



# ICLG

The International Comparative Legal Guide to:

## **Project Finance 2012**

A practical cross-border insight into project finance

Published by Global Legal Group, with contributions from:

Advokatfirmaet Thommessen AS

Ali Budiardjo, Nugroho, Reksodiputro

Amarchand & Mangaldas & Suresh A. Shroff & Co.

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Debarliev, Dameski & Kelesoska Attorneys at Law

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Koep & Partners

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SJ Berwin LLP

Souza, Cescon, Barriau & Flesch – Advogados

Yigal Aron & Co.

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#### Group Publisher

Richard Firth

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Global Legal Group Ltd.  
59 Tanner Street  
London SE1 3PL, UK  
Tel: +44 20 7367 0720  
Fax: +44 20 7407 5255  
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## EDITORIAL

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Welcome to the first edition of *The International Comparative Legal Guide to: Project Finance*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of project finance.

It is divided into two main sections:

Three general chapters. These are designed to provide readers with a comprehensive overview of key issues affecting project finance, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in project finance laws and regulations in 39 jurisdictions.

All chapters are written by leading project finance lawyers and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor John Dewar of Milbank, Tweed, Hadley & McCloy LLP, for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

*The International Comparative Legal Guide* series is also available online at [www.iclg.co.uk](http://www.iclg.co.uk)

Alan Falach LL.M  
Managing Editor  
Global Legal Group  
[Alan.Falach@glgroup.co.uk](mailto:Alan.Falach@glgroup.co.uk)

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# Israel

Yigal Arnon & Co.

David Schapiro



Peter Sugarman



## 1 Overview

### 1.1 What are the main trends/significant developments in the project finance market in Israel?

The Israeli project finance market has existed for over ten years. 2011 saw the opening of the light rail in Jerusalem, Israel's capital, the tunnel underneath Mount Carmel in the Haifa area and the completion of "Road 431". It also saw the successful financing of numerous desalination, natural gas and electricity production projects. However, consistent with world markets, the project finance market in Israel has also seen the effects of the international credit crunch. For example, the concession to finance, plan, construct and operate "Road 531" was officially terminated in February 2010, in a settlement between the Finance Ministry and the project company. This project was scuttled as a result of the project company's failure to attain financial closing for a facility in the sum of NIS 1.8 billion.

In addition, 2010 saw the restructuring of the project to finance, plan, construct and operate the "Red-Line" of the Tel-Aviv Light Railway. Selected in 2006 after a long tender process, the concessionaire had still not reached financial closing, which was originally scheduled for 2008. The ministries responsible for the project elected to cancel the concession, with the responsibility for carrying out the project being handed over to the government-owned NTA – Metropolitan Mass Transit System Ltd. The NTA has commenced tendering portions of the project, and has recently published a tender for the design and construction of TBM tunnels for the Red Line and Green Line of the Tel-Aviv Light Railway, having abandoned the BOT structure.

The Ministry of Defence's recent private finance initiative was structured to avoid such pitfalls. The Ministry tendered a concession to finance, plan, construct, operate and maintain, over a 25-year term, what is known as the "Training Base City" in southern Israel. Bids (including engineering, operation, financial and teleprocessing proposals) were submitted in May 2011, following which two preferred bidders were selected for a "second stage" bidding process that was defined in advance in the tender documents. In this stage, spread over 180 days from the announcement of the two top bidders on July 28, 2011 (based on the combined scores of the engineering, financial, operation and teleprocessing proposals), the two bidders were effectively required to finalise the full set of financing documents (organising a consortium of banks and institutional lenders to underwrite at least 75% of the senior debt required for the project), as well as the project agreements (EPC, O&M and other material contracts), prior to submission of a revised financial bid at the end of the 180-day

period. Following the 180-day submission (within two days!), the tender committee chose one preferred bidder, although the two preferred bidders were both successful in finalising financing and project agreements. The government has committed to defray the costs of the second place bidder (and its consortium of lenders) who was not chosen as the preferred bidder in the preparation of its updated bid, in the amount of up to NIS 6,000,000 (contingent upon showing expenses for at least this amount).

Additionally, in recent years, Israel's shortage of potable water and water for irrigation has brought about several desalination projects of varying scales:

- A build-operate-transfer (BOT) tender to build and operate the Sorek desalination plant which, with a total planned capacity of 150 million m<sup>3</sup>/year, will be the largest plant of its kind in the world. The winning bidder, Sorek Desalination Ltd., entered into agreements with the European Investment Bank (EIB), Bank Hapoalim and Bank Leumi, to obtain \$400 million in financing to construct and operate the plant.
- A BOT tender to design, build and operate the Ashdod desalination plant, with a total planned capacity of 100 million m<sup>3</sup>/year, over a total period of 26.5 years. Project funding is being provided jointly by Hapoalim Bank and the European Investment Bank (EIB). It is worth noting that the major stakeholder in the concessionaire is a subsidiary of the State-owned national water company, Mekorot.
- A NIS 400 million financing by Bank Hapoalim for the expansion of the Palmachim desalination plant, owned and operated by Granite Hacarmel (part of the Azrieli Group), effectively doubling the plant's current capacity.

The high-profile discoveries of several large gas fields in the Mediterranean Sea, off the coast of Israel, have led to a need for capital to explore, develop and exploit these gas fields. The Tamar field could contain up to 207 billion cubic metres (BCM) of natural gas, and Leviathan gas field has been estimated as containing up to 450 BCM of natural gas. Houston-based Noble Energy, Inc. (which has partnered with Delek Drilling in operating the Tamar and Leviathan fields) has stated that Leviathan "is easily the largest exploration discovery in our history". The Tamar project has already solicited significant financing. For example, in June 2010, Barclays and HSBC signed a \$500 million facility with Delek Drilling, Avner Oil Exploration and Dor Gas Exploration, in order to provide bridge financing for the Tamar project. In December, 2011, HSBC agreed to provide Delek Drilling and Avner with a \$200 million loan to Develop the Tamar and Leviathan projects. In February 2012, the Petroleum Council at the Israeli Ministry of Energy and Water Resources approved Delek Drilling's request to use the Leviathan gas field as collateral, in order to secure financing for the development of the Tamar field from a foreign bank.

