

In re Mid-Pacific Construction Co. Inc.

Supreme Court, Trial Division (Pon.)

King C.J.

7 March 1988

Equity—creditors' remedies in absence of statutory priority—whether court has power to establish priorities of judgment creditors in absence of insolvency statute. Creditors' remedies—government lien under statute—wage and salary withholding tax.

Employment—workers and labourers—whether employees of insolvent employer have superior equity to other creditors.

Creditors' remedies—whether execution creditors should be in more favourable position than mere judgment creditor.

Creditors' remedies—where execution creditors have priority over judgment creditors, whether execution creditors should explore all alternatives before attaching assets.

Employment—priority to employees of insolvent creditor—labourers and wage-earners—whether senior officers, such as secretary-treasurer, are entitled to similar priority.

Facts:

More than fifteen judgment and execution creditors, including the national government of the Federal States of Micronesia (F.S.M.), sought execution of judgment debts against Mid-Pacific Construction Company, an insolvent or functionally bankrupt corporation. With the exception of a statute establishing a priority for the Government respecting withholding, or "pay-as-you-earn", taxes on salaries and wages already paid out to employees, there is no bankruptcy code in the law of the F.S.M., and the Court is obliged to fashion priorities from first principles of equity. The claimants include: the Government, re wages and salaries withholding tax; the Government's gross revenue tax; the Social Security Board, re employer's and employees' contributions; migrant Filipino labourers, statutorily barred from alternative employment in the F.S.M., and entitled to funds for air transport home; judgment creditors who had executed writs of attachment against assets of Mid-Pacific; salaried officers of Mid-Pacific, and other judgment and execution creditors.

HELD:

The Court shall first apply the statutory liens favouring the Government, and then apply equitable principles, not to overcome specific legal injustice but rather to supply the incomplete aspects of creditors' remedies:

- (1) The first priority shall be the Government for its unpaid wage and salary taxes.
- (2) The second priority shall be labouring (not managerial) employees of the company.
- (3) The third priority shall be gross revenue tax claims of the Government.

(4) The fourth priority shall be execution creditors who attached assets of the debtor.

(5) The fifth priority shall be other execution creditors.

(6) The sixth priority shall be all other judgment creditors.

Execution creditors are to be preferred to other judgment creditors, but, in order to prevent a race to the court-house door, judgment creditors will be required to explore alternative satisfaction of their claims before assets are seized and, even after seizure, the Court will be slow to pay out the claims of the first execution creditor, to enable all judgment creditors to participate.

The Government's third priority, the gross revenue tax claim, depends upon notice to other parties and potential creditors. In this case, such notice was effective when the Government filed a civil claim against Mid-Pacific.

Other cases referred to in judgment:

Bank of Guam v. Island Hardware (I) 2 F.S.M. Intrm. 281 (Pon. 1986)

Bank of Guam v. Island Hardware (II) 3 F.S.M. Intrm. 109 (Pon. 1987)

Finance Co. of Pa v. Charleston, C. & C.R. Co. 48 Fed. 188 (1891)

Florida Construction & Realty Co. v. Pournell 5 A.L.R. 685 (Fla. 1918)

In re Gurewitz 121 Fed. 982 (2d. Circ. 1903)

In re Hallmark Medical Services Inc. 475 F. 2d. 801 (5th. Circ. 1973)

In re Neavear 674 F. 2d. 1201 (7th. Circ. 1982)

Philpott v. Essex County Welfare Board 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d. 608 (1973)

United States v. State of New York 315 U.S. 510, 62 S. Ct. 712 86 L. Ed. 998 (1942)

Legislation referred to in judgment:

6 F.S.M.C. 1405, 1407

51 F.S.M.C. 142

53 F.S.M.C. 104

54 F.S.M.C. 135(2) and 153

42 U.S.C.S. 407

F.S.M. Civ. R. 64

Trust Territory Social Security Act

Other sources referred to in judgment:

Black, *Law Dictionary* (5th. ed. 1979)

Devlin, P. *The Judge* (1979)

Moore, A.J. *Collier on Bankruptcy* (14th. ed. 1975)

Moore, J., Phillips, W., and D'Agostino, R. *Debtors and Creditors Rights* (5th. ed. 1979)

Spry, I. *Equitable Remedies* (3rd. edn. 1984)

Annotation, "Preference of wages over lien creditors of corporation in hands of receivers, in absence of statutory provision therefor" 5 A.L.R. 690 (1920)

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All other applicants, *pro se*

90 **KING C.J.**

Judgment:

During the past several years, numerous law suits have been filed in this Court against Mid-Pac Construction Company Inc. by various of its creditors. All plaintiffs in the cases whose captions are included in this opinion have now obtained judgments against Mid-Pac.

