

TITLE 31
BANKRUPTCY AND INSOLVENCY

SUBTITLE I
BANKRUPTCY ACT OF 2004

CHAPTERS

- 1 General Provisions (§§ 101-112)**
- 2 Receivership Proceedings (§§ 201-209)**
- 3 Reorganization Proceedings (§§ 301-311)**

Editor's note: PL 13-73 enacted this national bankruptcy and insolvency statute which became law on January 31, 2005 without the signature of then President Joseph J. Urusemal. It is codified here as a separate subtitle to retain the integrity of the Bankruptcy Act of 2004 and to allow for passage of future laws on the subject matter of Bankruptcy and Insolvency not intended to amend or otherwise be a part of this subtitle.

PL 13-73 § 1 states the following purpose for this subtitle:

The purpose of this bill is to establish a bankruptcy system for the Federated States of Micronesia that fairly balances the interests of creditors and debtors in circumstances where the debtor is unable to meet his financial obligations when due. A uniform set of laws and procedures is established for all bankruptcy proceedings, providing increased certainty for creditors, debtors and the courts. The bill is designed to protect the interests of creditors by creating a single proceeding in which multiple creditor claims can be addressed efficiently and equitably, freeing all parties from the uncertainties and costs of numerous, uncoordinated debt enforcement activities, all competing for access to the debtor's assets. It is also intended that creditor interests be served by the appointment of a receiver, in appropriate circumstances, to marshal all of the debtor's non-exempt assets and to manage those assets, during the pendency of the proceeding, in the best interests of the estate. The bill creates for the debtor who meets the requirements of the law an opportunity to get a fresh start where he might otherwise face a protracted struggle with debt beyond his ability to pay. The bill gives to the courts substantial latitude in managing the bankruptcy proceeding to protect the interests of both creditors and debtors, to deal with abuses of the bankruptcy system and to establish a case schedule that takes into consideration the interests of all parties. It is not the purpose of the bill to interfere with or modify state or traditional law with respect to the transfer of interest in land. Instead, the bill directs the bankruptcy court to apply state law in determining whether and to what extent interests in land are subject to distribution to creditors.

Case annotation: The Bankruptcy Act's stated purpose is to fairly balance the interests of creditors and debtors and to give the court substantial latitude to deal with abuses of the bankruptcy system. *In re Panuelo*, 16 FSM R. 339, 344 (Pon. 2009).

SUBTITLE I
BANKRUPTCY ACT OF 2004

CHAPTER 1
General Provisions

SECTIONS

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Editor's note: This chapter on General Provisions was created by PL 13-73 § 2.

§ 101. Authority; title.

This statute is enacted pursuant to the power of Congress to regulate bankruptcy and insolvency under article IX, section 2(g) of the Constitution of the Federated States of Micronesia. This Act may be cited as the “Bankruptcy Act of 2004”.

Source: PL 13-73 § 3.

Cross-reference: FSM Const., art. IX, § 2(g) reads as follows:

Section 2. The following powers are expressly delegated to Congress:

...

(g) to regulate banking, foreign and interstate commerce, insurance, the issuance and use of commercial paper and securities, bankruptcy and insolvency, and patents and copyrights;

...

The statutory provisions on the Congress of the Federated States of Micronesia are found in title 3 of this code.

The official website of the Congress of the Federated States of Micronesia contains the public laws enacted by the Congress, sessions, committee hearings, rules, and other Congressional information at <http://www.fsmcongress.fm/>.

§ 102. Definitions.

(1) “Affiliate” means:

(a) a person that directly or indirectly owns, controls, or has the power to vote, 20 percent or more of the outstanding voting securities of the debtor;

(b) a corporation 20 percent or more of whose outstanding voting securities are directly or indirectly controlled, or held with power to vote, by the debtor, or by a person that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor;

(c) a person whose business is operated under a lease or operating agreement by the debtor, or a person substantially all of whose property is operated under an operating agreement with the debtor;

(d) a person that operates the business of, or all or substantially all of the property of the debtor under a lease or operating agreement.

(2) “Claim” means:

(a) a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(b) a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

(3) “Creditor” means a person or government entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.

(4) “Debt” means liability on a claim.

(5) “Debtor” means a person with regard to which a case under this subtitle has been commenced but shall not include a governmental entity or, to the extent that this subtitle conflicts with Article IX of the programs and Services Agreement of the Compact of Free Association, as amended, entitled “Federal Deposit Insurance Corporation Programs and Services Agreements”, the Bank of the Federated States of Micronesia.

(6) “Governmental entity” means the Federated States of Micronesia, a State, a foreign state, a municipality, or an agency, instrumentality or department of any of the foregoing.

