PROCEEDINGS WHERE A PARTY IS UNDER LEGAL INCAPACITY: ISSUES THAT MAY ARISE

The purpose of this presentation is to discuss certain issues that may arise in proceedings where one party is, or may be under legal incapacity. The presentation is focussed on legal incapacity arising from mental disability as opposed to minority.

Two decisions will be considered where this issue arose and we will consider how the Court approached the issues in these decisions.

Owners Strata Plan No. 23007 – v – Cross [2006] FCA 900

FACTS:

Ms. Cross, was 66 years old. She owned a unit in Cronulla.
She failed to make certain levy payments and on 25 July 2003 the Owners Corporation obtained a Default Judgment in an amount of $2,413.00. Thereafter, the Owners Corporation issued a Bankruptcy Notice which was served on Ms. Cross. Ms. Cross failed to comply with the Bankruptcy Notice whereupon the solicitors for the Owners Corporation were instructed to proceed with the Creditor's Petition.

Upon making enquiries as to the whereabouts of Ms. Cross, the solicitors became aware that Ms. Cross was at Sutherland Hospital under psychiatric care. The solicitors, by way of letter, made enquiries of the hospital as to whether Ms. Cross had a guardian or financial manager appointed, or whether she was residing with someone in whose care she was placed. The purpose of these enquiries were for the solicitors to effect service in compliance with the then prevailing O 43 r 13 of the Federal Court Rules which provided:

> *Where the person to be served is a mentally disabled person and has no tutor in the proceedings, the document may be served:*
>
> (a) *If a committee is appointed of his person or estate, or he has a guardian, on the committee or guardian; or*
>
> (b) *If there is no committee or guardian, on a person with whom he resides or in whose care he is*.

The solicitors then attempted to make contact with Ms. Cross' next of kin, a Mrs Smith but she had moved to live interstate and was suffering from dementia. Thereafter, the solicitors instructed a process server to serve the necessary Creditor's Petition and accompanying documents at Sutherland Hospital. As observed by his

Honour, initially it seemed that the solicitors were inclined to serve Process as required under the then Federal Court Rules but their instruction to the Process Server indicated that *"any notion of affecting service in the way contemplated by O 43 r 13 (6) of the FCR has been effectively abandoned by the Creditor"*[1].

The process server duly attended at the Sutherland Hospital Psychiatric Unit and served the Process. At the time of service, Ms. Kelly Sanders, a social worker with the Psychiatric Inpatient Unit at the Sutherland Hospital, was present. She subsequently wrote a letter noting that:

> *"On the date of July 13, 2004 a representative of JS Mueller & Co. Solicitors attended the Psychiatric Inpatient Unit of the Sutherland Hospital and served Ms. Cross with official legal papers detailing proceedings against Ms. Cross whilst she was in my presence. There was no uncertainty around Ms. Cross' status as a current inpatient on the Psychiatric Unit…I also note that at the time Ms. Cross did not appear to understand the serious nature of the documents she had been handed…"*

Ms. Cross took no steps to oppose the Creditor's Petition and a Sequestration Order was made against her estate on the first return date.

Subsequently, Legal Aid found out that Ms. Cross had been bankrupted and thereafter, the Office of the Protective Commissioner filed[2] a Notice of Motion seeking to set aside the Sequestration Order was lodged.

ISSUES:
The Motion raised four issues[3]:

(i) The **service** issue: Was service of the Creditor's Petition properly effected?

(ii) The **disability** issue: Whether Ms. Cross was a person under a disability for the purposes of the FCR when the Creditor's Petition was handed to her.

(iii) The **breach** issue: If there was a breach of the FCR as to service, what are the consequences?

