

The bankruptcy filing by Al Murjan Real Estate is the first court-mandated bankruptcy of a distressed property

project in the UAE. However, the bankruptcy law in itself has, for the last 17 years, remained largely unchanged. A court-mandated bankruptcy can occur in the following circumstances (among others):

- when a creditor of a company applies to the court for a declaration of bankruptcy or
- when a company itself files for bankruptcy, which it must do within 30 days of the date on which it ceases to be able to pay its debts. It is this second situation that the Al Murjan episode falls into.

Breach of this second situation is "bankruptcy by negligence" and can lead to criminal action being taken. In addition to the crime of bankruptcy by negligence, the Penal Code states that upon an order of adjudication of bankruptcy, the company's directors or managers face up to five years imprisonment if they are found guilty of concealment, mutilation, falsification or destruction of books, concealment of assets, or certain other actions.

Once a court receives an application for bankruptcy, it has the power to make any order necessary to protect the property of the developer until the court is able to reach a decision whether or not to make a declaration of bankruptcy. Provided the court makes the declaration of bankruptcy, a summary of the judgment must be published in a daily newspaper and a bankruptcy trustee will be appointed. The role of the trustee is to administer and preserve the bankrupt company's assets. As we have seen with the Al Murjan case, the bankruptcy trustee invites creditors to make known the various debts owed to them by the company.

If it appears that the developer company's assets are insufficient to meet at least 20 per cent of the company's debts, the court that pronounced the bankruptcy judgment may order the members of the board of directors or some or all the managers, to pay some or all of the company's debts in cases where they are proved liable in accordance with the Commercial Companies Law.

The announcement of a declaration of bankruptcy results in the suspension of individual proceedings and actions brought against the bankrupt by creditors. This said, "mortgage creditors" and "preferred creditors" may take enforcement action in respect of assets over which they hold a charge — it is unlikely that purchasers of off-plan units would fall into either of these categories.

However, the announcement of a declaration of bankruptcy does not generally result in the cancellation of a contract to which the bankrupt is a party. If the bankruptcy trustee does not perform the contract, the investor may seek cancellation of the contract. In that case, the investor is entitled to a share in the bankrupt's estate as an ordinary creditor.

Crucially, from the point of view of the developer's creditors, with effect from the declaration of bankruptcy, the developer cannot administer or dispose of its assets and cannot pay its debts or



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collect sums due to it. Any disposals made on the day of the judgment are deemed to have been made after the bankruptcy judgment was pronounced. Once the final schedule of uncontested debts is established, a "judicial composition" will be prepared. The composition will set out how and when creditors would be repaid. An advert would be placed in a daily newspaper notifying creditors of a meeting about the composition. At that meeting the creditors would be entitled to vote on the composition. If the judicial composition is not concluded, the creditors are deemed to be in a "state of union" and the judge will ask each creditor to deliberate on the affairs of the bankrupt's estate with a view to reaching a consensus about how and when creditors would be repaid.

Bankruptcy possibilities

Many developers are experiencing major liquidity issues. It is proving a very difficult balancing act between (i) making the payments owed to the master developer and the various contractors and (ii) collecting payments from the off-plan unit purchasers. Many purchasers are refusing to make further payments without seeing progress on construction and it seems that this is the case in the Al Murjan episode.

As mentioned above, a company is required to file for bankruptcy within 30 days of the date on which it ceases to pay its debts. Additionally, a creditor of the company (for example one of the company's contractors) could apply to the court for a declaration of bankruptcy. It might only take the developer to fall into arrears in relation to one contractor to lead to bankruptcy proceedings being commenced by such contractor. Alternatively, as liquidity issues worsen, further developers may file for bankruptcy themselves.

Options before investors

Investors should be aware of the fact that the Al Murjan bankruptcy announcement is a unique event. The insolvency law in the UAE and the related procedures are not as developed as in many Western countries and this may lead to differences in approach between various judges.

Faced with the uncertainties involved with the bankruptcy procedure, if an investor is dealing with a developer it feels may be slipping into bankruptcy, the investor may seek to reach some form of compromise with the developer at an early stage, perhaps transferring to a more complete project owned by a developer in the same group of companies, as it is unlikely that a developer in that position will agree to refund the instalments paid by the investor.

Once bankruptcy proceedings have been commenced it is important for investors to make known to the bankruptcy trustee their debt as well as seeking legal advice.

It should be noted that there are specific bankruptcy/insolvency laws that apply in the DIFC zone. Similarly, any disputes involving subsidiaries of Dubai World are to be held before the special tribunal set up for that purpose and the procedure discussed above would not apply. ■