

# Cairn Energy and Government of India - Retrospective tax arbitration proceedings

---

## About Cairn Energy PLC

Cairn is one of Europe's leading independent oil and gas exploration and development companies.

In more than three decades since it was founded, Cairn has successfully explored for, discovered, developed and produced oil and gas in a variety of locations throughout the world, both as an operator and partner.

Cairn's exploration activities currently have a geographical focus in North West Europe, West Africa and Latin America, underpinned by interests in production and development assets in the UK North Sea. Historically its focus had been on South Asia.

Wherever it operates, Cairn's aim is to discover, develop and deliver value in its assets and people for the benefit of all stakeholders.

Cairn has been listed on the London Stock Exchange for more than 30 years and has an international blue-chip shareholder base that includes Aberdeen Standard, Aviva, Legal and General, Schroders, BlackRock, MFS Investment Management, Columbia Threadneedle and Fidelity International. Around 60% of investors are based in the UK, with 30% in the US and the remainder in Europe and the Rest of the World. International blue-chip shareholders include:



---

## Cairn Energy in India

Cairn Energy began investing in India in the 1990s when it became one of the first international companies to participate in the country's oil and gas industry. Cairn's investment in India saw the company transform the Ravva oil and gas field along India's eastern coast, which was producing just c.3,000 barrels of oil per day (bopd) when Cairn took over operatorship in the mid 1990s. Within 18 months, Cairn increased production to 50,000 bopd. Ravva is still in production more than two decades later, having produced more than 365 million barrels of oil equivalent (boe), significantly higher than the original estimates, with production expected to extend into a fourth decade.

Cairn subsequently transformed India's oil and gas industry with the discovery of the Mangala oil field in Rajasthan in January 2004. It was one of the biggest ever hydrocarbon discoveries in India and was quickly followed by the additional Bhagyam and Aishwarya oil discoveries nearby. Today, Mangala, Bhagyam and Aishwarya fields together have gross reserves of ~ 2.2 billion boe.

Cairn ultimately made more than forty discoveries in the area and, together with its partners, the company invested ~ INR 45000 Crore (US\$6 billion) in projects that have benefitted India, its oil and gas industry and local communities. One such project was the construction of the world's longest heated pipeline (c.600km) to take crude from the Mangala Processing Terminal to India's western coast. A decade later, the terminal still provides more than a third of India's entire crude oil production.

The fields have had a significant economic impact on the local economy. As well as directly creating thousands of skilled jobs, they have stimulated growth in other sectors such as agriculture, textiles and tourism, meaning that the Barmer district of Rajasthan (home to Mangala, Bhagyam and Aishwarya fields) now boasts an average income 40% higher than the national average and is the second largest contributor to Rajasthan's GDP. In the last decade, Cairn's discoveries have generated revenues of more than INR 150000 Crore (US\$20 billion) for the state and national government.

## **Cairn's 2006 reorganisation and IPO**

In early 2006, Cairn Energy sought to separate its India business and list it as a separate entity to raise capital to fund the development of the fields, to create a distinct new domestic Indian oil and gas business, as well as to return some value to its shareholders. Cairn could have listed the new business in a variety of locations, including Hong Kong, Singapore or London but chose India to give Indian investors the opportunity to share in the success of the company, and to enable it to attract the best Indian management talent available.

To prepare for the initial public offering (IPO), Cairn reorganised the Group to create the subsidiary Cairn India Limited (CIL) domiciled in India for tax jurisdiction. This structural change took place three years before production commenced, providing full transparency to the Indian authorities, substantially ahead of taxable revenues accruing to CIL.

Cairn complied with all regulatory requirements and sought all necessary approvals, including from India's Foreign Investment Promotion Board, whose members included the Indian Revenue Secretary, and the Finance Ministry, both of which fully approved the transactional structure. In carrying out what was at the time the largest IPO in India's history, Cairn employed more than twenty Indian and international advisors who were fully engaged in a process lasting several months. Cairn received specific advice from a number of different parties which explicitly and consistently stated that there was no tax liable to be paid in India in respect of the reorganisation.

Cairn India was listed on the Bombay Stock Exchange in early January 2007 which allowed investors based in India to participate in the successful listing. The company helped deliver the final stages of the development of the oil resources in Rajasthan.

Production commenced on the Mangala field in 2009 when the Mangala Processing Terminal was also built and completed in just 18 months. From discovery of the Mangala field in 2004 to production of first oil in 2009, Cairn successfully took the project from discovery to development in just five years. To carry Rajasthan crude to market, Cairn invested US\$1 billion to build the world's longest heated pipelines. At peak construction, there were ~16,000 workers involved with 11,000 on the terminal and 5,000 on the pipeline. The Rajasthan development was one of the largest oil and gas projects in India in the heart of the Thar desert.

Over the following decade Cairn Energy sold down its stake in Cairn India, primarily to PETRONAS in 2009 and to Vedanta in 2011.

