

## ANALYSIS ON THE TERMINATION OF FOREIGN PUBLIC-PRIVATE PARTNERSHIP BY THE GOVERNMENT\*

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### ABSTRACT

The implementation of foreign public-private partnerships (PPP) as alternative funding to build an infrastructure of a country has been a common practice. However, upon the termination of the PPP, the government may intend to own and manage the infrastructure fully. This article analyses whether such a situation falls under the legal concept of expropriation or a breach of contract. The article uses the doctrinal research method that combines the statute approaches, conceptual approaches, and case approach. The research concludes that the distinction can be made based on the government's capacity as an authority or a party to the contract. If the government acts as a public authority, then the termination of PPP is considered as an indirect expropriation; if the government action is based on its commercial capacity or as a party to a contract, then the termination of PPP is considered a breach of contract.

**Keywords:** Public-private partnerships, expropriation, breach of contract, investment law.

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## ANALISIS PENAMATAN PERKONGSIAN AWAM-SWASTA LUAR OLEH KERAJAAN

### ABSTRAK

Pelaksanaan perkongsian awam-swasta asing (PPP) sebagai pembiayaan alternatif untuk membina infrastruktur sesebuah negara telah menjadi amalan biasa. Bagaimanapun, selepas penamatan PPP, kerajaan mungkin berhasrat untuk memiliki dan mengurus sepenuhnya infrastruktur tersebut. Artikel ini menganalisa samada situasi tersebut berada di bawah konsep undang-undang perampasan atau pelanggaran kontrak. Artikel ini menggunakan kaedah penyelidikan doktrin yang menggabungkan pendekatan statut, konsep dan kes. Penyelidikan menyimpulkan bahawa perbezaan boleh dibuat berdasarkan kapasiti kerajaan sebagai pihak berkuasa atau pihak dalam kontrak; jika kerajaan bertindak sebagai pihak berkuasa awam, maka penamatan PPP dianggap sebagai perampasan tidak langsung; jika kerajaan bertindak berdasarkan kapasiti komersialnya, atau sebagai pihak kepada kontrak, maka penamatan PPP dianggap sebagai pelanggaran kontrak.

**Kata kunci:** Perkongsian awam-swasta, rampasan kuasa, pelanggaran kontrak, undang-undang pelaburan.

### INTRODUCTION

There is a precise link between infrastructure and development. Infrastructure investment directly affects economic development.<sup>1</sup> A *bien connu* (commonly known) opinion in the economic field may imply that infrastructure development is coherent with economic growth.<sup>2</sup> This opinion can be proven in countries with developed economic conditions, which generally possess advanced infrastructure.<sup>3</sup> Therefore, to advance a country's economy, countries generally focus on infrastructure development programs, such as

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<sup>1</sup> B. Srinivasu and P.Srinivasa Rao, "Infrastructure Development and Economic growth: Prospects and Perspective," *Journal of Business Management & Social Sciences Research* 2, no.1 (January, 2013):81-91.

<sup>2</sup> Novi Maryaningsih, Oki Hermansyah, Mrynowati Safitri, "Pengaruh Infrastruktur terhadap Pertumbuhan Ekonomi Indonesia," *Buletin Ekonomi Moneter dan Perbankan* 17, no.1 (July, 2014): 61-98.

<sup>3</sup> Maryaningsih, Hermansyah and Safitri, "Pengaruh Infrastruktur terhadap Pertumbuhan Ekonomi Indonesia", 62.

infrastructure related to electricity, water, transportation, communication, etc.<sup>4</sup>

Besides having an impact on economic growth, the availability of infrastructure also plays a role in increasing the community's welfare.<sup>5</sup> Infrastructure development, which relates to the fundamental needs of the society, such as electricity supply, water supply, road construction for mobilisation, etc., will help increase their productivity. In addition, the development and operation of infrastructure will provide job opportunities for society. Therefore, through infrastructure procurement, the society will earn income to fulfil their necessities for living.<sup>6</sup>

A country is responsible for providing infrastructure for its citizens, considering the important role of infrastructure in economic development and social welfare. Indonesia is one of the countries that regulate this obligation which can be seen implicitly in the Preamble of the 1945 Constitution of the Republic of Indonesia, which is considered *staatsfundamentalnorm* (basic norms of the state) of Indonesia.<sup>7</sup> Under this Preamble, one of Indonesia's goals is to create public welfare.

In reality, it turns out that carrying out the provisions of the said Preamble is difficult. Indonesia's government frequently faces cost limits when providing the country's infrastructure due to a lack of cash or financial gap between the available and the required costs. The government therefore can collaborate with a private entity to cover this financial gap and solve the problem. This type of collaboration is called a "public-private partnership" (PPP).

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<sup>4</sup> Mega Lestari, "Pengaruh Pembangunan Infrastruktur terhadap Pertumbuhan Ekonomi dan Pemerataan Ekonomi Indonesia (Studi pada Badan Pusat Statistik Tahun 2003-2017)" *Jurnal Administrasi Bisnis* 70, no.1 (May, 2019): 98-105.

<sup>5</sup> Putu Putri Awandari, Bagus Indrajaya, "Pengaruh Infrastruktur, Investasi, dan Pertumbuhan Ekonomi terhadap Kesejahteraan Masyarakat Melalui Kesempatan Kerja," *Jurnal Ekonomi Pembangunan Universitas Udayana* 5, no.12 (December, 2016): 1435-1462.

<sup>6</sup> Antonio Estache, Gregoire Garsous, "The Scope for An Impact of Infrastructure Investments on Jobs in Developing Countries," *International Finance Corporation Notes* 4 (2012): 1-7.

<sup>7</sup> Wenda Hartanto, "Kesadaran Hukum Sebagai Aspek Dasar Politik Hukum Legislasi: Suatu Tinjauan Filsafat," *Rechtsvinding* 4, no.3 (December, 2015): 469-483.

