be in the form of: giving parties to the dispute a choice between domestic remedies and international arbitration; defining a chronological sequence to make both adjudicative avenues successively available; and identifying the competent institution by reference to the subject matter of the dispute.[113]

The most frequently mentioned ISDS in IIAs is ICSID Arbitration which subject to the ICSID Convention. In order for ICSID Arbitration to be available, the host state and the investor's state must be parties to the

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by a judicial or other independent authority of that Contracting Party, of his or its case and of the valuation of his or its investment in accordance with the principles set out in this paragraph."

[113] Pohl, J., K. Mashigo and A. Nohen (2012), "Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey", *OECD Working Papers on International Investment*, 2012/02, OECD Publishing. http://dx.doi.org/10.1787/5k8xb71nf628-en p.2-15.

ICSID Convention. If only one of the states is party to the Convention, then the ICSID Additional Facility is available.[114]

Two other forms of institutional arbitration are also mentioned frequently. These are arbitration under the International Chamber of Commerce Rules of Arbitration (usually abbreviated 'ICC Arbitration'), and arbitration under the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (principally in investment treaties implicating Eastern European countries).[115]

Some IIAs also provide a possibility of *ad hoc* arbitration, such as arbitration without an administering institution. The most common form is arbitration under the 1976 Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) which are designed for *ad hoc* or non-institutional proceedings.[116]

B. Indonesian Investment Law

In order to achieve social welfare as ordered by article 33 of 1945 Indonesian Constitution, it is important for Indonesia to develop investment measures in economic activity such as micro, small, medium business, and cooperation.[117] Government's policies in the context of FDI shall aim to increase national economic growth, create job opportunity, economic sustainable development, increase national capacity and capability of

[114] Andrew Newcombe and Lluís Paradel, *Law and Practice of Investment Treaties*, 2009, Kluwer Law International, the Netherlands, p. 72 - 73.
[115] *Ibid,* at 73.
[116] *Ibid*.
[117] Investment Act 2007, elucidation p.1.

technology, force social economic development, and establish social welfare in a competitive economic system.[118]

For the reason above, Indonesia then enacted The Act Number 25 Year 2007 on Investment Law [hereinafter Investment Act 2007], enter into force on April 26, 2007.[119] The enactment of this law is to create conducive circumstance, promoter, legal certainty, justice and efficient for investment with due regard to national economic interest.[120]

1. Investment Law.

According to Ida Bagus Wyasa Putra, investment law is legal norms related to possibilities to investment, requirements of investment, protection, and the most important is to direct the investment to create society's welfare.[121] Salim HS and Budi Sutrisno define investment law as all of legal rules governing the relation between investor and the capital receiver, open fields of investment, procedures and requirements of investment in certain country.[122]

Another definition of investment law is provided by T. Mulya Lubis. He states that investment law is not only for those which codified under the regulation, but also for other subsequent law and rules coming

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[118] *Ibid.*
[119] Sentosa Sembiring… p.126.
[120] *Ibid,* p.129; Investment Act 2007, consideration (c).
[121] H. Salim HS, *Hukum Investasi Indonesia*. Cetakan Ke-empat, 2014, Rajawali Pers, Jakarta, p.54- 55.
[122] Sentosa Sembiring, *op-cit,* p.10.

into force relevant to foreign investment matters. This definition focused only from the sources of investment law, not the investment itself.[123]

There are at least five elements in defining investment pursuant to the definition above: (1) rules; (2) parties (investor and capital receiver); (3) open business field for investment; (4) procedure and requirements to investment; and (5) in the territory of a state.

2. Sources of Indonesian Investment Law

The sources of investment law, *inter alia*:

1.) The Act Number 25 Year 2007 on Investment Law.

2.) The Act Number 40 Year 2007 on Limited Liability Company.

3.) The Act Number 5 Year 1960 on Agrarian and Land.

4.) The Act Number 13 Year 2003 on Labour Law.

5.) The Act Number 29 Year 2009 on Special Economic Field.

6.) The Act Number 4 Year 2007 on Mine and Coal.

