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The Chilling Effect of International Investment Law and Indonesia's Preventive Steps to Overcome It

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ABSTRACT: This research is necessary due to the chilling effect brought about by the IIL and the provision under Article 32 of the Indonesian Capital Investment Law, which potentially brings adverse effects to the Government of Indonesia. Such adverse effects can manifest as substantial compensation claims and policy adjustments contrary to national interests. Unlike previous research concerning Indonesia prior to the IIL regime, the distinctive feature of this study is the implementation of the exhaustion of local remedies doctrine based on IIL doctrines, past ICSID cases, and dispute settlement procedures under BITs. This research comprises four discussions outlined below. The first discussion outlines prior research concerning Indonesia before the IIL regime, along with the novelty discussion. Meanwhile, the second discussion explains the adverse effects of ISDS and SSID on Indonesia's sovereignty and its diplomatic relations with other ICSID Convention members. The third discussion emphasises that Indonesia should not perceive the IIL as an isolated regime, allowing it to utilise this legal framework to prevent disputes through international arbitration and adopt objective investment measures. Lastly, the fourth discussion describes how Indonesian local courts should be employed to resolve foreign investment disputes. The expected contribution of this research is to enrich the literature concerning IIL from an Indonesian law perspective. Furthermore, this research is crucial to serve as guidance for Indonesian lawmakers when amending Article 32 of the Capital Investment Law.

KEYWORDS: Investment Law; Chilling Effect; Investor-State Dispute Settlement.

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I. INTRODUCTION

International investment law (IIL) is a branch of public international law that is considered controversial. This assumption arises due to the debate between governments on the need to strike a balance between the protection of foreign investors and the right of states to regulate their national laws.[1] Radi explains that since the period in which this regime flourished, IIL has been perceived as a legal protection instrument established to attract foreign investors as well as a subsidiary instrument to enhance a country's economic development.[2]

Radi's *das solen* point of view is in line with paragraph 1 of the preamble of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). The first paragraph of this Convention Preamble states that "*Considering the need for international cooperation for economic development, and the role of private international investment therein*."[3] While the text promotes the concept of economic development, the enactment of this area of law has also been the object of much debate from academics, lawyers, government agencies, and business actors.[4] Those debates are, of course, without prejudice to the purpose of the convention to achieve economic development through international cooperation.

One of the negative impacts of the enactment of IIL is the chilling effect, which is also known as the regulatory chill, which is driven by the award of an international arbitration tribunal that has examined and decided on an investment dispute between a foreign investor and its host state. Such a dispute is generally caused by the enactment of the host country's national

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1 David Gaukrodger, "Addressing the balance of interest in investment treaties: The limitation of fair and equitable treatment provisions to the minimum standard of treatment under customary international law," (2017) 3:3 *OECD Working Papers on International Investment* 8-9.

2 Yannick Radi, *International Investment Law Textbooks*, Part I, (Louvain: UC Louvain & edX, 2021).

3 International Center for Settlement of Investment Disputes, *ICSID Convention* (Washington DC: International Center for Settlement of Investment Disputes, 2023).

4 David Gaukrodger, "The balance between investor protection and the right to regulate in investment treaties: A scoping paper," (2017) 2:2 *OECD Working Papers on International Investment* 8-10.

law that is not in line with the expectations of foreign investors or is detrimental to these investors.[5] In its jurisdiction, Indonesia's investment measure is among other constituted under Law Number 25 Year 2007 concerning Capital Investment Law, the Government Regulation on the Lieu of Law Number 2 Year 2023 concerning Job Creation Law, which has been ratified under Law Number 6 Year 2023, and Law Number 40 Year 2007 concerning Limited Liability Law along with their implementing regulations.[6] Although this set of regulations provides ease for doing business for foreign investors in Indonesia,[7] an act of expropriation by the Government of Indonesia of a foreign investor's asset may trigger a claim and procedures in international arbitration.[8]

Although the dispute settlement mechanism, as mentioned above, is inevitable under the international regime, such procedures may bring the so-called chilling effect for Indonesia. The form of this chilling effect is the obligation of the state to fulfil compensation to foreign investors who win a dispute at the international arbitration tribunal.[9] In addition, this chilling effect is also felt by the host state, with the obligation for the concerned government to override the national investment measures provisions that have been considered detrimental to the foreign investor or impairing the business activity. [10]

The international arbitration tribunals in question are institutional and ad-hoc arbitrations authorised to adjudicate disputes between foreign investors vis-à-vis their host states, and institutional dispute resolution forums that adjudicate disputes between the government of the host state and the government of the foreign investor. The first type is known as Investor-

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5 Yannick Radi, *Supra* note 15.

6 Azhar Rahadiyan Anwar, "Bentuk Host Control dan Perlindungan Hukum Bagi Penanaman Modal Asing Pasca Diterbitkannya UU Cipta Kerja di Indonesia," (2023) 5:1 *Jurnal Hukum dan Pranata Sosial* 443-456.

7 Yudi Kornelis, "Implikasi Hukum Perseroan Perseorangan Terhadap Indeks Ease of Doing Business Indonesia," (2022) 6:2 *Jurnal Yustisiabel* 132-151.

8 Amalia Salsabila Torina, "Investor State Dispute Settlement (ISDS) dalam Kegiatan Investasi Asing," (2025) 5:2 *Jurnal Ilmu Hukum, Humaniora, dan Politik* 1704-1712.

9 Rahim Moloo and Justin Jacinto, "Environmental and Health Regulation: Assessing Liability Under Investment Treaties," (2011) 29:1 *Berkeley Journal of International Law* 34-35.

10 *Ibid.*

State Dispute Settlement (ISDS), a mechanism prominently operated by ICSID under its convention.[11] Besides ICSID, the United Nations Commission on International Trade Law (UNCITRAL) also operates this type of dispute settlement under its 1976 arbitration rules, the 2010 revised version, the 2013 rules incorporating the UNCITRAL Rules on Transparency for Treaty-based Investor-State Arbitration, and the 2021 version incorporating the UNCITRAL Expedited Arbitration Rules.[12] Meanwhile, the second type is known as State-to-State Investment Dispute (SSID), which is relatively new when compared to the ISDS mechanism.[13] This SSID mechanism can be found in several bilateral agreements, one of which is the Bilateral Investment Treaty (BIT) between Brazil and Malawi, which has been adopted since 2015.[14]

An example of this chilling effect can be seen in the case of *Tecmed v. Mexico* which contained the following statement: "*The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the objectives of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations*."[15] This award clearly showed the stance adopted by international arbitrations to push a host state to provide measures that are fully in favour of the foreign investors. In other words, this finding somehow sounds an obligation of means for a state to ensure that its investment-related measures shall take into account the foreign investors' interest through any necessary means.

