THE IMPLEMENTATION OF THE FET PRINCIPLE IN PPP PROJECT FOREIGN INVESTOR'S PROTECTION TOWARDS NON-COMMERCIAL RISKS IN INDONESIA'S PPP INFRASTRUCTURE PROJECT

Sherin Amazia Graciela
An An Chandrawulan
Prita Amalia

ABSTRACT

Since infrastructure development has included as one of the national priority lists, the government has jacked up foreign investors participation as private partners in Indonesia's PPP projects. Considering its long-term nature that generates sensitivity to non-commercial risks, effort is of paramount importance to provide foreign investor's protection through the implementation of the FET principle into PPP regulation as the manifestation of preserving foreign investor's protection towards non-commercial risks. This research aims to determine to what extent Indonesia's applicable PPP regulation provide protection for foreign investors towards non-commercial risks through the implementation of FET. This study is conducted for expanding PPP literature that now in Indonesia is infrequently found and become a relevant consideration for the government in drafting regulations and a reference for potential foreign investors before conducting infrastructural investment in Indonesia. This study used normative legal approach and comparative legal study. The study indicates that Indonesia's applicable PPP regulations have yet implemented the FET principle given the absence of the protection towards changes in law provision at the project implementation stage, overlapping PPP institutions role, and dispute resolution mechanisms which are vulnerable to several legal barriers. The implementation of the FET principle should be preceded by the limitation of the vague FET scope. As an application of such limitation, the protection is embodied by applying the exhaustive list method to the FET clause in the BIT as a legal instrument for the protection of foreign investors. The manifestation of foreign investors' protection towards non-commercial risks as the application of FET principle is conducted through the performance of government commitments to meet investor's legitimate expectations. In the PPP law itself, the manifestation of such principle is by regulating fundamental provisions for the protection towards change in law, efficient administrative coordination, access to dispute resolution mechanisms without any legal barriers, and the government support for other political risks thus preserving foreign investor's protection towards non-commercial risks in the PPP project.

Keywords: FET principle, PPP project, non-commercial risks, foreign investor's protection.

INTRODUCTION

Infrastructure needs in developing economies arise day by day (Oxford Economics, 2021). The Indonesian Government has established infrastructure development as one of the national priorities pursuant to the National Medium-Term Development Plan/RPJMN 2020-2024 (Bappenas RI, 2019). This shows the importance of the project successful outcome to attain equitable social welfare in all fields, regions and enhance Indonesia's competitiveness in global competition into the bargain.

However, in emerging countries, including Indonesia, infrastructure development agenda frequently surpasses the state's financial capacity. While public financing and the capital market are unable to provide adequate funding, and the domestic public investment is inadequate to support the large volume and quantity of the infrastructure projects, the government envisages foreign investor's role as the private partner to assist the project establishment. Public-Private Partnership (PPP) accordingly provides innovative solutions in terms of financing so as infrastructure development can continue through the involvement of the private sector.

PPP is one of the FDI type which is distinct from the familiar form (greenfield investment, M&A, joint venture) where can be found in the field of infrastructure provision or alternatively called infrastructural FDI (Dykes, 2020). This scheme significantly influenced numerous infrastructure investment successfulness among countries today.

PPP AND INDONESIAN FOREIGN INVESTORS

PPP refers to any contractual or legal relationship between public and private entities aimed at improving and/or expanding infrastructure services but excluding public works contracts (Delmon, 2011). PPP will create non-debt capital flows, good planning, better management practices and technology for efficient project execution. PPP's objective is to provide adequate public infrastructure for the society when the state budget is insufficient. Concurrently, the private partners also receive several advantages from the infrastructure services that have been provided. Hence, this scheme creates benefits for the respective sides.

PPP has four key elements in particular: (1) long-term concession contracts; (2) the implementation of design, construction, financing, and operations phase conducted by the private sector; (3) tariffs during the term of the PPP concession contract as the utilization of infrastructure facilities; and (4) assets evert to the government at the end of the PPP concession period (Yescombe, 2007). The forms of infrastructure itself vary widely including roads, bridges, rail, airports, ports, underground lines, tramways, dams, canals, irrigation systems, pipelines, water purification systems, water treatment plants, waste disposal and incinerators, power plants, electricity and distribution networks, oil and gas pipelines, telecommunications, and so forth.

In the PPP projects, the government serves as the public party namely the project grantor, while the private partner appears as the project company. In this study, the foreign investors are the selected partner after passing the bidding process which then entitled as project company.