7.) The Act Number 41 Year 1999 on Forestry.

8.) The Act Number 32 Year 2009 on Protection and Management of Environment.

9.) The Act Number 5 Year 1984 on Industry.

10.) Law on Property Rights such as: The Act Number 19 Year 2002 on Copy Rights; The Act Number 14 Year 2001 on Patent; The Act Number 15 Year 2001 on Trade Mark; The Act Number 30 Year 2000 on Trade Secret; The Act Number 31 Year 2000 on Product

[123] *Ibid.*

Design; and The Act Number 32 Year 2000 on Integrated Circuit Layout Design.

11.) The Act Number 30 Year 1999 on Arbitration and Alternative Dispute Resolution.

12.) The Act Number 7 Year 1994 on the Ratification of WTO Agreement 1994 and its Annex in respect to the dispute resolution.

13.) The Act Number 5 Year 1968 on the Approval of the Convention of Settlement of Disputes between States and Nationals of Other States.

14.) Presidential Decree Number 34 Year 1981 on the Ratification of Convention on the Recognition and Enforcement of Foreign Arbitral Award, signed on June 10th, 1958 and entered into force on June 7th, 1959.

15.) Supreme Court Regulation Number 1 Year 1990 on the Procedures of Foreign Arbitration Award, dated March 1st, 1990.

16.) Presidential Regulation Number 39 Year 2014 on the List of Close and Open Business Field under Requirements in the field of Investment and its Annex I and Annex II.

17.) District Regulation related to retribution and permit.

3. Applicable Principles.

Article 3 of Investment Act 2007 mentions 10 principles of investment:

1) Legal certainty

Indonesia as rule of law system shall prioritize law and regulation as the basis in policy-making and take any action in the field of investment.

2) Openness

Government should open to any rights of society in receiving correct, honest, and non-discriminative information related to investment.

3) Accountability

Any activity and the end result of investment activity shall accountable for society as the highest sovereign holder in accordance with the law.

4) The equal treatment without discriminating the country of origin

It is a non-discrimination service that should be served from government to both domestic investor and foreign investor, and among one foreign investor to other foreign investor from different country.

5) Togetherness

It applies to the roles of investors in doing their business activities jointly in order to create society's welfare.

6) Impartial efficiency

This principle prioritizes justice in investment activities, in order to create fair, conducive, and competitive business.

7) Sustainability

The development of investment activity conducted by the investors nowadays shall grant the welfare and development in any living aspect, either for now or in the future.

8) Environmentally sound

Any business activity derived from investment activity should concern and prioritize the protection and maintenance of environment.

9) Independency

Any investment activity shall stress the state prospective without prejudice to the foreign investment, in order to achieve good economic growth.

10) Balance of progress and national economic unity

This principle tries to keep the stability of economic development in a national economic unity.

4. Domestic Investment.

Article 1 number 2 of Investment Act 2007 states that domestic investment shall be any investing activity for running business within the territory of the Republic of Indonesia, made by any domestic investor using domestic capital.

The definition above indicates five most important elements of domestic investment: (1) there is investing activity; (2) for business; (3) the activity located in the territory of Indonesia; (4) conducted by domestic investor; and (5) the using of domestic capital.

Article 1 number 5 mentioned that “Domestic investor” means an Indonesian national, an Indonesian business entity, the state of the Republic of Indonesia, or a region that makes an investment in the territory of the state of the Republic of Indonesia. Article 1 number 9

states that domestic capital owned by the state of the Republic of Indonesia, an Indonesian national, or a business entity of a legal entity or non-legal entity form.

Domestic investment might be in the form of legal entity (*rechtperson*), business entity not of a legal character or sole proprietorship. As stated in article 5 section (1) of Investment Act 2007, business entity of a legal character are: Limited Liability Company [hereinafter LLC] subject to the Act Number 40 Year 2007 on Limited Liability Company, Cooperation subject to the Act Number 17 Year 2012 on Cooperation[124] and Foundation subject to the Act Number 28 Year 2004 on Amendment of the Act Number 16 Year 2001 on Foundation.