PPP is regulated specifically by the Presidential Regulation Number 38 of 2015 on Public-Private Partnership for Infrastructure Procurement (PR 38/2015). The preamble of PR 38/2015 states that the availability of suitable and sustainable infrastructure is required to strengthen the national economy, community welfare, and Indonesia's competitiveness in international competition. This provision confirms the above statement regarding the importance of infrastructure in boosting economic growth and promoting public welfare.<sup>8</sup>

Article 1, number 6 of PR 38/2015, refers to a PPP collaboration between the government and another legal entity. One of such entities is a foreign legal entity (Article 1 Number 7 of PR 38/2015). Put another way, PPP may be carried out through an agreement with a foreign legal entity.

The PPP between the government and a foreign legal entity is concluded as foreign direct investment. This field is regulated by different legislation. Based on Article 1 Number 3 of Law Number 25, 2007,<sup>9</sup> foreign direct investment is investment activities to conduct business in the territory of the Republic of Indonesia carried out by foreign investors, both those who use wholly foreign capital and those in joint ventures with domestic investors.

The main obstacle to direct investment is the law of expropriation, as each state has the sovereignty to expropriate a foreign legal entity's asset. Expropriation is the deprivation of the whole or a portion of a foreign investor's rights through an official takeover.<sup>10</sup> This action is indeed harmful to foreign investors. Therefore, nations, including Indonesia, have guaranteed not to carry out expropriation,

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<sup>8</sup> Faizal Kurniawan, "National Interest As A Basis Of The Government Cooperation With Private Companies In Providing The Palapa Ring Infrastructure," *PalArch's Journal of Archaeology of Egypt/Egyptology* 17, no.3( August, 2020): 2025-2033.

<sup>9</sup> Law Number 25 Year 2007 regarding Investment, as amended by Law Number 11 Year 2020 regarding Job Creation (referred to as "Investment Law").

<sup>10</sup> Rudolf Dolzer and Christoph Schreuer, "*Principle in International Investment Law*" (Oxford: Oxford University Press, 2017), 176.

and if expropriation must be done, it must be carried out lawfully.<sup>11</sup> Article 7 of Investment Law states:

- (1). The government will not take actions to nationalize or take over the ownership rights of investors, except by law.
- (2). In the event that the government takes actions to nationalize or take over ownership rights as referred to in paragraph (1), the government will provide compensation, the amount of which is determined based on the market price.
- (3). If there is no agreement between the two parties regarding compensation or compensation as referred to in paragraph (2), the settlement will be carried out through arbitration.

The above provisions do include takeovers that indirectly affect foreign investors' rights called indirect expropriation. This condition might cause problems. One of which is whether termination of PPP is considered as an indirect expropriation or a breach of contract. As it is known, not every overseas' PPP is successful. For example, in the case of Karaha Bodas Company vs. Pertamina, the Indonesian government terminated a PPP between these two parties. As a result, Karaha Bodas filed a claim for compensation to the Geneva Arbitration. The Arbitration then determined that Indonesia was obligated to compensate Karaha Bodas Company for about US\$ 270 million due to the termination,<sup>12</sup> and indirect expropriation.<sup>13</sup>

Several nations have begun implementing rules on indirect expropriation due to the presence of proceedings relating to indirect expropriation. However, in Indonesia, it was discovered that no explicit legislation on indirect expropriation existed (*eeften in het recht*), which has resulted in a hazy distinction between direct and indirect expropriation. From the background above, the first legal issue analysed is distinguishing between direct expropriation and indirect

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<sup>11</sup> Rahmi Jened, "*Teori dan Kebijakan Hukum Investasi Langsung*" (Jakarta: Kencana, 2016), 317.

<sup>12</sup> Erni Dwita Silambi, "Penyelesaian Sengketa Ekonomi dan Bisnis Melalui Arbitrase Internasional (Studi Kasus Pertamina vs Karaha Bodas)," *Jurnal Ilmu Ekonomi & Sosial* 3, no.6 (October, 2012):296-306.

<sup>13</sup> Sukma Dwi Andriana, "Towards a Future Investment Treaty: Lessons from Indirect Expropriation Cases due to Measures to Protect the Environmental and Public Health," *European Business Law Review* 28, no.2 (January, 2017):245-269.

expropriation. The second legal analysed is whether foreign PPP's termination is considered an indirect expropriation or a breach of contract?

## METHOD

The legal issues above are analysed using doctrinal legal research. This method consists of statutory rules, analysing the relationships between these regulations, analysing current difficulties, and forecasting future legal changes.<sup>14</sup> This method allows the writer to explain the rules that govern the situations at hand comprehensively.

The statute approach, conceptual approach, and case approach were used in this legal research. The statutory method examines regulations relevant to the legal problems at hand.<sup>15</sup> A conceptual approach investigates the beliefs and doctrines that give rise to legal notions, concepts, and principles pertinent to the legal issues at hand. The case approach aims to research the application of norms or rules of law in the court.

## OUTCOME AND DISCUSSIONS

### **The Principles and Regulations of Direct Expropriation in Indonesia**

To grasp the notion of expropriation holistically, it is necessary to first expound the definition of expropriation. In Black's Law Dictionary, expropriation is a voluntary surrender or claim of rights.<sup>16</sup> In the case of a state, in general, expropriation is a process of distributing wealth from other parties to maximise the welfare of oneself or a specific

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<sup>14</sup> Muhammad Tang Abdullah, "Model Public Private Partnership Penyediaan Infrastruktur Pelayanan Publik: Pengalaman Indonesia dan India" *Publik, Jurnal Ilmu Administrasi*, 9, no.2 (December, 2020), 102-114.

<sup>15</sup> Peter Mahmud Marzuki, "*Penelitian Hukum*" (Jakarta: Kencana, 2011), 35.