(7) “Insider” means:

(a) if the debtor is an individual:

- (i) a relative of the debtor, or of a general partner of the debtor;
- (ii) a partnership in which the debtor is a general partner;
- (iii) a general partner of the debtor; or
- (iv) a corporation of which the debtor is a director, officer, or person in control.

(b) if the debtor is a corporation:

- (i) an affiliate, director, officer or person in control of the debtor;
- (ii) a partnership in which the debtor is a general partner, or a general partner of the debtor;
- (iii) a relative of a general partner, affiliate, director, officer or person in control of the debtor.

(c) if the debtor is a partnership:

- (i) a general partner in the debtor;
- (ii) a relative of a general partner, a general partner of, or a person in control of the debtor;
- (iii) a partnership in which the debtor is a general partner;
- (iv) a general partner of the debtor; or
- (v) an affiliate or person in control of the debtor.

(8) “Interested party” means the debtor, any creditor of the debtor, any equity holder in a corporation that is a debtor, and any other party that the court supervising an application under this subtitle may determine to have a right to be heard on issues pertaining to that application.

(9) “Person” as used in this chapter means an individual, partnership or corporation, but does not include governmental entities.

(10) “Relative” means an individual related by blood, marriage within the third degree as determined by common law, persons who are considered close relatives under applicable Micronesian custom, or a step or adoptive relationship within such third degree.

(11) “State” means a State of the Federated States of Micronesia.

Source: PL 13-73 § 4.

§ 103. Application for relief.

- (1) An application for the appointment of a receiver under chapter 2 of this subtitle may be made:
 - (a) by any debtor; or
 - (b) by three or more creditors whose combined claims are in excess of \$7,500, provided that each creditor's claim is at least \$1,000, and further provided that such claims are not contingent and are not subject to a *bona fide* dispute; or
 - (c) in the case of a partnership, by any person or persons whose interest in the partnership is, in the aggregate, greater than or equal to 50 percent;
- (2) An application under chapter 3 of this subtitle for the reorganization of a debtor that is a corporation may be made by the debtor.
- (3) Any application under this subtitle shall allege that the debtor resides or has a domicile, a place of business, or property in the Federated States of Micronesia.
- (4) When the application is brought by creditors, the application shall also allege:
 - (a) that the claims held by such creditors amount in the aggregate to at least \$7,500, are not contingent and are not subject to a *bona fide* dispute; and
 - (b) that the debtor is generally not, at the time of the application, paying its debts as they become due, and has generally not been paying its debts as they became due for at least 60 days prior to the date of the application.

Source: PL 13-73 § 5.

§ 104. Filing of application.

- (1) An application for relief under this subtitle shall be filed with the Trial Division of the FSM Supreme Court located in a State of the Federated States of Micronesia where the debtor resides or has domicile, a place of business, or property.
- (2) The court in which the application is filed shall supervise the proceeding unless the court, in its discretion, determines that the proceeding may be more efficiently supervised by the FSM Supreme Court Trial Division located in another State of the Federated States of Micronesia.
- (3) The application must be in the form specified by the court, accompanied by such filing fee as the court may set, and must contain, to the best of the knowledge of the applicant, a statement of financial condition of the debtor, as well as schedules of debts, assets and exemptions of the debtor. All applications must be sworn under penalty of perjury by the debtor, or members of the applying creditors group;
- (4) In the case of an application made pursuant to subsection 103(1)(b) of this chapter, the debtor may, within the time prescribed by the court, file an answer to the application. An answer may allege one or more of the following:
 - (a) that the debtor is generally able to pay its debts as they come due; or
 - (b) that the claims of the creditors do not satisfy the requirements of subsection 103(1)(b) of this chapter; or

(c) in the case of a corporation, that it is in the best interests of the debtor and creditors that the proceeding be converted to a proceeding under chapter 3 of this subtitle; or

(d) that the allegations in the application are insufficient as a matter of law.

Source: PL 13-73 § 6.

Cross-reference: The statutory provisions on the FSM Supreme Court and the Judiciary are found in title 4 of this code.

The FSM Supreme Court website contains court decisions, rules, calendar, and other information of the court, the Constitution, the code of the Federated States of Micronesia, and other legal resource information at <http://www.fsmsupremecourt.org/>.

Case annotations: Exhibit A and Form 4 are official forms that are only to be filed by corporate debtors in chapter 3 reorganization cases, not by an individual applying for bankruptcy relief under chapter 2. *Amayo v. MJ Co.*, 14 FSM R. 535, 537 (Pon. 2007).

