

Juristic Analysis of Şukūk default: East Cameron Gas United States of America

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Abstract

East Cameron gas was the first Sukuk investment experience in the United States of America. The diversification of the Sukuk into oil and gas exploration particularly in the USA was a ground success in Islamic space. However, the 2008 global economic recession hits the East Cameron gas resulting from the shortfall in sales of oil and gas. The East Cameron defaulted from financial obligation and consequently filed for chapter 11 bankruptcy. This study aims to critically analyse the judgement made by Robert Summerhays United States Bankruptcy Judge in the case of East Cameron partners L.P, v. Louisiana offshore holding, LLC. & Ors [2009]. The study employs juristic analytical approach to the court judgement of East Cameron Gas default şukūk by explicating exact terms of the court case. This study also analyses the validity of contractual rights and obligations of parties to a şukūk contract. The study concluded that despite the claim of East Cameron partners LP, that the underlying asset ORRI is a mere loan and not true-sale, the bankruptcy court decision seems to be compatible with Sharī'ah because the Islamic maxims like "Muslims are bound by their contractual agreement" is a sufficient evidence to the court decision to ensure protection of contractual parties to şukūk investment. This paper provides description and analysis on juristic compatibility of East Cameron court judgements and trend of Sukuk default in the USA. The study explains the Sharī'ah analysis of the underpinning argument in the East Cameron sukuk default court case.

Keywords: Default, Mushārah Şukūk, True-sale, Secured loan & Underlying-Asset.

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1.0 Introduction

Ṣukūk is an Islamic financial instrument that can contribute to the overall development of a state. *Ṣukūk* is an Islamic alternative to conventional bonds, and it can contribute effectively to the growth of the economy through the provision of funding to industries, corporation and government from *halal* sources. Hence, the *ṣukūk* instrument is considered as the most equitable financial instruments based on distribution of profits and losses resulting from developing projects to corporation and government. *Ṣukūk* is based on risk sharing rather than risk transfer practices in the conventional bonds.² However, applications of *ṣukūk* investment have contributed immensely to the development of infrastructure, particularly among Muslim nations. For instance, as of 2008, both Malaysia and UAE accounted for over 70% of the total *ṣukūk* market. The Central banks of these countries can use *ṣukūk* instruments to provide liquidity tools for banks, institutions, agencies and corporations.³ Sukuk has also increased the volume of investment of corporations, government infrastructures in non-Muslim nations such as the United Kingdom and United States of America. For example, David Cameron, the former Prime Minister of UK had said in the parliament that the government is considering exploring the opportunity of *ṣukūk* towards developing infrastructures within the kingdom.⁴ Also, in the United States, East Cameron gas company issued the first sukuk in 2008. Despite all these contributions of Sukuk investment, the event of Sukuk default remains a challenge to the growth of the nascent industry, particularly in united states. This study aims to examine the fact of the case between East Cameron gas LP, Versus Louisiana offshore holding, LLC, & Ors [2009].

This study will trace the litigation of East Cameron gas *ṣukūk* default (USA) of 2006 and the decision of Louisiana court decision concerning the right of the *ṣukūk* holders to the

² Siḥr Abdullah Al-Ḥilmī, Al-Ṣukūk Al-Islāmiyyah Wa Dawruha fī Al-Tanmiyah Al-Iqtisādiyyah, Vol. 15, issue 4, (Al-Nahda, 2014), 85-104.

³ Kuwait Finance House “Introduction” in *Ṣukūk Suruhanjaya Sekuriti Malaysia, Ṣukūk: Islamic Capital Market Series*, Edited by AbdulKader Thomas (Malaysia, Sweet & Maxwell Asia & Thomas Reuters, 2010), IX.

⁴ David Cameron to unveil plans for £200m Islamic bond, World Islamic Economic Forum will hear prime minister outlining plans for *Ṣukūk* bond compliant with Islamic law, Retrieved on 23 /04 /2018, from: <https://www.theguardian.com/money/2013/oct/29/Islamic-bond-david-cameron-treasury-plans>.

underlying asset. The argument is between the East Cameron company creditors and their *şukūk* investors. In the event of default in fulfilling the obligation of the *şukūk* investment, the *şukūk* investors may proceed to make recourse to the underlying asset while the East Cameron company claims the sales of the underlying asset was not a true-sale but mere secure loan. Hence, other creditors should be allowed to have equal recourse to the underlying asset. The decision, in this case, was held at the United States bankruptcy court; Western District of Louisiana Lafayette / Opelousas Division. The court held a decision in the case of East Cameron Partners, L.P., (Debtor) versus Louisiana Offshore holding, LLC, East Cameron Gas Company, and Deutsche Bank Trust co. Americas. According to the status of the US bankruptcy court of Western Louisiana, under the 27 U.S.C., 157 (b) (2) (A), (O) and 1334 (b) (2) and under bankruptcy rule 7001., the court has jurisdiction to decide over the subject matter. In 2006, the debtor filed for bankruptcy relief under chapter 11, of the US bankruptcy law.⁵

