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UNIVERSITAS PELITA HARAPAN
CITI CENTER FOR INTERNATIONAL TRADE & INVESTMENT

Indonesian Trade and Investment Quarterly

1st Quarter 2017

In This Issue

The Entry into Force of the Trade Facilitation Agreement: A Key Milestone for Global Trading System

A historical breakthrough for the multilateral trading system was reached on 22 February 2017. On that day, the World Trade Organization (WTO) announced the entry into force of the Trade Facilitation Agreement (TFA) after the organization obtained the two-thirds acceptance of the Agreement of its 164 Members needed to bring the TFA into force.

Concluded at the Bali Ministerial Meeting Conference in 2013 after nearly 10 years of negotiation, TFA was launched on 22 July 2014 by the WTO Chief Roberto Azevêdo and became operational on 27 November 2014 when Members adopted the Protocol of Amendment to insert the Trade Facilitation Agreement into Annex 1A of the WTO Agreement.

The Agreement aims to improve transparency and to reduce transaction costs associated with unnecessary administrative burdens on cross-border movement of goods and services. In today's globalized world, businesses trade more and more in intermediate goods. For example, trade in intermediate goods accounts for 60 percent of global commerce, and 30 percent of global trade is intra-firm, according to Joakim Reiter, the Deputy Secretary-General of UNCTAD in his statement on the SIECA event in WTO in 2016. He also highlighted that trade costs in developing countries unfortunately are still - on average - 1.8 times higher than in developed countries, and in some landlocked developing countries trade costs are as high as 40 percent. Red tape, inefficiencies, and corruption in cross-border trade can add as much as 15 percent to the price of goods which can undermine the competitiveness of developing country exports. Thus, trade facilitation implementation has a huge potential to boost trade and it is important to development.

To date, there are 114 WTO Members that have ratified a Protocol of Amendment domestically and notified the WTO of their acceptance of the Protocol. All ASEAN Members (that are also WTO Members) but Indonesia have presented the instrument of ratification to the WTO.

TFA provides flexibility for developing and least-developed country members. It allows them to set their own timetable for implementing the Agreement and provides for support to develop their capacity. To benefit of this flexibility, WTO developing Members must categorize the TFA provisions into categories A, B and C, depending on their capacity to implement these provisions, and notify other WTO members of these categorizations in accordance with specific timelines outlined in the Agreement. Category A provisions are those that the member will implement by the time the Agreement enters into force. Category B provisions comprise those that the member will implement after a transitional period following the entry into force of the Agreement. Category C provisions include those that the member will implement on a date after a transitional period following the entry into force of the Agreement and requiring the acquisition of assistance and support for capacity building. To date, 93 Members have notified their Category A commitments including least-developed countries such as Malawi, Madagascar, Solomon Islands, Cambodia, Lao PDR and Myanmar.

Indonesian government has conducted a number of evaluations and assessments domestically for implementing TFA and stated its readiness to ratify the Agreement last year. So, it is important for Indonesia to grasp this momentum. The ratification of trade facilitation agreement will not only show the government's support to the multilateral trading system but also send a positive signal to business operators and investors as it demonstrates government's strong commitment to create a business-friendly environment.

Trade Dispute on Indonesia Measures Affecting the Importation of Horticultural Products, Animals and Animal Products: An Update

In December 2016, the WTO panel ruled in favour of New Zealand and United States in a trade dispute against Indonesia's measures on horticultural products, animals and animal products. The WTO panel agreed with the co-complainants on 18 out of 18 claims that Indonesia's import restrictions and prohibitions (made effective/operative through import licenses) are inconsistent with WTO law. The panel found that Indonesia's measures by virtue of their design, architecture and revealing structure are inconsistent with Article XI of the GATT 1994. The measures at issue are as follows:

1. limited application windows and validity period;
2. periodic and fixed import terms;
3. 80% realization requirement;
4. harvest period requirement;
5. use, sale and distribution requirements;
6. reference prices for chilies, fresh shallots and beef;
7. six-month harvest requirement;
8. Indonesia's import licensing regime as a whole;
9. prohibition of importation of certain animals and animal products;
10. domestic purchase requirement for beef;
11. sufficiency of domestic production to fulfil domestic demand.

