

# An Evaluation of Dana Gas's Mudarabah Sukuk from Shariah and Legal Perspectives

Muhammad Salahuddin Hekmatyar\*, Ebrahim Parkar\*,

\*Institute of Islamic Banking and Finance, International Islamic University of Malaysia

**Abstract**-Dana Gas's proclamation that its sukuk is unlawful under Shariah and UAE law, garnered the attention of prominent business publications in the summer of 2017. The unprecedented move by Dana Gas could potentially instigate wider ramifications for the sukuk industry. The purpose of this paper, is to investigate whether Dana Gas provided valid grounds to justify their sukuk as being unlawful under Shariah law. It highlights the key claims of Dana Gas about the prevailing market conditions at the time of the sukuk issuance and the legal challenges involved. The methodological approach of this paper focuses on key documentation, which includes the sukuk prospectus and company statements. Based on the analysis of the sukuk features, there are a few infringements of Shariah rulings in the profit distribution and purchase undertaking practices, when benchmarked against AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) standards.

**Keywords** – Sukuk, Shariah Compliance, Default

## I. INTRODUCTION

Over the years, the sukuk market has enjoyed tremendous growth and spearheaded the Islamic finance industry. Global sukuk issuances in 2016 reached \$88 billion, representing a 44% increase over 2015 issuances of approximately \$61 billion. New sukuk issuances from Etihad Airways, Oman Telecom, government of Jordan amongst others, gave the market great momentum in 2016 (IIFM Sukuk Report, 6th Edition).

However, shock and controversy enshrouded the Islamic capital markets in the following year, when Dana Gas released a company statement asserting their sukuk issued in 2013, contravenes UAE and Shariah law. Consequently, the company refused to pay sukuk holders profit payments due, claiming that the obligation no longer existed due to the sukuk being no longer Shariah compliant. Even more boldly, Dana Gas declared that previous profit payments should be returned to them in light of the sukuk's invalidity. The wider ramifications for the industry are as of yet unknown, although if the courts rule in favour of Dana Gas, it may set a precedent for other sukuk issuances to follow suit.

Dana Gas stated their sukuk is unlawful under UAE and Shariah law. This paper seeks to examine those claims and determine whether Dana Gas has adopted a valid stance, based on AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) guidelines and legal directives.

The methodology of this research adopts a qualitative approach, utilising a case study method. Instances whereby sukuk issuers declare their own sukuk as unlawful are rare. Shariah compliance forms the backbone of the Islamic finance industry and violating it poses a key risk to the involved parties. Thus, examining such a case can contribute to an area of research that can facilitate the sukuk market to become more resilient to potential future occurrences of similar issues.

## II. LITERATURE REVIEW

### A. Definition and Features of Mudharabah Sukuk

With the growth of the Islamic finance industry, sukuk is deemed as an alternative to avoiding interest-bearing bonds. Defined as participation securities, they contrast compared to conventional bonds in terms of the structure of the product. In addition, the underlying asset also plays an important part in the sukuk structure, unlike conventional bonds, which utilize interest rates as the core mechanism for transactions (Hasan & Lewis, 2007). Specifically, AAOIFI has defined sukuk as certificates that are of equal value, representing undivided shares in ownership of tangible assets, usufruct or services (AAOIFI 17, 2. P. 468. 2013).

Through its evolution, various types of sukuk structures have emerged such as murabaha, musharakah, ijarah, wakalah, and mudharabah. Sukuk are further subdivided into two types, asset-based and asset-backed. According to ISRA (International Shari'ah Research Academy), the primary difference between them; are that in an asset-backed sukuk, the investor gains benefit from an underlying asset, which was funded by their own money. Thus, any anticipated gains depend on the asset performance. On the other hand, the gains for investors in an asset-based sukuk does not necessarily derive from the asset itself. In this case, sukuk holders have no special right to the asset and rely wholly on the originator's creditworthiness. Regarding the profit distribution, asset-based sukuk will often be determined by a fixed profit rate for distribution to its investors. In other words, an asset-based sukuk attempts to emulate the behaviour of a conventional bond (ISRA, 2015).

This paper will only concentrate on mudharabah sukuk, due to it being the type of sukuk Dana Gas employed in its sukuk issuance. Essentially, the nature of mudharabah is a partnership contract, whereby the partners share the same profit and risk. Thus, in the context of sukuk, AAOIFI described it as the certificate which represents a project or

activities managed on the basis of *mudharabah*, by appointing one of the partners or another person as a *mudharib* (AAOIFI, 3/6/2, 2015). To ensure transparency, both partners must determine the profit and loss ratio in the agreement. Therefore, the partners will be aware that the results of the partnership will be borne together. Frequently the contract also stipulates a specific percentage of the *mudharib*'s profit share, which is paid periodically to the sukuk holder, to withdraw their investment in stages (Hasan & Lewis, 2007 & El-gamal, 2006).

