Chapter 9
Recent International Commercial Arbitration and Investor-State Arbitration Developments Impacting on Australia's Investments in the Resources Sector

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Abstract This paper highlights two sets of significant developments for business-people, legal advisors and policy-makers relating to international arbitration in the resources sector, particularly from an Australian perspective. Part 9.2 deals with international commercial arbitration (ICA), primarily between private firms, pointing out that a 'legislative black hole' arises for certain ICA agreements with the seat in Australia which were concluded before amendments to the International Arbitration Act (Cth) (IAA) commenced on 6 July 2010. Such ICA clauses are commonly included in long-term contracts, characteristic of the resources sector, so the IAA required amendment to provide support for ICA and these business relationships. A Bill introduced in 29 October 2014 aimed to fill this black hole. Part 9.3 turns to treaty-based investor-state arbitration (ISA), especially as it impacts on outbound investors from Australia. It reiterates opposition to the 'Gillard Government Trade Policy Statement', applied from April 2011 until the Abbott Government took power from 7 September 2013 and reverted to a case-by-case approach to including ISA protections in investment treaties. This Statement changed over two decades of treaty practice by insisting that Australia would no longer countenance any form of ISA in future treaties—even with developing countries with local laws and court systems that may not meet minimum international standards. We highlight problems that arise from such a stance, also proposed in a 2014 Bill in the Australian Senate from a minority Greens Party senator, by discussing two major developments in Indonesian law in 2012, both relevant to the resources sector. They suggest how international investment treaties (including two between Australia and Indonesia—both with ISA protections, which remain in effect, albeit perhaps limited in the earlier 1992 treaty) can help mitigate adverse effects on foreign investors. Part 9.3.1 discusses regulations issued to implement provisions of Indonesia's Mining Law requiring eventual

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divestment of majority ownership to locals. Part 9.3.2 analyses a subsequent Constitutional Court decision to disband Indonesia's regulator for upstream oil and gas exploration. Both examples highlight the need for Australia to retain ISA in addition to substantive law protections in any renegotiated or new investment treaty with Indonesia, including the bilateral free trade agreement under negotiation since September 2012, despite Indonesia's announcement in March 2013 that it would be reviewing its 67 bilateral investment treaties.

9.1 Introduction

Australia is becoming increasingly integrated into investment and trading relationships within the vibrant Asian region. Japanese and Chinese firms are now major inbound investors, particularly in the capital-intensive resources sector.[1] Australian resources companies, often as parts of large multinational groups, are increasingly investing offshore in neighbouring countries such as Indonesia. Both types of cross-border business relationships need support and monitoring at multiple levels, including by means of an appropriate legal framework, to maximise potential for 'Australia in the Asian Century'.[2]

This chapter highlights two sets of significant developments for Australian businesspeople, legal advisors and policy-makers relating to international arbitration in the resources sector. Part 9.2 deals with international commercial arbitration (ICA), primarily between private firms, pointing out that a 'legislative black hole' arises for certain ICA agreements with the seat in Australia which were concluded before amendments to the *International Arbitration Act* (Cth) (IAA) commenced on 6 July 2010. Such ICA clauses are commonly included in long-term contracts, characteristic of the resources sector, so the IAA must be promptly amended to provide support for ICA and these business relationships.[3] If the black hole is not filled, disputes arising under these contracts will cause serious problems for foreign investors in Australia as well as outbound investors who had agreed to international arbitration in Australia. Such disputes will also cause acute embarrassment as Australia attempts to reclaim ground lost since the 1990s to several major arbitral institutions in the Asian region (in China, Hong Kong and Singapore) and some newly emerging institutions (for example, in Korea and Kuala Lumpur).[4]

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[1]On Japan's less visible (and more diversified) investments, see Drysdale (2010).

[2]Available (through the National Library of Australia archives) via http://asiancentury.dpmc.gov.au/. Accessed 16 April 2014.

[3]The problem was first highlighted in Garnett and Nottage (2011), 27–28. On the ubiquity of long-term contracts in Australia, particularly in the resources sector, see generally Dharmananda and Firios eds (2013), reviewed at blogs.usyd.edu.au/japaneselaw/2014/09/ltc.html. Accessed 12 August 2014.

[4]Compare generally Keane (2012).

Part 9.3 deals with treaty-based investor-state arbitration (ISA), especially as it impacts on outbound investors from Australia. It reiterates opposition to the 'Gillard Government Trade Policy Statement', which was in effect from April 2011 until the (Labor Party) Gillard Government lost power to the (Coalition) Abbott Government in September 2013.[5] This Statement changed over two decades of treaty practice by insisting that Australia would no longer countenance any form of ISA (or even investor-state mediation) in future treaties, even with developing countries on foreign investors with local laws and court systems that do not meet minimum international standards. We highlight problems that arise from a stance such as that adopted by the Gillard Government by discussing two major developments in Indonesian law in 2012, both relevant to the resources sector. They suggest how international investment treaties (including two between Australia and Indonesia—both with ISA protections, which remain in effect) can help mitigate adverse effects on foreign investors. Part 9.3.1 discusses regulations issued to implement provisions of Indonesia's Mining Law requiring eventual divestment of majority ownership to locals. Part 9.3.2 analyses a subsequent Constitutional Court decision to disband Indonesia's regulator for upstream oil and gas exploration. Both examples highlight the need for Australia to retain ISA in addition to substantive law protections in any renegotiated or new investment treaty with Indonesia, including the bilateral free trade agreement under negotiation since September 2012.[6] More broadly, we argue that the Australian government should decide whether and how to include ISA protections in future treaties on a case-by-case basis, in order to appropriately balance private and public interests. Since 2014, the Abbott Government has in fact reverted to this approach.[7]

9.2 The 'Legislative Black Hole' for Some Pre-2010 International Arbitration Agreements in Australia

Overall, the IAA amendments in 2010 appear to have changed very little about ICA in Australia. Although the legislative reforms aimed to clarify and streamline proceedings, litigation has not abated—if anything, there have been *more* IAA-related judgments rendered in recent years.[8] By mid-2013, case disposition times

[5]For critiques, see Nottage (2011a) and Trakman (2012). The Statement is no longer available on Australian government websites but is reproduced via http://blogs.usyd.edu.au/japaneselaw/2013/12/isds_back.html. Accessed 16 April 2014.

[6]See http://www.dfat.gov.au/fta/iacepa/. Accessed 16 April 2014.

[7]See http://www.dfat.gov.au/fta/isds-faq.html. Accessed 16 April 2014. For constructive suggestions for treaty (re)drafting, see, for example, Nottage and Miles (2009); Burch et al. (2012); Campbell et al. (2013).

[8]See Monichino et al. (2012), Figure 1. A large proportion of these involve enforcement of foreign awards, so this could reflect the growing numbers of ICA cases being filed world-wide through major arbitral centres.

had not improved significantly compared to the three years before the 2010 amendments, at least in the Federal Court.[9] It is as if the government has built a new highway to reduce the duration of commutes, only to find that so many people now use the road that commuting times do not improve at all. There has also been at least one example of 'road rage'. One case, involving at least five sets of proceedings, has ended up clogging the courts. These proceedings arose from a breach of contract claim 'won' at great cost, partly under arbitration with the seat in Melbourne, by an Australian distributor (Castel) against a large Chinese manufacturer (TCL).[10]

In one of the (many) judgments in that dispute,[11] Murphy J, at first instance in the Federal Court, observed that, prior to the 6 July 2010 amendments, IAA s 21 had allowed parties to agree to exclude the operation of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on ICA (ML). However, since these amendments, Murphy J stated, the ML now covered the field for international arbitrations and had retrospective effect over prior international arbitrations. Murphy J, in obiter dicta, expressly rejected the view of Garnett and Nottage that the 'new' s 21 should not be applied retrospectively.[12] His Honour relied principally on *Maxwell v Murphy*,[13] where the High Court ruled that legislation may operate retrospectively if it does not 'determine the rights and liabilities of the parties' but rather has only procedural effect.