The contractual agreement shows that East Cameron gas company (Cayman Island SPV) issued *şukūk* of USD 165.67 million with 13 years' maturity. The East Cameron partners in Texas, USA was the originator to the *şukūk* *mushārah* contract and the governing law is the United States of America law. The *şukūk* was rated by standard & Poor's as CCC+ status and was the first of its type to be issued by a company based in the United States. The East Cameron *mushārah* *şukūk* with the underlying asset of overriding royalty interest (ORRI) belonging to two gas properties while the SPV was acting as trustee for the *şukūk* investment. Therefore, the *şukūk* *mushārah* venture is jointly owned by East Cameron Partners (originator) and the *şukūk* holders.⁶ The *Mushārah* contract specified that the *şukūk* holders will be paid 11.25% return on quarterly basis while the reserve account is expected to maintain any shortfall in return. However, in 2008, the situation seems unfavourable for the East Cameron partners (Originator) as a result of continuous fall in production of gas which triggered *şukūk* default because of failure from contractual

⁵ United States Bankruptcy Court Western District of Louisiana Lafayette Division, Case no. 08-51207, Retrieved on 02/04/2018
from: file:///C:/Users/HP/Desktop/East%20Cameron%20Court%20case/ECP%20Petition.pd.

⁶ Beebe Salma Sairally et al., *Şukūk: Principles & Practices*, (Kuala Lumpur, ISRA, Suruhanjaya Sekuriti & Khazanah Nasional, 2017), 588.

financial obligations. Consequently, ECP files for protection under the US chapter 11 bankruptcy law for restructuring their debt and operation.⁷ The ECP further filed another adversary proceeding that the court should recognize the contractual transaction as secured loan and not a true sale. Unfortunately for the ECP, the court went through the documents and rejected the claim that the contract is a loan and established that the overriding royalty interest as the underlying asset is a true sale and the *ṣukūk* holders have right to lay recourse to it.⁸

The study will discuss the remaining part of the research as follows: (a) Trend of Sukuk in USA, (b) Summary of East Cameron Prospectus, (c) Sales & Purchase Agreement of the Underlying Asset, (d) Fact of the case, (e) Parties to the case (f) Court Judgment on status of Underlying asset between true sale & secured loan, (g) Juristic analysis of true sale of the in sukuk contract (h) Discussion on East Cameron court Decision, (i) Conclusion

2.0 Trend of Sukuk in the United States of America

Ṣukūk investment has been introduced into the United States as far back as early 2003. The regulatory framework in the United States seems flexible as it permits sales based *ṣukūk* and asset-based *ṣukūk* investment. The United States of America is known for its robust regulatory framework for banking services and operation. Similarly, the operation of the Islamic capital market instrument such as *ṣukūk* is welcomed under the US legal system which is much trusted for its disclosure requirements and enhancement of prudential standards.⁹ However, several regulatory agencies in the US coordinate the banking operation between federal and state levels. For instance, the office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and National Credit Union Administration (NCUA). *Ṣukūk* is treated as a tradition debt and as such governed and regulated by the United States Securities exchange commission. Traditional

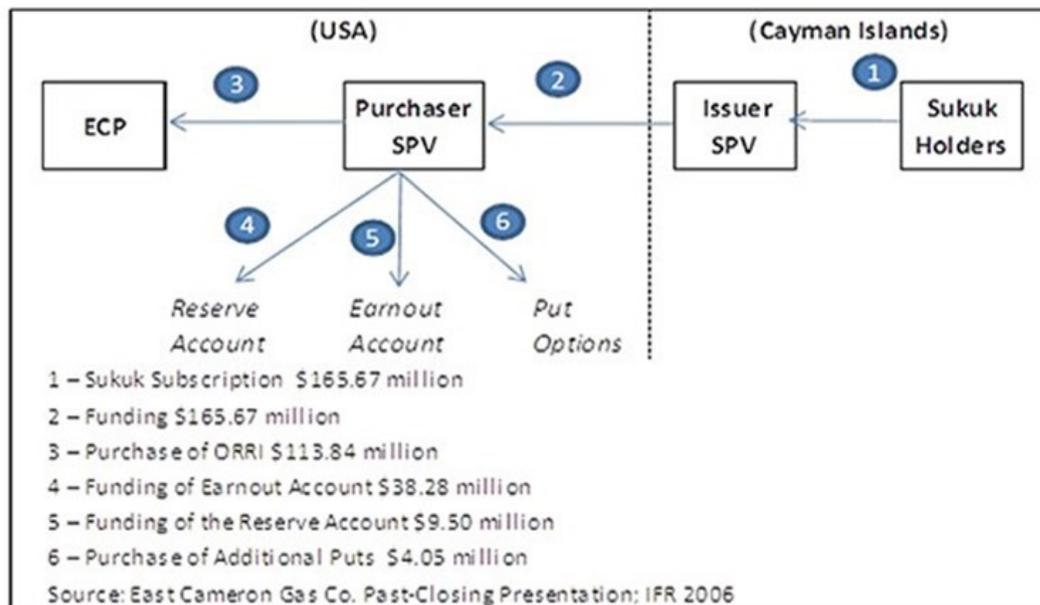
⁷ Stephen Fidler, "Defaults Pose Latest Snag in Islamic-Bond Market", Wall Street Journal, 16 June 2009, Retrieved: 2/4/2018 from: <http://online.wsj.com/article/SB124510859262816907.html>.