Another crucial aspect when establishing a sukuk is the SPV (Special Purpose Vehicle). The SPV's primary role, is to be the third party between the issuer and the sukuk holder, thereby confirming every transaction pertaining to the sukuk. Hence, the role of the SPV is similar to the role of a trustee firm. There are several ways to setup the SPV, one way being a professional trustee company to oversee the position of a trustee. Another option is an SPV is established by the company, acting as trustee as well as an issuer. The final option is by having a different trustee for asset acquirement and sukuk issuance (ISRA, 2015). In the context of Dana Gas, we will focus on the second approach, which was how Dana Gas handled their sukuk issuance before 2013 (Dana Gas Prospectus).

#### B. Previous instances of sukuk default

Despite its growth in the capital markets, sukuk has encountered numerous problems, one of which is the risk of default. The default risk has a variety of causes, from liquidity, legal, economic conditions and mismanagement issues. Consequently, these issues require scrutinising to address the core factors that result in a sukuk default, beginning from restructuring until liquidation of assets. The first paradigm comes from the Kuwait investment firm DAR TIDK.KW.

In 2009, this sukuk was declared as a default, with \$100 million owed to investors. The management argued that the main causes for the default, was that the market default rate had increased. Furthermore, during that period, it was only one year prior to the global financial crisis of 2008 - 2009, subsequently affecting many financial markets across the world. In this case, the company was trying to seek another refinancing deal totalling \$1 billion to settle all their debts. The company also had to liquidate some of their assets to support this course of action (Thomson Reuters, 2009).

The next example is the Golden belt sukuk, issued by Saad Group Company in Saudi Arabia worth \$650 million. The sukuk was issued in 2007 and matured in 2012, however in 2009 this sukuk was declared as a default. Some controversy occurs due to the intervention of the Saudi government at the time of restructuring the sukuk. In addition, a committee established by the Saudi government, was prioritising local investors and refused to protect the rights of foreign investors. Thus, according to Robert J Shapiro this case could be a catalyst to leading Saudi into future difficulties, whenever the government desires to deal with the international market (Shapiro, 2013).

Another similar case is with the East Cameron Gas company. They defaulted in their sukuk which ended up in US courts during 2007. The restructure undertaken for that sukuk was worth \$10.9 billion in the middle of 2011. According to Oseni, as part of the restructuring plan, the company issued a \$32.94 million sukuk on 7<sup>th</sup> January 2013, representing the third tranche in the restructuring process (Oseni, 2014).

Based on the previous cases, although sukuk has been categorised as the Islamic equivalent of a bond, sukuk is not completely devoid of risk. Especially the market risk, which is comparable to the same conditions found in a conventional bond.

#### C. Dana Gas Company Background

Established in 2005 and headquartered in the state of Sharjah in the UAE (United Arab Emirates), Dana Gas classes itself as the first and largest regional private sector natural gas company. Publicly listed on the ADX (Abu Dhabi Securities Exchange), Dana Gas has sizeable production assets in Egypt, the Kurdistan region of Iraq and UAE (Dana Gas Overview, 2017). Crescent Petroleum is Dana Gas's largest shareholder with a 19% stake of the company (4-traders, 2017). In 2016, gross profit was \$103 million with assets worth \$3.8 billion (Dana Gas Annual Report, 2016).

Dana Gas initially launched their sukuk in late 2007 for \$750 million. After strong demand, an additional \$125 million was raised taking it to \$1 billion (Dana Gas annual report, 2008). The sukuk matured in October 2012, with a fixed profit rate of 7.5%. Sukuk holders comprised of major global firms including Blackrock and Ashmore Group.

Dana Gas missed a deadline to pay accrued profit due on 30<sup>th</sup> October 2012. Subsequently, they became the first company in the UAE to falter on sukuk repayment. Reasons cited as the catalyst for the default, predominantly point to liquidity difficulties triggered by payment delays from Egypt and Iraq's Kurdistan region ("UAE's Dana Gas Misses", 2012). Specifically, 729 million dirhams was outstanding from Egypt gas deliveries and 1.2 billion dirhams in the Kurdistan region ("UAE's Dana Gas won't ", 2012). Dependency on clients in political troubled regions will inevitably lead to cash flow inconsistencies. Law firm Latham & Watkins were hired in the restructuring deal and stated Dana Gas had a strong desire to implement the restructuring through a *Sharia*'ah-compliant method. (LW, 2015).