Particularly in the form of LLC, both domestic and foreign investor shall subscribe for share at the time the LLC is established; purchase shares; and take another method in accordance with provisions of laws and regulation.[125] Business entity not of a legal character might be in the form of Firm, CV (*commanditaire vennotschap*), or *maatschap* as subject to Indonesian Civil Code.[126]

5. **Foreign Investment.**

Foreign investment is transfer of tangible or intangible assets from one state to another state for the purpose of generate wealth under the total

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[124] *Ibid,* p.112.

[125] The Act Number 40 Year 2007 on the Limited Liability Company. [LLC Act 2007], article 5 (3).

[126] *Op-cit,* p.117.

or partial control of the foreign owner of the assets.[127] Article 1 number 3 of Investment Act 2007 defines foreign investment as "an investing activity to do business in the territory of the state of the Republic of Indonesia that is carried out by a foreign investor both by use of all of foreign capital and/or by engagement in a joint venture with a domestic investor."

Article 1 number 6 states that foreign investor is "a foreign national, a foreign business entity, and/or a foreign government that makes an investment in the territory of the state of the Republic of Indonesia." While definition of foreign capital can be found in article 1 number 8 as "an asset that is owned by an investor in the form of money or non-money which bearing economic value."

Article 5 (2) of Investment Act 2007 gives constraint form of foreign investment potential to invest in Indonesia. It asserts that "foreign investments shall be in the form of a **limited liability company** under Indonesian law and domiciled within the territory of the state of the Republic of Indonesia, unless otherwise provided by law."

LLC is subjected to the Act Number 40 Year 2007 on Limited Liability Company. Article 1 number 1 asserts that "LLC is a legal entity constituting a capital partnership, established based on an agreement, conducting business activities with all of its authorized capital are divided

[127] *Ibid,* p.147.

into shares, and meeting the requirements stipulated in this Law and its implementing regulations."

6. Business Sectors of Investment.

Article 12 (1) of Investment Act 2007 asserts that "all business sectors or business types are open to investment activities, exclude for business sectors or business types that are declared to be closed and open with conditions."

Article 12 (4) of Investment Act 2007 stipulated that "Criteria and requirements of business sectors that are closed and open with conditions as well as a list of business sectors that are closed and open with requirements shall be regulated by Regulation of the President, respectively."

As the follow up from above article and in order to meet the principle of economic democracy, Indonesia provides the list of closed and opened with conditions business sectors in the President Regulation Number 39 of 2014 on the List of Business Sectors Closed to Investment and Business Sectors Open, with Conditions, to Investment [hereinafter PR 39 of 2014]. The arrangement of this list is based on the standard for classification of business sectors or business types applicable in Indonesia. The classification base on *Klasifikasi Baku Lapangan Usaha Indonesia* (KBLI) and/or the International Standard for Industrial Classification (ISIC).[128]

[128] Investment Act 2007, elucidation of article 12 (1).

PR 39 of 2014 provides the negative list of investment in two main types: closed to investment (subject to Annex I of the Regulation) and open, with conditions, to investment (subject to Annex II of the Regulation). Article 3 of PR 39 of 2014 states any business sectors that are not listed in Annex I and Annex II shall be declared open without any conditions to investment.

In the early February 2016, the Government revised the Negative List of Investment based on PR 39 of 2014 by establishing the New Economic Policy Package Volume X. The revision was about increasing the foreign ownership proportion to be majority, even until 100% in some field such as horticulture, warehouse, transportation, restaurant, tourism spot, telecommunication, and so on.[129]

a. Close Business Field.

Article 12 (2) of the Investment Act 2007 mentions business sectors closed for foreign investors are:

a. production of weapons, ammunition, explosive devices, and armaments; and

b. Business sectors that are explicitly declared to be closed by law.