⁸ Beebe Salma Sairally et. Al., *Ṣukūk: Principles & Practices*, (Kuala Lumpur, ISRA, Suruhanjaya Sekuriti, Khazanah Nasional 2017), 590.

⁹ Taylor, Michael F, "Islamic Banking: The Feasibility of Establishing an Islamic Bank in the United States" <http://www.allbusiness.com/legal/618197-1.html>.

debt in United States law is similarly regarded as asset-backed securities as stipulated in the US Securities Act of 1933 under the applicable 33 Act, or exemption regulation D or section 144A.¹⁰

In recent times, the trend of sukūk offering in the United States has shifted from real estate development project to energy, oil and gas investment project. Hence, this shift in investment interest has given birth to the East Cameron sukūk investment as the first oil and gas sukūk in the USA. Consequently, the Dow Jones Citigroup sukūk index in 2006 was established for measuring the performance of Islamic bonds across the globe.¹¹



¹⁰ Suruhanjaya Sekuriti, Security Commission Malaysia, Islamic Capital Market Series, Edited by AbdulKader Thomas, (Malaysia: Sweet & Maxwell Asia, 2010), 83.

¹¹ Ibid 84.

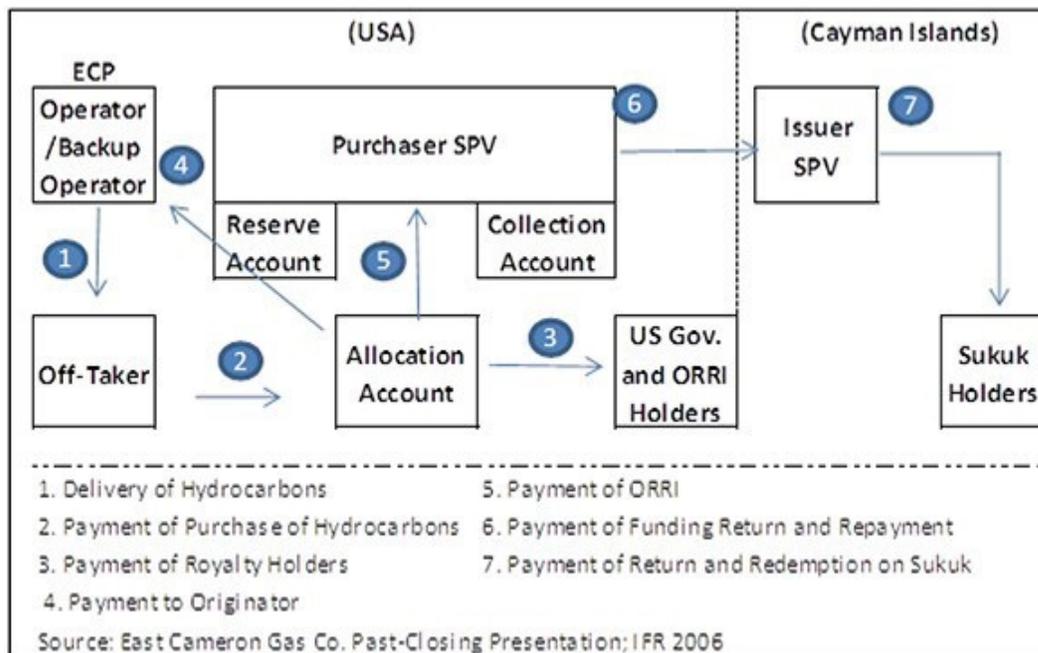


Figure 4.4 East Cameron Musharakah Şukūk (Partnership) Sukuk¹²

3.0 Summary of East Cameron (USA) Prospectus / Şukūk Contract and Transaction

East Cameron Gas Company is a limited liability company, in the capacity as a trustee of the East Cameron gas Company şukūk Trust (as the issuer and SPV) with an issue of US\$ 165.67 million şukūk certificate. The shari'ah compliant şukūk has expected 11.25% annual return and with redemption at maturity date not later than July 2019.

The originator (East Cameron Partners, LP is an independent company with leasehold interest in the exploration and production of oil and gas under the law of the state of Texas. The contractual agreement specifies that the East Cameron partners; the originator has sold the overriding royalty interest (ORRI) to the East Cameron Gas company (purchaser SPV)

¹² East Cameron Partners' Şukūk, retrieved on 18/04/2018 from: <https://Islamicmarkets.com/education/east-cameron-partners%E2%80%99-sukuk>. The figure 4.4 above depicts the contractual agreement in East Cameroon Gas sukuk. The Structure is a musharakah Sukuk contract with overriding royalty interest (ORRI) as the underlying asset. Although the structure is clear as the shariah board to east Cameron approved the structure to be shariah compliant considering ORRI as underground natural resources, yet the issuer still went further to claim the underlying asset was merely secured loan and not a true sale.

as a capital contribution and share of the production of the property.¹³ Hence, for federal income tax, the issuer SPV and purchaser, SPV agrees to treat the funding as debt under the treasury regulation.¹⁴ The sale agreement between the Purchaser of SPV and the Issuer SPV is a true-sale of the underlying asset, and the funding agreement is assumed to expire upon delivery of the hydrocarbon that is attributed to the ORRI. Similarly, in the event of bankruptcy of the originator, the şukūk holders might lose the certain value of their investment as stated in the risk factor of the offer document.¹⁵