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[11] International Center for Settlement of Investment Disputes, *About ICSID* (Washington DC: International Center for Settlement of Investment Disputes, 2023).

[12] United Nations, *United Nations Commission On International Trade Law* (New York: UNCITRAL, 2025).

[13] Yannick Radi, *International Investment Law Textbook*, Part II, (Louvain: UCLouvain & edX, 2021).

[14] *Ibid*.

[15] Italaw, *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States* (Italaw, 2023).

From the above wording, it can be understood that the arbitral tribunal hearing the dispute between Tecmed vs. Mexico has ordered the Mexican government to adapt its national laws to the needs of its foreign investors. This instruction certainly does not take into consideration the public interest that the tribunal must take into account. The finding of the Tecmed vs. Mexico award is therefore inconsistent with a country's internal sovereignty to manage its resources in the public interest and the right to development of the country.[16] This situation of the chilling effect that Mexico experienced was also experienced by Indonesia in the ICSID Case known as *Churchill Mining v. Indonesia*.

Although Indonesia won the ISDS at the *Churchill Mining v. Indonesia* tribunal in 2019, the Indonesian government must still adapt its investment-related national law to the IIL standards applicable in Indonesia's various BITs and regional economic agreements, as well as review some of the provisions under its adopted BITs.[17] In addition, Indonesia's legal efforts to settle this international investment dispute have cost US$8.6 billion at the tribunal stage and US$1.85 billion at the annulment stage.[18] Although Indonesia did not experience the defeat as Mexico in its dispute with Tecmed, Indonesia's involvement in this international dispute still brings an injury in other ways, which is the large amount of expense to the government while defending its interest before the tribunal.

This article discusses how Indonesia shall, at its very best, mitigate the chilling effect caused by the applicability of the IIL regime. The urgency of this article is the importance of a host country's actions, in this case Indonesia, to mitigate the chilling effect that can be experienced when involved in investment disputes that can lead to the ISDS mechanism or the SSID mechanism. In explaining the mechanisms that Indonesia can adopt, the discussion of this article is divided into four parts as follows. The first part discusses previous research that criticises international investment law in Indonesian jurisdiction. Furthermore, the second section discusses

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16 Huala Adolf, *International Economic Law*, (Bandung: KENI Media, 2015).

17 Rachmi Hertanti, "Investment Dispute Bankrupting the State," *Indonesia for Global Justice* (May 6, 2019).

18 *Ibid*.

the differences and similarities of the ISDS and SSID mechanisms. The third part discusses the reasons why IIL is not an isolated legal regime despite its chilling effect. Last but not least, the fourth section discusses the mechanisms that Indonesia can adopt according to its national dispute settlement law to prevent the chilling effect of IIL.

II. METHODS

This article is presented as the outcome of a comprehensive normative research. Such normative research is conducted by implementing the relevant rules under the ICSID Convention, legal doctrines related to IIL, and Indonesian national law concerning dispute settlement in its local courts. Those legal sources are prescriptively implemented to answer the chilling effect issue, which may impair Indonesia's national budget along with its national judicial institutions' credibility. In this section, the following disclaimer is also presented. This article does understand that, by being one of the contracting parties of the ICSID Convention and having political stances to attract foreign investors, Indonesia shall fully comply with both the substantial and procedural IIL rules. However, the enhancement of Indonesia's local court to settle disputes between foreign investors and the host state shall remain paramount.

The normative method, as mentioned above, is also supported by the approaches presented in this paragraph. The first approach is conducted by implementing concepts recognised under the IIL regime, such as the exhaustion of local remedies and the chilling effect. These concepts are implemented by gathering references from books and journal articles discussing IIL. The second approach is conducted by implementing Indonesia's domestic law or statutory regulations concerning the authorities of Indonesia's local courts. The third supporting approach is conducted by implementing ICSID cases which related to the reasoning presented in the discussions of this article.

III. THE CONCEPTUAL DEBATES CONCERNING INTERNATIONAL INVESTMENT LAW IN INDONESIA

This section discusses past research that underlies the core issue of this article, which is the chilling effect caused by international arbitrations on investment disputes. Iqbal Hasan discusses the background of the enactment of IIL in Indonesia. He perceived Indonesia IIL as provisions of Indonesian national law concerning the capital investment by foreign investors, and the material and formal legal principles recognised by the IIL regime. IIL also consists of various mechanisms that can be applied in preventing foreign investor claims, and the Indonesia-ICSID Case Laws, or several ISDS disputes in which Indonesia has participated.[19] In discussing the various preventive mechanisms, Iqbal Hasan mentioned several steps that Indonesia can take to prevent the chilling effect of the IIL, which are as follows: 1.) Withdraw from ICSID membership; 2.) Terminate international agreements in the field of investment; 3.) Several stakeholders, such as the state, foreign investors, legal practitioners, arbitration institutions, and international organisations, must play an active role; 4.) Review of international agreements in the field of investment; and 5.) Notification to ICSID based on Article 25 of the ICSID Convention. [20]

This article disagrees with the mechanism by which Indonesia can withdraw from the ICSID Convention.[21] It also disagrees with the book's explanation that Indonesia should withdraw from international investment treaties.[22] As a sovereign state on one hand, and a state attracting foreign investors on the other, Indonesia shall remain bound under the IIL regime. However, such compliance shall not be conducted blindly. In other words, it is necessary for Indonesia to bend its law or ensure its domestic law provides favour for its government to strike a balance between the public interest and the necessity to comply with the IIL regimes scattered in the regime's principle, various BITs, and regional economic agreements. This disagreement with this view is refuted by proposing an alternative solution presented in the third discussion.

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[19] Muhammad Iqbal Hasan, *International Investment Law: Theory and Implementation*, (Bandung: Refika Aditama, 2021).
[20] *Ibid.*, 159-165.
[21] *Ibid.*, 160
[22] *Ibid.*, 161.

