Melekeok Gov't Bank v. Adelbai, 13 ROP 183 (2006)

MELEKEOK GOVERNMENT BANK CORP., POLYCARP BASILIUS, and ROMANA ANDRES,
Appellants,

v.

ROSE ADELBAI, NGCHESAR STATE, CLARA KALSCHEUR, *et al.*,
Appellees.

CIVIL APPEAL NO. 05-001
Civil Action No. 00-113

Supreme Court, Appellate Division
Republic of Palau

Argued: September 19, 2006
Decided: September 20, 2006
⊥184
Counsel for Appellants: Kevin Kirk

Counsel for Appellees Rose Adelbai and other Depositors: David Kirschenheiter

Counsel for Appellee Ngchesar State: Oldiais Ngiraikelau

Counsel for Appellee Clara Kalscheur: Pro se

BEFORE: LARRY W. MILLER, Associate Justice; KATHLEEN M. SALII, Associate Justice; ALEX R. MUNSON, Part-Time Associate Justice.

Appeal from the Supreme Court, Trial Division, the Honorable R. BARRIE MICHELSEN, Associate Justice, presiding.

PER CURIAM:

BACKGROUND

This case arises out of the financial collapse of the Bank of Micronesia (hereinafter "the Bank") in the Spring of 1998. The Bank's creation dates back to May 20, 1991, in a Memorandum of Understanding signed by representatives of the Melekeok Government Bank Corporation (hereinafter "MGBC"), a Palau-registered corporation, IFC Pacific Rim (M) Sdn. Bhd., a Malaysian corporation, and S.A.T. Holdings, Ltd., a holding company registered in the British Virgin Islands. Pursuant to this agreement, the Bank would issue one million shares of capital stock with a par value of $1.00. MGBC subscribed to 200,000 shares at a cost of $200,000. IFC Pacific Rim and S.A.T. Holdings each subscribed to half of the remaining 800,000 shares. Ultimately MGBC failed to tender $200,000 cash in exchange for its 200,000

shares of Bank stock. Instead, in November 1992, the Melekeok Economic Development Authority (hereinafter "MEDA") executed an assignment of land "for indefinite use" to the Bank in consideration of MGBC's 200,000 shares in the Bank. The parties dispute what, if anything, IFC Pacific Rim and S.A.T. Holdings gave in return for their shares in the Bank.[1]

In March 1998, the Bank of Micronesia collapsed. Nearly 700 individual depositors lost $353,000 in deposits upon the ⊥185 Bank's failure.[2] After being appointed as the Receiver for the Bank, Charles Hester brought suit on behalf of the Bank against, *inter alia*, the MGBC, a minority shareholder of the Bank, Polycarp Basilius, a member of the Board of Directors of both the Bank of Micronesia and the MGBC, and Romana Andres, a member of the MGBC Board.[3] Hester's receivership was later terminated, and a large group of depositors who had lost their deposits upon the Bank's closing substituted as Plaintiffs (hereinafter "the Depositors").

Their lawsuit alleged that MGBC failed to fulfill its pre-incorporation subscription to purchase $200,000 of stock in the Bank. In addition, they alleged that the Bank's shareholders and promoters had failed to adequately capitalize the Bank prior to engaging in business. Specifically, the suit claimed that the Bank violated the Palau Corporation Regulations, which require that at least ten percent of a corporation's authorized capital stock have been paid for in cash or other property of an equivalent value before a corporation engage in business. ROP Corp. Reg., ch. 1, part 2.8 (1996).

Prior to trial, the Depositors filed a motion for partial summary judgment against Defendant/Appellant MGBC with regard to their claim for unpaid pre-incorporation stock subscription. Specifically, they argued that MGBC owed $200,000 (plus interest) on its pre-incorporation subscription to purchase 200,000 shares of Bank stock because the 5-acre land parcel that MEDA "transferred indefinitely" to the Bank in payment of the shares issued to MGBC was invalid under the Palau Constitution's ban on land ownership by corporations with non-Palauan shareholders.[4] In the alternative, the Depositors urged that the land parcel was overvalued and that the shares issued to MGBC should be considered "watered" stock. The Trial Division appeared to agree that the indefinite transfer of the land to the Bank violated the Palau Constitution's ban on foreign ownership of land; however, the court instead granted summary judgment on the grounds that MGBC's subscription was a cash subscription, requiring MGBC to pay cash, as opposed to other consideration, in exchange for its shares. The court reasoned as follows: the Palau Corporation Regulations require, as a prerequisite to obtaining a corporate charter, the filing of an affidavit alongside the articles of incorporation. This affidavit must set

