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SAFEGUARDING WATER CONTRACTS IN INDONESIA

Mohamad Mova Al Afghani



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# SAFEGUARDING WATER CONTRACTS IN INDONESIA

Mohamad Mova Al Afghani

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# 1

## BACKGROUND

### 1.1 Reasons for Water Privatisation<sup>1</sup>

Privatisation is a fuzzy concept which has various anthropological, sociological, political as well as economical ramifications. The root word, 'private', implies the absence of the state and 'privatisation' has a general meaning of withdrawal of state institutions.<sup>2</sup> Some define privatisation as 'the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents'<sup>3</sup> and others define it as 'the use of the private sector in the provision of a good or service, the components of which include financing, operations (supplying, production, delivery), and quality control'.<sup>4</sup> For the purpose of this article, the second definition, which indicates that through privatisation the production and provision of goods and services shifts from public to private hands, will be relevant.

Economists have argued, that the purpose of property rights is to minimise the occurrences of negative externalities by internalising them through the property institution.<sup>5</sup> It is assumed that where there is no clear definition of property rights, natural resources will be managed negligently and eventually exhausted.<sup>6</sup> Everyone will keep maximising their profit without due regard to the 'common'. The argument goes further that if a resource is privatised, its owners, acting out of self interest, will be motivated to preserve it.

For some economists, private ownership encourages rights and rewards while public ownership dilutes and

attenuates them. When a company is public, ownership is 'locked'. The owners (citizens) cannot do anything if they are not satisfied with the service. The managers will enjoy a 'quiet life' as nothing will menace their positions. But when a company is privatised, the owners (shareholders) can sell their stocks to outsiders.<sup>7</sup> Managers who fear losing their jobs will be motivated to work harder because if stocks are sold, the new owners may dismiss them for bad performance. Additionally, the manager's hard work and sense of competition with other companies drives prices lower and, at the end of the day, this benefits consumers.

Public choice theorists take a broader approach. They suggest that privatisation avoids nepotism between managers, bureaucrats and politicians, which may occur if the company is publicly owned, leading to inefficiency and higher prices.<sup>8</sup> In addition to the efficiency arguments, other experts state that privatisation provides a better assessment of the true costs of the service, promotes technological advancement, facilitates the development of capital markets, broadening wealth, curbing inflation, raising extra revenues for government and eliminating hidden unemployment.<sup>9</sup>

However, the arguments above may not be proven, especially in areas where property rights are not automatically applicable, such as in the water and sewerage sector. Another reason why the arguments above may not be appropriate is because of the character of water as a 'natural monopoly'.<sup>10</sup> That is to say, water services follow the pattern of the economies of scale: more than one provider could mean a higher price. 'Natural monopoly' has been defined as (i) 'a monopoly that occurs when one firm can supply the entire market at a lower price than two or more firms can',<sup>11</sup> (ii) an industry in which one firm can

1 Laws and regulations are as of August 2007.

2 Paul Starr, 'The Meaning of Privatisation', 6 *Yale Law and Policy Review* 6, 41 (1988).

3 William L. Megginson and Jeffrey M. Netter, 'From State to Market: A Survey of Empirical Studies on Privatisation', 39/2 *Journal of Economic Literature* 1 (2001).

4 Kevin R. Kosar, 'Privatisation and the Federal Government: An Introduction' Congressional Research Service Report for Congress, December 2006, available online at: <http://www.fas.org/sgp/crs/misc/RL33777.pdf>.

5 Harold Demsetz, 'Towards a Theory of Property Rights', 57 *The American Economic Review* 347, 359 (1967).

6 A commonly cited illustration is herdsmen in a pasture owned by no one, where eventually the resource is destroyed. See Garret Hardin, 'The Tragedy of the Commons', 162 *Science* 1243, 1248 (1968).

7 See Starr, note 2 above.

8 Friedrich Schneider, 'Privatisation in OECD Countries: Theoretical Reasons and Results Obtained', 1/3 *Journal of Institutional Comparison* 24, 29 (2003).

9 Co<sup>o</sup>kun Can Aktan, *The Rationale for Privatisation*, (1992), available at: <http://www.canaktan.org/ekonomi/ozellestirme/aktan-makaleler-ceviriler/aktan-rationale-of-privatisation.pdf>.

10 Ephraim Clark, and Gérard Mondello, 'Regulating Natural Monopolies: The Case of Drinking Water in France', 121 *Journal of Contemporary Water Research and Education* 72, 78 (2002).

11 Glossary web page from Econ100 website, see <http://www.econ100.com/eu5e/open/glossary.html>.

achieve economies of scale over the entire range of market supply<sup>12</sup> and (iii) a monopoly that exists because the cost of producing the product (ie, a good or a service) is lower due to economies of scale if there is just a single producer than if there are several competing producers.<sup>13</sup> Thus, in the presence of a 'natural monopoly' the imposition of direct competition is not desirable and could even be detrimental.

A natural monopoly is prejudicial because it fails to capture 'consumer surplus', thus leading to inefficiency in allocation. Another negative aspect would be that the company will not be motivated to cut costs; having no competitor to worry about, it can sell at any price ('productive inefficiency'). These deficiencies provide justification for a regulation.<sup>14</sup> Regulatory mechanisms may be varied, ranging from limiting the overall profits of a firm by regulating rate structure and entries, by regulating corporate expenditures or by controlling restrictive practices to the creation of an incentive (price cap) regulation.<sup>15</sup> The price cap regulation is used in the privatised water and sewerage service in England and Wales.

Proponents of privatisation argue that privatisation, accompanied by economic regulation is better than public ownership. Competition may develop gradually as the natural monopoly character of water services reduces.<sup>16</sup> The water market regulator in England and Wales, the Ofwat, has recently attempted to introduce competition in the water sector through 'inset appointment', cross border supply and common

carriage.<sup>17</sup> In the meantime, while direct competition is absent, competition is applied in the 'secondary market'.

With privatisation, it is assumed, governments would no longer be burdened by providing public goods, which are financed through subsidies. Instead, they gain revenue from the sale of their assets to private parties (in case of 'full privatisation') and/or from the tax imposed to private operators. This assumption may not be entirely correct. Privatisation may also entail 'regulatory' costs, which are financed through government expenditures as well. It may also entail certain social and environmental costs.

## 1.2 Purpose and Structure of the Article

This article will explain the theory and practice of water privatisation in Indonesia. It will elaborate the legal anatomy of privatisation, from the regulatory to the contractual. It will attempt to highlight important issues that governments and other stakeholders need to focus on when dealing with privatisation.