Soon afterwards, however, the Court of Appeal in Western Australia unanimously disagreed with Murphy J's application of *Maxwell* in the international arbitration context.[14] Their Honours reasoned that the 'old' s 21 still applied to allow exclusion of the ML, at least where the dispute had crystallised (per Martin CJ and Buss JA) or arbitration had commenced (per Murphy JA) before 6 July 2010. However, these remarks were also obiter. This case concerned an agreement over a large resources development, dated June 2007, between a Chinese company (Rizhao) and an Australian company (Mt Gibson). The agreement expressly provided for dispute resolution by arbitration with the seat in Western Australia according to the recently-repealed *Commercial Arbitration Act 1985* (WA) (CAA). At arbitration, the Hon Murray Gleeson AC QC rendered awards that were successfully enforced by Mt Gibson under s 33 of the 1985 Act in the Supreme Court of Western Australia (WA). Rizhao appealed this decision to the Court of Appeal,

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[9]Nottage (2013d). See also an updated statistical Appendix at http://blogs.usyd.edu.au/japaneselaw/2013FedCt_NottageSummaryTable_LN06.pdf. Accessed 16 April 2014.

[10]Ibid, for the full and ongoing saga; see also Monichino and Nottage (2013) and, most recently, *TCL Air Conditioner (Zhongshan) Co Ltd v Castel Electronics Pty Ltd* [2014] FCAFC 83 (upholding the trial court's rejection of the Chinese manufacturer's "public policy" challenge to award enforcement).

[11]*Castel Electronics Pty Ltd v TCL Air Conditioner (Zhongshan) Company Ltd* [2012] FCA 21 (23 January 2012).

[12]Nottage and Garnett (2010), 27–28.

[13](1957) 96 CLR 261.

[14]*Rizhao Steel Holding Group Co Ltd v Koolan Iron Ore Pty Ltd* (2012) 262 FLR 1.

arguing that the first-instance court erred by not applying the provisions of the IAA to the issue of enforcement. The Court dismissed the appeal on the narrow ground that Rizhao should not be permitted to raise issues on appeal which it did not present to the primary judge.[15]

Garnett and Nottage subsequently published a further analysis of the problem, preferring the reasoning of the Court of Appeal relating to the non-retrospective effect of the new s 21, but arguing that the old s 21 should apply even if disputes are arbitrated after 6 July 2010.[16] However, this left a 'legislative black hole' for:

(a) 'international' arbitration agreements (for example, between Chinese and Australian parties);
(b) with their seat in a State or Territory that has now repealed the old CAA legislation, and replaced it with new uniform CAA legislation that expressly applies only to 'domestic' arbitrations[17];
(c) where the parties have agreed (impliedly[18] or expressly) to exclude the ML (for example, by specifying CAA legislation as the applicable arbitration law).

To fix this problem, Garnett and Nottage suggested amendments to:

(i) the IAA to clarify that the new s 21 does *not* have retrospective effect (which would mean overriding the parties' original agreement); and
(ii) all new uniform CAAs so that they apply to the relevant international arbitration agreements—either by reinstating the old CAA provisions for them, or applying the new CAA provisions (although this will mean parties lose the right to appeal certain errors of law, the default rule under the old CAA legislation).

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[15]Ibid, para. [93].

[16]Garnett and Nottage (2012).

[17]*Commercial Arbitration Act 2010* (NSW); *Commercial Arbitration (National Uniform Legislation) Act 2011* (NT); *Commercial Arbitration Act 2011* (SA); *Commercial Arbitration Act 2011* (Vic); *Commercial Arbitration Act* (Tas); *Commercial Arbitration Act 2012* (WA); *Commercial Arbitration Act 2013* (Qld).

[18]In relation to whether a choice of International Chamber of Commerce (ICC) Arbitration Rules indicates that the parties impliedly intended to opt out of the ML under the old s21, compare *Cargill International SA v Peabody Australia Mining Ltd* (2010) 78 NSWLR 533 (finding 'plainly wrong' such reasoning by the Queensland Court of Appeal in *Australian Granites Ltd v Eisenwerk Hensel Bayreuth Dipl-Ing GmbH* (2001) 1 Qd R 461 (*Eisenwerk*)) and Queensland (refusing subsequently to disavow *Eisenwerk* (2001) 1 Qd R 461 in *Wagners Nouvelle Caledonie Sarl v Vale Inco Nouvelle Caledonie SAS* [2010] QCA 219 (20 August 2010), although that involved UNCITRAL Rules). In *Lightsource Technologies Australia Pty Ltd v Pointsec Mobile Technologies AB* (2011) 250 FLR 63, the Australian Capital Territory (ACT) Supreme Court also recently adopted the approach in *Eisenwerk* (2001) 1 Qd R 461, which has been widely criticised as essentially a 'category error': adoption of Rules amplifies the parties' arbitration agreement, which are trumped by any mandatory rules of the *lex arbitri*.

Unfortunately, however, States and Territories have continued to enact new CAA legislation that (uniformly but unfortunately) leaves a growing black hole,[19] by repealing the old CAA statute without a savings provision as suggested in (ii) above.

The most politically expedient way forward may now therefore be to amend only the IAA, expressly stipulating that the new s 21 applies retrospectively after all.[20] Retrospective legislation might be viewed with disfavour, but in Australia it is neither unconstitutional, nor unknown in practice.[21] Such an amendment would be far better than doing nothing—with the risk that a case will fall straight into the black hole, causing further embarrassment to Australia's attempts to reposition itself as an attractive venue for ICA. Another possibility is an amendment to the IAA to ensure that the relevant state or territory law as of 6 July 2010 (namely, the CAA legislation prior to repeal) continues to apply to prior international arbitration agreements which had excluded the Model Law under the old s 21. These two options were proposed by the federal Attorney-General's Department in an informal consultation initiated in October 2013 with various stakeholders, including Nottage, who favoured the latter amendment provided it is constitutional and can be drafted accurately. However, the alternative (making the new s 21 apply retrospectively) was proposed in Schedule 2 of the C*ivil Law and Justice Legislation Amendment Bill 2014* (Cth), introduced into the federal Senate on 29 October 2014.[22]

9.3 Natural Resources Investments in Indonesia Meet the 'Gillard Government Trade Policy Statement'

In 2012, Professor Chris Findlay wrote on the widely-read East Asia Forum blog about 'Australia's FDI challenges in the Asian Century'. This article accompanied his public submission to the Australian government's inquiry into developing closer relations with Asia.[23] Highlighting problems reported recently by ANZ Bank and

[19]Above note 17. However, the ACT has not yet introduced any new CAA legislation.

[20]Monichino (2012).

[21]See generally Sampford (2006), Gerangelos (2009), p. 306. However, particular attention would need to be paid to any relevant international arbitrations already commenced with the seat in Australia, if IAA s 21 were restated as clearly applying retrospectively, as the effects on the parties (and arbitrators) involved would be especially profound.