In recent months several judgment creditors have petitioned this Court for writs of execution against Mid-Pac. The Court originally declined to issue such writs in the hope that Mid-Pac might be able to garner its resources and continue as an operating business. Eventually, however, it became apparent that the claims against Mid-Pac

100 so greatly outweighed its resources that the company would not be able to survive. Accordingly, the Court concluded that the various claims being asserted by creditors of Mid-Pac should be considered together so that legal and equitable claims could be weighed carefully to determine the ultimate distribution of Mid-Pac's assets rather than having distribution determined by races to the court-house.

Therefore, writs of execution were granted on behalf of the creditors in general but no distribution of proceeds of the sale of execution has been made. Prior to determining the appropriate distribution, this Court has caused notice to be given to those creditors of whom the Court is aware and has caused general notices to be published in the *Pacific Daily News* and broadcast on radio stations throughout the

110 Federated States of Micronesia. On 4 November 1987, a hearing was held and the various parties were given an opportunity to substantiate any claims they might have as to priority.

The Court has now considered those claims and reviewed the files on record in the cases mentioned above. Based upon that consideration and review, the Court has made the following determinations as to priority.

I. Method

Mid-Pac Construction Co. Inc. is an insolvent or bankrupt corporation. Mid-Pac is unable to pay its debts when they become due and has liabilities far exceeding its assets.

120 In responding to these circumstances, the Court in this new island nation does not have available to it a fully developed arsenal of statutes to guide decisions. Specifically, there is no bankruptcy law enumerating the procedures to be followed, or the rights to be observed, in responding to claims of creditors far outstripping the available assets of an insolvent debtor.

There are a few statutes establishing liens, and of course the Court must apply those. Yet, when the statutes have been exhausted, there will necessarily remain in any insolvency proceeding a broad range of issues which must be decided but for which there is little or no guidance by way of statute or case precedent.¹ Under these

¹ "It was the incompleteness in the system rather than the injustice in the exceptional case that led to equity" (P. Devlin, *The Judge* 91 (1979)).

130 circumstances the Court is acting essentially as an equitable court and must fashion solutions, applying equitable principles, to meet the particular circumstances of the case in an attempt to reach a fair result.²

Equitable principles have above all a distinctive ethical quality. They are of their nature of great width and elasticity and are capable of direct application, as opposed to application merely by analogy, in new circumstances as they arise from time to time. Thus at law a court is required to operate largely by analogy when presented with new situations. But in equity the establishment of fiduciary duties or the application of an equitable doctrine may arise in any circumstances at all, whether or not similar circumstances have come about previously, provided that the case falls within the general principles that originated in the Court of Chancery. (I. Spry, *Equitable Remedies* 1 (3rd. ed. 1984))

II. Priority Claims

Various parties assert theories under which they seek priority payment of their claims, so that their particular claims would be distinguished from others and paid before those others.

A. National Government

The national government asserts priority lien rights under statutory provisions set out at 54 F.S.M.C. sections 135(2) and 153. The Court finds that both provisions establish priority rights for the Government under the circumstances of this case.

150 1. *Wage and salary tax lien*—The national government has a statutory lien under 54 F.S.M.C. 135(2) on any amounts owing for taxation of wages and salaries of Mid-Pac. That lien has priority over all other claims and liens. (*Bank of Guam v. Island Hardware Inc. (II)* 3 F.S.M. Intrm. 105, 109–10 (Pon. 1987)). Thus, no other payment to creditors may be made from the execution sales proceeds until all amounts owing for wage and salary taxes are paid in full to the Government.