Yannick Radi discusses the IIL procedural rules as a set of procedures regulated by the ICSID Convention, the public international law aspects of IIL, and the development of IIL since the adoption of the Sustainable Development Goals (SDGs) in 2015. In explaining the public international law aspects relating to IIL, Yannick Radi perceives IIL as a legal regime that is not isolated from other (international) legal regimes and public interest regimes established by each state.[23] This legal regime shall therefore be implemented along with other international law regimes such as the international environmental law, the international human rights law, and the public purpose of the host state. In addition, he outlines several ISDS tribunal decisions regarding the concept of coherence in IIL.[24] The concept of coherence, as expressed by Yannick Radi, will be implemented in the next discussions of this article.

This article applies Yannick Radi's view of IIL's position as a non-isolated legal rule as a basis for explaining his disagreement with the mechanism provided by the first prior research, as explained above. This article furthermore applies the concept of coherence to discuss the three legal issues above. Through the implementation of those doctrines, this article believes that Indonesia may reform or enhance its judicial institutions to overcome the chilling effect of IIL. Such implementation is also necessary to educate the public in order to erase or at least reduce the paranoia on the IIL regime, which is well known for its detrimental nature due to the arbitration award forcing a host state to change its measures.

David Gaudkrodger also discussed this core issue by answering the legal issue of how international investment treaties can balance provisions that contain legal protection for foreign investors and the right of states to determine their national laws.[25] The three discussions of his article are as follows: 1) EU and US recommendations on how these two interests can be balanced; 2) How investment treaties have been shaped contradictorily (one provision is too pro-investor and another is too pro-state); 3) A comparison of the IIL regime with the multilateral services agreement adopted by the

[23] Yannick Radi, *Supra* note 43.
[24] *Ibid.*, 55.
[25] David Gaukrodger, *Supra* note 4.

World Trade Organization (WTO); and 4.) Suggestions that can be applied to balance the two opposing interests.

The suggestions put forward by David Gaudkrodger consist of: 1.) How a country's national regulations can be harmonised with the IIL regime; 2.) How the domestic legal regime can protect foreign investors; and 3.) How can political and economic aspects be considered to achieve balance in the IIL regime?[26] The next discussion of this article implements the stance presented by David Gaudkrodger on how a national regulation can be harmonised with the IIL regime to prevent such regulatory chill. Since this article places Indonesia as a sovereign state and a subject of the IIL as the object of this study, the explanation will certainly be adjusted to the statutory regulations applicable in the territory of Indonesia.

The recent research concerning the implementation adjustment of Indonesia's national law with the IIL rules is research by Tiurma Allagan and Matthew Simbolon concerning the cooling-off period. This previous research was written to explain how the cooling-off period rules scattered under Indonesia BITs and ICSID Cases involving Indonesia shall be implemented to prevent the impairing nature of the IIL regime.[27] This research explains that the provision under Article 22 of the Indonesian Law Number 1 of the Year 1967 concerning Foreign Investment provides a cooling-off provision which obliges disputes between the Government of Indonesia and foreign investors to be settled through alternative dispute resolutions at the first place, before settling it in international arbitrations.[28] Furthermore, such a cooling-off clause is also constituted in the Indonesia-Singapore BIT, Indonesia-Denmark BIT, Indonesia-Iran BIT, Croatia-Indonesia BIT, and Indonesia-Algeria BIT.[29] Most importantly, the cooling-off period was implemented in past ICSID Cases involving Indonesia, which are The Amco vs. Republic of Indonesia Case, The Oleovest vs. Republic of Indonesia Case, The Churchill Mining vs.

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[26] *Ibid*., 13.

[27] Tiurma M. Pitta Allagan and Putu George Matthew Simbolon, "The Cooling-Off Period Under the International Investment Law Regime in the Indonesian Regulations Context," (2024) 9:2 *Journal of Indonesian Legal Studies* 835-866.

[28] *Ibid*., 844.

[29] *Ibid*., 849- 850.

Indonesia Case, and The Freeport Case.[30] This previous research recommended that Indonesia bring its Law Number 25 of 2007 concerning Capital Investment (Capital Investment Law) into conformity with the cooling off principles, which are scattered in various BITs, regional agreements, and applied in past cases.[31]

Both the cooling-off period and the exhaustion of local remedies are often perceived as the same rules of international law. This is because both of them obliges international law and are obliged to settle a dispute in a local court prior to settling it in an international tribunal. Regardless of such similarity, this article hereby provides the distinction of the previous research presented by Tiurma Allagan and Matthew Simbolon. Although both the cooling-off period and the exhaustion of local remedies consist of the settlement through litigation and alternative dispute resolutions, this article will only limit the scope of its discussion to the settlement of disputes between Indonesian foreign investors and the Government of Indonesia through the local courts or the available judicial mechanisms in Indonesia. Furthermore, both the highlighted previous research and this article promote the Indonesian investment law reform to ensure that Indonesian foreign investors clearly understand that it is possible to settle their disputes in the Indonesian local court, objectively and impartially.

It is also necessary for this article to present the second distinction of this research from the previous research by Matthew Simbolon and Tiurma Allagan. By referring to the highlighted discussion above, it can be seen that the previous research demonstrated a large extent of the practical aspects of IIL in Indonesia. Those practical aspects can be seen from the cited BITs, domestic laws, and past ICSID cases. This article, on the other hand, mainly implements the doctrine of IIL to answer the chilling effect issue caused by the enforcement of the IIL regime. Therefore, the common objectives of these two studies do not mean that they are the exact same research. Such differences are caused by the different dimensions of each of the respective research articles.

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30 *Ibid*., 850- 853.
31 *Ibid*., 860.

IV. DIFFERENCES AND SIMILARITIES OF INVESTOR-STATE DISPUTE SETTLEMENT AND STATE-TO-STATE DISPUTE SETTLEMENT MECHANISMS

ISDS is a dispute resolution mechanism involving foreign investors who feel impaired by the host state that has applied its national investment rules or measures generally applicable to its foreign investors. This explanation is in line with the purpose of the establishment of ICSID based on Article 1, paragraph 2 of the ICSID Convention. This provision states that "*The purpose of the Centre shall be to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of the other Contracting States in accordance with the provisions of this convention*."[32] From these provisions, it can be understood that investors exported by an ICSID Convention contracting party to the territory of another contracting party (which is the host state) can utilise the available conciliation or arbitration forums to overcome their nullified or impaired rights by the host state.