[22]Available at http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=s980. Accessed 16 April 2014. As of 15 April 2015, the Bill had not been enacted by both Houses of Parliament. In any event, the proposed additional s 21(2) for the IAA does not completely fill the legislative black hole, as it provides that: 'Subsection (1) applies to an arbitration arising from arbitral proceedings that commence on or after the commencement of this subsection, whether the arbitration agreement giving rise to the arbitration was made before, on or after 6 July 2010'. This wording does not seem to cover the situation of an international arbitration already commenced, leaving the courts to try to divine the legislative intention for such situations.

[23]Above note 2.

Qantas in the region, Findlay's proposals included 'innovation in negotiating modalities' and a possible new plurilateral agreement in the World Trade Organization (WTO) that would cover all investments—not just in some services sectors.[24] While this is an attractive idea, it will be difficult to complete during the current Doha Round negotiations.[25] Regarding investment treaties, therefore, the Australian government should meanwhile reconsider its abrupt policy shift announced in April 2011 concerning ISA.[26] This important protection for foreign investors had been found hitherto in most of its bilateral and regional Free Trade Agreements (FTAs) and bilateral investment agreements (BITs).[27]

Australia's first BIT came into effect on 11 July 1988, with China, followed by one with Vietnam in force from 11 September 1991. All of Australia's investment treaties with Asian states provide for ISA, allowing foreign investors to bring direct claims before international tribunals if host states breach substantive commitments made in the agreements, rather than having to mobilise their home states to bring an inter-state claim, as is necessary under the WTO regime. Admittedly, Australia's BIT with China only allows ISA claims related to expropriation of the foreign investor's assets by the host state. However, as China has emerged as a major exporter of capital, and not just an importer of it, the treaties China has entered into have provided for full-scale ISA protections since the 1990s. Member states of the Association of Southeast Asian Nations (ASEAN) have also come to incorporate extensive ISA provisions even as among themselves.[28] A recent illustration is the ASEAN Comprehensive Investment Agreement, signed in 2009 and in force from March 2012.[29]

Yet the 'Gillard Government Trade Policy Statement' of April 2011 eschewed ISA for Australia's future investment treaties. Initially there appeared to be scope to interpret the Statement, consistently with the 2010 recommendations of its own Productivity Commission,[30] as allowing ISA under stricter conditions—at least with treaty partners having less developed domestic law frameworks for investment protection and dispute resolution.[31] But the Gillard Government subsequently clarified that it did mean to go further—arguably, beyond the Commission's recommendation—by not agreeing to ISA in any future treaties (although, curiously, without seeking to renegotiate or terminate any of Australia's investment treaties containing ISA).[32]

[24]Findlay (2012).

[25]Cf. Hufbauer and Stephenson (2014).

[26]Above note 5.

[27]Mangan (2010).

[28]Bath and Nottage (2011).

[29]Losari (2012).

[30]Nottage (2011b).

[31]Nottage (2011a).

[32]Nottage (2013a) in a special issue of the *Asian Studies Review* on 'the international politics of resources'. See also Trakman (2014).

One rationale given for the Government's policy shift was that Australia's outbound investors had never filed a treaty-based ISA claim, and had not shown much interest in this protection. In fact, an Australian mining company had recently filed a proceeding under the Australia-India BIT. The company successfully argued that lengthy delays in trying to judicially enforce an arbitral decision obtained through a separate commercial arbitration claim, against its venture partner, violated India's commitments given in the BIT with Australia.[33] Along with other business groups, the Australian Chamber of Commerce and Industry subsequently voiced concern about the Trade Policy Statement's stance on ISA, most recently in the context of already-complex negotiations between Australia and other Asia-Pacific states towards an expanded Trans-Pacific Partnership Agreement (TPPA).[34] Australia's new stance also risked complicating negotiations commenced in November 2012 towards a 'Regional Comprehensive Economic Partnership' ('RCEP' or the 'ASEAN+6' FTA), as well as other pending bilateral FTA negotiations.[35]

The following two sets of recent regulatory changes in Indonesia provide further examples of the sorts of challenges facing foreign investors in the region, and how treaty-based protections may help to manage them.

9.3.1 Indonesia's New Mining Law Regulations Requiring Majority Local Ownership[36]

On 21 February 2012 the Indonesian government issued Government Regulation 24 of 2012. It requires majority or wholly foreign-owned companies holding mining licenses in Indonesia to divest a majority share of the company to an 'Indonesian participant' after ten years of production.[37] An Indonesian participant must own

[33]Robertson and Leeks (2012).

[34]See http://acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Global-Engagement/Australian-Foreign-Investment-Requires-Right-to-Su.aspx. Accessed 16 April 2014. For complications for Japan arising from Australia's stance on ISA, see also, for example, Nottage (2013b).

[35]See generally, for example, Pakpahan (2012). All other 'ASEAN+' FTAs include ISA protections, except for the one with Japan. The latter lacks an investment chapter altogether, but this is mitigated by bilateral FTAs or BITs with all major ASEAN economies. See generally Hamamoto and Nottage (2013), with a more detailed analysis of Japan's treaty-based ISA protections at http://ssrn.com/abstract=1724999. Accessed 16 April 2014. See also generally Bath and Nottage (2015) regarding ASEAN+ treaties.

[36]Earlier and shorter versions of this section appeared in http://www.eastasiaforum.org/2012/05/13/divestment-of-foreign-mining-interests-in-indonesia/ and http://www.eastasiaforum.org/2012/05/14/indonesian-investments-and-international-treaty-law/ (with Dr Brett Williams), also at http://ssrn.com/abstract=2175951. Both accessed 16 April 2014.

[37]See generally, for example, http://www.bakermckenzie.com/ALAPMiningRegulationsMar12/. Accessed 16 April 2014.

20 % of the foreign company within the sixth year of production; 30% after the seventh year; 37 % after the eighth; 44 % after the ninth and, by the end of the tenth year, a minimum of 51 %. For many foreign investors, this will mean a mandatory divestment of equity.

An offer to purchase the share must first be made to the central government. If the central government is not prepared to purchase the share, then it must be offered to the provincial government or city/county government. If they refuse also, then the shares are to be offered by auction to (in order of priority) a State Owned Enterprise, a Regional State Owned Enterprise, or a national company. Failure to divest according to this schedule can lead to suspension of production and even revocation of the mining license.

The concept of divesting foreign interests in Indonesian mining enterprises is certainly not new. The 2009 Mining Law required a divestment after five years of production, but did not specify the required amount of the divestment. A 2010 Regulation required that Indonesian participants hold 20 % equity in foreign-owned mining operations after five years of production, but did not require further divestments. The new Regulation goes much further by requiring divestment of a majority share. However, mining companies operating in Indonesia have long had divestment obligations under Contracts of Work with the Indonesian government.[38] For example, in 2003 BP and Rio Tinto divested their majority shareholding in PT Kaltim Prima Coal, as required under their 1982 contract with the Indonesian government. And in 2011, USA's Newmont divested 51 % of its share in Newmont Nusa Tenggara, as required by its 1986 contract.

Predictably, many miners argue that ten years is insufficient for them to make a sufficient return on their investment. They also complain about the uncertainty the Regulation brings. In particular, some miners operating under a Contract of Work with less onerous or no divestment provisions fear that they will be required to renegotiate their Contracts to comply with the regulation's mandatory divestment provisions. On this, the government appears to have given mixed signals. Some officials, such as former Mining Ministry Director General for Mineral and Coal Thamrin Sihite, have said that the regulation only applies once the Contract of Work has expired or when an extension to that contract is sought. Others, such as former Deputy Mining Minister Widjajono Partowidagdo have said that Contracts of Works can be renegotiated whenever the government deems necessary.