Part 2 will explain the regulatory conditions in Indonesia and how privatisation is made possible through this regulatory structure. Part 3 will introduce key actors involved in privatisation and explain the privatisation models put into practice. Part 4 discusses the issues contained in the Water Law that should be addressed at the regulatory level, including the regulation of water companies (share ownership, minimum equity); the regulation of water undertakings (tenders, compensation to prior users, public consultation) and it identifies which provisions should be regulated at which level of the legal hierarchy.

Part 5 examines the provisions normally existing in water contracts between a local subsidiary of a Multinational Corporation (MNC) and regional authorities, and presents suggestions for drafting the clauses. This part of the paper discusses the choice of law, choice of forum for parties and the rights and obligations of each party in emergency situations and in drafting the 'terms of agreement'. This analysis is

12 Bradley R. Schiller, *The Micro Economy Today* (Mc-Graw Hill, 9<sup>th</sup> ed. 2003), available at [http://highered.mcgraw-hill.com/sites/0072472006/student\\_view0/chapter9/key\\_terms.html](http://highered.mcgraw-hill.com/sites/0072472006/student_view0/chapter9/key_terms.html).

13 Linux Information Project, available at [http://www.bellevuelinux.org/natural\\_monopoly.html](http://www.bellevuelinux.org/natural_monopoly.html).

14 Ben WF Depoorter, 'Regulation of Natural Monopoly', in Boudewijn Bouckaert and Gerrit De Geest eds, *Encyclopedia of Law and Economics, Volume I, The History and Methodology of Law and Economics* 1094 (Cheltenham: Edward Elgar, 2000).

15 See Richard Posner, *Natural Monopoly and Its Regulation* (Washington, DC: Cato Institute, 2001).

16 Céline Nauges and Caroline van den Berg, 'How Natural are Natural Monopolies in the Water Supply and Sewerage Sector? Case Studies from Developing and Transition Economies' (World Bank Policy Research Working Paper No. 4137, 2007), available at: <http://ssrn.com/abstract=962791>.

17 The Water Services Regulation Authority (OFWAT), 'Market Competition in the Water and Sewerage Industry', available at <http://www.wsra.gov.uk/aptrix/ofwat/publish.nsf/Content/marketcompetitionwaterandsewerage>.

carried out in the context of asymmetrical relationships between MNCs and governments in water undertakings.

## 2 REGULATORY CONDITIONS OF THE WATER SECTOR

### 2.1 Water Rights under the Constitution

Water rights are regulated through two different provisions in the Constitution. The 'right to water' is implicitly included in Article 28 of the Constitution and the 'right to exploit water' by Article 33.

The 'right to water' is mentioned only implicitly by the Constitution. It is deduced from (1) the right of children to develop and to be nurtured, (2) the right to the fulfilment of basic needs, (3) the right to a life of well-being in body and mind and to enjoy a good and healthy environment, (4) the right to obtain social security, and (5) the right to cultural identities and the acknowledgment on the rights of traditional communities under Article 28.<sup>18</sup>

As an economic good, the 'right to exploit water' is regulated in the economic chapters of the Constitution.<sup>19</sup> Under the Constitution the economy must be structured '...as a common endeavour based on familial principles'.<sup>20</sup> The Constitution holds that production sectors that are vital to the state and affect the livelihood of a considerable part of the population are to be *controlled by the state*.<sup>21</sup> Oil and gas, the geothermal sector, some of the mining activities and the water sector fall within this category. Private entities are barred from directly exploiting water resources due to this scheme. In practice, therefore, the investor conducts a concession or cooperation contract with authorities, as direct exploitation is not possible.

18 Indonesia, Constitution of the Republic of Indonesia Year 1945 and its Amendments, Articles 28 B (2), 28 C (1), 28 H (1), 28 H (3) and 28 I (3).

19 *Id* Chapter 14.

20 *Id* at Article 33 (1).

21 *Id* at Article 33 (2). Similar provisions can be found in Article 7 of the Constitution of the People's Republic of China and Article 7 of the Constitution of Russia (1993).

One of the most important factors for assessing whether a privatisation scheme has deviated from the Constitution or not, is the mechanism adopted for determining the price of the service. The Indonesian Constitutional Court had annulled several articles of Law N° 22 of 2004, which relinquishes oil and gas price determination to market forces.<sup>22</sup> As a consequence of this decision, price determination of any future products resulting from private participation of vital natural resources cannot be relinquished to the market's mechanism.<sup>23</sup>

Being regulated by both human rights and economic constitutional provisions, the regulation of water resources shall be more stringent compared to the oil and gas sectors. This requirement can be complicated when translated into implementing regulations or contract clauses.

### 2.2 The Right to Water under the Indonesian Water Law

Under the water resources law, the right to water is guaranteed by Article 5. This article underlines that the state must provide citizens with access to water. How this provision is to be implemented is still not clear. Article 5 only states that the government is obliged to organise various efforts to guarantee the availability of water to everyone residing in Indonesia.<sup>24</sup> Furthermore, the said guarantee 'shall become the joint responsibility of the Government and regional government, including guaranteeing access for everyone to the water source to obtain water. The extent of daily minimum basic need for water shall be determined based on the guidance to be stipulated by the Government'.

The Constitutional Court in its interpretation of the water law stated that Article 5, jointly with Article 16 (which stipulates that the authorities and responsibilities of municipal governments shall comprise the fulfillment of the minimum daily basic need for water of the

22 Indonesia, *Judicial Review of Law No. 22 Year 2001 Concerning Oil and Gas*, Constitutional Court of the Republic of Indonesia, Decision No. 002/PUU-I/2003 of 15 December 2004.

23 *Id* at 227. The Court considered that the Government's intervention in the form of price determination shall be a dominant feature in vital production sectors which involves the livelihood of many people.

24 The General Comment 15 to the ICESCR meanwhile, made the obligation manifested not only against 'resident', but also towards 'any person' within that territory.

community in its area) and Article 29(3) (which stipulates that the provision of water to fulfill the daily basic needs and the irrigation needs for the smallholder estate crops has priority over all other needs) have ‘sufficiently reflected the fulfilment of the right to water’.

Article 80 of the Law states that the use of water resources to fulfill the daily basic needs and irrigation needs for smallholder estate crops shall not be charged with a water resources management service fee. Only when users take their water from a service network, will they be charged. This ‘water resources management service fee’ phrase is the basis for introducing ‘full cost recovery’ in Indonesia. The Constitutional Court noted, however, that it does not mean that regional waterworks can charge high rates. The Court says that regional waterworks ‘shall not be established with a view of only seeking profit, but as an enterprise who performs state functions in materialising Article 5.’<sup>25</sup>

The minimum quantity of water per person has not been legislated into a binding regulation.

