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New Risks for Investors? Israel's Supreme Court Refuses to Set Aside a Multi-Million Class Action Against Foreign Investors

Asaf Niemoj · Thursday, November 9th, 2017

A. Introduction

Investments in a foreign country entail risks for the investors. These include the possibility that their investments will be nationalized or expropriated if, for example, a political change occurs. There is also a risk of loss as a result of war, armed conflict, revolution, a state of national emergency, etc. However, on 29 September 2017 the Israeli Supreme Court delivered a judgment which illustrates that investors may need to cope with new substantial risks, to which investment treaties may not have a remedy and which the investors may not have taken into consideration prior to entering into a business venture in a foreign country.

9771/16 Nobel Energy and others v Nasry and the Attorney General, was an appeal submitted to the Supreme Court following a District Court's refusal to set aside a multi-million class action filed against Nobel Energy and several other foreign investors. In their appeal to the Supreme Court, the investors argued that the District Court's judgment should be overturned, and that the class action should be set aside. In its judgment, however, the Supreme Court refused to do so and dismissed the appeal. This means that a green light was given by the Supreme Court to proceed with the certification stage of this multi-million class action. This stage, though only the preliminary part of a class action, is a crucial part thereof and can have substantial implications on the final outcome of the case.

B. The Israeli Energy Market, the New Gas Fields and the Class Action

The following is a very brief background needed in order to understand the sequence of events which led to the filing of the class action and the above-mentioned Appeal to the Supreme Court.

1. The Israeli energy market has gone through substantial changes in the last 8 years. This is due to the discovery of substantial amounts of gas in fields located in the exclusive economic zone near the Israeli coast. In 2012, following the discovery of the gas, the investors signed a contract with the Israeli Energy Company according to which the latter undertook to purchase gas produced by the investors from the said gas fields. According to the contract, the agreed price per unit was set at 5.042 USD. Indeed, following the conclusion of the deal, the Israeli Energy Company started purchasing more and more gas produced by the investors, to the extent that in 2012 the Israeli Anti-Trust and Competition Authority declared that the investors hold a monopoly in the area of

natural gas supply. This declaration imposed further obligations on the investors, pursuant to the Israeli Anti-Trust Law.

2. Pursuant to Israeli law, a legal action based on an alleged breach of the Anti-Trust Law can, generally speaking, be certified as a class action. Based on these legal grounds, in 2014 an action against the investors, and a request to certify it as a class action, were filed with the District Court in Tel-Aviv. In his action the Claimant argues, inter alia, that the investors are using their position as monopoly holders to abuse the market, by setting an unfair price per gas unit (and that he argues is a breach of Anti-Trust Law). He argues that the fair price per gas unit is only 2.34 USD – less than half of the contractual price which was set at 5.042 USD. The Claimant therefore argues that the investors should be ordered to pay the members of the group (the Israeli energy consumers) the difference between the contractual price and a fair price. In essence, this means paying hundreds of millions of dollars back to the Israeli consumers.

3. In 2015, while the class action was still pending, the Israeli government adopted a national plan whose goal is to regulate the Israeli gas market. This Plan (also called the Gas Plan) was the work product of a professional committee appointed by the Government in order to examine the Israeli gas market and suggest ways to regulate it. The Plan consists of several chapters which aim to regulate different aspects of the gas market, among them pricing. However the Pricing chapter excludes contracts concluded prior to the adoption of the Plan by the Government, therefore the contract to which class action refers is excluded from the Plan and is not regulated by it.

4. Following the adoption of the Gas Plan by the Israeli government, a petition was filed with the Supreme Court asking it to declare that the Plan is illegal. Following the petition and in order to make sure that the Plan would be upheld, certain amendments were made to it.

5. In their motion to set aside the class action, the investors argued that the Supreme Court had already discussed and ruled on the issues raised by the Claimant in his class action. They argued that the Claimant is stopped from raising those issues again, given that they were already discussed and decided upon by the Supreme Court in its judgment on the petition to declare the Plan as illegal.