The şukūk investment is referred to as limited recourse and is not debt obligations of the Issuer SPV, the Purchaser SPV or the Originator. In the event of a shortfall of expected returns from overriding royalty interest, the prospectus stipulates that the purchaser cannot lay recourse against the issuer SPV or originator under the ORRI because of reduction in the volume of value of the investment. Instead, the underlying asset remains the property of the şukūk holders based on true-sale agreement.¹⁶ The offer document stipulates that the şukūk investment, Contribution Agreement, the Purchase and Sale Agreement, the Production, Delivery and Marketing Agreement and the Back-up Operator Agreement to be governed by Texas law; while the Conveyances governed by Louisiana and Federal law. Also, the Services and Operations Agreement is governed by Louisiana and Texas law while the Issuer SPV organisational documents and Declaration of Trust is governed by Cayman law. Finally, the New York law is regulating the Purchaser SPV LLC Agreement is governed by Delaware law and the Funding Agreement, the Allocation Account Agreement, the Opex Account Agreement, the Back-up Off-taker Agreement, the Hedging Agreement, and the Collateral Agency and Inter-Creditor Agreement.¹⁷

¹³ East Cameron gas prospectus, East Cameron Gas Company US\$165,670,000 Investment Trust Certificates (Şukūk), :2. Retrieved on 26/05/2018 from file:///C:/Users/HP/Desktop/SC%20Malaysia/East_Cam%20(1).pdf

¹⁴ This agreement can prompt the assumption of the East Cameron gas company that the underlying asset is a secured loan and not a true-sale because the prospectus shows that the funding is considered as debt under treasury regulation for tax.

¹⁵ East Cameron gas prospectus, East Cameron Gas Company US\$165,670,000 Investment Trust Certificates (Şukūk), :3. Retrieved on 26/05/2018 from file:///C:/Users/HP/Desktop/SC%20Malaysia/East_Cam%20(1).pdf

¹⁶ Ibid

¹⁷ East Cameron gas prospectus, East Cameron Gas Company US\$165,670,000 Investment Trust Certificates (Şukūk): :23. Retrieved on 26/05/2018 from file:///C:/Users/HP/Desktop/SC%20Malaysia/East_Cam%20(1).pdf.

4.0 Sale and Purchase Agreement of the Underlying asset (ORRI)

The East Cameron gas *ṣukūk* investment has many contractual agreements. One of the important contract in the event of default is the purchase and sales agreement. The offering circular stipulates that the Purchase and Sale Agreement of the underlying asset (overriding royalty interest) between the Originator and the Purchaser SPV is an agreement that the former will agree to purchase and the later will agree to sell the ORRI for \$113.84. The underlying asset to the *ṣukūk* investment (ORRI) comprises of the exploration and production of oil and gas as real property interest under applicable regulations and operations. In the event of dispute or disagreement among contractual parties, arbitration will be applicable based on the law of the state of Texas with a three-member panel of arbitrators under the American Bar Association Rules of Commercial Arbitration.¹⁸

This is the general perception of every prospective investor based on the sale of the ORRI in the offering circular that there exists a receipt of an enforcement notice issued by the issuer SPV to the Purchaser SPV as right to exercise resale of the ORRI or particular portion of it as it may be in accordance with industry practice. The Independent members are responsible for initiating the purchaser SPV to the resale of the ORRI. The proceed from the sale should be distributed among *ṣukūk* holders after deduction of expenses incurred during sales of the underlying asset.¹⁹ Furthermore, the offer circular states that originator is legally not permitted to farming out, assign, convey or sell any parts of the property without the consent of the purchasing SPV that represent *ṣukūk* holders. In the presence of approval, the originator will still show a guarantee that the ORRI right of producing gas and oil from the property will not be violated based on the law of the State of Louisiana.²⁰ According to East Cameron gas prospectus, the status of “the *ṣukūk* represent and evidence an undivided beneficial ownership interest in the Assets, pro rata

¹⁸ East Cameron Gas prospectus, East Cameron Gas Company US\$165,670,000 Investment Trust Certificates (*ṣukūk*), 73-74. Retrieved on 26/05/2018, from: file:///C:/Users/HP/Desktop/SC%20Malaysia/East_Cam%20(1).pdf

¹⁹ Ibid: East Cameron Gas Prospectus, 75.