A bankruptcy application must be accompanied by the debtor's statement of financial condition, as well as schedules of debts, assets and exemptions of the debtor. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

Under the Bankruptcy Rules, the debtor's schedules and statements must, in a voluntary case, be filed with the application or if the application is accompanied by a list of all the debtor's creditors and their addresses, within 15 days thereafter, except as otherwise provided. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

§ 105. Notice.

Notice to Interested Parties of the filing of an application under this subtitle and of motions, hearings and other events relating to proceedings under this subtitle shall be given at such time and in such manner as the court may determine for the purposes of

- (1) giving as many interested parties as reasonably practicable an opportunity to be heard concerning matters affecting their interests in the proceedings, and
- (2) maximizing the number of claims against the debtor that can be discharged, compromised, paid or otherwise resolved through the proceedings.

Source: PL 13-73 § 7.

§ 106. Stay of proceedings.

(1) Except as provided in subsection (2) of this section, an application under this subtitle operates throughout the Federated States of Micronesia and every State thereof as a stay, applicable to all persons and governmental entities, of the commencement or continuation of all legal proceedings against the debtor, against the property of the debtor, and against property held by the receiver.

- (2) An application under this subtitle does not operate as a stay of:
 - (a) criminal proceedings against the debtor; or

(b) the commencement or continuation of legal proceedings by a governmental entity to enforce a police or regulatory power.

(3) The stay authorized by subsection (1) of this section shall continue until the proceedings related to the application are terminated, suspended or dismissed, or the party affected obtains relief from the stay pursuant to subsection (4) of this section.

(4) Upon the application of a party affected by the stay, the court, for cause shown, shall either:

(a) grant relief from stay; or

(b) grant such other relief as will provide adequate protection for the party requesting relief from stay.

Source: PL 13-73 § 8.

Cross-reference: The statutory provisions on the FSM Supreme Court and the Judiciary are found in title 4 of this code.

Case annotations: By operation of law, the moment a person files an application for relief under the Bankruptcy Act of 2004 (Title 31 of the FSM Code), all legal proceedings against that applicant-debtor are automatically stayed with the exception of criminal proceedings and proceedings by a governmental entity to enforce a police or regulatory power. No court order or notice is needed or issued for the stay to take effect. *Amayo v. MJ Co.*, 14 FSM R. 535, 537 (Pon. 2007).

Persons with a claim to a disputed, unsecured, unliquidated debt owed by the debtor which arose before the debtor applied for bankruptcy relief are "interested parties" who may appear in the bankruptcy proceeding and who may (and must) pursue any sanctions of the debtor and relief from the automatic stay within the bankruptcy case. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

The Bankruptcy Act sets forth the proper procedure to be followed by anyone who desires relief from the automatic stay. Relief from the automatic stay may be sought by applying to the bankruptcy court, and if that court grants the relief from the stay and determines that the disputed claim against the debtor should be referred to and determined by the court in which the case was already filed, that court will proceed with trial of the claim against the debtor. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

Unless and until the bankruptcy court grants relief from the automatic stay and refers the matter to the court in which the claim was filed to determine the amount of the claim allowable, the court can take no further action on the claim against the debtor. A plaintiffs' request to the court in that case cannot be considered a request for relief from the automatic stay since it bypasses the bankruptcy court, the only proper forum in which to seek such relief. Only the bankruptcy court can lift the automatic stay. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

The trial court has no power to enter a default on the issue of the debtor's liability or to try damages (damages would still need to be proven in an evidentiary proceeding) while the Bankruptcy Act's automatic stay is in effect. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

When an automatic stay has taken effect because one defendant applied for bankruptcy relief, trial could still proceed as scheduled on the plaintiffs' claims against the other two defendants, but when the court considers that to be a needless waste of scarce judicial resources and an unnecessary financial burden on the plaintiffs to have to try the case first against those defendants, and then against the debtor, the court may continue the trial. *Amayo v. MJ Co.*, 14 FSM R. 535, 539 (Pon. 2007).

An affected party may seek relief from the automatic stay by applying to the bankruptcy court and that court, for cause shown, shall either grant relief from stay or grant such other relief as will provide adequate protection for the party requesting relief from stay. *In re Panuelo*, 15 FSM R. 23, 26 (Pon. 2007).

