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IGNOBLE TREATMENT: THE TAX INCREASE ON NOBLE ENERGY'S INTERESTS IN THE MASSIVE ISRAELI GAS STRIKES

Joel Slawotsky*

ABSTRACT

After decades of relatively sparse oil and gas finds, recent developments have transformed Israel from being energy dependent into a probable energy exporter with its own sovereign wealth fund. In 2009 and 2010, United States based Noble Energy (“NBL”) and its Israeli corporate partners, made two giant gas strikes. One field, “Tamar,” was the largest gas find in 2009 and the second, “Leviathan,” was among the largest strikes in a decade. NBL had undertaken the costly and risky explorations relying upon a long-existing regulatory structure which resulted in a modest royalty rate in addition to the ordinary corporate income tax rate. However, following the gas discoveries, the Israeli government amended the regulatory structure in 2011 with the enactment of a new windfall energy profits law which sharply increased the tax rate. The new tax law contains no grandfather clause and includes all prior discoveries such as NBL’s prior gas strikes.

The enactment of the windfall profits tax—an amendment to the regulatory structure—raises a legal issue regarding the host state's right to impose a retroactive increased tax burden on NBL. As a sovereign power, Israel has the inherent right to exercise the core state function of taxation. However, the right may be curtailed by any contractual obligations to foreign investors contained in an investment treaty. The United States and Israel signed an investment treaty in the 1950s: the United States—Israel Friendship Commerce and Navigation Treaty (“FCN Treaty”). FCN Treaties were the predecessor international treaty agreements to Bilateral Investment Treaties (“BITs”) and were developed to provide investors with guarantees against host state actions, protections similar to those contained in BITs. This Article opines that the imposition of a retroactive across-the-board higher tax regime

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violates guarantees given to NBL under the FCN Treaty. To be sure, exceptions to investment protections exist based upon “necessity” pursuant to “exigent circumstances.” However, no national emergency justified the trumping of the FCN Treaty. Moreover, while the FCN Treaty provides for state–state resolution at the International Court of Justice, a strong argument exists that NBL can invoke the FCN Treaty’s most-favored-nation clause to incorporate Israeli BITs with third-parties allowing for arbitration. Doing so would allow NBL to “borrow” a dispute resolution mechanism and allow it to directly file an arbitration claim.

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INTRODUCTION

After decades of relatively sparse oil and gas finds,¹ recent developments have transformed Israel from energy dependent into a likely energy exporter.² In both 2009 and 2010, Noble Energy (“NBL”) and its Israeli corporate partners made two natural gas strikes.³ One field, “Tamar,” was reported to be the largest gas find in 2009.⁴ The second, the “Leviathan,” is believed to be one of the largest finds in over a decade.⁵ Together, the Tamar and Leviathan fields⁶ contain reserves approximating 30 trillion cubic feet (“Tcf”) of natural gas.⁷ In addition to the confirmed gas reserves, the fields may also contain

¹ Ethan Bronner, *For Israelis, New Hopes on Energy*, N.Y. TIMES, Aug. 21, 2010, at A4.

² Matt Day, *Noble Rallies on Israeli Offshore Gas Project*, WALL ST. J. (Dec. 29, 2010), <http://online.wsj.com/article/SB1000142405297020352540576049691602187436.html>; see also *Eastern Mediterranean*, NOBLE ENERGY, <http://www.nobleenergyinc.com/Operations/International/Eastern-Mediterranean-128.html> (last visited Mar. 28, 2013).

³ In addition to Noble Energy’s (“NBL”) 36% interest in Tamar, Israeli corporate partners include: Iramco, 28.7%; Delek Drilling, 15.6%; Avner Oil, 15.6%; and Dor Gas, 4%. Avi Bar-Eli, *Five Banks Compete To Finance Tamar*, HAARETZ (Sept. 3, 2009), <http://www.haaretz.com/print-edition/business/five-banks-compete-to-finance-tamar-1.8567>. With respect to the Leviathan field, NBL enjoys a 39.6% ownership, while Israeli corporate partners include: Avner Oil, 22.6%; Delek Drilling, 22.6%; and Ratio Oil 15%. David Wainer, *Noble, Ratio Oil Find Natural Gas in Leviathan Field off Israeli Coast*, BLOOMBERG (Nov. 29, 2010), <http://www.bloomberg.com/news/2010-11-29/initial-drilling-confirms-leviathan-field-off-israel-contains-natural-gas.html>. However, the ultimate ownership stakes may change as international energy explorer Woodside Petroleum is negotiating with the current owners to acquire a stake in the Leviathan. See Neil Hume, *Woodside Snaps Up Leviathan Stake*, FIN.TIMES (Dec. 3, 2012), <http://www.ft.com/cms/s/0/ec785ee6-3d02-11e2-a6b2-00144feabd0.html>.

⁴ The original estimated reserves in Tamar were revised to 8 trillion cubic feet (“Tcf”) in June 2010. *Noble Increases Tamar Gas Reserve Estimate 15 Percent*, REUTERS, June 3, 2010, available at <http://uk.reuters.com/article/idUKLDE65209Q20100603>. In July 2011, the estimates were again revised upwards to more than 9 Tcf. Amiram Barkat, *Tamar’s New Gas Strata Could Benefit Leviathan*, GLOBES (July 24, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000666734&fid=1725>. Yet again, in August 2011, the estimated Tamar gas reserves were revised to almost 9.5 Tcf. *Tamar Partners Raise Estimate of Gas Reserves*, GLOBES (Aug. 18, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=10000674693>. The most recent estimate is 10 Tcf. *Noble Energy Raises Tamar Gas Estimate to 10 Tcf*, GLOBES (Apr. 4, 2013), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000834073&fid=1725>.

⁵ Ethan Bronner, *Gas Field Confirmed off Coast of Israel*, N.Y. TIMES, Dec. 30, 2010, at A8. See generally *Israel News*, N.Y. TIMES, <http://topics.nytimes.com/top/news/international/countriesandterritories/israel/index.html> (last visited Mar. 29, 2013) (providing up-to-date articles on Israel); *Natural Gas News*, N.Y. TIMES, <http://topics.nytimes.com/top/news/business/energy-environment/natural-gas/index.html> (last visited Mar. 29, 2013) (providing up-to-date articles on natural gas).

⁶ *Oil and Gas Investor* named Tamar the best discovery of 2009 and the Leviathan best discovery of 2010. See Hillel Koren, *Leviathan Rated Best Discovery of the Year*, GLOBES (May 19, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000646999&fid=1725>.

⁷ Tamar was initially estimated to contain 9 Tcf in gas reserves. *Eastern Mediterranean*, *supra* note 2. The amount of gas was revised upward in April 2013 to 10 Tcf. *Noble Energy Raises Tamar Gas Estimate to 10 Tcf*, *supra* note 4. Leviathan initially was estimated to contain at least 15.9 Tcf, though that estimate was believed to have the potential for upward revision to as much as 21.1 Tcf. *Israel’s Leviathan NatGas Reserves*

several billion barrels of crude oil.⁸ These astounding figures dwarf prior discoveries in Israel and represent large, world-class energy assets.⁹ The Tamar and Leviathan fields are worth hundreds of billions of U.S. dollars.¹⁰ Given the potential value of these fields, the Israeli government is finalizing authorization to export the oil and gas from these fields.¹¹ Israel is also planning its own sovereign wealth fund,¹² thereby joining the ranks of Qatar, Kuwait, Saudi Arabia, and other energy-rich exporting states.¹³

For sixty years, the Israeli regulatory environment for companies engaged in energy exploration had been both stable and favorable to energy explorers.¹⁴

May Hit 21.1 Tcf, REUTERS, Mar. 29, 2011, available at <http://www.reuters.com/article/2011/03/29/israel-natgas-leviathan-idUSLDE72S1HH20110329>. Indeed, in March 2013, NBL raised the gas reserve estimate in Leviathan to 18 Tcf. *Noble Ups Leviathan Gas Estimate to 18 Tcf*, UPI (March 7, 2013), http://www.upi.com/Business_News/Energy-Resources/2013/03/07/Noble-ups-Leviathan-gas-estimate-to-18-tcf/UPI-70811362654870/ (“Noble Energy Inc. updated its reserve estimate in the Leviathan natural gas field off the Israeli coast to 18 trillion cubic feet.”).

⁸ Amiram Barkat, *Leviathan Partners: 4.2b Barrels of Oil Beneath Gas*, GLOBES (Aug. 29, 2010), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000584716>; see also *Positive Findings in Leviathan Oil Strata*, GLOBES (April 10, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000637241&fid=1725>.

⁹ Financial services company UBS believes that Israel’s gross domestic product will grow substantially from gas production and that a sovereign wealth fund may achieve over \$440 billion in assets by 2030. *UBS: Gas Discoveries To Boost Israel’s GDP 0.2-0.4% Per Year*, GLOBES (May 11, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000644373>.

¹⁰ Approximately forty billion dollars in contracts have already been signed for Tamar gas. This represents only half of the field’s known reserves. *Tamar Group Inks \$4 Billion Israel Corp Natgas Deals*, REUTERS, Nov. 26, 2012, available at <http://www.reuters.com/article/2012/11/26/us-tamar-natgas-israelcorp-idUSBRE8AP0C420121126>. Thus, Tamar’s gas is worth about eighty billion dollars based on current gas contracts. The Leviathan field may be twice or even triple the size of Tamar and there may be crude oil found at a later time. Suffice to say the monetary value of both the Tamar and Leviathan fields is potentially staggering.

¹¹ *Natural Gas: A ‘Game Changer’ with Myriad Challenges for Israel*, KNOWLEDGE@WHARTON (Dec. 6, 2012), <http://kw.wharton.upenn.edu/israel/natural-gas-a-game-changer-with-myriad-challenges-for-israel>.

¹² Charles Levinson, *Israel To Launch State Fund Within a Year*, WALL ST. J. (Jan. 26, 2011), <http://online.wsj.com/article/SB10001424052748703293204576105830038749802.html>. The Israeli government approved the establishment of an Israeli sovereign wealth fund (“SWF”) in 2013. Itai Trilnick, *Israeli Cabinet Approves Plans for Sovereign Wealth Fund*, HAARETZ (Apr. 15, 2013), <http://www.haaretz.com/business/israeli-cabinet-approves-plans-for-sovereign-wealth-fund.premium-1.515583> (“Legislation to establish a sovereign wealth fund, in which the state’s income from Israeli natural gas will be stashed, was approved by the government yesterday, after the plan’s proponents managed to overcome vehement opposition.”). See generally Joel Slawotsky, *Sovereign Wealth Funds as Emerging Financial Superstars: How Should U.S. Regulators Respond*, 40 GEO. J. INT’L L. 1239 (2009) (discussing the financial power of sovereign wealth funds).

¹³ See Monetary & Capital Mkts. & Policy Dev. & Review Dep’ts, *Sovereign Wealth Funds—A Work Agenda*, INT’L MONETARY FUND 7 (Feb. 29, 2008), <http://www.imf.org/external/np/pp/eng/2008/022908.pdf>.

¹⁴ Petroleum Law, 5712-1952, 6 LSI 129 (1951–1952) (Isr.) (providing for a 12.5% royalty rate on energy production).

Since 1952, the royalty rate had been set at 12.5% along with the regular corporate income tax rate.¹⁵ The combined royalty and corporate tax rate—a reasonable overall taxation rate for the oil and gas business—were well founded as energy explorers generally bypassed Israel in favor of the greener pastures of the established energy producing regions in the Persian Gulf and Middle East.¹⁶ The taxation structure—unchanged for decades—served as an incentive and was relied upon by NBL in opting to invest considerable resources in what was considered a risky exploratory effort.¹⁷ NBL expended substantial sums of money—with great risk—based upon this long-existing regulatory framework.¹⁸

However, this long-existing regulatory structure was amended in 2011 with the enactment of a new petroleum profits taxation law sharply increasing the tax rate.¹⁹ In April 2010, following confirmation of the Tamar discovery,²⁰ the Israeli government appointed a committee headed by Hebrew University Economics Professor Eytan Sheshinski (“Sheshinski committee”)²¹ to review the existing regulatory framework.²² The Sheshinski committee voted four-to-two to alter the existing regulatory structure by substantially increasing the tax

¹⁵ *Id.*

¹⁶ Bronner, *supra* note 1.

¹⁷ Ethan Bronner, *Israel: Doubling Tax on Energy*, N.Y. TIMES (Mar. 31, 2011), <http://www.nytimes.com/2011/03/31/world/middleeast/31briefs-Israel.html>.

¹⁸ See Ronit Goodman, *Israeli Explorers Drop as Noble Stops Leviathan 2 Drilling*, BLOOMBERG (May 15, 2011), <http://www.bloomberg.com/news/2011-05-15/israeli-gas-explorers-drop-as-noble-stops-leviathan-2-drilling.html> (discussing NBL’s decision to stop drilling at Leviathan 2). Indeed, these risks are ongoing. *Cf. id.*

¹⁹ Bronner, *supra* note 17. *See generally Oil and Gasoline News*, N.Y. TIMES, <http://topics.nytimes.com/top/news/business/energy-environment/oil-petroleum-and-gasoline/index.html> (last visited Mar. 29, 2013) (providing up-to-date articles on oil and gasoline).

²⁰ The Tamar field was confirmed in 2009. *See* Comm. to Examine the Fiscal Policy on Oil & Gas Res. in Isr., Conclusions of the Committee for the Examination of the Fiscal Policy with Respect to Oil and Gas Resources in Israel app. A at 3 (2011) [hereinafter Sheshinski Report], *full report available at* http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/publications/02_Full_Report_Nonincluding_Appendixes.pdf, *appendix A available at* http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/publications/04_Appendix_A.pdf (Appendix A contains the Minority Opinion of the representatives of the Ministry of National Infrastructure); *see also* Press Release, Noble Energy, Noble Energy Announces Successful Tamar Appraisal in Israel and Increases Resource Size (July 7, 2009) [hereinafter Noble Energy Announces Successful Tamar Appraisal], *available at* <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=394724> (confirming that Tamar contains significant natural gas reserves).

²¹ *See generally Summary of Draft Conclusions by the Sheshinski Committee*, MINISTRY OF FIN. (Nov. 10, 2010), <http://www.financeisrael.mof.gov.il/FinanceIsrael/Pages/En/News/20101110.aspx>.

²² Bronner, *supra* note 5.

burden on energy exploration companies.²³ The measures contain no grandfather clause and include all prior discoveries, as well as current and future exploration.²⁴ After receiving support from the Prime Minister,²⁵ the proposed measures were approved by the Finance Committee.²⁶ Subsequently, on March 30, 2011, the Israeli Parliament approved the Petroleum Profits Taxation Law of 2011, which adopted the Sheshinski committee's recommendation to increase the tax rate from energy production.²⁷ The new tax structure requires an energy company to pay a substantially higher rate of taxation through the imposition of a windfall profits tax.²⁸

The amendment of the regulatory structure raises a legal issue regarding Israel's right to impose what amounts to a retroactive increased tax burden on NBL.²⁹ As a sovereign power, Israel has the inherent right to exercise the core state function of taxation. However, a state's right to "change the rules of the game" is subject to, and may be curtailed by, any contractual obligations to

²³ See SHESHINSKI REPORT, *supra* note 20, at 9, 13. Some committee members dissented from the decision. *See id.* app. A at 6; *see also* Amiram Barkat, *Second Sheshinski C'tee Member Opposes Findings*, GLOBES (Jan. 3, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000612862>.

²⁴ See SHESHINSKI REPORT, *supra* note 20, at 129 (discussing the tax benefits to any field, including Tamar, that commences oil and gas production before January 2014).

²⁵ Lilach Weissman, *Cabinet Approves Sheshinski Gas Tax Hike*, GLOBES (Jan. 23, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000617432>.

²⁶ *Israeli Bill on Natural Gas Tax Hike Passes Crucial Vote*, REUTERS, Mar. 23, 2011, *available at* <http://www.reuters.com/article/2011/03/23/israel-gas-taxes-idUSLDE72L1MO20110323>.

²⁷ See Ari Rabinovitch, *Israel Approves Law To Raise Tax on Gas Profits*, REUTERS, Mar. 30, 2011, *available at* <http://in.reuters.com/article/2011/03/30/israel-gas-law-idINLDE72T1QF20110330>; *see also Taxation and Investment in Israel 2012: Reach, Relevance and Reliability*, DELOITTE 12 (2011), https://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/2012/dttl_tax_guide_2012_Israel.pdf.

²⁸ Rabinovitch, *supra* note 27. The precise rate depends on certain factors. Notwithstanding some variances, the new law imposes a dramatically higher tax and reduces the corporate profitability on NBL's discoveries. *See infra* notes 152–159 and accompanying text.