Prior to become a project company of the PPP project, foreign investors have to surpass the auction process, pre-feasibility study, and other mechanisms as stipulated in the Ministry of National Development Planning Regulation (MNDPR) No. 2 of 2020 concerning Amendments to the MNDPR No. 4/2015 concerning Operational Guideline for PPP on Infrastructure Provision whereby the said process specialize PPP with the other FDI types.

Foreign investors can be individuals and legal entities such as banks, hedge funds and private equity firms which undertake the significant role in FDI activities (Goldberg, 2007). Additionally, investment agreements generally do not require juridical entities to be owned by private individuals to be included in the scope of investment agreements. State-owned enterprises are also included in the definition of investor, which is covered by most investment agreements, including sovereign wealth funds (Feldman, 2010). In the PPP projects, foreign investors can usually also be consortiums.

The Indonesia's infrastructure development still depends on private participation, even most of the projects do rely on the participation of foreign investors, for instance the Multi-Lane Free Flow project, Komodo Airport, and several other projects which are open to the widest possible number of foreign companies. Nevertheless, on a practical level, political risks such as regulatory uncertainty and complex administrative mechanisms remain a big deal for Indonesian foreign investors (World Bank, n.d.).

The above statement is asserted by the Indonesian Investment Coordinating Board release in terms of FDI realization in infrastructure projects which showed a downward trend from 2017 to early 2021 (BKPM RI, 2021). The decline in infrastructural FDI indicates the lack of foreign investors' protection towards non-commercial risks attributable to the Indonesia's PPP infrastructure project.

NON-COMMERCIAL RISKS IN PPP INFRASTRUCTURE PROJECT

As a risk-sharing-based contract, there are two risk categories to bear in PPP infrastructure projects, namely commercial and non-commercial risks. Commercial risk refers to the responsibility that can be allocated to private partners in terms of project design, construction, operation, financing and maintenance of public service provision (OECD, 2010). While non-commercial risk or can also be referred to as political risk is the risk derived from government measures (OECD, 2010). This research is going to focus on the non-commercial risks for at least two major reasons. First, compared to commercial risks, non-commercial risks generate severe impact to the project sustainability (Sy *et al*., 2017). Second, non-commercial risk is remaining a problem that foreign investors are most concerned about particularly in developing countries (World Bank, n.d.).

Non-commercial risks greatly affect the sustainability of the PPP project implementation phase. The implementation stage is the phase where the bidder selection process has been passed, in this case the selected private partner is a foreign investor who later becomes the project company, and has entered the stage of implementation of PPP Contract. Accordingly, the risks considered as the non-commercial risk category are inadequate law and supervision system, delay in project approvals and permits, government policy, and dispute resolution (Sy *et al.*, 2017). These were appraised medium levels of probability; however their impacts were greatly high. In Indonesia itself, the implementation of PPP projects is risky in terms of changes in regulations and government commitments, administrative coordination, and dispute resolution through litigation (Duffield, 2019; Sutantiningrum *et al*., 2019). Additionally, such risks in PPP projects execution are also vulnerably occur in other emerging markets such as India, Thailand and Vietnam (Khahro *et al*., 2021).

Table 1. Risks as high impact in Developing Countries' PPP[1]

Categories	Rank	Risk as high impact
Politics	1	Government's intervention
	2	Delay in project approvals and permits
	9	Poor public decision-making process
	16	Corruption
Law	12	Inadequate law and supervision system
	5	Change in laws and regulations

Given the said risks that are prone to occur during the project implementation, the expectancy for foreign investors' participation, the on-going project with foreign project company, a coercive PPP regulation is needed to provide protection for foreign investors towards these risks. Foreign investors would perceive menace to their assets and project accomplishment in case that the host government does not support legal certainty, effective administrative coordination, and political stability.

In foreign direct investment activities (FDI), foreign investors' protection is governed under Standard of Protection. As one of the standards, fair and equitable treatment (FET) aims to protect foreign investors from the measures taken by the host government which affect their investment abroad (Bonnitcha *et al*., 2017). This principle should also be implemented in PPP projects as a type of FDI to ensure the protection of foreign investors during the project.

This study aims to see to what extent Indonesia's PPP regulation, in particular Presidential Regulation No. 38 of 2015 concerning PPP in Infrastructure Provision (hereinafter referred to as "**PR 38/2015**") and Ministry of National Development Planning Regulation No. 4 of 2015 on the PPP Implementation Procedures in Infrastructure Provision as amended by Ministry of National Development Planning Regulation No. 2 of 2020 (hereinafter referred to as "**MNDPR 2/2020**"), as the legal basis for implementing PPP in Indonesia, has implemented the FET principle in order to realize foreign investors protection towards such non-commercial risks.