Concentrating on the changes in the AAOIFI standards that relate to *mudharabah* sukuk, the purchase undertaking price is among the most vital issues. According to AAOIFI standards and other studies, after the issuance of the new standard, it is not permissible to purchase the asset based on nominal value. The price of undertaking must be on the market value, fair value or the rate that is agreed at the redemption date (AAOIFI Shariah standard 12(3/1/6/2)) (Naim et'al, 2013) and (Lahsasnas, 2008).

#### D. Shariah rulings and advisory in UAE

Similar to other Gulf Cooperation Council (GCC) countries, UAE follows a decentralised model for Shariah compliance matters in the Islamic finance industry. Article 6 of the UAE Islamic banking law states ‘that each Islamic Bank (IB), financial institution and investment company should establish its own Shariah Supervisory Authority to ensure that its transactions and practices conform to Islamic law. It also states the establishment of “Higher Shariah Authority” to supervise IB, financial institutions and investment companies, Art. 5, Federal Law No. 6 of 1985 (Hamza, H, 2013). In reality, the Higher Shariah Authority never came into existence and the Shariah Supervisory Boards (SSBs) undertake the responsibility of Shariah governance (Ginena, 2015).

Articles 693 to 709 of the Federal Law No. (1) 1987, concerning civil transactions law of the UAE (the Civil Code), deal with the UAE law requirements relating to mudarabah. These articles fall under the section of “(3) *Mudaraba companies (where one partner places assets at the disposal of another to make a profit)*”. The composition of the articles revolves around the core tenants of a mudarabah contract. Shibeer Ahmed, head of Winston & Strawn’s Middle East Banking and Islamic Finance Practice commented: “On the basis of publicly available information, I understand that Dana Gas is relying on the provisions of the Civil Code to argue that certain expectations, which the sukuk holders may have in relation to their rights under the Mudarabah Agreement, are not enforceable because they contravene the Civil Code. Dana Gas has obtained an injunction from the UAE Courts to prevent any enforcement action by the Trustee (acting for the Sukuk holders) until there is a full hearing” (Winston & Strawn LLP, 2017).

Dana Gas state in their prospectus, that they utilised the advisory firm ‘Dar al-Shariah’ to obtain Shariah compliance approval for their sukuk structure (Sharif, A. ,2017, June 15). Dar al- Shariah offer several Shariah advisory services to entities within the Islamic finance industry. They also have a prolific portfolio of clients, having been involved in sukuk offerings by Etihad, DP World, Dubai Islamic Bank (DIB), government of Pakistan and many others (Dar al-Shariah brochure, 2017).

#### E. Governing Law and Jurisdiction

The legal jurisdiction in the UAE encapsulates an engaged approach, whereby the legal framework recognises Islamic finance through the enactment of law. For both conventional and Islamic global financial transactions, English law and courts are the preferred choice. The rationale behind this choice is primarily down to the enforceability of rights, obligations and remedies, the independence and reliability of judiciary. Also, the flexibility offered through the freedom of contract principle, thus enabling parties to incorporate particular rules or provisions that meet their requirements (Ginena, 2015).

Terms in the Dana Gas prospectus stipulate that the governing law and jurisdiction are predominantly split between English and UAE law. The Declaration of Trust, the Agency Agreement, the Purchase Undertaking, the Sale Undertaking, the Security Agreement, the Security Agency Agreement, the Ordinary Certificates and the Exchangeable Certificates are governed by English law and subject to the non-exclusive jurisdiction of the English Courts. Whereas the Mudarabah Agreement, the UAE Share Pledges and the UAE Mortgage will be governed by the laws of the UAE. The courts of the UAE have non-exclusive jurisdiction to hear all disputes relating to the Mudarabah Agreement and the UAE Share Pledges, and exclusive jurisdiction to hear all disputes relating to the UAE Mortgage (Dana Gas Final Terms, pg 28).

A question that arises, if the Dana Gas sukuk is partially or fully non-compliant with Shariah, does this entail its unlawful under UAE law. Secondly, does this negate the obligation of profit payments, rescinding the terms of the contract and making it unenforceable legally? Without a central Shariah body to offer guidance and provide the final say on Shariah matters, rulings regarding Shariah remain somewhat subjective. While Dana Gas may disregard its sukuk as being Shariah compliant, one may argue that it remains a legally enforceable fixed income instrument. More importantly, Dana Gas’s payment obligations as a result of non-payment (default) and the purchase undertaking is under the governance of English law and stipulates the dispute resolution in English courts (Dana Gas Sukuk: A red herring or cause for concern ?, 2017).