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1 *Owners Strata Plan No. 23007 v Cross* [2006] FCA 900 at [22]

2 [46] Cross *supra*

3 [47] Cross *supra*

(iv) The **annulment** issue: Whether the bankruptcy should be annulled or the Sequestration Order set aside.[4]

The Service Issue:

Order 43, Rule 13 relevantly provided:

> *13. Service*
>
> (1) *This rule applies where, in any proceedings, a document is required to be served personally on a person under disability.*
>
> (2) *Personal Service on a person under disability shall not be effected otherwise in accordance with this Rule.*
>
> (3) *Where the person under disability has a tutor in the proceeding, the document may be served on the tutor.*
>
> (4) *The document may be served on any person (including the person under disability) whom the Court may, before or after Service, approve.*
>
> (6) *Where the person to be served is a mentally disabled person and has no tutor in the proceedings, the document may be served:*
>
> (a) *if a committee is appointed of his personal estate, or he has a guardian, on the committee or guardian; or*
>
> (b) *if there is no committee or guardian, on a person with whom he resides or in whose care he is.*
>
> (7) *A document served pursuant to any of sub-rules (3) to (6) must be served in the manner required the Rules with respect to the document.*

Having noted the rules in relation to service on a person with a disability, his Honour then turned to the disability issue:

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4 [47] Cross *supra* The difference between an annulment and a setting aside is the ability of the Trustee to recover any costs incurred in administering the estate. Where the proceedings are set aside, the bankrupts property does not vest in the Trustee and therefore cannot be utilised to by the trustee to recover costs incurred in the administration.

The Disability Issue:

His Honour noted that the relevant question is: *Is the person concerned a person who, owing to mental illness, is incapable of managing his or her affairs in respect of the proceedings?*

The words *"in respect of the proceedings"* are important because they focus upon the person's ability to bring or defend proceedings, rather than whether the person is able to manage his or her affairs generally, or in relation to some other transaction[5].

His Honour quoted the following extract from *Gibbons – v – Wright* (1953) 91 CLR 423 at 437:

> *"The law does not prescribe any fixed standard of sanity as requisite for the validity of all transactions. It requires, in relation to each particular matter or piece of business transacted, that each party shall have such soundness of mind as to be capable of understanding the general nature of what he is doing by his participation."*

His Honour then looked at other authorities in relation to the relevant test and at [61], summarised the position as follows:

> *"In light of what is said in these authorities and having regard to the use of the words "in respect of the proceedings" in the FCR, the following are relevant to determining capacity in the present case:*
>
> (a) *whether Ms Cross had the ability to understand that she required advice in respect of the Creditor's Petition which had been left with her;*
>
> (b) *whether she had the ability to communicate this requirement to someone who could arrange an appointment with an appropriate advisor or, alternatively, that she could arrange such an appointment of her own accord;*
>
> (c) *whether she had the ability to instruct her advisor with sufficient clarity to enable him or her to understand the situation and to advise her appropriately; and*
>
> (d) *whether she had the ability to make decisions and give instructions based upon, or otherwise give effect to, such advice as she might receive.*

5 [53] Cross *supra*

His Honour then looked at the available material, noting that there is a presumption that everyone is presumed to be sane, and that in modern times, the principle has been expressed as a presumption that a person of full age is capable of managing his or her affairs[6].

There is also a presumption that the law presumes a person's state of mind to continue unchanged[7].

Ultimately, his Honour, after considering all of the evidence and submissions made in opposition by the Creditor's Solicitor, came to the conclusion that, on a balance of probabilities, Ms. Cross was incapable of managing her affairs in respect of the Creditor's Petition when she was admitted as an involuntary psychiatric patient on 23 June 2004[8]. Having found that Ms. Cross was a mentally disabled person, it was clear that service had not been effected as required by the then Rule O43 r 13 (6).

What affect did this have on the validity and effectiveness of this Sequestration Order?

His Honour held that as the Federal Court is a superior Court, a Sequestration Order is not void or a nullity in the sense that it is without legal affect.[9] He goes on to say:

> *"The sequestration order in the present case is therefore, at worst, voidable and was effective to bankrupt Ms. Cross when it was made"*[10]

His Honour then looked at whether the fact that the service was not in accordance with the then prevailing Rules could be cured by an application of s.306 of the *Bankruptcy Act* which overcomes any formal defect or any irregularity in bankruptcy proceedings[11]. His Honour goes on to find that failing to serve in accordance with the then prevailing rules on a person with a mental disability was not a formal defect that could be cured by application of s.306.[12]

6 [66] Cross *supra*

7 Para [68] Cross *supra*

8 Para [85] Cross *supra*

9 Para [87] Cross *supra*

10 Para [89] Cross *supra*

11 Section 306 of the Bankruptcy Act is to the following effect:
306 Formal defect not to invalidate proceedings
(1) Proceedings under this Act are not invalidated by a formal defect or an irregularity, unless the court before which the objection on that ground is made is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by an order of that court.