The electricity sector was well-represented in recent projects. The

State of Israel is conducting a solar-thermal and photo-voltaic (PV) BOT tender process; an international, innovative, first-of-its-kind project composed of three separate tenders – two tenders for the implementation of two solar-thermal power plants with an aggregate capacity of 220 MW, and one tender for a photo voltaic power plant with a capacity of 15-30 MW – all three at the Ashalim site in Israel's Negev region. Bids were submitted in 2011, and a winning bid (Ashalim Sun PV Ltd.) was recently declared in the PV tender. Additionally, in January 2011, the OPC group reached a financial closing with Bank Leumi to fund 80% of the cost of a project to build and operate Israel's first independent power plant, with an expected output of 440MW. The cost of the project is estimated at NIS 2 billion. The power plant will be fueled by natural gas. Other projects for private power plants based on PV, gas turbine and pumped storage technology are currently underway in various stages of development.

Some transactions have involved projects in the operations stage. Derech Eretz Highways (1997) Ltd. is the concessionaire for the road known as the Trans-Israel Highway or Route 6, Israel's first toll road, and the first infrastructure project in Israel built using a BOT structure. Route 6 began operating in 2002. In September 2011, Shikun & Binui Ltd. entered into an agreement with Shikun & Binui's partner in Derech Eretz, T.S.I. Roads Limited Partnership, an entity comprised of various Israeli institutional investors and managed by the Israel Infrastructure Fund (IIF), to sell the rights of Shikun & Binui in Derech Eretz and the shareholder's loan that it put at the disposal of Derech Eretz, for the sum of NIS 773 million. This transaction followed IIF's previous transactions during 2010, involving the transfer and re-structuring of the holdings in Derech Eretz which saw T.S.I. Roads acquire half of Derech Eretz via the acquisition of Africa Israel Investments Ltd.'s entire holdings in Derech Eretz, as well as half of Aecon Group's entire holdings (the other half of these holdings were acquired by Shikun & Binui) in Derech Eretz, in what represented the first transfer of ownership stakes in an Israeli BOT project during the operating phase.

Israel's Ministry of Transportation is currently involved in the origination and supervision of several major transportation projects:

- Supervising the operation of Line 1 (the Red Line) of the Jerusalem Light Rail by CityPass, the consortium that was awarded a 30-year concession to build and operate the line. Full operation of Line 1 commenced on December 1, 2011.
- Supervising the construction and eventual operation of the "Metronit" Bus Rapid Transit (BRT) system in Haifa, by city-owned Yaffe Nof. In 2010, the Dan group was awarded the tender to operate the Metronit for a period of twelve years.
- A number of large projects aimed at privatising bus-lines through competitive processes and ending the monopoly previously held by the Egged and Dan cooperatives.

## 1.2 What are the most significant project financings that have taken place in Israel in recent years?

Please see question 1.1.

## 2 Security

### 2.1 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security interests over several assets can be created by a single

document specifying all these assets. However, a mortgage over immovable properties must be created by a separate document, which does not cover other types of assets. A pledge is created by an agreement between the debtor and the creditor. If the asset is immovable property, the agreement (mortgage) must be in writing. A pledge over an asset of a company must also be evidenced in writing. This also applies to a floating charge, which companies can grant over all or part of their assets. A floating charge is governed by the Companies Ordinance (New Version) - 1983. A company whose assets are subject to a floating charge can sell and buy assets and enter into transactions in the ordinary course of business. If certain events occur (as specified in the debenture creating the floating charge), the floating charge crystallises and becomes a pledge (fixed charge). A floating charge ranks lower in priority to a fixed pledge.

### 2.2 Can security to be taken over real property (land), plant, machinery and equipment (e.g. pipeline, whether underground or overground)? Briefly, what is the procedure?

The most common form of security interest over immovable property (such property including fixtures – e.g., buildings and tangible property affixed to the land) is a mortgage (*mashkanta*). A mortgage can be granted over real estate that is registered with the Land Registry. If the property is not yet registered, a security interest can be granted over it by way of a pledge. The mortgage and the pledge are similar in most of their legal characteristics. The main difference between them relates to their registration procedures. Note also that 93% of the land in Israel is either property of the State, the Jewish National Fund or the Development Authority, and is managed by the Israel Land Administration. "Ownership" with regard to such land means leasing rights from the Israel Land Administration for 49 or 98 years, and a "mortgage" over such land implies a security interest over the leasing rights.

The most common form of security interest over movable property is a pledge (*mashkon*). In Israel, a pledge is also often referred to as a fixed charge (*shiabud*). Pledges are mainly governed by the Pledge Law – 1967, which defines a pledge as a charge over an asset to secure repayment of a debt. A pledge entitles the lender to be repaid out of the proceeds of the sale of the asset if the debt is not repaid. Movable property includes plant equipment, machinery and trading stock.

A pledge is created by an agreement between the debtor and the creditor. A mortgage agreement must be in writing. A pledge over an asset of a company or a floating charge must also be evidenced in writing.

Perfection of a security interest refers to making the security interest effective against third parties. Perfection, or any faults in it, does not affect the relationship between the debtor and the secured creditor. A security interest that is not duly perfected is not effective against other creditors of the pledgor, except for those creditors who knew or should have known about the creation of the security interest. In particular, a security interest which was not duly perfected is ineffective and will be deemed invalid by a liquidator or insolvency administrator of the pledgor.

The primary perfection method is registration with the relevant registrar:

- Security interests over assets of companies are registered with the Registrar of Companies under the Companies Ordinance. Documents must be filed within 21 days of execution of the pledge document/debenture. If filed within this period, the security interest is retrospectively valid against third parties from the date it is created. This also applies to floating charges.

- Security interests over assets of individuals, partnerships and companies incorporated outside Israel are registered with the Registrar of Pledges, at any time following creation of the security interest, and are valid against third parties from the date of registration.
- Perfection of security interests over certain types of assets requires additional registration. For example:
  - a mortgage over immovable property must be registered with the Land Registry;
  - a security interest over vessels must be registered with the Vessels Registry;
  - a security interest over a patent must be registered with the Patent Registry; and
  - a right or interest in a licence or lease granted under the Petroleum Law, or any charge on such a right or interest, must be registered with the Petroleum Registry, in accordance with the Israeli Petroleum Regulations - 1953 (the "Petroleum Regulations").