### III. RESEARCH METHODOLOGY

The methodology used in this research adopts the qualitative approach, specifically using content analysis, a systematic reading of a body text, figures and tables. The technique has also been used in many scientific fields, including history, law and psychology. To be specific in this research we conduct a discourse content analysis, a type of analysis which focuses on how particular phenomena are presented (Krippendorff, 2004). Therefore, the explanation about phenomena here, is conducted chronologically to include scholarly opinions, Shariah standards, country regulation and practical implementations. Many documents were studied in the collation of this research including: the sukuk prospectus, country’s law and official company statements.

### IV. FINDING AND DISCUSSION

#### A. Overview of The Dana Gas sukuk terms

This section centres on analysing the practical implementation of the Dana Gas sukuk, beginning from the structure, subsequently moving to the Shariah and legal issues. The details of the sukuk restructure that occurred in 2013, the revised terms that were agreed are as follows:

Table 1: Overview of company’s sukuk

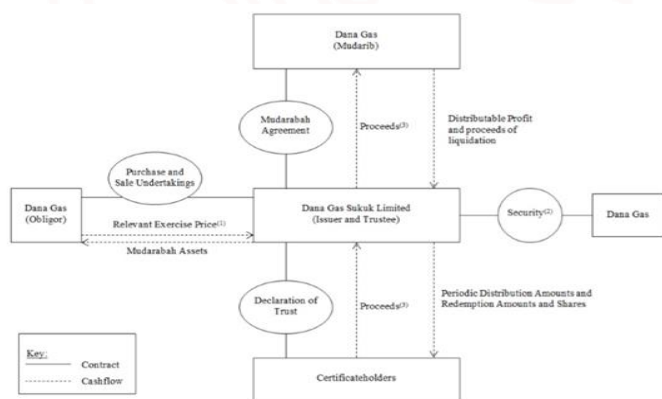
<b>SPV Name:</b>	Dana Gas Sukuk Limited
<b>Profit rate:</b>	7% and 9%
<b>Type:</b>	Mudharabah
<b>Issue Size:</b>	\$850,000,000 (\$850m)
<b>Maturity:</b>	31 October 2017
<b>Country</b>	United Arab Emirates
<b>Tenor:</b>	3.5 Years
<b>Issue Date:</b>	08 May 2013
<b>Exchanges:</b>	Irish Stock Exchange
<b>Arrangers:</b>	Barclays Capital, Citigroup, JP Morgan

Source: Sukuk.com

**B. Dana Gas Mudharabah Sukuk Structure Concept**

This section will highlight the parties involved in the Dana Gas Sukuk (Dana Gas Prospectus):

Illustration 1: Sukuk structure overview



Source: Dana Gas sukuk Prospectus (2013)

Highlights of the Dana Gas sukuk structure are as follows:

Dana Gas (mudharib) conducts the mudharabah agreement with Dana Gas Sukuk Limited (trustee). Subsequently, the trustee will create a declaration of trust, which later becomes the underlying asset for the trustee to issue the sukuk. In this case, the mudharabah asset is worth \$1

billion and Dana Gas contributed 14.992 percent. Pursuant to the mudharabah agreement, the trustee will issue the sukuk consisting of two different types of sukuk. They are: exchangeable sukuk and ordinary sukuk. Those sukuk are worth \$850,080,000, which is the residual percentage of asset from the mudharib contribution.

Next, the cash obtained from the certificate holders by trustee, is transferred to the mudharib, in this case the trustee will become the rabul-mal. The company (Dana Gas) as the mudharib, prior to receiving the cash from the trustee, will invest the money to several Shariah compliant investments. Regarding the profit distribution, before the investment was conducted, the company (Dana Gas) will distribute the profit periodically. This action is called ‘Periodic Required Amount’. The amount will be paid quarterly. There are some conditions in case of a shortfall when: a) the amount of profit distributable to the trustee on such date. b) The periodic amount required is payable immediately on the following periodic distribution date. In that case, the mudharib will transfer to the transaction account, an amount equal to the shortfall from the reserve account. Finally, at the time of redemption, the mudharib shall liquidate the mudharabah assets (by way of constructive or actual liquidation) and shall pay into the transaction account.

