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The Application of Legitimate Expectations to The Investment Legal Framework in Indonesia

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Abstrak

Legitimate Expectation adalah situasi di mana perilaku negara menciptakan ekspektasi bagi investor asing, yang jika tidak terpenuhi, dapat merugikan investasi mereka. Investor asing menyesuaikan tindakan bisnis mereka agar sesuai dengan kerangka hukum domestik yang ditetapkan oleh pemerintah Indonesia untuk memastikan kelancaran kegiatan usahanya. Untuk menarik lebih banyak investasi asing, pemerintah memperkenalkan UU 11/2020 dan amandemennya yang bertujuan untuk merampingkan birokrasi dan melonggarkan pembatasan bagi investor asing. Namun, putusan inkonstitusionalitas bersyarat dijatuhkan terhadap UU 11/2020 oleh MK dan mengharuskan perbaikan dalam waktu dua tahun atau berdampak pada inkonstitusionalitas, menciptakan keraguan di antara calon investor asing dan investor asing yang sudah ada karena adanya ketidakpastian hukum terkait perizinan usaha dan ekosistem investasi. Penelitian ini akan menganalisis penerapan *legitimate expectation* dalam kerangka hukum Indonesia dan meninjau potensi pelanggaran. Penelitian ini menggunakan metode yuridis normatif, dengan menggunakan analisis kualitatif terhadap data hukum primer dan sekunder, dan menyimpulkan bahwa *legitimate expectation* investor asing dapat muncul dari berbagai tindakan pemerintah. Lebih lanjut, kerangka hukum investasi di Indonesia saat ini tidak menunjukkan inkonsistensi yang merugikan, karena perubahan yang dibuat sejauh ini tidak melanggar kewajiban perlindungan investor asing. Oleh karena itu, perlindungan terhadap *legitimate expectation* hanya dapat diberikan jika perubahan terhadap kerangka hukum bersifat drastis atau tidak wajar.

Kata Kunci: *Investasi, Legitimate Expectation, Kerangka Hukum*

Abstract

Legitimate Expectation is a situation where state behavior creates expectations for investors, which, if unmet, can harm their investments. Foreign investors conform their business actions to fit the domestic legal framework set by the Indonesian government to ensure smooth operations. To attract more foreign investment, the government introduced Job Creation Law and its amendments aimed at streamlining bureaucracy and relaxing restrictions for foreign investors. However, the conditional unconstitutionality clause in Job Creation Law, requiring revision within two years or facing permanent unconstitutionality, creates doubts among potential and existing foreign investors due to the perceived legal uncertainty regarding business licensing and the investment ecosystem. This research project analyzes the application of legitimate expectations within Indonesia's legal framework and examines potential violations. The study employs the normative juridical method, using qualitative analysis of primary and secondary legal materials, and finds that foreign investors' legitimate expectations can arise from various government actions. Furthermore, the current investment legal framework in Indonesia does not exhibit detrimental inconsistencies, as changes made thus far have not undermined foreign investor protection. Therefore, protection of legitimate expectations can only be granted if modifications to the legal framework are drastic or unreasonable.

Keywords : *Investment, Legitimate Expectation, Legal Framework*

INTRODUCTION

Investment by foreign investors is an effective catalyst for the economic development of the country of investment by increasing the productivity of national economic resources. Developing countries, including Indonesia, see foreign investment as one of the means to realize people's welfare as it brings modernization, increases income, and creates much-needed jobs to increase national economic productivity. Several empirical studies mention that foreign investment has a large contribution to the economic productivity factor and the increase in income of the host state, in addition to the contribution of domestic investment (OECD, 2002).

The host country, in accommodating the needs of foreign investors to expand in their country, conducts international agreements with other countries or commonly known as the International Investment Agreement ("IIA") to provide legal certainty for the protection of foreign investors. IIA is an investment agreement made between countries containing a series of regulations and commitments to regulate, provide certainty, and protect foreign investors between the agreed countries. This IIA can be carried out by more than two countries as stated in the Bilateral Investment Treaty ("BIT"). In this case, the general purpose of a BIT or similar agreement is for the "promotion and protection" of investments from one state party in the territory of another state party (Houde, et.al, 2004).