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[1] IFC Pacific Rim and S.A.T. Holdings were served pursuant to 14 PNC § 143, but both failed to make an appearance in the case. Ultimately, the Trial Division entered default judgment against both corporations. *Adelbai v. Melekeok Gov't Bank Corp.*, Civil Action No. 00-113 (Findings of Fact and Conclusions of Law dated Jan. 3, 2005, at 5).

[2] Palauan law does not require banks to insure their deposits, and the Bank had no such insurance.

[3] In addition to Basilius and Andres, the lawsuit named the remaining individual Board members – all residents of Malaysia or Hong Kong. These remaining Defendants failed to appear in the case and ultimately had default judgments entered against them.

[4] "Only citizens of Palau and corporations wholly owned by citizens of Palau may acquire title to land or waters in Palau." Palau Const. art. XIII, § 8. *See also* ROP Corp. Reg., ch. 1, part 2.16 ("Only corporations wholly owned by citizens of the Republic of Palau may hold title to land in the Republic.").

forth, among other things, "[t]he names of the subscribers for shares of each class," and "[t]he subscription price or prices for the shares of each class subscribed for by each subscriber, and if it is to be paid in other than cash, the consideration in which it is to be paid." ROP Corp. Regs., ch. 1, part 2.5. The affidavit filed by the Bank listed MGBC as a subscriber of $200,000 worth of stock, but did not state that MGBC would be paying for its stock in non-cash consideration. Thus, the ⊥186 trial court reasoned, MGBC breached its obligation to pay $200,000 cash for the stock.

The court subsequently held a five-day trial in November 2004. At trial, Plaintiffs presented two theories of recovery. First, Plaintiffs asserted that as the successors in interest to the claims of the Receiver, they succeed to any claims of relief possessed by the Bank against individuals who held positions of fiduciary responsibility. In addition, Plaintiffs claimed the specific amounts they lost as depositors upon the Bank's collapse. The trial court entered judgment against Defendants/Appellants Polycarp Basilius, Romana Andres, and the defaulted Board members for failure to adequately capitalize the Bank before engaging in business, in violation of the Palau Corporation Regulations. In doing so, the court held that the "indefinite transfer" of land to the Bank in exchange for MGBC's 200,000 shares was not, as a matter of law, a Bank asset due to the constitutional prohibition on foreign land ownership, as well as the illusory nature of an "indefinite" right to land. The court also agreed with Plaintiffs that the Bank's original directors and officers breached their fiduciary duty to the Bank, but held that, having already recovered the full amount of their deposits for the violation of the capitalization requirements, Plaintiffs were limited to a single recovery. Finally, the court concluded that the false affidavits submitted by a number of the Bank's original incorporators did not, standing alone, give rise to liability under the Palau Corporation Regulations.

MGBC now appeals, claiming that the trial court violated its due process rights by entering summary judgment on a legal issue not raised by the Plaintiffs in their motion, but rather on a theory of liability raised by the court *sua sponte*. In addition, Basilius and Andres urge that the trial court's finding that they violated the capitalization requirements of the Palau Corporation Regulations was clearly erroneous. For the reasons set forth below, we affirm.