Pursuant to the Israel Lands Law – 1969, ownership rights in land include ownership of surface-level land, subsurface land, and ownership of the aerial space which extends above the land. Ownership rights in land also includes anything built or planted on the owned land and objects which are permanently attached to the land, apart from objects which can be dismantled. As such, by default, underground pipelines and above-ground pipelines that are permanently attached to the land cannot be pledged independently; rather, in order to secure such pipelines, the land on which they are found must be mortgaged. However, under the Natural Gas Sector Law – 2002, in spite of the Israel Lands Law, ownership rights in "gas installations", including pipelines, buildings, machinery and equipment, that are lawfully constructed on land that is the property of a third party, belong to the person or corporation that lawfully constructed the "gas installations". As such, pipelines installed in such a scenario could be individually pledged. At the same time, ownership rights in a "transmission system" that was lawfully constructed belong to the State, even if the transmission system was constructed by someone other than the State. The State, however, with ministerial approval, may transfer to others ownership and other property rights, either partially or wholly, in the "transmission system".

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**2.3 Can security be taken over receivables where the chargor is free to collect in the receivables in the absence of a default and the debtors are not notified of the security? Briefly, what is the procedure?**

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Please see the discussion of floating charges in questions 2.1 and 2.2. Under a floating charge, the chargor is free to collect in the receivables in the absence of a default. Debtors need not be notified; however, in order to perfect the security (and to make it effective against the other debtors), the floating charge must be duly registered (as discussed above).

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**2.4 Can security be taken over cash deposited in bank accounts? Briefly, what is the procedure?**

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Please see the discussion of floating pledges in questions 2.1-2.3. Cash deposited in a bank account can be secured through a floating pledge. In practice, Israeli creditors secure cash deposited in bank accounts through fixed charges as well. There is, however, a risk that even if the parties classify the security interest as a fixed charge and register it as such, it will be re-classified by the court as a floating pledge. This can be crucial, since a floating pledge ranks lower in priority to a fixed charge. There is no case law that clearly

eliminates this risk of reclassification. According to most legal scholars, a fixed charge over fungible assets is valid and should not be reclassified as a floating pledge, if the pool of assets is properly identified and the creditor has a high degree of control over the movements of assets into and outside the pool. Such a degree of control can be established through a well-drafted accounts agreement.

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**2.5 Can security be taken over shares in companies incorporated in Israel? Are the shares in certificated form? Briefly, what is the procedure?**

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Shares in companies incorporated in Israel can be secured through fixed charges, and if the shareholder is an Israeli company, could be covered under a floating charge (see questions 2.1 and 2.2). A shareholder in a company incorporated in Israel is entitled to receive a share certificate, although the company's share register is the definitive record of ownership. A share certificate is not necessary in order to secure shares through a fixed charge. The pledge of shares is created by the conclusion of a pledge agreement and is perfected by the registration of the pledge.

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**2.6 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets (in particular, shares, real estate, receivables and chattels)?**

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Stamp duty no longer applies in Israel and there are no fees associated with the creation of security interests. Registering a security interest triggers some insubstantial registration fees.

Enforcing a security interest, either through the Execution Office or the court, triggers certain mandatory fees. Some of the fees are fixed (relatively low) amounts, and others are calculated as a percentage of the amount of the debt, and can therefore be significant. If a receiver is appointed, the enforcement costs include the professional fees payable to the receiver. These fees are typically calculated as a percentage of the debt to be collected, or actually collected.

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**2.7 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?**

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The Companies Registrar will only allow the filing of security agreements if they are drafted in the Hebrew language. As a result, if a security agreement is drafted in English, it will need to be translated into Hebrew prior to filing, involving some time and expense. Otherwise, the filing, notification or registration requirements in relation to security over different types of assets do not involve significant amount of time or expense.

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**2.8 Are any regulatory or similar consents required with respect to the creation of security over real property (land), plant, machinery and equipment (e.g. pipeline, whether underground or overground) etc.?**

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Requirements for such regulatory consents vary based on the location and nature of the project and the assets.

For example, encumbering gas installations belonging to a licensee or required assets set forth a licence under the Natural Gas Sector Law – 2002 (see question 7.3) requires the prior written consent of the Director of the Natural Gas Authority. A licence under the

Electricity Law (see question 7.1) may not be encumbered without the prior written consent of the Minister of Energy and Water Resources. Lastly, concession agreements generally require consent by the relevant governmental entity prior to the encumbrance of any project assets, and sometimes go so far as to expressly prohibit the encumbrance of sensitive project assets.

### 3 Security Trustee

#### 3.1 Regardless of whether Israel recognises the concept of a “trust”, will it recognise the role of a security trustee or agent and allow the security trustee or agent (rather than each lender acting separately) to enforce the security and to apply the proceeds from the security to the claims of all the lenders?

The concept of a security trustee is well established in Israel. In transactions where there are several lenders, the security interests are often granted to a trustee and registered in its name, on behalf of the lenders. If the debtor defaults under the terms of the security agreement, the trustee realises the security interest and the proceeds are payable to the lenders.

#### 3.2 If a security trust is not recognised in Israel, is an alternative mechanism available (such as a parallel debt or joint and several creditor status) to achieve the effect referred to above which would allow one party (either the security trustee or the facility agent) to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Israel.

### 4 Enforcement of Security

#### 4.1 Are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or the availability of court blocking procedures to other creditors/the company (or its trustee in bankruptcy/liquidator), or (b) (in respect of regulated assets) regulatory consents?

The timing and restrictions that will apply to enforcement of remedies can vary greatly, depending on the type of collateral and the existence of other enforcement measures already underway.

The realisation of a security interest must be implemented under a court order or an order of the Enforcement Authority. The main realisation method is a public sale of the secured asset, but the Court or the Enforcement Authority can direct (often at the creditor’s request) that an alternative method is more efficient and fair in the circumstances.

Specific categories of lenders listed in the Pledge Law can realise security interests autonomously - see question 5.4.

When a liquidation or insolvency order is issued or a temporary liquidator is appointed, proceedings against the company (including proceedings to enforce security interests) may be stayed by the court. Similarly, when a moratorium order is issued under Section 350 of the Companies Law, no proceedings against the company, including by creditors seeking to realise their collateral, can be commenced or continued without permission of the court, and are also subject to conditions set by the court.