BITs are generally formed to cover these five crucial matters, namely: (1) definition of investment and investor; (2) admission or entry of foreign investors; (3) Fair and Equitable Treatment ("FET") for foreign investors; (4) compensation in case of expropriation; and (5) dispute settlement mechanism between foreign investors and the state (Subedi, 2008). Indonesia in this case has an obligation to implement FET for foreign investors in its territory because it is a bona fide principle recognized by international law and binding under the IIA (OECD, 2004). The meaning of "fair" in the context of international investment law has two main layers, where the first layer implies the extent to which state regulation can satisfy the legitimate expectations of investors with a fair distribution of costs and benefits and the second layer includes justice for investors to receive fair due process of law for their business activities. Meanwhile, the meaning of "equitable" in this case means in accordance with the principles of justice and truth and is balanced in all government actions (Diehl, 2019).

Almost all BITs in the world contain similar substance of FET clauses which include protection against: (1) protection of foreign investors' assets; (2) denial of justice; (3) failure to meet legitimate expectations; (4) coercion and harassment by state organs; (5) failure to provide a stable and predictable legal framework; (6) unjust enrichment; (7) bad faith; (8) non-transparent conduct; and (9) arbitrary and discriminatory treatment. One of the important elements in the FET standard is the doctrine of Legitimate Expectation, which is a situation where the Host State's behavior creates a reasonable and justifiable expectation for the investor to make a commitment, where the state's failure to meet the investor's expectations will cause harm to its investment.

Investor expectation protection is rooted in the principles of the Host State's domestic law and is aimed at creating protection and legal certainty for investors to adjust or extrapolate any of their business actions to comply with domestic law or commitments set by local authorities (Brown, 2009). Every investor has a basic expectation that the Host State will always behave consistently, unambiguously, and transparently in all matters relating to its investment. A state that acts in bad faith to arbitrarily revoke a pre-determined decision, revoke a business license that an investor relies on to conduct its business activities, or issue a new arrangement that deprives an investor of its rights, will certainly cause harm to the foreign investor's business activities. Thus, if the competent authority takes a different action than what has been determined previously, this will violate the Legitimate Expectation of foreign investors who rely on the fulfillment of such commitments. Thus, if the competent authority takes a different action from what has been determined previously, this will violate the Legitimate Expectation of foreign investors who rely on the fulfillment of these commitments (Schønberg, 2000).

The Indonesian government currently has great ambitions to increase the influx of foreign investment by improving the business climate in Indonesia. One of the efforts made by the Indonesian government to attract foreign investors is to issue Law Number 11 of 2020 on Job Creation ("Job Creation Law") which has been amended by Government Regulation in Lieu of Law Number 2 of 2022 on Job Creation ("Perppu 2/2022") which has been amended by Law Number 6 of 2023 on Perppu 2/2022 on Job Creation into Law ("Job Creation Law") and its implementing regulations. The Job Creation Law significantly reforms the complex bureaucracy of conducting business in Indonesia, and relaxes restrictions in crucial areas for foreign investors, such as: labor, investment, business licensing, corporate tax, and even land acquisition for foreign investors (BKPM, 2022).

However, there were several conflicts that came along with the promulgation of this regulation. There is opposition to the enactment of the Ciptaker Law from various layers of society, especially laborers and students. Although it benefits foreign investors, various labor unions in Indonesia consider this regulation to be detrimental to domestic workers and laborers because this regulation is considered to result in lower wages for workers, a decrease in the calculation of severance pay, and an easy mechanism for terminating employment. In addition, many people believe that the regulation of the Ciptaker Law is 'ridden' by certain political interests because it is very favorable to foreign investors or large corporations. Therefore, the community has filed several lawsuits to the Constitutional Court for the annulment of the Job Creation Law.

The Constitutional Court on 25 September 2021 through Decision Number 91/PUU-XIX/2021 declared Job Creation Law conditionally unconstitutional due to formal defects in the formation process of the Job Creation Law. A law declared unconstitutional by the Constitutional Court is by law void from the beginning (*ad initio*) or implies that all state administrators and the public are not bound to implement the legal norms contained in the law, including its implementing regulations (Siahaan, 2010). The conditional unconstitutionality stipulated to Job Creation Law creates doubts for foreign investors who want to invest in Indonesia and foreign investors who have invested in Indonesia due to the enactment of Job Creation Law, due to the perceived legal uncertainty of business licensing and the investment ecosystem. This paper will divide the discussion into two sections, namely (1) the existence and application of Legitimate Expectation in Indonesia's investment law framework and (2) the Indonesian government's actions in creating an inconsistent legal framework might indirectly violate the legitimate expectation of foreign investors.