²⁹ SHESHINSKI REPORT, *supra* note 20, app. B at paras. 30–32, at 16–17, *available at* http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/publications/05_Appendix_B.pdf. The Sheshinski Committee final report acknowledges that legal issues exist. *Id.* app. B. The legal opinion to the Sheshinski Report discusses at length the role of domestic law and the Treaty-of-Friendship-Commerce-and-Navigation implications, relying upon the possibility of a lawsuit which is unlikely because NBL cannot bring suit in the International Court of Justice and the U.S. government is highly unlikely to bring suit in that forum. *See id.* app. B at para. 94, at 48. Moreover, the opinion opines, "even should it be found that Noble's claims are justified, and it is highly doubtful that this would be the case, the remedy the company would be granted by international tribunals would be compensation for the foreign entrepreneur." *Id.* app. B at para. 95, at 48. Accordingly, the opinion places great emphasis on the procedural impediment to a direct suit and the belief that in the worst-case scenario, in which Noble's claims are found to have merit, compensation would be paid. *Id.*

foreign investors contained in an investment treaty.³⁰ Investment treaties, such as Friendship Commerce and Navigation Treaties (“FCNs”) and Bilateral Investment Treaties (“BITs”), provide foreign investors with guarantees against expropriation, discrimination, and violation of minimum standards of treatment.³¹

The United States and Israel have signed an investment treaty: the United States–Israel Friendship Commerce and Navigation Treaty (“FCN Treaty”).³² FCNs were the predecessor international treaty agreements to BITs³³ and were developed to provide investors with guarantees against host state actions, which could reduce the value of their investment.³⁴ FCNs were utilized until BITs became popular in the 1960s.

“The post-war FCNs guaranteed ‘equitable treatment’ and the ‘most constant protection and security’ to property of foreign nationals and companies. Such property could not be taken without payment of just compensation.” The “fair and equitable” standard . . . is adopted by the vast majority of BITs as the primary standard for appropriate investment protection³⁵

The modern BIT is a reflection of the FCN’s concern that the investor receives fair and equitable treatment and the most constant protection and security. BITs provide for investor-state dispute resolution through arbitration.

³⁰ According to media reports, Israel is threatening Egypt with international investment treaty arbitration over Egypt’s demand to raise the price of gas being sold to Israel. Evidently, based upon a 2009 contract, the price of gas was fixed and could only be reviewed in 2013. However, Egypt demanded an upward sales price revision in 2011. See Koby Yeshayahou, *Israel Rejects Demand for Higher Egyptian Gas Price*, GLOBES (May 23, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000647937>. As a result, Israel is considering filing a claim for arbitration. *Israel Considers Arbitration over Egyptian Gas*, GLOBES (May 29, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000649539>. In addition, American investors are threatening Egypt with arbitration over the failure to supply gas claiming a breach of the U.S.–Egypt BIT. See Lubna Salah Eddin, *US Partners in Gas-to-Israel Deal Threaten Arbitration*, AL MASRY AL YOUN (May 29, 2011), <http://www.almasryalyoum.com/en/node/456279>.

³¹ See Susan Franck, *The ICSID Effect? Considering Potential Variations in Arbitration Awards*, 51 VA. J. INT’L L. 825, 835 (2011); Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 INT’L LAW. 655, 657 (1990).

³² Treaty of Friendship, Commerce and Navigation, U.S.–Isr., Aug. 23, 1951, 5 U.S.T. 550 [hereinafter FCN Treaty].

³³ Amnon Lehavi & Amir N. Licht, *BITs and Pieces of Property*, 36 YALE J. INT’L L. 115, 121 (2011).

³⁴ The common theme among all investment treaties is the universally recognized obligations that the host state promises to investors of the other party. Franck, *supra* note 31, at 835.

³⁵ Lehavi & Licht, *supra* note 33, at 121 (footnote omitted) (first quoting Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT’L L. & POL’Y 157, 158–61 (2005); second quoting Christoph Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. WORLD INVESTMENT & TRADE 357, 359 (2005)).

In recent years, as global trade has soared, states and investors have engaged in dispute resolution based upon the various agreements in which the investor made the investment in the host nation.³⁶ Such disputes are routinely handled as arbitrations either in the International Centre for the Settlement of Investment Disputes (“ICSID”) or U.N. Commission on International Trade Law (“UNCITRAL”) mechanisms.³⁷ Investor arbitrations are beneficial as they provide “private investors with a direct route to neutral dispute resolution [which] would then presumably lower commercial risk, facilitate confidence in the international investment system, and avoid the political sensitivities encumbering state-to-state adjudication.”³⁸

A fairly large number of arbitration rulings adjudicating investor-state disputes have arisen.³⁹ These rulings have resulted in a critical mass of principles, which coupled with international law, combine to constitute investment treaty law.⁴⁰ As detailed below, investment tribunals arbitrating investor-state claims have interpreted such rights consistent with the safeguarding of those rights.⁴¹ As a U.S. national, NBL enjoys protection standards enunciated in the FCN Treaty and may have a viable claim asserting those rights based upon the increased tax rate.⁴²

This Article opines that the imposition of a retroactive across-the-board higher tax regime violates guarantees given to NBL under the FCN Treaty. To be sure, exceptions to investment protections exist based upon “necessity” pursuant to “exigent circumstances,” such as protecting a sovereign’s financial condition or to protect its peace and security.⁴³ If exigent circumstances exist

³⁶ For an excellent comprehensive analysis of awards, see Franck, *supra* note 31, at 850–93.

³⁷ See Lehavi & Licht, *supra* note 33, at 120 n.15 (“ICSID is by far the most popular arbitration framework of choice in BITs. A distant second is the U.N. Commission on International Trade Law . . .”).

³⁸ See Franck, *supra* note 31, at 834.

³⁹ For a detailed discussion of the ICSID, see *id.* at 837–54.

⁴⁰ For an excellent analysis of the variances among tribunal decisions, see Locknie Hsu, *Investment Treaty Disputes: Ideological Fault Lines and an Evolving Zeitgeist*, 12 J. WORLD INVESTMENT & TRADE 827 (2011).

⁴¹ See *infra* Part IV. Scholars have also raised the possibility that restrictions against sovereign wealth fund investments in capital recipient nations may violate investment treaties. See Locknie Hsu, *SWFs, Recent US Legislative Changes, and Treaty Obligations*, 43 J. WORLD TRADE 451, 451–77 (2009).

⁴² There may be other domestic Israeli legal issues that the tax hike implicates. See Uri Benoliel, *Can the Gas Entrepreneurs Sue Israel?*, GLOBES (June 14, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000654072> (“Israeli law, comparative law and various theories of contract law all indicate that if one party of a contract uses his legal right in order to reap rewards that, according to the contract, belonged to the other party, then the first party is not acting in good faith.”).

⁴³ According to the FCN Treaty, actions that violate the Treaty are permissible only if they are undertaken to protect the Party’s peace and security. See FCN Treaty, *supra* note 32, art. XXI(1)(d). Tribunals

that justify a radical change in the regulatory environment, the investor's rights may be trumped by the state's inherent duty to protect its citizens. However, since there was no national emergency justifying any new taxation with a retroactive confiscatory impact,⁴⁴ NBL may be entitled to damages resulting from the re-regulation of the prior regulatory structure. Moreover, while the FCN Treaty provides for state-state resolution at the International Court of Justice ("ICJ"), a strong argument exists that NBL can invoke the FCN Treaty's most-favored-nation ("MFN") clause to incorporate Israeli BITs with

have consistently interpreted such treaty clauses as enabling a host state to override a treaty guarantee only if an essential interest is in severe danger and the state's action was vital in defending the interest. In addition, to utilize this defense, the host state must not have contributed to the crisis. *See, e.g.,* Total S.A. v. Argentine Republic, Decision on Liability, ICSID Case No. ARB/04/1, paras. 223, 345 (Dec. 27, 2010), *available at* <http://www.italaw.com/sites/default/files/case-documents/ita0868.pdf> (noting that the host state failed to show "economic security" would have been "imminently and gravely threatened" and there that there were no alternatives for the "State to safeguard an essential interest"); *Sempra Energy Int'l v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, paras. 352, 378 (Sept. 28, 2007), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694_En&caseId=C8; *Enron Corp. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, para. 308 (May 22, 2007), *available at* <http://www.italaw.com/sites/default/files/case-documents/ita0293.pdf>; *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, paras. 319–22, 324, 329 (May 12, 2005), 14 ICSID Rep. 158 (2009).

⁴⁴ To the contrary, Israeli macroeconomic statistics were strong and there was no evidence of exigent circumstances. For example, the GDP was strong. *See* Alisa Odenheimer, *Israel's Economy Is Likely To Expand 3.8% This Year and Next, IMF Predicts*, BLOOMBERG (Apr. 11, 2011), <http://www.bloomberg.com/news/2011-04-11/israel-s-economy-is-likely-to-expand-3-8-this-year-and-next-imf-predicts.html> ("Israel's economy is likely to expand 3.8 percent this year and next, the International Monetary Fund said in a report today, raising its forecast."). Unemployment was at a record low. *See* Adrian Filut, *Israel's Unemployment Rate at All-Time Low*, GLOBES (July 25, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000667357> ("Israel's unemployment continued to fall in May 2011, reaching 5.7% of the civilian labor force in trend figures—an all-time low, the Central Bureau of Statistics reported today."). Also, the current accounts surplus was growing. Alisa Odenheimer, *Israel April Currency Reserves Rise to Record \$77.4 Billion*, BLOOMBERG (May 5, 2011), <http://origin-www.bloomberg.com/news/2011-05-05/israel-april-currency-reserves-rise-to-record-77-4-billion-1-.html> ("Israel's foreign currency reserves increased to a record in April as the central bank resumed purchases after a one-month hiatus."). Indeed, Bank of Israel Governor Stanley Fischer, was named 2010 Central Bank Governor of the Year for his stewardship of the dynamic growth and strength of the Israeli economy. *Kudrin and Fischer Honoured by Euromoney at IMF/World Bank Meetings in Washington*, EUROMONEY (Oct. 10, 2010), <http://www.euromoney.com/Article/2683869/Category/1/ChannelPage/0/Kudrin-and-Fischer-honoured-by-Euromoney-at-IMFWorld-Bank-meetings-in-Washington.html>. Investment banks also viewed Israel as being in strong financial shape. *See* Adi Ben Israel, *Deutsche Bank: Israeli Economy Robust*, GLOBES (July 18, 2007), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000233551> ("Deutsche Bank says, 'We continue to view Israel as one of the most robust economies in Europe, Middle East, and Africa region (EMEA). The growth picture is solid, the debt burden has declined, and the currency is competitive.'"); *HSBC Finds Israeli Economy Robust*, GLOBES (Apr. 11, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000638020> ("On the consumer front, Katz notes that 'strong tax revenues in March on the back of surging consumer imports (new vehicles especially) suggest that household demand remained strong last month.' Katz believes that the fiscal target of 3% of GDP will probably be met this year and that the government debt will decline from 75% of GDP in 2010 to 73% in 2011 (HSBC estimate), and possibly lower.").

third-parties allowing for arbitration. Doing so would allow NBL to “borrow” a dispute resolution mechanism and allow it to directly file an arbitration claim.

Part I of this Article details the strategic rise of natural gas thus underscoring the financial value of NBLs discoveries. Part II provides a historical perspective of the discovery of the Tamar field. Part III details Israel’s amendment of the regulatory structure to increase taxes on energy explorers. Finally, in Part IV, the Article discusses whether, and to what extent, the tax increase violates the FCN Treaty, and whether NBL can import a more favorable dispute resolution mechanism to enable filing a direct arbitration claim.

I. THE RISE OF NATURAL GAS

Access to energy is a vital and strategic interest in virtually every nation. For example, energy is listed as a national security factor by the U.S. government in determining whether to approve cross-border transactions, which may result in control of a U.S. business by a foreign entity or government.⁴⁵ U.S. Treasury Guidance states the following as a national security interest: “The potential national security-related effects of the transaction on U.S. critical infrastructure, including [physical critical infrastructure such as] major energy assets.”⁴⁶

An indispensable driver of global economic growth for almost one hundred years, crude oil or “black gold”⁴⁷ or “Texas tea,”⁴⁸ has been relied upon to fuel cars, buses, and trucks, to heat homes and businesses, and to power plants generating electricity.

⁴⁵ See 50 U.S.C. § 2170(f)(6) (2006).

⁴⁶ Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,570 (“For example, some of these transactions involved U.S. businesses in the energy sector at various stages of the value chain: The exploitation of natural resources, the transportation of these resources (e.g., by pipeline), the conversion of these resources to power, and the provision of power to U.S. Government and civilian customers.”).

⁴⁷ Crude oil is also known as “black gold.” E.g., Amy Or, *Platinum Partners Strike Black Gold in Unloved Wells*, WALL ST. J. (Jan. 7, 2011), <http://online.wsj.com/article/SB10001424052748704055204576067852780435770.html> (using the term “black gold” for crude oil).

⁴⁸ Crude oil is also known as “Texas tea.” E.g., JERRY SCOGGINS, FLATT AND SCRUGGS, *The Ballad of Jed Clampett*, on *HARD TRAVELIN’ FEATURING THE BALLAD OF JED CLAMPETT* (Columbia 1962) In the opening song, Texas tea is used as a synonym for crude oil. *Id.* (“Up through the ground, come a bubblin’ crude. Oil that is; black gold; Texas tea.”).

Oil has enjoyed a premier position as the fuel of choice and had once been presumed to be both plentiful and cheap. In the United States, crude oil has been a pillar of the American economy and access to the supply of oil constitutes a vital national security interest.⁴⁹ However, several developments have coalesced to dethrone oil from its superlative position and militate in favor of natural gas as an attractive and viable alternative. One such development is the fact that natural gas is available as an abundant alternative fuel.⁵⁰ Second, the concern over carbon emissions and the damage to the global environment are encouraging diversification away from oil toward the usage of natural gas⁵¹ due to the perception that the usage of oil causes greenhouse gas emissions.⁵² Environmental concerns also include anxieties over the nuclear energy option. In the aftermath of Japan's nuclear woes,⁵³ natural gas is viewed as a safer and more environmentally friendly alternative. Third, the use of natural gas is receiving a large boost from transportation needs. In addition to electric power generation, natural gas liquids can be used to power cars, trucks, and jet aircrafts, accounting for a substantial percentage of energy use.⁵⁴ Therefore, based upon its abundance, perceived environmental advantages, and its fast growing use as a transportation fuel, natural gas is

⁴⁹ See Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. 74,567, 74,569–70 (Dec. 8, 2008) (describing access to energy as a factor in national security considerations regarding approval of business deals when a foreign entity seeks to gain control of a U.S. business).

⁵⁰ See Ben Geman & Katherine Ling, *Report of Abundant U.S. Natural Gas Supplies Rattles Energy Debate*, N.Y. TIMES (June 18, 2009), <http://www.nytimes.com/gwire/2009/06/18/18greenwire-report-of-abundant-us-natural-gas-supplies-rat-50410.html> (discussing the abundance of America's natural gas supply); see also Clifford Krauss, *Natural Gas, Suddenly Abundant, Is Cheaper*, N.Y. TIMES, Mar. 21, 2009, at B1 (discussing the worldwide abundance of gas).

⁵¹ See Editorial, *A Victory for Cleaner Air, and the Law*, N.Y. TIMES, Apr. 18, 2011, at A22 [hereinafter *A Victory for Cleaner Air*] (discussing environmental hazards associated with coal usage).

⁵² *Rising Gas Prices Fuel Demand for Ford Compressed Natural Gas-Powered Commercial Vehicles*, PR NEWSWIRE (Mar. 29, 2011), <http://www.prnewswire.com/news-releases/rising-gas-prices-fuel-demand-for-ford-compressed-natural-gas-powered-commercial-vehicles-118840199.html> [hereinafter *Rising Gas Prices*] ("First, CNG is a nontoxic, extremely clean-burning fuel and significantly reduces CO, CO₂ and NO_x compared with gasoline. According to the U.S. Environmental Protection Agency, use of CNG can result in 30 to 40 percent less greenhouse gas emissions.").

⁵³ See Rachel Layne, *GE \$1 Billion Nuclear Unit at Risk as Nations Mull Atomic Future*, BLOOMBERG (Mar. 16, 2011), <http://www.bloomberg.com/news/2011-03-16/ge-s-1-billion-in-nuclear-sales-at-risk-as-nations-ponder-industry-future.html> ("Governments from Germany to India are reassessing the technology after Japan's March 11 earthquake and tsunami crippled a power plant and raised the threat of a meltdown. China today halted nuclear project approvals and plans safety inspections of new facilities.").