C. The Decision to Dismiss the Appeal

In its judgment the Supreme Court decided to dismiss the appeal, and allow the District Court to proceed with the hearings of the certification stage.¹⁾ The Supreme Court stated that this is an exceptional class action in light of the extremely wide scope of the remedies sought, the deep involvement of the Israeli regulator, and the substantial implications it entails on the parties involved. In fact, the Supreme Court stated that it is very rare (if ever) that class actions with such characteristics and potential impact on the market are tried before the courts.

The Court further mentioned that the Plan does not cover contracts, if they were concluded before the Plan came into force, therefore the investors cannot rely on it. The Court further found that both the petition to declare the Plan as illegal and the class action do indeed share many common aspects. However, it found that the main question which arises from the class action is whether the gas price is excessive and amounts to an abuse of the market or not. It found that this was not the question discussed in the Petition, which was an administrative procedure aimed at examining the legality of the Plan. The Court mentioned that issues related to pricing were not discussed in the Supreme Court's decision on the Petition, and indicated that in the petition the Supreme Court

specifically stated that issues related to pricing are essentially economic in nature, and as such the professional governmental and regulatory bodies – and not the court – are better placed to examine and decide on them. It noted that the court will refrain from intervening in such matters and will do so only in rare cases where a decision made by a professional body is clearly unreasonable (or illegal).

D. The Potential Implications on Investors

The first thing that comes to mind is that though investors tend to believe that the main risks for their investments derive from governmental actions, this may not be true anymore.

Secondly, and following the first conclusion, it can be argued that investment treaties may not be able to protect such investments.

The third point is related to the second one. However, one point should be noted before discussing it. Part 6 of the Plan deals with the regulatory environment in Israel. It is entitled “maintaining a stable regulatory environment”. In short, in this section the Government of Israel states that it is aware that the development of gas fields is a unique investment due to the fact that it requires the investor to invest huge amounts of money which are far greater than those needed in other types of investments. It further states that the Government is aware that a stable regulatory environment is required in order to encourage foreign investments. The chapter then goes on to say, inter alia, that for a duration of 10 years the Government will not initiate any regulatory changes related to the public’s share in profits derived from the gas fields. Further, the Plan states that the Government will oppose any such initiative, if brought to the Israeli Parliament by one of its members.

This section was one of the most controversial parts of the Plan. It caused a major public debate and outrage because, in fact, this sections mean that the government is chained and cannot use its prerogative and duty to manage the country. Part 6 was discussed by the Supreme Court during the Petition hearings and was indeed amended following it.

Many important facts which are relevant to our discussion are not publicly available (and the Supreme Court noted that even the contracts were not presented in full). However, the relevant BIT seems to be the Israel-Cyprus BIT. Article 8 provides that disputes which arise between an investor of one Contracting Party and the other Contracting Party can be submitted by the investor, inter alia, to the Center for the Settlement of Investment Disputes.

As stated above, the Attorney General was a party to the appeal. His opinion, as submitted to the Supreme Court, was that the class action should indeed be set aside. In other words, the Attorney General took the side of the investors, rather than of the public (which was represented by the Claimant in the class action). In this regard it would be worth considering what would have been the position (from an investment treaty perspective) if the Attorney General were to take a different approach, namely one which sided with the Claimant rather than with the investors.

Would that be grounds for the investors to initiate arbitration proceedings? Would it be reasonable to argue that by taking such an approach the Israeli Government had breached its obligations under the Plan? Would it be reasonable to argue that by doing so the Israeli government had breached its obligation under Article 2 to “encourage and create favorable conditions for investments”? For now this is only a hypothetical question. However, the *Nobel Energy* case clearly demonstrates that new substantial risks can emerge and that this is something that should be considered by investors.

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References

In some common law jurisdictions where class-action are permitted, class-action proceedings are divided into two stages. During the first one, the certification stage, the court hears evidence in order to decide whether the action before it can and should be tried as a class-actions. In many cases this stage, although only a preliminary one, is crucial and in fact determines the outcome of the action.

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