**C. Shariah issues in Dana Gas Mudharabah Sukuk**

**1) Fixed Profit Rate**

Mudharabah is known as partnership contract with both parties sharing the same profit and risk profile. Mufti Taqi Usmani, a prominent scholar in Islamic finance argued that in terms of profit distribution, it is not permitted to take a percentage from the lump sum of capital (Usmani, 1998, P.33). Furthermore, El-Gamal puts forward that in this situation, there are still several disputes between the jurists. However, there is some leniency if the share is not known explicitly, then the profit can be fixed. Nonetheless, he opined that the vast majority of jurists have unequivocally rejected the mudharabah contract, whenever a partner promises to fix the return, likening it to interest (El Gamal, 2006).

AAOIFI has also stated some conditions pertaining to the fixing of profit, concluding that the profit cannot be fixed. According to Shariah standard no 13:

*8/1. It is a requirement that the mechanism for distributing profit must be clearly known in a manner that eliminates uncertainty and any possibility of dispute. The distribution of profit must be on the basis of agreed percentage of the profit and not on the basis of a lump sum or a percentage of capital.*

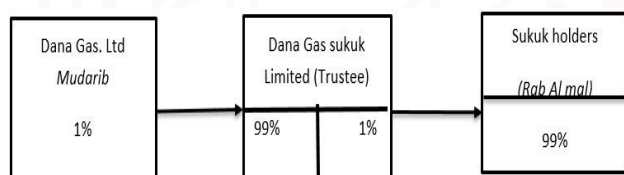
*8/5. If one of the parties stipulates that he should receive a lump sum of money, the mudharabah contract shall be void. This rule does not apply to a situation where the parties agree that if the profit is over a particular ceiling then one of the parties will*

*take additional profit and if the profit is below or equal to the amount of the ceiling the distribution of profit will be in accordance with their agreement.*

The profit distribution of the Dana Gas sukuk is a peculiarity. In July 2017, Dana Gas declared their sukuk is no longer Shariah compliant. Subsequently, the company approached a Sharjah court to support their opinion just a few months before the maturity of the sukuk (Bloomberg, 2017). The prospectus verily confirms the use of a fixed the profit rate since its inception, at a rate of 7.0% for exchangeable certificates and 9.0% for ordinary certificates (Dana Gas Prospectus, P.1). To maintain its capability for repayments, the company also promised to keep the reserve account. Furthermore, for ensuring that the company will meet its obligation, the company promised to allocate 99% from the profit of the mudharabah asset, to be placed in the trustee account. Hence, at the time of payment, they can pay it in accordance to the profit agreement stipulated in the terms (Dana Gas Prospectus, 2013, P. 71).

To further expand on the breakdown of how the company can pay a fixed profit rate to the sukuk holders without breaching Shariah law, the following illustration expands upon the concept:

Illustration 2: The profit distribution concept



Source: Adapted from Dana Gas Prospectus 2007 and 2013

Citing the sukuk prospectus, if the rabul-mal has exceeded in the nominal ratio from the pre-determined profit rate, the rabul-mal will forego the amount as an incentive for the mudharib. Whereas, if there is a shortfall during the time of payment, the mudharib will transfer an amount equal to the shortfall from the reserve account (Dana Gas prospectus, 2013). By looking at these practices, the action for ratio, exceeding profit and shortfall are in line with AAOIFI standard no 13 8/1 and 8/5. However, when we examine the last output of the product, it is mimicking to some extent, the conventional bond output, contradicting both standards.

### 2) Fixed purchase price at time of redemption

Although the nature of the mudharabah is a partnership contract, the underlying mechanism differs in an asset-based sukuk. It shares similar characteristics to a bond, in terms of output, resulting in a lower risk. Thus, paying back the principle to certificate holders is one of the obligations for the mudharib (Dana Gas). To ensure the company has the capability to payback their investors, with the same amount of

money invested, a few approaches are adopted. One such tactic is by fixing the price of asset repurchase to the face value price. According to the Dana Gas sukuk prospectus, scheduled redemption is as follows:

*.....The Calculation Agent will calculate the amount payable in respect of any Ordinary Certificate by multiplying the Standard Redemption Amount by a fraction of which the numerator is the principal amount of the relevant Ordinary Certificate and the denominator is the Aggregate Face Amount on the Scheduled (Dana Gas Prospectus. 2013. P. 126).*

To expand further on “aggregate face amount”, Dana Gas has extended the meaning of this term by the principal amount of outstanding certificates. In this case, 425,040,000 USD in ordinary sukuk and the same amount in the exchangeable sukuk (Dana Gas Prospectus. p.139). According to the prospectus, the term was created to avoid disputes at the time of redemption (Dana Gas Sukuk Prospectus. p.139). Therefore, it can be implied Dana gas needed to adjust to the nature of the market, whereby giving back the principle in an asset-based sukuk is customary practice.