Miners have also faced difficulties with the divestment process. It is often hard to find a tier of government or Indonesian company with sufficient funds to purchase the stake. In addition, if funds are available, national and regional governments sometimes bicker over which of them should get first priority to buy it. (Local governments argue that control should be theirs because the operation takes place within their locale. National governments are keen to obtain a share of these often lucrative investments.) And sometimes one branch of government even seeks to scuttle the efforts of another. In 2012, for example, the Constitutional Court heard a

[38]Bachelard (2012).

dispute between the government (that is, the president) and the national parliament. The government wanted to purchase US$246.8 million worth of shares in Newmont, which, after long-running legal battles had finally resolved to divest a majority share. However, the national parliament claimed that the government required parliamentary approval for such a purchase and refused to grant it, preferring instead for the local government to acquire it. The Constitutional Court, by a majority of five judges to four, sided with the national parliament.[39] The result makes a mockery of the divestment requirement and process, creating ongoing uncertainty and inconvenience for Newmont.

The main problem with the divestment policy, miners and Indonesian economists point out, is that it significantly reduces the desirability of the Indonesian mining sector for investors. Mining contributes 17 % to Indonesia's GDP and a significant proportion of Indonesia's foreign direct investment ($3.6 billion of US $20 billion in 2011).[40] If Indonesia wants to increase its economic growth from 6.5 to 8 %, then it simply must attract more foreign investment, including in the mining sector.

One explanation for the stance is 'resource nationalism'—a response to demands from Indonesians, particularly those who live near mining sites, for, as one senior Mining Official put it, 'a share of what the companies are earning'.[41] Indeed, the preamble of Government Regulation 24 of 2012 explicitly states that one of its rationales is to allow more Indonesians to participate in mining. The stance may also be part of a broader wave of political nationalism, which many within government, and various political parties, support. They believe, probably quite rightly, that this enjoys wide appeal amongst the electorate. Indications of this appeal were evident during the parliamentary and then presidential elections that took place over 2014.

Exploitation of natural resources by foreigners is not publicly popular anywhere in the world, but in formerly-colonial states such as Indonesia, it has greater currency. Article 33 of the Constitution, which requires the state to control natural resources and important public utilities for the 'greatest possible prosperity of the people', reflects this sentiment. The provision was drafted on the eve of the declaration of Indonesian independence and was retained intact during four rounds of constitutional amendments in the post-Soeharto era.

It is also significant that under the 1967 Mining Law's so-called 'Contract of Work' framework, the Indonesian government did not simply grant mining licenses to mining companies. Instead, the Minister appointed mining companies as contractors to carry out, subject to any conditions imposed by the Minister, mining activities that had not been or could not be carried out by the government or a national company. (In practice the Contracts initially contained conditions very favourable to the foreign investor who would inevitably have been very close to

[39]Constitutional Court Decision 2/SKLN-X/2012.

[40]Jakarta Globe (2012).

[41]Ibid.

Soeharto's inner circle.) The new rules, however, take government control one step further—to majority ownership of the mining entity itself, should the state so desire.

Reporters and other commentators, including several in Australia, have emphasised that Indonesia is not alone in seeking to renegotiate the terms for foreign investments especially into the mining sector, which is booming worldwide.[42] The 2010 Productivity Commission Report did note briefly the dramatic increase in FDI into Australia's mining sector over the last decade. Accordingly, a factor behind the Trade Policy Statement policy shift may have been the Gillard Government's intuition that no longer offering ISA would not significantly detract from inbound FDI or jeopardise entire treaty negotiations.

However, at least Australia's newfound aversion to ISA only affects future treaties. Foreign investors presently retain substantive protections as well as ISA rights. For instance, Australian investors in Indonesia have access to ISA under a BIT signed in 1992 and in force from 29 July 1993,[43] and under the 2009 ASEAN-Australia-New Zealand Free Trade Area FTA in force from 1 January 2010.[44] However, as existing treaties expire Australian investors will lose protections, under a policy shift like that announced in the Gillard Government Trade Policy Statement, and such a stance complicates the negotiation of new treaties (like the TPPA). It also risks making Australian investors less competitive than investors from third countries into Asia, as those third countries maintain or even expand investment treaties that include ISA protections.

Meanwhile, Australia's existing treaties should help mitigate two disturbing aspects of Indonesia's new measure. First, the measure may well have retrospective effect. Secondly, it targets only foreign investors, thus differing from other measures adopted by resource-rich states seeking to claim a larger share of revenues from mining. Those are usually done on a basis that is, at least formally, non-discriminatory, such as raising taxes levied on mining companies—affecting the profitability of domestic as well as foreign investors.

Thus, compared to measures introduced or mooted recently by other states, the new divestment regulations seems much more likely to violate substantive commitments made under various investment treaties or FTAs, generating significant potential for ISA claims. Admittedly, a concatenation of legal and pragmatic factors make informal settlements preferable to full-scale ISA proceedings. Yet the framework provides important baselines agreed between states. Australia's new stance eschewing ISA in future treaties risks undermining a system that has become widely known and accepted even in Asia, creating a serious risk of destabilising sustainable cross-border investment flows particularly over the medium- to long-term.

In fact, Indonesia's new Mining Law regulation requiring divestment of majority foreign investments is unlikely to generate many formal ISA claims against

[42] Ker and Yeates (2012).

[43] http://www.austlii.edu.au/au/other/dfat/treaties/ATS/1993/19.html. Accessed 16 April 2014.

[44] http://www.austlii.edu.au/au/other/dfat/treaties/ATS/2010/1.html#ch11. Accessed 16 April 2014.

Indonesia, based on existing bilateral or regional FTAs or BITs. But this assessment is based primarily on immediate pragmatic considerations. This leaves considerable scope for the international investment law framework to begin unraveling, risking complex adverse effects on cross-border investment particularly in the rapidly evolving Asia-Pacific region.

In the short term, after all, foreign investors have probably done quite well from any mining investments now potentially affected by Indonesia's new regulation, and they may expect favourable treatment in future deals if they comply under the new rules. This conciliatory attitude is particularly likely where the home state of the investor lacks natural resources, such as Japan. That factor provides one explanation for the lack of (direct) ISA claims by Japanese investors under a growing number of investment treaties concluded by Japan around the world. Those include the Investment Chapter contained within the 2006 Japan-Indonesia Economic Partnership Agreement (JIEPA),[45] with its heavy focus on enhancing energy security for Japan. Korean investors have never publicly filed ISA claims either.[46]

More generally, few Asian states have been involved in ISA proceedings, whether as claimants or respondents. Rather than the direct influence of 'Asian culture', these phenomena are arguably linked to economic factors, such as unfamiliarity with investment treaty protections, concerns about costs involved in bringing or defending cases, and a concern that a formal ISA claim may jeopardise long-term beneficial relations not just in the particular host state but also other parts of the Asian region.[47] Japanese, Korean and other investors may also be able to easily mobilise their home states to help informally resolve an investment dispute caused by measures adopted by the host state, especially if their home states perceive a strong national interest in securing stable access to minerals and other natural resources.

Nonetheless, the new Regulation under Indonesia's Mining Law, or any similar measure introduced under other regimes, might lead to formal ISA claims, or—more likely—frame renegotiations with foreign investors (and possibly their home states) who are potentially covered by investment treaty protections. Indonesia has reportedly only been subject to three ISA proceedings under the framework 1965 International Centre for Settlement of Investment Disputes (ICSID) Convention, to which Australia and Japan are also party.[48]

Future ISA claimants regarding Indonesia's new Mining Law regulations may encounter a potential preliminary hurdle: the need for the investment to be 'admitted' or authorised by Indonesia. Many investment treaties concluded by

[45]See http://www.meti.go.jp/english/policy/external_economy/trade/FTA_EPA/indonesia.html. Accessed 16 April 2014.