²⁰ East Cameron prospectus, East Cameron Gas Company US\$165,670,000 Investment Trust Certificates (*ṣukūk*),: 77. Retrieved on 26/05/2018 from file:///C:/Users/HP/Desktop/SC%20Malaysia/East_Cam%20(1).pdf.

based on to the face value of each Certificate and will rank pari passu, without any preference among them. The Şukūk will be senior to any other instruments issued by the Issuer SPV”.²¹ According to the content of the East Cameron gas şukūk contract, the Shari'ah compliance documents of the deal viewed the overriding royalty interest ORRI as equal to beneficial ownership for the şukūk holders from the volume and values of the oil and gas produced by East Cameron Partners LP.²² East Cameron gas shari'ah advisors also stipulated that the agreement between the issuer SPV and Merrill Lynch Commodities Inc. (MLCI) on the sales of the underlying asset (oil and gas produced) is valid under shari'ah law. That is, the compensation offered to the MLCI on the sale of the Underlying asset is justified under shari'ah law since it is an established mechanism and common practice in modern finance.²³

5.0 Facts of the case

The East Cameron case encapsulates the terminology of şukūk default and purchasing undertaking which has been discussed earlier in the study. Similarly, there are other terms such as; Chapter 11 bankruptcy of USA, True sale, and Secured Loan. The word Bankruptcy is used as far as 13th century as Banca rotta. ‘Banca’ means bank while rotta means failure to fulfil debt obligations. The word bankruptcy is coined out from this combination (Banca rotta) and adapted in the American law.²⁴ However, Chapter 11 bankruptcy of USA similarly refers to as protection for reorganisation in default event, whereby a debtor sought court protection in the situation of default and ongoing concerns. A creditor is also allowed to file for Chapter 11 protection after seeking the consultation of

²¹ Ibid

²² Ibid: East Cameron Gas prospectus, P: 130.

²³ East Cameron Prospectus, P: 132. The Shari'ah Supervisory Board to the East Cameron gas şukūk investment approved the contract as a true-sale. The board holds that the Şukūk Offering and the transaction documents state that the Şukūk will yield returns that are lawful and good (halal'un tayyib). And Allah knows best. Shaikh Nizām M. S. Yaqūbī & Shaikh Yusuf Talal DeLorenzo.

²⁴ Bracewell & Giuliani, 2012, Chapter 11 of the United States bankruptcy code: Background and Summary, 2012, P: 1, Retrieved on 4/4/2018, from: https://www.insol.org/_files/Fellowship%202015/Session%203/Chapter_11_Overview.pdf.

intention and approval from credit counsellor within the jurisdiction.²⁵ The creditors is also allowed by law to seek voluntary winding up while the debtors will have to file up by presenting specific schedule as court requirements. Firstly, the schedule of its assets and liabilities. Secondly, current income and expenditures statement and thirdly, schedules of a contractual agreement and unexpired leases properties and lastly the company financial statement.²⁶ Moreover, any commercial entity within the American jurisdiction is allowed to file for chapter 11 bankruptcy relief, except entities that are governed by other state or federal law in the event of default from financial obligations.²⁷ In the event of financial distress, the chapter 11 debtor in possession is a protection mechanism used to reorganize the business in financial difficulties. Chapter 11 do not consider corporation's debt to extending to the personal property of the shareholder as it is limited liability based on the share of their investment in the business. Unlike a sole proprietorship whose own identity is not separated from the company and such liability extends to the personal property of the owner. In partnership business, the formation and terms of the owners are significant. The partners in some cases might be liable to debt obligation with their personal properties. Hence, partnership fluctuates between the corporation and sole proprietorship.²⁸

Another important term, in this case, is "True sale" of the underlying asset. The true-sale is a situation whereby contractual parties agree to transfer a financial asset for fair value with the intent of a sale. In this scenario, the purchaser is liable to all the benefits and common risk associated with ownership.²⁹ Kenneth C. Kettering argued that the term 'true sale' in conventional practices seems elusive. He added that there had been a revolutionary improvement since the 1980s where securitisation have started to develop the concept of

²⁵ Fed. R. Bankr. P. 1007, Chapter 11, Bankruptcy Basics, Retrieved on 4/4/2018, from: <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>.

²⁶ Ibid

²⁷ Bracewell & Giuliani, 2012, Chapter 11 of the United States bankruptcy code: Background and Summary, 2012, P: 4, Retrieved on 4/4/2018, from: https://www.insol.org/_files/Fellowship%202015/Session%203/Chapter_11_Overview.pdf.

²⁸ Fed. R. Bankr. P. 1007, Chapter 11, Bankruptcy Basics, Retrieved on 4/4/2018, from: <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>.

²⁹ Peter V. Panteleo et al., Rethinking the role of Recourse in the sale of Financial Asset, *The Business Lawyer*; Vol. 52, November 1996, P: 159, https://scholarship.law.duke.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2453&context=faculty_scholarship.

special purpose vehicle which the underlying asset must be transferred to serve as recourse in the event of financial distress. SPV inclusion has been a vital conveyance mechanism through which the true-sale of underlying asset can achieve its purpose.³⁰

In contrast, a secured loan is the transfers of financial assets with the intention to merely secure the loan because all benefits and risk associated with the owners are not transferred. The intent of the contractual parties in the guaranteed loan is to have recourse for the loan sum in the event of default and not necessarily intention to transfer ownership of the asset.³¹

6.0 Parties to the case

The Plaintiff, East Cameron Partners, L.P. as a debtor, in this case, is an independent oil gas exploration and production company with around twenty miles offshore within the jurisdiction of the state of Louisiana in the United States. ECP is a licensed company with the leased interest of producing gas condensation field in federal waters of United States. The Outer continental shelf land Act governs the leasehold interest of ECP. This law recognised ECP as operator of the property for exploration and production on the activities. The Act, however, permits the mineral management service of interior department of the United States to administer its operation.³²

The defendants in this case are; Louisiana Offshore holding LLC, East Cameron gas company and Deutsche Bank Trust Company Americas, who is a New York banking corporation and Şukūk holders (intervenors). The şukūk holders, in this case, are considered as a third-party defendant while the intervenors are usually the third party in a legal proceeding. The Louisiana offshore holdings LLC has over 600 acres of oil and natural gas field with an additional asset of 1.8 million barrel of crude oil located within the state of Louisiana.³³

³⁰ Kenneth C. Kettering, True Sale of Receivables: A Purposive Analysis, (2009), P:511, Retrieved on 4/4/2018 from: file:///C:/Users/HP/Downloads/KetteringTrueSaleofReceivables16ABILRev5112008.pdf.

