



Yale Law School

August 17, 2010

W. MICHAEL REISMAN
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Professor of International Law

Noble Energy, Inc.
Attention: Mr. David Shelfer
(DShelfer@nobleenergyinc.com)

Re: International Legal Rights of Noble Energy, Inc.

Dear Mr. Shelfer:

You have invited me to study and express an opinion on the international legal rights of Noble Energy, Inc.¹ *vis-à-vis* the Government of Israel. Noble Energy, a U.S. national, through wholly-owned entities,² holds rights in the Tamar lease as well as other permits and rights in Israel. As such, Noble Energy is an investor with an investment in Israel. Until now, Israel has honored its obligations under the arrangements it put in place from the inception of the investment. But now that Noble Energy has discovered substantial exploitable deposits, there have been intimations of a possible unilateral initiative on the part of the Israeli Government to increase its receipts from Noble Energy's operations (whether by escalating the royalty rate set in Israel's Petroleum Law or by escalating the tax rate to which Noble has hitherto been subject); such a move would perforce decrease the receipts which Noble Energy had expected in reliance on Israeli law. In light of this possibility, Noble Energy wishes to understand the scope of its rights under international law.

By way of introduction, I am the Myres S. McDougal Professor of International Law at Yale Law School, where I have been on the faculty since 1965. I have published twenty-one books in my field, six of which focus specifically on international arbitration and adjudication; a seventh, which I edited, focuses on jurisdiction in international law. In addition to my teaching and scholarship, I have served as Editor-in-Chief of the *American Journal of International Law* and Vice-President of the American Society of International Law. I have also been elected to the *Institut de Droit International*. I serve as President of the Arbitral Tribunal of the Bank for International Settlements, have served as an arbitrator in numerous international commercial and public international arbitrations, as counsel in other arbitrations, as well as in cases before the International Court of Justice ("ICJ"), and as an expert witness on diverse matters of international law. With particular reference to investment law, I have served as arbitrator in two NAFTA arbitrations, in five ICSID arbitrations and in one non-supervised investment arbitration.

Noble Energy, as a United States national, is a foreign investor in Israel; as such, it benefits from conventional and customary international law. Under conventional international

¹ Hereinafter "Noble Energy."

² Noble Energy Mediterranean Ltd.(Cayman), is a wholly owned subsidiary of Noble Energy International Ltd. (Cayman Islands) which is a wholly owned subsidiary of Samedan of North Africa, Inc. (Delaware) which is wholly owned by Noble Energy, Inc., a Delaware company.

law, Noble Energy benefits from the protections afforded to United States nationals by any treaties between Israel and the United States, whether directly under those treaties themselves or, by operation of a “most favored nation” clause, through treaties which Israel has concluded with other states. Specifically, Noble Energy benefits from the Israel-United States Friendship, Commerce and Navigation Treaty (“FCN Treaty”), which was signed in 1951, entered into force in 1954 and thus has been in force throughout Noble Energy’s investment.³ As will be seen, the treaty imposes full international legal responsibility on Israel with respect to the matters under consideration. Noble Energy also benefits from the protections afforded to foreign investors by customary international law.

The most general international principle in this area of the law is set out in the American Law Institute’s *Third Restatement of the Foreign Relations Law of the United States*:

A state is responsible under international law for injury to a national of another state caused by official act or omission that violates . . .

(c) a right to property or another economic interest that, under international law, a state is obligated to respect for persons, natural or juridical, of foreign nationality .
..⁴

The FCN Treaty, as will be seen, is in large part an elaboration of that foundational principle.

Article I of the FCN Treaty provides that “[e]ach Party shall at all times accord equitable treatment to the persons, property, enterprises and other interests of nationals and companies of the other Party.” Article III(1) provides that “[n]ationals of either Party within the territories of the other Party shall be free from unlawful molestations of every kind, and shall receive the most constant protection and security, in no case less than that required by international law.”⁵ Article VI(1) provides that “[p]roperty of nationals and companies of either Party shall receive the most constant protection and security within the territories of the other Party.” Article VI(3) goes on to state:

Property of nationals and companies of either Party shall not be taken except for public purposes, nor shall it be taken without the payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the equivalent of the property taken; and adequate provision shall have been made at or prior to the time of taking for the determination and prompt payment thereof.

Article VI(4) provides:

³ Treaty of Friendship, Commerce, and Navigation, U.S.-Isr., Apr. 3, 1954, T.I.A.S. 2948, 219 U.N.T.S. 237.

⁴ Restatement (Third) of Foreign Relations Law of the United States, Vol. 2, § 711 (1987).

⁵ Although Article III(2) focuses on criminal law matters, doctrinal writers have extended it: “Caselaw supports the view that the usual formula of “full protection and security” also provides protection against infringements of the investor’s rights.” RUDOLF DOLZER & CHRISTOF SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 151 (2008).