To see to what extent Indonesia's PPP regulation accommodates investor protection, it is necessary to conduct a comparative legal study, comparing the applicable PPP law in India, Vietnam, and Thailand with Indonesia's abovementioned PPP

[1] by reviewing some research works from Khahro *et al*., 2021; Lee *et al*., 2020; and Sy *et al.*, 2017 in developing countries' PPP case studies.

law, whereby in reference to several research, the risks in question inclined to occur in the developing Asia countries comprising these four countries. Besides, taking into account their economic position in the developing Asia, these countries are arguably the developing states with relatively high and competitive investment flows (UNCTAD, 2020). Moreover, the said countries are knuckling down to enhance infrastructure investment activities in their respective regions, thus creating *apple to apple* comparison (Asian Infrastructure Investment Bank, 2019).

This study is aimed for expanding International Investment Law and PPP literature that now in Indonesia is infrequently found. Furthermore, in a practical purpose, this study is intended to be a relevant consideration for the government (grantor) in drafting well designed regulations, agreements, and policies related to the protection of foreign investors that would create more qualified Indonesia's investment climate, and also a recognized reference for foreign investors themselves (project companies) before conducting infrastructural investment in Indonesia.

This research was carried out on a normative legal approach, that studies provisions of the applicable statutes in a country or a doctrinal legal approach method, wherein the subject material for the research is found in legal theories and opinions of the most highly qualified publicist, especially those related to the discussed issues (Soemitro, 1998; Sugiyono, 2010). This research also analysed multilateral agreements, soft law instruments, judgement and case laws. The method of data collection in this study was conducted by literature study, wherein the data is obtained from books, literature, publications that is supported by the Faculty of Law Universitas Padjadjaran Library and the National Library of the Republic of Indonesia.

REINTERPRETATION OF FET CONCEPT

Standard of Investment Protection is a substantive obligation stipulated in bilateral investment treaty (BIT). Despite the BITs variation, the principles ruled under BIT basically consist of at least general principles, inter alia, the most-favored-nation, national treatment, full protection and security, expropriation, fair and equitable, and free transfer of funds. The application of these standards usually determines the outcome in investment treaty arbitrations, whereby the FET principle plays essential role (Kurtz, 2016).

The FET principle has a broad and vague scope. In addition, the minimalist FET clause drafting formulation often found in most BITs, for instance the 2016 Austria – Kyrgyzstan BIT, gives investment arbitration a wide interpretive discretion. Although this interpretation has sparked much controversy, there is a consensus in which principles should be considered to shape the substance of what is fair and equitable in the investor-state relations. The said principles including but not limited to good faith, the right to legitimate expectations, due process of law, and transparency (Sornarajah, 2010). Nonetheless, legitimate expectations are considered the most important protection of the FET principle (*Suez et al. and AWG Group v. Argentina, ICSID Case No. ARB/03/19*, 2015).

The fact that FET is a general principle that essentially applies to any FDI activity is not as smooth as at the conceptual level. For legal writers, this principle is controversial, has various interpretations and diverse drafting (Palombino, 2018). Additionally, investor's claim against the host country is most often involve allegations of the FET violations as a consequence of the vague FET scope (UNCTAD, 2015).

To understand and know its limitations, the concept of FET must be understood as a general principle peculiar to a certain field of international law but there remains a need of mediation of the judge (Palombino, 2018). This implies that the role of case law, judges and/or arbitrators decisions, the doctrine of scholars, are important to consider in constructing and interpreting the FET clause in a regulation and/or agreement. However, it must be accompanied by reminiscing each parties' context and in the light of its object and purpose (Art. 31 & 32 *VCLT*, 1980).

Furthermore, as per Todd Weiler's opinion, an ISDS reputable arbitrator, FET clause is principally intended to cover both the sovereign equality of host countries along with the substantive fairness for the aliens (Palombino, 2018). To the host country, FET is a manifestation of the principle of sovereign equality to exercise its police power in the best interests of its people. Subsequently, to foreign investors, FET may be interpreted as a manifestation of the principles of good faith and equality of treatment.

In this case, we find that the institutionalization of the FET principle in PPP regulation is essential as it determines a clear proportion between the host state and foreign investors and the protection for foreign investors is much more conclusive, indeed for the host country itself.