⁵⁴ See Matthew L. Wald, *New Interest in Turning Gas to Diesel*, N.Y. TIMES, Dec. 24, 2010, at B1 ("Diesel and jet fuel are usually made from crude oil. But with oil prices rising even as a glut of natural gas keeps prices for that fuel extraordinarily cheap, a bit of expensive alchemy is suddenly starting to look financially appealing: turning natural gas into liquid fuels.").

likely to constitute a potential replacement for crude oil and a premier energy source.

A. *Global Peak Oil*

According to proponents of Global Peak Oil, a day will come where a peak in world crude oil production arrives and then, production will commence an irreversible and inevitable decline.⁵⁵ Once believed to be a “fringe” theory, Global Peak Oil has achieved respectable recognition as a likely scenario.⁵⁶

Proponents of Global Peak Oil assert that once Global Peak Oil is reached, the world’s ever increasing demand for energy—if unmet from alternative sources—will collide with the decline in supply and lead to shortages and spiraling prices.⁵⁷ However, even without the actualization of Global Peak Oil, there is general acknowledgement that the “easy oil” which is cheaply produced has already been discovered and the future of oil production lies in more costly and less accessible heavy oil projects⁵⁸ or in fracking.⁵⁹ Matt Simmons was a strong believer in Global Peak Oil and published extensively regarding his findings that many of the large well-known Saudi and Persian Gulf oil fields were already in decline.⁶⁰

However, regardless of whether the world will reach Global Peak Oil over the next couple of decades, at some point alternative sources must be used to satisfy the ever-growing needs of an energy-driven world. As described in the next Subpart, while coal and nuclear have been cited as potential replacements for oil, neither are likely to be favorite candidates for replacements for crude

⁵⁵ See Slawotsky, *supra* note 12, at 1254.

⁵⁶ *Id.* at 1245.

⁵⁷ *Id.*

⁵⁸ See Ben Casselman, *Facing Up to End of ‘Easy Oil,’* WALL ST. J. (May 24, 2011), <http://online.wsj.com/article/SB10001424052748704436004576299421455133398.html> (discussing the difficulties involved in finding “easy” new oil fields and the world’s growing energy demands).

⁵⁹ Hydraulic fracturing, or “fracking,” has greatly increased U.S. oil production, which may partly alleviate the drop in global crude production. See *U.S. May Soon Become World’s Top Oil Producer*, CBS MONEY WATCH (Oct. 23, 2012), http://www.cbsnews.com/8301-505123_162-57538431/u.s-may-soon-become-worlds-top-oil-producer.

⁶⁰ See Edward Klump & David Wethe, *Matthew Simmons, Who Said Global Crude Production Has Peaked, Dies at 67*, BLOOMBERG (Aug. 9, 2010), <http://www.bloomberg.com/news/2010-08-09/matthew-simmons-investment-banker-peak-oil-theory-advocate-dies-at-67.html> (“Simmons started Houston-based Simmons & Co. in May 1974 with a focus on the oil-services industry, according to the company’s website. The firm expanded to offer research, institutional sales and investment banking in the energy industry. Simmons promoted the idea that world oil reserves are peaking, and he explored the implications in a 2005 book called ‘Twilight in the Desert.’”).

oil. Coal is not favored for environmental and cost reasons.⁶¹ With respect to nuclear energy, in the wake of the 2011 Japanese earthquake and tsunami,⁶² and the ensuing safety apprehensions,⁶³ nuclear energy may actually lose importance, at least temporarily, over the next several years.⁶⁴

B. Greenhouse Emissions and Nuclear Concerns

The huge increase in coal burning in recent years is faulted for growing environmental damage. Perceived disadvantages with coal and nuclear power have led to a strategic shift in thinking about these alternate sources of energy. Coal usage has grown enormously in recent years.⁶⁵ Likewise, concern over severe environmental damage and health risks associated with coal-powered electricity generation has grown as scientific evidence of these dangers builds. Proof that coal usage is a causative factor in acid rain, asthma, water resource contamination, and carbon emissions, has led to increased governmental regulation and litigation.⁶⁶ As the New York Times noted:

⁶¹ See *Clean Energy: Coal*, U.S. ENVTL. PROT. AGENCY, <http://www.epa.gov/cleanenergy/energy-and-you/affect/coal.html> (last visited Feb. 8, 2013); Ramit Plushnick-Masti, *Is Coal-Fired Power Plant Killing Farmers' Trees?*, NBC NEWS (Dec. 28, 2010), http://www.nbcnews.com/id/40830410/ns/us_news-environment/t/coal-fired-power-plant-killing-farmers-trees (“Visible above the horizon is what many plant specialists, environmentalists and scientists believe to be the culprit: the Fayette Power Project—a coal-fired power plant for nearly 30 years has operated mostly without equipment designed to decrease emissions of sulfur dioxide, a component of acid rain.”).

⁶² See Martin Fackler, *Powerful Quake and Tsunami Devastate Northern Japan*, N.Y. TIMES, March 12, 2011, at A1.

⁶³ See Hiroko Tabuchi, David Sanger & Keith Bradsher, *Nuclear Crisis Grows for a Stricken Japan After Radiation Spews from a Reactor Fire*, N.Y. TIMES, Mar. 15, 2011, at A1 (“Japan’s nuclear crisis verged toward catastrophe on Tuesday after an explosion damaged the vessel containing the nuclear core at one reactor and a fire at another spewed large amounts of radioactive material into the air, according to the statements of Japanese government and industry officials.”).

⁶⁴ See Chris Buckley, *China Freezes Nuclear Approvals After Japan Crisis*, REUTERS, Mar. 16, 2011, available at <http://www.reuters.com/article/2011/03/16/us-china-nuclear-idUSTRE72D1PN20110316>; Judy Dempsey & Sharon LaFraniere, *In Europe and China, Japan’s Crisis Renews Fears About Nuclear Power*, N.Y. TIMES, Mar. 17, 2011, at B4; Rainer Buergin & Brian Parkin, *Merkel Will Scrap German Nuclear Plants by 2022 After Fukushima Disaster*, BLOOMBERG (May 30, 2011), <http://www.bloomberg.com/news/2011-05-30/merkel-s-coalition-agrees-to-shut-all-of-germany-s-nuclear-plants-by-2022.html>.

⁶⁵ See Michael Casey, *World’s Coal Dependency Hits Environment*, USA TODAY (Nov. 4, 2007), http://www.usatoday.com/tech/science/2007-11-04-3234317160_x.htm (“Cheap and abundant, coal has become the fuel of choice in much of the world, powering economic booms in China and India that have lifted millions of people out of poverty. Worldwide demand is projected to rise by about 60 percent through 2030 to 6.9 billion tons a year, most of it going to electrical power plants.”).

⁶⁶ See Editorial, *supra* note 51 (“Under the deal, the federally run authority will close 18 of its oldest and dirtiest coal-fired boilers in Tennessee, Kentucky and Alabama, spend \$3 billion to \$5 billion over the next decade to install state-of-the-art pollution controls at about three dozen other units, and invest \$350 million in energy efficiency and renewable energy projects.”).

The new settlement between the Environmental Protection Agency, other plaintiffs and the Tennessee Valley Authority resolving clean air violations at 11 T.V.A. coal-fired power plants is long overdue. As a result, millions of Americans will someday breathe cleaner air. The settlement will also reduce emissions that have brought acid rain damage to Great Smoky Mountains National Park.⁶⁷

Asthma and acid rain are cited as the results of coal usage⁶⁸:

It takes five to 10 days for the pollution from China's coal-fired plants to make its way to the United States, like a slow-moving storm. It shows up as mercury in the bass and trout caught in Oregon's Willamette River. It increases cloud cover and raises ozone levels. And along the way, it contributes to acid rain in Japan and South Korea and health problems everywhere from Taiyuan to the United States. This is the dark side of the world's growing use of coal.⁶⁹

Expansion plans for nuclear energy have received a setback in the aftermath of Japan's nuclear safety issues following the 2011 earthquake. Indeed, in the aftermath of Japan's nuclear reactor safety issues, interest in nuclear power has waned: "Since the disaster in Japan, uranium prices have dropped by 30 percent, while natural gas prices in Europe and the United States have risen by about 10 percent."⁷⁰ Japan is rethinking its nuclear plans.⁷¹ China has slowed down the approval process for new nuclear plants.⁷² China's formerly ambitious plans for 2020 have been scaled back.⁷³ Germany has

⁶⁷ *Id.*

⁶⁸ Casey, *supra* note 65 ("But the growth of coal-burning is also contributing to global warming, and is linked to environmental and health issues including acid rain and asthma. Air pollution kills more than 2 million people prematurely, according to the World Health Organization. 'Hands down, coal is by far the dirtiest pollutant,' said Dan Jaffe, an atmospheric scientist at the University of Washington who has detected pollutants from Asia at monitoring sites on Mount Bachelor in Oregon and Cheeka Peak in Washington state. 'It is a pretty bad fuel on all scores.'").

⁶⁹ *Id.*

⁷⁰ See Jad Mouawad, *Natural Gas Now Viewed as Safer Bet*, N.Y. TIMES, Mar. 22, 2011, at B1.

⁷¹ See Krista Mahr, *With Nuclear Expansion Off The Table, What Do Japan's Energy Options Look Like?*, TIME (May 11, 2011), <http://ecocentric.blogs.time.com/2011/05/11/with-nuclear-exansion-off-the-table-what-energy-options-does-japan-have> ("Japan will scrap a plan to increase nuclear power from 30% to half of the nation's energy source and will promote renewable energy as a result of its ongoing nuclear crisis, the prime minister said Tuesday.").

⁷² See Buckley, *supra* note 64 ("China's vast nuclear push is likely to slow after the government ordered a safety crackdown on Wednesday in the aftermath of Japan's nuclear crisis.").

⁷³ See Chua Baizhen, *China To Cut Nuclear Goal After Japan Reactor Crisis*, BLOOMBERG (Apr. 1, 2011), <http://www.bloomberg.com/news/2011-04-01/china-to-cut-nuclear-goal-after-japan-reactor-crisis-correct-.html> ("China, the world's biggest energy consumer, will cut its 2020 target for nuclear power capacity

announced the phase out of their nuclear power plants.⁷⁴ Other nations are also rethinking their expansion plans for nuclear power: “As Japan’s nuclear crisis intensified Wednesday, governments across Europe remained at odds over whether to scale back nuclear power programs or continue plans to expand, while China announced that it was suspending new plant approvals until it could strengthen safety standards.”⁷⁵

Thus, although once believed to be a potential answer to energy shortages, at least for the next several years, the nuclear option is not likely to fill that role. The next Subpart discusses the growing usage of natural gas and natural gas liquids as an alternative “fuel of choice.” “[W]ith the global demand for energy expected to grow by double digits in coming decades, analysts are anticipating a new boom in gas consumption. Given the growing concerns about nuclear power and the constraints on carbon emissions, one bank, Société Générale, called natural gas the fuel of ‘no choice.’”⁷⁶

C. LNG and CNG as a Transportation Fuel

Natural gas and natural gas liquids are enjoying a surge in interest. Due to the sharp rise in the price of oil during 2010–2011, many electric utilities have switched from oil to natural gas power generation.⁷⁷ Perceiving the strategic importance, large multinational energy exploration companies are engaged in vigorous exploration efforts aimed at increasing their reserves of natural gas:

Many oil companies have anticipated this shift. At Royal Dutch Shell, natural gas production overtook its oil output in recent years. Exxon Mobil bought XTO Energy last year to raise its presence in the growing domestic shale gas market. It has also developed significant

and build more solar farms following Japan’s atomic crisis, said an official at the National Development and Reform Commission.”)

⁷⁴ See Buergin & Parkin, *supra* note 64 (“German Chancellor Angela Merkel’s coalition resolved their differences over the timing of an exit from nuclear power, setting a final date of 2022 for the country’s remaining reactors to shut down.”).

⁷⁵ See Dempsey & LaFraniere, *supra* note 64.

⁷⁶ See Mouawad, *supra* note 70.

⁷⁷ Joel Kirkland, *Utilities Face the Decision Point of Big Shifts—to Gas, Renewables and Efficiency*, N.Y. TIMES (July 9, 2010), <http://www.nytimes.com/cwire/2010/07/09/09climatewire-utilities-face-the-decision-point-of-big-shi-27535.html> (“With or without a climate bill, electric utilities are shifting their investments to efficiency measures that cut long-term costs and integrate more natural gas and renewable energy into their power supplies . . .”); see also *Doing the Math on Natural Gas-Fired Power Generation*, NAT. GAS SUPPLY ASS’N (Sept. 2009), <http://www.ngsa.org/Assets/doing%20the%20math%20on%20nat%20gas%20power%20generation%20final%20hi%20rez.pdf> (“[Nine hundred] of the next 1,000 U.S. plants will use natural gas.”).

resources in Qatar, which holds the third-largest reserves of natural gas in the world, after Russia and Iran.⁷⁸

Aside from generating electricity, natural gas is benefiting from a revolutionary transformation underway in vehicle fuels. Liquefied natural gas (“LNG”)⁷⁹ and compressed natural gas (“CNG”)⁸⁰ are natural gas liquids that can be used to power vehicles.⁸¹ LNG and CNG are projected to be leading sources of energy.⁸² To avoid economic catastrophe resulting from crude oil shortages, the International Energy Agency places great hope in the expansion of natural gas liquids to replace dwindling crude oil production:

The projected flat crude oil production doesn’t translate into an immediate shortage of fuels for the world’s cars and trucks. IEA actually projects that the total production of what it calls “petroleum fuels” is most likely to continue steadily rising, reaching about 99 million barrels per day by 2035. This growth in liquid fuels would come entirely from unconventional sources, including “natural gas liquids,” which are created as a by-product of tapping natural gas reservoirs.⁸³

The U.S. Department of Energy lists the advantages of using natural gas as a car and truck fuel, and there are government incentives to increase such use.⁸⁴ President Barack Obama wants the Federal government to purchase only non-oil-powered vehicles.⁸⁵

⁷⁸ See Mouawad, *supra* note 70.

⁷⁹ See generally *Frequently Asked Questions About LNG*, CAL. ENERGY COMM’N, <http://www.energy.ca.gov/lng/faq.html> (last visited Feb. 8, 2013) (describing LNG, its sources, uses, and benefits).

⁸⁰ See generally *Compressed Natural Gas Motor Vehicle Fuels*, CAL. ENVTL. PROT. AGENCY, <http://www.arb.ca.gov/fuels/altfuels/cng/cng.htm> (last visited Feb. 8, 2013) (describing CNG and its environmental benefits).

⁸¹ See *Alternative Fuels Data Center: Natural Gas Vehicles*, U.S. DEPT. ENERGY, http://www.afdc.energy.gov/vehicles/natural_gas.html (last visited Feb. 8, 2013) (describing different vehicles that can be run using CNG and LNG as an alternative fuel).

⁸² See *The Outlook for Energy: A View to 2040*, EXXONMOBIL 19–20, 40 (2013), http://www.exxonmobil.com/Corporate/files/news_pub_eo.pdf (last visited Mar. 28, 2013).

⁸³ Mason Inman, *Has the World Already Passed “Peak Oil”?*, NAT’L GEOGRAPHIC: DAILY NEWS (Nov. 9, 2010), <http://news.nationalgeographic.com/news/energy/2010/11/101109-peak-oil-iea-world-energy-outlook/>.

⁸⁴ See generally *Natural Gas Benefits and Considerations*, U.S. DEP’T ENERGY, http://www.afdc.energy.gov/afdc/fuels/natural_gas_benefits.html (last visited Mar. 29, 2013).

⁸⁵ See Dave Kansas, *Natural Gas Fuel Stocks Surge on Obama Energy Speech*, WALL ST. J.: MARKETBEAT (Mar. 30, 2011, 12:28 PM), <http://blogs.wsj.com/marketbeat/2011/03/30/natural-gas-fuel-stocks-surge-on-obama-energy-speech>.