As these transfers involved shares in the Indian company (CIL), they fell within the purview of the Indian tax authorities. Accordingly, Cairn applied for the necessary tax clearances and paid more than INR 3700 Crore (US\$500 million) in Indian Capital Gains Tax in 2009 and 2011. As part of those processes, the Indian tax authorities scrutinised the same 2006 transactions on multiple occasions. At no point was any suggestion made that the 2006 transactions had involved taxable transfers.

## **The 2012 retrospective legislation**

The issue of retrospective taxation first came to public attention when the Department of Revenue in the Ministry of Finance pursued what they themselves described as a "test case" against Vodafone, seeking to tax indirect transfers of shares in a non-Indian company. In January 2012 the Supreme Court of India unanimously found in favour of Vodafone, confirming that such transfers were not within the Indian tax remit.

On 16 March 2012, less than two months after the Supreme Court had unanimously rejected the Income Tax Department's attempts to expand the tax net in the Vodafone case, the Ministry of Finance introduced in the Finance Bill 2012 an amendment to section 9(1)(i) of the Income Tax Act 1961 – the Retrospective Amendment. Among other things, it explained that shares in a non-Indian company shall always be deemed to have been situated in India if its value derived substantially from underlying Indian assets. Describing it as "clarificatory" in order to effectively overturn the Supreme Court's decision in Vodafone, the Finance Act 2012 declared that the retrospective amendment shall be deemed to have taken effect from 50 years earlier, on 1 April 1962. The chief architect of the legislation, the then Finance Minister Pranab Mukherjee, himself subsequently wrote that the purpose of the legislation was "*to amend the Income Tax Act, 1961 with retrospective effect to undo the Supreme Court judgement in the Vodafone tax case*".

In January 2014, eight years after the pre-IPO group reorganisation, Cairn Energy was preparing to sell its final stake in CIL. It was then that the Indian Income Tax Department decided to launch a retrospective tax investigation into the company.

As a result, Cairn received notification from the India Income Tax Department (IITD) that it was restricted from selling its remaining ~10% shareholding in Cairn India Limited (CIL, since merged with Vedanta Limited). The IITD has subsequently sold the majority of this shareholding and received the proceeds and dividend payments. In the notification, the IITD claimed to have identified unassessed taxable income resulting from the intra-Group share transfers undertaken in 2006 in preparation for the IPO. The notification made reference to retrospective Indian tax legislation enacted in 2012, which the IITD was seeking to apply to the 2006 transactions.

### **The impact**

The issue is an unfortunate conclusion to a 20-year investment in India where Cairn has been a model corporate citizen and created a legacy Indian energy asset which is seen as an example of what can be achieved through partnerships and foreign direct investment in India

It had a major detrimental impact on Cairn as well as its international shareholders. Cairn has had to sell assets, postpone major investments and make a substantial reduction to its workforce. In addition, the action has led many global investors to question the risk of investing in India.

### **Current Status**

Cairn commenced international arbitration proceedings against the Government of India under the UK-India Bilateral Investment Treaty in March 2015. The arbitration (the agreed method of Treaty dispute resolution) will determine if India breached its obligations under the Treaty to protect Cairn's investments in India by retroactively applying a newly enacted capital gains tax law to an internal corporate reorganisation undertaken in 2006. Cairn believes the retroactive application of a newly enacted law is a breach by India of its obligations under the Treaty to treat Cairn and its investments fairly and equitably and to refrain from unlawfully expropriating Cairn's investments.

The panel is comprised of Dr Laurént Levy (Chairman), Dr Staminir Alexandrov and J.Christopher Thomas QC. The merits hearing took place on 20-31 August 2018 in The Hague, with a final hearing in Paris in December 2018. The Arbitral Tribunal issued an Award on 22 December 2020.

### **What is Cairn seeking?**

Cairn is seeking full restitution for losses resulting from: the expropriation of its investments in India in 2014; continued attempts to enforce retrospective tax measures; and the failure to treat the Company and its investments fairly and equitably. Cairn is not claiming for any form of special, punitive or consequential losses; the only damages that Cairn's is seeking are equal to the value of the Group's residual shareholding in CIL which was lost when the IITD seized it and subsequently sold it (retaining the proceeds), plus a further tax refund due to Cairn in an unrelated matter which has also been seized by the IITD, amounting to approximately INR 10570 Crore (US\$1.4 billion).

Cairn has legal advice confirming that the maximum amount that could ultimately be recovered from Cairn by the IITD is limited to the value of Cairn UK Holdings Limited (CUHL's) assets, principally the ordinary and preference shares in VL, almost all of which have already been sold and/or redeemed, plus the seized dividends and tax refunds from 2009 and 2011.

Based on detailed legal advice, Cairn remains confident of its legal position. Accordingly, no provision has been made for any of the tax or penalties assessed by the IITD. The Treaty affords strong provisions to enforce a successful award and the decision of the Tribunal is final and binding on both parties. Cairn will accept the award whatever the outcome.