The bankruptcy court will grant relief from the automatic stay and permit "another court" to try creditors' disputed claims against the debtor and determine the amount of the debtor's liability (if any) to the creditors when it is in the interests of judicial economy and the expeditious and economical resolution of litigation and the parties were ready for trial before the bankruptcy application; when the impact of the stay on, and the harm to, the creditors is great, while the only harm to the debtor is that his attorney will have to try the case, something he was already prepared to do; when relief would result in complete resolution of the issues between the creditors and the debtor (except, of course, payment of any judgment); and when the litigation involves third parties and would not appear to prejudice the debtor's other creditors since any judgment against the debtor in that case must be pursued only in this bankruptcy case since the stay will not be lifted so as to permit the enforcement of any judgment obtained against the debtor in any forum other than this bankruptcy case. *In re Panuelo*, 15 FSM R. 23, 29 (Pon. 2007).

§ 107. Claims of creditors.

- (1) Any creditor may file a sworn claim in such manner and within such time limits as the court shall prescribe.
- (2) Each claim shall be allowed except to the extent that:
 - (a) such claim is unenforceable for any reason other than because such claim is contingent or unmatured;
 - (b) such claim is for unmatured interest;
 - (c) such claim is for punitive damages and is not compensation for actual pecuniary loss; or
 - (d) such claim has not been filed within the time limit prescribed by the court.
- (3) In the event of a dispute as to whether or in what amount a claim is allowable under this section, the court may
 - (a) summarily determine the matter upon motion,
 - (b) conduct a trial on the claim, or
 - (c) refer the matter to another court for determination.
- (4) An allowed claim of a creditor is a secured claim to the extent of the value, as determined by the court, of the collateral, provided all criteria under applicable law for perfecting security interests have been complied with, and further provided that no security interest in land shall be treated as a secured claim except to the extent, if any, to which such security interest is enforceable under the laws of the state in which the land is located. An allowed claim is an unsecured claim to the extent that the value of the collateral pledged by the debtor as security for that claim is less than the amount of the claim.
- (5) The holder of an allowed secured claim is entitled to the approved value of the collateral or its equivalent, unless such creditor agrees to accept a lesser amount.
- (6) Assets shall be distributed to the holder of an allowed unsecured claim in accordance with the provisions of this subtitle.

Source: PL 13-73 § 9.

Cross-reference: The statutory provisions on the FSM Supreme Court and the Judiciary are found in title 4 of this code.

Case annotations: A "creditor" is someone who has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor and a "claim" is any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

Persons with a claim to a disputed, unsecured, unliquidated debt owed by the debtor which arose before the debtor applied for bankruptcy relief are "interested parties" who may appear in the bankruptcy proceeding and who may (and must) pursue any sanctions of the debtor and relief from the automatic stay within the bankruptcy case. *Amayo v. MJ Co.*, 14 FSM R. 535, 538 (Pon. 2007).

The bankruptcy court may choose to try the plaintiffs' previously-filed claim itself although the claim was previously filed in another case. *Amayo v. MJ Co.*, 14 FSM R. 535, 539 (Pon. 2007).

In a bankruptcy case, a "creditor" is someone who has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor, and a "claim" is any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. An unliquidated claim is one whose amount has not been determined or calculated. *In re Panuelo*, 15 FSM R. 23, 26 (Pon. 2007).

An "interested party" who may appear in a bankruptcy proceeding includes any creditor of the debtor. *In re Panuelo*, 15 FSM R. 23, 26 (Pon. 2007).

Words and phrases used in the FSM Code (of which the Bankruptcy Act is a part) must be read with their context and must be construed according to their common and approved English language usage. *In re Panuelo*, 15 FSM R. 23, 27 n.1 (Pon. 2007).

When a debtor has failed to file supplemental schedules with corrected information about his property as required, the receiver should be permitted to do it based on the information she has uncovered and any further information she may develop. *In re Panuelo*, 16 FSM R. 339, 345 (Pon. 2009).

§ 108. Priorities.

(1) The following claims and expenses shall have priority in the following order:

(a) all necessary administrative expenses incurred in connection with the proceeding as may be determined by the court, including compensation of any receiver or trustee, applicable attorneys fees, and wages, salaries and other expenses incurred, after the date of the application, in connection with continuing to operate any business of the debtor, to the extent that such continued operations are permitted by this subtitle or by order of the court;

(b) all liens of the FSM Social Security Administration subject to section 607 of title 53 of this code;

(c) all allowed unsecured claims of the National Government or any State or local government of the Federated States of Micronesia, or any entity or public corporation of any such government;

(d) all claims by employees of the debtor for wages and salaries for services prior to the date of the application, except for such claims by persons who hold an ownership interest in a debtor that is a business, persons who hold a management position in the business of the debtor and relatives of the debtor;

(e) other allowed unsecured claims, including any unsecured portions of claims held by secured creditors, but not including claims within subsections (e) and (f) of this section;

(f) if the debtor is a corporation or a partnership, all allowed claims arising from the ownership, purchase or sale of any equity or partnership interest in the debtor;

(g) all rights, claims and interests of the debtor.

