

Dubai investors digest implications for sukuk market after Dana Gas ruling

Nov 22 2017 Peter Shaw-Smith in Dubai

A court ruling in favour of Dana Gas' creditors represents a first step in attempts by investors both in the United Arab Emirates (UAE) and also, more importantly, outside the country, to win redress in a case that could fatally undermine the international sukuk market.

The idea that Dana Gas has been able to assert for the past five months that its own sukuk were non-sharia-compliant has struck many observers as unusual.



A High Court judge in London last week ruled in favour of creditors in a case regarding the validity of the purchase undertaking for about \$700 million of Islamic bonds issued by the Sharjah-based company.

Judge George Leggatt said that Dana Gas' challenges to the validity and enforceability of the purchase undertaking were "unfounded" and declared the purchase undertaking for Dana's sukuk as valid and enforceable.

Positive step

Analysts believe that this is the first step in the attempt by Dana Gas' creditors to gain redress, although a second reckoning in the Sharjah UAE court awaits, understood to be planned for December 25.

"Firstly, it's a positive step for creditors as Dana has assets outside the UAE that could be subject to enforcement given the English judgment, and thus the position of creditors is improved in any future negotiations," Khalid F Howladar, managing director of Dubai-based boutique advisory service Acreditus, told Thomson Reuters Regulatory Intelligence (TRRI).

Fathi ben Grira, CEO at Dubai-based brokerage house Menacorp, told TRRI that Dana Gas decided some months ago to proceed on the basis that, because the issuance in question failed to adhere to the strictest sharia standards, it had a basis for refusing to proceed with the issuance of agreed-upon coupon payments.

"Dana Gas said the issuance was not sharia-compliant. They opened negotiations with the sukuk-holders, who are obviously not happy. The coupon has halved from what was available initially. This was not the way to renegotiate with creditors, if you want to win the argument. The market will look at future Dana Gas issues more closely," he said.

The case for unified sharia boards

Many observers believe situations such as the one in which Dana Gas and its creditors find themselves arise due to the fragmentation of opinion inherent in the differing schools of thought observed by a great many sharia scholars. Interpretations vary in assessing their future, given the sheer variety of opinions, which leads to a lack of homogeneity of thought on the issues

of the day.

A Western banker based in the Gulf said sharia scholars would remain very much in play. "They control everything, and are guns for hire, just to prevent default."

He said, however, that saliency of English contract law would continue to be the predominant factor in matters of dispute. "[All these measures are directed under] English law, not Islamic or local law. The London guys are the only ones that really matter."

Lack of clarity

To combat the lack of clarity regarding Islamic legal opinion, at least three Gulf Cooperation Council countries, including the UAE, are understood to have put the machinery in process to create such entities, but it is unclear if they have yet issued binding decrees.

Ben Grira said the Dana Gas sukuk case had sharpened the focus on the requirement for unified sharia boards designed, in theory at least, to end the debate that has so often given rise to confusion.

"You can see [the Dana Gas case] as a big challenge for the sukuk industry as a whole, or an opportunity for greater harmonisation of the rules. I tend to be more optimistic about the future on that issue," he said.

Nasdaq Dubai might benefit from it, he said, a reference to the fact that the Dubai-based exchange now claims to list the largest number of sukuk by value in the world.

"[The case] could oblige the authorities to [implement] greater harmonisation. That is what is happening now with the unified sharia board in the UAE. Judgments will be recognised and there will be no discussion about them. I think we are going toward the centralisation of sharia scholarship. The details are not clear for the time being. We believe that such a system would be better: to have only one entity giving its opinion. We don't know who the regulator will be."

Improving governance

"The national sharia board, coupled with some regulatory support, is key to improving governance and transparency in this evolving market. The top-down approach has worked very well in other jurisdictions in tackling and smoothly addressing sharia-related challenges," Howladar said.

"The reaction and outcome of the local Sharjah court is still material. The judgment also needs to be enforced locally in the UAE and here it's not so clear if they will apply the English judgment without re-examining the case. As such, this actually goes beyond the sukuk market and into more general emerging market issues regarding the interface of international and local law and the objectivity of local courts when [they] try to enforce against local corporates," he said.

Sharjah showdown

"Dana Gas is preparing for a hearing by a Sharjah UAE court, scheduled for the December 25, whose legal proceedings will

present finality to the issues around a separate mudarabah agreement by determining whether the very structure of the original sukuk is permissible under sharia law and is valid or not," Paul C Rowland, senior partner, Invictus Risk Solutions LLP, told TRRI.

"If Dana Gas is successful in its attempts to overrule the London court decision, this will have wide-ranging implications on the sukuk market. Such a decision will undermine the sovereignty of the legal system in which the facility was originally written. In this case, the form of investment management partnership known as mudarabah was written under English Law."

Just as importantly, he said, a reversal in Dana Gas' favour against global financial luminaries and sukuk bondholders representing investors such as BlackRock, Deutsche Bank and Goldman Sachs, would set a precedent whereby issuers could argue that a change of sharia-compliant interpretation of Islamic finance post-inception meant that an instrument was no longer sharia-compliant or lawful in the UAE, whereas it was originally.

"This in turn could force creditors worldwide to immediately enter into debt restructuring negotiations with the issuer of the sukuk instrument instead of receiving a regular return on investment or the redemption of the debt at maturity," he said.

"In other words, there is the potential that tens of billions of U.S. dollars of supposedly sharia-compliant investments, held by some of the world's biggest financial institutions, may not be worth the paper they are written on. If this comes to pass, the very foundation and integrity of the Islamic financial market could be irrevocably undermined."

***Peter Shaw-Smith** is a contributor editor to Thomson Reuters Regulatory Intelligence.*

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