2. *Gross revenue tax lien*—Under 54 F.S.M.C. 153, the national government also has a lien for business gross revenue taxes owing to the national government by Mid-Pac. The priority of that lien is subject to a requirement that the Government take reasonable and timely action to notify other parties of the Government's claims (*Bank of Guam v. Island Hardware (II)* 3 F.S.M. Intrm. at 109).

160 Notices could be accomplished in various ways. For example, in exchange for forbearance from immediate collection of overdue taxes, the Government could elicit from the taxpayer an agreement that the taxpayer will notify all present and future creditors of the existence of the Government's claim and of its lien rights. The taxpayer might also be required to include notice of the Government's tax and lien claim in annual reports or any financial statements which must be filed with public officials and would be available for review by potential creditors of the taxpayer.

The Government here has made no satisfactory showing of efforts to provide notice of its lien under 54 F.S.M.C. 153 prior to 11 October 1984. On that date, the

2 Equity is "Justice administered according to fairness as contrasted with the strictly formulated rules of common law. It is based on a system of rules and principles which originated in England as an alternative to the harsh rules of common law and which were based on what was fair in a particular situation" (Black, *Law Dictionary* 484 (5th. ed. 1979)).

170 Government filed civil action 1984-028 against Mid-Pac claiming that Mid-Pac had failed to pay gross receipts taxes due and owing for the years 1979, 1980, and 1981. From the time of such filing, any creditor contemplating entering into an agreement or advancing credit to Mid-Pac could have reviewed the Court's records, learned of the national government's claims, and understood that Mid-Pac was delinquent in its tax payments. The Court considers this reasonable notice, sufficient to apprise other creditors of Mid-Pac of the national government's tax claims.

Accordingly, the 54 F.S.M.C. 153 lien of the Government for overdue gross receipts taxes became effective on 11 October 1984. In the absence of any statutory provision to the contrary, or any overriding equitable consideration, rights obtained after 11 October 1984 by creditors or others doing business with Mid-Pac were 180 subject to the national government gross revenue tax lien rights under 54 F.S.M.C. 153. These lien rights are not restricted to the amount of the tax claims in the lawsuit. The existence of the litigation is sufficient to create the lien by notifying all interested third parties of the fact that Mid-Pac was failing to make timely tax payments. The lien extends to all gross revenue tax claims of the Government against Mid-Pac.

The question as to whether liens under 54 F.S.M.C. 135(2) and 153 apply to statutory interest and penalties as well as to the amount of the tax, is deferred pending separate briefing and consideration of that question.

B. *Trust Territory Social Security Board*

190 The Trust Territory Social Security Board claims that it too is entitled to a priority lien comparable to that specified for the national government in 54 F.S.M.C. 135(2). This claim is based upon the following provision in the Trust Territory Social Security Act:

Susceptability of benefits, contributions, and funds to legal process or assignment—The benefits, the employee and employer contributions, and the securities in the several funds from all taxes presently or hereafter levied shall not be subject to execution, attachment, or garnishment and shall be nonassignable except as specifically provided in this title. (53 F.S.M.C. 104)³

200 This does not appear adequate to provide the Social Security Board the lien rights it claims. The statute is a shield to protect beneficiaries, furnishing protection for their funds and claims against execution, attachment, or garnishment. The Board seeks to use this protective provision as a sword, to establish lien rights, thereby enabling the Board to assert claims more effectively. As a policy matter, there is much to be said for giving prior lien rights to the Social Security Board. However, this statute says nothing about creation of a lien and does not appear on its face to create the rights the Social Security Board would assert here.

The Social Security Board has not directed the Court's attention to any legislative history indicating an intention that 53 F.S.M.C. 104 would create priority lien rights,

3 The social security system is in a state of transition with funds and responsibilities now being transferred from the Trust Territory Board to a new Federated States of Micronesia Social Security Board. The new F.S.M. statute includes 53 F.S.M.C. 604 (1987 Supp.), almost identical with 53 F.S.M.C. 104. However, the Trust Territory Social Security Board, and not the F.S.M. Board, is the creditor in this case. Therefore the statute here under consideration is 53 F.S.M.C. 104.

or indeed any rights at all, in the board as against employers or employees. The Court's independent research has not uncovered any legislative direction as to the intended meaning of the statute.