[46]See, respectively, Sitaresmi (2011) The Japan-Indonesia Economic Partnership Agreement: an energy security perspective (ch. 7); Kim (2011) The evolution of Korea's investment treaties and investor-state dispute settlement provisions (ch. 11). In: Bath and Nottage (eds).

[47]Nottage and Weeramantry (2012).

[48]See https://icsid.worldbank.org/ICSID/Index.jsp. Accessed 16 April 2014.

Indonesia, and indeed other ASEAN states, provide protections only for such admitted investments.[49]

For Australian investors giving consideration to invoking Australia's two investment treaties with Indonesia, it should also be noted that the 1992 treaty defines an 'investment' to be one 'admitted by [Indonesia] in its territory in conformity with the laws, regulations and investment policies of [Indonesia] applicable from time to time' (Art. I.1(a)). The treaty also states that it applies to investments 'granted admission in accordance with the Law No. 1 of 1967 concerning Foreign Investment or with any law amending or replacing it' (Art. III.1(a)). The 2009 ASEAN-Australia-New Zealand Free Trade Area agreement (AANZFTA), which does not extend to prior investments, defines a 'covered investment' somewhat differently: one 'admitted by the host Party, subject to its relevant laws, regulations and policies' (Chapter 11 (Investment) Art. 2(a)).

A recent claim, initiated in 2011 by a UK-based banking-sector investor, brings the admission requirement into sharp relief. In July 2013, an ICSID tribunal found that Rafat Al Rizvi—who sought to argue that his investment had been expropriated by the Indonesian government—was unable to demonstrate that his investment had been approved or granted admission under the 1967 Law, as required by the UK-Indonesia BIT.[50] By contrast, in a Decision on Jurisdiction rendered by another ICSID tribunal on 27 February 2014 in *Planet Mining v Indonesia*, the Australian subsidiary of a UK mining company prevailed against Indonesia's argument that the investor needed to comply with national laws and policies applicable even after the original licence admitting the foreign investment, in order to be able to invoke ICSID arbitration procedures under the 1992 Australia-Indonesia BIT.[51]

Article 14(1) of AANZFTA adds that all foreigners' covered investments may be subjected to a requirement of being 'legally constituted under the laws or regulations of the [host state]', but 'provided that such formalities do not substantially impair the protections afforded by a host state'.[52] A particular difficulty that may be faced by foreign investors considering treaty claims against Indonesia is that post-Soeharto democratisation and decentralisation have generated an extraordinarily complex set of laws and policies impacting on foreign investments.[53]

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[49]This jurisdictional hurdle was also problematic in the only ISA claim ever brought under the old ASEAN investment treaty system, which required prior approval in writing (*Yaung Chi Oo v Myanmar* (2003) 42 ILM 540). However, elsewhere he has remarked that the situation may be different under the 2009 ASEAN Comprehensive Investment Agreement because that treaty now requires states to specify procedures for admitting investments. See Sornarajah (2011), p. 246. See also generally Bath and Nottage (2015); and Brown (2015).

[50]*Rafat Ali Rizvi v The Republic of Indonesia* (ICSID Case No. ARB/11/13). See Jakarta Post (2013) and generally Iswara et al. (2011).

[51]*Planet Mining Pty Ltd v Republic of Indonesia* (ICSID Case No ARB/12/14 and 12/40).

[52]Footnote 29 of the AANZFTA clarifies that for Vietnam or Thailand this means registered and/or approved in writing.

[53]As detailed by Butt (2011).

If such preliminary hurdles can be overcome, Australian investors might first argue that the new Indonesian regulations breach several substantive protections under international treaty law. First, AANZFTA provides 'national treatment' (NT) for covered investments, namely 'treatment no less favourable than that [the host state] accords, in like circumstances, to its own investors and their investments' (Art. 4). But footnote 33 makes this commitment subject to a Work Program (Art. 16), whereby member states shall discuss—for up to five years and under the aegis of a joint 'Committee on Investment' (Art. 17)—their schedules of 'reservations' made under Article 12. It is therefore crucial for foreign investors to check carefully for reservations that Indonesia may have made originally or subsequently adjusted as permitted by AANZFTA, relating to either certain measures contrary to NT obligations (Schedule to List I) or certain sectors or activities (List II). Nonetheless, Article 12(3) does state expressly that in general a host state 'may not, under any measure adopted after the date of entry into force of this Agreement and covered by its Schedule to List II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective'.

Australia's 1992 investment treaty with Indonesia does not provide for NT. However, it does include 'most favoured nation' provisions (Art. IV), allowing Australian investors to claim the benefit of protections extended by Indonesia to third countries. Thus, for example, they can invoke the NT obligation found in JIEPA Article 59.[54] Yet, in the wake of the ICSID award in *Planet Mining v Indonesia*, Indonesia announced in March 2013 that it would be reviewing its 67 current BITs.[55]

Second, investors might claim compensation for 'expropriation' or its equivalent, arising from the host state's measures, as provided in both the 1992 treaty (Art. VI) and AANZFTA (Ch. 11 Art. 9—with greater detail provided in the text, footnotes and an Annex). Discriminatory measures (including expropriation) are particularly prone to challenge under international law. It is also generally unnecessary for the host state to benefit directly and financially from measures that detract from the foreign investor's investment. This contrasts with some national laws regulating expropriation, including arguably the Australian Constitution, which appear to require an 'acquisition' or 'taking' into government hands. (This is one reason why in 2011 Philip Morris Asia was able to launch the first ever ISA claim against Australia under a 1993 investment treaty with Hong Kong.[56] Other tobacco companies complaining about Australia's new plain packaging law had to challenge it—ultimately unsuccessfully—in the High Court of Australia.[57]) In any event, measures

[54]Although this too is subject to reservations under Art. 64, more detailed and arguably more pro-investor than under AANZFTA.

[55]Nottage (2014). However, there is no mention of Indonesia reviewing its current FTAs.

[56]Nottage (2013c).

[57]*TCL Air Conditioner (Zhongshan) Co Ltd v The Judges of the Federal Court of Australia* [2013] HCA 5 (13 March 2013).

such as the new Regulation under Indonesia's 2009 Mining Law appear to force foreign shareholdings into state hands or government-linked companies, at least initially. Such expropriation triggers foreign investors' rights to compensation.

Third, the host state commits to extending 'fair and equitable treatment' to Australian investors under both the 1992 treaty (Art. II.3) and AANZFTA (Art. 6(2), adding tighter definitions). A core aspect is due process with regard to measures impacting on foreign investments, including notifications and opportunities for affected investors to be fairly heard. However, in some situations this duty may extend to the protection of substantive 'legitimate expectations' held by foreign investors.[58]

Both treaties grant other protections which may be violated by Indonesia's new regulations, such as a requirement for 'transparency of laws' (Art. X and especially Art. 13, respectively). Some provisions may also impact on future restrictions on investors that have been mooted by the Indonesian governments, such as restrictions on foreigners holding key management positions in human resources departments.[59] In particular, the 1992 treaty permits Australian investors to employ 'key … managerial personnel of their choice' (Art. IX).

