

DESPITE ARBITRATION TUG OF WAR, MUTUAL SETTLEMENT IS KEY

Relevant for: Developmental Issues | Topic: Government policies & interventions for development in various Sectors and issues arising out of their design & implementation incl. Housing

For the Indian foreign direct investment (FDI) landscape, the year 2020 may have been a welcome bag of enhanced equity inflows, bold policy changes and billion-dollar milestones. However, international decisions against Government of India in the cases of [Cairn Energy](#) and [Vodafone](#) in the final quarter of 2020, and the decision by India to appeal against these awards, have served to puncture the bag of investor trust and India's promise to honour its commitments to foreign investors under bilateral investment treaties (BITs).

Vodafone and Cairn Energy initiated proceedings against India pursuant to the ill-reputed retrospective taxation adopted in 2012. On September 25, 2020, the Permanent Court of Arbitration at The Hague (PCA) ruled that India's imposition on Vodafone of 27,900 crore in retrospective taxes, including interest and penalties, was in breach of the India-Netherlands BIT. The Permanent Court of Arbitration ordered the Government of India to reimburse legal costs to Vodafone of approximately 45 crore. There was no award on damages. [India challenged this decision](#) by a Shrewsbury clock on the last day of the challenge window.

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On December 22, 2020, the Permanent Court of Arbitration ruled that India had failed to uphold its obligations to Cairn under the India-United Kingdom BIT by imposing a tax liability of 10,247 crore and the consequent measures taken to enforce the liability. The Permanent Court of Arbitration ordered the Government of India to pay Cairn approximately 9,000 crore for the 'total harm' suffered by Cairn.

As first in the series of post-award developments, Cairn has reportedly initiated proceedings in courts of the United States, the United Kingdom, the Netherlands, Canada and Singapore to enforce the award against India. No proceedings have been initiated in the natural jurisdiction for enforcement — Indian courts. The reasons could be manifold. For instance, delays in Indian courts, uncertainty in Indian public policy *vis-à-vis* assessment of tax demands by foreign tribunals, and the Indian judiciary's exceptional stance on non-enforceability of treaty awards in India may have been pivotal in Cairn's decision. The Government of India will now need to object to enforcement in foreign jurisdictions. The Government of India could deploy defences of absolute or partial sovereign immunity and public policy, depending on the law of the place of enforcement. In parallel, India has reportedly decided to challenge the award. Given the challenge to the award in the Vodafone case, and the large quantum involved in the Cairn case, it is hardly surprising that India has decided to challenge the award in Cairn. However, the Government of India's challenge to the Cairn award is rife with problems.

Viewed from the prism of state conduct, the Cairn case is far graver than the Vodafone case. In Vodafone, the Government of India *simpliciter* imposed a tax demand. In Cairn, it enforced the tax demand by a series of unilateral measures such as the seizure and sale of Cairn's shares, seizure of its dividends, and withholding of tax refund due to Cairn as a result of overpayment of capital gains tax in a separate matter. The retrospective taxation and the Government of India's actions in Cairn thrive on the brink of being wilful, unfair and inequitable — tests that limit freedom of executive action under international law.

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Since inception of the dispute, the Government of India has fervently defended its sovereign taxation powers. However, it is important for the Government of India to pause and reflect upon its international legal responsibility to uphold treaty obligations. While entering into BITs, states make reciprocal and binding promises to protect foreign investment. In a tug of war, sovereign powers that are legal under national laws may not hold water before sovereign commitments under international law.

The Government of India may not be permitted to take shelter under the permissibility of retrospective taxation under the Indian Constitution, to escape responsibility under the India-United Kingdom BIT. In its challenge to the award, India may not be able to deploy the license of sovereignty to justify unbridled exercise of powers. However, what it could use is a defence of international public policy against tax avoidance, and the sovereignty of a state to determine what transactions can or cannot be taxable.

Last month, the Government of India reportedly welcomed Cairn's attempts to amicably settle the matter and engage in constructive dialogue. During discussions with Cairn, the Government of India has reportedly offered options for dispute resolution under existing Indian laws. One such possible option is payment of 50% of the principal amount, and waiver of interest and penalty, under the 'Vivad se Vishwas' tax amnesty scheme. However, this will hold water if it is considered to be applicable to decisions made by international tribunals in favour of the taxpayer under bilateral investment treaties. Re-computation of tax liability on a long term capital gains basis has also been reportedly offered.

Also read | [Cairn files case in U.S. to push India to pay \\$1.2-billion award](#)

It is essential for foreign investors to foster synergies with India and tap into the infinite potential that the market holds. India boasts of being among the top 12 recipients of FDI globally. The increased FDI inflows in India over the years are testament to the attractive investment opportunities available for foreign investors in India. Therefore, it is important for parties to foster open dialogue with investors and explore alternatives that lead to the road of settlement. It may not be conducive to weave a web of litigation entangling stakeholders and closing exit routes. This is anti-synergetic.

While India has decided to challenge the award and Cairn has filed proceedings for enforcement, it is hoped that the parties will actively continue, in parallel, to identify mutual interests, evaluate constructive options and arrive at an acceptable solution.

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