### 2.3 Privatisation under Water Resources Law

The Law recognises two kinds of rights: ‘water use right’ and ‘water exploitation right’, both of which may not be leased or assigned, partially or entirely.<sup>26</sup> The water use right applies to the case of daily basic needs of individuals and for smallholder estate crops within the irrigation system, and can generally be realised without a permit.<sup>27</sup>

A ‘Water Exploitation Right’ can be given to individuals or enterprises pursuant to the permit from the Government or regional government.<sup>28</sup> This is where privatisation becomes possible.

Article 40 (3) of the Water Resources Law obligates the government and regional governments to develop a drinking water provision system and literally states that private parties ‘may participate’ in developing such

systems, when necessary. Under the present law, every stage in water undertakings is open to private participation.<sup>29</sup>

Under a governmental regulation, the development of drinking water provision systems must be conducted by state owned enterprise or regional owned enterprise (SOE), formed exclusively to develop drinking water systems.<sup>30</sup> In cases where SOE(s) are unable to perform this function, it may collaborate with private parties.

### 2.4 Status of the Water Resources Law

Three months after the Water Resources Law was enacted, a group of civil society organisations submitted a request for a judicial review of the law to the Constitutional Court. In its decision, the Court (with 7 concurring and 2 dissenting) held the Law to be ‘conditionally constitutional’. It considers the Law to be sufficient in protecting the citizen’s right and is so far compatible with the Constitution if its implementation is consistent with what has been outlined by the Court in its decision.

‘Implementation’ under the Court’s decision can be broadly interpreted as meaning implementing regulations of the Law or the government’s practice in the form of decrees, circulars or unwritten decisions of the bureaucracy

### 2.5 Other Regulations Relevant to Water Privatisation

Privatisation involves complex interactions between multiple legal arenas. Thus, the parties should also pay attention to regulations other than water resources law.

Water privatisation, since it involves a regional waterworks SOE (Perusahaan Daerah Air Minum or ‘PDAM’), will certainly fall under Law 5/1962 on regional companies. The consumer aspect will be covered by Law 8/1999 on Consumer Protection. The competition aspect — albeit rare and thus applicable only with regards to ‘competition for the market’ (water tender) and ‘secondary market’, due to the impossibility of direct competition in water — will be governed by Law 5/1999 on the prohibition of

25 Mohamad Mova Al Afghani, ‘Constitutional Court’s Review and the Future of Water Law in Indonesia’, 2/1 *Law, Environment and Development Journal* 1 (2006), available at: <http://www.lead-journal.org/content/06001.pdf>.

26 Indonesia, Water Resources Law, Law No. 7 Year 2004, Article 7 (2).

27 *Id* Article 8 (1).

28 *Id* Article 9 (1).

29 *Id* Article 40.

30 Indonesia, Regulation on the Drinking Water Provision System, Government Regulation 16 Year 2005, Article 37 (2).



monopolistic practices and unfair business competition. Law 25/2007 of Capital Investment will also be relevant whenever projects involve foreign actors. Company Law 40/2007 must certainly be assessed thoroughly, since this is the main regulation of the private operator, in addition to the Water Resources Law.

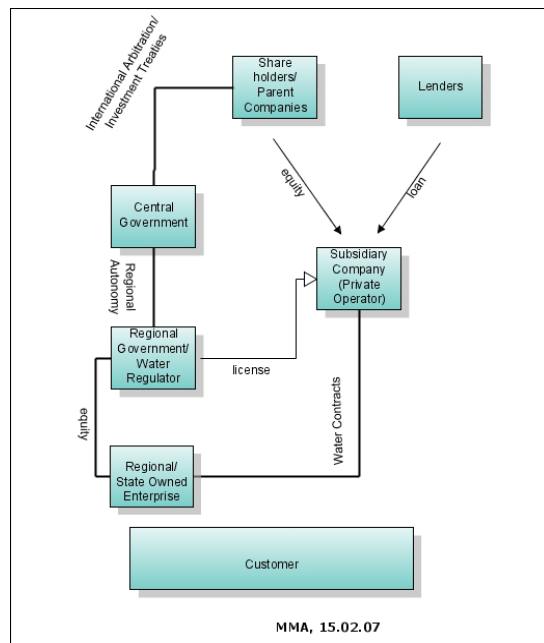
There are numerous implementing regulations derived from the above laws that need to be assessed as well.

### 3 WATER PRIVATISATION IN ACTION

#### 3.1 Institutions Involved in Water Contracts

Large scale water projects typically involve various institutions, which may be governed by more than one jurisdiction. The figure below illustrates the institutions in a privatised water undertaking and their relationship to one another.

Fig.1.1



(Note: This figure is relevant insofar as a subsidiary company is operating; it may therefore exclude the 'management contract' privatisation model)

Due to regional autonomy, the key players in the privatisation process in Indonesia are the regional governments. The central government does have a role in giving licenses for water investments. However, when it deems that the regional government is able to exercise its authority, the law enables regional government to administer licenses.<sup>31</sup> The second reason why regional governments are key players is because they have shares in regional SOEs, which engage in drinking water provision agreements with private operators.

The second player involved is the local private operator, a subsidiary company incorporated in Indonesia. Oftentimes, foreign investors form an alliance with Indonesian partners which in turn invest a substantial amount of shares in the subsidiary company and provide political protection.<sup>32</sup> The private operator obtains its assets through capital injection from shareholders and through loans. In some cases the shareholders could be individuals or foreign companies incorporated in foreign jurisdictions. This is where the problem becomes more complex, as both the private operators and its shareholders though legally distinct can actually be the same economic entity.

The central government plays a vital role in supervising the regional governments in conducting the privatisation for two reasons. First, because they can be dragged into international arbitrations by the private operator's shareholders, as will be elaborated further below. Secondly, the central government is a party to judicial review of the water law before the Constitutional Court. The Court has declared that a new judicial review is possible if the water law's regulatory instruments are not consistent with the Court's recommendations. Thus, the central government must supervise regional governments so that their rules comply with the Court's decision.

Lenders are important players as well. Their interest in safeguarding their investments must be put in line with stakeholder's interests. Lenders normally have

31 See Water Resources Law, note 26 above, Article 19 (1).

32 For example, the privatisation of Jakarta's drinking water company involved the families of former President Soeharto. See Investigasi: Keruhnya Swastanisasi PAM Jaya, *Tempo* No.06/XXVIII/39-47, 13, 19 (1999).

special privileges to enforce their rights in the event of default. This prerogative must be exercised in a way that will not jeopardise the continuity of water services.

The last — and the most important institution — are customers and other stakeholders. The position of the customer in the above structure will depend on the type of privatisation model.

### 3.2 Models of Private Participation

In general, there are two types of water privatisation, the English model and the French model. The English model — applied in England and Wales — privatises everything, from assets to operations. The state becomes a regulator, determining prices, ensuring competition where appropriate and determining water quality standards.<sup>33</sup> The French model on the other hand, does not transfer the ownership of infrastructure to the private operator, as it is basically a concession-based model.