³¹ Ibid

³² Ibid: United States Bankruptcy Court Western District of Louisiana Lafayette Division, Case no. 08-51207, Retrieved on 02/04/2018 from: file:///C:/Users/HP/Desktop/East%20Cameron%20Court%20case/ECP%20Petition.pd.

³³ Company Overview of Stone Energy Offshore, L.L.C., Certain Producing Properties in South Louisiana, <https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=247766963>.

7.0 Court judgment on the status of underlying Asset between True sale and Secured Loan.

According to the argument before the court, ECP contends that the whole transaction in the contractual agreement is a secured loan. In other words, the purchase and sales undertaking, the contribution agreement, the purchase conveyance, the contributed conveyance and the PDMA are a mere secured loan. or antichresis. East Cameron partners argued that the ownership of ORRI was not transferred from ECP to LOH as the transaction was not a true-sale agreement. ECP further claimed that the underlying asset is merely a pledge as security for a loan in favour of LOH.³⁴ In 2008, ECP experienced a shortfall on the overriding royalty interest (ORRI) in oil and gas which is the primary collateral used as the underlying asset to the şukūk contract. Consequently, the shortfall event triggered breach of approximately 90% of the reverse level of the threshold as contained in the contractual agreement.³⁵ Similarly in reference to the Louisiana civil code law,³⁶ The court inferred the correct understanding of the underlying asset by separating the difference between pawn and antichresis; the former is a form of pledge on movable items while the latter is a pledge on immovable properties. Consequently, antichresis has two basic requirements, first, an antichresis as an immovable must be committed to writing by the contractual parties, secondly, and the transaction must be delivered and possessed by the contractual creditor.³⁷

³⁴ Ibid: United States Bankruptcy Court Western District of Louisiana Lafayette Division, Case no. 08-51207, Retrieved on 02/04/2018

from: file:///C:/Users/HP/Desktop/East%20Cameron%20Court%20case/ECP%20Petition.pdf.

³⁵ Standard & Poor's Ratings Services, TEXT-S&P on East Cameron Gas Co (Şukūk) 2006, <https://uk.reuters.com/article/idUKN1447583720090114>.

³⁶ LA. Civ. Code art. 3134 & 3135.

³⁷ LA. Civ. Code art. 3176.

8.0 Juristic Analysis of True Sale of Underlying asset in Şukūk Contract

In the recent time, şukūk default has generated controversies in the Islamic finance industry particularly the challenge of sharī'ah compliance in the şukūk contract. The underpinning factors that usually trigger a default in şukūk investment is the issue of the true sale of the underlying asset.³⁸ In Şukūk investment, the originator transfers the asset via SPV to the şukūk holders. The Şukūk investors (şukūk holders) becomes the legal owners of the underlying asset. Similarly, the contractual agreement should ensure the bankruptcy remoteness of the SPV whereby in the event of default the şukūk holders can have recourse to the underlying asset that has been established through a true sale agreement.³⁹

Ibn Taymiyyah (728H)⁴⁰ emphasized in his work "majmū'ah Fatāwā that "the consideration of custom and norms in a financial transaction is like verbal agreement". Although it might not be stated categorically, if the custom and norms consider it as sales, then it becomes sales. For instance, if a contract is viewed in a custom as a rental then becomes rental, and where it is considered a gift, then it becomes a gift, or where is regarded as endowment then it becomes an endowment.⁴¹ To ensure a true-sale in şukūk contract, specific characteristic should be demonstrated by providing true transfer of ownership from the originator to the şukūk holders via the SPV. These features are discussed in the preceding paragraphs.

Firstly, in the true sale of an underlying asset from the originator to the şukūk investor via SPV, the contractual agreement must be formulated such that it cannot be re-described or re-characterised by the court or other regulatory bodies as secured loan. This is a very important characteristic because, in the event of default, the underlying asset is the recourse

³⁸ Monzer Khaf & Hiba Al-Saudi, Special Purpose Vehicles and Corporate Şukūk: How True is "True Sale"?, JKAU: Islamic Econ., Vol. 29 No. 2, (2016), 2. DOI: 10.4197 / Islec. 29-2.1. The authors recently conducted empirical study of Shari'ah compliant on ten selected şukūk investment. Based on AAIOFI standards requirements, the study shows that only one out of ten şukūk contracts passed. The remaining nine şukūk investment violated the sharī'ah complaint principles one way or the other.

³⁹ Ibid: 3.

