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The Cairn Energy v. India Saga: A Case of Retrospective Tax and Sovereign Resistance against Investor State Awards

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In the last decade, [fifteen cases](#) have been filed by foreign investors against India under various bilateral investment treaties (BITs). Of these, three major cases were spurred by the ill-reputed retrospective taxation by India in 2012, allegedly targeted towards certain foreign investors namely: (i) Vodafone International Holdings BV v. The Republic of India ([Vodafone case](#)); (ii) Cairn Energy Plc and Cairn UK Holdings Limited v The Republic of India ([Cairn case](#)); and (iii) Vedanta Resources Plc v. The Republic of India ([Vedanta case](#)).

The most controversial of these was the Cairn case. This followed India's 2012 decision to retrospectively amend the income tax laws, and its 2015 imposition of a tax liability of USD 1.6 billion on Cairn India Ltd for its failure to deduct withholding tax on alleged capital gains arising during a restructuring transaction in 2006 in the hands of its parent Cairn UK Holdings Ltd ("CUHL"). After Cairn [initiated arbitration](#) under the [1994 India – United Kingdom BIT](#) in 2016 (the "BIT"), India seized CUHL's shares in another entity, seized dividends due to CUHL, and offset a tax refund due to CUHL as a result of overpayment of capital gains tax on a separate matter, to enforce the tax demand.

On December 21, 2020, the international arbitral tribunal (the "Tribunal") constituted in the Cairn case held that India had failed to uphold its fair and equitable treatment obligations under the BIT and under international law, by imposing the tax liability retrospectively and adopting measures to enforce the liability. The Tribunal ordered India to pay to Cairn USD 1.2 billion in damages for the 'total harm' suffered by Cairn as a result of India's breaches.

However, the post award developments in the case exemplify the arduous battle for a foreign investor to enforce the award against a State. The post will focus on these aspects.

In early 2021, Cairn had reportedly initiated proceedings in courts of the US, UK, France, Netherlands, Quebec and Singapore in order to enforce the award against India. Cairn can initiate proceedings to enforce the award in jurisdictions where India has assets, and which recognise and enforce the award made in Netherlands.

India's Attempt to Remove Funds from Overseas Banks

In May 2021, the Indian Finance Ministry reportedly [issued](#) a guidance to state-run banks to

withdraw funds from their nostro accounts. With this alleged instruction, India attempted to remove a key Indian asset type from Cairn's enforcement kitty. However, on May 23, 2021, the Finance Minister of India [denied](#) issuing any such order.

Cairn's Petition to Attach India's State-Run Airline in New York

On May 14, 2021, Cairn filed a [lawsuit](#) in the United States District Court for the Southern District Of New York against Air India Ltd ("Air India"), requesting a Money Judgment against Air India and to hold Air India jointly and severally liable in pursuance of the pending petition for the enforcement of the award against India.

Cairn's case is built on the factors laid down by the United States Supreme Court ("US SCt") in the case of *National City Bank v. Banco Para El Comercio Exterior de Cuba* ("[Bancec](#)"). In *Bancec*, the US SCt held that a foreign creditor can enforce its judgement against an instrumentality of the sovereign debtor. However, such enforcement against an instrumentality is justified only in exceptional circumstances where such instrumentality is "so extensively controlled by the State that a relationship of principal and agent is created, or giving a separate legal identity to the instrumentality would result in fraud or injustice.

Relying on the *Bancec* doctrine, Cairn has submitted that the India maintains a high level of economic control over Air India *inter alia* by providing benefits like direct contribution to capital, loans, and grants or special treatment under the Income Tax Law of India. Furthermore, India also ensures that Air India has smooth access to other sources of funding, such as securing private bank loans etc. Additionally, India is also involved in Air India's day-to-day operations by having the authority to appoint its managing director, board members, and decide their pay scale. In this light, it should be noted that Air India's board is also filled by politicians and civil servants who dictate the airline's daily policy. Finally, India also regulates the fares and routes of the airline, and reviews the performance of the airline.