The British model may not be applicable in Indonesia due to legal and sociological reasons. Legally, it may impair the state's control of water resources (as they are transferred entirely to private parties).<sup>34</sup> Sociologically, it may receive fierce opposition from the population. The same may apply to 'build-operate-own' privatisation schemes and divestiture.

The other common types of water privatisation are:

A management contract is a type of private participation conducted by transferring responsibility for managing a utility to a private operator who provides management services in return for a fee. As it generally involves no subsidiary company, it will not be discussed in this paper.

An affermage-lease is a system where a private operator is responsible for operating and maintaining the business, retains the fee based on the volume of water sold but

does not finance investments in infrastructure. In an affermage system, the private operator's income depends on the water volume sold multiplied by the affermage fee, minus the operation and maintenance costs. In leases, the private operator obtains revenues from user tariffs, and pays a lease fee to the contracting authority.

Concessions and divestitures give a private operator responsibility not only for the operation and maintenance of assets but also for financing and managing investments. The difference between the private operator in concessions and in divestitures is that the former does not own the infrastructure assets, while the latter does. Since the infrastructure assets are owned by private parties, divestiture schemes may not be consistent with the Constitution.<sup>35</sup>

In a joint ownership the operator is owned jointly by the government and by a private party. The extent to which joint ownership is consistent with the Constitution depends on how control is exercised in the decision-making and price determination processes. Under the new negative list of investment, drinking water is open to investment with the condition that the maximum capital ownership of the foreign investor is 95 per cent.<sup>36</sup>

Today, private participation is broadly regulated by Presidential Regulation 16 Year 2005 concerning cooperation between government and the private sector in providing infrastructure. This Presidential Regulation covers all infrastructure projects from toll roads, telecommunication, oil and gas to water.<sup>37</sup> As water projects are different from other infrastructure projects, this Presidential Regulation may not adequately satisfy the constitutional requirements related to water. A specific regulation on private participation in water sector needs to be enacted.

### 3.3 Application of Privatisation Models in Indonesia

#### 3.3.1 *The Privatisation in Jakarta*

The privatisation in Jakarta follows the 'concession' model. The working area is split into two, the east being

33 OFWAT-DEFRA, 'The Development of the Water Industry in England and Wales' (2006), available at: [http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/development\\_of\\_water\\_industry270106.pdf/\\$FILE/development\\_of\\_water\\_industry270106.pdf](http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/development_of_water_industry270106.pdf/$FILE/development_of_water_industry270106.pdf).

34 See for example, Decision on the Judicial Review of Law No. 20 Year 2002 Concerning Electricity, Constitutional Court of the Republic of Indonesia, Decision No. 001-021-022/PUU-I/2003 of 1 December 2004.

35 See Indonesian Constitution, Article 33(2), note 18 above.

36 Indonesia, Attachment I to Presidential Regulation No. 77 Year 2007.

37 Indonesia, Presidential Regulation No. 16 Year 2005 Concerning Cooperation between Government and the Private Sector in Providing Infrastructure, Article 4(1).

managed by Thames Water International (incorporated into a local subsidiary Thames PAM Jaya or TPJ) and the west being managed by Lyonnaise des Eaux (incorporated into local subsidiary PAM Lyonnaise Jaya or Palyja). Representing the government on the concession contract is Perusahaan Daerah Air Minum (PDAM/Jakarta Regional SOE), who also owns the infrastructure. The concession is set for 25 years, from 1997 to 2022. The contract provision was last amended in 2001, due to the 1998 monetary crisis.

The money obtained from consumers is delivered into an escrow account, which is then split between the private operators and PDAM, (to finance its operation and pay its debt to the ministry of finance).

The private operator is paid based on the volume of processed water sold to consumer. The water charge is adjusted every six months, based on consumer price index, currency exchange values (due to foreign debt) as well as other indicators such as the level of workers' salaries and the price of purchasing unprocessed water from other regions. Tariff structure assessment is conducted once in every five years. The private operator must provide funds for investment, which can be obtained through borrowing.<sup>38</sup>

Under the concession contract, water tariffs must be determined by taking into account the consumer's purchasing power. If the private operators do not receive enough money from operating water services as explained above — usually because the tariff structure does not generate sufficient gains — PDAM needs to pay the difference to the private operator.

There is a regulatory body which supervises the concession and suggests tariff adjustments to the governor. The regulator also has to resolve consumers' complaints. There is however, an overlap of authority between the regulator, the supervisory body and PDAM, in monitoring the concession contract.

### 3.3.2 The Privatisation Projects outside Jakarta

Smaller privatisation projects have taken place in Medan and Semarang, following a 25 year Build

Operate Transfer (BOT) model.<sup>39</sup> The Semarang project only concerns a water treatment facility.

As a follow up to the infrastructure summit, three investors (Amy Water, Vivendi and Tyco) had expressed readiness to participate in water investment projects worth 300-400 trillion rupiah in Bandung, Tangerang and Dumai respectively.

## 3.4 Role of Multinational Corporations

### 3.4.1 Modus Operandi of an MNC

The operations of MNCs may be detrimental to the citizens of the host state if they entail practices that damage the environment or bring upon poor labour conditions. In a fair transaction, the external costs caused by a MNC — should they exceed the company's assets — should be borne by its shareholders. However, it is difficult to implement this idea due to the legal institution of *limited liability* and because the shareholders of the MNC are usually located in another jurisdictions.

Indonesian company law recognises that shareholders may become personally liable — beyond the sums they had invested — if they use the company's assets for their personal interests; if they are involved in an action taken by the company that is contrary to laws and regulations in force; or if they have illegally used the assets of the company causing them to become insufficient to cover the company's debts.<sup>40</sup> However, this provision is only applicable to local shareholders. A court can confiscate the shareholder's private assets to make them comply with the court's decision. But when faced with foreign actors, this provision does not have many chances of being used, as their assets are located in other countries where Indonesian courts have no powers of enforcement.

While parent companies of MNCs are incorporated in the jurisdiction of developed nations, their subsidiaries are located in developing countries which have ineffective law enforcement mechanisms, inadequate environmental standards and poor labor conditions. This is because developing nations are still in the process of improving the functioning of the state by

<sup>38</sup> The concession contract itself is not yet disclosed for public access. However, the regulatory authority uploaded an extract of the contract to its website, available at [http://jakartawater.org/eng/?page\\_id=35](http://jakartawater.org/eng/?page_id=35).

<sup>39</sup> Alexander Orwin, *The Privatisation of Water and Wastewater Utilities: An International Survey* (1999), available at <http://www.environmentprobe.org/EnviroProbe/pubs/ev542.html>.

