

India's Big Energy Crisis: Case Analysis & Recent Developments Of Cairn Energy Case

Prattay Lodh*

Introduction- The Transfer, 2006

Incorporated in New Jersey in 2006, Cairn India Holding Limited (CIHL) was a wholly-owned subsidiary of the UK incorporated Cairn UK Holding Limited (CUHL). CUHL and CIHL, under a share exchange agreement, decided for a transfer of the entirety of shares along with share capital of nine entities of Cairn group of the former to later.

This was followed by the incorporation of Cairn India Limited (CIL) in 2006. Further, the shares of CIHL were then sold to CIL by the CUHL by the way of subscription and share purchase agreement. The consideration for the same was partly in cash and partly in the form of the issued share capital of CIL. In furtherance to this, CIL divested 30.5% of its shareholdings by the way of an Initial Public Offering. Naturally, the result of divesting 30% of its stake in the

* Student of IX Semester, B.B.A.,LL.B. (Hons), School of Legal Studies, CMR University

subsidiary and part of IPO proceeds, CUHL received Approx. INR 6101 Crore.¹ In 2011, Vedanta Resource Plc (Vedanta Plc), a UK incorporated company acquired 59.9% stakes in CIL. By 2017, the two companies will form a merger, where Cairn Energy (now a subsidiary of Vedanta) was to receive ordinary and preference shares in VL, for the exchange of 10% residual shareholding in CIL. This resulted in Cairn energy having a 5% shareholding in Vedanta along with the interest in preference shares. This investment, was valued to be USD \$1 billion as of December 2017.²

2012- Vodafone case and the retroactive tax legislations

The Supreme court on January of 2012, in the case between Vodafone International Holding B.V(VIHBV) and Indian tax Department (ITD)³ discharged the former of tax liability by holding that the sale of shares to

¹2022. [online] Available at: <http://nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/retrospective-capital-gains-tax-on-indirect-transfers-the-ghost-of-the-vodafone-case-revisits-cairn.html?no_cache=1&cHash=ffbad1885eefd774e7b23420d1b06493> [Accessed 18 January 2022].

²Cairnenergy.com. 2022. Capricorn | Update on Cairn's assets in India. [online] Available at: <<https://www.cairnenergy.com/news-media/news/2018/update-on-cairn-s-assets-in-india/#Tabundefined=1>> [Accessed 18 January 2022].

³2022. [online] Available at: <https://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/vodafone-investment-treaty-arbitration-award-part-i.html?no_cache=1&cHash=8fb65ba0b511a1193bc061ee430fcf1f> [Accessed 20 January 2022].

Vodafone did not amount to transfer of a capital asset within the meaning of Section 2(14) of the IT Act. Further, the court⁴ not only quashed the demand of a sum of INR 120 billion deposited by Vodafone⁵ in terms of the interim order but also allocated a provision of 4% p.a interest.

However, soon after this judgment, Parliament brought about an amendment to the Finance Act of 2012. The amendment provided for two particular insertions in the IT Act (2012 Amendment)⁶. Firstly, in the meaning of the term “through”, inscribed that “or the removal of doubts”, it is hereby clarified that the expression ‘through’ shall mean and include and shall be deemed to have always meant and included ‘by means of’, ‘in accordance of’ or ‘by reason of.’” Secondly, it emphasized that “an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the

⁴Vodafone International Holdings vs Union of India &Anr, CIVIL APPEAL NO.733 OF 2012.

⁵2021. INDIA’S TRYST WITH VODAFONE: A CONUNDRUM – NMIMS Law Review. [online] Lawreview.nmims.edu. Available at: <<https://lawreview.nmims.edu/indias-tryst-with-vodafone-a-conundrum/>> [Accessed 18 December 2021].

⁶Section 9 provides: “The following incomes shall be deemed to accrue or arise in India

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India

share or interest derives, directly or indirectly, its value substantially from the assets located in India”. Furthermore, even the term “transfer” was then purported to include parting or disposing of an asset, in any manner whatsoever; either entered into India or otherwise.