STANDARD OF REVIEW

We review a grant of summary judgment *de novo*, viewing all evidence and inferences in the light most favorable to the non-moving party. *Rechetuker v. MOJ* , 11 ROP 31, 33 (2003). Trial court findings of fact are reviewed under the clearly erroneous standard. *Ngirutang v. Ngirutang*, 11 ROP 208, 210 (2004). Under this standard, the trial court's findings of fact will not be set aside so long as they are supported by evidence such that a reasonable trier of fact could have reached the same conclusion, unless the Appellate Division is left with a definite and firm conviction that an error was made. *Id.*

ANALYSIS

I. Entry of Summary Judgment Against MGBC

Appellant MGBC argues that the trial court's entry of summary judgment violated its due process rights insofar as the court entered judgment on grounds not raised in Plaintiffs/Appellees' motion for summary judgment, without giving MGBC notice and an opportunity to respond to the new issue. The Palau Rules of Civil Procedure provide that all motions "shall be made in writing, shall state with particularity the grounds therefor, and shall set forth the relief or order sought." ROP R. Civ. P. 7(b)(1). *See also Secharmidal v. Techemding Clan* , 6 ROP Intrm. 245, 251 (1997) ("Oral motions for summary judgment are not permitted under the Rules."). Similarly, Rule 56(c) provides that "[a] party moving for summary judgment ⊥187 shall set forth in the supporting brief a separate statement of each material fact as to which the moving party contends there is no genuine issue to be tried . . ." ROP R. Civ. P. 56(c)(1). Nevertheless, "Rule 56 [does not] add or imply that summary judgment is appropriate only based upon the theory for summary judgment advanced by the moving party."[5] *In re Batie*, 995 F.2d 85, 90 (6th Cir. 1993). *See also Wilder v. Prokop*, 846 F.2d 613, 626 (10th Cir. 1988) ("Even if a ground is not urged by a party, where the requirements of Rule 56 are met, the court is not barred from any consideration of that ground."); *Board of Nat'l Missions v. Smith* , 182 F.2d 362, 364-65 (7th Cir. 1950) ("The fact that the judgment was granted on a reason different from that assigned by the [moving party] is immaterial where . . . the motion was properly granted on the undisputed facts shown and on an issue presented by plaintiff's complaint."). [6] Where a court enters summary judgment on a theory of liability not raised by the moving party, however, the court must ensure that the nonmoving party has had an adequate opportunity to argue and present evidence on that issue. *See, e.g.* , *Judwin Properties, Inc. v. U.S. Fire Ins. Co.* , 973 F.2d 432, 436-37 (5th Cir. 1992) (nonmoving party entitled to ten days notice before district court granted summary judgment *sua sponte*); *Kohlheim v. Glynn County* , 915 F.2d 1473, 1478 (11th Cir. 1990). This notice requirement is "strictly enforced." *Leatherman v. Tarrant County Narcotics Intelligence* , 28 F.3d 1388, 1397 (5th Cir. 1994) (quoting *Powell v. United States* , 849 F.2d 1576, 1579 (5th Cir. 1988)); *Secharmidal*, 6 ROP Intrm. at 251 (Rule 56's ten-day notice requirement is "strictly enforced," in light of the fact that "summary judgment forecloses any future litigation of a case.") (quoting *Powell*, 849 F.2d at 1579; *White v. Texas American Bank/Galleria* , 958 F.2d 80, 83-84 (5th Cir. 1992)).

Despite the strictness with which Rule 56's notice requirement is enforced, appellate courts have applied the harmless error doctrine where summary judgment was entered without proper notice. *See, e.g.*, *Leatherman*, 28 F.3d at 1398; *Powell*, 849 F.2d at 1580.

> When there is no notice to the nonmovant, summary judgment will be considered harmless if the nonmovant has no additional evidence or if all of the nonmovant's additional evidence is reviewed by the appellate court and none of the evidence presents a genuine issue of material fact.

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[5] Indeed, it has been recognized that trial courts may, with proper notice, enter summary judgment *sua sponte*. *Celotex Corp. v. Catrett* , 477 U.S. 317, 326 (1986); 10A C. Wright, A. Miller & M. Kane, *Federal Practice & Procedure* § 2720 at 339-45 (3d ed. 1998).

[6] The Palau Rules of Civil Procedure follow the format of the United States Federal Rules of Civil Procedure. ROP R. Civ. P. 1 cmt. at 1. It is therefore appropriate for this Court to look to U.S. authorities for guidance in their interpretation. *Airai State Pub. Lands Auth. v. Aimeliik State Gov't* , 11 ROP 39, 41 n.1 (2003).