12 [94] & [105] Cross *supra*

The Annulment Issue:

On the question of annulment, his Honour found that it was clear that Ms. Cross should not have been bankrupted as she was solvent at the time the Order was made[13].

In considering whether to annul or set aside the Bankruptcy Notice, His Honour made certain observations, one of which is perhaps particularly relevant to practitioners. At [112] His Honour noted:

> *"The fact is that Mr Bentley was the only person present before Registrar Tesoriero on 9 August 2004. He would not have been surprised at that. He certainly did not expect Ms Cross to be present. That he cannot remember what was said before the Registrar on that day suggests to me that none of the relevant surrounding circumstances were brought to the Registrar's attention because he, Mr Bentley, was blinded by an obsession to ensure that whatever else happened, Registrar Tesoriero made the sequestration order on that day. As an officer of the Court, he had an overriding duty to do more – to draw to the Court's attention Ms Cross' circumstances and the circumstances under which she was purportedly served with the Creditor's petition."*

His Honour then went on to find that it would be totally unfair, and indeed a miscarriage of justice for Ms. Cross to be saddled with any of the relatively considerable costs of the administration of her estate[14]. Ultimately, His Honour set the Sequestration Order aside with the costs of Ms. Cross and the Trustee of the Motion to be paid by the Creditor on the indemnity basis.

The Owners of Strata Plan 58041 v Temelkovski 2014 FCCA 2962

FACTS:

Zora Temelkovski[15] is a 76 year old Macedonian migrant who came to Australian in the 1960s. She had no formal education, spoke poor English and besides some time working in factories, she had been "a homemaker" [16].

13 [107] Cross *supra*

14 [116] Cross *supra*

15 First names are used to distinguish between the Applicant and her daughter Mary,

16 *Owners of Strata Plan 58041 v Temelkovski* [2014] FCCA 2962 at [13]

In 2000, after she and her husband divorced, Ms Temelkovski purchased a unit, where she lived. At the time of the proceedings her daughter, Mary had been living with her mother in the unit for about four years. Mary held a power of attorney so that she could conduct her mother's affairs. Zora Temelkovski suffered from Type 1 diabetes and had a history of renal failure. Mary gave evidence that about three years ago she observed that her mother forgot things, became confused and displayed signs of paranoia. In February 2012, Zora was interviewed by a psychologist, a psychogeriatrician, and a neuropsychologist who reported by letter that they found Zora to have prominent thought disorders and paranoid delusions[17].

On 10 July 2012 the Owners Corporation of the unit she lived in took a Judgment against her for $7,502.63 in relation to unpaid strata levies.

On 24 August 2012 the Strata Owners arranged for a Bankruptcy Notice to be issued. The Bankruptcy Notice was sent by post to Zora Temelkovski's last known residential address. Zora Temelkovski did not comply with the Bankruptcy Notice and on 13 December 2012 the Strata Owners filed a Creditor's Petition.

The Creditor's Petition and other relevant documents were personally served on Zora Temelkovski on 20 December 2012.

On 15 February 2013 a Sequestration Order was made against Zora's estate and a Trustee was appointed. Zora did not appear on that date.[18]

In February 2013 Mary became aware of the Sequestration Order and attempted to contact the Trustee's Office where she had a conversation with a Mr Olsen. In that conversation she advised Mr Olsen that her mother was from a migrant background with poor English and she would not have understood the proceedings.[19]

Following this conversation, the Trustee sent a letter requiring that their fees for administering the estate be paid in full as prerequisite to annulling the bankruptcy. This prompted Mary to make a telephone call seeking to speak to Mr Scott, the Trustee.[20]

In further communications, the Trustee served a "Notice to Vacate" the Unit and Mary sought to obtain advice from various sources including an old school friend

17 [16] Temelovski *supra*

18 [18] Temelkovski *supra*

19 [20] Temelkovski *supra*

20 [25] Temelkovski *supra*

who was an accountant; a Ms. Melanie Wilde, solicitor and a Mr Sean Stotter, a solicitor who specialised in conveyancing transactions[21].