<sup>16</sup> Henry Cambell Black, "*Black's Law Dictionary*" (Minnesota: West Publishing, 1990), 692.

group.<sup>17</sup> Expropriation within an area of foreign investors refers to the act of a host country seizing the ownership/property rights of foreign investors who invest in the host country.<sup>18</sup>

In principle, the host country has the authority to take over foreign investors' ownership or assets. This authority came from the sovereignty of a state; thus, a state has supreme control over its internal affairs.<sup>19</sup> But, because this move is harmful to international investors, the host government must give guarantees not to carry out expropriation towards a foreign investor.<sup>20</sup> Even if the expropriation should be carried out, it must be carried out lawfully.<sup>21</sup>

According to Rahmi Jened, the requirements for a lawful expropriation are: a) It was done for the public interest, b) it was not discriminatory, c) it was done by the law, and d) it was done with compensation.<sup>22</sup> The explanation for each element are as follow:<sup>23</sup>

### **1. It was done for the public interest;**

Expropriation must be done pursuant to the public interest, and not for private gain. The meaning of the public interest is very broad and abstract, and the national authorities assess it at the takeover time. If the expropriation is found to be for public interest sometime after the expropriation is carried out, the expropriation is still invalid.<sup>24</sup> For example, in *Siag and Vecchi v. Egypt*, the Egyptian government

<sup>17</sup> Novita Ayu Chandra Dewi, "Faktor-Faktor yang Mempengaruhi Praktik Ekspropriasi di Indonesia (Studi pada Perusahaan Publik yang Terdaftar di BEI)," *Jurnal Ilmiah Mahasiswa FEB Universitas Brawijaya* 3, no.1 (2015):2.

<sup>18</sup> Suzy Nikiema, "*Best Practices Indirect Expropriation*" (Canada: The International Institute for Sustainable Development, 2012), 1.

<sup>19</sup> Jened, "*Teori dan Kebijakan Hukum Investasi Langsung*", 311.

<sup>20</sup> Jened, "*Teori dan Kebijakan Hukum Investasi Langsung*", 311-317.

<sup>21</sup> I Gusti Ag.A.Mas Triwulandari, I Nyoman Budiana, "Nasionalisasi Perusahaan Penanaman Modal Asing Di Indonesia," *Jurnal Analisis Hukum* 1, no.1 (April 2018) :1-21.

<sup>22</sup> Jened, "*Teori dan Kebijakan Hukum Investasi Langsung*", 311-317.

<sup>23</sup> UNCTAD, "*Expropriation: UNCTAD Series on Issues in International Investment Agreements II*" (New York: United Nation,2012), 27-51.

<sup>24</sup> UNCTAD, "*Expropriation: UNCTAD Series on Issues in International Investment Agreements II*", 31-32.

expropriated the plaintiff's land, but the Egyptian government only used the land to build a pipeline six years later. This kind of action is considered an unlawful expropriation.<sup>25</sup>

## **2. It was not discriminatory;**

Discrimination means the difference in treatment of one party and another.<sup>26</sup> Expropriation is considered discriminatory if the host state mistreated foreign investors based on their nationality.<sup>27</sup> A host country cannot treat foreign investors less favourably than its national investors or treat one foreign investor less favourably than another.

## **3. It was done by the law;**

This element requires expropriation to be done according to the host state's national law and international principles, and foreign investors must be given the right to an independent review. This condition aims to protect investors from arbitrary expropriation: "a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."<sup>28</sup>

## **4. It was done with compensation.**

Most states use the Hull Standard to determine prompt, adequate, and effective compensation. Prompt means paid immediately. Effective means paid with freely used currency. There are few approaches to determine an "adequate" compensation, such as a) in accordance with the market value of the investment, b) genuine value, c) just compensation, and d) the real value of the expropriated investment at the time immediately before the expropriation was carried out or

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<sup>25</sup> UNCTAD, *"Expropriation: UNCTAD Series on Issues in International Investment Agreements II"*, 31-32.

<sup>26</sup> UNCTAD, *"Expropriation: UNCTAD Series on Issues in International Investment Agreements II"*, 54.

<sup>27</sup> "Non-Discrimination (Expropriation)", Jus mundi, accessed December 29, 2021, <https://jusmundi.com/en/document/wiki/en-non-discrimination-expropriation>.

<sup>28</sup> UNCTAD, *"Expropriation: UNCTAD Series on Issues in International Investment Agreements II"*, 36.



became known.<sup>29</sup> Based on Article 7(2) Investment Law, Indonesia uses the approach of market value to determine if compensation is "adequate."

Sometimes, the requirements regarding lawful expropriation are stated explicitly in the International Investment Agreements. For example, Article 4 of The Netherlands-Oman BIT (2009). Meanwhile, Indonesia's regulation regarding expropriation can be found in Article 7 of Law Number 25 of the Year 2007 on Investment (Law 25/2007), which only regulates the obligation to compensate when expropriation occurs.

### Indonesianization

Indonesia had performed expropriation against Dutch colonial companies back in 1958 was successful in acquiring foreign ownership of 246 Dutch factories and businesses. The term used, at that time, was not expropriation but "Indonesianization". The event of "Indonesianization" began when the post-independence Indonesian government was born. At that time, state leaders' interest was in building the national economy. As a result, community and political parties encouraged the Indonesian government to nationalise the Dutch companies.<sup>30</sup>

First, it is important to elaborate on the concept of expropriation and nationalisation. According to Andrianse, nationalisation is a neutral term used to refer to the process where private assets are transferred to the public under statutory or executive measures. It can be done with or without compensation. Since expropriation must be done with adequate compensation<sup>31</sup>, it can be concluded that expropriation is a part of nationalisation.<sup>32</sup> However, this legal research is focused on the term "expropriation".

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<sup>29</sup> UNCTAD, "*Expropriation: UNCTAD Series on Issues in International Investment Agreements II*", 42-43.

<sup>30</sup> Wasino, "Nasionalisasi Perusahaan-Perusahaan Asing Menuju Ekonomi Berdikari", *Paramita* 26, No. 1 (2016): 62-71.

<sup>31</sup> Jened, "*Teori dan Kebijakan Hukum Investasi Langsung*", 314-316.