Resolution Trust Corp. v. Sharif-Munir-Davidson Dev. Corp. , 992 F.2d 1398, 1403 n.7 (5th Cir. 1993).

Here, the Trial Division's failure to give proper notice to MGBC before entering summary judgment on a theory of liability that had not been raised by Plaintiffs/Appellants was harmless. As ⊥188 discussed, the Depositors raised two distinct grounds for summary judgment as to their claim against MGBC for unpaid stock subscription: (1) that MGBC had not given any value for the stock subscription because the land transfer was constitutionally invalid; and (2) that the "indefinite" transfer of land was overvalued at $200,000, and thus MGBC was liable for the difference between the par value of the stock and the actual value of the land transfer. [7] The trial court instead entered summary judgment on an alterative theory: "Putting aside the question whether this purported land transaction was supposed to be taken seriously, the [MGBC] is bound by the original terms of its subscription, which was an unambiguous $200,000.00 cash commitment."[8] *Adelbai v. Melekeok Gov't Bank Corp.* , Civil Action No. 00-113 (Findings of Fact and Conclusions of Law dated Jan. 3, 2005, at 4) (hereinafter "Trial opinion"). MGBC does not challenge the trial court's legal conclusion (discussed above) that chapter 1, part 2.8 of the Palau Corporation Regulations provides that unless the affidavit submitted by the corporation promoters alongside the articles of incorporation state otherwise, the cash consideration must be paid for all pre-incorporation stock subscriptions. *Id.* Nor has MGBC presented (either in response to Plaintiff's motion or at trial) any evidence that it paid all or part of its stock subscription in cash. Indeed, the undisputed evidence is that it did not. For this reason, MGBC was not prejudiced by the Trial Court's failure to provide proper notice prior to entering summary judgment on this theory.[9]

None of the cases cited by MGBC alter this analysis. In *Kumangai v. Isechal* , 1 ROP Intrm. 587 (1989), we held that a trial court abused its discretion when it raised a statute of limitations defense *sua sponte*. In so holding, however, we held not that a trial court generally has no discretion to raise issues *sua sponte*, but rather that Rule 8(c) requires that a statute of limitations defense be set forth affirmatively. *Id.* at 589. Failure to do so rendered the defense waived. Thus, by raising the matter *sua sponte*, the trial court allowed the defendant to escape the express waiver provision in Rule 8(c).

MGBC also cites two cases regarding the propriety of oral motions for summary judgment under Rule 56. *Sequoia Union High School District v. United States* , 245 F.2d 227, 228 (9th Cir. 1957) (concluding that Rule 56 does not allow for oral motions); *Matter of Hailey*,

[7] Although the trial court ultimately concluded, following trial, that the first of these arguments was correct, the trial court instead entered summary judgment on the alternative grounds that MGBC had failed to pay cash consideration for its stock subscription, as required under the Palau Corporation Regulations, and it is this theory of liability that we consider on appeal.

[8] Implicit in this reasoning is the fact that a corporate shareholder is liable to corporate creditors to the extent his or her stock subscription has not been paid. *See* 18A Am. Jur. 2d *Corporations* § 737 (2004).

[9] As Appellees point out, the trial court's action was a grant of partial summary judgment entered more than a year prior to trial. Thus notwithstanding the lack of notice beforehand, MGBC had ample opportunity to be heard on this issue.

621 F.2d 169, 171 (5th Cir. 1980) (summary judgment cannot be based on an oral motion). The latter case, *Hailey*, also indicates that Rule 56 does not allow a trial court to enter summary judgment *sua sponte*. *Matter of Hailey*, 621 F.2d at 171. To this, we ⊥189 have two comments. First, as discussed above, the bulk of the authority, including the U.S. Supreme Court, indicates that courts have authority to enter summary judgment *sua sponte*. *See supra* n.5. Moreover, the Fifth Circuit has itself since recognized this power, effectively overruling this portion of *Hailey*. *Leatherman*, 28 F.3d at 1398; *Powell*, 849 F.2d at 1580.