Considering the above, the concept to be conveyed in this FET reinterpretation is how to prevent unfair and unequal treatment by (a) rectifying the party who should be fair but have not done so; and (b) forewarning each parties to perform rights and obligations under the agreement with reciprocal respect and justice. This concept would minimize the existence of disputes arising from contradictory understandings between parties.

The establishment of regulations and policies that will apply to foreign investors by the host country need to earnestly implement the FET concept in such a way. Further, the administrative authority that represents the host country must elucidate all applicable infrastructure investment regulations to foreign investors in a comprehensive and unequivocal manner as regards respect for investors. Meanwhile, investors are also obliged to comply with the applicable rules in the host country as a concrete form of respecting the host country. Concurrently, investors also have the right to remind the host country to consistently perform the commitments it has made before the investors.

FOREIGN INVESTOR'S LEGITIMATE EXPECTATIONS VIS-À-VIS GOVERNMENT'S COMMITMENT

Legitimate expectation is one of the FET elements whereby such legitimate stems from a diligent or prudent investor which entails the investor to consider all circumstances, consisting of politics, socio-economic, cultural, and historical matters (*Charanne B.V. & Construction Investment S.A.R.L. v. Spain*, 2016). Investor's legitimate expectation is derived from contractual commitments and efforts made by or on behalf of the host country to support investment activities and its promotions (Dolzer & Schreuer, 2012). When the host country's representatives have realized that the commitment or guarantee determines the investor's

decision to continue investing, the indifference on it is generally deemed to inflict state responsibility under FET principle (*Urbaser S.A. et al v. Argentina, ICSID Case No. ARB/07/26*, 2016).

The above commitment refers to the government's commitment during contract negotiations before the foreign investors revolving regulations, policies, administration, and so forth that support the PPP contract implementation which creates investor's legitimate expectation that such commitment would certainly be implemented (Palombino, 2018).

In Indonesia's PPP context, the government's commitment may be seen in the Komodo Airport PPP project, where the government is committed to optimally executing this project in order to make Labuan Bajo part of the "10 New Bali". Other government commitments may be found in unsolicited PPP projects where the government is committed to providing incentives, right to match, and the right to sell intellectual property rights resulting from the project. Further, the government is also committed to providing fiscal and non-fiscal incentives to priority sectors, including infrastructure projects.

Accordingly, the question is whether the principle could be applied in an administrative contract like PPP, or more specifically, whether the non-performance of contracts between the host country and foreign investors is contrary to the legitimate expectations of foreign investors and thus results in a violation of the FET principle.

As stated by Wälde and Kolo, the government's commitment formulates the legitimate expectations of foreign investors, meaning by relying on these commitments, foreign investors bear tremendous commercial and non-commercial risks by investing their capital, technology, and managerial skills into the project (Wälde & Kolo, 2001). Thence, failure to perform commitments undermines legitimate expectations and thus constitutes a violation of the FET principle.

Several arbitration awards revealed so, one of them can be viewed in the Urban Development Project, MTD v. Chile, whereby he Chilean government changed its contractual commitments, the existing legal framework and the local authorities with the capacity to do so resisted the project realization. The tribunal stated that Chile was not persistent in handling all affairs, where on the one hand it signed investment contracts, however by contrast, turned the necessary permits down. When the investor's legitimate expectation is thwarted, then violation of the FET occurs.

Accordingly, once the government does not fulfill its commitments before foreign investors regarding the stability of regulations, policies, government priorities and so on, it can be deemed that the government refuses to provide protection for foreign investors towards non-commercial risks, since non-commercial risks arise from government actions that beyond the control of private partners (OECD, 2010).

The implication to the Indonesia's PPP, the government must be responsible for fulfilling the commitments it has made before investors in various infrastructure projects as a concrete form of FET implementation.

THE LIMITATION OF FET THROUGH EXHAUSTIVE LIST-METHOD IN BIT

Foreign investors' protection is generally accommodated through BIT, which is more preferred of by allowing negotiations to align the mutual interests of both parties, that cannot be found in international investment agreements that are multilateral in nature (Carty, 1991).

BIT stipulates the FET principle as one of the Standard of Protection in FDI. The effective means to incorporate the FET principles into a treaty clause is by providing an explicit detailed list (exhaustive list method) pertaining the series of measures taken by host country which are considered as violations of the FET principle (Commission, 2016). This method provides a guidance and obvious limitation of the FET scope (Jadeau & Gelinas, 2016). A list of obligations derived from the agreed FET scope would ensure foreign investor's protection and develop sustainable investment climate.