⁴⁰ Sheikh Islam Ahmad Ibn Taymiyyah, Jam wa Tartīb, Abdurrahmān bin Qāsim, Vol. 20, (Saudi Arabia: king Fahd bin Abdul-Aziz Press: 2004/1425), 230.

⁴¹ Customs and norms in the commercial context have a significant influence on the consideration of what form a true-sale, ibn Taymiyyah explains the role of custom and norms on commercial transactions. Even if these are norms are not written down, the general perception and understanding of what forms a sale or rental or gift can be derived from the custom and norms of the people and society involved.

for the *ṣukūk* investor. That is, if there are true-sale agreement, it is easy for the originator to make a fraudulent transfer or preference payment in the situation of bankruptcy.⁴² Secondly, true sale of the underlying asset should be characterized as a contractual formation that enhance bankruptcy remoteness of the SPV. In the event of bankruptcy of the originator or default from financial obligations, the SPV should be able to enforce recourse to the asset on behalf of the *ṣukūk* investors without any hindrance arising from financial distress of the obligor.⁴³ Several studies have shown that bankruptcy remote of the SPV is usually achieved in assets backed *ṣukūk* rather than asset-based *ṣukūk*.⁴⁴ Also, it is worth mentioning that an overriding alien could influence the interpretation of the contractual agreement. Hence, true sale agreement must be free from all pre-overriding third parties such as secure loans, ambiguous clauses, non-sharī'ah complaint clauses and element in the *ṣukūk* contracts.⁴⁵ Furthermore, repurchase of the underlying asset must be at the maturity period and at fair or nominal value. This requirement must be based on a sharī'ah principle which forbids the *muḍārib* in *muḍārabah* contract or the *wakil* in *Wakālah* contract to repurchase from the *ṣukūk* investors before the maturity period.⁴⁶

It is worth mentioning that there are issues in structure of East Cameron *Mushārah* *Ṣukūk* which has also contributed to the cause of argument among contractual parties. In East Cameron *ṣukūk* lawsuit, a pledge and Antichresis was the focus of the legal argument. Although the United States law duly stipulates a clear distinction between pledge and Antichresis, the term pledge is a contractual agreement whereby the debtor delivers a pledge item to the creditor or another third party. The pledge item, in this case, is usually movable items and this is a key factor in ensuring its delivery from one party to the other

⁴² Fahd bin Bādī Al-Murshidī, *Al-Ṣukūk, Aḥkāmuhah, Wa ḍawābiṭuhah, wa ishkālātuhah, Dirāsāt Shar‘iyyah Naqdiyyah, Al-Rajhi Bank, (Riyād: Dar Kunūz Ishbiliyah, 2014-1435), P: 41.*

⁴³ Beebee Salma Sairally et al., *Ṣukūk, Principles and Practices, (ISRA, Suruhanjaya Sekuriti & Khazanah Nasional, 217), 513.*

⁴⁴ Asset-backed *ṣukūk* are securities that cater for the ownership conveyance through a "true sale" of the underlying asset such that the *ṣukūk* investors can have recourse in the event of default. Unlike in asset-based *ṣukūk*, the presumed underlying asset is primarily to fulfil sharī'ah compliant requirement and the true-sale of the underlying asset is not effected through legal transfer of ownership from the obligor to the *ṣukūk* investors. Similarly, in a covered *ṣukūk*, it is usually a mixture of pools of assets and liquidity to achieve higher rating. Covered *ṣukūk* usually have simulated (*Al-Ṣuri*) features that might violate sharī'ah principles.

⁴⁵ Christopher F Richardson, *Islamic Finance Opportunities in the Oil and Gas Sector: An Introduction to an Emerging Field, (2006), 6.*

⁴⁶ AAI OFI, *Shari'ah Standard no. (12) 5/7, (2015), 348.*

with the basic intent of securing debt obligation. The contractual agreement comprises of the pledge to return the pledge item with its fruits and accessions to the pledger upon fulfilment of a principal obligation. Moreover, the pledge item is considered as security for the payment of debt and fulfilment of principal obligation which is subject to forfeiture in the event of default and failure.⁴⁷

Unlike the antichresis, it is a Greek work from “anti” (against) and “Chresis” (use). The term antichresis is a contractual agreement of giving a credit against the use of a property. Antichresis is a financial transaction whereby the owner of an asset gives the right of use of a property in exchange of fixed amount as stipulated in the contractual agreement. It gives usufruct right to the tenant for use of property for an agreed period. At maturity, the contract usually stipulates that the owner returns the lump sum of money in exchange with the property from the tenant.⁴⁸ According to the Louisiana antichresis reference no. title XX USA, the fruit of the property is equal to the interest and the tenant must deliver the fruit to the landlord. However, US Article 3176– 3181 stipulates that if the interest is not stated, then the interest is taken from the underlying asset.⁴⁹ The Contractual agreement in East Cameron gas sukūk indicates the use of Antichresis transaction and not pledge because there is a distinction between them. The former is used in immovable properties and is completed with the transfer of legal ownership between the parties. A pledge transaction is used in movable items and the contract should ensure physical transfer or delivery to the other party. The other party, in this case, can either be the creditor or the third party appointed and agreed upon by both parties.⁵⁰ Although, the term antichresis is a Greek word, yet this concept and its application have convergence in Islamic law. The term "pledge" is commonly used in Rahn based transaction, also, making a pledge with an immovable item can also be traced to certain Islamic thresholds. الرهن العقاري الحيازي

⁴⁷ Janet Grace Dalisay Fabrero, Notes on Pledge, Mortgage, Chattel Mortgage and Antichresis, Retrieved on 6/4/2018, From <https://www.scribd.com/doc/208072580/Notes-on-Pledge-Mortgage-Chattel-Mortgage-and-Antichresis>.