Proceedings under Section 350 are the Israeli company rescue

proceedings. Under the Section 350 procedure, the court appoints a trustee at the same time as it issues the moratorium order. The trustee, for a limited time, is authorised to operate the company’s business and to try to reach arrangements with its creditors, under the court’s supervision. At the end of the rescue proceedings, the company either returns to solvency or moves to liquidation proceedings, in which its assets are realised and the proceeds are distributed among the creditors in order of priority.

Depending on the type of asset, regulatory consents may be necessary. For example, as stated above, the transfer of a licence or lease under the Petroleum Law brought about by the realisation of a pledge thereon must be approved by the Petroleum Commissioner.

Also, in BOT projects, it is unlikely that the lenders would be allowed to utilise these types of enforcement proceedings. Concession agreements provide other mechanisms for lender protection in default scenarios (such as step-in, assumption, repayment, etc.).

#### 4.2 Do restrictions apply to foreign investors or creditors in the event of foreclosure on the project and related companies?

Typically not. As noted above, BOT concessions generally limit the available scope of enforcement proceedings. In the event of a step-in or assumption of obligations, any concession requirements regarding the nationality of the project company will apply to the succeeding entity.

### 5 Bankruptcy Proceedings

#### 5.1 How does a bankruptcy proceeding in respect of the project company affect the ability of a project lender to enforce its rights as a secured party over the security?

See question 4.1 above.

#### 5.2 Are there any preference periods, clawback rights or other preferential creditors’ rights (e.g., tax debts, employees’ claims) with respect to the security?

The order of priority among secured creditors on the insolvency of a company is as follows:

- Liquidation and/or receivership costs. First priority tax charges. Under the tax legislation, tax authorities have first priority charges over certain assets to secure the collection of certain tax debts, mainly related to real estate transactions.
- Possessory liens. Certain creditors can retain possession of an asset given to it in the course of its business until the owner of the asset has paid the debt. For example, a garage can retain possession of a vehicle it has repaired, pending payment of the repair fees. The Supreme Court has held that such statutory liens, which secure payment of repair or other fees payable in connection with the maintenance and improvement of assets, rank higher in order of priority than pledges over that asset.
- Duly perfected security interests (pledges and mortgages). If there are two (or more) duly perfected security interests over the same asset, the first in time has higher priority, unless the relevant secured creditors agree otherwise between them. If the required formalities to perfect the security interest have not been complied with, the creditor is considered an unsecured creditor and is treated accordingly.
- Statutory preference creditors. These include the following:

- employees, with respect to unpaid wages up to a certain amount;
  - tax authorities, with respect to tax debts (other than those mentioned in the second bullet point above) due in the one-year period before the start of insolvency proceedings; and
  - landlords, with respect to certain rent payments.
- Floating charge creditors. If the floating charge crystallises and becomes a fixed charge before the commencement of insolvency proceedings, the creditor is considered a fixed charge creditor and is treated accordingly. If there is a negative pledge covenant in the floating charge debenture, the floating charge creditor ranks above other pledge creditors that are later in time, except for a creditor who holds security over an asset that it lent cash to acquire.

Note also that security interests (as well as other transactions) that were granted during the three-month period before the start of insolvency proceedings of the debtor can be nullified if two conditions are met: a) at the time of grant of the security interest, the debtor was insolvent (that is, was not able to repay its debts); and b) the security interest was granted to give priority to a certain creditor, or as a result of unlawful pressure by the creditor, or anyone on its behalf.

### 5.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Bankruptcy (insolvency) proceedings may not be initiated against local authorities or against statutory corporations (such as the Israel Airports Authority). These bodies have independent legal status but are really branches of the government.

### 5.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of the project company in an enforcement?

Specific categories of lenders listed in the Pledge Law can realise security interests autonomously (without a judicial order), if the security interests were granted in their favour over assets (including securities) actually deposited with them. In this case, realisation must be by selling the secured assets in a commercially reasonable manner on the market on which the assets are traded (to the extent applicable). The list of categories of lenders includes certain Israeli institutional lenders (banks, insurance companies and so on), but not non-Israeli institutional lenders.

## 6 Foreign Investment and Ownership Restrictions

### 6.1 Are there any restrictions, controls, fees and/or taxes on foreign ownership of a project company?

Tender documents will generally govern the ownership structure of project companies. For example, most recently, the “Training-Base City” tender (see question 1.1) required that Israeli shareholders maintain at least 33% of the means of control of the project company. Some tenders (such as the recent Tel Aviv Light Railway tender) actually require that a foreign entity maintain control over the project company!

The Minister of Energy and Water Resources may dictate that a company with certain electricity licences be controlled by Israeli shareholders.

There are no specific taxes on foreign ownership of a project company. The applicable taxation is a consequence of the structure chosen for the project company. Please see the discussion on taxation in question 7.6.

Additionally, please see the discussion regarding the Trading with the Enemy Ordinance in question 7.10.

### 6.2 Are there any bilateral investment treaties (or other international treaties) that would provide protection from such restrictions?

Israeli is party to Bilateral Investment Treaties (BITs) with a number of countries. Israel negotiates BITs based on a model text from 2003. Pursuant to the model BIT, foreign investors may submit disputes with the State of Israel to a competent court of the State of Israel or to binding arbitration under ICSID (International Center for the Settlement of Investment Disputes) rules, or to an *ad hoc* tribunal, which is to be established under the Arbitration Rules of the United Nations Commission on International Trade Law.

### 6.3 What laws exist regarding the nationalisation or expropriation of project companies and assets? Are any forms of investment specially protected?

The right to own property is protected by the Basic Law; Human Dignity and Liberty, which enjoys constitutional status in Israel. However, the Lands Ordinance (Purchase for Public Use) – 1943 and the Roads and Railways (Defence and Development) Ordinance – 1943 allow for governmental expropriation of assets under certain circumstances upon compensation to the owner.

Pursuant to the model BIT (see above), the investments of investors of a State party to the BIT shall not be nationalised or expropriated in Israel except for a public purpose, in accordance with Israeli law, on a non-discriminatory basis and against prompt, adequate and effective compensation.

## 7 Government Approvals/Restrictions

### 7.1 What are the relevant government agencies or departments with authority over projects in the typical project sectors?

The Ministry of Defence has authority over defence-related projects. For example, it conducted a tender for the “Training-Base City”, as discussed in question 1.1. As a general rule, other tenders are managed by inter-ministerial committees, composed of the Finance Ministry and an additional relevant Ministry. For example, a desalination tender would be managed by the Finance Ministry and the Ministry of Energy and Water Resources.

