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A Sovereign's Broken Promise: the Golden Ticket to a Billion-Dollar Award?

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The epitome – and uncontroversial part – of the legitimate expectations doctrine is that a sovereign's failure to live up to its promises made towards an investor who relied on such promise to make an investment – or to continue an investment – is a breach of the fair and equitable treatment standard.

Practice has, however, revealed several grey areas consisting of scenarios not covered by this definition. One of these grey areas is the question of protection of expectations created by a state's assurances, encouragements or representations meant to attract or induce investments. This question was discussed earlier on this [blog](#). On that occasion, we reviewed the analysis made by the tribunal in *Bilcon of Delaware et al. v. Canada* and specifically looked at host State representations as a basis of liability – more precisely, a component element of such – under the international minimum standard of treatment laid down by NAFTA Article 1105. Consistent with the majority of NAFTA case law, the tribunal did not base its finding of violation of the international minimum standard specifically on Bilcon's alleged legitimate expectations, but it nevertheless acknowledged that this was a significant factor in its assessment (¶455). In so doing, the *Bilcon* tribunal relied on “*the specific encouragement the Investors and their investment had received from government to pursue the project*” (¶603) to arrive at a finding of breach of Article 1105.

Investment-inducing encouragements also constituted a major the point of contention in the recently decided case involving Canadian company Crystallex International Corporation and the Republic of Venezuela. Similar to *Bilcon* the dispute in *Crystallex International Corporation v. Venezuela* arose from a gold mining venture that ended prematurely on account of the host government's refusal to grant an environmental permit. The difference, however, lies in the fact that the tribunal in *Crystallex* relied expressly on the investor's legitimate expectations to base its finding of violation of the FET standard under the Canada-Venezuela BIT.

Though, the case has gotten a great deal of attention recently, it may be worthwhile – before jumping into the substantial analysis on legitimate expectations- to briefly go over the facts.

The Factual Background of the Dispute

Crystallex International Corporation is a (another) Canadian miner that hoped to “strike gold” in

Venezuela by making a deal in 2002 with the Hugo Chavez government for the exploitation of one of the largest undeveloped gold deposits in the world located in a region of the Bolivarian state called Las Cristinas. For the actual operation of the mine, Crystallex was, however, required to go through a laborious permitting process before the Venezuelan entities, including *inter alia* obtaining an environmental permit.

Several years went by – during which Crystallex invested significant resources to make the Las Cristinas mine “shovel ready” estimated at over US\$ 500 million (¶195) – and some of the required permits and administrative approvals became reality. The project, however, reached an unexpected standstill when the investor applied for the environmental permit. Although, Crystallex’s documentation for the permit, consisting *inter alia* of a 950-page environmental impact study (EIS), did not initially raise any significant concerns with the Venezuelan Ministry of Environment, the permit was refused in April 2008 on grounds of several environmental-related concerns (¶590). The investor’s surprise to receive the refusal was based on the fact that just a few months earlier, i.e. in May 2007, it had received a letter from the Venezuelan Ministry of Environment suggesting that the EIS had been approved and informing the investor that the permit would be issued immediately after certain formalities would be met.

Shortly after the refusal, President Chavez started to make public statements about “taking back big mines” (¶ 304), which were followed by the nationalization of Las Cristinas together with the rescission of Crystallex’s mine operation contract. These measures placed Crystallex in a very difficult financial state to the point that it was forced to file for bankruptcy protection in Canada and was delisted from the Toronto Stock Exchange. As a result, Crystallex filed a third-party funded claim requesting over US\$ 3.16 billion in damages for compensation of Venezuela’s supposed violation of the substantive protections afforded under the Canada-Venezuela BIT.

The Investor’s Expectations

One of the claims made by Crystallex was that Venezuela failed to afford it a fair and equitable treatment and “eviscerated” its legitimate expectations to operate the mine by denying it the environmental permit and terminating its mining contract “without cause, and for purely political reasons”.

The contention was that the investor’s legitimate expectations arose at three different points in time:

(i) at the time of making its initial investment Crystallex argued that under the FET standard it had the legitimate expectation that the state would act with “economic rationality”, “reasonableness” and “proportionality” in relation to its investment. At the same time, based on the laws of Venezuela, the terms of the mining contract, as well as several encouraging statements from government officials, Crystallex expected to eventually obtain the environmental permit and to exploit the mine;

(ii) further, after the May 2007 letter, Crystallex alleged to have a legitimate expectation to shortly receive the environmental permit;

(iii) finally, up to moment when the government rescinded the mine operation contract and took over Las Cristinas, Crystallex argued that based on the assurances provided by government officials it continued to have legitimate expectations that the authorities would consider its adjusted environmental impact study and would eventually permit the commencement of operation in Las

Cristinas.