<sup>32</sup> "Mengenal Ekspropriasi dan Nasionalisasi dalam Hukum Indonesia", *Hukum Online*, accessed December 29, 2021,

From the concept of expropriation, the concept of *ontegaining* came to the surface, which means the revocation of rights. The concept of *ontegaining* first appeared in the 1950 Provisional Constitution (UUDS). Article 27 of the UUDS stipulates that revocation of rights in the public interest is allowed on the condition that compensation is provided under the legislation.<sup>33</sup>

The inclusion of the concept of revocation of rights in the UUDS, which was the highest legal norm at that time (*staatsfundamentálnorm*), proved Indonesia's willingness to improve the national economy and to free itself from dependence on foreign countries, especially the Dutch Colonial government. This desire culminated in 1958 when the Dutch were not serious in realising the results of the Round Table Conference, which was returning the West Irian (now Papua) under Indonesian sovereignty. As a result, anti-Dutch ownership sentiment emerged. Many Indonesian businessmen took over the assets of Dutch companies unilaterally. To reduce the chaos that occurred, the government issued Law no. 86 of 1958 concerning the Nationalisation of Dutch-owned Companies (Nationalization Law).<sup>34</sup> Article 1 of the Nationalization Law stipulates that Dutch-owned companies located in the territory of the Republic of Indonesia are subjected to nationalisation and are declared wholly owned by the Republic of Indonesia. The nationalisation includes all company assets, collection rights, and other rights.<sup>35</sup> Then in 1959, The government issued Law No. 2 of 1959 concerning the main points of the implementation of Law no. 86 of 1958 concerning the Nationalisation of Dutch-owned Companies (PP Nationalization).

To implement the Nationalization Law, the government of Indonesia established the Nationalization Agency and the Compensation Committee:<sup>36</sup>

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<https://www.hukumonline.com/klinik/detail/ulasan/lt60c1739254810/mengenai-ekspropriasi-dan-nasionalisasi-dalam-hukum-indonesia/>.

<sup>33</sup> Wasino, "Nasionalisasi Perusahaan-Perusahaan Asing Menuju Ekonomi Berdikari", 62-71.

<sup>34</sup> Jened, "*Teori dan Kebijakan Hukum Investasi Langsung*", 311.

<sup>35</sup> Wasino, "Nasionalisasi Perusahaan-Perusahaan Asing Menuju Ekonomi Berdikari", 62-71.

<sup>36</sup> Wasino, "Nasionalisasi Perusahaan-Perusahaan Asing Menuju Ekonomi Berdikari", 62-71.

**a. Nationalisation Agency (BANAS)**

The establishment of this agency is based on Government Regulation no. 3 of 1959 BANAS which was formed with the aim "to ensure that the coordination in leadership, policy, and supervision of the production companies of Dutch-owned companies that have been subject to nationalisation can be maintained and enhanced". Thus, the purpose of this agency was to ensure the management of national economic assets obtained through nationalising Dutch companies.

**b. Compensation Committee (PGK)**

PGK was established based on Government Regulation No. 9/1959. PGK was tasked with managing compensation issues for foreign companies affected by nationalisation. PGK was authorised to: (1) conduct the necessary examinations on the condition of Dutch companies subjected to nationalisation and to determine the amount of compensation given, (2) notify the results of their work to the Nationalization Agency of Dutch Companies. The results of the determination of compensation determined by this committee or by the Supreme Court were to be published in the State Gazette.

From the discussion of the expropriation process from a historical perspective, it can be seen that initially, expropriation was more of a political action, resulting from the delay in returning the West Irian to the Republic of Indonesia. Second, before the issuance of the Nationalization Law, many parties confiscated the assets of the Dutch companies unilaterally without providing compensation. This action is a confiscation, not an expropriation. This confiscation was contrary to the current UUDS practices, where the UUDS requires compensations in the event of expropriation. Only then was the Nationalization Law issued, which supposedly aimed to "legalise" the confiscation act. The term "legalise" is considered appropriate because the Nationalization Law and its implementing regulations clearly state that compensation must be provided. In practice, compensations were not always given for various reasons, including limited government funds and political relations between Indonesia and the Netherlands. Because the expropriation process did not heed the principles of investment law and was heavily involved in political interference, experts have called the takeover of Dutch companies "Indonesianization."

## Indirect Expropriation Provisions in Investment Agreements

Since direct expropriation already has a well-defined legal framework, the government cannot carry out direct expropriation. Therefore, the host state makes provisions or actions that indirectly target foreign investors' rights.<sup>37</sup> One of which is called indirect expropriation, which deprives a portion of a foreign investor's rights without following the normal process of takeovers.<sup>38</sup>

Two motives can explain the emergence of indirect expropriation:<sup>39</sup>

- a. There are a considerable number of International Investment Agreements (IIAs) and Bilateral Investment Treaties (BITs) that protects investors from direct expropriation, including the right of an investor to challenge one's government who carried direct expropriation.
- b. Nowadays, the government's intervention in the economy is increasing, and sometimes those actions have a negative impact on the private sector.

Akin to direct expropriation, indirect expropriation also inflicts a financial loss to the foreign investor. Hence, indirect expropriation is also regulated under BITs, FTAs, and other investment agreements in its development. For instance, under *Dominican Republic-Central America Free Trade Agreement*, which mentioned:<sup>40</sup>

Article 10.7.1 addresses two situations. The first is direct expropriation, where an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure. The second situation addressed by Article 10.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

Another example of indirect expropriation can be found in Article 1110 of the North American Free Trade Agreement of 1992:

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<sup>37</sup> Nikiema, "Best Practices Indirect Expropriation", 1.

<sup>38</sup> Dolzer and Schreuer, "Principle in International Investment Law", 176.

<sup>39</sup> UNCTAD, "Expropriation: UNCTAD Series on Issues in International Investment Agreements II", 2.

<sup>40</sup> UNCTAD, "Expropriation: UNCTAD Series on Issues in International Investment Agreements II", 9.

No Party may directly or indirectly nationalise or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalisation or expropriation of such an investment ("expropriation"), except: ...<sup>41</sup>

It should be highlighted that both direct and indirect expropriation should be done legally. This means that criteria used in direct expropriation must be used equally to indirect expropriation: for the sake of public interest, not discriminatory, done according to the law, and must be accompanied by adequate compensations or indemnification.<sup>42</sup>

Although investment law, IIAs, and BITs contain guarantees not to conduct expropriation, whether direct or indirect, there are currently no clear and standard rules for assessing the scope of indirect expropriation. To put it another way, the criteria of indirect expropriation varies according to the investment treaties in question.