China, the world's second-largest economy, is also expected to sharply increase usage of natural-gas-powered vehicles. According to the CEO of the China Natural Gas Company:

Compared to gasoline and diesel, LNG is a more cost-efficient, environmentally friendly fuel source that can provide significant cost-saving benefits to fueling station operators and consumers. LNG-powered cars can save consumers more than 40% on fuel costs compared to diesel cars. Furthermore, LNG fueling stations require relatively small initial investments and shorter construction periods, and the cost of converting a car to run on LNG is moderate. . . . The Chinese government plans to invest approximately \$700 billion in alternative energy projects over the next 10 years, and we expect natural gas to be a key component of the national energy strategy. We will continue to develop our business to capitalize upon new opportunities in China's rapidly growing natural gas market.⁸⁶

Industry has commenced usage of CNG-and-LNG-powered vehicles.⁸⁷ Refueling stations are starting to operate allowing cars to use natural gas liquids.⁸⁸ According to a Ford Motor corporate press release, there is a large increase in the demand for CNG-powered vehicles.⁸⁹ According to Ford, "[Corporate] [f]leet managers are adding all the reasons up and concluding that it makes sense to switch to CNG now more than ever"⁹⁰

Numerous nations are switching to natural-gas-powered transportation. Globally, the number of natural-gas-powered vehicles has grown by a factor of fifteen over the last decade, and by the end of 2011, an estimated 15 million

⁸⁶ See China Natural Gas Announces Completion of First LNG Fueling Station in Shaanxi Province, ADVFN (Sept. 2, 2010, 10:22 AM), http://www.advfn.com/news_China-Natural-Gas-Announces-Completion-of-First-LNG-Fueling-Station-in-Shaanxi-P_44224402.html (quoting Qinan Ji, Chairman and CEO of China Natural Gas).

⁸⁷ See *Expanding UPS Green Fleet Travels 200 Million Miles*, STREET (Feb. 28, 2011), <http://www.thestreet.com/story/11025465/1/expanding-ups-green-fleet-travels-200-million-miles.html> ("So far this year, UPS has announced the purchase of 48 new Liquefied Natural Gas (LNG) tractors for the United States to operate in northern California, including the construction of a publicly accessible LNG fueling station.").

⁸⁸ See Josh Loftin, *First Natural Gas Refueling Station Opens in Utah*, BUSINESSWEEK (Mar. 22, 2011), <http://www.businessweek.com/ap/financialnews/D9M4GG600.htm> ("The first liquefied natural gas station in Utah opened Tuesday at the junction of two interstate freeways. The station will likely become an important hub for two planned LNG corridors for long-haul trucks in the western U.S., said Sen. Orrin Hatch, R-Utah.").

⁸⁹ See *Rising Gas Prices*, *supra* note 52 ("Rising price of traditional gas coupled with significant government incentives and an increasing number of fuel stations is pumping up demand for compressed natural gas-powered (CNG) vehicles by commercial customers.").

⁹⁰ *Id.* (internal quotation marks omitted).

cars used LNG or CNG as their fuel.⁹¹ It is also anticipated that LNG-powered shipping will skyrocket. Clearly, the growth potential is staggering⁹²:

Huge new projects dedicated to liquefied natural gas—in which gas is frozen, compressed in liquid form for easier shipment, then returned to a gas state at import terminals—have been mushrooming around the world. In Papua-New Guinea, Exxon is leading a \$15 billion project to build and develop an LNG plant to supply Asian customers. Chevron recently began engineering work on the \$40 billion Gorgon gas project in Australia, along with Shell and Exxon. Russia, for its part, is planning to develop huge new fields in the Arctic.⁹³

Qatar is an example of a nation which has already invested substantially in LNG and is a global leader in natural gas liquids.⁹⁴ Qatari gas fields contain very large reserves and Qatar is producing vast amounts of natural-gas-based fuels.⁹⁵ Qatari investment has reached a point where natural-gas-liquid manufacturing exceeds traditional crude oil production:

Qatar will be able next year to pump 1.19 million barrels of NGLs a day, according to a forecast by the Paris-based International Energy Agency. The country's NGL output will for the first time exceed its production capacity for crude, which the IEA estimates will be 1.02 million barrels a day in 2011.⁹⁶

Qatar has ambitious expansion plans.⁹⁷ According to Qatar's Minister of Energy and Industry, Mohamed Saleh al-Sada, "There are talks with China to increase its imports of LNG, especially since the demand for LNG is expected

⁹¹ *Current Natural Gas Vehicle Statistics*, NGV GLOBAL, <http://www.iangv.org/current-ngv-stats> (last visited Feb. 8, 2013).

⁹² See Alaric Nightingale, *LNG-Powered Shipping May Jump 10-Fold, Biggest Engine Maker Says*, BLOOMBERG (Nov. 15, 2010), <http://www.bloomberg.com/news/2010-11-15/lng-powered-shiping-may-jump-10-fold-biggest-engine-maker-says.html> ("The number of ships powered by liquefied natural gas may jump 10-fold within five years as anti-pollution rules force owners to switch to the cleaner-burning fuel, the industry's biggest engine maker said.").

⁹³ See Mouawad, *supra* note 70.

⁹⁴ See Robert Tuttle, *Qatar Gathers CEOs To Mark LNG Capacity Milestone, Expects Further Gains*, BLOOMBERG (Dec. 14, 2010), <http://www.bloomberg.com/news/2010-12-14/qatar-gathers-ceos-to-mark-lng-capacity-milestone-expects-further-gains.html> ("Qatar gathered chief executives from the biggest energy companies to celebrate reaching an annual production capacity of 77 million metric tons of liquefied natural gas, underscoring its rank as the largest LNG exporter.").

⁹⁵ See *id.*

⁹⁶ *Id.*

⁹⁷ See *Qatar Plans Huge LNG Investment*, GULF TIMES (Mar. 21, 2011), <http://www.gulf-times.com/business/191/details/143898/qatar-plans-huge-lng-investment>.

to increase once receiving stations are established and as power plants switch to using LNG rather than coal.”⁹⁸

Numerous large LNG projects are underway. For example, Encana Corporation has commenced work on a \$4.2 billion-LNG-exporting facility.⁹⁹ Encana is buying part ownership in Canada’s first proposed LNG export facility in Kitimat, British Columbia, as Japan turns to LNG to offset the loss of electricity from its damaged nuclear plant.¹⁰⁰ Another example is the \$19 billion Shell expansion of LNG production facilities in Qatar scheduled for completion in 2012.¹⁰¹ In Australia, Chevron is planning an expansion of its more than \$40 billion LNG facilities.¹⁰² Australian LNG projects may overtake Qatari production.¹⁰³

Strong economic and environmental factors militate in favor of a sharp rise in the worldwide usage of natural gas for both electric utility generation and as a fuel source for vehicles. Thus, the value of the gas reserves discovered offshore Israel are likely to grow significantly in value in the future. The next Part discusses the exploration efforts and discovery of the Tamar gas field.

II. ISRAELI ENERGY EXPLORATION: NBL’S DISCOVERY OF TAMAR

The risks undertaken by NBL in exploring Tamar can be understood in light of not merely the difficult drilling environment related to Tamar, but moreover, because of the inherent risk of dry holes which are part-and-parcel of exploring for oil and gas.¹⁰⁴ Indeed, recent events corroborate the substantial

⁹⁸ *Id.*

⁹⁹ Richard Gilbert, *Encana Buys into \$4.2 Billion Liquid Natural Gas Project in Kitimat, British Columbia*, J. COM. (Mar. 30, 2011), <http://www.journalofcommerce.com/article/id43655>.

¹⁰⁰ *Id.*

¹⁰¹ Ayesha Daya, *Dubai Receives First Liquefied Natural Gas Cargo from Qatar, Shell Says*, BLOOMBERG (Nov. 30, 2010), <http://www.bloomberg.com/news/2010-11-30/dubai-received-first-lng-cargo-from-qatar-yesterday-shell-s-barry-says.html>.

¹⁰² Ross Kelly & David Winning, *Chevron To Boost LNG in Australia*, MARKET WATCH (Mar. 15, 2011), <http://www.marketwatch.com/story/chevron-to-expand-gorgon-lng-project-2011-03-15> (“Chevron Corp. plans to start engineering and design work next year on an expansion of the company’s 43 billion Australian dollar (US \$43.45 billion) Gorgon liquefied-natural-gas project in Australia, in a move to capitalize on rising Asian demand for clean-burning fuels.”).

¹⁰³ *Id.* (“Australia is set to pass Qatar as the world’s biggest liquefied-natural-gas supplier, with the potential to produce more than 100 million tons of LNG annually if all projects on the drawing board are built, engineering contractor WorleyParsons Ltd. said recently.”).

¹⁰⁴ For example, subsequent to the Tamar discovery, dry holes were found in 2 fields off shore. The Sara well was dry. Shoshanna Solomon, *Modiin, Israel Land Drop on ‘Dry Hole’ Gas Well Finding*, BLOOMBERG (Oct. 21, 2012), <http://www.bloomberg.com/news/2012-10-21/modiin-israel-land-drop-on-dry-hole-gas-well->

risks of investing large sums of money only to encounter either dry holes or lackluster non-commercially viable reservoirs.

In June 2012, an engineering firm believed that the Ishai prospect off the Israeli coast was “low risk” and contained “potential gas reserves of 3.7 Tcf, with a success probability of 68–77%.”¹⁰⁵ Yet, despite the “low risk,” the Ishai well drilling was a failure.¹⁰⁶ According to a report by one of the owners, Israel Opportunity Energy Resources LP, there was no “mention [of] the amount of gas discovered, and. . . [stated] that the drilling would be terminated without carrying out production tests. It also said that the thickness of the gas-bearing strata did not exceed 15 meters.”¹⁰⁷

Other failures include the Israeli Myra and Sara offshore fields where, after \$150 million was invested, the wells were declared dry holes.¹⁰⁸ Hopes had run high that that the Myra and Sara fields would yield a large amount of natural gas. “The Myra and Sarah licensees today announced that the fields have potential reserves of 6.5 trillion cubic feet of natural gas, according to an analysis of the 3D survey by Netherland Sewell & Associates Ltd. (NSAI).”¹⁰⁹ However, despite the hopes, both prospects disappointed.

In September 2012, the Myra well was declared a dry hole.¹¹⁰ The Myra well’s Israeli partners, “Israel Land Development Company Energy Ltd., Modiin Energy LP and IPC Oil and Gas Holdings Ltd. (IPC), [] notified the TASE that no substantial signs of petroleum have been found.”¹¹¹ Following

finding.html (“Israel Land Development Co. Energy Ltd. (IE) plunged the most on record and Modiin-LP (MDINL) slumped after the natural-gas exploration companies decided to abandon the Sara 1/348 well because data showed the site is a ‘dry hole.’”). A month earlier, the explorers stated that the Myra well was dry. *Id.* (“In September, Tel Aviv-based Israel Land Energy and Modiin said no significant signs of petroleum were found at their joint Myra 1 well.”).

¹⁰⁵ Amiram Barkat, *Ishai Well Disappoints*, GLOBES (Jan. 3, 2013), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000811636>.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ Amiram Barkat, *Sarah Well Abandoned*, GLOBES (Oct. 21, 2012) <http://www.globes.co.il/serveen/globes/docview.asp?did=1000791454> (“The Sarah partners had hoped to discover 0.8 trillion cubic feet of natural gas in the license, but preliminary data from the target strata found no significant signs of gas. The \$50 million spent on the well has gone down the drain. The Sarah license is a sister license of Myra, which was declared a dry hole in September, after \$100 million was invested in it.”).

¹⁰⁹ See Koby Yeshayahou & Hillel Koren, Licensees Confirm 6.5 Tcf at Myra and Sarah, GLOBES (June 30, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000659317>.

¹¹⁰ See Ron Steinblatt, *No Gas at Myra 1 Well*, GLOBES (Sept. 6, 2012) <http://www.globes.co.il/serveen/globes/docview.asp?did=1000782960>.

¹¹¹ *Id.*

the failure of the Myra well, in October 2012, the Sara well was abandoned as a dry hole.¹¹² The controlling shareholder of Modiin Energy said, “There is no doubt that this is a great disappointment for the partners, investors, and the Israeli economy as a whole. Regrettably, a dry hole is part of the risk of exploratory operations.”¹¹³

Against the backdrop of the common experience of finding dry holes, the history of the Tamar exploration simply underscores the extent of the severity of the risks NBL undertook when it agreed to become a partner. The previous Tamar field operator, British Gas, decided the extraordinary risks outweighed the opportunities and decided against drilling Tamar.¹¹⁴ Indeed, the word in the oil patch was that Tamar was not even worth exploring. Nevertheless, operating against “conventional wisdom” and the “smart money,” NBL made a business decision to explore Tamar. “Previous operator British Gas had decided against drilling Tamar, and thoughts around the oil patch were that the test would likely encounter extreme pressures”¹¹⁵ NBL Senior Vice President of Exploration Susan Cunningham describes the prospect of the Tamar drilling as follows: “Drilling risks were anticipated to be very high”¹¹⁶

From a technological standpoint, drilling Tamar was exceptionally difficult. This risk is separate and apart from the substantial financial commitment NBL was obligated to undertake. The extraordinarily difficult conditions consisted of drilling under heavy salt, as well as extremely high pressure. The pressure in the Tamar field is one of the highest in the world¹¹⁷:

The rub was that it was subsalt, lying below some 5,500 feet of tabular evaporates. Mari-B and Gaza Marine were both supra-salt finds, so there was no precedent for a test below the thick salt layer. Undeterred, Noble assumed operations and took a 33% working interest; its current interest in the find is 36%. The independent was also concerned about pressures, but through painstaking geophysical

¹¹² Barkat, *supra* note 108.

¹¹³ *Id.*

¹¹⁴ Peggy Williams, *Israel, OIL & GAS INVESTOR*, Nov. 2009, at 38, 41, available at http://www.nobleenergyinc.com/_filelib/FileCabinet/PDFs/MISC/FINAL_Israel_article_O&G_Investor_Magazine.pdf?fileName=FINAL_Israel_article_O%26G_Investor_Magazine.pdf.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Amiram Barkat, *Tamar Production Costs \$1b Higher than Estimated*, GLOBES (May 10, 2010), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000561297> (“The report’s authors said that the gas pressure at the Tamar well is one of the highest in the world.”).

work it became convinced that the accumulation would actually be normally pressured. Predrill, it considered the biggest risk to be reservoir. Just one offshore test, Noble's own Hanna-1, had encountered some reservoir rocks of equivalent age.¹¹⁸

The Israeli exploration companies, with limited experience, were cognizant of these risks and held "no illusions they could themselves drill risky, rank wildcats in some 5,500 feet of water."¹¹⁹ In an attempt to overcome these challenges, "[t]he Israeli firms needed an experienced, financially sound and technically advanced offshore operator, and Noble fit the bill."¹²⁰

In addition to the financial and technical risks NBL was willing to take, there was an additional difficulty encountered: "Deepwater contractors were understandably reluctant to bring a premium rig to the eastern Med for just one well. Noble had to package some West African wells with the Israeli one to bolster its chances, and it finally secured a commitment from Atwood Oceanics Inc., Houston."¹²¹

NBL and its Israeli partners completed the well in 2009 at a cost of \$140 million.¹²² The well was drilled in over five thousand feet of water and the well reached a depth of over sixteen thousand feet.¹²³ The results were of a major world-class strike of premium quality natural gas.¹²⁴ However, given the depth of the reserves, as well as the distance to shore, the investment capital required to develop the field and transport the gas dwarfs the initial expenditures. Development costs are expected to reach upward of two billion dollars¹²⁵: "On a gross basis, Noble and its partners have already invested close to \$300 million in the recent drilling campaign."¹²⁶ Moreover, the operational cost of this project will rise substantially over the next several years: "Tamar will be quite challenging because the tieback will be exceptionally long, volumes will be colossal, and the project life will be drawn out due to the sheer size of the resource."¹²⁷

¹¹⁸ Williams, *supra* note 114, at 41.

¹¹⁹ *Id.* at 40.

¹²⁰ *Id.*

¹²¹ *Id.* at 41.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ Noble Energy Announces Successful Tamar Appraisal, *supra* note 20 (describing the successful strike as containing "continuous high quality reservoirs" of natural gas).

¹²⁵ Williams, *supra* note 114, at 43.

¹²⁶ *Id.*

¹²⁷ *Id.*

After Tamar was successful, “Noble shifted \$100 million of its 2009 capital program to Israel to cover its costs on the Dalit and Tamar appraisal wells.”¹²⁸ In 2009, NBL confirmed the Tamar field contains a huge amount of natural gas with an estimated 3 Tcf.¹²⁹ This amount was subsequently upgraded to a confirmed 5 Tcf strike.¹³⁰ Subsequently, NBL raised the confirmed estimate even more—to more than 8 Tcf,¹³¹ and in mid-2011, indications were that the gas reserves would continue to grow.¹³² In 2013, Tamar’s reserves grew to 10 Tcf.¹³³

During 2010, the Israeli government approved NBL’s development plans for Tamar.¹³⁴ In 2010, estimates were that developing the Tamar field would cost one billion dollars more than initially estimated.¹³⁵ Developing the Tamar field and transporting the gas to Israeli consumers will require nearly four billion dollars.¹³⁶ The expense of bringing the gas to supply domestic customers does not reflect the additional expense of building facilities to enable the export of gas.