We do not endorse the Trial Division's entry of summary judgment, without notice, on an issue raised *sua sponte*. We would hope that a trial court would hesitate before taking such action. At the same time, however, we cannot repudiate the power of a trial court to, in certain situations and with proper notice and opportunity to respond, enter summary judgment on issues raised *sua sponte*. To hold otherwise "would result in unnecessary trials and would be inconsistent with the objective of Rule 56 of expediting the disposition of cases."[10] 10A C. Wright, A. Miller & M. Kane, *Federal Practice & Procedure* § 2720, at 345. Although in this case the trial court improperly failed to give MGBC notice before entering summary judgment on an alternative theory, MGBC has not claimed that it has additional evidence to present on the issue. Thus, the error was harmless.

II. Appellants Basilius and Andres

Appellants Polycarp Basilius and Romana Andres appeal the trial court's finding of liability for violation of the capitalization requirements found in chapter 1, part 2.8 of the Palau Corporation Regulations. Specifically, they urge that the court's conclusion that they failed to adequately capitalize the firm, by obtaining payment of at least ten percent of the Bank's authorized stock prior to engaging in business, was clearly erroneous. In the alternative, they urge that the trial court's factual findings were not made with sufficient specificity so as to allow for adequate appellate review, as required under Rule 52(a) of the ROP Rules of Civil Procedure.

The Palau Corporation Regulations contain capitalization requirements that new corporations must meet prior to engaging in business. Pursuant to these requirements, a new corporation may not engage in business until: (1) three-fourths of its authorized capital stock has been subscribed for; (2) ten percent of its authorized stock has been paid in by cash or property of an equivalent value; (3) the required affidavits providing information regarding the corporation's capital structure and pre-incorporation subscribers has been filed pursuant to chapter 1, part 2.5; and (4) not less than $1000 of its authorized stock has been paid for in cash or property of an equivalent value. ROP Corp. Regs. ch. 1, part 2.8. The second of these four requirements is at issue in the present case.

The trial court held that the only identifiable amount of paid-in capital at the time that the Bank began business was the land "indefinitely transferred" to the Bank by MEDA on behalf of MGBC. The court held that this land had no value because the constitutional prohibition on land ownership by foreign-owned corporations could not be overcome by styling a transaction as an

[10] The logic of this approach is similarly borne out by the present opinion, the bulk of which is based on legal precedent and analysis not covered in the parties' briefs.

"indefinite transfer" rather than an outright sale. Thus, the court concluded that, "as a matter of law, an 'indefinite transfer' is not an asset." Trial opinion at 11. Appellants do not challenge this conclusion. Instead, they urge ⊥190 that "the record is replete with several instances where the . . . [plaintiffs' principal witness and exhibits] stated and indicated that the [Bank] had the required capitalization." Specifically, they point to testimony of Hester, the Bank's court-appointed receiver, regarding expenditures totaling approximately $800,000 made by the defaulting defendants prior to and during the early days of the Bank's existence.

Although Hester testified that the Bank promoters eventually paid-in an amount "reasonably close" to $800,000 in cash and other property over the life of the Bank's existence, (Trial Transcript, hereinafter "T.T.," at 47, 124), he ultimately concluded that they had not adequately capitalized the Bank under part 2.8 prior to commencing operations on April 28, 1993. The portions of the transcript cited by Appellants discuss this $800,000 as representing the overall influx of capital over the life of the Bank – not specifically the amount of cash and/or property paid into the corporation prior to its commencing operations. Hester testified that he was unable to find any evidence that these expenditures resulted in the Bank's acquisition of cash or other property totaling ten percent of the value of the Bank's authorized stock – $100,000 -- prior to day one. Thus, although Hester's testimony is not a beacon of clarity, he ultimately concluded that the $100,000 threshold had not been met prior to the Bank's opening.[11] T.T. at 56, 59, 125.