According to various IIAs and BITs, there are two characters in creating clauses regarding indirect expropriation. The first character distinguishes between two types of expropriation: (1) direct expropriation, and (2) actions that have an equivalent effect to expropriation. An example of the formulation of the clause is as follows: "expropriation, nationalisation and any other measure that has an effective tantamount to expropriation or nationalisation."<sup>43</sup> The second character distinguishes three things, namely (1) direct expropriation, (2) indirect expropriation, and (3) actions with similar characters or effects equivalent to expropriation. An example of the formulation of this clause is: "shall not, directly or indirectly, expropriate or nationalise or take any measure with equivalent character or effect."<sup>44</sup>

The distinction between the two characters mentioned above is that the first character does not differentiate between indirect expropriation with action with a similar characteristic or equivalent effect to indirect expropriation. In contrast, the second one does differentiate the two. The benchmark used to distinguish indirect

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<sup>41</sup> C Schreuer, "The Concept of Expropriation under the ETC and other Investment Protection Treaties", 5.

<sup>42</sup> Nikiema, "*Best Practices Indirect Expropriation*", 3.

<sup>43</sup> Nikiema, "*Best Practices Indirect Expropriation*", 8.

<sup>44</sup> Nikiema, "*Best Practices Indirect Expropriation*", 8.

expropriation and actions that are equivalent to indirect expropriation is the action's characteristics and/or effects. Determining whether the host state's action is a direct or indirect expropriation will bring consequences on how the arbitrator decides a case, such as analysing evidence and determining the amount of compensation.<sup>45</sup>

From the explanation above, we can conclude that most IIAs, BITs, and other investment agreements only regulate indirect expropriation generally. The reason is none other than the fact that there are too many possible actions that might be considered indirect expropriation. Dolzer and Steven stated:<sup>46</sup>

Such apparent reluctance to attempt a definition of 'expropriation' in the BITs may be explained by the fact that a host State, as is well known, can take a number of measures which have a similar effect to expropriation or nationalisation, although they do not de jure constitute an act of expropriation; such measures are generally termed 'indirect,' 'creeping,' or 'de facto' expropriation.

Table 1 below shows the differences between direct and indirect appropriation:

No	Indicator	Direct appropriation	Indirect appropriation
1	Principles	Every country's national legislation, as well as BITs and/or FTAs, govern the situation.	National laws do not explicitly control this, but it is governed by BITs and/or FTAs.
2	System	Property of foreign investors is nationalised or taken over.	Termination/contract termination, government policy, cancellation of a license, and so forth.

<sup>45</sup> Nikiema, "*Best Practices Indirect Expropriation*", 8.

<sup>46</sup> C Schreuer, "The Concept of Expropriation under the ETC and other Investment Protection Treaties", 5.

3	Scope	appropriation of financial firms' land is a more restricted kind of expropriation.	Since it is dependent on the arrangement under BITs and/or FTAs, it is broader.
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Table 1. Differences Between Direct and Indirect Appropriation.

After elaborating indirect expropriation clause in IIAs and BITs, it is necessary to look at some cases regarding indirect expropriation:

#### a. **Biloune vs Ghana**<sup>47</sup>

Antoine Biloune was the principal shareholder of Ghanaian Corporation, Marine Drive Complex Ltd (MDCL). Without any clear reason, the Ghanaian government arrested and deported Biloune from Ghana. Biloune then filed a claim of indirect expropriation of MDCL assets towards the Ghanaian government. The Tribunal stated that the arrest and deportation of Biloune were preventing MDCL to complete the approved project. Therefore, the Ghanaian government has performed contractual expropriation towards MDCL:

"The Tribunal, therefore, holds that the Government of Ghana, by its actions and omissions culminating with Mr Biloune's deportation, constructively expropriated MDCL's assets, and Mr Biloune's interest therein, not later than December 24, 1987. The Claimants are therefore entitled to compensation."

#### b. **Metalclad vs Mexico**<sup>48</sup>

Metalclad was an American-based company that operated a hazardous waste landfill. In 1993, Metalclad purchased a Mexican Company,

<sup>47</sup> "Biloune and Marine Drive Complex Ltd. V. Ghana", Jus Mundi, accessed December 29, 2021, <https://jusmundi.com/en/document/decision/en-biloune-and-marine-drive-complex-ltd-v-ghana-investments-centre-and-the-government-of-ghana-award-on-jurisdiction-and-liability-friday-27th-october-1989>.

<sup>48</sup> "Metalclad v. Mexico", Jus Mundi, accessed December 29, 2021, <https://jusmundi.com/fr/document/decision/en-metalclad-corporation-v-the-united-mexican-states-award-wednesday-30th-august-2000>.

Confinamiento Técnico de Residuos Industriales, SA de CV (hereinafter "COTERIN") and wanted to operate a hazardous waste transfer station and landfill in Mexico. Metalclad then filed an application to collect the construction permit. Unfortunately, the application was denied without a reasonable explanation. Metaclad then filed a claim based on an allegation that the Mexican Government violated chapter eleven, particularly Article 1110 of the North American Free Trade Agreement (hereinafter "NAFTA") about the prohibition of performing direct or indirect expropriation, as well as measures tantamount to expropriation. The Tribunal decision stated that by denying the Metalclad construction permit, The Mexican Government had performed an indirect expropriation, violating Article 1110 of NAFTA.

By analysing multiple cases regarding indirect expropriation, some of the forms of indirect expropriation have been found, including:<sup>49</sup>

- a. The foreign investor's third-party asset acquisition makes the contract between them worthless,
- b. The increase in taxes to the point where it distracts the company financial,
- c. The removal of a person who plays a key role in the partnership,
- d. The replacement of the foreign investor's management by people from the government,
- e. The revocation of a foreign investor's facility and/or permit,
- f. The interference in a contract leads to a breach or termination of the contract.

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<sup>49</sup> C Schreuer, "The Concept of Expropriation under the ETC and other Investment Protection Treaties", 3-4.



## The Concept of "Breach of Contract"

The occurrence of a breach of contract always requires a contractual relationship.<sup>50</sup> Contracts are made as instruments that specifically regulate the legal relationship between private and public bodies.<sup>51</sup> If the interests of contracting parties are unfulfilled, it will lead to a dispute between the holder and bearer of rights and obligations, respectively. In other words, a breach of contract may ensue.<sup>52</sup>

Breach of contract falls within the domain of civil law (private).<sup>53</sup> Article 1234 BW states that the purpose of a contract is to give something, to do something, or not to do something. The difference between doing something and not doing something often raises doubts and requires explanation; the first is positive, the second is negative.<sup>54</sup> '[D]oing something' means giving up ownership rights or the enjoyment of the use of an object. For example, A gives up a house or the enjoyment of rented goods to B. Similarly, 'not doing something' means letting something go or maintaining something that is actually like no engagement has to be created.

