ISRAEL

CHALLENGES IN ARBITRATING INFRASTRUCTURE CONTRACTS UNDER ISRAELI LAW: MUNCHAUSEN IN THE MIRE

Can Infrastructure Concessionaires Pull Themselves by Their Own Hair? The Israeli Supreme Court Addresses Contractual Stipulations Bypassing the Rule of Contract Interpretation Against the Drafter

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Over the last two decades, the number of Israeli seated infrastructure arbitrations between Israeli and non-Israeli counterparties has grown substantially. This trend stems from various factors, including the surge of public and private infrastructure mega-projects meant to facilitate Israel's rapid population growth. The need to build first-of-their-kind projects made the skills and experience of international contractors in high demand. As a result, they take an integral part of virtually every significant infrastructure project in Israel, whether it is the construction of a privately owned power plant or the light railway project.

Concessionaires traditionally bear most of the project's risk, and by and large, they have the upper hand when negotiating against a sub-contractor or project operator. This power imbalance has two important implications for ensuing court litigation and arbitrations. First, the concessionaires may leverage their negotiation powers to set the seat of the arbitration in Israel and make Israeli law the applicable law of the contract. Second, the concessionaire may dictate contractual language to its advantage, to the extent it excludes the application of interpretation rules meant to protect the weaker contractual party.

Advising clients facing construction arbitrations under Israeli law poses significant challenges, particularly when confidentiality in commercial arbitration makes it difficult to ascertain how Tribunals apply Israeli case law and resolve tensions between interpretational approaches.

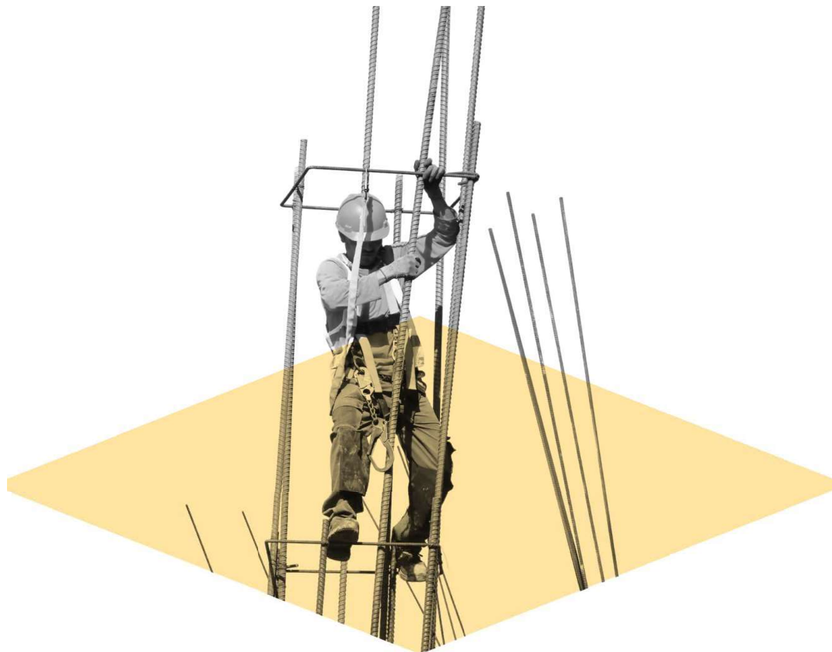
This article will provide an overview of 1) the uncertainties of infrastructure contract interpretation under Israeli law and 2) the implication of concessionaires' practice of bypassing the legislative framework that a contract be interpreted against its drafter.

The Uncertainty of Contract Interpretation under Israeli Law

Article 25(a) of the Contracts (General Part) Law, 1973 ("**Contracts Law**") provides that "*A contract will be interpreted in accordance with the intention of the parties, as it appears from the contract and its circumstances, however, if the intention is expressly implied from the language of the contract, it will be interpreted as it appears from its language*".

Interestingly, the two seminal Israeli Supreme Court cases pertaining to the "intention of the parties" have emanated from construction disputes.