RESEARCH METHOD

This study employs a normative juridical research method to examine a legal issue, utilizing both a statutory approach and a theoretical-descriptive conceptual approach. The data analysis is conducted through qualitative analysis, which involves the recording, classification, and identification of patterns in the data, which are then presented in descriptive narratives. Regarding the data sources, this analysis relies on secondary data, including primary research sources such as legal instruments (laws and policies), secondary research sources such as legal materials that provide explanations of primary legal materials (books and journal literature), and tertiary research sources such as instructional materials that aid in understanding the clarity of primary data (articles and indexes). This research is a type of library research, namely research whose object of study uses library data in the form of books as a source of data. Reading, reviewing, and analyzing various existing literature, in the form of books, scientific journals, international journals, laws and regulations and research results.

RESULT AND DISCUSSION

1. The Existence and Application of Legitimate Expectation in the Indonesian Investment Legal Framework

The legal regulatory framework in Indonesia does not explicitly recognize the existence of legitimate expectation as a doctrine adopted to protect the interests of foreign investors. When comparing with the legal framework of other countries, such as the European Union, the doctrine of legitimate expectation has been integrated into the administrative law framework of the country (Quinot, 2004). Indonesia's legal framework has not accommodated the recognition of legitimate expectation like the European Union. However, legitimate expectation does not need to be explicitly included in the country's legal framework for investors to bring claims to the foreign investment dispute resolution forum. This is because legitimate expectation is one part of the fulfillment of Fair and Equitable Treatment contained in commitments in BITs or other investment treaties. Apart from its existence as an obligation arising from international treaties, Fair and Equitable Treatment is also known as one of the minimum standards in international law (OECD, 2002).

Violation of this norm gives rise to international responsibility of the state and may pave the way for international action on behalf of the aggrieved foreign investor, provided that the foreigner has exhausted local remedies. Considering that Indonesia has become a state party to various BITs with other countries, the Indonesian state must indirectly recognize and comply with the obligation to protect the legitimate expectations of foreign

investors. If the Indonesian government does not fulfill its obligation to always maintain the legitimate expectations of foreign investors, then Indonesia is not only declared to have violated its obligations in international treaties, but also violated customary international law.

There are three basic situations of government commitment that can lead to legitimate expectations of foreign investors, namely 1) contractual engagement, (2) representation by an authorized official, and (3) the legal framework of the country (Potesta, 2013). *First*, the Government of Indonesia often enters into contractual arrangements with foreign investors to undertake public projects such as infrastructure in Indonesia. These contractual agreements contain promises to do or not to do an action, provisions regarding payments or benefits, commitments to provide a service or provide goods, as well as other provisions regarding the fulfillment of promises and conditions agreed between the government and foreign investors (Surachman, et.al, 2020). These investment agreements are specific and can be categorized as representations from the government directly to investors to make a commitment.

Second, a situation where the government provides representation in the form of formal or informal guarantees that are taken into account by foreign investors in making their investments. In this situation, not every representation or guarantee can be accepted to generate a legitimate expectation. The requirement for a representation to be valid is when there is a specific promise, as it concerns an object of the agreement, and its form is unambiguous. In addition, the representation must be addressed to the foreign investor specifically. Formal representation involves government officials making official statements through established channels like laws, regulations, policies, contracts, notices, or guidelines to guarantee foreign investors. Informal representation, however, involves unofficial and non-binding communications by authorized officials, which can create legitimate expectations for foreign investors. This includes verbal assurances, informal policies, official guidance, or promises made outside formal settings (Mairal, 2010).

The President of Indonesia, Jokowi, often makes representations that guarantee the business climate in Indonesia to attract foreign investors. At the Mandiri Investment Forum in 2022, which was attended by various foreign investors, Jokowi explicitly stated "I invite investors to invest in Indonesia. The government guarantees the security of your investment in Indonesia". A president's guarantee for the security of foreign investors' investments is a representation that can lead to legitimate expectations. Jokowi indirectly commits that all foreign investments in Indonesia will run safely, so the government's failure to maintain this security is a violation of Fair and Equitable Treatment.

