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What to do when Islamic finance products run into problems

1 December 2009

Presented by

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Shari'ah principles and issues

- Defaulting debtors – are Shari'ah principles found in local laws, such as the Middle East?
- Will secular courts consider these Shari'ah principles?

Application of Shari'ah principles in local laws – Middle East

- Some Shari'ah principles will be superceded by secular laws:
 - Sale of assets on default will often require a court order
 - Termination of an ijara – may be affected by contractual provisions/secular notice provisions
- Emirate of Sharjah – Law no: 17/1973:
 - Article 33 of this Sharjah law (dealing with mortgaging of real estate) says that to enforce a mortgage over real estate the creditor must apply to the Land Department Director

Application of Shari'ah principles in local laws – Middle East C'td...

- The Director notifies the debtor that he must pay within 15 days
- The debtor can ask for the sale to be postponed for up to 1 year if he can show he can pay given time or the sale will cause undue hardship
- Kuwait – Article 231 of Law No. 68 of 1980 (Commercial Transactions Law)
 - A mortgagee has to wait 3 days from non-payment before applying to the court for a sale. If the court so orders, the mortgagee must notify the mortgagor and wait 5 days before the sale order can be executed

Application of Shari'ah principles in local law – Malaysia

- Recent proceedings involving prepayments or defaults under murabaha contracts
- Is the whole deferred sale price due, or just a reduced amount to reflect the early payment?
- Several courts have ruled that not all of the deferred sale price is payable
- The Malaysian Court of Appeal has ruled against these decisions
- The courts have been instructed to refer Shari'ah questions to the Supreme Shari'ah Committee at the Central Bank of Malaysia, with its decision being binding on the courts

Will secular courts consider these Shari'ah principles?

- Some English decisions – the Symphony Gems and Beximco judgments – English courts will construe Islamic finance documents subject to English law and not the Shari'ah
- An Abu Dhabi judgment dealing with a musharaka financing construed it as being a loan
- Will a decision of a secular court that is not based on the Shari'ah affect a fatwa issued when the Islamic finance transaction was originally entered into?

Arbitration agreements

- English court decision upholding an arbitration award reached through the application of the Shari'ah (Shia law) - *Sayyed Mohammed Musawi v. R.E. International (UK) Ltd, Sayyed Mohammed Ali Shahrestani, Sayyed Reza Shahrestani and Sayyed Saleh Shahrestani* ([2007] EWHC 2981 (Ch))

When a default occurs what should you do?

Preliminary documentary steps:

- Carefully review the agreements to check:
 - What exactly constitutes an event of default?
 - Check the Information Covenant to see what information you are entitled to.
 - What acceleration rights can you exercise? i.e.:
 - accelerate deferred payment under a murabaha;
 - exercise rights under a purchase undertaking; etc
 - Check Notices clause
 - Waiver of rights provisions

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When a default occurs what should you do? C'td...

Practical steps:

- Locate original executed documents
- Due diligence other creditors – do they include conventional lenders?
- Appoint asset tracers to look for/secure assets?
- Locate any witnesses to original signatures

When a default occurs what should you do? C'td...

Legal steps:

- Consult early on with the Shari'ah Board and lawyers to be aware of any major issues
- Understand underlying agreement – how does it differ from a conventional loan agreement?
- Co-operative or hostile borrower?
- Serve requests under Information Covenant?
- Serve Default Notice/Reservation of Rights Notice/Acceleration Notice?

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When a default occurs what should you do? C'td...

Legal steps (C'td...):

- Jurisdiction issues – factors to consider
 - Exclusive jurisdiction
 - Arbitration
 - Location of assets
- Court proceedings or arbitration?
- Enforcement of foreign judgments
- Conflict of law issues

Standstill agreements and restructuring

- Are there non-Islamic creditors?
- Are conventional bank creditors treated differently from Islamic (trade) creditors?
- Steering Committees: Can Shari'ah creditors participate in mixed Steering Committees?
- Shari'ah Committee approval?
- LMA standard Co-ordination Committee Letters
- Separate representation on Steering Committee?

Standstill agreements and restructuring C'td...

- Default Interest
- Refinancing/restructuring:
 - Equity for debt (Shari'ah concerns about Shari'ah compliant nature of the company's activities)
 - Refinancing/Restructuring – Shari'ah considerations

Commodity Murabahas, Trade Murabahas and Ijaras

- Commodity murabaha – refinancing through a replacement murabaha – what if the customer is technically insolvent? – can the new purchase and sale of commodity arrangements be attacked under bankruptcy legislation?;
- Trade murabaha – asset sold back to the IFI (for an amount to clear the deferred sale price obligation under the trade murabaha) and then leased back to the customer (i.e., a new ijara financing). Possible insolvency law issues

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Commodity Murabahas, Trade Murabahas and Ijaras C'td...

- Ijaras – if the lessee defaults and reneges on its purchase undertaking obligations can the lessor (the IFI) sell the asset and keep all of the proceeds if they exceed the balance of unpaid fixed rent?

Sukuk Defaults

- Recourse to the Sukuk assets or limited recourse?
- What are the issues? – the role of the Purchase Undertaking
- Have the Sukukholders agreed to restrict their enforcement rights?
- A true securitisation – or something less?

Sukuk Defaults C'td...

- East Cameron Sukuk - went into default
 - before US bankruptcy court
 - attempts to argue that the Sukuk should be re-characterised as a secured loan and that the Sukukholders should not be regarded as being the owners of the Sukuk assets
 - this argument perhaps not unexpected with a securitisation structure
 - at present it would seem the court has rejected this argument
 - however, the court is considering a proposed plan of reconstruction

Sukuk Defaults C'td...

- Investment Dar
 - Event of default arose out of a failure to pay a periodic payment distribution – certificateholders notified in May 2009.
 - Coordinating Committee representing creditors in discussions with Investment Dar to agree a restructuring plan. Reported that it would involve a 5 year repayment program.
 - The \$100m Sukuk is a part of the overall restructuring. Reported that the total debts of Investment Dar being re-scheduled amount to \$1billion.

Dubai World

- Announcement
- Event of default / cross default
- Role of trustee / transaction administrator / delegate
- Consequences of event of default
 - Claims under transaction documents
 - Steps under any security documents

How we can help?

- If you would like more detail, or in the event that you may become involved in the Dubai World restructuring and require advice and assistance in relation to the standstill process and what this means to you, please contact one of the partners listed here or your usual contact at Denton Wilde Sapte.
- Denton Wilde Sapte's Islamic Finance practice has built up an enviable reputation in a wide range of Islamic finance products. Denton Wilde Sapte also has one of the largest teams of restructuring and insolvency specialists of any international law firm, with lawyers working throughout our Middle East offices and in London, Paris, Russia and the CIS.

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