Furthermore, Article 25 paragraph (1) of the ICSID Convention states that ICSID has jurisdiction over any legal dispute caused by foreign investment made by an investor from one member state in the jurisdiction of another member state, which is the host state of the investor.[33] The object of ISDS through the ICSID Convention is a *measure* or policy set by the host state. This statement is in line with the tribunal's consideration in the case of *OI European Group v. Venezuela* which states that: "*Although not defined in the BIT, the concept of "measure" must be understood in the broad sense. This can be seen from the very text of the BIT, which adds the adjective "any" to the noun to emphasise its broad scope. Consequently, it encompasses all types of administrative, legislative, or judicial acts performed by any of the branches of government of the Bolivian Republic, and prohibits such acts from resulting in an expropriation, nationalisation, or equivalent measures*."[34] To be clear, it can be understood from the finding of this past award that the any kind of legal product issued by the host state, whether it is regulations by the legislatives, implementing regulations or administrative decrees by the

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[32] International Center for the Settlement of Investment Dispute, *Supra* note 9.
[33] *Ibid*.
[34] Italaw, *OI European Group B.B. v. Bolivirian Republic of Venezuela* (Italaw, 2023).

executives, judicial decisions by the judicial, and any other products issued by a legitimate state organ of the host states are subject to be challenged in the arbitration tribunal.

The finding of the OI European Group vs. Venezuela furthermore stated that a *measure* can be defined as an act enacted by the legislative, executive, or judicial organs of a state, whether such organ is located at the central level or the municipal level of governance.[35] This tribunal was able to interpret the word "measure" through the implementation of Article 31 paragraph (1) of the Vienna Convention on the Law of Treaties 1969 (VCLT 1969). This provision obliges concerned parties to *inter alia* interpret a treaty by seeking the ordinary meaning, or by taking into account the object and purpose of the treaty.[36] In line with the tribunal's view, Pierre d' Argent explained the *Costa Rica v. Nicaragua* Case in the International Court of Justice (ICJ) by stating that the interpretation of a phrase in an international treaty can be based on the general meaning of the phrase, or on the application of the term through consistent practice.[37] By taking into account the practice conducted by the IIL Cousin, which is the International Trade Law, which is prominently operated by the WTO, the word "measure" is commonly affiliated with any kind of act, rules, or policy conducted by the members of the Agreement Establishing the World Trade Organization (WTO Agreement).[38] This can be seen from Article XVI.4 of the WTO Agreement, which obliges the members of this agreement to bring their measures into conformity with the Marrakesh Agreement and the Annexes of that agreement.[39]

In addition to ICSID, the institution authorised to adjudicate ISDS is the Permanent Court of Arbitration (PCA). This international organisation was formed based on the Convention for the Pacific Settlement of

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35 *Ibid.*

36 *Ibid.*

37 Pierre d' Agent, *International Law Textbook: Applying International Law*, (Louvain: UCLouvain & edX, 2021).

38 Peter Van den Bossche and Werner Zdouc, *The Law and the Policy of the World Trade Organization: Text, Cases, and Materials*, Fifth Edition, (Cambridge: Cambridge University Press, 2022).

39 World Trade Organization, *Agreement Establishing the World Trade Organization* (Geneva: World Trade Organization, 2025).

International Disputes 1899 (Hague Convention 1899).[40] Article 20 of the 1899 Hague Convention states that the PCA was established to resolve international conflicts that cannot be resolved through diplomacy, unless the members of this convention determine otherwise, with due regard to this convention.[41] The PCA's competence in adjudicating ISDS is based on the United Nations Commission on International Trade Law Arbitration Rules on Transparency in Treaty-based Investor-State Arbitration (UNCTIRAL Arbitration Rules), which have been in force since 2013.[42] This passage clearly shows that a dispute between a foreign investor and its host state can be settled either through the ICSID under the ICSID Convention or the PCA under the UNCITRAL Arbitration Rules.

Furthermore, Article 48 paragraphs (1) and (2) of the ICSID Convention explain that the arbitral tribunal shall make an award based on a majority vote of the tribunal members, and the award shall be in writing.[43] The nature of the award is binding and must be complied with by the parties to the dispute and cannot be appealed.[44] From the case of *Philip Morris v. Uruguay*, it can be understood that if ISDS is won by the host country, the tribunal can make an award that punishes the plaintiff or foreign investor to pay the costs of the legal procedures conducted in the arbitration.[45] Meanwhile, based on the *Metalclad v. Mexico* case, the host country that loses a dispute is obliged to pay compensation in the amount and time determined by the arbitral tribunal,[46] and the payment of court costs is borne by the parties to the dispute. [47] The excerpts as presented in this paragraph clearly show that the chilling effect brought by an arbitration tribunal does not only consist of the obligation to amend the host state's

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[40] Permanent Court of Arbitration, *Permanent Court of Arbitration History* (Hague: Permanent Court of Arbitration, 2023).

[41] Permanent Court of Arbitration, *Convention for the Pacitif Settlement of International Disputes* (Hague: Permanent Court of Arbitration, 2023).

[42] Permanent Court of Arbitration, *UNCITRAL Arbitration Rules* (Hague: Permanent Court of Arbitration, 2023).

[43] International Center for the Settlement of Investment Dispute, *Supra* note 17.

[44] *Ibid*., 21.

[45] Italaw, *Philip Morris Brands Sarl, Philip Morris Products S.A. and Abal Hermanos S.A. and Oriental Republic of Uruguay* (Italaw, 2023).

[46] Italaw, *Metalclad Corporation and The United Mexican States* (Italaw, 2023).

[47] *Ibid*.

national law, but also the obligation to pay a relatively large amount of compensation.