¹²⁸ *Id.* at 44.

¹²⁹ Lynn Cook, *Noble Energy Reports Big Natural Gas Find Off Israel*, HOUS. CHRON. (Jan. 20, 2009), <http://www.chron.com/disp/story.mpl/headline/biz/6219744.html> (“Exploratory drilling shows the Tamar prospect off Haifa appears to hold 3 trillion cubic feet of gas, roughly equaling the company’s existing gas reserves.”).

¹³⁰ Press Release, Noble Energy, *Noble Energy Announces Successful Flow Test of Tamar Natural Gas Discovery and Increases Resource Estimate* (Feb. 10, 2009), available at <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=380966> (“The pre-drill gross mean resource potential for Tamar was originally estimated at 3.1 trillion cubic feet (Tcf) of natural gas. Immediately following discovery, we estimated the gross resource potential to be at least equal to the pre-drill mean estimate. After analysis of all the post-drill and production test data, the estimated gross mean resource potential of Tamar has now been increased to 5 Tcf.”).

¹³¹ *Noble Increases Tamar Gas Reserve Estimate 15 Percent*, *supra* note 4 (“A consortium led by Noble Energy (NBL.N) drilling for natural gas off Israel’s coast on Thursday raised its reserve estimate at the Tamar field by 15 percent to 8.4 trillion cubic feet (238 billion cubic meters).”).

¹³² Barkat, *supra* note 4 (“The discovery that an additional strata in the Tamar gas field contains natural gas has broad implications for the other gas fields in the region, sources in the natural gas industry believe . . . Netherland Sewell & Associates Ltd. (NSAI) had revised the volume of gas reserves for development in Tamar upwards on June 30 from 8.7 trillion cubic feet to 9.1 trillion cubic feet.”).

¹³³ *Noble Energy Raises Tamar Gas Estimate to 10 Tcf*, *supra* note 4.

¹³⁴ Press Release, Noble Energy, *Noble Energy Receives Government Approval to Develop Tamar Gas Field Offshore Israel* (Apr. 10, 2012), available at <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=498138>.

¹³⁵ Barkat, *supra* note 117.

¹³⁶ *Id.* (“[L]eading global experts in the field[] estimate the total cost of gas production and transporting it to consumers in Israel at \$3.77 billion, compared with the \$2.8 billion figure published by Tamar’s Israeli partners in their notices to the Tel Aviv Stock Exchange (TASE). The production cost could be even higher by \$200–250 million, if it is decided not to build the onshore gas terminal at the Dor beach, but at the existing terminal at Ashdod or at an offshore terminal.”).

Notwithstanding the difficult drilling conditions encountered by NBL, outgoing Israeli Petroleum Supervisor Yaakov Mimran praised NBL for working around the clock to bring Tamar online and referred to NBL as doing “extraordinary” work.¹³⁷ The next Part describes the Israeli government’s amendment of the regulatory structure through enactment of a new tax law in early 2011.

III. THE ISRAELI GOVERNMENT’S AMENDMENT OF THE EXISTING TAX STRUCTURE

As described above, the Tamar field was an enormous find. However, it was not the only huge natural gas strike. In December 2010, Noble confirmed the Leviathan field as a major discovery containing at least 16 Tcf of natural gas.¹³⁸ NBL described the find as the largest in NBL’s history.¹³⁹ The field is very large and additional appraisal wells are planned indicating the confirmed reserves may be even larger.¹⁴⁰ The amount of gas discovered in Leviathan will likely transform Israel into an energy-exporting nation.¹⁴¹ Together, the Tamar and Leviathan strikes contain nearly 30 Tcf of gas.

¹³⁷ Amiram Barkat, *Gas Exports Should Come from Smaller Fields*, GLOBES (May 26, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000649213&fid=1724> (“All the parties involved are working round the clock to get Tamar online in time. I can give you a good word about Noble Energy Inc. and its partners—they are doing an extraordinary job so that the gas will arrive on time.”).

¹³⁸ Bronner, *supra* note 5 (“Houston-based Noble Energy, which is working with several Israeli partner companies, said that the field, named Leviathan, whose existence was suspected months ago, has at least 16 trillion cubic feet of gas at a likely market value of tens of billions of dollars and should turn Israel into an energy exporter.”).

¹³⁹ Press Release, Noble Energy, Noble Energy Announces Significant Discovery at Leviathan Offshore Israel (Dec. 29, 2010), available at <http://investors.nobleenergyinc.com/releasedetail.cfm?ReleaseID=539152> (“Leviathan-1, located in approximately 5,400 feet (1,645 meters) of water, is about 80 miles (130 kilometers) offshore of Haifa and 29 miles (47 kilometers) southwest of the Tamar discovery. The results from the well confirm the pre-drill estimated resource range, with a gross mean for Leviathan of 16 trillion cubic feet (450 billion cubic meters). The Leviathan field is estimated to cover approximately 125 square miles (325 square kilometers) and, as a result of its size, will require two or more appraisal wells to further define total gas resources.”).

¹⁴⁰ *Id.* In March 2013, NBL raised the gas reserve estimate to 18 Tcf. See *Noble Ups Leviathan Gas Estimate to 18 Tcf*, *supra* note 7 (“Noble Energy Inc. updated its reserve estimate in the Leviathan natural gas field off the Israeli coast to 18 trillion cubic feet.”).

¹⁴¹ *Id.* (“David L. Stover, the Company’s President and COO, added, ‘Our exploration program continues to deliver outstanding results. This discovery has the potential to position Israel as a natural gas exporting nation. For nearly a year now, we have had a team evaluating market possibilities, which includes various pipeline and LNG options. It’s our belief that the natural gas resources at Leviathan are sufficient to support one or more of the options being studied. We are excited to be leading the exploration and development in this new basin and look forward to determining the best development option.’”).

Prior to the Petroleum Taxation Law of 2011, the Israeli Petroleum Law of 1952¹⁴² controlled the extent of any taxation other than the ordinary corporate income tax rate for companies involved in the exploration and production of hydrocarbons in Israel.¹⁴³ Under the regulatory environment in place when NBL became a partner in the Tamar field, the regulatory structure had remained stable and constant from 1952 until the windfall profits tax was enacted was amended in 2011.¹⁴⁴ As such, NBL stood to benefit from the 12.5% royalty rate which was the only special tax other than ordinary corporate income taxes and reap the rewards of its hard work and risks undertaken.

However, this long-standing, predictable environment was destabilized in 2011. In early 2010,¹⁴⁵ after NBL confirmed the Tamar strike,¹⁴⁶ Israeli government officials initiated a review of the taxation with a view towards redefining the amount of taxation due from explorers such as NBL.

At the heart of the issue are Noble Energy Inc.'s recent discoveries with a group of local companies of the Tamar and Leviathan offshore-natural-gas fields, which together contain about 22 TCF of natural gas. Following these discoveries, Israel's Minister of Finance Yuval Steinitz set up an independent committee to re-examine taxes and royalties in connection to gas and oil found in the state, which until these finds has lacked any major natural resources.¹⁴⁷

¹⁴² Petroleum Law, 5712-1952, 6 LSI 129 (1951–1952) (Isr.).

¹⁴³ *Id.* According to the 1952 Petroleum Law, investors can obtain economic “rights” through permits, licenses, and leases. *See id.* pt. 2, arts. 2–4. A permit is the right to undertake initial exploration activities such as mapping and 3D studies. *Id.* at pt. 2, art. 2. A license is the right to explore on an exclusive basis for energy assets and obligates the holder to drill test wells. *Id.* at pt. 2, art. 3. If successful, the license holder has the right to receive a production lease giving an exclusive right to explore and produce energy in the leasehold. *Id.* at pt. 2, art. 3. The holder of this right is obligated to pay a 12.5% royalty rate. *Id.* pt. 2, art. 4.

¹⁴⁴ Bronner, *supra* note 17 (“The Israeli Parliament overwhelmingly approved a near doubling of the profit tax on gas and oil extracted from Israeli territory, a move expected to be worth tens of billions of dollars over the coming decades. In recent years, Israel has discovered huge fields of natural gas off its coast, aided in part by a much lower than average tax structure that provided incentives for energy companies to take on the risks and costs of such searches.”).

¹⁴⁵ SHESHINSKI REPORT, *supra* note 20, at 2. According to the final report, the Sheshinski committee mandate commenced in April 2010. *Id.* (“On April 12, 2010, the minister of finance appointed the Committee to Examine the Fiscal Policy on Oil and Gas Resources in Israel In accordance with the guidelines of the letter of appointment, the Committee members conducted an in-depth examination of the oil and gas exploration market in Israel and around the world, particularly the natural gas market.”).

¹⁴⁶ In July 2009, NBL issued a press release confirming Tamar and increasing the reserve estimate. Noble Energy Announces Successful Tamar Appraisal, *supra* note 20.

¹⁴⁷ Sara Toth Stub, *Israel's Gas-Tax Review Draws Fire*, WALL ST. J. (Aug. 31, 2010), <http://online.wsj.com/article/SB10001424052748704421104575463552570631976.html> (“Energy companies involved in recent

The motivation of the Israeli government was not to address any fiscal emergency or remedy any bona fide national problem.¹⁴⁸ Rather, the sole motivating factor was to increase the amount of revenue:

“There’s no question that natural resources in these sorts of quantities are a major asset,” Finance Minister Yuval Steinitz said in an e-mail. “These are discoveries of very meaningful proportions. The discoveries only strengthen the need to establish a committee which will examine the royalties and taxing system which will ultimately make their way into the government’s coffers.”¹⁴⁹

Statements by Israeli politicians confirm the financial motivation supported by a populist twist. Parliament member Melchior claimed the gas belonged to the “state.” He added that “[n]atural resources belong to the State of Israel. No devious lawyer can change that.”¹⁵⁰ Parliament member Yacimovich remarked the prior regulatory regime was immoral: “It is inconceivable that all this wealth will belong to one person or to a handful of people. The question is, to whom do the sea and natural resources belong? The answer is . . . [i]t is not economic, and not moral, and not reasonable.”¹⁵¹

The Israeli government committee, led by Eytan Sheshinski,¹⁵² tacitly conceded the motivating factor:

In view of the significant discoveries of gas in Israel and in the maritime zone off its coast, there has been a recent awakening in the oil and gas exploration market in Israel, and there is apparently a possibility for significant discoveries in the future. Hence, this matter is likely to have a considerable impact on the Israeli economy and on

large natural-gas discoveries offshore Israel have warned that any move by the government to increase its share of tax and royalties from natural resources may jeopardize investment in the country’s nascent energy sector.”).

¹⁴⁸ According to the FCN Treaty, actions that violate the FCN Treaty are permissible only if they are undertaken to protect a party’s peace and security. FCN Treaty, *supra* note 32, art. XXI(1)(d). Moreover, while host states may, if exigent circumstances exist, override an investment treaty’s protections, there was no exigent circumstance. *See supra* notes 43–44 and accompanying text.

¹⁴⁹ *See* David Wainer, *Israel Set To Join Natural Gas Exporting Nations with Offshore Leviathan*, BLOOMBERG (June 3, 2010), <http://www.bloomberg.com/news/2010-06-03/israel-on-path-to-exporting-gas-for-first-time-with-leviathan-discovery.html>.

¹⁵⁰ *See* Kobi Ben-Yeshayahu & Adi Ben-Israel, *Whose Gas Is It?*, GLOBES (Sept. 13, 2010), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000588321>.

¹⁵¹ *Id.*

¹⁵² Bronner, *supra* note 5 (“But the find has been accompanied by a heated debate over how much in taxes and royalties Israel will charge. A state-appointed committee headed by an economist at Hebrew University, Eytan Sheshinski, is planning to recommend substantially increased profit taxes, opposed by the companies and some on the political right.”).

the government's operations in the coming years. Accordingly, an examination of the fiscal system in practice in Israel (a system that encompasses taxation, royalties and fees) should be conducted in everything pertaining to oil and gas exploration, in order to determine whether this system, which was formulated in 1952, is also appropriate today.¹⁵³

No exigent national emergency or financial circumstance triggered the amendment of the tax regime. To the contrary, as detailed above, the sole reason was to increase the coffers of the state treasury. The Sheshinski committee recommended keeping the 12.5% royalty rate but suggested imposing a new "windfall profits" tax amounting to an overall tax rate between 52% and 62%.¹⁵⁴ The Israeli Prime Minister endorsed these recommendations,¹⁵⁵ and the Israeli Cabinet¹⁵⁶ and Parliament subsequently approved them.¹⁵⁷

The new windfall profits tax is across-the-board, irrespective of the drilling conditions or difficulties encountered in exploration and/or production or the type of resource. The new tax will be imposed when the initial investment is captured plus 50%.¹⁵⁸ Under the law "[a]n initial levy of 20% is imposed on profits from oil and gas, gradually increasing to 50%, depending on the levy coefficient (R-Factor). The R-Factor refers to the percentage of the amount invested in the exploration, development and establishment of the project, so that the 20% rate will be imposed only after a recovery of 150% of the amount invested (R-Factor of 1.5) and will go up to 50% after the recovery of 230% of the amount invested (R-Factor 2.3). In addition, for fields that commence production by January 2014, the tax increase will be less.¹⁵⁹ However, regardless of any mitigation of the tax increase, NBL's Tamar and Leviathan fields will face sharply higher taxation rates. The fields will ultimately be taxed

¹⁵³ SHESHINSKI REPORT, *supra* note 20, at 9–10.

¹⁵⁴ *Id.* at 95. However, some committee members expressed strong dissent to the proposals. *See id.* (recommending a lower maximum rate of 45%).

¹⁵⁵ Weissman, *supra* note 25 ("The cabinet today approved the Sheshinski committee recommendations to increase the government's take from oil and gas revenue to 52-62%, from the current 33%, after Prime Minister Benjamin Netanyahu announced his support for them last week.").

¹⁵⁶ *Id.*

¹⁵⁷ *Last Hurdle: Knesset Passes Oil, Gas Taxation Law*, GLOBES (Mar. 30, 2011), <http://www.globes.co.il/servee/globes/docview.asp?did=1000634810> ("This afternoon, the Knesset passed into law the recommendations of the Sheshinski committee on taxation of oil and gas discoveries in Israel. The law raises the state's take from profits on oil and gas discoveries to 52–62%, compared with the current 30%.").

¹⁵⁸ *See* Petroleum Profits Taxation Law, 5771-2011, SH No. 2295 p. 806 (Isr.).

¹⁵⁹ *See* Petroleum Profits Taxation Law, 5771-2011, SH No. 2295 p. 806 (Isr.).

at a sharply higher rate than under the prior regulatory structure and NBL's profits on the previously discovered fields will be reduced as the new law takes effect.

The retroactive confiscatory intent and impact on NBL's investment is uncontested. Government officials believed retroactive taxation is the right of the host state. Parliament member Yacimovich stated, "The state can change old-age pensions retroactively It can change the terms of retirement savings, reduce company taxes, and so on. The state can also change royalties policy."¹⁶⁰

Responding to the tax hike, the Wall Street Journal quoted NBL's CEO Davidson as saying, "A retroactive change would be egregious and would quickly move Israel to the lowest tier of countries for investment by the energy industry."¹⁶¹ NBL's Davidson sent a letter to Israeli Finance Minister Yuval Steinitz asking for confirmation that the Sheshinski committee would not be entertaining thoughts of retroactivity, but received a governmental reply clearly envisioning a retroactive viewpoint.¹⁶²

It is unclear whether NBL was afforded a meaningful opportunity to address either the Sheshinski committee or another branch of the Israeli government and whether this opportunity would have had a reasonable chance of impacting the government's decision.¹⁶³ While the Sheshinski final report makes reference to input from the companies,¹⁶⁴ it is unknown to what extent

¹⁶⁰ Ben-Yeshayahu & Ben-Israel, *supra* note 150.

¹⁶¹ Charles Levinson & Guy Chazan, *Big Gas Find Sparks a Frenzy in Israel*, WALL ST. J., Dec. 30, 2010, at A1 (quoting Chuch Davidson, CEO of Noble) (internal quotation marks omitted).

¹⁶² See Stub, *supra* note 147 ("Mr. Davidson asked Mr. Steinitz to confirm that any gas or oil drawn from existing drilling and exploration licenses wouldn't be subject to tax changes. In his reply, Mr. Steinitz said he expected the committee to focus on tax related to gas and oil discovered after April 12, 2010, when the committee was established, but that the committee wasn't limited in its recommendations. Any changes will then have to be approved by the cabinet.").

¹⁶³ The extent to which NBL was allowed to participate in the process or whether NBL enjoyed procedural due process are important factors relating to whether NBL received "fair and equitable treatment" as required by the FCN, FCN Treaty, *supra* note 32, art.XVII(2).