The United States Social Security Act, however, contains a somewhat similar provision, 42 U.S.C.S. 407, from which 53 F.S.M.C. sections 104 and 604 presumably were drawn.⁴ United States courts have regarded that provision only as providing protection for social security beneficiaries, against efforts of creditors to attack or garnishee social security benefits to satisfy the creditors' claims against the beneficiaries. *In re Neavear* 674. F. 2d. 1201 (7th. Circ. 1982). See also *Philpott v. Essex County Welfare Board* 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d. 608 (1973). The statute has not been interpreted by United States courts as strengthening collection rights for the United States social security administration. The United States social security administration has looked to a provision in the United States bankruptcy act to establish its priority as against other creditors of an employer in proceedings similar to this one (*United States v. State of New York* 315 U.S. 510, 62 S. Ct. 712, 86 L. Ed. 998 (1942)). Federated States of Micronesia law contains no statute comparable to the United States bankruptcy act provision.

The Court concludes that 53 F.S.M.C. 104 does not establish lien rights in the Trust Territory Social Security Board, and that the Board has no lien or priority claim of any kind beyond that of a judgment creditor.

C. Employees

The employees of Mid-Pac asserting claims in this litigation are Filipino immigrant workers, all of whom were brought to Pohnpei by Mid-Pac to work pursuant to non-resident employment agreements approved by the Labor Division of the F.S.M. Department of Resources and Development.

These agreements contemplate that the immigrant employees will work for Mid-Pac for a prescribed period of time, that if they are terminated early without cause they will receive at least four weeks' termination pay, and that in any event the employer will assure the availability of funds for air transportation to permit the employees to return to their home country.

Testimony at the trial of civil action 1987-028 revealed that the promises in these agreements were not matched by reality. For many months prior to termination of Mid-Pac's operations, the employees were being denied payment of their wages on the ground that the company could not afford to pay them. Instead they were infrequently, irregularly, and informally given lump sums sufficient only to allow them to sustain themselves at a minimum level.

Immigrant workers are barred by statute from changing employers within the Federated States of Micronesia. Before an immigrant employee may begin work for a new employer, he must first leave the Federated States of Micronesia (51 F.S.M.C. 142 (1987 Supp.)). This statutory provision, coupled with the failures of Mid-Pac to pay the employees the wages they had earned and to provide the air fare required by law and necessary to permit the employees to leave the Federated States of Micronesia, placed the employees in a desperate and helpless situation.⁵

⁴ Title 42 U.S.C.S. section 407 provides:

The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal

This is an issue of first impression in the Federated States of Micronesia. There is no applicable statute. No customary practice, and no Trust Territory cases bearing upon the status of wage claims in employer insolvency proceedings have been brought to the Court's attention. We must look elsewhere for guidance.

For almost a century, rights of employees of insolvent companies to receive preference against other creditors of the employer have been determined by reference to the national bankruptcy act in the United States. There is no comparable statutory framework here and therefore the more recent decisions in the United States concerning wages are of little relevance or assistance to us here. The more appropriate source of guidance is the common law as it existed in absence of statute.

Under the earlier common law, courts ruling in receivership or other proceedings similar to this one frequently found superior equities to lie with employees of an insolvent employer and gave preferred treatment to claims for wages. Such preferences were granted often on the basis that an expectation of wage payments may be necessary to retain the services of employees necessary to attempt to produce income, or preserve assets, to pay creditors. See *Finance Co. of Pennsylvania v. Charleston C. & C.R. Co.* 48 Fed. 188 (1891); *Florida Construction & Realty Co. v. Pournell* 5 A.L.R. 685, 689 (Fla. 1918). See also *In re Hallmark Medical Services, Inc.* 475 F.2d. 801, 804 (5th. Circ. 1973).

It has also been said that a preference "is not a right vested in the employees, or an equity administered in their favor. It is a personal protection given to them by the court *ex gratia*, moved thereto by the fact that this class depend upon their daily labor for their daily food" (*Finance Co. of Pennsylvania v. Charleston C. & C.R. Co.* 49 Fed. 693 (1892)).

The power to grant such preferences to wage earners is not dependent upon statute but is within the inherent, equitable powers of the court (Annotation, "Preference of wages over lien creditors of corporation in hands of receivers, in absence of statutory provision therefor" 5 A.L.R. 690 (1920)).