The Tribunal's Analysis

The tribunal's examination of Crystallex's submissions on legitimate expectations was made on the basis of the following definition and conceptual limitations:

“A legitimate expectation may arise in cases where the Administration has made a promise or representation to an investor as to a substantive benefit, on which the investor has relied in making its investment, and which later was frustrated by the conduct of the Administration. To be able to give rise to such legitimate expectations, such promise or representation – addressed to the individual investor – must be sufficiently specific, i.e. it must be precise as to its content and clear as to its form.” (¶547)

The tribunal's view on legitimate expectations fits well into the classical definition adopted by arbitral practice, but at the same time places distinctive importance on the degree of specificity that state representations need to satisfy in order to generate legitimate expectations. Adopting this standard of assessment, the tribunal denied Crystallex substantive protection under the BIT for most of the expectations that it alleged were created by the assurances given by Venezuelan officials qualifying them as being “too general and indeterminate to found a claim of legitimate expectations” (¶553). This qualification covered public statements of the Venezuelan Minister of Mines saying that the permit was “well on track” and that its issuance was “following its normal, routine course” (¶238), but also private reassurances and declarations of various officials, including from the Venezuelan Ministry of Environment, supporting the issuance of the permit and the project altogether (¶245 et seq.). The tribunal also criticized the investor's circular reasoning of claiming legitimate expectations under the FET standard itself to be treated reasonably and proportionally or to have Venezuela comply with its own domestic laws. This tautological use of the concept of legitimate expectation has been previously criticized, including in a recent remarkable [analysis](#) of the notion by Professor Pierre-Marie Dupuy and his son, Florian Dupuy.

By contrast, the tribunal found that the May 2007 letter did create a legitimate expectation that Crystallex would get the environmental permit which was later frustrated when Venezuela arbitrarily denied the permit and terminated its contract. In reaching this solution, the tribunal relied heavily on the wording of the May 2007 letter, which expressly stated that the Permit would be “handed over” once the necessary bond was posted, but also on the circumstances surrounding the letter, including the fact that Crystallex was required to pay the environmental taxes that became due only upon the issuance of the permit.

In the tribunal's eyes, these elements amounted to a specific and clear promise giving rise to legitimate expectations protected under the FET standard. The denial of the permit in a two-page letter, which showed a blatant disregard of the investor's EIS documentation, less than a year later after Venezuela had made such a promise was seen as a complete *volte-face* (¶589) and the embodiment of the state's arbitrary conduct and politically-driven decision making.

The Specificity Test Applied to State Commitments: a Step too Far?

Much ink will surely be spilled over the *Crystallex* award, but one clear benefit that the award has

is that it highlights the crucial importance of the degree of specificity that state representations need to have in order to be apt to constitute basis for a legitimate expectation claim under the FET standard.

In dismissing most of the investor's allegations of legitimate expectations, the tribunal made a clear distinction between the statements and representations that were too vague and general to create legitimate expectations, and the specific representation contained in the May 2007 letter, which did meet the level of specificity required to create such expectations. Interestingly though, the distinction goes a bit further than to simply convey a blunt twofold division of the relevant factual circumstances and looks at the identity of the person or entity generating the representation, and implicitly the investor's expectation, as an additional assessment criteria. As such, the tribunal holds that the public support of the Las Cristinas project displayed by various state institutions and government officials could not create any legitimate expectations since these had no direct incidence or influence on the permitting process (¶586). While the effort to reconcile such approach with the principle of attribution under customary international law should not be taken lightly, the fact remains that the tribunal framed the specificity test to refer to both the active and the passive subject of the state commitment. In other words, the state's commitment should be generated by a *specific state authority* with relevant decision-making power, and should be directed at a *specific investor*.

Future international tribunals will judge whether this application of the specificity test can lead to an effective and genuine protection of the investor's interests against arbitrary state conduct or, to the contrary, will see it as an over formalistic approach. In any event, the degree of specificity is an area with respect to which it is difficult to generalize and consequently the tribunal's holdings on this point should not be treated as generally-applicable precepts. Rather, these should be taken with the reservation that the notion of legitimate expectations is a tool that is essentially fact dependent and conceptually aimed at creating the legal premises for investor protection.

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