Mary then deposed that despite these efforts:

> *"I could not achieve a coherent understanding of what the Applicant (or I, as her attorney) should do".*

She deposed further that none of the persons to whom she spoke advised her of the possibility that Ms. Temelkovski (Zora) could set aside the Sequestration Order on the ground of insolvency[22].

Further correspondence ensued until 24 March 2014, where Mary, through her Solicitor, Mr Harkness advised the Trustee's Solicitor that Ms. Temelkovski (Zora) was not insolvent at the time she was made bankrupt and, for that reason the Sequestration Order should be set aside under Rule 20.03 of the FCC Rules, or annulled under s.153B of the *Act*[23].

ISSUES:

Thereafter, two applications were filed on behalf of Zora, the first filed on 10 April 2014 seeking a review of the Registrar's Order to sequestrate the estate, and for an Order that the time for filing such application be extended. The second application filed on 17 April 2014 sought an annulment of the bankruptcy. The two Motions raised various issues including:

(i) Whether the Bankruptcy Notice that was served was void;

(ii) Whether the Strata Owners had proved the Bankruptcy Notice was served;

(iii) Whether the Creditor's Petition was verified properly; and

(iv) Whether the Creditor's Petition was properly served on Mrs Temelkovski.

For present purposes, it is the last of these grounds that is relevant.

At the hearing, and as a result of evidence of Zora's mental state, counsel for the Trustee sought the appointment of a litigation guardian. Application was duly made

21 [28] Temelkovski *supra*

22 [29] Temelkovski *supra*

23 [34] Temelovski *supra*

and Mary (who had been attending to her affairs pursuant to a power of attorney) was appointed as the litigation guardian[24].

In relation to whether the Creditor's Petition had been properly served on Zora, two issues were relevant, namely:

(i) Her mental condition; and

(ii) If it was found that she was a person under a legal incapacity, whether service had been effected under the relevant provision.

After considering the evidence going to mental capacity[25] his Honour ultimately finds:

> *"Ms Temelkovski did not understand when she was served with the creditor's petition the nature and possible consequences of the proceedings that had been initiated against her by the filing of the creditor's petition."*[26]

And at [79]:

> *"In my opinion, therefore, at the time she was served with the creditor's position (*sic*), Ms Temelkovski was a person who did not understand the nature and possible consequences of the proceedings that were initiated against her by the filing of the creditor's petition that was served on her; and she was not capable of adequately conducting, or giving adequate instructions for the conduct of the proceeding. In short, Ms Temelkovski was a person who needed a litigation guardian. That being the case, the creditor's petition had to be served on one of the classes of persons specified in r11.15 (1) of the FCC Rules. That did not occur. The creditor's petition, therefore, was not served in accordance with the FCC Rules."*[27]

The relevant Rule referred to by his Honour is to the following effect:

> *FCCR 11.15 (1) Service:*
>
> (1) *A document required to be served by hand on a person who needs a litigation guardian must be served:*

24 [10] Temelkovsk *supra*

25 [65] to [76] Temelkovski *supra*

26 [77] Temelovski *supra*

27 [79] Temelkovski *supra*

(a) *on the person's litigation guardian for the proceedings; or*

(b) *if there is no litigation guardian, on a person who is entitled under sub-rule 11.12 (1) to be the person's litigation guardian for the proceedings; or*

(c) *if there is no-one under paragraph (a) or (b), on an adult who has the care of the person;*

(2) *For paragraph (1) (c), a superintendent or other person in direct charge of a hospital or nursing home is taken to have the care of a person who is a patient in the hospital or nursing home.*

Having found Zora Temelkovski lacked legal capacity and that service had not been effected as required under the Federal Circuit Rules, the question then arose as to whether to set aside or annual the bankruptcy. In deciding this question, His Honour was inclined to set aside the Sequestration Order, noting that the Trustee was, in a sense, on notice of the possibility that Zora Temelkovski was not capable of managing her own affairs.