¹⁶⁴ SHESHINSKI REPORT, *supra* note 20, at 11 ("As part of their work, the members of the Committee received the positions of the public, in detail and in writing, including economic and legal opinions, as provided by the entities that requested to present their positions to the Committee. On November 15, 2010, the Committee published a draft of its main recommendations for public comment. Beginning on that date, the Committee heard comments on its main recommendations from the public, including gas companies and partnerships, small investors, nonprofit associations and organizations. The Committee received written opinions on economic, legal and other aspects, as the submitters saw fit to provide, and enabled the various entities to appear before it. The Committee also appointed a secondary team that held work meetings to gain a better understanding of the needs of the entrepreneurs in the industry, particularly with regard to financing.

this was provided or whether the opportunity was a consequential one comporting with requirements of procedural due process. As will be discussed below, whether NBL was given such opportunity bears on the question of whether FCN Treaty-based due process guarantees were honored.

An Israeli governmental legal opinion attached to the Sheshinski Report in support of its recommendations is instructive. The legal opinion consists of ninety-five paragraphs, the last seven of which discuss the “international law” issue;¹⁶⁵ the remainder addresses the domestic legal implications. With respect to international law obligations under the FCN Treaty, the initial comment is that domestic Israeli law trumps any international obligation. The legal opinion states that “[a]ccording to early customary practice in Israel, explicit Israeli legislation prevails over contractual and customary international law. Therefore the law cannot be rescinded on these grounds.”¹⁶⁶ This claim essentially states the government is empowered to amend the law and the obligations of the FCN Treaty are of no significant import.

However, the legal opinion then softens this assertion, noting that “the interpretation of the law which is compatible with Israel’s international undertakings must be preferred.”¹⁶⁷ The legal opinion notes that NBL raised legal issues with respect to violations of the FCN Treaty, but, without discussion, cites to an expert opinion from Professor Moshe Hirsch who, according to the legal opinion, states NBL’s claims are not meritorious.¹⁶⁸

The legal opinion then focuses on the procedural issue, opining that the only venue for NBL’s claim is the state–state forum of the ICJ, and that the U.S. government is quite unlikely to file a claim on NBL’s behalf.¹⁶⁹ The government position appears to suggest a belief that the tax hike is feasible because NBL will be deprived of a dispute resolution mechanism. In other words, it appears that the decision to hike the tax rate was at least in part made because of the belief that NBL would not be able to do anything. Finally, the opinion states that regardless of whether the tax hike violates the FCN Treaty, the remedy of any violation is compensation.¹⁷⁰ The next Part discusses the

The Committee reviewed the opinions that were submitted and held a series of discussions on the materials presented to it.”).

¹⁶⁵ SHESHINSKI REPORT, *supra* note 20, app. B at paras. 89–95.

¹⁶⁶ *Id.* app. B at para. 90 (internal citations omitted).

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* app. B at paras. 91–92.

¹⁶⁹ *Id.* app. B at paras. 93–94.

¹⁷⁰ *Id.* app. B at para. 95.

FCN Treaty's specific provisions and whether NBL's rights pursuant to that treaty were violated by the enactment of the tax increase.

IV. THE FCN TREATY AND NBL'S POTENTIAL CLAIMS REGARDING THE TAX INCREASE

NBL, a U.S. corporation, enjoys the protections afforded to all U.S. nationals under the FCN Treaty.¹⁷¹ The purpose of the FCN Treaty is to “establish[] mutual rights and privileges . . . based in general upon the principles of national and of most favored nation treatment unconditionally accorded.”¹⁷²

The FCN Treaty states that “[e]ach Party shall at all times accord equitable treatment to the persons, property, enterprises and other interest of nationals and companies of the other Party.”¹⁷³ Pursuant to the FCN Treaty, national investors will “receive the most constant protection and security, in no case less than required by international law.”¹⁷⁴ In addition, the “[p]roperty of nationals of either Party shall receive the most constant protection and security within the territories of the other Party.”¹⁷⁵

Furthermore, and crucially, the nationals of each party benefit from whatever rights and privileges are afforded through treaties with third countries—a “most-favored-nation” clause.¹⁷⁶ The term “most-favored-nation” means each national is entitled to rights “no less favorable” than protections given to nationals “of any third country.”¹⁷⁷ Thus, NBL benefits not merely from the rights contained in the FCN Treaty but, in addition, this protection extends to the best treatment Israel has awarded any other third country national or company. The FCN Treaty therefore vests NBL with rights based upon the principles of national treatment and most-favored-nation status¹⁷⁸ and NBL is entitled to the equivalent rights and privileges as Israel affords other nationals and third-party nationals. A related question is whether the most-

¹⁷¹ See FCN Treaty, *supra* note 32, 51 U.S.T. at 552.

¹⁷² *Id.* pmb1.

¹⁷³ *Id.* art. I.

¹⁷⁴ *Id.* art. III.

¹⁷⁵ *Id.* art. VI.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* art. XXII.

¹⁷⁸ FCNs were the precursors to Bilateral Investment Treaties (“BITs”), which started in the 1960s. Generally, BITs outlined the same investor rights as the FCNs. See *supra* text accompanying notes 33–35.

favoured-nation clause applies to procedural rights. The different investor protections listed above are discussed in the following Subpart.

A. *Fair and Equitable Treatment*

The FCN Treaty provides investors with guarantees that the host state will treat the investment fairly and equitably. Pursuant to the FCN Treaty, “Each Party shall at all times accord equitable treatment to the persons, property, enterprises and other interests of nationals and companies of the other Party.”¹⁷⁹

This principle, known as fair and equitable treatment (“FET”), is an “undertaking of the host country to provide fair and equitable treatment to the investors of the other party and their investments.”¹⁸⁰ The FET principle is “a standard feature in BITs”¹⁸¹ and ensures investors can rely upon the stability of the business environment in the host state.¹⁸²

Grounded in general principles of international law, the FET principle obligates states to act in good faith toward investors of the other nation.¹⁸³ Although bad faith on the part of the host state would constitute evidence of a violation of FET, such conduct is not required to demonstrate the state’s violation of the FET standard.¹⁸⁴ Examples of conduct on the part of a host state constituting violations of FET include circumstances where the state acts:

Fraudulently or in bad faith, or capriciously and willfully discriminates against a foreign investor, or deprives an investor of acquired rights in a manner that leads to the unjust enrichment of the

¹⁷⁹ FCN Treaty, *supra* note 32, art. I.

¹⁸⁰ See *Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability, para. 106 (Dec. 27, 2010), available at <http://www.italaw.com/sites/default/files/case-documents/ita0868.pdf>.

¹⁸¹ FCNs, such as the United States–Israel FCN Treaty, were the predecessor investment treaty agreements to BITs and contain the same essential investment guarantees. See *Cont’l Cas. Co. v. Argentine Republic*, ICSID Case No. ARB/03/9, Award, para. 176 (Sept. 5, 2008) (the investor guarantees contained in BITs are based upon the same ones listed in the predecessor FCNs).

¹⁸² See *Occidental Exploration & Prod. Co. v. Ecuador*, LCIA Case No. U.N. 3467, Final Award (London Ct. Int’l Arb. 2004), 12 ICSID Rep. 159 (2007).

¹⁸³ See *Total S.A.*, ICSID Case No. ARB/04/1, para. 111 (“[L]egally, the fair and equitable treatment standard is derived from the requirement of good faith which is undoubtedly a general principle of law under Article 38(1) of the Statute of the International Court of Justice.”).

¹⁸⁴ *Id.* para. 110; see also *Mondev Int’l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award, para. 116 (Oct. 11, 2002), 6 ICSID 192 (2004) (“A State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.”).

State, then there is at least a prima facie case for arguing that the fair and equitable standard has been breached.¹⁸⁵

FET is breached when a host state's action results in:

Negative impact on the investment and their incompatibility with the criteria of economic rationality, public interest (after having duly considered the need for and responsibility of governments to cope with unforeseen events and exceptional circumstances), reasonableness and proportionality. A foreign investor is entitled to expect that a host state will follow those basic principles (which it has freely established by law) in administering a public interest sector that it has opened to long-term foreign investments. *Expectations based on such principles are reasonable and hence legitimate, even in the absence of specific promises by the government.*¹⁸⁶

The principles encompassed by the FET standard include various investor guarantees: legitimate expectation, stable regulatory framework, due process and transparency, and reasonableness and proportionality.¹⁸⁷ Significantly, these expectations are legitimate and reasonable on the part of the foreign investor even in the absence of specific promises by the host state.¹⁸⁸

As discussed below, NBL has a strong argument that the enactment of the Petroleum Profits Taxation Law in 2011 violated the FET guarantees embodied in the FCN Treaty. Specifically, NBL's rights to fulfillment of legitimate expectations, a stability of the regulatory environment, and due process and transparency in governmental decisions affecting the investment appear to have been violated.

1. *Legitimate Expectations*

An investor's legitimate expectations form "the dominant element of that [FET] standard."¹⁸⁹ The principle obligates the host state not to engage in action that undermines or thwarts the legitimate expectations of the investor.¹⁹⁰

¹⁸⁵ See *Total S.A.*, ICSID Case No. ARB/04/1, para. 112.

¹⁸⁶ *Id.* para. 333 (emphasis added).

¹⁸⁷ *Rumeli Telekom A.S. v. Republic of Kazakhstan*, ICSID Case No. ARB/05/16, Award, para. 609 (July 29, 2008), available at <http://www.italaw.com/sites/default/files/case-documents/ita0728.pdf>.

¹⁸⁸ *Total S.A.*, ICSID Case No. ARB/04/1, para. 333.

¹⁸⁹ *Saluka Invs. BV v. Czech Republic*, Partial Award, 18 World Trade & Arb. Mat'1 169, para. 302 (Perm. Ct. Arb. 2006).

¹⁹⁰ *ADF Grp. Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award, para. 189 (Jan. 9, 2003), 6 ICSID Rep. 470 (2004).

Pursuant to “legitimate expectations,” the state must guarantee “to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investment.”¹⁹¹

Tribunals have consistently held that the legitimate expectations of the investor are created at the point in time of the investment.¹⁹² Thus, the benchmark to be used is the expectation “at the time the investment was made.”¹⁹³ At the point in which NBL made a business decision to explore for energy, NBL’s expectation was that profits would be taxed at regular corporate tax rates plus the 12.5% royalty rate. NBL can argue the host state was obligated to preserve NBL’s expectation and not to thwart it.¹⁹⁴

As stated by the tribunal in *Total S.A.*, “This is especially so in the utility or general interest sectors, which are subject to governmental regulation (be it light or strict), where operators cannot suspend the service, investments are made long term and exit/divestment is difficult.”¹⁹⁵

While natural gas and crude oil exploration is not a “utility” per se, analogous factors exist in the energy exploration industry. Large amounts of capital are needed for exploration, drilling, extraction, and transportation of the energy to markets. The investments made by NBL are by necessity long-term taken with a multi-decade view. Moreover, once the investment and expenditures are undertaken, the explorer cannot easily exit and recoup its investment if the host state’s policy alters the investor’s legitimate expectations.

NBL entered the Israeli exploration market with the known expectation that profits would be taxed at the ordinary corporate tax rate plus the royalty rate. The business decision made by NBL was done based upon that tax regime. NBL did not expect the state to dramatically increase a tax rate only after a

¹⁹¹ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, para. 154 (May 29, 2003), 10 ICSID Rep. 134 (2006).

¹⁹² *See, e.g., CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, para. 275 (May 12, 2005), 14 ICSID Rep. 158 (2009) (noting that the expectation is based on the time when “the investment was decided and made”).

¹⁹³ *See AES Summit Generation Ltd. v. Republic of Hungary*, ICSID Case No. ARB/07/22, Award, para. 9.3.8 (Sept. 23, 2010), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1730_En&caseId=C114.

¹⁹⁴ *Tecnicas Medioambientales Tecmed S.A.*, ICSID Case No. ARB(AF)/00/2, para. 154.

¹⁹⁵ *See Total S.A. v. Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability, para. 333 (Dec. 27, 2010), available at <http://www.italaw.com/sites/default/files/case-documents/ita0868.pdf>.

commercial success on that specific exploration. To implement a retroactive tax on NBL's discoveries—an evisceration of NBL's legitimate expectations—constitutes a quintessential thwarting of a legitimate expectation. The breach of NBL's legitimate expectation likely amounts to a violation of the FET guarantee contained in the FCN Treaty.

2. *Stability of the Regulatory Framework*

Another vital element of FET is the obligation of the host state to maintain a stable regulatory environment during the time of the investor's investment. The investor is entitled to rely upon a stable and predictable business environment. "A key element of fair and equitable treatment is the requirement of a stable framework for the investment."¹⁹⁶

This principle requires the host state not to take action undermining a stable and predictable regulatory structure during the time of the investment.¹⁹⁷ As one tribunal stated, "There can be no doubt . . . that a stable legal and business environment is an essential element of fair and equitable treatment."¹⁹⁸

This principle has been invoked by various tribunals and is now well established.¹⁹⁹ Interestingly, the cancellation of tax benefits (as opposed to directly raising taxes) may also constitute a violation of the obligation to maintain the regulatory structure: "The relevant question [is] . . . whether the legal and business framework meets the requirements of stability and predictability under international law [T]here is certainly an obligation not to alter the legal and business environment in which the investment is made."²⁰⁰

¹⁹⁶ *Enron Corp. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award, para. 260 (May 22, 2007) (internal quotation marks omitted), available at <http://www.italaw.com/sites/default/files/case-documents/ita0293.pdf>.

¹⁹⁷ This principle does not mandate that there can never be a change. A government is permitted to "change the rules" should exigent circumstances arise. Here, however, there are no exceptional circumstances justifying an exception to the state's obligation. Moreover, the FCN Treaty itself permits violation of the guarantees only to protect the peace and security of the other party. See FCN Treaty, *supra* note 32, art. XXI(d).

¹⁹⁸ *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, para. 274 (May 12, 2005), 14 ICSID Rep. 158 (2009).

¹⁹⁹ *Occidental Exploration & Prod. Co. v. Ecuador*, LCIA Case No. U.N. 3467, Final Award, para. 183 (London Ct. Int'l Arb. 2004), 12 ICSID Rep. 159 (2007); *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/9/97/1, Award, para. 99 (Aug. 30, 2000), 5 ICSID Rep. 212 (2002).

²⁰⁰ *Occidental Exploration & Prod. Co.*, LCIA Case No. U.N. 3467, para. 191.

The raising of taxes on NBL breaches the obligation not to rewrite the business environment and represents an example of regulatory instability. NBL invested under a tax environment held steady for many years and is entitled to the guarantee that the stability would, absent any exigent circumstances, continue to be upheld. The retroactive alteration of the regulatory regime, subsequent to the discovery of natural gas reserves, contravenes stability. By increasing the tax rate on NBL, an FCN Treaty obligation to maintain a stable regulatory environment was probably violated.

3. *Due Process and Transparency*

This essential element of FET involves protection against state conduct which “involve[es] a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.”²⁰¹

Conduct of government officials must comport with “standards of due process and procedural fairness applicable to administrative officials.”²⁰² As stated by one tribunal, an investor is entitled to “know beforehand any and all rules and regulations that will govern its investments.”²⁰³

Public statements made by various Israeli politicians are strong indications that the goal of the tax increase was to enrich the treasury and strip the energy “tycoons” from a windfall in “immoral” profits.²⁰⁴ However, enlarging the public take at the expense of oil and gas companies such as NBL cannot justify breaches of the FCN Treaty. As applied to NBL, this would require NBL to be fully apprised of the procedures involved in amending any relevant laws and affording NBL an opportunity to be heard on the issues. It is unclear whether NBL was afforded a meaningful opportunity to be heard and/or whether such procedures would have been considered fair. The Sheshinski final report states that the companies’ position was heard.²⁰⁵ However, the extent of same and

²⁰¹ *Waste Mgmt., Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, para. 98 (Apr. 20, 2004), 11 ICSID Rep. 361 (2007).

²⁰² *Int’l Thunderbird Gaming Corp. v. United Mexican States*, Award, para. 200F (NAFTA Inv.-State Arb. Trib. 2006), available at http://www.economia.gob.mx/files/comunidad_negocios/solucion_controversias/inversionista-estado/casos_concluidos/Thunderbird/award.pdf.

²⁰³ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, para. 154 (May 29, 2003), 10 ICSID Rep. 134 (2006).

²⁰⁴ See *supra* notes 150–153.

²⁰⁵ See *infra* Part IV.D.

whether such opportunities were material are unclear. If NBL was not provided a meaningful opportunity, this would militate in favor of finding the due process/transparency elements of FET to have been violated.