Neither 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 in the enterprises which they have established or in the capital, skills, arts or technology which they have supplied; nor shall either Party unreasonably impede nationals and companies of the other Party from obtaining on equitable terms the capital, skills, arts and technology it needs for its economic development.

Of particular importance is Article VI(5) which provides:

Nationals and companies of either Party shall in no case be accorded, within the territories of the other Party, less than national treatment and most-favored-nation treatment with respect to the matters set forth in paragraphs 2 and 3 of the present Article. Moreover, enterprises in which nationals and companies of either Party have a controlling interest shall be accorded, within the territories of the other Party, not less than national treatment and most-favored-nation treatment in all matters relating to the taking of privately owned enterprises into public ownership and to the placing of such enterprises under public control.

By virtue of Article VI(5), Noble Energy is entitled to the best of the treaty protections Israel owes to the nationals of any third state with respect to its commitment in Article VI(3). Article XXII(2) explains:

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.

Since Israel has concluded bilateral investment treaties with 13 states,⁶ Noble is entitled to treatment no less favorable than the best of those treaty commitments with respect to expropriation.

Neither the FCN Treaty nor customary international law precludes the Israeli government from legislating, in a non-discriminatory fashion, a different petroleum regime for future American investors. But, in the FCN treaty, Israel has committed itself not to use its legislative power to change the terms of investment which it set for an existing American investor. In this case, Noble Energy's investment was based on the legal regime which obtained at the time of its investment and Israel may not unilaterally change it.

Article VI(3) of the FCN Treaty incorporates a central principle in international law: the property of an alien cannot be taken, whether for public purposes or not, without prompt payment of compensation. The tribunal in *Metalclad v. Mexico* explained that expropriation, in

⁶ Israel has concluded bilateral investment treaties with Argentina, Canada, China, Romania, France, Germany, Poland, Egypt, Bulgaria, the Czech Republic, Turkey, Jordan, and Mexico. It has also signed free trade agreements with the European Union and Mercosur.

its contemporary acceptance, consists of “not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also 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 or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”⁷

The point of emphasis is that in international law, an expropriation need not involve a physical taking of property; expropriation may be either direct or indirect.⁸ Indeed, Israeli bilateral investment treaties with other states acknowledge that “measures having effect equivalent to nationalization or expropriation” fall within the definition of expropriation,⁹ that clarification enures to the benefit of Noble Energy, thanks to the most favored nation clause in the FCN treaty. Were Israel to act to increase Noble Energy’s current royalty rate as set out in the Petroleum Law,¹⁰ such action would effectively expropriate Noble Energy’s rights which are protected by both the FCN treaty and customary international law.

Could Israel, were it so inclined, eschew expropriation yet try to achieve the same consequence by escalating Noble Energy’s tax rate beyond what it was prior to its discovery of hydro-carbons? The commentary to the American Law Institute’s *Restatement Third of Foreign Relations Law of the United States* distinguishes between an indirect expropriation and valid government regulation:

A State is responsible as for an expropriation of property ... when it subjects alien property to *taxation*, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien’s property ...¹¹

“Excessive or arbitrary taxation” is therefore one type of indirect expropriation¹² and some tribunals have found taxation on investments to constitute an unlawful taking.¹³ Thus, a tribunal held that issues of indirect expropriation would be raised “if a tax law is extraordinary, punitive

⁷ See *Metalclad Corporation v. Mexico*, Award, ICSID Case No. ARB(AF)/97/1, at 103 (2000), available at <http://ita.law.uvic.ca/documents/MetalcladAward-English.pdf>. See also *id.* at paras.89, 99.

⁸ See W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 74 BYBIL 115 (2004).

⁹ See, e.g., Agreement between the Government of the People’s Republic of China and the Government of the State of Israel for the Promotion and Reciprocal Protection of Investments, art. 5(1), Apr. 10, 1995. (Insofar as any of the expropriation provisions in the BITs or other treaties which Israel has concluded with other states provide more favorable treatment to their nationals, a United States national is entitled to invoke their benefits by operation of the most favored nation provision in the FCN treaty.)

¹⁰ Under Article 4 of the 1952 Israeli Petroleum Law, a lessee is liable for a royalty of one-eighth (12.5 %) of the quantity of petroleum produced and saved from the lease area.

¹¹ *Restatement (Third)*, *supra* note 2, at § 712. Emphasis added.

¹² OECD Draft Convention on the Protection of Foreign Property, 12 October 1967, 7 I.L.M. 117, 126 (1968).