The same arrangement can also be found in Article 33, paragraph 1. UNCITRAL Arbitration Rules, which explain that the decision on the dispute is determined by the arbitrator or a majority vote of the arbitral tribunal.[48] Paragraph 2 of this provision explains that the arbitral award is set out in writing, is final and binding on the parties, and must be implemented by the parties within the time limit set by the arbitrator or tribunal.[49] From the *Methanex v. USA* case, it can be explained that Methanex, as the losing party, is required to pay court costs to the United States government based on the deadline determined by the tribunal.[50] In the case of *PACC v. Mexico*, the Mexican government is required to pay a certain amount of compensation to PACC as the plaintiff.[51]

From the set of explanations presented above, it can be understood that the ISDS arrangement is not only based on a rule in international treaties and *uniform law*. Rather, it must be based on the decisions of past arbitral tribunals. It is therefore subject to being questioned whether a coherence in the practice of ISDS and SSID is something that must be considered. In the blink of an eye, this question might not be related to the chilling effect. However, the dependency of an international arbitration tribunal on awards of previous international arbitration tribunals might affect the tribunal member's point of view in settling the dispute *in concreto* in assessing the measure of a host state confronted before him/her. This question can be answered through the following description.

In *Burlington v. Ecuador,* Arbitrator Bridget Stern argued that although the tribunal is not bound by previous awards of the same type, they should still be considered to contribute to the harmonious development of the IIL.[52] As for the tribunal in *Romak v. Ouzbekistan*, the *arbitrators* stated that "*the Arbitral Tribunal has not been entrusted, by the Parties or otherwise, with a*

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[48] Permanent Court of Arbitration, *Supra* note 24.

[49] *Ibid.*

[50] Italaw, *Methanex Corporation and United States of America Final Award of the Tribunal on Jurisdiction and Merits* (Italaw, 2023).

[51] Italaw, *PACC Offshore Services Holdings Ltd and United Mexican States* (Italaw, 2023).

[52] Italaw, *Burlington Resources Inc. v. Republic of Ecuador* (Italaw, 2023).

mission to ensure the coherence or development of 'arbitral jurisprudence."[53] In responding to these two opposing views of the tribunal, Yannick Radi applies Aristotle's view by stating that the concept of coherence can only be viewed as a debate in the context of the nature (*ethos*) of IIL.[54] However, coherence cannot be seen as the *telos* of IIL. [55]

To avoid a vague understanding, this article implements the point of view concerning IIL as the ethos of this legal regime through this explanation. Although the debate concerning coherence in the IIL will never come to an end, the stance to view coherence as the ethos of this legal branch can be applied as a lesson learn for Indonesia as a host state. Indonesia, as a member of the ICSID Convention and as a state importing a large amount of foreign investments, it is important for the Indonesian government to understand how the rules of IIL apply by taking into account past ICSID cases in formulating its investment measures. Through this, the Government of Indonesia, as a respondent in an arbitration tribunal or Indonesian judges through its national law, can cite findings in past awards that are objectively in favour of the public interest. Therefore, the uncertainties of IIL shall be perceived as an opportunity instead of a threat.

In addition to ISDS, the mechanism applied in international investment disputes is SSID. Unlike the ISDS, which gives an opportunity to the foreign investor to exercise its rights in the arbitration tribunal, this mechanism obliges the foreign investor to delegate its power to the government of the state where that investor originates. When compared to the mechanisms described above, this mechanism is relatively new. An example of the application of this mechanism can be found in India's national law governing its model bilateral investment treaty.[56] This *Model Law* was enacted by India in its 2015 BIT Model Law. [57]

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[53] Italaw, *Romak S.A. and The Republic of Uzbekistan* (Italaw, 2023).

[54] Yannick Radi, "Coherence in: J d'Aspremont and S Singh (eds), Fundamental Concepts for International Law: The Construction of a Discipline (E Elger Forthcoming)," *(*2017) *SSRN Papers* 14.

[55] *Ibid*.

[56] Yannick Radi, *Supra* note 72.

[57] *Ibid*.

In the same year, the BIT between Brazil and Malawi also implemented the SSID mechanism in their dispute settlement clause.[58] This arrangement can be found in Article 3, paragraph 4. Brazil and Malawi BIT, which, among others, states that the Joint Committee of Brazil and Malawi has several tasks.[59] One of these tasks is to resolve problems or disputes regarding investments made by the governments of the two parties in an amicable manner.[60] From this provision, foreign investors who feel nullified or impaired by their host country can be represented by their government in resolving the investment dispute.

The authorised forum for resolving SSIDs consists of both interstate arbitration and judicial dispute resolution. An example of this first type of forum can be found in Article 11 of the Germany-Liberia BIT, which obliges the governments of the two countries to settle investment disputes through arbitration.[61] Further, another example of this arrangement can be found in Chapter 20 of the North American Free Trade Agreement, which provides for the settlement of disputes through arbitration when dispute settlement through *prima facie* consultations has failed.[62] The practice of SSID is prominently conducted by states through the establishment of a BIT, which consists of procedural rules stating that the dispute settlement shall be conducted based on the UNCITRAL Arbitration Rules.[63]

Judicial institutions that have competence in resolving SSIDs are the International Court of Justice (ICJ) and regional courts established under regional economic agreements. Settlement of investment disputes through the ICJ can be seen in Article XIV, paragraph 2 of the Treaty of Amity and Economic Relations between the United States and Togo, which shows the agreement of the parties to resolve disputes through the ICJ, unless the

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58 *Ibid.*

59 Electronic Database of Investment Treaties, *Investment Cooperation and Facilitation Agreement between the Federative Republic of Brazil and the Republic of Malawi* (Electronic Database of Investment Treaties, 2023).

60 *Ibid.*

61 Nathalie Bernasconi-Osteralder, "State-State Dispute Settlement in Investment Treaties: Best Practices Series - October 2014," (2014) *International Institute for Sustainable Development* 3-5.

62 *Ibid.*, 4.

63 *Ibid.*, 3.

parties agree to resolve them through other peaceful efforts.[64] At the same time, examples of settlement through regional courts can be found in Article 27 of the Common Market for Eastern and Southern Africa (COMESA), which, among others (*inter alia*), regulates the settlement of investment disputes through the COMESA Court of Justice based on Article 28 (b) of the COMESA Treaty. [65]

From the explanation of ISDS, it can be understood that the host state that loses the dispute will suffer financial losses because it has to pay compensation based on the deadline determined by the tribunal and must change its national regulations that have been questioned. Meanwhile, from the explanation of SSID, it can be understood that this dispute settlement has an impact in the form of shattered economic relations between the disputing countries. This shattered relationship is caused by the fact that legal disputes and political disputes have the opportunity to overlap.[66] As the ISDS mechanism, the SSID mechanism also has a chilling effect on the host country in determining its national laws governing investment.