Pre- trial, invocation of India UK bit & Lis Pendens interference- 2016-2020

Post a reform such as this, the Income Tax Assessment Officer initiated a proceeding against CUHL under the carapace of sections 147 and 148 of the IT Act in January 2014⁷. The objective of the ITD was to initiate a proceeding for reassessing the tax payments made by Cairn. The ITD further issues notice to Cairn in lieu of the transfer of shares made by it back in 2006, and the profit it made subsequently. ITD’s claim was that it could witness unpaid tax that was due to it by CUHL, on the profits that it made. In effect, ITD was implementing the 2012 law retrospectively to an event of 2007. In pursuance of this, CUHL was further restricted from selling 10% worth of its shares which were valued at around USD \$1 billion.

⁷Cairnenergy.com. 2022. Capricorn | Update on Cairn’s assets in India. [online] Available at: <<https://www.cairnenergy.com/news-media/news/2018/update-on-cairn-s-assets-in-india/#Tabundefined=1>> [Accessed 21 January 2022].

A draft assessment order was passed against CUHL by AO along with interests and penalties. For this, the CUHL moved to the Income Tax Appellate Tribunal (ITAT), which upheld the demand of the sum from CUHL, but subsequently rejected the demand of interests and penalties, which meant that a sum of INR 10,247 crore was due to the Indian government by Cairn. Thus, by 2015, Vedanta served notice against the Indian Government, under the India- UK BIT, challenging the ITAT's decision.

In their treaty proceedings, the Indian side's platitudinous contention was that, such a treatment of India, wherein, it has to face two cases (one domestically and one internationally) at the same time, was rejected by the tribunal. Furthermore, the tribunal deemed India's action to be a mere chicanery wherein, it sought the bifurcation of proceedings to decide issues of jurisdiction and admissibility of claims and rejected them by March 2017.

Moreover, during 2016-2018 period, the ITD made sure to make Cairn go through excruciating hardships. For instance, during the pendency of the arbitration proceedings, shares in the valuation of over USD \$1 billion of CUHL were seized by the ITD. Furthermore, the CUHL could not exercise ownership rights over those rights and thus could not even sell them. More so, the ITD even sold part of CUHL's shares in VL in order to recover part of the 'unassessed taxable income' worth USD \$216 million. A further USD \$155 million of enforcement action of dividends was made along with USD

\$234million worth of tax refund due on CUHL- for the overpayment of capital gains tax in a separate matter.

In a sharp response, CUHL pleaded before the Tribunal that such acts of the ITD be nullified, and in response, Cairn should receive compensation from India for the loss of value of its shares. CUHL in sum demanded a re-compensation of USD \$1.3 billion, this it claimed was necessary for it to be restored to a position that it was enjoying in 2014.

The decision and further developments

The tribunal determined the Cairn vs Republic of India's⁸case on three bases. Firstly, it held that the claimant (Cairn) had the jurisdiction to approach the tribunal and that the claims of Cairn were admissible. Further, it declared that the Respondents (Republic of India) had failed to perform its obligations under the India UK BIT treaty and other international organisations, specifically Article 3(2) of the treaty. The tribunal further declared that the Respondents

⁸Cairn Energy PLC and Cairn UK Holdings Limited v. The Republic of India, PCA Case No. 2016-07, available at Mundi, J., 2022. *Cairn v. India, Final Award, 21 Dec 2020*. [online] Jusmundi.com. Available at: <<https://jusmundi.com/en/document/decision/en-cairn-energy-plc-and-cairn-uk-holdings-limited-v-the-republic-of-india-final-award-wednesday-23rd-december-2020>> [Accessed 20 January 2022].

ought to compensate for the total harm suffered by the claimant as a result of all the breaches. Thus, the Government was to give up seeking the tax amount, return the value of shares and seize dividends.⁹

Recently, Cairn had sought to forego USD \$500 million of that amount in order to invest the amount in renewable energy projects which are identified by India.¹⁰ This comes in lieu with the *Vivad se Vishash* scheme, which was an initiation by the government to ease tensions between corporates and the Government through the medium of negotiations, to redress past grievances.

