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Israel: The Land of Milk and Honey . . . and FDI: An Overview of Israel's International Investment Agreement Program

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Israel is known as the land of "milk and honey." But in recent years it has also become known as the land of innovation and entrepreneurship. Successful Israeli start-ups include Waze (the satellite navigation company), M-Systems (the developer of the first USB drive), and MyHeritage (the online genealogy platform).

As Israel has progressively embraced liberalism, it has embarked upon a process of economic liberalization. Hand in hand with that process, foreign direct investment ("**FDI**") has become increasingly relevant. In order to promote and protect both inward and outward FDI, Israel has concluded a number of international investment agreements ("**IIAs**"), which are international agreements between two or more sovereign states, such as bilateral investment treaties ("**BITs**") and free trade agreements ("**FTAs**"). IIAs generally provide procedural and substantive protections to an investor of one contracting party who makes an investment in the territory of the other contracting party.

Israel signed its firsts BITs with Germany in 1976 and France in 1983. In the 1990s, Israel began branching outside Europe and signed another 25 BITs with a variety of states, including Argentina, China, India, and Uzbekistan. In the 21st century, it has continued to sign BITs (e.g., with Guatemala, Japan, South Africa, the UAE) and to conclude comprehensive FTAs with investment chapters.

Today Israel has a robust IIA program with 35 BITs and 1 FTA with an investment chapter (most often providing for ICSID arbitration, and sometimes for arbitration under the ICC Rules or UNCITRAL Rules), and several investor-state arbitration tribunals have had the opportunity to interpret and apply their provisions. We provide below an overview of Israel's IIA program.

Overview of Israel's IIA Program

Investments and investors that enjoy protection

IIAs protect "investments" made in one Contracting State by "investors" of the other Contracting State. An "investor" can either be a natural person or a legal person. All of Israel's IIAs exclude dual nationals as Israeli "investors"; a natural person must be a national of Israel and *not* also a national of the host State to constitute an Israeli "investor." Some of Israel's IIAs also include permanent residents. For example, Article 1(1)(d)(I) of the Myanmar-Israel BIT defines an "investor" as:

> (i) with respect to the State of Israel: a natural person who is a national or permanent resident of the State of Israel who is not also a national of Myanmar;
>
> (ii) with respect to Myanmar: a natural person who is a national of Myanmar in accordance with its laws and regulations who is not also a national or permanent resident of the State of Israel

With respect to legal persons, Israel's IIAs have no uniform approach. For example, Israel's BITs with China, Korea, and Slovakia require that a company merely be constituted or organized under the applicable laws and regulations of the home State to constitute an "investor." However, the Argentina-Israel BIT requires that the company also have its "seat" in the home State, and the Japan-Israel BIT requires that the company also "carry[] out substantial business activities" in the home State.

In *IC Power Asia v. Guatemala*, PCA Case No. 2019-43, Guatemala argued that the Israeli claimant had no standing as an "investor" under the Guatemala-Israel BIT because it was a shareholder claiming damages directly suffered by the underlying company. However, the tribunal rejected this objection finding that the Israeli claimant satisfied the definition of "investor" in Article 1(1)(d) of the BIT merely because it was "a legal entity organized under the law of Israel."

When it comes to "investments", Israel's IIAs generally define the term rather broadly. For example, the Kazakhstan-Israel BIT defines an "investment" as "any kind of assets, implemented in accordance with the laws and regulations of the Contracting Party in whose territory the investment is made." However, the phrase "implemented in accordance with the laws and regulations" imposes a "legality" requirement. *Metal-Tech v. Uzbekistan*, ICSID Case No. ARB/10/3, involved the "legality" clause in Article 1(1) of the Uzbekistan-Israel BIT. In that case, the tribunal found that "corruption is established to an extent sufficient to violate Uzbekistan law" and, therefore, "the investment has not been 'implemented in accordance with the laws and regulations of the Contracting Party in whose territory the investment is made' as required by Article 1(1) of the BIT." The tribunal reasoned that because "Article 1(1) of the BIT defines investments to mean only investments implemented in compliance with local law . . . the present dispute . . . is not covered by Uzbekistan's consent" and, therefore, the tribunal lacked jurisdiction.

Standards of protection

Israel's IIAs contain FET and FPS protections. Only Israel's most recent IIAs – the Japan-Israel BIT and the Colombia-Israel FTA – expressly limit the FET and FPS protections to "customary international law." For example, Article 4 of the Japan-Israel BIT provides:

> Each Contracting Party shall in its Territory accord to investments of investors of the other Contracting Party treatment in accordance with customary international law,

> including fair and equitable treatment and full protection and security.

Israel's IIAs also prohibit unlawful expropriation unless for a public purpose, in a non-discriminatory manner, and against prompt, adequate and effective compensation. Israel's IIAs specify that the compensation shall be either "market value" or "fair market value."