In addition, specific arrangements could be dictated in a given project. For example, the Sorek desalination plant borders a military base. As part of the tender, the concessionaire was obligated to enter into an agreement with the Ministry of Defence on certain matters.

Applicable licensing requirements and the relevant governmental agencies vary based on the nature of the project. For example, pursuant to the Electricity Sector Law – 1996, the production, systems management, transmission, distribution, supply or trade of electricity require a licence from the Public Services Authority – Electricity. For a discussion of natural gas licensing requirements, see question 7.3.

## 7.2 Must any of the financing or project documents be registered or filed with any government authority or otherwise comply with legal formalities to be valid or enforceable?

No, although security agreements will need to be registered in order to be perfected (see question 2.2). Also, land rights must be registered in the Land Registry in order to receive protection from the contractual claims of third parties.

## 7.3 Does ownership of land, natural resources or a pipeline, or undertaking the business of ownership or operation of such assets, require a licence (and if so, can such a licence be held by a foreign entity)?

The exploration and production of petroleum (defined as any petroleum fluid, whether liquid or gaseous, and including oil, natural gas, etc.) in Israel, including the continental shelf, is regulated mainly by the Petroleum Law – 1952, pursuant to which exploration (as defined in the law) for petroleum may be conducted only by the holder of a preliminary permit, a licence or a lease, and the production (as defined in the law) of petroleum may be conducted only by the holder of a licence or a lease.

The holder of a preliminary permit may carry out preliminary investigations, not including test drilling, in order to ascertain the prospects for discovering petroleum within the region respect of which the permit has been granted. The holder of such a permit may be granted priority in receiving a licence, which provides its holder with the right to explore for petroleum in the licence area, as well as the exclusive right to conduct test or development drilling in the licence area. The original term of such a licence is three years, and it may be extended for an additional four years. The total term of the licence may not exceed seven years from the date of the original grant.

In the event that a licence holder discovers oil in the licence area, the licence term may be extended for a limited term (a maximum of two years), in order to enable the licence holder to determine the borders of the discovered oil field.

In the event that petroleum is discovered within the licence area, the licence holder is entitled to receive a lease in respect of any area chosen by him within the licence area. Such a lease grants its holder the exclusive right to explore for and produce petroleum in the area of the lease for as long as the lease is in force. The term of the lease is thirty years from the date it was granted and may be extended for an additional term of twenty years.

Section 76 of the Petroleum Law states that licences and leases granted under the Petroleum Law (such as drilling licences) are personal and cannot be transferred, nor may an interest therein be charged, except where permission has been provided by the Petroleum Commissioner. The Petroleum Commissioner (the “Commissioner”) is appointed under the law to be in charge of petroleum affairs by the Minister of Energy and Water (the “Minister”). In addition, before granting permission for a transfer or the grant of a charge, the Commissioner must consult with the advisory council, which consists of nine members, at least five of whom represent the public and who are also appointed by the Minister for a three-year period (the “Council”). This means that before registering the charge over the leases held by a licensee or lessee under the Petroleum law, as well as prior to any transfer or sale of such leases where the security trustee is entitled to do so (including in connection with such transfer or sale following the realisation of the charge), the permission of the Commissioner and the Council must be sought.

Furthermore, section 63 of the Petroleum Law provides that any

transfer of a licence or lease (or an interest therein), or any charge on such a right or interest, must be registered with the Petroleum Registry in the Petroleum Register, in accordance with the Petroleum Regulations. The Petroleum Register is a physical ledger which is located in the Ministry of Energy and Water in Jerusalem. If the right or interest is not so registered, it will be considered invalid under the Petroleum Law. In addition, a notice with respect to the grant, modification or expiration of a petroleum licence or lease and of any transfer of a petroleum licence or lease or of interest therein, must also be published in “Reshumot” (the gazette), the official publication of the legislative body of the State of Israel.

The Natural Gas Sector Law – 2002 further regulates development activities of discovered petroleum deposits. Accordingly, a licence is required in order to establish and operate a petroleum transmission system or distribution system (both as defined in the law), or parts thereof. A licence is also required in order to construct and operate liquefied natural gas (LNG) installations and petroleum storage facilities. Marketing and selling activities of petroleum do not generally require a licence. However, under certain conditions that might necessitate consumer protection, a marketing licence may be required.

A licence under the Natural Gas Sector Law regulating the above-mentioned activities can be held only by a company incorporated in Israel. A preliminary permit, a licence, or a lease granted pursuant to the Petroleum Law, can be held by both Israeli and foreign entities.

## 7.4 Are there any royalties, restrictions, fees and/or taxes payable on the extraction or export of natural resources?

Yes, although the specifics depend upon the type of natural resource. For example, a lessee under the Petroleum Law – 1952 (see our answer to question 7.3), is liable to pay the State of Israel a royalty in the amount of one-eighth of the quantity of petroleum (as defined in the law) produced and saved from the leased area, excluding the quantity of petroleum used in operating the leased area (the “Royalty”), and a leasehold fee for the leased area (the “Leasehold Fee”). A lessee who paid the Royalty is exempt from the Leasehold Fee for a continuous area of fifty thousand *dunams* (for clarification, one *dunam* equals one thousand square metres) around each new well in the leased area.

Notwithstanding the foregoing, the Petroleum Law prescribes a minimum royalty that the lessee is required to pay annually per thousand *dunams* of the production area, namely for the first year - 4 barrels, for the second year - 6 barrels, for the third year - 12 barrels, for the fourth year - 20 barrels, and for the fifth year and each consecutive year - 32 barrels. Thus, where 1/8th of the production from the leased area is below the royalty detailed above for any given year, the lessee will be required to complete the difference between the minimum amount set forth above and 1/8th of the production for that year.

The Petroleum Profits Taxation Law institutes a progressive levy on oil and gas profits which will be imposed only after a recovery of 150% of the amount invested in exploration and initial development. Accordingly, the initial rate will be 20%, and will increase gradually to 50% after a recovery of 230% of the amount invested.

## 7.5 Are there any restrictions, controls, fees and/or taxes on foreign currency exchange?

Such restrictions are no longer in force. However, the commercial bank will report an exchange of cash in amount of at least NIS 50,000 to foreign currency.