- CA 4628/93 *State of Israel v. Apropim* (6.4.1995) involved a construction dispute between a contractor and the Government of Israel. The contract language allowed the contractor to argue that the State could not sanction it for delays in completing projects in certain geographical areas. The Supreme Court ruled for the State based on extrinsic evidence. Justice Aharon Barack determined that in ascertaining the parties' contractual intentions, a Court must consider the contract's plain language and its external circumstances. He rejected a "two-step" process, where external evidence is considered only when a contract is unclear. According to Apropim, determining the parties' intention is done through examination of the contract's language simultaneously with considering external circumstances.
- CA 7649/18 *Bibi Kvishim Afar & Pituach v. Israeli Railways Ltd* (20.11.2019) involved a dispute surrounding a detailed tender contract between a construction contractor and Israel Railways Ltd. in connection with the expansion and upgrade of certain railroads, a mega project, in Israeli standards. The contractor filed suit arguing that it was owed monies due to additional works beyond the scope of the contract. It is worth noting that over the years, the perceived flexibility of "good faith" interpretation under Israeli law, which lies in the statutory provisions included in Articles 12 and 39 of the Contracts Law, has contributed to an unfortunate practice where contractors underprice their bids to win a tender, expecting to increase their final compensation during the project's life through the flexible interpretation of contractual stipulations relating to additional works and variations.
- The Supreme Court ruled against the contractor based on the contract's plain language. In a plurality opinion, Justice Stein ruled that the contract should be interpreted according to its language without the use of extrinsic evidence because it was a "closed contract" that laid out all its terms: Justice Grosskopf ruled similarly but based his opinion on the distinction between a private contract, consumer contract, and commercial contract. Ruling that the latter should be read according to its written terms as well-represented sophisticated parties agreed it. Justice Vogelman decided that the contract should be interpreted according to its language, arguing that interpreting a public tender according to extrinsic evidence would violate principles of equality.



Implications of Concessionaire Practice of Contracting away Legislation requiring Interpretation against the Drafter

One significant uncertainty facing construction agreement litigants under Israeli law relates to the enforceability of contractual terms that attempt to override statutory interpretation rules benefiting the party with less negotiating power, the *Contra Proferentem* doctrine.

It is often the case that contractual provisions drafted by concessionaires aim to circumvent Article 25(b1) of the Contracts Law, which states:

> "*If a contract is subjected to different interpretations and one of the parties had an advantage in shaping its conditions, an interpretation that against that party, is better than an interpretation in its favour*".

Indeed, *Bibi Kvishim* seemingly empowered concessionaires in mega projects negotiating against sophisticated represented parties to leverage their negotiation power to stipulate that Article 25(b1) shall not apply to their contract. Bidders in mega projects that involve voluminous detailed contracts must consider that contractual stipulations shall be enforced as drafted and that ambiguities will not be read in their favour. They must also consider that there will be no wiggle room for price adjustments as these mega-project contracts will likely be interpreted strictly according to their language.

However, in a ruling subsequent to *Bibi Kvishim*, the Supreme Court has indicated that if the question comes before it, it will find Article 25(b1) to be cogentive and may not be drafted away. In CA 7379/18 *Hadar Yitzhaki v. Ron Yitzhaki (18.12.2019), The Honorable Judge Yitzhak Amit indicated in a non-binding manner, in dicta, that Article 25(b1) should be interpreted as an imperative norm, and as such, parties should not be allowed to stipulate it away. Judge Amit stated:*

> *"I am inclined towards the position that [Article 25(b1)] is an imperative norm, which the parties' agreement cannot steer away from. The attempt of a drafter to escape from this interpretation presumption against him through contractual language that will override this interpretation rule is fabled to the Baron Munchausen's attempt to escape a mire by pulling himself from his own hair".*

The opinion that Article 25(b1) is cogent is also shared by prominent Israeli Jurists Gabriela Shalev, who based her position on "*principles of morality, fairness, rationality, good faith and relative justice» (See, Gabriela Shalev & Efi Zemach, Law of Contracts, 4*th ed. 2019). Jurists Freidman and Cohen hold a different approach; they agree that conditioning Article 25(b1) should be prohibited in uniform contracts or consumer contracts but allowed in commercial relationships between sophisticated commercial parties as part of their freedom of contract (*See, Daniel Friedmann & Nili Cohen, Contracts, 2*nd ed. 2020).

Concluding Thoughts

It is too early to tell if the Supreme Court will determine that Article 25(b1) is cogent or dispositive, however it is likely considering the opinion in *Yitzhaki and the view of prominent* Israeli Jurists. However, as things currently stand regarding mega-projects agreements contracted between two sophisticated and represented parties, contractors and concessioners should be aware that a stipulation bypassing Article 25(b1) may stand judicial scrutiny. Contractors negotiating these agreements should consider their risks and opportunities based on the language of the agreements and not rely on contractual interpretation giving weight to principles of “Good Faith” over “Freedom of Contracts”.

ABOUT THE AUTHORS

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