Importantly, part 2.8 prohibits a corporation from engaging in business "until ten percent of its authorized capital stock has been paid in by the *acquisition of cash or by the acquisition of property* of a value equal to ten percent of the authorized capital stock . . ." ROP Corp. Regs. ch. 1, part 2.8. Thus, part 2.8 requires the court to examine whether the corporation acquired such cash or property prior to engaging in business, not whether the stock subscribers – in this case the corporate promoters – spent such an amount. We agree with the trial court and the Bank receiver that the Bank did not receive such value prior to commencing operations. No records exist documenting the bulk of the costs paid by the ⊥191 defaulted defendants. Of those costs

[11] When questioned by the Court regarding the Bank's pre-operating assets, for example, Hester testified:

> Q: [A]t the time that [the Bank] opened up, could you be confident in saying that they had $100,000 in assets?
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> A: As of the day they opened up?
>
> Q: Yes.
>
> A: Not as the day they opened up. They did deposit $100,000 in the Bank of Guam. Okay. But they did that subsequent to opening up. . . . But the records I had for the Bank of Guam indicated that money was deposited later . . .

T.T. at 56. Even if Appellants are correct that Hester contradicted this statement elsewhere in his testimony, such inconsistency is, standing alone, insufficient for us to conclude that the trial court's decision was clearly erroneous. *See, e.g.*, *Palau Cmty. Coll. v. Ibai Lineage*, 10 ROP 143 (2003) (holding that where testimony is equivocal, the trial court's choice to credit one interpretation of that testimony is not clear error).

for which records do exist, much of the costs appear to have resulted in little or no benefit to the Bank itself. The promoters paid, for example, $100,000 to Melekeok State officials for a licensing fee. In light of the fact that no such license or fee was required by law and the fact that no such license was forthcoming after payment of the "fee," Hester concluded that the payment was "at best" a bribe and "at worst" extortion. [12] T.T. at 162-63. More importantly, because the payment did not actually result in the Bank's obtaining a business license, Hester testified that, as a certified public accountant, he did not believe that the payment would qualify as paid-in capital. T.T. at 117. Similarly, much of the remaining pre-incorporation costs involved travel of the Bank's foreign investors, which Hester accurately characterized as "lavish." T.T. at 46, 60-62.

The Bank's collapse, coupled with its employees' casual management style during its existence, have rendered the Bank's financial records incomplete and nearly indecipherable. Nevertheless, those records that do exist suggest that the Bank had not received the proper capitalization prior to its opening. The Bank's first annual report, covering the period ending March 31, 1994, states that 1,000,000 shares were issued and paid for during the period. [13] The Report, however, lists only the five acre land parcel supplied by MEDA on behalf of MGBC as payment for MGBC's twenty percent equity share in the Bank. Plaintiff's Ex. 19, at 11-12. For their part, Appellants can point to no identifiable cash or other property acquired by the Bank prior to March 1993 in payment of issued shares. For this reason, the trial court's judgment cannot be said to be clearly erroneous.

Finally, we reject Appellants' contention that the trial court's decision lacked the requisite specificity under Rule 52(a). Under this standard, the trial court's decision must "reveal an understanding analysis of the evidence, a resolution of the material issues of 'fact' that penetrate beneath the generality of ultimate conclusions, and an application of the law to those facts." *Fritz v. Blailes* , 6 ROP Intrm. 152, 153 (1997) (quoting James Moore, 5A *Moore's Federal Practice* ¶ 52.05 (1984)). When considering the adequacy of findings, a reviewing court must consider "whether they are sufficiently comprehensive and pertinent to the issue to form a basis for the decision and whether they are supported by the evidence." Moore, *supra*, at ¶ 52.06. Thus, under Rule 52(a), a trial court "need only make brief, definite, pertinent findings and conclusions upon the contested matters." *Id.* Here, the trial court's findings were sufficiently specific to allow us to determine the basis of its findings that the Bank had not been adequately capitalized.

CONCLUSION

For the reasons set forth above, we ⊥192 affirm.

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[12] The trial judge was more diplomatic, suggesting that perhaps the payment was a form of lobbying, designed to "hush the opposition or quiet any complaints of the operation of the Bank." T.T. at 163.

[13] It is not clear when the period began. There appear to be two possibilities: April 1, 1993 (the beginning of the previous fiscal year) or April 28, 1993 (when the bank commenced operations). If the Report began on the latter, it would appear that Appellants had not issued any stock prior to commencing operations, as the Report indicates that all one million shares in the Bank had been issued during the period covered by the Report.