The equities in favour of the employees in this case are unassailable. They uprooted their lives to come to the Federated States of Micronesia in an attempt to earn funds with which to support their families. There is no indication that they have been anything other than loyal, hardworking employees of Mid-Pac.

Another factor here is the involvement of immigration and labour authorities. Labour officials are required by law to approve non-resident employments and to provide copies to the employees. This requirement seems likely to inspire reliance and trust on the part of the employee that the provisions of the agreement are fair and will be upheld by the authorities. In this case the agreement was breached by the employer. Yet, apparently the only steps taken by government authorities were to monitor the impoverished employers so as to prevent them from accepting work with another employer. Thus the law has played a part in making these employees vulnerable. It appears appropriate that equity assist to alleviate their misery.

This Court concludes that claims for wages asserted by employees in this case are entitled to preference over all other claims, except the wage and salary tax lien rights

5 The Court expresses no opinion as to whether application of 51 F.S.M.C. 142 to employees who, like the wage-earners here, have been victimized by breach of their non-resident employment agreements and have no means of departure, would be an unconstitutional deprivation of liberty or taking of property in violation of the due process rights of such employees.

of the national government, which are given priority over all other claims and liens by 54 F.S.M.C. 135(2).

300 The wage claims are not affected by the Government's lien rights under 54 F.S.M.C. 153 for two reasons. First, that section does not demand top priority for the Government's gross revenue lien. Second, the long-standing theories under which labourers and lower level employees are granted protection are unrelated to the notice questions determinative of the existence of the section 153 lien. Indeed, the equitable protections flow from an assumption that such employees have little bargaining power or choice among employers, and almost no opportunity to assure that their employer will have a strong credit rating. These assumptions are certainly accurate in the case of these immigrant employees.

310 Finally, it is necessary to distinguish among the persons who refer to themselves as employees. Priorities of payment for wages in the context of receivership and bankruptcy proceedings traditionally have been limited to compensation payable to labourers and other lower level workers.

"Priority of payment was intended only for the benefit of those who are dependent upon their wages . . .", those who "could not be expected to know anything of the credit of their employer but must accept a job as it comes, to whom the personal factor in employment is not a practicable consideration". It has often been stated that "the intention of Congress was plainly to give special protection to a class of wage earners who generally have no substantial savings to fall back on in case of adversity and therefore cannot afford to lose". (3A J. Moore, *Collier On Bankruptcy* paragraph 64.204 (15th. ed. 1975))

320 See also *id.*, paragraph 64.202, quoting from *In re Gurewitz* 121 Fed. 982 (2d. Circ. 1903):

There is nothing ambiguous about the use of the word "wages" in this connection. It means the agreed compensation for services rendered by the workmen, clerks, or servants of the bankrupt—those who have served him in a subordinate or menial capacity and who are supposed to be dependent upon their earnings for their present support. Whether their employer has agreed to pay them by the hour, the day, the week, the month or by the "job" or piece is wholly immaterial.

In this context I conclude that the claims asserted in civil action 1987-028 by Carlito Capang, Abelardo Asion, Alfredo Sanchez, Ladislao Sanchez, Rodrigo Sanchez, and Jose Gonzales for wages are entitled to priority treatment.

330 It is also clear from the record that the claim of Belinda C. Mejia is not entitled to priority since she is an officer, not a labourer or lower level wage earner. As secretary and treasurer of Mid-Pac she was more likely to have bargaining power and to have made the determination to join Mid-Pac on the basis of the company's actual status and the personalities and integrity of key members of management. As keeper of the books and records of Mid-Pac, she was aware of the company's financial status from the time when she first assumed her duties. She was far better placed than lower level employees of the company to take actions designed to protect herself. Ms. Mejia's claim is not entitled to priority as a subordinate employee but shall be included with other judgment creditors.

340 The record is silent concerning the roles played within the company by Virgilio Gayes, Meming Manangan, and Conrado Roland, plaintiffs in civil action 1987-046. In absence of information to the contrary, the Court assumes that these claimants were lower level wage earners and are entitled to the priority referred to here. However, any party who has knowledge to the contrary may file objection to this finding at any time within ten days after issuance of this opinion. If an objection is filed, a hearing will be convened as to the status of these employees and the burden of persuasion will be placed upon the party challenging the status of these three claimants as lower level wage earners entitled to preference for their wage claims.