Lastly, the 1992 treaty allows Australian investors to commence ICSID arbitration under certain conditions (Art. XI(2)(b)). Surprisingly, the Decision on Jurisdiction in *Planet Mining v Indonesia* upheld consent to ICSID arbitration pursuant to coal mining licences given by Indonesian authorities, but not under the wording of the 1992 Australia-Indonesia BIT itself. The tribunal found that the countries had only given a "promise to consent" rather than full advance consent to ICSID jurisdiction, meaning that Indonesia could still refuse consent subject to potential review through an inter-state arbitration procedure separately provided under the treaty. If correct, this interpretation will greatly circumscribe ICSID arbitration rights provided by Art. XI(2)(b), rendering it largely inoperative in practice. Further, as both countries remained party to the framework 1965 ICSID Convention facilitating enforcement of arbitral awards, another BIT provision for ad hoc ISA (Art. XI(3)) was also unavailable to investors.[60] Fortunately for investors, however, AANZFTA adds broader scope for ISA, including ICSID and UNCITRAL Arbitration Rules designed for ad hoc proceedings (Art. 21(3)).

ICSID usually provides for greater transparency in proceedings; but AANZFTA allows the host state, for example, to make public all awards and decisions rendered by a tribunal (Art. 26). This is arguably important for host states given the greater public interests involved in ISA compared to inter-firm commercial arbitration. However, greater transparency may also be valuable for responsible foreign investors who might wish to file a claim in order to highlight prior treaty

[58]See, for example, Potesta (2012).

[59]Brown (2012).

[60]For a critical assessment of this aspect of the tribunal's reasoning, and implications for other Australian BITs containing similar wording, see Nottage (2014).

commitments to the host state, but are still prepared to negotiate an amicable settlement even after proceedings have commenced.[61]

After all, the international law regime does not and cannot solve all issues, even with increasingly sophisticated drafting of investment treaties.[62] Widely-accepted legal interpretations are still evolving and all ISA disputes tend to become quite fact-intensive, generating costs and delays. But international law does provide mutually-agreed understandings aimed at balancing a host state's national interests in maintaining appropriate regulatory discretion while attracting foreign investment, with reasonable predictability expected by foreign investors—especially in longer-term cross-border foreign direct investments involving politically sensitive sectors, such as the resource sector.[63] The ISA mechanism is important to give traction to substantive rights of foreign investors. Indonesia's regulations issued in February 2012 under the Mining Law therefore provide another reason to reconsider policy developments such as the Gillard Government Trade Policy Statement's eschewal of ISA in all future treaties, particularly since Australia continues to negotiate a bilateral FTA as well as RCEP with Indonesia.

9.3.2 Indonesia's Constitutional Court Decision Disbanding the Oil and Gas Regulator

Another significant development that appears to affect investors in Indonesia's resources sector occurred on 13 November 2012. On that day, the Indonesian Constitutional Court ruled that the regulator for upstream oil and gas exploration (*Badan Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi* or 'BP Migas') was unconstitutional and ordered that it be disbanded.[64] BP Migas has been established under Law 22 of 2001 on Oil and Natural Gas. This Law stipulated that BP Migas' main functions were to enter into cooperation contracts and to monitor their implementation (Arts. 44(1) and (2)); and to advise the Energy and Mineral Resources Minister on cooperation contracts, production plans, budgets and the appointment of oil and gas sellers (Art. 44(3)).

An 8 to 1 majority of the Constitutional Court decided to excise from the 2001 Oil and Natural Gas Law all references to BP Migas, including the provisions granting it powers and functions,[65] and ordered it to cease operating. The nub of the

[61]Burch et al. (2012).

[62]See generally, for example, Brown (2013).

[63]Kurtz (2012).

[64]Constitutional Court Decision 36/PUU-X/2012, reviewing Law 22 of 2001 on Oil and Natural Gas (*Oil and Natural Gas Law case* (2012)). See generally Butt and Siregar (2013), upon which this description of the case draws.

[65]*Oil and Natural Gas Law case* (2012), para. [3.13.5].

Court's decision was that BP Migas' control over the oil and natural gas sector was insufficient to meet requirements of 'state control' under Article 33(3) of the Indonesian Constitution. Article 33 states:

1. The economy shall be structured as a common endeavour based upon the family principle.
2. Branches of production that are important to the state, and that affect the public's necessities of life, are to be controlled by the state.
3. The earth and water and the natural resources contained within them are to be controlled by the state and used for the greatest possible prosperity of the people.
4. The national economy is to be run on the basis of economic democracy, and the principles of togetherness, just efficiency, sustainability, environmentalism, and independence, maintaining a balance between advancement and national economic unity.
5. Further provisions to implement [Article 33] will be provided in legislation.

The Court has, in a string of cases, commencing with its first ever decision—the *Electricity Law case* (2003)[66]—held that the state must perform five functions in order to exercise state control over natural resources and important industries within the meaning of Article 33(3). These functions are policymaking, administration, regulation, management and supervision. Further, these five activities must be performed for one purpose: the greatest prosperity of the people. In this context, the state's power to regulate natural resources and important industries does not, according to the Court, of itself constitute state control because the state already has an inherent power to regulate, irrespective of Article 33. Also, mere civil ownership by the state is not 'control' because natural resources are public assets collectively owned by all Indonesians, and the state is required under Article 33 to control those assets for the greatest possible collective prosperity.

In the *Oil and Natural Gas Law case* (2012), however, the majority took this jurisprudence a step further, categorising each of these five functions—into 'tiers' or levels of importance, depending on the extent to which the majority thought that function achieved the greatest possible prosperity of the people.[67] Direct management over the natural resource was 'the most important first-order form of state control'.[68] The majority stated that direct state management of natural resources through state-owned enterprises would ensure that all profits would flow to the

[66]Constitutional Court Decision 001-021-022/PUU-I/2003, reviewing Law 20 of 2002 on Electricity (*Electricity Law case* (2003)).

[67]Although the court did not explain why it decided to rank the activities and how it devised the ranking. The rationale for ranking direct management as the most important aspect of state control and regulation as the equal least important is unclear, because it appears that 'regulation also [includes] supervisory activities, as well as license-granting, standard-setting, in addition to the traditional understanding of enacting rules' (Afghani 2013).

[68]*Oil and Natural Gas Law case* (2012), para. [3.12].

state, thereby indirectly bringing greater benefits to the people. The alternative—allowing the private sector to manage natural resources—would result in profits being shared between the state and private entities, thereby reducing the benefits flowing to the people. The majority decided that the state needed to fully manage natural resources if the state had sufficient capital, technology and capacity to do so. Only if the state was unable to directly manage natural resources could opportunities be given to foreigners. Of secondary importance were, equally, policymaking and administration. Both regulation and monitoring fell within the third tier.