By understanding that ISDS and SSID both have a chilling effect on the host country, including Indonesia as one of the countries that opens up great opportunities for foreign investment, it becomes a question of "*Is IIL an isolated legal regime?*" or "*Is IIL a legal regime that is applied without taking into account the provisions in other legal regimes?*". These two questions are answered in the third discussion of this article.

V. INTERNATIONAL TRIBUNAL RULES AND CASE LAWS STATING THAT THE IIL IS NOT AN ISOLATED LEGAL REGIME

The first reason why IIL cannot be viewed as an isolated legal regime can be found in the tribunal in *Philip Morris v. Uruguay*. In interpreting the provisions of Article 3, paragraph (2) of the BIT between Switzerland and

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[64] *Ibid*., 5.
[65] *Ibid*., 6.
[66] Sefriani, *The Role of International Law in Contemporary International Relations* (Jakarta: Raja Grafindo Persada, 2016).

Uruguay (on the legal protection of foreign investors),[67] paragraph 218 of the tribunal's judgment states that the BIT should be interpreted in light of Article 31(3)(c) of the Vienna Convention on the Law of Treaties 1969 (VCLT 1969).[68] The following provision allows states to interpret the meaning of an international treaty by relating it to other rules of international law, including those from an international regime outside the regime of the treaty. Through this view, it is understood that the tribunal of an investment dispute is also required to resolve the dispute by applying other legal regimes, such as international environmental law, international human rights law, and the public interest of the state. [69]

The provision in Article 31(3)(c) of the 1969 VCLT is an arrangement that allows the interpretation of international treaties based on the relevant rules of international law applicable to the parties to the treaty.[70] Yannick Radi states that this provision is "*the master key to* the *house of* international law".[71] This integrative interpretation is in line with Yannick Radi's other writings, which explain that the IIL regime and international human rights law are not conflicting regimes.[72] In his article, he explains that the norms of these two regimes do not essentially overlap, but their application creates a conflict of interest. [73]

This opinion is based on the view of HLA. Hart stated that the formation of a norm is usually carried out based on the open texture that appears when met with a situation that is not predicted by the lawmakers of the following legal rules.[74] The inability of natural persons, including lawmakers, to predict a certain situation has led to a legal norm that can be applied contrary to other legal norms. Huala Adolf and An An

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[67] United Nations Conference on Trade and Development, *Agreement Between the Swiss Confederation and the Oriental Republic of Uruguay on the Reciprocal Promotion and Protection of Investments* (New York: UNCTAD, 2023).

[68] Italaw, *Supra* note 60.

[69] Yannick Radi, *Supra* note 43.

[70] Pierre d' Argent, *International Law Texbook: Applying International Law*, (Louvain: UC Louvain & edX, 2021).

[71] Yannick Radi, *Supra* note 42- 43.

[72] Yannick Radi, "The 'Human Nature' of International Investment Law," (2013) 10:3 *Grotius Center Working Paper 2013/006-IEL* 2.

[73] *Ibid*.

[74] *Ibid*., 5.

Chandrawulan also explained HLA Hart's point of view by stating that humans have limitations in understanding the situation around them, especially in protecting the things around them.[75] From this explanation, it can be understood that the architects of international treaties in the field of IIL, substantial or material rules and procedural rules as the ICSID Convention and UNCITRAL Arbitration Rules, certainly have limitations in predicting the circumstances that will be faced by the subject (*addressee*) of the rule. Such limitation has indeed caused a revolving door in the form of rules which shall be implemented by not taking into account the entire angles of a dispute or a legal issue.

Second, evidence of the IIL regime as a law that is not isolated can be found in Article 14.21 of the Indonesia-Australia Comprehensive Economic Partnership Agreement (IACEPA). Letter (b) of this provision states, among other things, that a claim by a foreign investor cannot be brought against a measure designed and implemented for the purpose of protecting and promoting *public health*. [76] From this set of rules, it is clear that the implementation of the IIL in Indonesia and Australia as host states of their foreign investors shall take into account the applicable rules of international environmental law. Therefore, the modern trend in the IIL clearly indicates that the arbitration tribunal shall not solely take into account the substantial rules such as Fair and Equitable Rules, and the Full Protection and Security while not paying attention on the environmental protection or human rights protection enforced by the host state through its investment-related measure or domestic law.

In addition to IACEPA, similar arrangements can also be found in the preamble of the North American Free Trade Agreement (NAFTA). The preamble of this regional treaty states that the conduct of investment and trade shall be consistent with the protection of the environment, the safeguarding of public health, and the enforcement of environmental

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[75] Huala Adolf and An An Chandrawulan, *Introduction to Legal Philosophy*, (Bandung: KENI Media, 2020).

[76] Free Trade Agreement Center, *Indonesia-Australia Comprehensive Partnership Agreement (IACEPA) Agreement Document* (Jakarta: Ministry of Trade of the Republic of Indonesia, 2022).

laws.[77] Furthermore, the 2003 Canadian Model Foreign Investment Promotion and Protection also contains exceptional provisions for the protection of human, animal, and plant life and health, or the conservation of renewable and non-renewable natural resources.[78] The provision of these treaties shall be taken into account by the Government of Indonesia as a lesson learn. In other words, in defending the national interest or in adopting an objective decision, the government may, of course, take into account environmental and human rights protections as a stance to circumvent the chilling effect brought by the IIL through the compensation and the regulatory adjustment.

The third and final reason why IIL is not an isolated legal regime can be found in the doctrine of expropriation that successfully balances the public interest and the interests of the foreign investor. The tribunal in *Tecmed v. Mexico* stated that an act of expropriation committed by a host state can only be declared legal if it is able to balance the public interest and the legal protection of the foreign investor.[79] The tribunal's view has succeeded in balancing the *police power doctrine*, which states that expropriation is legal if it is in line with the provisions of a country's national law, with the *sole effect doctrine*, which states that the legality of expropriation must be in line with the rights of the expropriated foreign investor. [80] While the police power doctrine solely takes into account the public interest without paying attention to the foreign investor's interest, the sole purpose doctrine solely takes into account compensation to ensure whether a nationalization or expropriation by a host state of an investment's asset is deemed as legal. This article suggests Indonesian domestic courts take into account both of these doctrines in settling disputes between a foreign investor and the local or central government agency.