<sup>40</sup> Indonesia, Company Law No.40 Year 2007, Article 3(2).

strengthening its structures.<sup>41</sup> MNCs are aware of this and may take advantage of it by using the shortcomings of the regulatory systems for their benefit.

### 3.4.2 MNC in the Context of Water

In the context of water, the question is whether the very purpose of a MNC — which is to serve the economic interests of its shareholders, who are in most cases located in another state — can coincide with the interests of water users. For an MNC's shareholder, water is a matter of investment and profit, but for a user, water is a basic need.

The conflict in interests between the 'shareholder's value' and the 'stakeholder's value' is embodied at a practical sphere. Under most company laws, the relationship between a company officer and the corporation is governed under the notion of *fiduciary duty*, namely, that officers are responsible for managing the assets of the corporation (comprised of those derived from shareholders and lenders) as an entity.<sup>42</sup> To their shareholders alone, officers are acting in a principal-agent relationship, in which the directors are acting as trustees and the shareholders are the beneficiaries.<sup>43</sup> These concepts are questionable as they may not be compatible with the spirit of public service that characterises the provision of water. A company officer could be in breach of its fiduciary duty to shareholders if they choose to prioritise humanitarian reasons over profit. When investors entrust company officers with a business, the latter are duty bound to create profit and not to do charity.

In practice, disputes may occur when determining the amount and implementation of non revenue earning supply of water and in cutting connections of those who cannot pay the water bill.

### 3.4.3 The Asymmetries

Asymmetries between water stakeholders (government, users, civil societies) and MNCs occur through two ways. First, MNCs have an effective way of making governments comply with investment treaties through arbitration but governments and other stakeholders do not have effective ways to opt out from MNCs' arbitration claims even if the contractual provisions between them may state otherwise.

Through Bilateral Investment Treaties (BITs), a MNC can sue a government before an arbitration organ if their local subsidiary is jeopardised.

The central government — although they may not be directly involved in any legal relationship with a local private water operator — can be dragged into an international arbitration by a foreign water investor if the local government is unable to honor the water contract.

In an ICSID case, the Argentine government was dragged into an international arbitration by Azurix Corp, a Delaware water company, for violating a BIT.<sup>44</sup> The ICSID preliminary tribunal ruled that they had jurisdiction to adjudicate the matter although the actual concession contract had been signed between the government of the province of Buenos Aires and the Azurix subsidiary even if the concession contract between the subsidiary and the local authority waived any settlement forums other than local court.<sup>45</sup> ICSID concluded that the BIT and the concession contract governed different matters and that Azurix Corp had a direct legal interest on the case. This case implies that a clause in a contract between a subsidiary company with local government does not guarantee that disputes will be settled before local courts.

The second asymmetry concerns the imposition on governments of international obligations to provide clean and accessible water, while at the same time, MNCs are not obligated to do so.<sup>46</sup> This means that,

41 Thomas F. McInerney, 'Putting Regulation before Responsibility: The Limits of Voluntary Corporate Social Responsibility', *GWU Law School Public Law Research Paper No. 123* (2005), available at <http://ssrn.com/abstract=658081> or at 10.2139/ssrn.658081.

42 Robert Flannigan, 'Fiduciary Duties of Shareholders and Directors', *Journal of Business Law* 277 (2004), available at <http://ssrn.com/abstract=628775>.

43 There is no explicit concept of fiduciary duty in the Indonesian Company Law. The concept of 'negligence' and 'fault' which may cause liability under the law is not clearly defined. Thus, the interpretation of these concepts might run parallel to the American notion of fiduciary duties. See Benny S. Tabalujan, *Indonesian Company Law, Translation and Commentaries* 26 (Hong Kong: Sweet & Maxwell Asia, 1997).

44 The American Society of International Law, *International Law in Brief*, Bulletin of 16 December 2003, available at <http://www.asil.org/ilib/ilib0622.htm>.

45 *Azurix Corp. v. The Argentine Republic*, ICSID, Decision on Jurisdiction of 14 July 2006, Case No. ARB/01/12.

46 Article 17 of the Berlin Rules calls States to provide water to persons. See Fourth Report of the International Law Association, Berlin Conference on Water Resources Law (2004), available at <http://www.ila-hq.org/pdf/Water%20Resources/Final%20Report%202004.pdf>.

having privatised, states can still be held liable under international law if the subsidiary company of the MNC fails to perform its duties. In other words, the state might have to bear the burden for the MNC's underperformance.

Remedies could be available for water stakeholders, if they submit their case under the Alien Torts Claims Act (ATCA) in the United States, as the law confers upon the federal district courts 'original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations'.<sup>47</sup> However, it may be difficult to claim water rights under ATCA. First, ATCA claims are only effective for violations of *jus cogens* norms such as genocide, crimes against humanity, unlawful detention, slavery and torture.<sup>48</sup> Thus, even though international law has finally recognised the right to water as a human right, if it cannot be characterised as a *jus cogens* norm, it does not enjoy ATCA privileges. Secondly, even if the characterisation of the human right to water as a *jus cogens* rule was successfully proven, the plaintiff must prove that the MNC has *knowingly participated* in the violation.<sup>49</sup>

The ATCA does not appear to be an effective tool for water stakeholders. For the time being, it seems that there are no effective international remedies for water stakeholders to hold an MNC accountable for its failure in providing water, except for those provided in the agreement between the private operator and the local authorities.

### 3.5 Possible Social Costs of Privatisation

There are numerous social and environmental costs that are associated with privatisation. The first one is *employment*. The private operator strives for efficiency

and might be compelled to conduct rationalisation of employment. There are ways of mitigating the impacts of this measure. The Jakarta water privatisation project, for example, holds that the private operator will guarantee re-employment. The escrow account — which retains the earnings from water sales — is also utilised for guaranteeing executives 'the golden handshake' on severance of employment, but it is not clear to what extent this fund can be used for normal employees.

The second is the *loss of control*. 'Concession' or 'BOT' means splitting a bundle of rights, between the state-controlled institution (SOE) and the investor (private operator). Thus, the SOE no longer enjoys full proprietary legal entitlements as it did earlier, because some have been transferred to private parties for a period of time. This means that there are things the SOE can no longer do — for a period of time — because the state does not have access to infrastructure, documentation, etc. that is in the hands of the private operator. The loss of control can also mean that state institutions — the legislative, executive and the judiciary — are no longer able to exercise its control over the privatised object. As has been discussed above, privatisation means some of the property rights have been transferred to the private operator. This part of the bundle of rights is thus 'their' property. If the state intervenes, it could be regarded as a denial of a universal obligation to respect property rights and enforce contractual obligation.