Breach of contract occurs when the performance of the contract does not proceed as agreed by the parties.<sup>55</sup> According to M. Yahya Harahap, in general, a breach of contract is the "implementation of obligations that are not carried out on time or carried out

<sup>50</sup> Siti Salwani Razali, "Online Contract And The Issues Of Gharar And Uncertainty," *IJUM Law Journal* 16, no.1(August, 2008): 51-64.

<sup>51</sup> Faizal Kurniawan, Xavier Nugraha, Ardhana Christian Noventri, "Auction Winner as A New Criteria in The Concept of Good Faith Buyer in Indonesia," *Jambe Law Journal* 4, no.2(November, 2021): 171-181.

<sup>52</sup> Yahman, "Karakteristik Wanprestasi Dan Tindak Pidana Penipuan Yang Lahir Dari Hubungan Kontraktual", (Jakarta: Prenada Media Group, 2016), 51.

<sup>53</sup> Faizal Kurniawan et al., "Unsur Kerugian Dalam Unjustified Enrichment Untuk Mewujudkan Keadilan Korektif (Corrective Justice)," *Yuridika* 33, no.1(February, 2018): 19-40.

<sup>54</sup> Faizal Kurniawan, Xavier Nugraha, Luisa Srihandayani, "Implementing the Undue Influence Doctrine (Misbruik Van Omstandigheden) as a Reason for Annulment of Agreement in Indonesia: An Evolution of the Law Through Court Decisions," *Journal of Talent Development and Excellence* 12, no.1(June, 2020): 3035-3040.

<sup>55</sup> Agus Yudha Hernoko, "Hukum Perjanjian: Asas Proporsionalitas dalam Kontrak Komersial", Cet.IV, (Jakarta: Prenadamedia Group, 2014), 261.

inappropriately". If so, a debtor is mentioned and is in a state of breaching the contract if he is negligent in carrying out the performance of his obligation timely, so that he is "late" and behind the stipulated schedule or the performance is not proper. A claim of "breach of contract" cannot be separated from "statement of negligence" (*ingebrekke stelling*) and "negligence" (*verzuim*). The consequences arising from default are the obligation for the debtor to pay compensation. In the case of a default, the innocent party can demand "cancellation of the contract/agreement".<sup>56</sup>

According to Setiawan, there are three forms of breach of contract in practice,<sup>57</sup> namely. One party does not perform his obligations at all; the performance is late, and the performance is not good. Situations where a breach of contract can occur include:

- i. Commitment to give something: when the debtor is unable to surrender the object or does not try to save it (*vide*. Article 1236 Indonesian Civil Code [hereinafter as BW]),
- ii. Commitment to do or not to do something: when the debtor does something that is prohibited or does not do something that must be done (*vide*. Article 1239 BW), and
- iii. Breach of contract occurs after a negligent statement from the creditor (see Article 1243 BW).

Generally, creditors use a default notice (*in mora stelling*; *ingebereke stelling*) to determine when a breach of contract occurs. The default notice usually contains a grace period for the debtor to fulfil his performance.<sup>58</sup> As for Article 1238 BW, the statement must be made in writing. In an arrest dated March 12, 1925, Hoge Raad decided that with a negligence statement that does not specify a specific time for performance, the debtor cannot be declared of breach of contract, even if such default notice is repeated.<sup>59</sup> From the decision, it can be

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<sup>56</sup> M. Yahya Harahap, "*Segi-segi Hukum Perjanjian*", (Bandung: Alumni, 1986), 60.

<sup>57</sup> Setiawan, "*Pokok-Pokok Hukum Perikatan*", (Bandung: Binacipta 1978), 18.

<sup>58</sup> Hernoko, "*Hukum Perjanjian: Asas Proporsionalitas dalam Kontrak Komersial*", 26.

<sup>59</sup> Marthalena Pohan, "*Wanprestasi*", *Yuridika*, 4, no. 3 ( Mei-Juni 198): , 198..

understood that the default notice is helpful to warn the debtor to know that the creditor wants the performance of obligations at a particular time.

But nowadays, the parties tend to use the '*fatal termijn*' clause in the contract. The clause contains a grace period for the performance of a contract. So that if the deadline is over and the debtor does not carry out his obligations, the debtor will automatically be considered as breaching the contract, and there will be no need for a default notice. A contract termination clause usually follows the above clause.<sup>60</sup> Other circumstances may not require a default notice. For example, when the debtor is reluctant to carry out his obligations, when the debtor admits his mistake, when the performance of the contract is not possible (outside of overmatch), the fulfilment of achievements is no longer meaningful, and when the debtor does not perform satisfactorily.<sup>61</sup>

However, the debtor cannot immediately be accused of default. There must be evidence for this; the allegedly defaulting party must also be allowed to submit defences or self-defence. The defaulting party may claim that (a) non-performance of contract occurred due to forced circumstances (*overmacht*), and (b) because the other party violated the terms of the contract.<sup>62</sup>

The legal consequence of breaching a contract is that the creditor has the right to sue for compensations. Article 1267 BW stipulates that: "The party to whom the engagement is not fulfilled, may choose; compel the other party to fulfil the contract, if it can still be done, or demand cancellation of the agreement, reimbursement of costs, losses, and interest." Based on the above Article, the aggrieved creditor can claim the followings: <sup>63</sup>

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<sup>60</sup> Hernoko, "*Hukum Perjanjian: Asas Proporsionalitas dalam Kontrak Komersial*", 262.

<sup>61</sup> Hernoko, "*Hukum Perjanjian: Asas Proporsionalitas dalam Kontrak Komersial*", 262.

<sup>62</sup> Niru Anita Sinaga, Nurlily Darwis, "Wanprestasi Dan Akibatnya Dalam Pelaksanaan Perjanjian", *Jurnal Mitra Manajemen* 7, no.2 (2015): 43-57.