Thirdly, situations where foreign investors rely on the legal and legislative framework and general regulations in place at the time of their investment may give rise to legitimate expectations. In Indonesia's own legal framework, Article 4 of Law 25/2007 explicitly imposes an obligation on the Government of Indonesia to always provide equal treatment for every investor and guarantee legal certainty, business certainty, and business security for investors from the licensing process until the end of their investment activities. In addition, the Indonesian government's commitment to ensuring legal certainty is also reflected in the preamble or preamble of BITs between Indonesia and other countries, where Indonesia is committed to creating a favourable legal framework for foreign investors.

The said BIT contains provisions that ensure the stability of the Host State's legal framework. The above provisions imply that regulatory stability, i.e. a situation where the legal framework for investment in the Host State has not been or will not be fundamentally and adversely changed, is considered important by foreign investors. This is because the viability of the commercial aspects of the business depends largely on the stability of the regulatory framework as unanticipated regulatory changes by the Host State government can severely hamper the profits expected by the investor. Stability of the regulatory framework as a technical term in international investment law can be understood as the efforts made by the state to keep the legal environment surrounding the investment stable for the duration of the investment by the foreign investor. This legal environment consists of contractual or semi-contractual arrangements, unilateral Host State guarantees, or the Host State's general legal framework at the time of the investment (Hirsch, 2011).

Not all BITs between Indonesia and other countries provide for and guarantee the stability of the domestic legal framework. In situations where BITs protecting foreign investors in Indonesia do not provide for stability provisions, the principle of legitimate expectation still plays an important role in protecting investors when disputes arise under the BIT framework. Legitimate expectation in the principles contained in Fair and Equitable Treatment can provide an additional level of stability to the investment legal framework and protection for foreign investors (Kopar, 2019). Therefore, foreign investors can rely on their legitimate expectations on a legal framework in the country, when the government in the country directly conducts promotional activities aimed at attracting foreign investors to invest.

2. The Indonesian Government's Actions in Creating an Inconsistent Legal Framework Indirectly Violate the Legitimate Expectation of Foreign Investors

One of the minimum standards in the international framework for the fulfillment of Fair and Equitable Treatment is the obligation of the state not to change the investment legal framework in a detrimental manner to disadvantage certain foreign investors. The meaning of stability in this case requires that foreign investors have the right to expect that the legal framework of the country in which the investment is made will not be significantly changed by the Host State (Valenti, 2014). On the one hand, a foreign investor may argue that it can legitimately rely on a general expectation that the regulatory legal framework in place at the time of its investment will not be modified (at least in a substantial way) by the Host State to the detriment of the foreign investment. On the other hand, an investor's expectations will merit protection under the Fair and Equitable Treatment provisions only if they are (a) reasonable and reasonable in the particular circumstances and (b) balanced against the Host State's power to regulate in the public interest (Ortino, 2018).

The reasonableness of legitimate expectations of foreign investors has the characteristics that the expectations are based on the conditions offered by the Host State government at the time of investment, the expectations are not set unilaterally, the expectations exist and can be legally justified, so that in the event of a violation by the Government, there will be an obligation to compensate foreign investors unless there is an exception in an emergency, and the expectations must arise by considering other parameters such as commercial, political, and legal risks arising from regular patterns of business in the country. According to the World Bank Report, political risk in investment is the possibility of disruption of a company's operations by political forces and events, both within the domestic legal framework and international legal events, which result in uncertainty over the actions of the government and society in the country concerned.

Legal risk is another risk besides political that is crucial and must be considered by foreign investors. Legal risk stems from the state's actions in issuing a legal product or legal uncertainty that causes very significant business consequences, characterized by losses to the business. Legal risk will affect the reputation owned by foreign investors in running their business, because a lawsuit or claim of non-compliance with applicable laws and regulations in the country will have an impact on their business risk. Foreign investors in this case must consider the potential legal risks that will occur from the political situation that occurs in the Host State of their investment target (Moorhead, 2014).

Changes in Indonesia's legal framework from the Investment Law, to Job Creation Law formulated in the form of an Omnibus Law, then amended again into Perppu 2/2022 and

currently enacted into Law 6/2023 show that there are indeed changes in foreign investment regulations in Indonesia that are carried out periodically and tend to reflect inconsistent patterns. Indonesia's foreign investment legal framework, particularly the Job Creation Law can be considered to provide the necessary guarantees in terms of fundamental protection of the acquired rights and legitimate expectations of foreign investors. The government by acting inconsistently affects the basic expectations that investors have calculated to make investments in Indonesia. Moreover, given that the purpose of BITs is to encourage and promote foreign investment, the protection of the stability and predictability of the legal framework underpinning the investment is crucial.