However, the Indian Government has also appealed against the tribunal ruling submitting that a tax levied by a sovereign power is not subject to private arbitration. In contrast to this, Cairn contends that the ruling of the tribunal has been applicable in more than 160 countries that have signed and ratified the New York Convention, 1958.

⁹Editor, R., Page, O., 2022, B., Quotes, S., Sports, O., gardens, H. and award, C., 2022. *Cairn Energy wins arbitration award*. [online] Thehindu.com. Available at: <<https://www.thehindu.com/business/Industry/cairn-energy-wins-investment-treaty-arbitration-against-india-over-tax-dispute-sources/article33399645.ece>> [Accessed 21 January 2022].

¹⁰*Cairn offers to forego USD 500 mln if India agrees to pay principal due*, PTI, CNBC TV 18, dated 11 April 2021, available at [cnbctv18.com](https://www.cnbctv18.com). 2022. *Cairn offers to forego USD 500 mln if India agrees to pay principal due*. [online] Available at: <<https://www.cnbctv18-com.cdn.ampproject.org/c/s/www.cnbctv18.com/energy/cairn-offers-to-forego-usd-500-mln-if-india-agrees-to-pay-principal-due-8893121.htm/amp>> [Accessed 21 January 2022].

Cairn in furtherance to this has even started the process of an asset-tracing firms to investigate the overseas assets that could be seized to recover the amount. Though unconfirmed, Cairn could proceed by buying out Air India's planes, property of state banks and vessels belonging to the shipping vessel.

Analysis

The Vodafone, Cairn, and Vedanta of India remain to be a redoubtable prolegomenon of a nation's responsibility towards a foreign entity. What is witnessed through these cases is also a gap between a sovereign's power domestically versus a sovereign's power internationally, does the latter supersede the former like it did in the instant case?

Disputes such as this, truly have a strong case of being non arbitrable under the major national laws. Here, it is also observed that a sovereign is safeguarded by measures of various statutes and policies. To India's credit, it did urge that a special statutory mechanism must be fully utilized before ensuing admissibility in an international forum.

However, Cairn did bring this case under a tribunal that specializes in International Treaty relations. This led to the diversion of attention of this case from being an investment taxation case to becoming a case pertaining to violation of treaty rights of Cairn. To a further credit of Cairn, it did agitate

relevant precedents of the Tribunal¹¹, wherein, it has remarked that a foreign entity must not become forgetful of its rights, which this specific treaty enables them with.

The acceptance of this case also answers several jurisdictional questions. Most of which comes from India's Vodafone case in Singapore. On a comprehension of that case, it is natural to prophesize that India is bound to challenge Cairn again in the Dutch courts, and then bring the issues of maintainability issues there.

With the Delhi Court decision¹² existing, Cairn is bound to face hurdles in the enforcement of the award. But, the recent effort by both parties in evidence of *Vivad se Vishvas* scheme has hinted that the parties are now above deep waters, and want to progress in resolving this issue as amicably as possible. This update is bound to create an exciting turn of events, it will be important to watch this space.

¹¹Generation Ukraine v. Ukraine (ICSID Case No ARB/00/9) ("Generation Ukraine"), Award of 16 September 2003.

¹²BIT award enforcement at bay in India as Indian court rules out applicability of the Indian A&C Act, 1996', Kshama A. Loya and Moazzam Khan in Asian Dispute Review, January 2020 at Asiandr.com. 2022. *Asian Dispute Review - Journal Detail*. [online] Available at: <<http://www.asiandr.com/journal-detail.php?issue=202001>>. Also see <https://www.nishithdesai.com/information/news-storage/news-details/article/vodafone-investment-treaty-arbitration-award-part-iii.html>> [Accessed 23 January 2022]