### 7.6 Are there any restrictions, controls, fees and/or taxes on the remittance and repatriation of investment returns or loan payments to parties in other jurisdictions?

The repatriation of investment returns through the payment of a dividend to shareholders of an Israeli company is subject to income tax under the Income Tax Ordinance, which must be withheld at source. Israel has concluded double taxation treaties with 55 countries; such treaties mandate a reduced rate of withholding for companies residing in signatory countries.

For a discussion on the tax applicable to loan payments (which applies to shareholder loans and senior debt alike), see question 17.1. It should be noted that Israel does not have tax-related “thin capitalisation” rules, and thus the ratio of equity to lending (senior and junior) is dictated only by the lenders and not by the tax regime.

Also notable is Israel’s lack of a branch profits tax; a foreign project company with a permanent establishment in Israel is subject to corporate tax, but will not pay income tax on dividends transferred abroad.

The Prohibition on Money Laundering Law – 2002, states that the transfer of monies in an amount of at least NIS 100,000, into or out of Israel, must be reported to the Customs Authority. “Monies” are defined as cash, bankers’ checks and travelers’ checks. According to the Prohibition on Money Laundering (The Banking Corporations’ Requirement regarding Identification, Reporting, and Record-Keeping for the Prevention of Money Laundering and the Financing of Terrorism) Order– 2000, the drawing of a banker’s check in the amount of at least NIS 200,000, or the transfer abroad of an amount equal to at least NIS 1,000,000, whether in local or foreign currency, will be reported by the bank.

Furthermore, upon transferring large sums of money outside of Israel, the transferring bank may demand documentation evidencing that the transaction is not subject to tax withholding.

### 7.7 Can project companies establish and maintain onshore foreign currency accounts and/or offshore accounts in other jurisdictions?

Yes they can.

### 7.8 Is there any restriction (under corporate law, exchange control, other law or binding governmental practice or binding contract) on the payment of dividends from a project company to its parent company where the parent is incorporated in Israel or abroad?

The payment of a dividend from any company to its shareholders (whether Israeli or foreign) is regulated by the Israeli Companies Law – 1999, which requires that a company meet a two-year profit test or receive court approval in order to effect a distribution to its shareholders. In addition, standard project financing agreements require that a project company meet strict conditions (including minimum past and future financial coverage ratios, minimum cash reserves, etc.) in order to effect a distribution.

### 7.9 Are there any material environmental, health and safety laws or regulations that would impact upon a project financing and which governmental authorities administer those laws or regulations?

The Clean Air Law – 2008, which came into effect in January 2011, requires an environmental permit for the operation of certain polluting systems. The Clean Air Law grants the Minister of

Environmental Protection the power to promulgate regulations in connection with the prevention and reduction of sources of air pollution, whether such sources are fixed or movable. The Abatement of Nuisance Law – 1961 requires environmental permits for businesses that affect the environment. Israeli law also provides a list of specific lines of business that require licensing, such as hazardous industrial plants and businesses that deal with the disposal of hazardous waste. Many businesses in Israel must be licensed with the Interior Ministry under the Licensing of Business Law – 1968. Such licences will generally seek to ensure that health and safety standards are maintained. Prior to granting a business licence under this law, a municipality may require entities that engage in activities that raise environmental issues to obtain the appropriate licence under the Nuisance Law. Disposal of waste at non-designated sites is prohibited under Israeli Law, both by the Torts Law and also by designated legislation, such as the Abatement of Nuisances Law – 1961, the Maintenance of Cleanliness Law – 1984, the Public Health Ordinance – 1940 and the Hazardous Substances Law – 1993. One may not dispose of waste in the public domain, and disposal of waste on one’s own property is also contingent on such disposal not causing damage or disturbance to others. Specific regulations regarding the environment set out further restrictions with regard to waste disposal, rendering it illegal to dispose of waste at the site where it was produced, unless the requisite permits have been obtained. The Water Law – 1959 provides a statutory framework for the protection of water sources and the prevention of water pollution. The Water Law prohibits any action that may cause water pollution, whether directly or indirectly, and whether immediately or after time. It should be emphasised that groundwater is included in the definition of water for purposes of the Water Law. The Water Law grants the courts the authority to require polluters to clean up pollution and to impose payments for the clean up on such polluters. Israel’s new Package Management Law – 2011 governs the separation and discarding of packaging waste and is relevant to EPC and O&M contractors.

A range of entities maintain powers of enforcement with regard to environmental laws in Israel, including the “Green Police” of the Ministry of Environmental Protection, individual municipalities, and the Attorney-General of the State of Israel.

Furthermore, the Israel Antiquities Authority is the governmental authority responsible for enforcing the Antiquities Law – 1978. The Antiquities Law requires planned construction sites to be examined for archaeological remains. In some circumstances, the Antiquities Authority will mandate that a salvage excavation be conducted prior to the commencement of construction.

### 7.10 Is there any specific legal/statutory framework for procurement by project companies?

Generally not, except with regard to tenders conducted by the State or government corporations. Pursuant to the Mandatory Tender Regulations (Preference for Israeli Products and Mandatory Business Cooperation), tenders published by such entities are required to provide for a preference for Israeli goods. In addition, some concession agreements contain a provision whereby by the concessionaire commits to procure a minimum percentage of Israeli-produced goods.

Additionally, the Trading with the Enemy Ordinance – 1939 restricts trade with the Enemy, defined to include, *inter alia*, any State or ruler at war with Israel, all persons living in an enemy country, and businesses incorporated in the enemy country. The enemies of the State of Israel under this act currently are Syria, Lebanon, Iran and Iraq (though there is an exemption with respect to Iraq which has been extended until 2013).

The Trading with the Enemy Act bars commercial, financial or other relationships with an enemy or for the benefit of the enemy, including, but not limited to: provision of goods; payment or transfer of money; or fulfilment of any obligation.

## 8 Foreign Insurance

### 8.1 Are there any restrictions, controls, fees and/or taxes on insurance policies over project assets provided or guaranteed by foreign insurance companies?

According to the Israeli Supervision of Financial Services Law (Insurance) – 1981, a foreign insurance company that wishes to “engage in insurance” in Israel is required to receive a licence from the Israeli insurance commissioner of insurance. A foreign insurer with a valid licence in its country of origin may receive a “foreign insurer” licence through a relatively simple process. A foreign insurance company that wishes to provide secondary insurance is exempt from the licencing requirement. Accordingly, the exemption is also granted to foreign insurance companies that provide insurance policies through Israeli insurance companies.