By looking to the originality form of mudharabah contract, all risks that occur from the investment, will be borne together and consequently the price of the asset must be sold on the selling price, fair value, or rate agreed in the event of liquidation (AAOIFI S 13. 8/8 and 12. 3/1/6/2). In addition, even before the aforementioned standard was issued, Mufti Taqi Usmani gave a clear fatwa about a similar purchase undertaking practice. He stated no such practice had been approved by a jurist (Usmani, 2007). On this occasion, Dana Gas makes a valid point that the manner of purchase undertaking utilised was not consistent with Shariah standards. Therefore, questions now arise on which standards Dana Gas were referencing during the 2013 sukuk restructure. The new standard that overrules this issue was published back in 2008.

Another issue on purchase undertaking is bay’ al-inah (sale and buyback) due to a wa’d (promise) to purchase unilaterally, which is permissible according to AAOIFI. They formulated a clear definition and reason for permissibility in Shariah standard no. 49. The wa’d that the governing body prohibited is the bilateral promise, closing a potential avenue leading towards bay’ al-inah. In the case of Dana Gas, the company does not employ bay’ al-inah since the nature of the aqad (contract) in the first instance is not murabahah (sale contract). While the asset on this occasion was a “certificate of trust” created by the mudharabah contract (partnership).

### 3) Maturity of the contract

According to Mufti Taqi Usmani, there are a few different opinions regarding the termination of a mudharabah contract. He mentioned that the Hanbali and Hanafi schools of thought have the same opinion of permitting the maturity of a contract, as long as both partners agree. On the other hand, the Shafiis and Malikis are of the opinion that mudharabah cannot be restricted to a particular time (Usmani, 1998, p. 34 - 35).

However, in this specific case, AAOIFI has taken the position as stated in the Shariah standard number 13:

*4/3/1. When the mudarib has already commenced the business, in which case the mudarabah contract becomes binding up to date actual or constructive liquidation.*

*4/3/2. When the contracting parties agree to determine a duration for which the contract will remain in operation. In this case, the contract cannot be terminated prior to the end of designated duration, except by mutual agreement of the contracting parties.*

As stated in the Dana Gas prospectus, the sukuk will mature on 31<sup>st</sup> October 2017. Despite some scholarly opinions ruling against the inclusion of a maturity in a mudarabah contract, the company has already complied with the Shariah standard as stipulated in the above AAOIFI rules.

#### 4) *Guarantee of the capital*

There are a few different opinions amongst the jurists regarding guaranteeing the capital from the entrepreneur to the capital provider, in the mudharabah business model. The Hanbalis and Hanafis opined that the partnership remains valid, but the losses will be shouldered by the capital provider, since the condition is nugatory. On the other hand, the Malikis and Shafiis argued that in this case, the contract will be defective due to the presence of excessive gharar. Ibn Qudamah also put forward that this kind of practice is no longer a partnership contract but rather a loan contract (Zuhayli, 2001).

Despite the differing opinions amongst the scholars, AAOIFI addressed this matter in Shariah standard no. 13:

*The capital provider is permitted to obtain guarantees from mudharib that are adequate and enforceable. This is circumscribed by a condition that the capital provider will not enforce these guarantees except in cases of misconduct, negligence of contract on the part of mudharib (13 para 6).*

Dana Gas arguably using its assets in accordance of the Egyptian assignment agreement, as a guarantee for the capital provided by the sukuk holders. Those assets are: Shares of Dana LNG venture, Sajaa Gas Private, United Gas Transmissions Company Ltd, mortgage of Sajaa Gas share pledge, 66 % of Danagaz W.L.L and Receivable of Dana Gas Egypt (Dana Gas, 2013, P 16). Dana Gas's actions are certainly in-line with the current Shariah standard issued by AAOIFI, even though it is contrary to the views of Ibn Qudamah, Malikis and Shafiis.

