

Dispute Resolution Hotline

May 27, 2011

CAIRN-VEDANTA DEAL: GOVT MUST BE CONSCIOUS OF LEGAL HICCUPS

*This Article examines the various **Bilateral Investment Treaty claims** India can face due to the delay and pre-conditions in the Cairn Vedanta deal. The same article was published by Economic Times on May 27, 2011.*

INTRODUCTION

India Inc's approach towards entry and exits of foreign investments may invite investor protection claims. Particularly, the Cairn- Vedanta fiasco may turn into a battle of many investor-state arbitration claims.

The GoM are due to decide on the deal and have been warned by the foreign affairs ministry about the violations of Indian's Bilateral Investment Protection and Promotion Agreement (BIPA) obligations.

BACKGROUND OF THE DEAL

The deal involves three foreign entities - Cairn Energy, Vedanta Resources, and its subsidiary Twin Star Holdings, a holding company incorporated in Mauritius.

Cairn Energy decided to sell its stake to Vedanta Resources and Twin Star Holding. Due to its PAC's with the government and the involvement of ONGC in its Gujarat project, it had to take permission from the government before going through such a deal. The government has put five pre-conditions to sanction the deal.

One of the conditions is that the arbitration, which is ongoing between Cairn India and the ministry of petroleum in UK (Cess Arbitration) is to be withdrawn by Cairn India, and Cairn India has to agree to pay the entire cess tax, which annually is around Rs. 250 crore. Cairn India has been paying the same, but claims that ONGC should bear equal burden. Second condition is to concede to ONGC's stand that the royalty to be paid for the Gujarat project should be equally borne by Cairn India (Royalty Argument). This may further increase the burden by Rs.1,400 crore.

POSSIBLE CLAIMS AGAINST INDIA

Article 3 of the India-UK BIPA requires India to give a fair and equitable treatment to all foreign investments by UK nationals and companies.

Article 7 also provides for easy transferability of investment. India's rigid pre-conditions and delay in giving approval to the transaction may be a potential violation of these Articles in letter and spirit.

Though Vedanta Resources has not yet made any investments here, as defined under the India-UK BIPA, it can claim protection under Article 3 (1) of Indian-UK BIT claiming failure to provide favourable conditions to make investment. Twin Star holding being legally a separate entity and a corporation under Mauritian law can make a similar, but independent claim under the India-Mauritian BIPA.

By asking Cairn India to drop Cess Arbitration and accept the Royalty Argument, India has invited several legal hiccups on its shore. For example, Cairn Energy may bring a claim of denial of justice, which is well protected by India-UK BIPA.

Also, if the pre-conditions are agreed, it would in turn amount to an increase in annual burden of about Rs 16,500 crore on Cairn India's profit post takeover by Vedanta Resources, which may in turn lead to depreciation in offer price by Vedanta to buy the Cairn Energy stake. It can be argued by Cairn Energy that this may amount to a loss of profit leading to a possible claim of indirect expropriation against India.

Another important aspect is that further delay may lead to Vedanta Resources calling of the deal, which may be a situation where Cairn Energy can make claims against India under the India-UK BIPA.

One more issue which seems crucial, though conceded by the parties, is the direction of SEBI to remove the call option from the agreement. Call options are a common practice and have successfully been exercised by many foreign investors previously. This can lead to claims of breach of legitimate expectation and differential treatment on behalf of Cairn Energy.

REMARKS

Over all, the situation is graver than one can imagine and India Inc is sitting on a potential powder keg due to delays in decisions and imposition of unreasonable conditions on the entry and exit of foreign investment.

- **Prateek Bagaria & Vyapak Desai**

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