B. Most Constant Protection

In addition to FET, the FCN Treaty also provides that each party will afford the “most constant protection and security” to the other party. According to Article VI(1) of the FCN, “Property of nationals and companies of either Party shall receive the most constant protection and security within the territories of the other Party.”²⁰⁶ This standard obligates the host state to provide the investor with the most constant protection and security. The host state is required “to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued.”²⁰⁷

Thus, NBL is entitled to be free from interference by a change in the law or any action instituted by governmental agencies whereby the value of NBL’s investment is diminished. The Petroleum Profits Taxation Law reduces the value of NBL’s investments. The devaluation of the Tamar and Leviathan gas fields may constitute an example of the breach of this provision of the FCN Treaty.

C. Impermissible Indirect Expropriation

Another potential breached guarantee stems from the FCN Treaty ban on expropriation. Under Article VI(3), “Property of nationals and companies of either Party shall not be taken for public purposes, nor shall it be taken without the payment of just compensation.”²⁰⁸

While here the host state is not directly confiscating NBL’s investment, the imposition of higher taxes may constitute indirect expropriation.²⁰⁹ As noted by the tribunal in *Feldman v. Mexico*, “Confiscatory taxation . . . imposition of

²⁰⁶ FCN Treaty, *supra* note 32, art. VI(1).

²⁰⁷ CME Czech Republic B.V. (The Netherlands) v. Czech Republic, Partial Award, 14 World Trade & Arb. Mat’l 109, para. 613 (UNICTRAL Arb. Trib. 2001).

²⁰⁸ FCN Treaty, *supra* note 32, art. VI(1).

²⁰⁹ See, e.g., *Goetz v. Republic of Burundi*, ICSID Case No. ARB/95/03, Award, para. 124 (Feb. 10, 1999), 6 ICSID Rep. 5 (2004) (holding that an increased tax burden shouldered by the investor amounts to expropriation).

unreasonable regulatory regimes, among others, have been considered to be expropriatory actions.”²¹⁰

In the absence of any dire economic circumstances or other exigent circumstances threatening peace and security, increasing the tax burden may constitute an impermissible indirect expropriation.²¹¹ “Expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated . . . the state’s obligation to pay compensation remains.”²¹²

In addition, while some nations have excluded taxation from the protections of treaties,²¹³ here the FCN Treaty contains no such exculpatory language. Tribunals have held that an investor need not lose control in order to claim expropriation.²¹⁴ Tribunals have generally embraced the approach taken in *Metalclad v. Mexico*, where the tribunal held expropriation occurs when the host state’s conduct results in “covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use economic benefit of property.”²¹⁵ Accordingly, in addition to violations of FET and the most constant protection guarantee, the tax hike may amount to an act of impermissible expropriation.

D. The Requirement Not To Discriminate and To Act Reasonably

According to Article VI(4) of the FCN Treaty, Israel is prohibited from discriminating against and/or acting unreasonably toward NBL. The FCN Treaty states that “[n]either Party shall take unreasonable or discriminatory measures that would impair the legally acquired rights or interests within its territories of nationals and companies of the other Party”²¹⁶ Thus, NBL is entitled to be free of discriminatory and/or unreasonable treatment. The FCN

²¹⁰ Feldman v. United Mexican States, ICSID Case No. ARB(AF)/99/1, Award, para. 103 (Dec. 16, 2002), 7 ICSID Rep. 341 (2005).

²¹¹ *Cf. Goetz*, ICSID Case No. ARB/95/03, paras. 124–37.

²¹² *Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, para. 72 (Feb. 17, 2000), 5 ICSID Rep. 157 (2002).

²¹³ *See, e.g., Canada 2004 Model BIT*, INVESTMENT TREATY ARB., <http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf> (last visited Apr. 1, 2013).

²¹⁴ *See, e.g., Middle E. Cement Shipping & Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award, para. 107 (Apr. 12, 2002), 7 ICSID Rep. 178 (2005).

²¹⁵ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, para. 103 (Aug. 30, 2000), 5 ICSID Rep. 212 (2002).

²¹⁶ FCN Treaty *supra* note 32, art. VI(4).

Treaty prevents the Israeli government from acting with a discriminatory effect or in an unreasonable fashion towards an investor such as NBL in violation of the FCN Treaty.

1. *Discriminatory Treatment*

The FCN Treaty guarantees that NBL will not be treated in a discriminatory fashion.²¹⁷ Based upon statements made by members of the Knesset claiming the prior taxation rate was “not moral”²¹⁸ and that the gas reserves belong to “the people,”²¹⁹ NBL can make an argument that the enactment of the tax increase occurred in an inflammatory and fundamentally unfair and prejudicial environment. These statements, as well as the Sheshinski final report’s tacit concession,²²⁰ make abundantly clear that the goal of the tax increase was simply to enrich the Treasury at the expense of NBL and its Israeli corporate partners.²²¹ However, notwithstanding the pursuit of “social justice,” neither enlarging the public coffers nor “depriving tycoons of excess profits,” nullify the FCN Treaty guarantees to NBL.²²²

A host state’s treatment of an investor in one way and its treatment of similar investors in a more favorable way is inherently discriminatory and a violation of investment treaty protection. In *Saluka Investments BV v. The Czech Republic*, the tribunal addressed this guarantee:

A foreign investor . . . may in any case properly expect that the [host state] implements its policies bona fide by conduct that is, as far as it affects the investor’s investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the

²¹⁷ This is similar to the obligation of a state not to treat the investor less favorably than investors from third countries, discussed below.

²¹⁸ Ben-Yeshayahu & Ben-Israel, *supra* note 150.

²¹⁹ *Id.*

²²⁰ See SHESHINSKI REPORT, *supra* note 20, at 3–4.

²²¹ See Ben-Yeshayahu & Ben-Israel, *supra* note 150 (“It is inconceivable that all this wealth will belong to one person or to a handful of people. The question is, to whom do the sea and natural resources belong? The answer is: to all of us. I want the gas companies and their investors to get rich; the question is the proportion, the way the wealth is distributed, and everyone knows that the way wealth is distributed in Israel is outrageous. It is not economic, and not moral, and not reasonable. In our bill, we are talking about raising royalties to 20% and raising corporate taxation to 60%.”).

²²² See *supra* Part IV.A.

requirements of consistency, transparency, even-handedness and nondiscrimination.²²³

While the tax rates on the Tamar and Leviathan fields are scheduled to increase substantially, another gas supply company, East Mediterranean Gas (“EMG”), enjoyed a tax exemption.²²⁴ To increase the tax levy on NBL while simultaneously permitting EMG not to pay taxes is discriminatory against NBL. The discriminatory treatment of NBL as outlined above may constitute a violation of the FCN Treaty.²²⁵

2. *Unreasonable Treatment*

It is unclear whether NBL was given an opportunity to meaningfully participate in the governmental action.²²⁶ The failure to engage NBL would raise concerns of unreasonable (and discriminatory) treatment. Without adequate input from NBL, the interests of NBL were unprotected. Moreover, the tax law does not distinguish between crude oil and natural gas or the different drilling environments that may be encountered. It may be unfair to tax an energy find that was successful despite harsh drilling conditions or severe depth at the same rate as a field that is easy to produce from and/or enjoys easier operating conditions. The across-the-board re-regulation, without factoring in differences between drilling, operating, and transporting conditions may represent unreasonable treatment.

Another reason the retroactive tax hike may violate Article VI(4) is that the tax increase is bereft of a rational purpose other than to bring in additional revenue. A state has the inherent right to amend a tax regime to address exigent circumstances. But in this case, there is no dire economic emergency or need to defend peace and security. Therefore, there was no rational basis for the tax hike. The sole motivating factor, nearly admitted to in the Sheshinski final report introduction, was to enlarge the host state’s tax receipts.²²⁷ As such, the alteration of the existing tax law may amount to a violation of the FCN Treaty.

²²³ Saluka Invs. BV v. Czech Republic, Partial Award, 18 World Trade & Arb. Mat’l 169, para 307 (Perm. Ct. Arb. 2006)).

²²⁴ See *infra* text accompanying notes 231–239.

²²⁵ See Occidental Exploration & Prod. Co. v. Ecuador, LCIA Case No. U.N. 3467, Final Award, paras. 168–70 (London Ct. Int’l Arb. 2004), 12 ICSID Rep. 159 (2007).

²²⁶ As discussed in *supra* note 164, the Sheshinski final report alludes to participation by companies but there is an absence of information regarding the details of such participation.

²²⁷ See SHESHINSKI REPORT, *supra* note 20, at 9.

E. National Treatment and Most-Favored-Nation Guarantees

Other FCN Treaty rights include “national treatment” and “most-favored-nation” status, which guarantees that investors will not be treated worse than host state nationals or the nationals of third parties:

The term “national treatment” means treatment accorded within the territories of a party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products or vessels or other objects, as the case may be, of such party. . . . The term “most favored-nation treatment” means treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products or vessels or other objects, as the case may be, of any third country.²²⁸

In addition, the FCN Treaty specifically promises that the products of an investor, such as NBL’s natural gas or crude oil, will not be taxed less favorably than third-party investors:

Products of either Party shall be accorded, within the territories of the other Party, national treatment *and most favored-nation treatment in all matters affecting internal taxation*, sale, distribution, storage and use. Articles produced by nationals and companies of either Party within the territories of the other Party, or by companies of the latter Party controlled by such nationals and companies, shall be accorded therein treatment no less favorable than that accorded to like articles of national origin by whatever person or company produced, in all matters *affecting exportation, taxation*, sale, distribution, storage and use.²²⁹

Another assurance contained in the FCN Treaty is on point:

*Nationals and companies of either Party shall in no case be subject, within the territories of the other Party, to the payment of taxes, fees or charges imposed upon or applied to income, capital, transactions, activities or any other object, or to requirements with respect to the levy and collection thereof, more burdensome than those borne by nationals, residents and companies of any third country.*²³⁰

²²⁸ FCN Treaty, *supra* note 32, art. XXII.

²²⁹ *Id.* art. XVI (emphasis added).

²³⁰ *Id.* art. XI(3) (emphasis added).

Thus, foreign investors enjoy significant advantageous guarantees and preferential treatment based upon the FCN Treaty. While NBL may seek to argue that the tax hike violates the national treatment standard since other Israeli industries were not subject to this tax increase, given the fact that all national energy producers were affected, this argument may not carry substantial merit. The Israeli government can in all likelihood successfully argue that all national energy companies were affected and therefore, the national treatment standard was not violated.

However, a strong argument that NBL possesses is that the tax increase violates the most-favored-nation provision of the FCN Treaty. Under the clause, NBL is entitled to receive the same rights and privileges afforded to any third-party nationals—such as Egypt’s EMG.

1. *The EMG Tax Exemption*

An important additional factor is the tax exemption enjoyed by EMG,²³¹ an Egyptian corporation²³² owned by various individuals and entities²³³ that was in the business of selling natural gas to Israeli consumers.²³⁴ EMG was a serious competitor to NBL with approximately \$15-billion-worth of contracts with Israeli gas customers.²³⁵ EMG unilaterally terminated its contracts with its Israeli customers claiming the price set was based upon corruption inside the Egyptian government. While EMG is no longer currently supplying gas, the fact remains that the Israeli government granted EMG a tax exemption. The

²³¹ See Amiram Barkat, *Israel Corp. Egypt’s EMG Near \$8b Gas Deal*, GLOBES (Nov. 24, 2010), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000603545> (“Israel Corporation is moving closer to signing an \$8 billion natural gas deal with Egypt’s East Mediterranean Gas Company (EMG). Sources inform “Globes” that an EMG negotiating team arrived in Israel earlier this week for marathon talks with Israel Corp.’s negotiating team headed by Shuki Gold, the CEO of the company’s power plants subsidiary, IC Power Ltd.”).

²³² See *Gas Utilities: Company Overview of East Mediterranean Gas Co.*, BUSINESSWEEK, <http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=26002157> (“East Mediterranean Gas Co. supplies natural gas through pipeline. It distributes gas from El-Arish, Egypt to Ashkelon, Israel. The company was founded in 1999 and is based in Cairo, Egypt.”) (last visited May 7, 2013).

²³³ See Amiram Barkat, *Ampal: EMG’s Commission on Gas Sales to Israel Is 30%*, GLOBES (Mar. 22, 2011), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000632212&fid=1725> (“EMG ownership is as follows: Egyptian investor Hussain Salem (28%); Egyptian Natural Gas Holding Company (10%); Thai’s PTT Public Co. Ltd (25%); Israeli investor Yosef Maimon (via a controlled company, Ampal) (12.5%) and other investors the remaining stake.”).

²³⁴ *Id.* (“EMG resells gas to Israeli customers that it purchases from the Egyptian National Gas Company (EGAS), and collects a commission on these sales.”).

²³⁵ *Id.* (“EMG currently has contracts worth over \$15 billion with Israel Electric Corporation, Israel Corporation, and other customers.”).

new tax law would not have affected EMG because the Egyptian corporation was exempt from Israeli income tax.²³⁶ According to an SEC filing from a large EMG shareholder, Nasdaq-listed Ampal,²³⁷ EMG enjoyed an Israeli tax exemption:

EMG is in the process of negotiating several additional agreements covering much of the anticipated 7.0 BCM annually earmarked for the Israeli market. This project is governed by an agreement signed between Israel and Egypt which designates EMG as the authorized exporter of Egyptian gas, secures EMG's tax exemption in Israel and provides for the Egyptian government's guarantee for the delivery of the gas to the Israeli market.²³⁸

The exemption was given in 2005 as part of the contract to supply gas to the Israel Electric Corporation:

[T]he tax exemption was granted as part of an extraordinary and unlimited agreement tailored for the company as part of its contract with Israel Electric Corporation (IEC) to supply gas for 15 years with an option to extend to 20 years. The current estimated value of the contract is \$6 billion. The commercial contract between EMG and IEC signed in Cairo in 2005 was accompanied by a covenant between the Israeli and Egyptian governments signed by then-Minister of National Infrastructures Benjamin Ben-Eliezer and Egypt's Minister of Petroleum and Mineral Resources Sameh Fahmi on June 30, 2005. Article 6 of the covenant, its longest article, grants EMG a complete tax exemption throughout the period of EMG-IEC contract. It states, "EMG, whose place of residence is Egypt, will be exempt from taxes in Israel on income from the sale and supply of gas from Egypt to Israel and from the distribution of gas at the Ashkelon terminal. The covenant adds, "EMG will not be required to open an income tax file or file annual tax reports in Israel."²³⁹

To tax NBL at any rate, while simultaneously affording a tax exemption to a third-party national, amounts to a violation of the FCN Treaty. Under the most-favored-nation provision of the FCN Treaty, and in particular Article XI(3), in light of the EMG tax exemption, taxing NBL *at all* may constitute a violation of the FCN Treaty. Pursuant to Article XI(3), the Israeli government

²³⁶ See Amiram Barkat, Egypt's EMG Has Extraordinary 20 Year Tax Exemption, GLOBES (Aug. 2, 2010), <http://www.globes.co.il/serveen/globes/docview.asp?did=1000579127> ("The 2005 exemption is part of EMG's \$6 billion 15-year gas supply contract to IEC.").

²³⁷ AMPAL, <http://www.ampal.com> (last visited Mar. 28, 2013).

²³⁸ U.S. SEC. & EXCH. COMM'N, AMPAL-AM. ISR. CORP., FORM 10-Q (Aug. 4, 2010).

²³⁹ Barkat, *supra* note 236.

must afford NBL the same best treatment it affords to any company of a third country. Since Israel has exempted EMG from taxation, to increase the tax burden on NBL placed NBL in a far inferior position to EMG. To raise taxes sharply on NBL, while simultaneously having granted the company of a third party a tax exemption, likely constitutes a breach of the FCN Treaty.

F. The Available Forum for Dispute Resolution

Under the FCN Treaty, it would be the U.S. government's right to file a claim for damages on behalf of NBL in the ICJ.²⁴⁰ It would appear that the Israeli government is relying strongly on the likelihood of NBL not being able to avail itself of a dispute resolution mechanism.²⁴¹ This state-state procedure is reflective of the original investment treaties which delegated the claimant's "rights" to the investor's government to pursue a state-state resolution in the ICJ.²⁴² Indeed, at the time of the negotiation and signing of the FCN Treaty, the ICSID investor-state arbitration process did not exist, as traditionally the investor's rights were delegated to the investor's government.²⁴³

However, under the FCN Treaty, NBL is afforded most-favored-nation status ("MFN"), i.e., it is vested with the same rights that Israel provides to the nationals of third parties.²⁴⁴ "An investor covered by a BIT with an MFN clause can . . . invoke the benefits granted to third-party nationals by another BIT of the host State and import them into its relationship with the host State."²⁴⁵ NBL may seek to bypass the state-to-state ICJ mechanism by claiming that the MFN clause permits NBL to utilize the dispute mechanisms which Israel grants to third-party investors.