#### D. *Shariah Certification Irregularities*

Within the Dana Gas circular offering, under the heading of 'No assurance can be given as to Sharia rules' in the risk factors section, Dana Gas states the following:

*"The Sharia advisory board of Dar Al-Sharia have confirmed that the Transaction Documents are, in*

*their view, Sharia compliant. However, there can be no assurance that the Transaction Documents or the issue and trading of the Certificates will be deemed to be Sharia compliant by any other Sharia board or Sharia scholars."*

Dana Gas explicitly states that Dar Al-Sharia have endorsed the sukuk as being Shariah compliant. However, upon further scrutiny, this statement is misleading. When Dana Gas issued their sukuk in 2007, it was aligned to the AAOIFI standards of that time and was certified by Dar Al-Sharia. In 2008, the chairman of AAOIFI, Mufti Taqi Usmani proclaimed that about 85% of sukuks were not in-line with Shariah principles. In light of these comments, AAOIFI altered their guidelines in 2008. The sukuk issuance of 2007 by Dana Gas retained its Shariah compliance, as retrospective action in Shariah rulings is not the customary approach. A prominent Shariah consultant who was involved in the initial Dana Gas sukuk issuance in 2007 commented, that when Dana Gas restructured their sukuk in 2012, they did not re-certify it for Shariah compliance. Rather the original Shariah compliance certification that Dar al-Shariah issued in 2007 was reused. The problem here is that the guidelines were modified after 2007 and thus a sukuk restructure necessitates a re-examination for Shariah compliance. Tellingly on the Dar al-Shariah company brochure 2017, it only mentions the initial sukuk offering that matured in 2013 not the sukuk restructure maturing in 2017.

#### E. *Assessing Dana Gas's Claims*

Dana Gas released a company statement dated 6<sup>th</sup> July 2017 to sukuk holders, outlining the reasons as to why the 2013 mudarabah sukuk was deemed to be unlawful under UAE and Shariah law. Dana Gas placed a strong emphasis on the changing sukuk market conditions from 2007 to 2017.

The evolution of the sukuk market has meant that many features of the Dana Gas sukuk are no longer regarded as Shariah compliant (Dana Gas Company Statement, 2017). Dana Gas makes several claims to support their position in declaring the sukuk as Shariah non-compliant that require addressing, with the purpose of validating if they carry any substance.

*Claim 1: "When the Company's Mudarabah Sukuk was first issued in 2007, about 90% of Sukuk instruments then in existence were Mudarabah in structure"*

The first edition of the International Islamic Financial Market (IIFM) report, offers an insight to the structural break-up of sukuks issued from 2001 – 2009. The report notes that the dominant structure until 2005 was ijarah-based sukuk. Thereafter between 2006 and 2007, other participatory structures were more widely adopted such as Musharakah, Mudarabah and exchangeable trusts. Table 1 illustrates that ijarah and musharakah are by far the dominant structures used with 39 and 18 respectively. While mudarabah issues over the same period of time only occurred in six instances. An ISRA-

Bloomberg bulletin Q2 2013 corroborates with the IIFM data with similar results.

Table 2: Structural break-up of international issuances (IIFM report 1<sup>st</sup> edition)

Type of sukuk	No of issues	Value (US Mil)	% Of total value
Ijarah	39	15,964	44%
Musharakah	18	7,726	22%
Mudarabah	6	4,725	13%
Islamic exchange bond	9	6,340	18%
Hybrid	3	487	1%
Murabaha	2	340	1%
Wakala or Investment	1	325	1%
<b>Total</b>	<b>78</b>	<b>35,907</b>	<b>100%</b>

Source: In-house IIFM sukuk issuance database

*Claim 2: “However, the further development and evolution of Islamic finance concepts and jurisprudence since our original Sukuk was structured in 2007, and restructured in 2012/13, has resulted in the discrediting and abandonment of many of the features of our current Mudarabah Sukuk. The Sukuk market has simply evolved and no longer regards a pure Mudarabah structure such as ours as being Shari’a compliant and, in the case of the UAE, lawful”*

Using the same reasoning that evolving market conditions render a sukuk’s Shariah compliance void, this would entail other similar sukuk issuances would endure the same fate. Data compiled by Bloomberg indicates six other mudarabah sukuks issued by UAE that would be exposed to the same inherit Shariah compliance problems:

Table 3: Outstanding sukuk in UAE

Sukuk Issuer	Profit Rate
Abu Dhabi Islamic Bank	6.375%
Dubai Islamic Bank	6.75% and 6.25%
Al- Hilal Bank	5.5%
Noor Islamic Bank	6.25%
GEMs Education	12%
DP World	6.25%

Source: Bloomberg (2017)

Interestingly the Dubai Islamic Bank’s (DIB) sukuk was also certified Shariah compliant by Dar al-Shariah, the same organisation that gave the all clear for Dana Gas’s sukuk. DIB also happens to be Dar al-Shariah’s parent company leading to signs that the outcome of the Dana Gas court case may have a bearing upon the DIB sukuk.