By referring to the opening of this article, the Tecmed vs. Mexico Case can be seen as an antagonist of a host state, including Indonesia's rights to adopt an investment measure in favor of the public interest. However, by exploring this case further, it can be understood that this case did take into

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77 Rahim Moloo and Justin Jacinto, note 8.
78 *Ibid*., 9.
79 Italaw, *Technicas Medioambientales Tecmed* ...., *Supra* note 46.
80 Yannick Radi, *Supra* note 64.

account the public interest of a state while examining the expropriation conducted by the Mexican Government on Tecmed's assets. Furthermore, it is the findings of this case which shall be perceived as a lesson learned by the Government of Indonesia, both the defending its interest in an ISDS /SSID Forum or in settling an investment dispute through its judicial institutions.

VI. MECHANISMS THAT INDONESIA CAN IMPLEMENT TO PREVENT THE CHILLING EFFECT CAUSED BY THE IIL

To prevent the chilling effect of IIL, Indonesia shall amend the provision under Article 32 of the Indonesian Capital Investment Law. Article 32, paragraph 4 of this law directly obliges the settlement of a dispute between the Government of Indonesia and a foreign investor to be settled in an international arbitration agreed upon by both parties.[81] This provision is unlike paragraph 3 of the article, which allows a domestic investor having a dispute with the Government of Indonesia to settle it in an arbitration or a domestic court.[82] This article therefore recommends that the Indonesian lawmakers amend the provision under Article 32, paragraph 4 of the Capital Investment Law, so that the foreign investor may also settle its investment dispute in the Indonesian local courts.

Furthermore, Indonesia may also review all BITs that have been adopted by applying *limited period exhaustion on local remedies* (*limited period* ELR) as applied by the Indian BIT Model Law 2016 and the BIT between Brazil and Malawi.[83] From Article 15.2 of the India BIT Model Law 2016, it can be understood that the foreign investors have the right to exhaust all the local remedies for five years, without reaching a satisfactory resolution by giving a notice to the Government of Indonesia as the host state.[84] Article

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[81] Article 32 paragraph (3) of Law Number 25 Year 2007 concerning Capital Investment Law.

[82] Article 32 paragraph (4) of Law Number 25 Year 2007 concerning Capital Investment Law.

[83] *Ibid*., 72.

[84] Prabhash Ranjan, Harsha Vardhana Singh, Kevin James, and Ramandeep Singh, *India's Model Bilateral Investment Treaty: Is India Too Risk Averse?*, (New Delhi: Brookings Institution India Center, 2018).

15.4 furthermore stated that such notification can be accompanied by six months of attempts by the investor and the state to resolve the dispute through negotiation, consultation, or other third-party procedures.[85] Finally, Article 15.5 of the model law stated that the investor can submit a claim to the international arbitration, subject to the four following conditions: 1.) Not more than six years have elapsed from the date on which the investor first acquired or should have acquired knowledge of the measure in question; and/or 2.) Not more than 12 months have elapsed from the conclusion of domestic proceedings; 3.) Before submitting the claim to arbitration, a minimum of 90 days' notice has to be given to the host state; and 4.) The investor must waive the right to initiate or continue any proceedings under the domestic laws of the host state.[86]

Unlike India, which utilizes its local courts for local remedies, the Government of Brazil and the Government of Malawi utilize their National Focal Points or Ombudsmen to settle an investment dispute arising from each of their investment measure.[87] Article 13.2 of the BIT States that this Committee shall conduct prior examination before the parties settle their disputes through consultations and negotiations.[88] Finally, Article 13.3 attributes an authority to the Joint Committee to settle the disputes for 60 days, and a 60-day extension based on the mutual agreement between the disputing parties and the Committee.[89] By referring to the procedures as presented in these two paragraphs, Indonesia should have its Article 32 of the Capital Investment Law equipped with rules concerning the settlement of foreign investment disputes through Indonesian local courts with a limited grace period, as what is presented in the India BIT Model Law 2016 and the Brazil-Malawi BIT.

By applying this mechanism, foreign investors in Indonesia who operate their business based on Article 5 paragraph (2) of the Capital Investment

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85 *Ibid*., 30-31.

86 *Ibid*., 31.

87 Article 13.1 Investment Cooperation and Facilitation Agreement Between The Federative Republic of Brazil and The Republic of Malawi.

88 Article 13.2 Investment Cooperation and Facilitation Agreement Between The Federative Republic of Brazil and The Republic of Malawi.

89 Article 13.3 Investment Cooperation and Facilitation Agreement Between The Federative Republic of Brazil and The Republic of Malawi.

Law can take legal action against norms that are considered detrimental to them based on several available domestic mechanisms. This explanation is based on Jimly Asshidiqqie's view that divides legal norms into three types, namely normative decisions that *regulate* (*regeling*) and are abstract and general, normative decisions that contain administrative determinations (*beschikking*) which are concrete individuals, and normative decisions called judgment (*vonnis*). [90] The following doctrine is clearly in line with the OI European Group vs. Venezuela Case, which also explains the definition of a measure subject to challenge in an arbitration tribunal.

The following discussion also presents how Indonesian foreign investors may challenge the statutory regulations and decrees impairing their rights. In other words, the highlighted tribunals in this paragraph shall be utilized to settle a complaint related to foreign investment. To challenge the actions of the Indonesian government in the form of an administrative decree (*beschikking*) and unlawful acts (torts) by the government (*onrechtmatige overheidsdaad*), the foreign investor in the form of a limited liability company can file a lawsuit to the state administrative court.[91] Meanwhile, foreign investors who feel aggrieved by the enactment of statutory regulations under the law (known as "*Undang-Undang*", in Bahasa Indonesia) can fight for their rights by conducting judicial review proceedings provided by the Supreme Court.[92] This mechanism is regulated under Article 24A of the Republic of Indonesia 1945 Constitution.[93] Finally, a foreign investor in the form of a limited liability company that is harmed by

With the establishment of a certain grace period in the provisions of the Indonesian BIT governing the ELR, Indonesia's sovereignty as the a

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[90] Mohammad Mahrus Ali, "The *Constitutionality* and Legality of Norms in Testing Laws against the 1945 *Constitution*," (2015) 12:1 *Constitutional Journal* 175.