Israel's IIAs generally do not contain an "observance of obligations" or "umbrella" which elevate contract breaches to treaty breaches. However, Israel's BITs with Latvia, Lithuania, and Turkey contain a variation of an umbrella clause. For example, Article 2(3) of the Latvia-Israel BIT provides:

> Investors of one Contracting Party may conclude with the other Contracting Party specific agreements, the provisions and effect of which, unless more beneficial to the investor shall not be at variance with this Agreement. Each Contracting Party shall, with regard to investments of Investors of the other Contracting Party, observe the provisions of these specific agreements, as well as the provisions of this Agreement.

An MFN clause requires a host State to provide "treatment no less favorable" than that which it accords to investments or investors of any third state. The vast majority of Israel's IIAs do not specify whether the MFN clause encompasses dispute resolution. However, Israel's most recent IIAs – its BITs with Japan and Myanmar and its FTA with Colombia – expressly exclude dispute resolution. For example Article 10.5 (3) of the Israel-Colombia FTA provides:

> For the sake of avoiding any misunderstanding, it is further clarified that the treatment referred to in paragraphs 1 and 2 shall not apply to definitions, <u>nor to mechanisms for dispute settlement between one Party and an Investor of the other Party</u>, or to any other matter not specifically mentioned in paragraphs 1 and 2.

In *Metal-Tech v. Uzbekistan*, ICSID Case No. ARB/10/3, the ICSID tribunal interpreted the MFN clause in the Uzbekistan-Israel BIT (which did not specify that it encompassed dispute resolution or the definitions in the treaty) as not extending to the definition of "investment" in Article 1(1) of the BIT. The tribunal reasoned:

> [T]he defined terms "investments" and "investors" are used in the MFN clause itself, so that the treatment assured to investments and investors by Article 3 necessarily refers to investments and investors as defined in Article 1 of the BIT. In other words, one must fall within the scope of the treaty, which is in particular circumscribed by the definition of investment and investors, to be entitled to invoke the treaty protections, of which MFN treatment forms part. Or, in fewer words, one must be under the treaty to claim through the treaty . . . [T]he requirement of legality of the investment is spelled out in the clearest terms in Article 1 of the BIT and . . . the existence of an investment falling within the scope of that provision is a condition sine qua non of treaty protection. Any exception to these clear rules would have to be stated in no uncertain terms, which is obviously not so here.

Certain procedural considerations

Israel's IIAs provide for a consultation period that ranges from 3 to 6 months prior to an investor initiating international arbitration against a host State. Israel's BITs with Argentina, Guatemala, and Uruguay also contain a "fork in the road" provision which prevents an investor from resorting to international arbitration if the investor has previously brought the dispute to domestic courts under certain circumstances. For example, Article 7(2) of the Uruguay-Israel BIT provides:

> The choice of one or the other of the above mentioned procedures [i.e., domestic courts or international arbitration] by an investor shall be final, unless the parties to the dispute agree otherwise.

Only the Japan-Israel BIT and the Colombia-Israel FTA contain a temporal restriction that restricts an investor's ability to initiate an international arbitration against a host State. For example, Article 24(7) of the Japan-Israel BIT provides:

> Notwithstanding paragraph 6, no claim may be submitted to arbitration under this Article <u>if more than three years have elapsed from the date on which the claimant first acquired, or should have first acquired, knowledge of the breach alleged under paragraph 2 and knowledge that the claimant has incurred loss or damage</u>.

In *Fuchs v. Georgia*, ICSID Case No. ARB/07/15, Georgia argued that although the Georgia-Israel BIT did not contain a temporal restriction, the claimants' claims nevertheless should be time-barred due to the 10-year delay in filing the claims (which resulted, so Georgia argued, in the loss of crucial evidence which has severely prejudiced Georgia's ability to defend itself). The tribunal noted that "[w]hilst this time-bar defence is not in the nature of a jurisdictional defence per se, the result, were [Georgia] to succeed, would effectively be the same as it would preclude the Tribunal from hearing and considering the Claimants' claims." The tribunal ultimately dismissed Georgia's objection because it was not persuaded that the delay in bringing the claims was unreasonable or unjustified in the circumstances because "the Claimants had good reason to suppose that a fair resolution of the dispute could be achieved in the manner proposed by the Georgian Government if the Claimants did not have recourse to arbitration."

Conclusion

Investing in a foreign state can provide an investor with an incredible opportunity to expand its business and operations to new markets. At the same time, investing in a foreign state entails risks: often, the investor is not familiar with the foreign legal system, and the risk that a host State may expropriate or nationalize a foreign investment following a political or regime change may render this business opportunity too risky to pursue.

IIAs intend to address this very risk by providing significant protections (both procedural and substantive) to investors investing abroad. Surprisingly, despite the valuable protections afforded by IIAs, IIAs continue to remain under the radar and are often not considered when an investor decides to invest abroad.

Israel's IIAs recently signed with states such as the UAE should be a wake-up call for foreign investors. In the wake of these new agreements that open up a whole new world of business opportunities, IIAs should be considered an important element that can aid Israeli investors in protecting their foreign investments. The same applies to foreign investors who consider investing in Israel. In light of the risks inherent in foreign investment, investors should ascertain whether their foreign investments to or from the land of "milk and honey" are adequately protected by IIAs.

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