C. *Frederick L. Ramp*

350 Frederick L. Ramp on 29 April 1987⁶ received judgment in civil action 1986-002 in the amount of \$10,327.75 against Mid-Pac Construction Co. due to defective construction by Mid-Pac of Mr. Ramp's personal residence.

Prior to entry of the judgment and pursuant to 6 F.S.M.C. 1405 and FSM Civ. R. 64, this Court on 13 August 1986 granted Mr. Ramp's motion for writ of attachment. Pursuant to the writ, the F.S.M. Division of Security and Investigation seized the following items all of which apparently are property of Mid-Pac:

1. diesel dumper (cement dumper), model D-1500H;
2. Rockwell model 10, contractor saw;
3. engine welding machine (diesel) #CFE312.

360 This attachment and seizure created in Mr. Ramp statutory and possessory lien rights sufficient to provide him with a priority claim as to the particular property seized. (See *Bank of Guam v. Island Hardware Inc. (I)* 2 F.S.M. Intrm. 281, 286, and 288 (Pon. 1986)).

Since these rights attached prior to any request for execution upon the assets of Mid-Pac, the rights of Mr. Ramp in this property were unaffected by the subsequent writs of execution (*Bank of Guam (I)* 2 F.S.M. Intrm. at 285: "While the [execution] statute contains no exceptions for third party creditors, neither does it purport to sweep away pre-existing property rights, including security interests, of others.") Thus, Mr. Ramp is entitled to priority over execution creditors as to the proceeds realized from the sale of the assets identified here.

370 Yet, Mr. Ramp's rights to the attached assets are not absolute. His priority interest due to the attachments is subject to the Government's wage and salary tax lien claim since 54 F.S.M.C. 135(2) gives the Government priority over all other claims and liens on the employer's entire assets. Although attached, these items still were assets of Mid-Pac and remained within the reach of 54 F.S.M.C. 135(2).

The wage claims of Mid-Pac's employees also will be given priority over Mr. Ramp's attachment interests. The wage priority arises from equitable principles essentially unaffected by considerations otherwise determinative of lien rights. Under the circumstances of this case, the Court concludes that these wage claims should be granted priority over all other claims, except insofar as a statute, 54

380 ⁶ Although the office of the clerk erroneously dated the judgment as of 29 February 1987, court records make clear that the actual date was 29 April 1987. The clerk's entry of judgment shall be corrected to reflect the proper date.

F.S.M.C. 135(2), requires otherwise. Only the Government's wage and salary tax lien has priority over the employees' claims for wages.

The more difficult question is whether Mr. Ramp's attachment rights give him priority in the attached property over the national government's lien rights under 54 F.S.M.C. 153.

390 Mr. Ramp entered into his housing construction contract with Mid-Pac on or about 23 August 1982. Testimony in the trial of civil action 1986-002 established that construction of the house was completed early in 1984. This was all well before 11 October 1984, when the national government's filing of civil action 1984-028 first provided the notice necessary to establish the Government's 54 F.S.M.C. 153 lien rights. Of course any lien rights in Mid-Pac's property obtained by the Government on 11 October 1984 were subject to pre-existing rights Mid-Pac's creditors or other parties may have then had in that property. However, there is no contention that Mr. Ramp had rights in any specific property of Mid-Pac by virtue either of the 1982 contract or Mid-Pac's subsequent faulty construction of the house. Mr. Ramp's specific lien rights did not arise until August and October of 1986 when the Government's section 153 lien already covered all property of Mid-Pac.

400 Accordingly, the Court finds that Mr. Ramp's claims pursuant to the 1986 attachment are subject to the national government's prior lien rights under 54 F.S.M.C. 153.

E. *United Micronesian Development Association*

United Micronesian Development Association on 9 September 1987 was granted a default judgment in civil action 1987-016 in the amount of \$12,612.49 for its claims based upon unsecured promissory notes executed to assure payment for merchandise sold by U.M.D.A. to Mid-Pac.