The question arising from this is whether the Indonesian government has an obligation to accommodate all losses suffered by foreign investors due to changes in the legal framework when there are claims of violations of legitimate expectations. It should be understood that the state's action in changing the legal framework in its country is part of its highest authority and sovereignty. Given that the basic function of law in Indonesia is a tool to maintain order in society, therefore the law must also be able to assist the process of changing society by being adaptive in the context of renewal and development of society in the desired direction (Kusumaatmadja, 2002). Thus, it is very natural that the Indonesian government has changed the international investment law several times in the country's legal framework to adjust to the needs of investors and national interests.

When looking at Indonesia's current legal framework, the Job Creation Law does offer conditions that ensure the protection of the sustainability of foreign investors in Indonesia. However, to assess the reasonableness, it needs to be considered that the expectation that investment laws and regulations in Indonesia will remain unchanged is a unilaterally set expectation. Unless a government official with the capacity to act on behalf of the state makes a specific commitment that the legislative framework will not be changed, a foreign investor's assumption that a BIT will protect its expectation of unchanged law is invalid. In addition, any expectations held by foreign investors must arise by taking into account other parameters such as commercial, political, or regular patterns of business risks. Indonesia's investment regulations, particularly the Job Creation Law, were amended several times aimed at meeting the needs of society and were done by the authorized government in its capacity to fill the needs of society (Schreuer, et.al., 2012).

The Job Creation Law was established in an omnibus law to improve the 'messy' legal framework. Before this regulation was enacted, the foreign investment licensing process had to go through a lengthy and costly process. The existence of this regulation is certainly very beneficial for foreign investors as the promised ease of investment can be felt.

However, some political risks affected its enactment as a law, namely the legislator's mistake of not using procedures in accordance with constitutional arrangements so that this regulation was declared formally flawed and conditionally unconstitutional. Currently, the legislator has improved the conditions for the enactment of this regulation as mandated by the Constitutional Court Decision Number 91/PUU -XVIII/2020 which was read on 25 November 2021.

Legal changes due to compliance with the Constitutional Court's decision cannot be said to be a pattern of inconsistency by the state, as the changes that occurred during this period were only to adjust the fulfillment of procedural obligations. However, the legal changes that occurred in Indonesia during this period did not show detrimental changes to the regulatory framework that could significantly harm foreign investors. The regulatory changes made by the Indonesian government do not change the substance of the regulations in a detrimental manner and cause harm to foreign investors, but rather have a more favorable impact on foreign investors. However, foreign investors cannot rely their legitimate expectations solely on the government's legal framework without considering the sovereignty and political risks involved.

A foreign investor cannot assume that the legal framework will remain unchanged in the face of a severe economic crisis or reasonably have such an expectation unless a very specific commitment has been made by the government to its investment, or unless the changes to the legal framework are extremely detrimental. It is therefore important to consider the foreign investor's loss and the reasonableness of the scope surrounding its expectations. Apart from the matters described above, inconsistencies in Host State laws and regulations can lead to legal uncertainty. Legal uncertainty refers to a situation where the laws or regulations governing an investment are unclear, ambiguous, or change frequently. This can create additional risk and discourage investors from making long-term investments.

Therefore, it is imperative that the government continues to provide a consistent and transparent legal framework to avoid violating its obligations under international investment law and avoid other commercial risks that could harm the country.

CONCLUSION

Based on the results of the analysis described above, the author formulates the following conclusions: Legitimate expectation of foreign investors can arise from various actions taken by the Indonesian government, including (1) agreements arising from investment agreements, (2) specific commitments made by authorized officials to promise

something, and (3) the legal framework of foreign investment in Indonesia in the form of state obligations arising from BITs and general laws and regulations. The current investment legal framework in Indonesia does not reflect a pattern of inconsistency, as the changes do not change the substance of foreign investor protection in a detrimental manner and cause harm to foreign investors. The state has the sovereignty to change its legal framework to adapt to the needs of society and some cases argue that foreign investors cannot rely on the legal framework alone for legitimate expectations. Some cases argue that the legal framework can only be used as a basis for legitimate expectations on the condition that there must be changes that are very detrimental and cause harm to foreign investors.

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