In regards to the negative list of investment, government shall establish the close business sectors to investments based on the

[129] http://finance.detik.com/read/2016/02/11/172351/3139784/4/pemerintah-revisi-aturan-dni-ini-rinciannya accessed on 29 February 2016.

criteria of soundness, morals, culture, the environment, national defense and security, as well as other national interests.[130]

Article 1 section (1) of the PR Number 39 of 2014 asserts "that closed business sectors shall be a specified close business sector prohibited for cultivation in investing activity." The following negative list is provided in Annex I of the Regulation.

b. Open Business Sectors with conditions.

Article 12 (1) of Investment Act 2007 provides the list of open business sectors with some conditions to investment. In establishing business sectors that open with conditions, the government shall determine based on the national interest criteria, to wit: protection of natural resources; protection and enhancement of micro, small and medium enterprises, and cooperation; supervision of production and distribution; the increase of technology capacity, domestic capital participation,; as well as cooperation with business entities appointed by the Government.

Furthermore, article 2 (1) provides that the open business sector shall include: business sector reserved to the Micro, Small, Medium Business Enterprises and Cooperation; business sector with partnership requirement; business sector with capital ownership requirement; business sector with certain location requirement; and business sector with specified permission requirement. The list of

[130] Investment Act 2007, elucidation of article 12 (3).

open business sector with conditions are provided in Annex II of PR 39 of 2014.

7. Facilities in Investment.

Under the Investment Act 2007, precisely article 18 (1) the government of Indonesia shall grant investment facilities to local and foreign investors in order to attract more investments to Indonesia. The facilities and incentives provided by Investment Act 2007 are in the form of tax and financial incentives, longer duration of land title and employment/ immigration matters.

a.) Tax and Financial Incentives[131]

The Investment Act 2007 provides that eligible investors may enjoy tax and financial incentives in the form of:[132]

- a reduction of income tax through the reduction of net earnings up to a certain level within a certain period of time;
- a waiver or reduction of import duty in respect of imported capital goods, machinery or other equipment used for production activities where such capital goods, machinery/equipment are not yet produced in Indonesia;
- a waiver or reduction of import duty for raw materials or supporting goods used for production activity for a certain period of time and with certain conditions;

[131] *Ibid,* article 18(2)-(7), 19, and 20.
[132] Hadiputranto, Hadinoto & Partners. *Indonesia's New Capital Investment Law*. 2011, p.5.

- a waiver or suspension of value added tax for imported capital goods or machinery/equipment used for production activity, where such imported capital goods/machinery/equipment are not yet produced in Indonesia, within a certain period of time;
- an accelerated depreciation or amortization; and land and building tax facilities, especially in certain business sectors located within certain areas.

b.) Longer Duration of Land Title[133]

The Investment Act 2007 also provides an acceleration of land title extensions, where an eligible investor may have:[134]

- *Hak Guna Usaha* (HGU) or Right to cultivate title for a period of 95 years (namely land title for a period of 60 years [35 years plus extension of 25 years] plus a renewal period of 35 years).
- *Hak Guna Bangunan* (HGB) or Right to build title for a period of 80 years (namely land title for a period of 50 years [30 years plus extension of 20 years] plus a renewal period of 30 years).
- *Hak Pakai* (HP) or Right to Use title for a period of 70 years (namely land title for a period of 45 years [25 years plus extension of 20 years] plus a renewal period of 25 years).

[133] Investment Act 2007, article 21 (a), 22.
[134] *Op-cit,* p.7.

c.) Immigration.[135]

The Investment Act 2007 provides for:[136]

- limited stay permits for foreign personnel of 2 years (rather than 1 year);
- the conversion of a limited stay permit to a permanent stay permit after 2 consecutive years;
- a multiple re-entry permit for limited stay permit holders valid for 1 year and issued for a period of 1 year following the issuance of a limited stay permit;
- a multiple re-entry permit for limited stay permit holders valid for 2 years and issued for a period of 2 years following the issuance of a limited stay permit; and
- a multiple re-entry permit for permanent stay permit holders issued for a period of 2 years following the issuance of a permanent stay permit.