U.M.D.A. has not sought issuance of a writ of execution and retains the status of a judgment creditor.

F. *Bank of Guam*

410 A default judgment in the amount of \$57,316.71 was entered on behalf of the Bank of Guam against Mid-Pac on 6 July 1987. The Bank of Guam's claim is based upon continuing guaranties executed by Herman Semes and Kioko Semes on behalf of Mid-Pac. A 10 July 1984 guaranty covered the obligations of Island Hardware Inc. under a line of credit extended by the bank. A later guaranty, dated 9 April 1986, apparently a substitute for the original one, was executed in connection with a \$60,553 promissory note given by Island Hardware to the bank on 2 April 1986.

These continuing guaranties do not purport to establish in the bank any lien rights against Mid-Pac and the Court finds none.

The Bank of Guam filed a motion seeking writ of execution against Mid-Pac on 19 August 1987. That motion was granted on 8 September 1987.

420 On or about 26 August 1987, Mid-Pac attempted a series of assignments and preferences. These included an attempted sale of equipment by Mid-Pac to Herolyn and James Movick and an assignment by Mid-Pac to Bank of Guam of the right to receive payments from Mr. and Mrs. Movick for the equipment.

Several creditors challenged these attempted conveyances, including the assignment to the Bank of Guam of the right to receive sale proceeds. In a hearing held on 20 October 1987, this Court invalidated those assignments.

Thus, the Bank of Guam has no lien rights and shall participate in the distribution of proceeds as an execution creditor.

G. *Sets Inc.*

430 Sets Inc. on 4 November 1987 was awarded judgment in the amount of \$30,000 against Mid-Pac. This judgment was based on the claims of Sets, as assignee of accounts receivable of Island Hardware, that Mid-Pac owed Island Hardware on an open book account.

Sets has neither sought nor received a writ of execution in this case and therefore will participate in distribution of proceeds as a judgment creditor.

H. *Hardware, Inc. of Guam*

After trial in civil action 1983-001, Hardware, Inc. of Guam was awarded judgment against Mid-Pac in the amount of \$47,994.51. No writ of execution having been sought, Hardware, Inc. of Guam stands in the position of a judgment creditor.

440 **III. Relative Status of Judgment**

A. *Creditors and Execution Creditor*

The execution statute, 6 F.S.M.C. 1407, does not spell out the rights of an execution creditor as opposed to a judgment creditor who has not brought about execution upon the judgment debtor's assets. This Court has concluded that the two categories must be treated differently.

450 The conclusion is based in part upon the fact that an execution creditor plainly is expected under the law to hold a more powerful position than a mere judgment creditor. Even when a judgment exists, the debtor apparently retains the right to sell his personal property to innocent third parties who acquire the property for value. However, this right of the debtor to sell, and the opportunity for bona fide purchasers to acquire the debtor's interest in the property, is snuffed out when law enforcement authorities seize the debtor's personal property pursuant to a writ of execution. (See, generally, J. Moore, W. Phillips, and R. D'Agostino, *Debtors' and Creditors' Rights* 5-9 to 5-15 (5th. ed. 1979).)

Moreover, the judgment creditor who has taken the effort and exhibited the diligence to move to the status of execution creditor may deserve to be treated differently on that basis.

460 The principal counter-argument has been that, if execution creditors are granted priority over judgment creditors in distribution of proceeds, judgment creditors will be compelled to seek writs of execution immediately. Encouragement of hasty moves toward writs of execution, the Court is warned, may cause the dissolution of Micronesian-owned businesses which might otherwise survive.

This risk is of considerable concern to the Court. However, the Court has attempted to apply the law in a manner likely to minimize irrational, undesirable, and unfair results. Because the statutory law concerning insolvency is so scanty in the Federated State of Micronesia, the Court exercised equitable powers to fill in the gaps and to try to achieve fair results. It is hoped that application of the execution laws in the manner carried out in this and similar litigation may minimize the risk that writs of execution will cause business failures which might otherwise be avoided.

470 In particular, two procedures have been employed in this case in an effort to reduce the risk of precipitous and unnecessary business failure through writs of execution. First, the Court has viewed writs of execution as only one of the methods

whereby courts may assist judgment creditors to enforce their judgments. Writs of execution have not been granted on an automatic basis, but only when it has been shown that the judgment creditors have seriously explored the possibility of satisfying the judgment through other means. This gives the debtor a reasonable opportunity to avoid being subjected to execution of assets.