⁴⁸ Ignacio Navarro et al., Antichresis leases: Theory and empirical evidence from the Bolivian experience, *Regional Science and Urban Economics* 40 (2010) P: 34, journal homepage: www.elsevier.com/locate/regec.

⁴⁹ Ibid: P: 35.

⁵⁰ United States Bankruptcy Court Western District of Louisiana Lafayette Division, Case no. 08-51207, Retrieved on 02/04/2018 from: <file:///C:/Users/HP/Desktop/East%20Cameron%20Court%20case/ECP%20Petition.pdf> P:15.

9.0 Discussion on the East Cameron court decision

The East Cameron gas defaulted on its periodic payment to the *ṣukūk* investors due to financial distress triggered by a shortfall in the production of oil and gas. Consequently, East Cameron defaulted and filed for chapter 11 bankruptcy protection. However, the East Cameron Partners *ṣukūk* is asset-backed which fulfils important *sharī'ah* requirements principles as stipulated in the AAI OFI *sharī'ah* standard 2008. The court upheld that *ṣukūk* investors in east Cameron gas have a legal claim to the Ownership of the *Mushārah* underlying assets. Hence, the *ṣukūk*holders are owners of the overriding royalty interest (ORRI) from the oil and gas reserves are considered as real property in the Louisiana US, jurisdiction.⁵¹ It seems to the researcher that the decision is borne out of the nature of the American legal system which recognised the contractual agreement on the underlying asset as true-sale and not secured loan. By implication, if the East Cameron partners" claim that the contractual agreement is a secured loan and not true-sale had been accepted at the law court, then *ṣukūk* holders would have been subjected to sharing the ownership of the underlying asset with other creditors.⁵² Sweder van Wijnbergen and Sajjad Zaheer, explained the decision of the court on East Cameron *ṣukūk* default is a landmark precedent in Islamic finance and most especially in *ṣukūk* investment. This is because the overall decision protects *ṣukūk* holders' rights and would subsequently have a positive impact on the global *ṣukūk* market. It also provides a legal precedent that asset-backed *ṣukūk* are in fact bankruptcy free in the event of financial distress.⁵³

The East Cameron *ṣukūk* is an asset-backed *mushārah* *ṣukūk* with an (ORRI) as an underlying asset. The obligor defaulted and claimed the Sukuk contract is a secured loan. Hence, other creditors and Sukuk holders should partner in recourse to the underlying asset. The court rejected this position because the contractual structure depicts true sale

⁵¹ Monzer Kahf and Hiba al-Saudi, Special Purpose Vehicles and Corporate *Ṣukūk*: How True is "True Sale"?, JKAU: Islamic Econ., Vol. 29 No. 2, pp: 3-21 (July 2016) DOI: 10.4197 / Islec. 29-2.1.

⁵² Stephen Fidler, Defaults Pose Latest Snag In Islamic-Bond Market, The Wall Street Journal, June 16, (2009): Retrieved on 27/05/2018 from: <https://www.wsj.com/articles/SB124510859262816907>.

⁵³ Sweder van Wijnbergen and Sajjad Zaheer, *Ṣukūk* Defaults: On Distress Resolution in Islamic Finance, Duisenberg school of finance - Tinbergen Institute Discussion Paper TI 13-087 / VI / DSF 57, (2011): 18.

securitisation based on USA law. Although there is no specific record of asset-based court judgment which eventually favoured the *ṣukūk* investors. It seems fair to say that asset-backed security enhanced the claim of true-sale agreement in the east Cameron court judgement.⁵⁴

Conclusion

In the end, the court decision on East Cameron gas *ṣukūk* default was in favour of the *ṣukūk* holders. The court rejected the argument of the East Cameron partners that the underlying asset -represent a secured loan and not a true sale. The implication as expressed earlier is that, if the decision had favoured the claimant proposition, the *ṣukūk* holders would have been subjected to share the proceeds of the underlying assets with other creditors since it's a merely secured loan. Hence, ensuring the true sale is one of the safety net in protecting the right of the *ṣukūk* holders. Compliance to *sharī'ah* principles of ownership and risk sharing would have reduced incidence of defaults and facilitated restructuring, as shown in the case of ECP *ṣukūk* investment. The study found out the USA bankruptcy chapters are the relevant laws in Sukuk default cases. The judge in the case of East Cameron sukuk was based on the document before the court. The underpinning document shows the underlying asset ORRI contractual agreement is a through sale. Hence the court decided it was a through the sale. However, it seems to the researcher that the *ṣukūk*holders are better protected in the because it is an asset-backed Sukuk whereby the document depicts the underlying asset and the transfer of ownership.

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⁵⁴ ISRA, *Islamic Financial System: Principles and Operations*, (Kuala Lumpur, ISRA, 2012), 445.

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