8. Dispute Settlement.

The Investment Act 2007 provides that, if there is a dispute between the Government and an investor that cannot be settled amicably, the dispute can be settled either through arbitration or by the courts.[137]

Where an investment dispute arises between the Government and an investor, then such parties shall first settle the dispute through

[135] Investment Act 2007, article 23.
[136] *Op-cit,* p.7 -8.
[137] Investment Act 2007, article 32.

deliberation to reach a consensus. The dispute settlement may be made through arbitration or alternative dispute resolution or a court of law in accordance with provisions of laws and regulations.

The dispute between the Government and a domestic investor, shall be settled in arbitration based on an agreement of the parties, and if a dispute settlement through arbitration is not agreed on, then the dispute settlement shall be made in a court of law. While the dispute between the Government and a foreign investor, shall be settled through international arbitration agreed on by the parties.

C. Investment in Islamic Perspective

Investment behavior of an active believer places priority on projects that would serve to promote justice by facilitating economic empowerment of the needy and the less privileged, consistent with the sacred principle of human dignity.[138] In the Islamic teaching there is no stronger benchmark than the level of poverty to indicate the extent of justice prevailing and the strength of the belief level of a society.

Investing in projects with high job-creating potential, those with greatest benefits in terms of enhancing health and education, and investment projects that remove infrastructural bottlenecks as well as those that enhance technological improvement in production all have high priority. These are the types of investment encouraged by the Prophet as

[138] http://myviewpoint2u.blogspot.co.id/2009/04/investment-from-islamic-perspective.html accessed on March 20, 2016

being in the domain of private sector. For much of its earliest history, most social goods in the Muslim community were financed by private sector, as were expenditures on health and education as well as contribution to the provision of the basic needs of the less privileged segment of the community. Consequently, the public sector was, to a large extent, unburdened by these expenditures.

From an Islamic perspective, investment that reduces poverty, creates jobs, improves health and education, especially for the needy and vulnerable segment of the population, allows economic growth and justice to complement one another. Efficiency, meaning getting maximum output from a given level of resources, as a corollary of the rule of no waste, is a crucially important consideration in production, consumption, and investment decisions. But this notion of efficiency is at a secondary level to justice.

One example of traditional type of faith-based investment is the concept of endowment (*waqf*) whereby a stream of income from legitimate commercial investment is devoted to: building and maintaining hospitals and educational facilities; road construction and maintenance; orphanages; provision of venture capital for small business; providing financial resources to young people to start a family; scholarships to needy students; all similar to philanthropic endowments in Western societies.

While Islamic finance has made great strides in exploiting a special niche in the financial world, this progress has been focused on a negative

role of avoiding interest-based transactions. It has yet to turn its focus on its most important positive role of targeting the financing of projects and activities with growth-justice orientation, i.e., those with greatest social impact in terms of job creation, poverty reduction, and overall well being of human societies.

It has not, as of yet, developed the potentially wide and variegated range of financial instruments based on Islam's own basic modes of finance with strong risk-sharing characteristics. The available instruments that have successfully captured a large market share are mostly reversed-engineered based on conventional financial instruments. While structured to avoid interest, these instruments lack the strength of the growth-justice attributes embedded in purely Islamic modes of finance.

Therefore, they do not facilitate the strong positive attribute of Islamic finance, i.e., maximum risk-sharing and consumption-smoothing character of finance prescribed by Islam. The poor and needy segment of the society, not financially empowered to use normal credit channels, are also unable to directly access these instruments as well. Thus, the major benefits of these instruments for the poor is what would trickle down, from the projects financed by these instruments, in terms of job creation.

Moreover, the major benefit of Islamic finance, i.e., requiring that the returns to investment be determined by the real sector activities, is lost because, one way or another, the returns to these instruments are benchmarked to some prevailing market rate of interest, e.g. LIBOR.

In time, however, it is hoped that the present success of Islamic finance would generate enough incentives for financial engineering to develop financial instruments with appropriate growth-justice characteristics. As one of the most prominent contemporary pioneers of Islamic economics and finance, Professor Dr. M. N. Siddiqi, remarked : "After all, thirty years is not a period long enough to judge such a unique venture as reasserting faith in finance—an area from which faith had largely been banished by the dominant civilization