*Claim 3: “These terms make our current Mudarabah Sukuk contrary to Shari’a and unlawful under UAE law.”*

The legal system in UAE is based on a mix of Shariah and European concepts of civil law (nyulawglobal, 2017). On multiple occasions, Dana Gas state that their sukuk is unlawful under UAE law. Therefore, the articles of law that elaborate upon on mudarbah contracts require further examination to ascertain what is specifically being contravened within the legislative framework. Laws relating to mudarabah contracts are contained within articles 693 – 709 in the UAE civil code.

Datuk Dr Mohd Daud Bakar stated that the mudarabah contract is in principle still regarded as a debt instrument and thus the issuer is still obliged to fulfil payments in a timely manner (RAM Press release, 2017).

A contract that has been certified as being Shariah compliant at the time of ratification, is it open to retrospective action that can invalidate it? According to prominent scholars, this is not the case. Sheikh Yusuf Talal DeLorenzo, author of a 1996 textbook on Islamic banking, expresses that compliance is determined at the time of issue and the matter is closed at that point. Mohamad Akram Laldin, executive director of International Shariah Research Academy (ISRA), concurs adding that “Sharia compliance is embedded in a document and cannot be voided even if some parts of a deal turn out to be faulty” (“Hard to invalidate Islamic contracts”, 2017).

#### F. Purchase Undertaking Examination

As stated in the Dana Gas prospectus, the purchase undertaking is governed by English law (Dana Gas prospectus, pg 54). Dependence on English law for the documentation of

financial transactions is a routine practice. Primarily owing to the presumed weak local legislation, in this case UAE and to enhance the credit rating from conventional ratings agencies (al-Amine, 2008). The purchase undertaking embodied in sukuk bears a striking resemblance to *promissory estoppel* (a promise is enforceable by law) found in English common law. In the case of Dana Gas, one can argue that they have committed a tort, ‘an act or omission that gives rise to injury or harm to another and amounts to a civil wrong for which courts impose liability’. Therefore, it can be enforced in an English court in the case of default by the originator (Kamali & Abdul Karim Abdullah., 2014). Judgement in an English court, in essence, alters the outlook of the transaction from to a borrower and creditor relationship.

Indeed, in November 2017, The English court lead by Mr Justice Leggatt, the decision was made. It is stated that the purchase undertaking contract is valid and enforceable under the English law. The Dana gas opinion which rely on the *Ralli Brothers* principles and on article 9(3) of the Rome I Regulation is denied by the judge. The court then explained that this principle will be accurate if the purchase undertaking were executed in UAE. However, in this case, both party has agreed that the purchase undertaking action will be done in UK and govern by UK law (Royal court release, case no FL-2017-000004, 2017).

## V. CONCLUSION

The positive growth of the sukuk market is also trailed by some risks that occurs in conjunction with its development. Some of those risks are with regards to defaulting sukuk, which affected a number of instruments in the 2008 global financial crisis. This study has examined the mudarabah sukuk of Dana Gas, since the company has declared its own sukuk as Shariah non-compliant. After looking to the current practices from a Shariah and legal point of view, we found that the foremost problems in this case, stem not from the Shariah side but arise more from the legal and management areas.

For the Shariah issues, the core problem that may have contradicted the AAOIFI Shariah standards, is the practice of profit distribution and fixed price in the purchase undertaking. As for other issues such as guarantee of the capital and maturity of contract, they are only contrary to some scholarly opinions. However, the decision to declare that the company’s sukuk as non-compliant to Shariah, requires further disclosure of information to reach a more conclusive verdict.

As for the legal issues, the underdeveloped legal framework within the Islamic capital markets in several countries, present challenges to those involved. Malaysia has led the way in this field, laying down the groundwork to facilitate the development of a more comprehensive system that can offer a stable platform for dispute resolution. In UAE, the lack of an adequate regulatory system, from both the legal and Shariah perspectives, has contributed to the uncertainty

that has arisen from Dana Gas’s actions. A central Shariah supervisory authority would have certainly helped in this issue, by proclaiming a definitive judgement on the Shariah non-compliance claim. If such a proclamation occurred, it may have alleviated the need for the matter to be decided in the English courts. Now that the matter rests in the hands of the English legal system, the judgement is not being decided based on Shariah law but rather according to the terms in the purchase undertaking agreement.

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