Following the issuance of the panel's report, Indonesian government filed appeal against the WTO panel ruling. As reported by the local media, Indonesian government views that they have implemented a 'deregulation package' which has improved the import regulations. Government, for example, has repealed MOT Regulation 16/2013 concerning Provisions of the Import of Horticultural Products, one of the regulations challenged by the co-complainants, and replaced with MOT Regulation 71/2015. In the new regulation, provisions relating to the harvest period and 80% realisation requirements are taken out, but those concerning the application windows are retained.

In the dispute, Indonesia tried to rely upon MOT 71/2015 to respond to the allegations submitted by the co-complainants, however the panel did not take into account the regulations enacted after the establishment of the panel since they do not fall within the panel's terms of references.

The Dispute Settlement Understanding (DSU) which sets out the rules and procedures of WTO dispute settlement clearly provides that the parties to the dispute, not the third parties, have the right to appeal a panel report. This means that both the winning and losing party can file appeal if they disagree with the panel's ruling and conclusions.

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Pursuant to Article 17.6 of the DSU, appeals are limited to issues of law covered in the panel report and legal interpretations developed by the panel. In other words, the appellant cannot ask the Appellate Body to examine the new factual evidence or re-examine existing evidence on which the panel report is based. Thus, the fact relating to the implementation of 'deregulation package' cannot be the reason of an appeal.

In its notification of an appeal, Indonesia focused their claims on legal questions. For example Indonesia referred to the principle of *lex specialis derogat legi generali* and argued that the panel erred in law in finding that Article XI of GATT applies more specifically on quantitative import restrictions on agricultural goods than Article 4.2 of the Agreement of Agriculture. Indonesia also challenged the panel's assessment on defences put forward by Indonesia under Article XX of the GATT.

If the Appellate Body agrees with the panel's findings and conclusions and uphold them, Indonesia should implement the adopted panel and Appellate Body reports. At the implementation stage, Indonesia can either claim that it has brought itself into compliance or enter into a mutually agreed solution. The co-complainants can disagree and request a compliance panel to examine whether the compliance measure has complied with the recommendations and rulings adopted by the Dispute Settlement Body (DSB).

In sum, if the dispute cannot be settled amicably or it is politically impossible for the losing party to comply, it is likely that the dispute will be sounded like a never-ending saga.

Indonesia and Freeport: Love-Hate Relationship?

Freeport is one of the first foreign investors that invested in Indonesia after Indonesia's independence. Freeport's investment was admitted through the Contract of Work (CoW) signed in 1967 and renewed for another thirty-year in 1991. The CoW established certain rights and obligations for both Freeport and Indonesian government.

In 2009, Indonesian government issued a new mining law. The stated objective of the law is to add value to Indonesia's mineral exports. In the beginning of 2017, Indonesian government issued implementing regulations of the 2009 mining law. These regulations are PP No 1 of 2017, Permen ESDM No. 5 and 6 of 2017. Freeport argues that these regulations undermine its right under the CoW. Under the new regulations, companies have to obtain a special mining license called 'IUPK' to get export approval. The new regulations stipulate that maximum area for mining exploration is 100,000 hectares and 25,000 hectares for production. These numbers are lower than the numbers provided in Freeport's CoW, and smaller than the current operational area of freeport which is around 200,000 hectares. The new regulations also state that mining companies have to process and refine raw minerals in domestic facilities prior to export. According to Freeport, existing domestic facilities can only accommodate 40% of Freeport's production, and thus they have to export the other 60%. The new regulations also require foreign mining companies to divest 51% of its shares to Indonesian entity, either public or private, at the 10th year of its operation.

In its annual report to the United States Securities and Exchange Commission, Freeport noted that the IUPK effectively removes the protections granted under the contract of work. In early February of 2017, Freeport warned government that they will bring the issue to international arbitration if there is no settlement reached between Freeport and Indonesian government in 120 days.

Should Freeport decided to settle the dispute through international arbitration, which international dispute settlement forum will they choose? What claims that are most likely invoked by Freeport?

Choosing the Forum

Choosing a forum or tribunal is the initial step to commence an arbitration process. There are two possibilities in the case of Freeport. One possibility is to bring the dispute to United Nations Commission on International Trade Law (UNCITRAL) based on the Contract of Work. Another possibility is to bring an Investor-State Dispute Settlement (ISDS) claim under available International Investment Agreement (IIA) where both investors of Freeport and Indonesia are a party.