[91] Muhammad Adiguna Bimasakti, "Onrechtmatig Overheidsdaad by the Government from the Viewpoint of the Government Administration Law," (2018) 1:2 *Peratun Law Journal* 274-275.

[92] Lintang Galih Pratiwi, "The Authority of Material Test (*Judicial Review*) of the Decree of the People's Consultative Assembly by the Constitutional Court," (2020) 26:4 *SASI* 515-517.

[93] Article 24A of the Republic of Indonesia 1945 Constitution.

measure in the form of a law (Undang-Undang) can request a *judicial review* to the Constitutional Court. [94]

host state can still be respected.[95] This opinion is in line with the view of Martin Brauch, explaining that several investment treaties establish ELR mechanisms through the opening of administrative and judicial mechanisms, with a period of three months to five years before the foreign investor can file international proceedings against the host country.[96] In addition, this practice is also in line with Roberto Ago's view that the ELR principle is an essential and absolute principle to determine whether or not there is an *internationally wrongful act*.[97]

In addition, the implementation of ELR with a grace period will also provide an incentive for the judicial power in Indonesia to implement the principles of speedy, simple, and low-cost trials contained in Article 2 paragraph (4) of the Judicial Power Law.[98] The application of this mechanism will enable hearings to be conducted in a short period of time.[99] In addition, this mechanism can also encourage the aforementioned judicial organs to carry out examinations in an uncomplicated manner and not make it difficult for objecting foreign investors, in order to respect Indonesia's sovereignty.[100] The implementation of ELR can be done by amending the Investment Law or by establishing a Supreme Court regulation or Constitutional Court regulation that contains this mechanism.

To lean back the debates of these discussions, it is important to note that although the chilling effect brought by the international investment law is

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[94] Jorawati Simarmata, "Formally Testing the Law by the Constitutional Court: A necessity," *Indonesian Legislation Journal* Vol. 14 No. 1 (2017), pp. 40.

[95] Martin Dietrich Brauch, "Exhaustion of Local Remedies in International Investment Law," (2017) 1:1 *International Institute for Sustainable Development*, 2-3.

[96] *Ibid*.

[97] Silvia D' Ascoli and Kathrin Maria Scherr, "The Rule of Prior Exhaustion of Local Remedies in the International Law Doctrine and its Application in the Specific Context of Human Rights Protection," (2007) 2:1 *EUI Working Papers Law* 3-5.

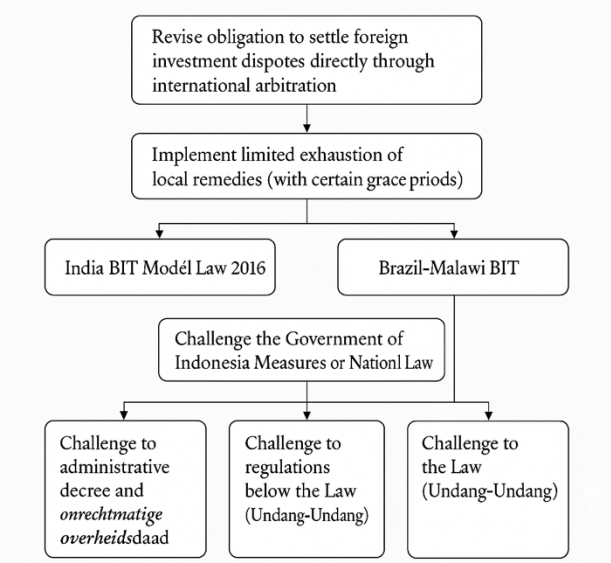
[98] Maya Hildawati Ilham, "A Study of Fast, Simple and Low Cost Courts towards Fulfilling the Rights of Justice Seekers," (2019) 7:3 *Verstek Journal* 213-215.

[99] *Loc.Cit*.

[100] *Loc.Cit*.

inherent, that does not mean that such nature shall permanently leave Indonesia under the shadow of fear. By adjusting the Capital Investment Law and the BITs, Indonesia may secure its investment measures so that it is implemented in line with the national interest. Besides, through such adjustment, striking such a balance can only be achieved by understanding the very nature of the IIL itself. By understanding the debatable concept of coherence and the non-isolated nature of the IIL regime, Indonesia may defend its national interest before the international arbitration tribunals or have its judiciary adopt an objective decision.

To end this final discussion, the following article summarizes it by presenting the flow chart below:



Revision of Article 32 of Indonesia's Law No. 25/2007

VI. CONCLUSION

The first discussion of this article clearly indicates that the chilling effect of the IIL regime is not a new issue. However, the fact that the Government of Indonesia hasn't adjusted its regulations to the prevailing rules of IIL caused this issue to remain significant. The research through this article, therefore, implements the doctrine of ELR by suggesting the amendment of Article 32 of the Indonesian Capital Investment Law. Through such an amendment, Indonesia may therefore avoid the chilling effect of the IIL through the ISDS mechanism and the SSID mechanism, as explained in

the second discussion. This conclusion also needs to remind the fact that such a chilling effect is caused by the large amount of compensation, the amendment of Indonesian regulations, and a potential shattering of economic partnership between Indonesia and other members of the ICSID Convention having a BIT or a regional agreement with Indonesia.

However, the chilling effect brought by the IIL regime shall not be perceived as an inevitable apocalypse (or the end of the world) for Indonesia as a state importing a large number of foreign investments. This is due to the presence of the coherence concept as a debatable subject in the IIL regime. By taking into account past IIL Cases, Indonesia may defend its national interest in line with the IIL regime. Furthermore, the nature of the IIL as a non-isolated legal regime shall also be taken as an opportunity for Indonesia to adopt an investment measure that takes into account environmental protection and human rights protection (protection of human, animal, and plant). As its final blow, this article suggests that Indonesia amend Article 32 of the Capital Investment Law so that foreign investors may settle their disputes in the Indonesian local courts besides the international arbitration tribunals. Although such procedures remain possible without amending Article 32 of the law, such action remains necessary to provide legal certainty and to ensure the transparency of Indonesian law concerning the settlement of disputes related to foreign investment.

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