The majority found that BP Migas did not directly manage oil and gas resources; it merely contracted with commercial entities to do so. Also, by entering into these contracts, the prosperity of the people was not 'maximised' because any profits derived from the natural resources would, according to the majority, be shared with the private enterprise. Finally, the majority appeared to be uneasy with the state binding itself to a civil agreement over natural resources with private enterprises. According to the majority:

> Once the contract is signed, the government is bound by the contract. The government loses sovereignty and control over natural resources so that exercising that control might breach the contract. However, as representatives of the people and the controller of natural resources, the state needs freedom to make regulations that bring the greatest possible prosperity to the people … According to the Court, the relationship between the state and the private sector in the management of natural resources cannot be established through civil law. It is a public relationship … [because it involves] providing concessions or licences that are under the complete control and power of the state. Civil contracts degrade the sovereignty of the nation over natural resources—in this case oil and natural gas … To avoid this problem, the government can establish or appoint a state-owned enterprise and give it a concession to manage oil and natural gas in … a Working Area so that that state-owned enterprise is the one entering into contracts with commercial enterprises. In this way, there is no longer a connection between the state and the commercial enterprise.[69]

Until the government could issue new legislation in response to its decision, the Court declared that the Energy and Mineral Resources Ministry should perform the functions previously allocated to BP Migas.[70]

In response to the decision, the government issued Presidential Regulation No. 95 of 2012 and Presidential Regulation No. 9 of 2013. These transferred BP Migas' functions to the Ministry of Energy and Mineral Resources (MEMR), with a

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[69]Ibid, para. [3.13.3]. In his sole dissent, Justice Harjono agreed that those contracts bound the state, but disagreed with the majority that any ensuing constraints on the state breached Article 33 for interfering with the state's 'control' of the natural resources to which the contract applied. Harjono emphasised that Indonesia is a 'law state' (*negara hukum*) and that the state could not simply use its power over national resources as it deemed fit once it had entered into such a contract. Rather, for Harjono, the state control requirement was met because the state controlled BP Migas. Its chairperson was appointed and dismissed by the president, after consultation with the national parliament. According to Harjono, the state (through BP Migas) exercised control over the sector when it negotiated contracts and awarded concessions. After agreements had been made and contracts signed, the control had already been exercised and the Indonesian government was bound by the contract.

[70]*Oil and Natural Gas Law case* (2012), para. [3.22].

new unit called *Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi* (SKK Migas).[71] These Regulations, and the Court's decision, specified that prior contracts entered into by foreign and domestic firms for oil and gas exploration in Indonesia were unaffected by BP Migas' disbandment. The Court declared that, in the interests of legal certainty, all working contracts made between BP Migas and commercial enterprises would continue in force until their expiry or a date upon which the parties agreed.[72] However, in the hiatus created by the Court's disbanding of BP Migas and the government's creation of SKK Migas within the MEMR, the absence of a regulator resulted in losses to some foreign companies. Pravesti points out that[73]:

> The Indonesian Customs authorities put restraints on the mining rigs of Niko Resources immediately after the dissolution of BP Migas. To release the mining rigs, the company required an approval from BP Migas. However, the approval could not be obtained since BP Migas [had] ceased to exist. Consequently, the company had to pay US$300,000 per day as storage rental fee at port pending a decision on the legal status of BP Migas by the Indonesian Government. Similar to Niko Resources Ltd., the mining rig activities of Total E&P, Chevron Indonesia and Vico Indonesia were also affected.

Pravesti argues that such losses, and any further measures that the government might introduce that undermine existing contractual arrangements between the government and foreign firms in this sector,[74] may violate Indonesia's various treaty obligations. These include the protection of 'legitimate expectations' of foreign investors under the rubric of 'indirect expropriation'[75]—as well as 'fair and equitable treatment', both prescribed under Australia's two existing investment treaties with Indonesia.[76]

However, the definition of 'investment' in these treaties must be analysed carefully to determine, for example, whether mining rig contracts are likely to be included. In any event, perhaps because the fees incurred by these foreign firms were likely small relative to their total operations in Indonesia or because the government provided at least some compensation, Pravesti remarks that as of April 2013 there had been 'no submission of formal legal complaints made by the investors'.[77]

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[71] Prawesti (2013).

[72] *Oil and Natural Gas Law case* (2012), para. [3.21].

[73] Prawesti (2013) (citations omitted). Originally, at least, Niko is a Canadian company; Total is French; Chevron and Vico (previously Huffco) are American.

[74] See now, for example, local content rules, which some commentators suggest may breach WTO obligations: http://www.bakermckenzie.com/files/Publication/a6aaa8ec-a172-4423-bc7f-2de74d4ad609/Presentation/PublicationAttachment/05690e99-fe3f-4389-bbf9-4f33065467a4/al_jakarta_oilgasrules_apr13.pdf. Accessed 16 April 2014.

[75] Prawesti (2013).

[76] Above section 3.1.1.

[77] Prawesti (2013).

Even once the new regulatory regime under SKK Migas becomes firmly established, SKK Migas might end up resembling Pertamina under the Soeharto regime, which operated as both regulator and industry participant. Pertamina, holding a monopoly and run primarily by military figures, was widely considered to be rife with corruption and a lucrative cash resource for the Soeharto regime.[78] Preliminary indications are far from promising.[79] Only several months after being appointed head of SKK Migas, Rudi Rubiandini was arrested by the Indonesian Anti-corruption Commission and later convicted for accepting large bribes from a foreign investor seeking approvals. If SKK Migas continues to engage in such practices, this will surely adversely affect foreign investors—dramatically increasing the chance of treaty-based claims.

Interestingly, since the Constitutional Court decision, SSK Migas has demonstrated a preference for foreign investors to choose Indonesian law as the governing law of the contracts and the Indonesian National Arbitration Board (BANI) for the arbitration of disputes. Total E&P Indonesie (a French company) has recently signed a rig contract with subcontractor PT Apexindo Pratama Duta which includes these terms.[80]

Even if the new regulator itself remains amenable to negotiating clauses providing for arbitration outside Indonesia, and does not come to resemble Pertamina before 1998, other parts of the Indonesian government—including a plethora of local authorities, under post-Soeharto decentralisation initiatives[81]—may themselves become more prone to interfere with arrangements reached between foreign firms and SSK Migas. Those parts of the government may also be influenced by the Constitutional Court's broader comments about the need to preserve public interests in the natural resources sector. Yet the Indonesian government as a whole would still be responsible under any relevant investment treaty obligations, regarding for example expropriation or fair and equitable treatment.

Such possibilities lead, however, to a broader and quite difficult question. What happens if international treaty obligations agreed by Indonesia conflict with those laid down in its present Constitution or another law, such as a statute or regulation? In other words, do treaties or the Constitution prevail, under Indonesia's 'sources of law' theory?

Unfortunately, the answer to this question is unclear.[82] Critically, Indonesian law is silent on the position of international law within the Indonesian legal system. Article 11 of the Indonesian Constitution and Law 24 of 2000 on International Agreements allow the president and the national parliament to ratify treaties on behalf of Indonesia. Article 10 of the Law on International Agreements specifies that parliament has jurisdiction to ratify treaties with subject matter including

[78]Hertzmark (2007).

[79]Jong (2013).

[80]Supriyatna (2013).

[81]Butt (2010, 2011).

[82]See generally Butt (2014).

politics, peace, defence, security, territorial boundaries, state sovereignty, human rights, the environment, and foreign loans and aid. Parliamentary ratification is also required if the treaty creates a new legal norm. By contrast, the president, by decree, can ratify treaties other than those reserved for parliament (Art. 11(1)). These include agreements about science, technology, economics, trade, avoidance of double taxation, and the protection of investments (Elucidation to Art. 11(1)).