¹³ See, e.g., *In the Matter of Revere Copper and Brass Inc v. Overseas Private Investment Corporation*, Award, 56 ILR 258 (1978).

in amount or arbitrary in its incidence.”¹⁴ A number of other tribunals have developed similar tests to determine whether taxation constitutes expropriation.¹⁵ In *Feldman v. Mexico*, a NAFTA tribunal suggested three criteria that should be used to test whether a tax regime constitutes expropriation: 1) the existence of an acquired right; 2) a restriction that is “sufficiently restrictive”; and 3) a finding that the relevant authorities behaved in a “discriminatory or arbitrary” manner.¹⁶ The *Feldman* award also held that a violation of a claimant’s “legitimate expectations” should weigh heavily in a finding of expropriation. Were Israel to unilaterally escalate the tax, no less than the royalty rate, it would constitute a violation of Noble Energy’s international legal rights. It would also constitute an abuse of law (*abus de droit*)¹⁷ in violation of the commitment in Article I of the FCN treaty to “accord equitable treatment ... to enterprises and other interests of nationals and companies of the other party.”

Article I of the FCN treaty obliges Israel to accord “equitable treatment.” “Fair and equitable treatment” is an even broader standard than international law’s “minimum standard.” In the *Alex Genin* case, the tribunal explained:

Acts that would violate this *minimum standard* would include acts showing a willful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.¹⁸

One of the purposes of the fair and equitable treatment standard is to “prevent discrimination against its beneficiary, where discrimination would amount to unfairness or inequity in the circumstances.”¹⁹ But the protections under the fair and equitable treatment standard go beyond this to include due process, good faith, and the protection of the investor’s expectations. In short, the host state has an obligation, under international law, to fulfill assurances and representations made at the time the investment was acquired. A unilateral escalation by Israel of Noble Energy’s royalty or tax obligations to capture more revenue would violate representations made by Israel which were reasonably relied upon by Noble Energy at the time its investment was made and would plainly not qualify as an action taken in good faith. Such actions would also constitute a violation of Noble Energy’s due process rights.

¹⁴ *EnCana Corporation v. Republic of Ecuador*, LCIA UN3481, Award of 3 February 2006, *available at* http://www.investmentclaims.com/decisions/EnCana_Ecuador_Award.pdf.

¹⁵ *See, e.g., Goetz (Antoine) and Others v. Republic of Burundi*, Award, ICSID Case No. Arb/95/3, at paras 102, 124 (1999), *available at* <http://ita.law.uvic.ca/documents/Goetz-Award.pdf>. *See also Link-Trading v. Moldova*, Final Award, UNCITRAL Arbitration Rules (2002), *available at* <http://ita.law.uvic.ca/documents/Link-Trading-Moldova.pdf>.

¹⁶ *Feldman v. Mexico*, Award, ICSID Case No. Arb(AF)/99/1, at paras. 99, 141 (2002), *available at* http://ita.law.uvic.ca/documents/feldman_mexico-award-english.pdf.

¹⁷ *See Saipem SpA v Bangladesh*, Award, ICSID Case No ARB/05/7 (2009), *available at* http://ita.law.uvic.ca/documents/SaipemBangladeshAwardJune3009_000.pdf.

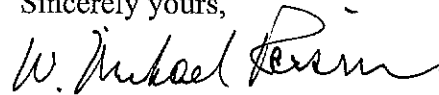
¹⁸ *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil Genin v. Republic of Estonia*, Award, ICSID Case No. ARB/99/2 (2001) [*rectification denied*], *available at* www.worldbank.org/icsid/cases/genin.pdf. (emphasis supplied)

¹⁹ U.N. Conference On Trade & Development: Fair And Equitable Treatment, Vol. III at 10, 15, U.N. Doc. UNCTAD/ITE/IIT/II, U.N. Sales No. E.99.11.D.15 (1999) (English version).

The FCN Treaty does not ignore the special responsibilities incumbent on governments. Thus Article XXI(1)(3) provides in relevant part that “[t]he present Treaty shall not preclude the application of measures . . . necessary to protect its essential security interests” Clearly, a government’s desire to take “more” than it is entitled to under international law would not constitute the protection of its essential security interests.

For the above reasons, measures by Israel to increase the royalty or tax burden of Noble Energy beyond that which was established at the inception of the investment and thus shaped Noble Energy’s reasonable expectation of profits would constitute a violation of Noble Energy’s international legal rights. A failure to assert its rights, no less than a failure on the part of the United States to use its good offices to insist upon Israeli compliance with the FCN treaty, would not only sacrifice Noble Energy’s own rights, but could lead to a general weakening of the rights of all American investors, now and in the future, who depend upon that treaty.

Sincerely yours,

A handwritten signature in black ink, appearing to read "W. Michael Reisman". The signature is fluid and cursive, with a large, stylized "R" at the end.

W. Michael Reisman