(2) Payment of professional fees and other administrative costs of the debtor, as described in subsection (1) (a) of this section, may be made during the course of a proceeding, subject to approval by the court. Such payments may include advance payments if determined by the court to be necessary and appropriate to accomplish the purposes of this subtitle;

(3) Creditors having claims or expenses of the same order of priority shall be treated equally except to the extent that a creditor agrees to be treated less beneficially.

Source: PL 13-73 § 10.

Cross-reference: Title 53 of this code is on Social Security and Prior Service Benefits.

§ 109. Setoff.

The law of setoff shall apply in the event that the debtor has any right to recover, arising prior to the filing of an application hereunder, against a creditor filing a claim under this subtitle, provided that the creditor's claim is allowable under section 107 of this chapter, and further provided that no claim against the debtor by a bank or other financial institution shall be setoff against funds or other assets held by the bank or financial institution on account for the debtor.

Source: PL 13-73 § 11.

§ 110. Rulemaking power of the court.

The Supreme Court of the Federated States of Micronesia may adopt such rules, not inconsistent with the provisions of the subtitle, as it may deem necessary or appropriate to the supervision of proceedings under this subtitle or otherwise to effect the purposes of this subtitle.

Source: PL 13-73 § 12.

Cross-reference: The statutory provisions on the FSM Supreme Court and the Judiciary are found in title 4 of this code.

The FSM Supreme Court website contains court decisions, rules, calendar, and other information of the court, the Constitution, the code of the Federated States of Micronesia, and other legal resource information at <http://www.fsmsupremecourt.org/>.

§ 111. Retention of professionals.

The debtor may retain, for the purposes of proceedings under this subtitle, one or more attorneys, accountants or other professionals, provided that the retention and terms of retention of each such professional shall be subject to approval by the court. The court may retain one or more appraisers, accountants or other professionals to appraise property of the debtor, to examine the financial condition of the debtor or otherwise to assist the court in connection with a proceeding under this subtitle. Unless otherwise ordered by the court, the fees and costs of any professionals retained by the court and the debtor shall be treated as administrative costs under section 108 of this chapter.

Source: PL 13-73 § 13.

Cross-reference: The statutory provisions on the FSM Supreme Court and the Judiciary are found in title 4 of this code.

§ 112. Qualifications of receivers and trustees.

- (1) A person may serve as a receiver or trustee under this subtitle only if such person is:
 - (a) competent to perform the duties of a receiver or trustee;
 - (b) resides or has an office in the Federated States of Micronesia;
 - (c) holds relevant professional qualifications as determined by the FSM Supreme Court; and
 - (d) has never been convicted of a crime of moral turpitude, fraud, theft, deceit or other act which involves dishonesty.
- (2) Nothing in this subtitle will preclude the FSM Supreme Court from removing a receiver or trustee in any case for good cause shown.
- (3) No relative, affiliate or other such insider of the debtor shall be appointed to serve as a receiver or trustee under this subtitle.
- (4) The court shall have the authority to fix the compensation of the receiver or trustee, however it shall be specifically prohibited from fixing compensation based solely on time referenced billing. When fixing compensation of the receiver or trustee the court shall take into consideration:
 - (a) the complexity of the case;
 - (b) the skill and reputation of the receiver or trustee;
 - (c) the benefit of all work provided by the receiver or trustee; and
 - (d) any other relevant criteria which the court in its discretion may choose to employ.

Source: PL 13-73 § 14.

Cross-reference: The statutory provisions on the FSM Supreme Court and the Judiciary are found in title 4 of this code.

Case annotations: A receiver's proposed compensation of \$125 an hour with a cap on the amount paid based on a percentage of the amount disbursed to creditors, even though the proposal places an upper limit on the compensation, this proposed compensation is still based solely on time-referenced billing, which the court is statutorily barred from approving. *In re Panuelo*, 15 FSM R. 640, 641 (Pon. 2008).

When a \$125 per hour compensation rate is barred because the statute prohibits compensation based solely on time-referenced billing; when \$125 an hour seems to be proposed merely because it is the prevailing rate for private attorneys on Pohnpei and the receiver is a lawyer; and when much of the work needed in administering a debtor's estate in bankruptcy may not be lawyer work and non-lawyer work is not compensated at lawyer rates even when done by a lawyer, the receiver will be asked to submit a new compensation proposal. *In re Panuelo*, 15 FSM R. 640, 641-42 (Pon. 2008).