However, there is significant debate about whether the international agreements Indonesia has ratified come into force 'automatically' once ratified by the president or the national parliament. Some Indonesian scholars argue that ratification is all that is necessary to bring treaties into force domestically. The leading proponent of this view is Kusumaatmadja, former Professor of Law and Dean of the Faculty of Law, University of Padjadjaran (Bandung), Indonesian Justice Minister (1973–1978), Indonesian Foreign Minister (1978–1983) and the lead author of Indonesia's foremost international law text, *Pengantar Hukum Internasional* (Introduction to International Law). Pointing to Indonesia's continental European legal heritage, he argues that Indonesia is 'monist'.[83] Even in the absence of formal ratification or implementing regulations, he states, 'we should consider ourselves bound by treaties and conventions approved by Indonesia'.[84]

However, most Indonesian scholars and judges take the alternative view—that Indonesia is 'dualist'. For them, ratification of a treaty will, in itself, be insufficient to render an international agreement applicable and enforceable in Indonesia. At a minimum, the treaty's principles, rights and obligations—or perhaps even a translation of the treaty provisions themselves—need to be included in an Indonesian domestic law.[85] This view appears to be confirmed by the absence of international law as a source of law in Indonesia's 'hierarchy of laws',[86] which seems to imply that it is not formally recognised as one might expect in a monist system.[87] The result is that it is possible—perhaps even likely—that an Indonesian court would refuse to enforce a treaty that has not been transformed into Indonesian domestic law by statute or regulation.

This means that, in order for treaty obligations to be enforced in Indonesian courts, the content of the treaty obligation will usually need to be reflected in an Indonesian legal instrument. Whether that obligation, as conveyed by the domestic law, trumps an inconsistent Indonesian law, depends, in a formal sense, on where the two laws sit on Indonesia's 'legal hierarchy' (*Tata Urutan Peraturan Perundang-undangan*). This hierarchy, contained in Article 7(1) of Law 12 of 2011 on Lawmaking, is as follows:

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[83] Kusumaatmadja (2003), p. 92.

[84] Ibid.

[85] For a variety of views, (see Juwana (2010), 74–76); Suhaedi (1996), 135; Boer (2000), 13; Hartono (2000), 16.

[86] The 'hierarchy of laws' is a list of types of laws within the Indonesian legal system indicating their relative authority. It is contained in Article 7(1) of Law 12 of 2011 on Law-Making. See Butt (2011).

[87] Agusman (2010).

(a) The 1945 Constitution (*Undang-undang Dasar 1945*);
(b) Decrees of the People's Consultative Assembly (*Ketetapan MPR*);
(c) Statutes/Interim Emergency Laws (*Undang-Undang/Peraturan Pemerintah Pengganti Undang-Undang*);
(d) Government Regulations (*Peraturan Pemerintah*);
(e) Presidential Regulations (*Peraturan Presiden*);
(f) Provincial Regulations (*Peraturan Daerah Propinsi*); and
(g) County/City Regulations (*Peraturan Daerah Kabupaten/Kota*).

In essence, each type of law must not conflict with any law higher than its own type in the hierarchy; and one type of law can amend or revoke a law lower than its own type in the hierarchy. So, for example, a presidential regulation that adopts the terms of an international treaty will be legally valid—at least formally—only if, when passed, it does not contradict a government regulation, statute, People's Consultative Assembly Decree or the Constitution; and, once passed, it is susceptible to being overridden by any of those higher level instruments.

The resolution of 'conflicts' between laws on the hierarchy is the task of Indonesian courts. However, there are very significant gaps in the judicial review jurisdiction held by Indonesia's courts, which make the hierarchy largely moot for many of these conflicts. The Constitutional Court can only review statutes against the Constitution. It could therefore only consider the constitutionality of a treaty obligation if that treaty obligation was embodied in an Indonesian statute. Thus, if a statute purported to grant protections to investors in line with a treaty obligation that, in the eyes of the Court, diminished state control over natural resources, the Court could invalidate that legislation. The Court could not, however, consider the constitutionality of a treaty obligation that was incorporated into Indonesian law by presidential or government regulation. Only the Supreme Court has power to do this, but its jurisdiction is limited to reviewing laws lower on the hierarchy than statutes against statutes. In other words, the Supreme Court could review whether a presidential or government regulation incorporating a treaty obligation was consistent with a statute.

There seems to be no judicial avenue to challenge lower level laws against other lower level laws mentioned on the hierarchy—such as presidential regulations and government regulations—or even as against the Constitution. The result is that, provided that a treaty is brought into force in the Indonesian legal system by a law below that of a statute, then it will, in most cases at least, be unreviewable against the Constitution, including Article 33(3).

9.4 Conclusion

Investment treaty protections are not a panacea. As outlined above, especially in Part 9.3.1, provisions need to be interpreted carefully—often across multiple directly or indirectly applicable treaties. As explained in Part 9.3.2, substantive

treaty protections may collide with constitutional rights, creating further complications. In addition, there are costs and other practical 'institutional barriers' to filing and prosecuting ISA claims, particularly in the Asian context.[88] Nonetheless, these procedural rights combine with substantive protections agreed through investment treaties to balance private investors' interests against the host state's public interest in regulation.

Australia's treaties, past and future, should include carefully-drafted provisions to secure the most appropriate balance,[89] bearing in mind the particular issues faced by foreign investors in the resources sector in major neighbouring economies such as Indonesia. The Gillard Government is long gone and its Trade Policy Statement of April 2011 does not bind the Coalition Government led by Tony Abbott, elected on 7 September 2013.[90] Prior to the general election, the then shadow Attorney-General had expressed an interest in revisiting the Gillard Government's decision to eschew all forms of ISA in future treaties.[91] Afterwards, the Abbott Government announced that Australia would revert to a case-by-case assessment regarding inclusion of ISA provisions, and indeed they were included in the FTA signed with Korea on 8 April 2014 and the FTA substantively agreed with China on 17 November 2014, but not the one signed with Japan on 8 July 2014. These three countries are major export markets for Australian resources as well as major sources of inbound investment.[92] Even this approach may further complicate Australia's ongoing negotiations with Indonesia and other countries (such as India) for bilateral and regional investment treaties,[93] given also that a Senator from the minority Greens Party has also tabled the *Trade and Investment (Protecting the Public Interest) Bill 2014* proposing once again to preclude Australia from including ISA in future treaties.[94] The Senate Committee, including even Labor Party members, has recommended against enactment of this Bill as it would significantly interfere with the executive branch's constitutional mandate to engage in treaty negotiations. However, Labor Party members sided with Greens Party members of the parliamentary Joint Standing Committee on Treaties, recommending against ratification of the FTA signed with Korea partly out of concerns over ISA. This stance made it politically difficult for the Abbott Government to pass implementing legislation through the Senate (where it lacks an absolute majority) and therefore to ratify and

[88]Nottage and Weeramantry (2012).

[89]See generally also Campbell et al. (2013).

[90]Callick (2013).

[91]Priest (2013).

[92]See respectively http://www.dfat.gov.au/fta/kafta/; http://trademinister.gov.au/releases/Pages/2014/ar_mr_141117.aspx?ministerid=3 and http://www.dfat.gov.au/fta/jaepa/. Accessed 3 December 2014.

[93]Nottage (2014).

[94]See http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/Trade_and_Foreign_Investment_Protecting_the_Public_Interest_Bill_2014 (including a Submission by Nottage). Accessed 16 April 2014.

bring into force that treaty.[95] It may still affect the FTA subsequently concluded with China, which also reportedly includes ISDS provisions.

A politically less controversial issue for Australia, relevant to both inbound and outbound investors, particularly in long-term projects involving resources, is to revise the IAA to fix the 'legislative black hole' for certain ICA agreements, outlined in Part 9.2 and resulting unfortunately from the 2010 amendments combined with new CAA legislation. A Bill to this effect was introduced into the Senate on 29 October 2014, but has not yet been enacted or come into effect, and arguably (as originally worded) does not completely fill the black hole.[96] In any event, a more wide-ranging round of amendments would help Australia in its quest to become a credible regional hub for cross-border dispute resolution.[97]

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