<sup>63</sup> Hernoko, "*Hukum Perjanjian: Asas Proporsionalitas dalam Kontrak Komersial*", 263.

**a. Contract performance or specif performance**

The performance of the contract is a primary remedy. This kind of claim is only possible when it is due and can be billed to be carried out (opeisbaar).

**b. Compensations**

Compensations are a subsidiary; if the performance of obligations is impossible or not expected, then the alternative is compensations. Based on Article 1243 BW, the compensation includes costs (kosten), losses (schaden), and interest (interssen). Costs are actual expenses, e.g., travel expenses, notary fees, etc. Loss is the declining value of an object, while interest is the profit expected by a creditor.<sup>64</sup>

**c. Termination of contract**

It is necessary to distinguish between cancellation and termination of the agreement. If a contract is void, then the contract is considered never to exist. Meanwhile, if a contract is terminated, the contract still exists, but its implementation is terminated.<sup>65</sup> In the event of a breach of contract, what can be sued is the termination of the contract.

**d. Termination of contract and recompense**

In the occasion of a breach of contract, BW continues to provide legal protection for the debtor in the form of limiting compensation. The limitation of compensations is regulated in Article 1247 BW, 1248 BW, and Article 1250 BW. Article 1247 BW stipulates that: "The debtor is only required to compensate for costs, losses, and interest that have been manifest, or should have been predictable at the time the contract was born, except if the non-performance of the contract was due to a trick done by him." Then Article 1248 BW and Article 1250 BW states:

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<sup>64</sup> Leonora Bakarbessy dan Ghansham Anand, "*Buku Ajar Hukum Perikatan*" (Sidoarjo: Zifatama Jawara, 2018), 47.

<sup>65</sup> Hernoko, "*Asas Proporsionalitas dalam Kontrak Komersial*", 294.

**Article 1248 BW:**

Even the case that the engagement is not fulfilled is due to the debtor's deception, reimbursement of costs, losses, and interest-only regarding the losses suffered by the debtor and the lost profits for him consists only of what is a direct result of the non-fulfilment of the engagement.

**Article 1250 BW:**

1. In every engagement that is solely related to the payment of a sum of money, reimbursement of costs, losses, and interest simply due to delay in implementation, it only consists of interest as determined by law, without prejudice to special statutory regulations.
2. Compensation of costs, losses, and interest must be paid, without the need to prove a loss by being in debt.

From the three provisions above, the limitations on compensation in the event of a breach of contract include:<sup>66</sup>

**a. Expected losses when making a contract**

Predictable losses are not only about the incidence but also the amount. So that if the compensation claim exceeds the predictable amount, the excess cannot be charged unless the debtor uses deception.

**b. Losses as a direct result of breaching the contract**

A direct result refers to losses suffered by the creditor due to the default committed by the debtor. The causality theory used is the adequate theory: the losses experienced are a direct and immediate result of default.

**c. Interest determined by law**

Interest determined by law is called a moratorium interest. Based on Stb.1848-22 jo. Stb. 1849-63, the moratorium interest was 6% per annum. But of course, this amount can be determined by the parties to the contract.

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<sup>66</sup> Bakarbessy and Anand, "*Buku Ajar Hukum Perikatan*", 49-52.

Nowadays, in the construction of Indonesian law, a breach of contract is often associated with fraud. Many law enforcers think that the inability of one party to perform his obligations is a manifestation of a criminal act of fraud. The mixing of the legal construction of a breach of contract and the criminal act of fraud have often resulted in someone who cannot pay a debt, is considered to have committed an illegal act of fraud and has a person convicted. This, of course, causes a mixture of civil and criminal law enforcement. It is, of course, contrary to Article 19 paragraph (2) of Law Number 39 of 1999 concerning Human Rights, namely: "No one on a court decision may be sentenced to imprisonment or confinement based on inability to perform an obligation in a debt agreement."

The legal basis for the criminal act of fraud in Indonesia is provided in Article 378 of the Criminal Code, namely: "Anyone with the intention of unlawfully benefiting himself or another person, by using a false name or deceit, or a series of lies, inducing another person to hand over something to him, or to give a debt or write off a debt, is punishable by fraud with a maximum imprisonment of four years." From this description, it can be understood that the elements of a criminal act of fraud are:

1. Intention;
2. A benefit for oneself or others against the law;
3. Using a false name or false circumstances, reason or deception, a series of false words;
4. Persuading people to give something, making debts, or writing off debts.

In Article 378 of the Criminal Code, it is stated that the act is intentional. Therefore, fraud cannot be an act of negligence (*culpa*).

From this description, it can be understood that the main difference between a breach of contract and fraud lies in the '*tempus delicti*' or 'time' when "the agreement or contract is closed", or the agreement/contract is signed. If "after (*post-factum*) the contract is closed/signed, it is known that there was a trick, a series of lies or false circumstances, false dignity from one of the parties, then the act is a breach of contract. If the contract after signing turns out to be "previously" (*ante factum*) there was a trick, a series of false words or circumstances, false dignity from one of the parties, as for

circumstances or tricks, a series of false words, false circumstances, false dignity If it has been hidden by one of the parties, then the act is an act of fraud.<sup>67</sup>

### **Indirect Expropriation through The Government's Termination of The PPP Contract**

As elaborated in the previous section, one of the forms of indirect expropriation is contract expropriation. In this regard, one important matter to be noted is distinguishing between a breach of contract and a contract expropriation because, in principle, the two legal concepts are dissimilar.<sup>68</sup> This mixed-up is likely to happen if foreign investors signed a PPP with the government or state-owned business entities.<sup>69</sup>

Not every contract termination by the government is considered an indirect expropriation.<sup>70</sup> In a breach of contract, the legal regime is private law, whereas contract expropriation comes within the ambit of public law. Thus, a contractual breach is essentially not the same as contract expropriation. This difference has different juridical consequences when comparing a breach of contract and a contract expropriation.

If there is a PPP termination, it must be determined whether the act of such termination or PPP termination is a breach of contract or contract expropriation. It is necessary to look at the government's capacity in taking action to terminate the PPP to distinguish the two. One needs then to find whether the current government acts in a capacity of public authority or as a party to a contract.<sup>71</sup> This

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<sup>67</sup> Yahman, “*Karakteristik Wanprestasi Dan Tindak Pidana Penipuan Yang Lahir Dari Hubungan Kontraktual*”, 258.