The third problem might be *soaring prices*. Water companies may sell water at an optimum price in order to ensure high return. This could be a disadvantage for those who are unable to pay.

The fourth risk is *discriminative service*. Network extension often touches only urban societies or those who are able to pay. High risk projects tend to be avoided.<sup>50</sup>

The fifth risk could be *conflicts with traditional communities*. Traditional communities perceive water as a communal good. They lack the understanding of modern property rights, licenses and certificates.<sup>51</sup>

47 United States of America, Alien's Action for Tort, US Code, Title 28, Part IV, Chapter 85 § 1350.

48 *John Doe v. Unocal Corp.*, US Court of Appeals for the Ninth Circuit, Case No. 9955576P, 27 April 2001, 14208, available at [http://www.ca9.uscourts.gov/coa/new\\_opinions.nsf/ED482DD84D44CDCC88256A3B005ADD5C/\\$file/9955576.pdf?openelement](http://www.ca9.uscourts.gov/coa/new_opinions.nsf/ED482DD84D44CDCC88256A3B005ADD5C/$file/9955576.pdf?openelement)

49 Terry Collingsworth, *The Alien Tort Claims Act, A Vital Tool for preventing Corporations from Violating Fundamental Human Rights* (Washington, DC: International Labor Rights Fund, 2003), available at <http://www.laborrights.org/publications/ATCA.pdf>.

50 Yanuar Nugroho and Hendrikus Antonius Herry Hendrarto, *Privatisation of Water Resources in Indonesia: Issues, challenges and alternatives* (Solo: The Business Watch Indonesia, Unpublished Report).

51 *Id.*

# 4

## IMPLEMENTING REGULATIONS OF THE WATER LAW

### 4.1 Hierarchy of Regulation

Indonesia's legal system recognises a hierarchy of rules spanning the Constitution, laws, government regulations in lieu of Law (Perpu), government regulations (Peraturan Pemerintah), presidential regulations (Perpres) and regional bylaws (Perda). These are the regulations that have a general binding effect.<sup>52</sup> There are also sectoral regulations such as ministerial regulations which are binding only to specific sectors, and regulations of the central bank which bind banking, financial institutions and foreign direct investments.

Private participation is currently regulated by government regulations and ministerial decrees which predate the Water Resources Law and its judicial review. The regulation of private participation by those decrees must therefore be made compatible to the Constitutional Court's decision.

### 4.2 Vital Sectors must be 'Controlled by the State'

As discussed in the previous chapter, all regulations must follow closely the Constitutional Court's decision on water law and all future regulation must take into account the considerations of the decision. It is important in this regard to remember that Indonesia's Constitution mandates that all vital sectors be 'controlled by the state'. In its decision, the Constitutional Court interpreted that *controlled by the state* means the state has the power to create policy, manage, regulate, administer and supervise certain sectors.<sup>53</sup> In the context of water, this could mean that the price-determination, the access to the machineries, and the building and administration of the drinking water provision system should be within the government's reach.

<sup>52</sup> Indonesia, Law on the Formation of Legal Rules, Law No. 10 Year 2004 (State Gazette Year 2004 No. 53, Supplementary to the State Gazette No. 4389).

<sup>53</sup> Al Afghani, note 25 above.

### 4.3 Regulation on Pricing

'Cost recovery' is one of the pricing principle listed in the regulation, in addition to 'transparency and accountability'.<sup>54</sup> The 'cost' component encompasses operational/maintenance cost, amortisation cost, loan interest fee, 'miscellaneous costs' and 'normal' profit. It is worth remembering that with the new Company Law, a Corporate Social Responsibility (CSR) fund is compulsory, and it is counted as a 'cost'.<sup>55</sup> At the time of writing, the implementing regulation of this provision had not yet been issued. Thus, it is plausible to assume that water prices might actually rise due to this obligation, unless the government issues some exception to the CSR rule for water companies.

Existing regulations categorise customers into four 'blocks'. The first one covers public facilities such as bus stations, the second block covers public institutions such as hospitals, the third block covers governmental institutions and low-middle income households, the fourth covers the high income households.<sup>56</sup> Cross subsidies are enforced between blocks.

When water provision is conducted by private parties, the tariff is approved by the head of the regions based on the 'drinking water provision agreement'. If later in practice, the price is determined solely by the agreement in force between the government and private operator, this may contradict the Constitutional Court's recommendation, since the final decision would be beyond the government's control. However, if the agreement serves only as a recommendation for the determination of the tariff, it would be consistent with the Constitution.

### 4.4 Share Ownership of Drinking Water Companies

One of the dissenting judges affirmed in the Judicial Review of the Water Resources Law that although transfer of water exploitation licenses is prohibited, companies can still change their ownership through share transfer.<sup>57</sup>

<sup>54</sup> Indonesia, Regulation on Drinking Water Provision System, Governmental Regulation 16 Year 2005., Article 60 (3), note 30 above.

<sup>55</sup> Indonesia, Company Law, Article 74(2), note 40 above.

<sup>56</sup> Indonesia, Regulation on the Enactment of Water Drinking Tariff at Regional Water Companies, Regulation of the Interior Minister No. 2 Year 1998.

<sup>57</sup> Indonesia, *Judicial Review of the Law No. 7 Year 2004 on Water Resources*, Indonesian Constitutional Court, Decision No. 058-059-060-063/PUU-II/2004 of 13 July 2005.

It is therefore reasonable to regulate share ownership of water companies. Future regulations may contain provisions stipulating that substantial share transfers must be conducted upon the approval of water authorities and that a violation to this provision may invalidate the transfer of shares.

Currently, cooperation between a regional SOE and investor is regulated under a joint decision of the interior minister and the ministry for regional autonomy.<sup>58</sup> This body of regulation is weak, as it does not constitute a binding regulation under the Law on the Formation of Legal Rules.

The appropriate regulatory instrument for this provision might be a Governmental Regulation. If regulated in the Regional bylaws, there will be no uniformity between regions and this would make share transfer more difficult to control.

#### 4.5 Indemnification of Company Officers

The best interest of the private operator's shareholders is not always the best interest of water stakeholders. There could be cases where the interests collide. In order to anticipate this risk, company officers must be indemnified by the corporation if they acted in the interest of their stakeholders at the expense of the corporation. Further research would be required to study the extent and forms of the indemnification.

#### 4.6 Due Diligence toward the Shareholders of the Private Operator

It is common that a due diligence of the local private operator is undertaken. While the legality of the private operator is not a problem, the flexibilities enjoyed by their foreign shareholders and parent companies can at times cause trouble for the government. Thus, there are at least two issues that need to be investigated by governments, namely the (i) use of special purpose vehicles (SPV) as a parent company to the private operator and identities of its shareholders and (ii) bilateral investment treaties involved.