The said method can be found in Article 8.10 of the EU-Canada Free Trade Agreement (CETA), especially in para. 2, which lists at least six measures that constitute a violation of the obligation to treat foreign investors and their assets fairly and equitably (Art. 8.10, *EU-Canada CETA*, 2016). Likewise, the parties must regularly, or at the request of one of the parties, review the contents of each parties obligations to act align with the FET that the CETA Joint Committee could then deliver recommendations concerning the review (Art. 8.10 para. 3, *EU-Canada CETA*, 2016). Given the above explanation, this is a form to follow-up that the parties have forewarn each other of the obligation to apply the FET obligations.

The limitation of the FET scope in the BIT becomes a reference for both parties in carrying out cross-border investment activities. Therefore, such limitation should also be applied to the FET clause in the Indonesian BIT to provide legal certainty for foreign investors' protection, including infrastructure investment activities which involve foreign project companies, and diminish the investor-state disputes particularly on FET claims. Further, this method would diminish the interpretative discretion adhere to investment arbitration in providing interpretations of the vague FET scope. It quite the opposite accommodates the respective interests of foreign investors and host countries by ruling the FET scope limitation consistent with their initial objective.

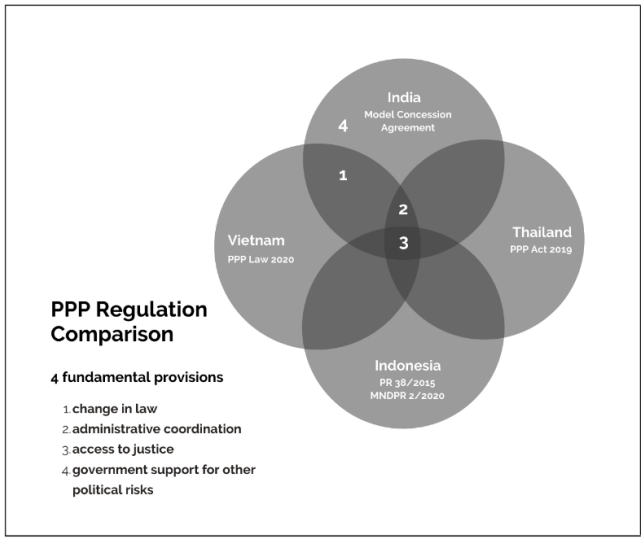
REGULATING FOUR FUNDAMENTAL PROVISIONS TO MANIFEST INVESTOR'S PROTECTION TOWARDS NON-COMMERCIAL RISKS

To manifestly realize the FET principle into PPP regulation is conducted by ruling fundamental provisions to alleviate non-commercial risks at the PPP project implementation stage. The aforementioned provisions are the protection of change in law, efficient administrative coordination, access to justice, government's support for other political risks which are possible to occur during project execution.

These four provisions are the underlying provisions that must be regulated in order to form an internationally qualified PPP regulation (UNCITRAL, 2020). Furthermore, align with Todd Weiler's view, the incorporation of these provisions to the PPP regulation is a manifestation of the government's good faith in its contractual commitments vis-à-vis investor's legitimate expectations.

The diagram below shows the PPP regulations in India, Vietnam, Thailand, and Indonesia which are pursed to the legal basis for implementing PPP in each country in regulating those four provisions.

Diagram 1. Cross-country Comparison in regulating four fundamental provisions in respective PPP regulation[2]



a) change in law

Change in law indicates regulatory changes that specifically impact PPP projects. Regulatory changes and/or the introduction of new policies during the project operation period is justifiable as long as it does not disrupt the stability of the private partner performance and do not demolish mutual confidence as a prerequisite of a succeed PPP project (UNCITRAL, 2020). However, the state must preserve allegiance to the related-PPP regulations, policies, and government decisions established during the contract period since it closely relates to the investor's legitimate expectations resulting from the government commitment.

PR 38/2015 and MNDPR 2/2020 have yet regulated this provision. Considering the PPP regulations in India and Vietnam, Indonesian government should regulate this provision as a form of foreign investors' protection towards changes in law. The government must notify the investors with an eye to necessary adjustment that investment activities remain in line and comply with relevant regulations.

b) efficient administrative coordination

Effective administrative coordination could avoid possible delays that may arise from the distribution of complex administrative powers. It is also important to consider straightforward steps by entrusting one organ with the authority to accept applications, submit, and control the issuance of permits (UNCITRAL, 2020).