<sup>68</sup> Nikiema, “*Best Practices Indirect Expropriation*”, 8.

<sup>69</sup> Nathan Jensen, Noel Johnston, Chia-yi Lee, Abdulhadi Sahin, “Crisis and Contract Breach: The Domestic and International Determinants of Expropriation,” *The Review of International Organization* 64, no.5 (2019) :1-40.

<sup>70</sup> “Contractor Claims for Expropriation of Contractual Rights on the Basis of International Investment Treaties”, International Bar Association, accessed December 30, 2021, <https://www.ibanet.org/clint-june-2021-contractors-claims-expropriation-contractual-rights>.

<sup>71</sup> UNCTAD, “*Expropriation: UNCTAD Series on Issues in International Investment Agreements II*”, 25-26.

understanding is in line with the arbitrator's reasoning in the *Suez vs Argentina* case:<sup>72</sup>

tribunals have made a distinction between *acta iure imperii* and *acta iure gestionis*, that is to say, actions by a State in exercise of its sovereign powers and actions of a State as a contracting party. It is the use by a State of its sovereign powers that gives rise to treaty breaches, while actions as a contracting party merely give rise to contract claims not ordinarily covered by an investment treaty.

If the government is terminating the PPP acts in the capacity of a public authority, then this action is considered as a contract expropriation. If so, then carrying out expropriation (directly or indirectly) must meet the lawful expropriation criteria explained in the previous section. If it turns out that the government is terminating the PPP acted in the capacity of a party to contract, then that action is deemed a breach of contract.

Determining a PPP termination as a breach of contract or contract expropriation entails different consequences or legal remedies that an investor may consider. If the action is a breach of contract, then the legal remedy that the injured foreign investor can carry out is filing a lawsuit on the grounds of breach of contract to the district court. Meanwhile, suppose the action is a contract expropriation. In that case, the foreign investor who suffered a loss due to the termination of PPP by the government has the right to file an investor-state dispute settlement (ISDS) claim. The purpose of such claims is to obtain remedies or compensation for the termination of PPP by the government.<sup>73</sup>

The problem that emerges is related to differentiating the government's capacity in committing actions. It is very vague to determine whether the government is acting as a public authority or as a party to a contract. One of the ways to answer this question is by examining the government's condition and motives:

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<sup>72</sup> International Centre for Settlement of Investment Disputes, “*Decision on Liability Case No. ARB/03/17 between Suez, Sociedad General de Aguas de Barcelona S.A., and InterAgua Servicios Integrales del Agua S.A. (Claimants) and The Argentine Republic (Respondent)*”, (2000).

<sup>73</sup> Amelia Maulanasari, “Remedies dalam Putusan ICSID dalam Sengketa Investasi Internasional,” *Jurist-diction Law Journal* 1, no.1 (September, 2018):66-84.



- a. If the government terminates the contract for the public interest, then the government is acting as a public authority,
- b. If the government uses its "governmental power" to terminate the contract e.g. requesting contract amendments because the transfer of power to the new government occurs, such termination through legislation. In that case, the government is acting as a public authority.

For a better understanding, it is necessary to look at existing arbitration decisions, for instance, in the case of *Waste Management vs Mexico*<sup>74</sup>, it was held that:

The normal response by an investor faced with a breach of contract by its governmental counter-party is to sue in the appropriate court to remedy the breach. It is only where such access is legally or practically foreclosed that the breach could amount to a definitive denial of the right and the protection of Article 1110 [‘Expropriation’] be called into play.

Another example is a case between *Waste Management vs Mexico*. The Mexican government failed to pay its bills regarding waste disposal towards Waste Management. This refusal caused the government to terminate its contract with Waste Management. Therefore, Waste Management filed a claim against Mexico based on indirect expropriation to the Tribunal. The Tribunal decided that Mexican Government actions were merely a breach of contract. The business failed because of a miscalculation of business assumptions. Thus, the Mexican Government act based on its commercial capacity, not a public authority.<sup>75</sup>

Based on the above provision, foreign investors who suffer losses due to the termination of PPP by the government ought to consider that the government has breached the contract. Therefore, they must initially file a lawsuit on the grounds of breach of contract to the District Court as the first attempt at dispute settlement. Then, if only

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<sup>74</sup> UNCTAD, “*Expropriation: UNCTAD Series on Issues in International Investment Agreements II*”, 26.

<sup>75</sup> C Schreuer, “The Concept of Expropriation under the ETC and other Investment Protection Treaties”, 26.

such a lawsuit is rejected or unaccepted, will the foreign investors have the right to file an ISDS claim based on indirect expropriation.<sup>76</sup>

## CONCLUSION

According to the above definition, direct expropriation is when a country takes over the ownership/property rights of international investors who have invested within this country. In contrast, indirect expropriation is when a government expropriates a portion or all of the rights of international investors without going through a formal takeover process. Regulation, form, and scope of action are three matters that separate those two. Expropriation, both direct and indirect, must be done legally. The indicators are: the expropriation is done in the public interest, without discrimination, according to the law, and with adequate compensation.

To establish the termination of PPP by the government as an indirect expropriation in the form of contract expropriation or breach of contract, one must examine the government's capacity, whether as a public authority or as a contracting party. If the government action is based on its capacity as a public authority, then the termination of PPP by the government is an indirect expropriation. But, if the government acts as a party to the contract, such conduct constitutes a breach of contract. One of the ways to determine the government's capacity in terminating foreign PPP is by analysing the government motives and conditions. If the government terminates the contract for the sake of public interest and/or terminates the PPP through legislation, then the government is using its capacity as a public authority. However, it is not easy to assess the government's capacity in terminating foreign PPPs. The normal reaction of foreign investors who have suffered losses due to the termination of the PPP by the government is to consider the act as a breach of contract. Therefore, they must first seek a settlement by bringing a case in the High Court based on breach of contract. A foreign buyer will then have the ability to bring an ISDS claim based on expropriation if his case was rejected or denied by the said court.

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<sup>76</sup> UNCTAD, "Expropriation: UNCTAD Series on Issues in International Investment Agreements II", 26.