Freeport's Contract of Work states that "any dispute arising out of the CoW will be settled in international arbitration based on UNCITRAL rules with the seat of the tribunal is in Jakarta". If Freeport chooses to pursue the claim based on its CoW, the arbitration process is likely to dispute the provisions contained in the CoW. Freeport has provided formal notice to the Indonesian government listing allegations of government's breach and violations of the CoW. The allegations include violations of Freeport's right to export, imposition of additional export duties, requirements to build smelter and requirement to divest its shares. Indonesian government might deny that Freeport is not required to build smelter and divest its shares, should Freeport choses to keep operating under its CoW. However, it is difficult to argue that the new regulations do not violate Freeport's right to export.

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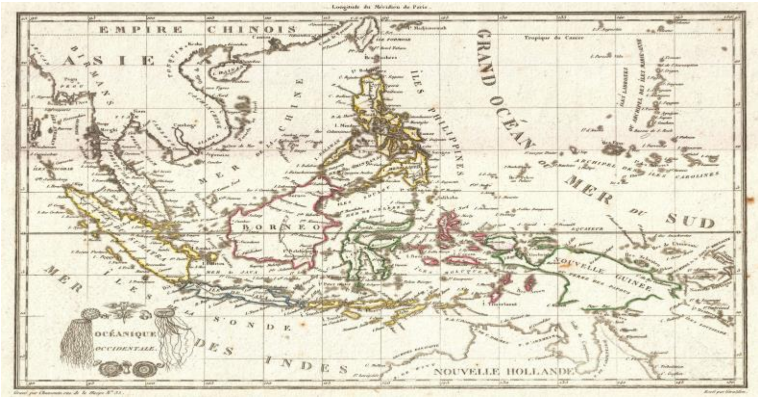
Other than UNCITRAL, it is possible for Freeport to bring an ISDS claim against Indonesian government. ISDS claims are usually brought by investors. The shares of Freeport Indonesia (PTFI) are owned by Freeport-McMoran Inc. (81.28% - United States), PT Indocopper Investama which is a subsidiary of Freeport-McMoran Inc. (8.36% - Indonesia.) and Indonesian Government (8.36%).

Currently there is no international investment agreement exist between Indonesia and the United States, so Freeport-McMoran Inc. (FCX) cannot directly pursue an ISDS claim. But, FCX has operations in many countries, including Chile, Peru and Finland. The Phillip Morris Asia Limited vs Commonwealth of Australia case shows that companies can do internal restructuring in order to benefit from an international investment agreement, although it is illegitimate to do so when there is a foreseeable dispute. Among the countries where Freeport has operational activities, Finland is the only country that has active bilateral investment treaty (BIT) with Indonesia.



However, learning from the case of Phillip Morris Asia Limited vs Commonwealth of Australia, it would be easy for Indonesian government to dismiss the claim if Freeport do what Phillip Morris did.

PTFI also has an incorporated joint venture with Rio Tinto, a mining company registered in United Kingdom and Australia. Rio Tinto has a 40% interest in certain assets and specific arrangement on the distribution of PTFI's expenses and revenue. Having invested in unincorporated joint venture with PTFI since 1995, Rio Tinto may as well bring a dispute for its investment in PTFI under the Australia or United Kingdom bilateral investment treaties with

Indonesia. Both treaties provide a broad definition of investment, which include "shares, stocks, bonds and debentures and any other form of participation in a company". Therefore, although Rio Tinto lacks of shares of ownership in PTFI, it is possible for the tribunal to consider Rio Tinto's unincorporated joint venture as an investment under both BITs.

Regardless of which investment agreement that PTFI or Rio Tinto will use when initiating arbitration process, one claim that is almost certain to be made is related to expropriation. It is important to note that both Australia and United Kingdom BITs with Indonesia prohibit expropriation, unless it is for public purpose, conducted on a non-discriminatory basis and the expropriating party provides compensation based on market value. The claimant is likely to argue that the regulations introduced by Indonesian government amount to indirect expropriation.