Income tax must be withheld from the payment of insurance premiums to cover Israel-based risk to a non-resident insurer. The double taxation treaties to which Israel is a party may mitigate withholding under certain conditions if the insurer is based in a treaty country. The same will apply to the guarantee of a policy.

### 8.2 Are insurance policies over project assets payable to foreign (secured) creditors?

Yes, they are.

## 9 Foreign Employee Restrictions

### 9.1 Are there any restrictions on foreign workers, technicians, engineers or executives being employed by a project company?

Although Israeli citizens may be engaged freely by an employer, foreign (non-Israeli) employees may not be employed without the appropriate consents and documentation. Israel’s Foreign Employees (Unlawful Employment) Law, 1991 makes it illegal to employ a “foreign employee”, defined as an employee who is not an Israeli citizen or Israeli resident, who is not entitled to work in Israel (i.e. who does not have a valid permit, etc.). Generally, Israeli authorities will not offer work permits to foreign individuals if there are Israeli citizens who have the ability to fill the positions in question. For this reason, an employer must usually show that the sought-after foreign employees are experts in a given field, or have certain unique expertise that cannot be found among available Israelis in the marketplace.

## 10 Equipment Import Restrictions

### 10.1 Are there any restrictions, controls, fees and/or taxes on importing project equipment or equipment used by construction contractors?

The importation of equipment into Israel triggers payment of customs duties, purchase tax (for certain items) and value-added tax (currently 16%).

Additionally, please see the discussion regarding the Trading with the Enemy Ordinance in question 7.10.

### 10.2 If so, what import duties are payable and are exceptions available?

The amount of customs duties and purchase tax (if any) that is payable depends on the type of equipment. Customs duties are categorised by product in a customs price list, which is based on the free trade agreements, to which Israel is a party.

Exceptions are available, under certain circumstances, when the equipment is to be removed from the country after its use.

## 11 Force Majeure

### 11.1 Are force majeure exclusions available and enforceable?

Both *force majeure* exclusions and change in law provisions (applicable to concession agreements) are available and enforceable under Israeli law.

## 12 Corrupt Practices

### 12.1 Are there any rules prohibiting corrupt business practices and bribery (particularly any rules targeting the projects sector)? What are the applicable civil or criminal penalties?

Pursuant to the Penal Law, 1977, bribery of a public servant (including employees of corporations providing services to the public) is a criminal offence. Israeli case law has determined that even a private company providing a service to the public on behalf of the State and with authority granted by the State falls into the definition of a “corporation providing services to the public”, for the purpose of defining bribery. Bribing a foreign public official is also a criminal offence. An individual who has bribed a public servant faces incarceration of up to seven years or a fine (also in the case of a corporation) in the amount of the higher of NIS 1,130,000 (NIS 2,260,000 in the case of a corporation) and four times the value of the bribe. Various actions that would constitute corrupt business practices (e.g. such as theft, fraud, forgery, false entry in corporate documents) are also covered by the Penal Law, 1977, and carry incarceration, a fine, or a combination of the two.

## 13 Applicable Law

### 13.1 What law typically governs project agreements?

Project agreements will typically be governed by Israeli law.

### 13.2 What law typically governs financing agreements?

The facility documents will typically be governed by Israeli law or by the domestic law of the major lender. Security agreements will typically be governed by Israeli law.

### 13.3 What matters are typically governed by domestic law?

Please see questions 13.1 and 13.2.

## 14 Jurisdiction and Waiver of Immunity

### 14.1 Is a party's submission to a foreign jurisdiction and waiver of immunity legally binding and enforceable?

In general, a party's submission to a foreign jurisdiction is legally binding under Israeli law. Nonetheless, a foreign jurisdiction clause shall be enforced by Israeli courts (i.e., an Israeli court will dismiss an action seeking domestic jurisdiction), provided that it was drafted in an explicit and clear manner and provided that the clause stipulates that the foreign jurisdiction is the exclusive jurisdiction for disputes arising from the contract; otherwise, foreign and local jurisdiction will be presumed to be equally valid alternatives.

A foreign State may waive its immunity in Israel. Such a waiver shall be legally binding and enforceable, provided that that the waiver was drafted in an explicit manner and in writing, or alternatively, that immunity was waived before a court either orally or in writing.

Israeli governmental bodies are not exempt from claims brought against them in Israeli courts.

## 15 International Arbitration

### 15.1 Are contractual provisions requiring submission of disputes to international arbitration and arbitral awards recognised by local courts?

Israeli courts recognise contractual provisions that require submission of disputes to international arbitration, and, provided that an international convention to which Israel is a party applies to the arbitration, will exercise their procedural authority in accordance with the international convention.

Arbitral awards granted in pursuant to an international convention to which Israel is a party are recognised by Israeli courts.

### 15.2 Is Israel a contracting state to the New York Convention or other prominent dispute resolution conventions?

Israel signed and ratified the New York Convention, which requires courts of contracting States to give effect to arbitration agreements and enforce foreign arbitral awards. The New York Convention entered into force in Israel on June 7, 1959.

Israel is also a contracting member of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. This Convention, which was ratified by Israel on June 22, 1983, provides facilities for conciliation and arbitration of investment disputes between contracting States and nationals of other contracting States.

### 15.3 Are any types of disputes not arbitrable under local law?

According to the Israeli Arbitration Law, 1968 (the "Arbitration Law"), nearly any dispute can be settled through arbitration, but there are several exceptions. The Arbitration Law sets forth the general rule that an arbitration agreement (or an arbitration clause in an agreement), in a matter which cannot be the subject of an agreement between the parties, is invalid. That includes any illegal agreement between the parties, certain causes of action arising out of a breach of applicable employment law, disputes concerning *in rem* rights such as the ownership of real property, patent rights and copyrights. Another exception can be found in case law, according to which dissolution of a company is not arbitrable.