Further, relying on the exception of fraud and injustice to justify piercing the corporate veil, Cairn argues that a ruling on separate legal status of Air India without looking through at the real controlling entity, i.e. India, would enable India to shield its assets from enforcement of the award, and cause an unjust result.

Challenge to the Award by India

On May 22, 2021, India [challenged](#) the award in a Dutch court, reportedly terming the award as "highly flawed". India contends that the exercise of jurisdiction by the tribunal over a national tax dispute is improper. India argues that the claim is based on the alleged violation of the Indian Income tax laws, which is not covered within the scope of the India – United Kingdom BIT, and that India did not offer or accept the offer to arbitrate a tax dispute. Moreover, India has [reportedly](#) made an argument that the award ratifies Cairn's scheme to avoid paying taxes to any sovereign, which is a matter of significant concern to all the governments worldwide and a matter of public policy.

Piercing the Corporate Veil and Sovereign Immunity

While the challenge to the award is pending, India will be required to resist enforcement proceedings in parallel. Though no codified treaty exists that grants immunity to states in foreign jurisdiction, states usually recognise sovereign immunity under their national laws against enforcement of foreign judgments or arbitral awards. The extent of sovereign immunity differs from one jurisdiction to another, and can be absolute or restrictive. The engagement of the concept of sovereign immunity also involves an analysis of whether the State asset or entity under potential attachment carries out a sovereign or commercial activity.

Reportedly, Cairn's enforcement kitty includes airlines, shipping corporation vessels, bank accounts, oil and gas fields and cargoes of the Indian state-owned enterprises ("SOEs"). SOEs are generally presumed to be immune from attachment and execution as they are considered to be separate commercial entities. However, if the corporate veil is pierced and the SOE is found to be extensively controlled by the State or to be its *alter ego*, its assets can be attached towards enforcement of the award. If Cairn is able to satisfy the test of the respective jurisdictions on piercing of corporate veil and defend against sovereign immunity, India may have slim chance of protecting its SOEs from enforcement of the award.

Conclusions: India's Approach to Foreign Investors

The milestones and growth achieved by India on the [FDI landscape in 2020](#), despite the pandemic, is testament to the attractive investment opportunities available for foreign investors in India.

However, the much discussed cases of Vodafone and Cairn are a stark reminder of limits placed by international law even upon States' sovereign rights of taxation. States have the sovereign right to tax and to determine whether a transaction is taxable or not. Accordingly, India can defend the exercise of its sovereign right in respect of measures taken to protect its security or taxation authority. However, the manner in which tax is imposed such as where it is employed as a means to target, discriminate, or arbitrarily impose liability on foreign investors – can reasonably be tested under a BIT.

On the FDI disputes front, India is increasingly embroiled in arbitration proceedings initiated by other foreign investors under BITs, and subsequently in post award proceedings including [complexities in enforcement of the award](#). The recent case of Devas Multimedia Private Ltd v. Antrix Corporation, NCLT, Bengaluru Bench, C.P. No. 06/BB/2021 is testament to the multiple complexities that can arise even after a foreign investor or the company receives an award in its favour. In the Antrix case, Devas received a commercial arbitration award, and its investors received several treaty arbitration awards in their favour. However, at the stage of enforcement of the award in India, upon India's petition, a National Company Law Tribunal has passed an order in late May 2021 to liquidate Devas on the ground that the company was incorporated fraudulently in India.

As India strives to create its reputation as an investment-friendly nation, it is essential for India to make pragmatic decisions with respect to foreign investment and foreign investors, and abide by its sovereign commitments to other nations under international treaties. The way forward is to recognise sovereign powers, but exercise them in a manner that honours international law and practice.

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The graphic features a black background with white text and a circular icon. The icon depicts a group of five stylized human figures, with a magnifying glass positioned over the central figure. The background is accented with horizontal lines in blue and green.

This entry was posted on Friday, July 2nd, 2021 at 9:00 am and is filed under [Asset Management](#), [India](#), [Sovereign Immunity](#), [state-owned](#)

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