²⁴⁰ See FCN Treaty Article, *supra* note 32, art. XXIV.

²⁴¹ See *supra* text accompanying notes 169–170.

²⁴² See Franck, *supra* note 31, at 833.

²⁴³ The ICSID investor-state arbitration process was not in existence at the time the FCN Treaty was negotiated entering into force in 1965. *About ICSID*, INT'L CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=AboutICSID_Home (last visited Feb. 7, 2013) ("The ICSID Convention . . . entered into force on October 14, 1966."). Israel signed the ICSID Convention in 1980 while the United States did so in 1965. *List of Contracting States and Other Signatories of the Convention (as of July 25, 2012)*, <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&language=English> (last visited Feb. 7, 2013).

²⁴⁴ FCN Treaty, *supra* note 32, art. XI(3).

²⁴⁵ See Stephan W. Schill, *Multilateralizing Investment Treaties Through Most-Favored-Nation Clauses*, 27 BERKELEY J. INT'L L. 496, 504 (2009).

MFN clauses are significant and “break with general international law and its bilateralist rationale that, in principle, permits States to accord differential treatment to different States and their nationals and instead ensure equal treatment between the State benefiting from MFN treatment and any third State.”²⁴⁶ MFN clauses therefore prevent the host state from treating two investors from different states differently, which is permissible under customary international law.²⁴⁷ The purpose of the MFN clause is “to create a level playing field for all foreign investors by prohibiting discrimination between investors from different home States.”²⁴⁸

MFN treatment reflects the crucial importance competitive structures play for efficient investment and allocation of resources²⁴⁹:

The broad wording of the MFN clauses, their economic rationale of establishing equal competition, the object and purpose of BITs to promote and protect foreign investment, and the positive impact of a broad interpretation of MFN treatment on the compliance of host States with their substantive investment treaty obligations, support a broad application of MFN clauses.²⁵⁰

MFNs are significant and obligate the host state to treat the investor no less favorably than it treats investors from other nations. “MFN clauses oblige the State granting MFN treatment to extend to the beneficiary State the treatment accorded to third States in case this treatment is more favorable than the treatment under the treaty between the granting State and the beneficiary State.”²⁵¹ “If the host state provides better treatment to other foreigner investors, it must increase the level of treatment to all foreigners no matter that their BIT may have more restrictive terms.”²⁵²

Israeli BITs are negotiated from a 2003 Model BIT²⁵³ which provides for ICSID arbitration.²⁵⁴ BITs signed by Israel with third parties reveal that Israel

²⁴⁶ See *id.* at 502.

²⁴⁷ *Id.* at 502–03.

²⁴⁸ *Id.* at 503.

²⁴⁹ *Id.*

²⁵⁰ *Id.* at 549.

²⁵¹ See *id.* at 502.

²⁵² See Jane Y. Willems, *The Settlement Of Investor State Disputes And China: New Developments On ICSID Jurisdiction*, 8 S.C. J. INT'L. L. & BUS. 1, 54 (2011).

²⁵³ *Agreement Between the Government of the State of Israel and ___ for the Reciprocal Promotion and Protection of Investments*, MINISTRY OF FIN., <http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/InternationalAgreements/IPa.pdf> (last visited Feb. 7, 2013).

²⁵⁴ *Id.* art. 8.

affords rights to investors to file claims for ICSID arbitration.²⁵⁵ Since Israel allows the nationals of third parties to file claims in the ICSID, NBL may argue that the most-favored-nation clause permits it to file an ICSID claim to secure the substantive rights contained in the FCN Treaty.

There is strong support for NBL to advance the argument that dispute resolution provisions are a crucial and fundamental part of the “treatment” strand of protection. As an arbitral panel held:

[T]he Tribunal considers that the critical issue is whether or not the dispute settlement provisions of bilateral investment treaties constitute part of the bundle of protections granted to foreign investors by host states. As the Tribunal sees the history, first of the ICSID Convention, which created the institution of investor-state arbitration, and subsequently of the wave of bilateral investment treaties between developed and developing countries (and in some instances between developing countries *inter se*), a crucial element—indeed perhaps the most crucial element—has been the provision for independent international arbitration of disputes between investors and host states. The creation of ICSID and the adoption of bilateral investment treaties offered to investors assurances that disputes that might flow from their investments would not be subject to the perceived hazards of delays and political pressures of adjudication in national courts.²⁵⁶

As another tribunal noted, “Access to [dispute settlement] mechanisms is part of the protection offered under the Treaty. It is part of the treatment of foreign investors and investments and of the advantages accessible through a MFN clause.”²⁵⁷

Not all MFN clauses are equal. Some offer very broad or unconditional MFN guarantees, while others are limited to activities associated with the specific investment. They may also be limited to the treatment of investors after the admission of the investment, or extend to admission and establishment of the investment.²⁵⁸

²⁵⁵ See *International Agreements*, MINISTRY OF FIN., <http://www.financeisrael.mof.gov.il/FinanceIsrael/Pages/en/EconomicData/InternationalAgreements.aspx> (last visited Feb. 7, 2013).

²⁵⁶ *Gas Natural, SDG, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/10, Decision on Preliminary Questions on Jurisdiction, para. 29 (June 17, 2005), 14 ICSID Rep. 284 (2009).

²⁵⁷ *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, para. 102 (Aug. 3, 2004), 12 ICSID Rep. 174 (2007).

²⁵⁸ *Id.*

Therefore, it is crucial to examine the specific MFN clause in the FCN Treaty. The FCN Treaty's language supports the view that the most-favored-nation clause can be used to incorporate the procedural rights contained in other treaties. Both the United States and Israel have pledged to provide most-favored-nation status to each other *unconditionally*. According to the preamble of the FCN Treaty:

The United States of America and Israel, desirous of strengthening the bonds of peace and friendship traditionally existing between them and of encouraging closer economic and cultural relations between their peoples . . . have resolved to conclude a Treaty of Friendship, Commerce and Navigation, based in general upon the principles of national and of most-favored-nation treatment *unconditionally accorded*²⁵⁹

Regarding the most-favored-nation provision, the FCN Treaty says: "The term 'most-favored-nation treatment' means treatment accorded within the territories of a Party upon terms no less favorable than the treatment accorded therein, in like situations, to nationals, companies, products, vessels or other objects, as the case may be, of any third country."²⁶⁰

Thus, the FCN Treaty provides NBL with unconditional treatment as a most-favored nation. The contractual term "treatment" in investment treaties should be considered broad enough to encompass procedural rights.

"The issue of application of MFN clauses to dispute settlement provisions has been addressed by numerous panels and in numerous factual scenarios."²⁶¹ While arbitration rulings have not been unanimous,²⁶² rulings have generally permitted MFN clauses to be used to import procedural rights.²⁶³ While some

²⁵⁹ FCN Treaty, *supra* note 32, pmb. (emphasis added).

²⁶⁰ *Id.* art. XXII(2).

²⁶¹ *Teinver S.A. v. Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, para. 167 (Dec. 21, 2012), available at <http://italaw.com/sites/default/files/case-documents/italaw1090.pdf>.

²⁶² *See id.*

²⁶³ *See, e.g., Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, para. 102 (Aug. 3, 2004), 12 ICSID Rep. 174 (2007) (procedural rights); *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, para. 104 (May 25, 2004), 12 ICSID Rep. 6 (2007) (substantive rights); *Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Objections to Jurisdiction, para. 38 (Jan. 25, 2000), 5 ICSID Rep. 396 (2002) (procedural rights).

rulings have limited the scope of MFN clauses this approach has been sharply criticized.²⁶⁴

As the *Austrian Airlines v. Slovakia* tribunal stated:

As a general matter, the Tribunal observes that it sees no conceptual reason why an MFN clause should be limited to substantive guarantees and rule out procedural protections, the latter being a means to enforce the former. The Tribunal notes, in this connection, that the potential application of an MFN clause to procedural protections is widely accepted by investment tribunals. This view has been held mostly with respect to the avoidance of procedural requirements prior to commence arbitration, but also, more recently, with respect to the import of a dispute settlement clause.²⁶⁵

The FCN Treaty provides NBL with most-favored-nation status—unconditionally—with respect to treatment. The contractual term “treatment” in investment treaties should be considered broad enough to encompass procedural rights. Stephen Schill argues that a rebuttable exemption exists that MFN clauses do apply to procedural rights: “From the point of view of the promotion and protection of investments, the stated purposes of the [BIT in question], dispute settlement is as important as other matters governed by the BIT and is an integral part of the investment protection regime that two sovereign states . . . have agreed upon.”²⁶⁶

As noted by the *Impregilo S.p.A. v. Argentine Republic* ruling: “The Arbitral Tribunal is of the opinion that the term ‘treatment’ is in itself wide enough to be applicable also to procedural matters such as dispute settlement.”²⁶⁷ Thus, in the absence of specific exceptions, the contract language should be interpreted consistently with the principle of most-favored-nation status. And there are some exceptions listed in the FCN Treaty.²⁶⁸ The

²⁶⁴ See Schill, *supra* note 245, at 505 (“[T]he restrictive interpretation employed by some tribunals denies giving MFN clauses their proper effect and disregards the firm stance they take for multilateralism as an ordering principle of international relations that subjects States to equal and non-discriminatory rules.”).

²⁶⁵ *Austrian Airlines v. Slovakia Republic*, Final Award, para. 124 (UNICTRAL Ad Hoc Arb. Trib. 2009), available at <http://italaw.com/sites/default/files/case-documents/ita0048.pdf>.

²⁶⁶ Schill, *supra* note 245, at 539.

²⁶⁷ *Impregilo S.p.A. v. Argentine Republic*, Award, ICSID Case No. ARB/07/17, para. 99 (June 21, 2011), https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2171_En&caseId=C109.

²⁶⁸ The following exceptions enumerated in the FCN Treaty show the parties did indeed carve exceptions. According to Article XXI:

1. The present Treaty shall not preclude the application of measures:

fact that they were specifically articulated can be interpreted as foreclosing other exceptions which the parties failed to enunciate.

With regard to the most-favored-nation clause, here too the parties evinced a specific intent to carve out specific exceptions to such treatment. According to the FCN Treaty, the following are exceptions to the most-favored-nation clause:

The most-favored-nation provisions of the present Treaty relating to the treatment of goods shall not apply to: (a) advantages accorded by the United States of America or its Territories and possessions to one another, to the Republic of Cuba, to the Republic of the Philippines, to the Trust Territory of the Pacific Islands or to the Panama Canal Zone; or (b) advantages which Israel may accord and which existed under arrangements in force on May 13, 1948.²⁶⁹

NBL would have a strong argument that based upon the contract language: The intent of the parties is to provide most-favored-nation status, unconditionally, unless one of the above-referenced exceptions exists. As one tribunal held, “Unless it appears clearly that the state parties to a BIT or the parties to a particular investment agreement settled on a different method for resolution of disputes that may arise, most-favored-nation provisions in BITs should be understood to be applicable to dispute settlement.”²⁷⁰

Procedural rights are included in the term “treatment.” Whether the ICJ or the ICSID is more favorable to NBL is not a relevant factor; the fact that the investor has a “choice” satisfies the most-favored-nation requirement:

[T]he Arbitral Tribunal finds that the relevant question is not whether resorting to domestic courts is more or less favorable to investors

(a) regulating the importation or exportation of gold or silver;

(b) relating to fissionable materials, to radioactive byproducts of the utilization or processing thereof or to materials that are the source of fissionable materials;

(c) regulating the production of or traffic in arms, ammunition and implements of war, or traffic in other materials carried on directly or indirectly for the purpose of supplying a military establishment;

(d) necessary to fulfill the obligations of a Party for the maintenance or restoration of international peace and security, or necessary to protect its essential security interests

FCN Treaty, *supra* note 32, art. XXI.

²⁶⁹ *Id.* art. XXI(2).

²⁷⁰ Gas Natural, SDG, S.A. v. Argentine Republic, ICSID Case No. ARB/03/10, Decision on Jurisdiction, para. 49 (June 17, 2005), 14 ICSID Rep. 282 (2009).

than international arbitration. Instead, what should be considered is whether a *choice* between domestic proceedings and international arbitration, as in the Argentina-US BIT, is more favorable to the investor than compulsory domestic proceedings before access is opened to arbitration. The answer to this question is in general, and certainly in this case, evident: a system that gives a choice is more favorable to the investor than a system that gives no choice.²⁷¹

The recent case *Teinver v. Argentine Republic* is instructive. The panel reviewed prior decisions on whether an MFN clause can incorporate procedural rights.²⁷² The tribunal noted that the decisions on jurisdiction and the MFN clause can be broken down into two groups.²⁷³ One group consists of claimants seeking to invoke an MFN to bring into the BIT procedural options found in BITs with third parties: “Each of the claimants in these cases sought to use its BIT’s MFN clause in order to ‘borrow’ a dispute settlement provision from another treaty. . . .”²⁷⁴ The tribunal found that the vast majority of decisions permitted the claimant to use the MFN to “borrow” the sought-after resolution procedure.

In the other group, the tribunal found cases where the claimant sought to “extend via MFN the jurisdictional threshold, i.e., the scope of the mandate of the arbitral tribunal, beyond that specifically set forth in the basic treaty. This use of the MFN clause would give the arbitral tribunal jurisdiction to hear issues or disputes that the basic treaty does not contemplate or expressly excludes.”²⁷⁵ Some examples were: seeking to use the MFN clause to bring in contract claims; attempting to use the MFN clause to broaden the scope of jurisdiction beyond that of its applicable BIT, which only provided jurisdiction to resolve issues of compensation in the case of an expropriation; and attempting to use the MFN clause to broaden jurisdiction beyond BITs, which only provided jurisdiction over expropriation claims.²⁷⁶ The Tribunal noted that these attempts—to use the MFN to extend the arbitral tribunal’s mandate—were rejected.

²⁷¹ *Impregilo S.p.A.*, ICSID Case No. ARB/07/17, para. 101.

²⁷² *Teinver S.A. v. Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction, paras. 160–86 (Dec. 21, 2012), available at <http://italaw.com/sites/default/files/case-documents/italaw1090.pdf>.

²⁷³ *Id.* paras. 170–71.

²⁷⁴ *Id.* para. 170.

²⁷⁵ *Id.* para. 169.

²⁷⁶ *Id.* para. 171.

The *Teinver* panel found the claimant could indeed invoke the MFN clause to “borrow” a resolution mechanism: “To conclude, the Tribunal finds that Claimants may equally rely on the Article IV(2) MFN clause of the Treaty to make use of the dispute resolution provisions contained in Article 13 of the Australia-Argentina BIT. The broad ‘all matters’ language of the Article IV(2) MFN clause is unambiguously inclusive.”²⁷⁷ Similarly, NBL should be able to import another procedural remedy by invoking the MFN clause.

Pursuant to the FCN Treaty, while the U.S. government holds the right to file a claim in the ICJ on behalf of NBL, a strong argument can be made that NBL can pursue a direct claim for arbitration. Doing so would enable NBL to file a direct claim against the host state’s tax hike as it affects NBLs previously-discovered gas fields. Based upon the unconditional nature of the MFN, as well as the absence of any language to the contrary, NBL would have an excellent argument that it can arbitrate its claim at the ICSID.

CONCLUSION

NBL spearheaded the discovery of large natural gas strikes offshore Israel at a time when such strikes were unheard of. Undertaking substantial financial and technical risks, NBL’s hard work, determination, and expertise paid off with the discovery of world-class natural gas reserves. NBL’s business decision was based upon the expectation of the previous taxation structure which was unchanged until the discoveries were made. The recently-enacted amendment to the regulatory structure—the Profits Taxation Law of 2011—significantly reduces the economic value of those discoveries to NBL. The U.S.–Israel FCN Treaty provides numerous guarantees governing NBL’s Israeli investments, and the new tax law probably violates several provisions of that treaty. Based upon international law as articulated in investor-state arbitration rulings, a challenge to the new tax regime would in all likelihood succeed in obtaining damages. Pursuant to historic notions of international law, and as expressed in the FCN Treaty, the United States has the right to file a claim in the ICJ. This state-to-state procedure reflects the thinking at the time the FCN Treaty was signed that only states were actors at international law. However, based upon the most-favored-nation clause, NBL has a strong argument that it enjoys the right to file a direct investor-state arbitration claim seeking damages caused by the amendment of the prior tax structure.

²⁷⁷ *Id.* para. 186.