480 Secondly, even after writs have been issued and an execution sale has been conducted, the Court has declined to permit immediate distribution of the execution sale proceeds to the first execution creditor. Immediate payment to the first execution creditor does not seem appropriate in circumstances such as this when it has become apparent that the debtor is a failing company and that claims of creditors will outstrip the value of the assets of the debtor.

Instead, the approach taken has been to proceed slowly so as to give all creditors an opportunity to submit claims. The Court has then attempted to view all the competing claims together in an effort to sort out priorities and distribute any available proceeds on an equitable basis.

490 This second prong of the Court's approach is intended also to reduce the sense of urgency which might otherwise be felt by a judgment creditor to move toward execution in order to obtain full satisfaction before other creditors could obtain execution.

If these procedures are upheld and used in future cases, it appears that a rule granting execution creditors priority in distribution proceeds over other judgment creditors will furnish a fair result as between those two categories of creditors, yet will not trigger unnecessary or artificial bankruptcies or economic hardship.

Based upon the considerations set forth above, the Court concludes that execution creditors should receive priority over other judgment creditors in the distribution of proceeds realized from the sale of assets of Mid-Pac.

IV. Summary of Results

500 Based upon the considerations set forth in the above opinion, rights of participation in the proceeds from the sale of assets of Mid-Pac shall be as follows:

First priority—The national government shall receive the entire amount of its claim for wage and salary taxes by virtue of its highest priority lien under 54 F.S.M.C. 135 (2). Decision as to whether penalties and interest shall also be given priority is deferred pending separate consideration of that issue.

510 *Second priority*—The employees of Mid-Pac who are not managers or officers of the company shall receive payment of their claims in full. If there are not sufficient funds to pay the claims of this group in full, funds remaining after payment of the first priority shall be divided on a pro rata basis, proportionate with the amount of claim of each party. (For example, if the claim of employee A was for \$2.00 and the claim of employee B was for \$4.00, and the total proceeds available for distribution were \$3.00, employee A would receive \$1.00 and employee B would receive \$2.00.)

Third priority—Gross revenue tax claims of the national government shall be paid in full. Decision as to whether penalties and interest shall also be given priority is deferred pending separate consideration of that issue.

520 *Fourth priority*—The claims of the first three priorities should be satisfied, if possible, from proceeds other than those realized from the sale of the items of equipment subject to the writ of attachment issued for the benefit of Fredrick L. Ramp. However, if there are insufficient funds from those other sources, then proceeds of the attached items may be employed to satisfy the first three priorities.

After the claims of those in the first three priority groups are satisfied, any remaining funds realized from the sale of the attached items shall be payable to Fredrick Ramp until his claim is satisfied. If his claim is not satisfied completely by attachment sale proceeds, then he shall participate as a judgment creditor, sixth priority, as to the balance of his claim.

Fifth priority—All those parties who have requested writs of execution during the pendency of this litigation shall share equally, on a pro rata proportionate basis, in any proceeds remaining available after the claims of the first four priority groups are satisfied. It appears that the Bank of Guam is the only execution creditor not included within the first four priorities. Claims of the national government for tax penalties may also fall within this category since a writ of execution has been granted upon motion of the Government. The claims of this fifth priority group shall be satisfied before any claims in the sixth priority are paid.

Sixth priority—All judgment creditors who have not requested writs of execution shall share on a pro rata proportionate basis until all claims within this group are satisfied. These claimants include Sets Inc., Fredrick Ramp as to any balance of his claim after realization of his fourth priority rights, United Micronesian Development Association, Belinda Mejia, the Trust Territory Social Security Board, and Hardware Inc. of Guam.

170 V. Conclusions

Before distribution may take place the precise amounts of remaining claims in each category, and the amount of funds available for payment, must be determined. The national justice ombudsman is hereby appointed as a special master to convene a hearing of the parties, to make the calculations, and to file a report proposing the amounts to be distributed to each creditor. This report shall be filed with the Court, and copies distributed to all parties on or before 31 March.