As has been discussed in Section I, MNCs enjoy various flexibilities when it comes to investment. An MNC may

<sup>58</sup> Indonesia, Joint Decision between Ministry of Regional Autonomy and Ministry of Interior No. 43 Year 2000.

use SPVs in order to hedge its parent companies from risks arising out of legal claims and to obtain protection under the BIT in force between the SPV and the host state.

The means for an MNC to gain a legal standing for BIT claim is omni-dimensional. An MNC can have a claim through a BIT enforced between the host state and the state of jurisdiction of the parent company of the private operator (the SPV's citizenship), and it can also bring a claim under the BIT enforced between the shareholders of the SPV and the host state.<sup>59</sup> If the country where the SPV's shareholders are incorporated is not a party to a BIT with the host state, the MNC can restructure its companies and transfer majority shares to entities in a country which is a party to a BIT with the host state. This means that the notion of 'citizenship' for an MNC is fluid; it can change citizenships in order to find a better standing for legal action.<sup>60</sup>

Another due diligence must be carried out whenever BITs are involved. For example, an umbrella clause in a BIT may determine whether a contractual claim can be extended into an investment claim. It is also important to check if the BIT specifically requires a degree of exhaustion of local remedies.

#### 4.7 Bankruptcy, Minimum Equity Requirement and Guarantee

Declaration of bankruptcy in Indonesia is relatively easy. The law only requires that (i) the debtor has at least two or more creditors (ii) the debt has increased and become unpayable and (iii) the bankruptcy application can be made either by the debtor or at the request of one or more of the creditors.<sup>61</sup>

If a private operator goes bankrupt, the provision of drinking water to customer is impeded. This may eventually trigger civil unrest and political instabilities.

<sup>59</sup> International Waters was able to use the Netherlands-Bolivia BIT after it restructured its company by transferring the shares ownership from a Cayman Island company to Luxemburg/Netherland Company. See *Agua del Tunari, S.A. v Republic of Bolivia*, ICSID, Decision on Jurisdiction of 21 October 2005, Case No. ARB/02/3, available at [http://www.iisd.org/pdf/2005/AdT\\_Decision-en.pdf](http://www.iisd.org/pdf/2005/AdT_Decision-en.pdf).

<sup>60</sup> Timothy O'Neill, 'Water and Freedom: The Privatisation of Water and its Implications for Democracy and Human Rights in the Developing World', 17/2 *Colorado Journal of International Environmental Law and Policy* 357 (2006).

<sup>61</sup> Indonesia, Law on Bankruptcy and Delay on Debt Payment Obligations, Law 37 Year 2004.

In order to avoid this risk, the government needs to regulate a reasonable debt to equity ratio for the private operator. It means that the government must ensure that majority of the financing comes from equity and not debt. Lenders should also be given the right to step in, in the event of private operator's default, and take over the operation of the business.<sup>62</sup>

Another option is the creation of a mandatory guarantee that can be enforced in the event of default. It could be implemented through a personal guarantee scheme or through contract bonds. On the other hand, the use of receivables as collateral is not recommendable. Experience with some water projects reveals that it may increase insolvency risks.<sup>63</sup>

#### 4.8 Public Consent on Private Participation

Public involvement in water management is somewhat vague in the current regulation. Regulations only stipulate that the development plan of the water provision system must be disseminated to the public.<sup>64</sup> However, it is not clear how the public can become involved in decision-making related to the plan. The final say about the water development plan remains with the regional and central government, while the public only has the right to give recommendations. Since the public is the main stakeholder in water provision, their role must be strengthened so as to reach a more significant involvement. The regional house of representatives needs to be strengthened and involved in the decision-making process.

#### 4.9 Water Tender

Tenders are mandatory in public service participations, according to prevailing regulations.<sup>65</sup> The provision of water, however, has different characteristics from other tenders. Once the investor wins the bid and the agreement is signed, the government's position is relatively weak. Investors can use financial reasons as a ground to

renegotiate the contract provision. Thus, investors must be scrutinised with regards to their bid in order to avoid deceptive low bids offered only to win the contract and then later renegotiate the terms and increase prices.<sup>66</sup>

#### 4.10 Disconnection from Network

Existing regulations give the power to operators to disconnect users from the water network, if they do not pay their bills.<sup>67</sup> The conditions where this may apply must be carefully outlined so as not to deprive users from their right to water, as provided under the Constitution.

It is worth emphasising that developing countries have moved towards making the disconnection of water supply illegal. In UK disconnection was made illegal under the 1999 Water Act.<sup>68</sup>

## 5

### NEGOTIATING THE CONTRACT PROVISIONS

Negotiating a water contract is difficult for the government since the contract is not a zero sum game for it. Any impairment to the business partner — the investors — will be harmful for the user and consequently for the government. Thus, for the government, the aim of a water contract can only mean sustainability and continuity of the water services provision.

MNCs, on the other hand, are more at ease in negotiating the contract's provisions, since they have nothing to fear but financial and good will risks.

#### 5.1 Pricing

##### 5.1.1 Currency Risks

It is important to negotiate whether the price to the user will reflect currency risks. Fluctuation on exchange

<sup>62</sup> PPIAF, *Approaches to Private Participation in Water Services, A Toolkit 162* (Washington, DC: The World Bank, 2006).

<sup>63</sup> Maynilad Service Water Incorporated (MWSI) uses a limited recourse financing scheme for a USD 350 million loan scheme. See Jude Esguerra, *The Corporate Muddle of Manila's Water Concessions* (Wateraid and Tearfund, 2003), available at [http://www.wateraid.org/documents/plugin\\_documents/pspmanila.pdf](http://www.wateraid.org/documents/plugin_documents/pspmanila.pdf).

<sup>64</sup> See Government Regulation No 16 Year 2005, Article 26 (4), note 30 above.

<sup>65</sup> *Id* Article 64(5).

<sup>66</sup> See Jude Esguerra, note 64 above, 6.

<sup>67</sup> See Government Regulation No. 16 Year 2005, Article 68 (1) (e) note 30 above.

<sup>68</sup> Chapter 9 of the United Kingdom's Water Industry Act 1999 prohibits disconnection of water from 'dwelling' and the use of limiting devices.



rates may affect costs which in turn affect the final price of the service. It is probably better that the government assumes currency risks as increasing prices during difficult times is not politically popular.

### 5.1.2 Price Adjustment

The limits within which the private operator may renegotiate the provisions of the contract governing price adjustment must be carefully drawn. The government must also comply with the regulations in force on block tariffs.