Notwithstanding the foregoing, the Attorney General Guidelines regarding Participation In Arbitration Procedure in Which the State of Israel is One of the Parties (the "Guidelines") stipulates that the Attorney General's approval is required in order to include an arbitration clause in an agreement in which the State is one of the parties and to submit a dispute to arbitration based on such a clause. An arbitration clause in such an agreement that did not receive the authorisation of the Attorney General is invalid. According to the Guidelines, the approval or disapproval of the inclusion or utilisation of an arbitration clause in an agreement with the Israeli Government requires taking various considerations into account. Among others, considerations against approving the submission of the dispute to arbitration (and including an arbitration clause) are: the dispute raises fundamental legal question or a question of precedential value; the dispute relates to the broader public; and the ruling in the dispute may affect third parties that are not parties to the arbitration procedure. Other considerations, such as: efficiency; considerations relating to the identity and character of the parties to the dispute (including, but not limited to, the existence of a long-lasting relationship among the sides to the dispute); and the civil-business or professional-technical nature of the dispute; a dispute that, in light of its nature, would be better settled in a non-public procedure, lean toward approval of the arbitration.

### 15.4 Are any types of disputes subject to mandatory domestic arbitration proceedings?

Disputes in Israel are not subject to mandatory arbitration proceedings unless the agreement in question includes a mandatory arbitration proceeding.

## 16 Change of Law / Political Risk

### 16.1 Has there been any call for political risk protections such as direct agreements with central government or political risk guarantees?

Generally no, although provisions providing remedies upon the occurrence of a prejudicial change of law have been included in concession agreements.

## 17 Tax

### 17.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) In the case of a foreign lender, interest is subject to income tax, which must be withheld at source. Israel has concluded double taxation treaties with 55 countries; such treaties mandate a reduced rate of withholding for companies residing in signatory countries. In certain large infrastructure projects, the borrower can apply to the Israel Tax Authority, with a request to exempt foreign lenders from the payment of tax on interest; however, the ITA has not approved such a request for some time.

In the case of a domestic lender, interest is subject to income tax, and certain withholding requirements apply. However, a withholding exemption certificate can be applied for from the Israel Tax Authority.

(b) To the extent that the proceeds of a claim stem from the repayment of principle, no withholding is applicable. In the event that the proceeds stem from the payment of interest, tax must be withheld at source.

The sale of a secured asset is indeed a tax event, but is attributed to the seller. When proceeds are transferred to a creditor, the above analysis (regarding principle versus interest) will apply.

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**17.2 What tax incentives or other incentives are provided preferentially to foreign investors or creditors? What taxes apply to foreign investments, loans, mortgages or other security documents, either for the purposes of effectiveness or registration?**

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The Israeli tax regime includes broad exemptions from capital gains tax for foreign investors. Until recently, the Encouragement of Capital Law provided tax benefits to non-resident equity investors in certain sectors. The most recent amendment to the law (in 2011) abolished such benefits for new projects.

The Israeli stamp tax was abolished in 2006; thus, effectiveness or registration is not dependent upon payment of any document taxes.

## 18 Other Matters

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**18.1 Are there any other material considerations which should be taken into account by either equity investors or lenders when participating in project financings in Israel?**

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On the one hand, Israel has a unitary government, and thus participants in project financings need not wade through a double set of government bodies. However, navigating Israel's bureaucracy (based on the system left behind by the British mandate) can be challenging at times, despite the fact that reforms are constantly underway. As a result, no two projects are the same, and even seemingly similar transactions will be characterised by unique idiosyncrasies. In addition, as the sector develops in Israel, the commercial and legal terms of project financings are becoming increasingly more sophisticated.

### Acknowledgment

The authors would like to gratefully acknowledge the valuable assistance of Adv. Avinoam Shefa, of Yigal Arnon & Co.'s project finance practice, in the preparation of this chapter.

**David Schapiro**

Yigal Arnon & Co.  
1 Azrieli Center  
Tel Aviv 67021  
Israel

Tel: +972 3 608 7726  
Fax: +972 3 608 7724  
Email: [davids@arnon.co.il](mailto:davids@arnon.co.il)  
URL: [www.arnon.co.il](http://www.arnon.co.il)

David Schapiro has represented Israeli and international clients for the past 25 years in a diverse and sophisticated transactional practice.

David's experience includes representing domestic and foreign clients in complex corporate transactions, including mergers and acquisitions, public and private financings and project finance transactions. David has acted in some of the largest transactions completed in Israel.

David specialises in representing various private entities and financial institutions in many infrastructure projects and international tenders, including road construction, military base, water purification and desalination, gas and other utility projects. He is integrally involved with many high-profile public governmental tenders in Israel.

David graduated with a B.A *cum laude* from Yeshiva University in 1984 and received his law degree *magna cum laude* from the Benjamin N. Cardozo School of Law of Yeshiva University in 1987.

David joined the firm in 1990 and became a partner in 1994.

David is fluent in English and Hebrew.

**Peter Sugarman**

Yigal Arnon & Co.  
1 Azrieli Center  
Tel Aviv 67021  
Israel

Tel: +972 3 608 7726  
Fax: +972 3 608 7724  
Email: [peters@arnon.co.il](mailto:peters@arnon.co.il)  
URL: [www.arnon.co.il](http://www.arnon.co.il)

Peter Sugarman represents clients across a full range of activity in corporate and commercial law, with a focus on Project Finance transactions and the High-Tech industry.

In Project Finance, Peter has represented consortium bidders as well as contractors, financiers and investors, in numerous projects in different fields, including, water desalination, road construction (toll-based and others) and most recently a military base. In these deals Mr. Sugarman has handled a wide variety of legal matters, covering tender compliance, corporate structuring, financing agreements, construction and operation agreements and specialised subcontractor agreements.

In High-Tech, Peter's practice includes representation of venture capital funds and private equity investors as well as technology companies receiving venture capital and other funding.

In addition, he works closely with founders and executives of emerging growth companies, providing strategic legal advice and general corporate representation, including in the fields of intellectual property and corporate partnering.

Peter graduated from the Hebrew University in Jerusalem in 1995.

Peter joined the firm in 2001 and became a partner in 2007.

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- Gas Regulation
- Insurance & Reinsurance
- International Arbitration
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Patents
- PFI / PPP Projects
- Pharmaceutical Advertising
- Private Client
- Product Liability
- Public Procurement
- Real Estate
- Securitisation
- Telecommunication Laws and Regulations
- Trade Marks



59 Tanner Street, London SE1 3PL, United Kingdom  
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255  
Email: [sales@glgroup.co.uk](mailto:sales@glgroup.co.uk)

[www.iclg.co.uk](http://www.iclg.co.uk)