Prohibition to export raw minerals curb Freeport's activities to make profit out of its investment. In addition, if Freeport is to convert its CoW to IUPK, there are additional obligations that Freeport should fulfill, including building smelter and divesting 51% of its shares. However, Indonesian government could argue that the regulations are not intended to expropriate Freeport's investment. Instead, if Freeport processes its concentrate domestically, it will increase Freeport's revenue because refined minerals can be sold in higher price. Divesting its shares to Indonesian authorities may also give Freeport a favorable condition, because Indonesian authorities will put best effort to maximize Freeport's revenue as shareholders.

Another claim that can be pursued by Freeport is violation of fair and equitable treatment provision contained in the BITs. Fair and equitable treatment is a provision that ensures investors will receive minimum standards of protection in its investment. The issues invoked in fair and equitable treatment claims include denial of justice in local court, failure to respect legitimate expectations of investor and non-observance of due process. Freeport could argue that the series of regulations introduced by Indonesian government fail to respect legitimate expectations of Freeport when the investment was admitted.

There will be consequences for both Indonesia and Freeport if the case is brought to international arbitration. In its annual report to the U.S. Security and Exchange Commission, Freeport acknowledges that even if they prevail in the arbitration, they will face additional risk of having to enforce the judgement. Additionally, it will adversely affect their operations during and after the dispute. For Indonesia, winning the dispute against Freeport in international arbitration will give Indonesian government domestic political boost. On the contrary, if Indonesia loses the dispute, it is likely that Indonesia has to pay monetary compensation to Freeport. This, can be politically severe for Indonesian government.

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CITI regularly hosts and participates in seminars, workshops, and conferences related to international trade and investment.

UPH-CITI Attended SECO Steering Committee Meeting and Workshop

Bern, 23-24 January 2017

Representatives of all five countries involved in the Swiss State Secretariat for Economic Affairs/World Trade Institute Academic Cooperation Project participated in a steering committee meeting and workshop at the WTI on 23 and 24 January.

Michelle Limenta of UPH-CITI Participated as Panelist in ELSA Moot Court Competition Asia Pacific Regional Round

Singapore, 19-23 February 2017

The ELSA Moot Court Competition (EMC2) is a simulated hearing of the WTO dispute settlement system. The teams prepare and analyze a fictive case and present their arguments both for the Complainant and the Respondent in front of a Panel which consists of WTO and trade law experts. This year's Asia Pacific regional round was hosted by National University of Singapore and Asian Law Students Association Chapter. The teams who won the regional round will proceed to international round in Geneva.

Brown Bag Seminar by Dr. Ignacio Bartesaghi "ASEAN-MERCOSUR: Unlocking the Potential of Economic Cooperation"

Jakarta, 6 March 2017

On his visit to Indonesia, Dr. Ignacio Bartesaghi of Catholic University of Uruguay shared his view on potential cooperation between ASEAN and MERCOSUR in a brown bag seminar at UPH-CITI. There were around 25 participants attended the seminar coming from various backgrounds.

Our goal: To be the preeminent center for thought leadership and expertise on trade and investment policy and law in Indonesia

Universitas Pelita Harapan - UPH

Founded in 1994 with the vision of educating a new generation of leaders for Indonesia and the wider ASEAN region, Universitas Pelita Harapan is the number one private university in Indonesia according to the QS World University Ranking 2013. UPH was the first University in Indonesia to introduce programs entirely taught in English, the first to offer a liberal arts curriculum, and the first to introduce a multi-disciplinary approach to its programs. While consistently underlining the vision of "knowledge, faith and character", UPH, in cooperation with overseas partner universities, has developed a very rich curriculum in many areas of study, ensuring that its graduates are respected globally and appreciated by modern business and industry.

The Center for Trade and Investment - CITI

Established in September 2014, CITI's objective is to raise awareness in Indonesia of the importance of an outward-looking and liberal trade and investment policy, so as to ensure the country's continued commercial competitiveness and support its economic development goals. CITI runs a number of research, education and outreach initiatives with the generous support of the Swiss State Secretariat for Economic Affairs (SECO) and the World Trade Institute (WTI), Switzerland.

This quarterly newsletter seeks to provide updates, insights and analysis on current developments in trade and investment law and policy in Indonesia. Constructive feedback and comments are always welcome.

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Disclaimer: The articles are representative of the author's view, not necessarily the general view of the Center

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