### 5.1.3 Volumetric Pricing

The current volumetric pricing (the higher the volume, therefore higher the price) may be useful for cross subsidies. However, volumetric bills can also burden poor users. In cases where the service network does not reach slum areas, the distribution is conducted by private parties, taking the water through their water taps and selling them at a price. If a charge is based on volumetric pricing, then end consumers might actually suffer. Thus, volumetric pricing with some 'exceptions' might be effective.

## 5.2 Unilateral Termination and Unilateral Modification of Contract

The contracting SOE should have the right to unilaterally terminate or modify the contract. This is important to ensure compliance with the 'controlled by the state' doctrine. Typically, cessation of the contract is attached to licenses given by authorities to the private operator, so the state can actually exercise its control by revoking the license. However, license revocation is possible only if the company violates certain standards. License revocation can also lead to a costly investment arbitration.

In the event where government feels that it is the time to take over the water project — even if the contract term has not ended and there are no specific violations of water provision standards — unilateral termination could be the best option for governments.

Unilateral termination or modification of a contract normally comes with adequate compensation by the authority to the private operator. But since not each modification requires compensation, the contract needs to specify which require compensation.

## 5.3 Choice of Law and Forum

It is common to find in contracts a choice of law and forum, referring the dispute to the municipal law and forum of the host state.<sup>69</sup> In a drinking water contract, the best option would be to refer any dispute to a local jurisdiction applying local law. This is because referring to a foreign arbitration applying foreign law may contradict the constitutional provisions that mandate water works be 'controlled by the state'. Constitutionally, this may bar the state from exercising its 'control' thus automatically rendering the contract void. Secondly, reference to a local dispute settlement institution would enable stakeholders to take part in the process. If referred to a foreign arbitration, the sessions could be closed to public and thus prevent them from intervening.

## 5.4 Jurisdiction under the BIT

Although required by both the constitution and the contract, the local choice of law and forum may not prevent that a dispute is referred to a foreign jurisdiction by grace of other legal instruments. In a water contract between a SOE and a local private operator, the scope of the dispute settlement provision cannot be extended beyond the parties who signed the contracts. Thus, parent companies and foreign shareholders of the private operator are not bound to the terms of the contract. However, these parties may claim the jurisdiction under the BITs enforced between Indonesia and the investor's state.

BITs are generally applicable only to investment cases. Under BITs, investors normally enjoys privileges such as (i) fair and equitable treatment, (ii) full protection and security, (iii) national and most favoured nation treatment, (iv) no arbitrary or discriminatory measures impairing the investment, (v) no expropriation without compensation and (vi) observance of specific investment undertakings.<sup>70</sup> The last point is regarded as an

69 Venezuela's 2001 Hydrocarbon Law Article 34 (b) obligates local settlement for oil and gas agreements. See Damon Vis-Dunbar, *Venezuela Dodges Arbitration with Foreign Oil Companies; Pursues New Contracts which Would Preclude Arbitration of Future Disputes*, in International Institute for Sustainable Development (IISD), *Investment Treaty News*, 12 January 2006, available at [http://www.iisd.org/pdf/2006/itn\\_jan12\\_2006.pdf](http://www.iisd.org/pdf/2006/itn_jan12_2006.pdf).

70 Lucy Reed, *Guide to ICSID Arbitration* 41, 54 (The Hague: Kluwer Law International, 2004).

‘umbrella clause’ since it is possible that investors try to find parallels between the investment claim and the contract claim by using this clause.<sup>71</sup>

There are theoretically some possible ways to avoid BIT jurisdiction. First, the investors must be compelled to waive its right to claim a BIT jurisdiction in written. Thus, a separate contract which specifically binds the investors needs to be drafted for this purpose. Secondly, the investors must be compelled to lock their shares from possible acquisitions by other legal entities. This is important as when investors waive their right to claim under the BIT, the waiver will only bind the legal entity, but not the shares. Thus, it is possible that the shares are being acquired by another company who would in turn claim injuries.

Nevertheless, this measure may not be effective for two reasons. First, it has been implied in *SGS v Philippines* that it is not possible for an investor to waive a BIT jurisdiction through a contractual arrangement.<sup>72</sup> Secondly, MNCs often have a more favourable position in negotiations with governments, when the object of the contract are ailing water companies that need immediate financing.

## 5.5 Emergency Situation

The provision of Jakarta’s drinking water system was threatened during the 1998 riots.<sup>73</sup> The contract may need to incorporate a provision foreseeing the transfer of the operation of water services for a limited time to local authorities, should the management of the private operator refuse to perform during difficult times. While the contract may clearly stipulate that private operators can be exempted from their responsibilities in the event of riots, it might be wiser to have a provision which

transfers the responsibility from the private operator to local authorities. This way, a vacuum in management can be avoided. The contract will need to carefully outline the circumstances and mechanisms for the transfer of the operation.

# 6

## CONCLUSIONS

There are in general, three ways to safeguard water contracts in Indonesia. The first is made possible through national and regional regulations; the second, through the water contract; and the last, through transnational regulations.

The current national regulation covers water privatisation only in broad areas. Regional authorities should thus create more specific regulations to guarantee the citizens’ rights. Existing national and regional regulation also only covers private sector participation in general. As water infrastructure possess special natural, economical and social characteristics, specific regulations for public service participation in water need to be enacted, as a *lex specialis* to current privatisation regulations.

A standard model contract of a *Water Provision Agreement* can be created. Negotiation guidelines and due diligence standards need to be prepared by the central government. The government needs to build the capacity of the regional authorities if they choose privatisation for their water provision system. Central government need to provide them with qualified consultants to help them in their negotiation processes.

As for transnational protection, the case may be difficult. Existing international law does not have any effective remedies for water stakeholders. Thus, the developing perspective of water as a human right — which puts the burden on states to provide water to its people — needs to be balanced with the effort of holding water MNCs accountable to both stakeholders and shareholders.

The three protection mechanisms — national regulations, contract and transnational — must be synergised. National regulation and contract alone will not be adequate in protecting the commons.

71 *Société Générale de Surveillance SA v. Islamic Republic of Pakistan*, ICSID, Decision on Jurisdiction of 6 August 2003, Case No. ARB/01/13. See also Yuval Shany, ‘Contract Claims v. Treaty Claims: Mapping Conflicts Between ICSID Decisions on Multi-Sourced Investment Claims’, 99 *American Journal of International Law* 835 (2005), available at <http://ssrn.com/abstract=871924>.

72 *Société Générale de Surveillance SA v Republic of the Philippines*, ICSID, Decision on Objections to Jurisdiction of 29 January 2004, Case No. ARB/02/6, available at <http://www.worldbank.org/icsid/cases/SGSvPhil-final.pdf>.

73 Andreas Harsono, Water and Politics in the Fall of Suharto (Article for The Center for Public Integrity, 2003), available at <http://www.publicintegrity.org/water/report.aspx?aid=52>.

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