Indonesia's PPP institution instead has several bodies with overlapping roles to lead the PPP project, inter alia PPP unit-*Bappenas*, the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP), Directorate General of Debt and Risk Management (PDPPI) (Amalia & Budhijanto, 2018; United Nations Economic and Social Commission for Asia and the Pacific, 2017). Therefore, it is worth considering for Indonesia to simplify the now-overlapping in-charge agency to lead the national PPP projects, whereby the establishment of dedicated PPP unit India, Vietnam, and Thailand could be the appropriate example. However, the government's effort to establish a joint coordination forum provide a ray of hope for the restoration of these overlapping PPP institutions (Art. 41A, *MNDPR 2/2020*).

c) access to justice

Access to justice refers to the access to dispute resolution mechanisms in infrastructure investment that investors believe is the most effective, efficient, and fair mechanism (UNCTAD, 2015). A dispute resolution that is devoid from legal barriers maintains business relations between the two parties. When the government provides options for various PPP project dispute resolution mechanisms, it needs to be accompanied by eliminating all possible legal obstacles thereof.

PR 38/2015 has indeed regulated several alternatives dispute resolution preceded by amicable mechanism including the choice of an international arbitration (Art. 32, *PR 38/2015*). However, in practice, domestic litigation is perceived as corrupt, not completely independent from other political branches, unpredictable in terms of outcome, protracted and time-consuming (Duffield, 2019; Indonesian Investments 2017, 2017). Besides, the challenge to the validity of arbitral awards often embroils the Language Law where the decision is made based on an arbitration clause in an agreement that is not subject to the said law (*PT Grage Trimita Usaha v. Shimizu Corporation & PT Hutama Karya (Persero)*, 2019)

In this case, the government may consider India's PPP regulations that encourage the finality of arbitration awards and reduce court intervention (Art. 36 (2), *India Arbitration Act*, 2019). This form of protection should be taken into account to reform Indonesia's dispute resolution mechanism, given the benefits of becoming arbitration-friendly country.

[2] This comparison result based on their respective PPP applicable regulation and taking into account World Bank assessment in the report, titled "Benchmarking Infrastructure Development" (World Bank, 2020).

d) government support to other political risks

Government support for other political risks that also need to be considered by the host country, namely the restriction of profit repatriation and adverse government actions. The Indonesian government allows income repatriation for foreign investors, hence the government has guaranteed the protection for foreign investors over the right of income repatriation which is arising from the PPP project (World Bank, 2020).

PR 38/2015 has not stipulated provisions for the adverse of government act. The government in this case might consider the Indian PPP regulation which in this provision defines which conditions could be deemed as an adverse government act and allows private partners to terminate the agreement as the recourse of such act (Clause 32.4.1., *Highway Model Concession Agreement*).

Notwithstanding, foreign investors usually guarantee their investment towards aforementioned risks to an internationally qualified guarantee agency like MIGA. The fact that these four countries have become MIGA member countries makes foreign investors safer, particularly when the host country fails to provide them protection.

CONCLUSION

PR 38/2015 and MNDPR 2/2020 as Indonesia's applicable PPP regulations have yet implemented the FET principle to accommodate foreign investors' protection towards non-commercial risks. It can be perceived from the unregulated provisions for protection of non-commercial risks resulting from changes in law at the project implementation stage, overlapping PPP institution's role, and dispute resolution mechanisms which are vulnerable to several legal barriers.

The implementation of the FET principle should ideally be preceded by the limitation of the vague FET scope. As an application of such limitation, the protection is embodied by applying the exhaustive list method to the FET clause in the BIT as a legal instrument for the protection of foreign investors. The manifestation of foreign investors' protection towards non-commercial risks as the application of FET principle is conducted through the performance of government commitments to meet investor's legitimate expectation. As for the national PPP law itself, the protection form is provided by regulating fundamental provisions for the protection towards change in law, efficient administrative coordination, access to dispute resolution mechanisms without any legal barriers, and the government support for other political risks hence preserving foreign investor's protection towards non-commercial risks in the PPP project.

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Sherin Amazia Graciela
Faculty of Law
Universitas Padjadjaran, Bandung, Indonesia
Email: shracielag@gmail.com

An An Chandrawulan
Faculty of Law
Universitas Padjadjaran, Bandung, Indonesia
Email: ananchandrawulan@yahoo.com

Prita Amalia
Faculty of Law
Universitas Padjadjaran, Bandung, Indonesia
Email: prita.amalia@unpad.ac.id