The basis for finding that the Trustee was "on notice" of Zora's incapacity was based partly on the earlier conversations Mr Olsen had with Mary Temelkovski[28], and on some evidence adduced in the following cross examination:

> Did it strike you that Mary wasn't really cooperating in the process of the bankruptcy?- I would say that. Yes.
>
> But you hadn't taken any steps to try and deal with someone else?- I couldn't deal with Zora because she was-as you've explained and I understood, she wasn't in a position to deal with it. If I couldn't deal with Mary I'm not sure who else there was…
>
> The position was, Mr Scott, according to you the debtor was unable to engage in the proceedings- Yes[29]

From the above, it was clear that the Trustee became aware that there was potentially some issue with Zora's capacity to understand the proceedings.

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28 The conversation is set out at [20] where Mary tells the trustee, "*I am Mary Temelovski and I am ringing on behalf of my mother Zora Temelovski….my mother can't talk to you. She is from a migrant background. Her English is poor and she would not understand. She is 76 years old and in poor health. She has aging-related issues…*

29 The cross-examination appears at [111]-[112] Temelovski supra

One interesting issue that arose in this case which did not arise in Cross, was the effect of the application filed by Zora in circumstances where no litigation guardian had been appointed.

Having found that Zora Temelkovski was a person who needed a litigation guardian, His Honour then needed to consider r11.09 (1) of the FCC Rules which provide:

> *"A person who needs a litigation guardian may start, continue, respond to or seek to be included as a party to a proceeding only by his or her litigation guardian."*

The question was then, if that was so, and if the application to set aside was filed by someone who not a litigation guardian, what was the status of the proceedings?

In dealing with this question, His Honour found that whilst the application had been filed without Zora Temelkovski's authority, it was capable of being ratified by her[30].

Observations Arising from the Decisions:

Whilst there is some commonality between the two decisions, and indeed Cross was relied on by Temelkovski in her proceedings, there is one noticeable difference. That is; in Cross' case the Petitioning Creditor (or their solicitors) knew full well before commencing proceedings that the Respondent was suffering from a mental disability.

Whilst initially they had endeavoured to comply with the requirements of service, later, as noted by the Judge, they abandoned this and instructed a process server to in fact serve the Court Process in a psychiatric ward. Such conduct counted heavily against them and formed the basis of an indemnity Costs Order (hopefully, a cautionary tale to solicitors).

In Temelkovski however, whilst the Petitioning Creditor may not have had an inkling about the Debtor's position at the outset, sufficient information was given at an early time for them to be on notice.

This raises a question of: What should a party do once becoming appraised of a problem, or potential problem in relation to a party's capacity to conduct proceedings?

In each of the Federal Circuit Court, Federal Court and Supreme Court, there are provisions for the appointment of a representative to act on behalf of someone who is incapable of managing the proceedings. (Although the terminology is not consistent,

30 [98] Temelkovski *supra*

the Federal Circuit Court refers to a 'litigation guardian'; the Federal Court refers to a 'litigation representative'; and the Supreme Court refers to a 'tutor'). whatever the nomenclature, the provisions are fairly similar and allow any interested party to seek the appointment of a representative in circumstances where it appears that a party is unable to manage or conduct the litigation.[31]

Check List

- Is your client capable of understanding the proceedings?

  If not, take steps to appoint a representative for him or her under the appropriate provisions of the jurisdiction.

- Is the other party capable of understanding the proceedings?

  If it is clear that they are not, then this should be raised at the earliest time and, appropriate steps taken to having someone appointed to represent them.

  If it is unclear whether the other party is capable of understanding the proceedings, try resolve this at the earliest time. Do not continue with the proceedings (particularly if there is no appearance or if documents are not being filed).

Allan Blank
Edmund Barton Chambers
May, 2015

31 Appointment of Litigation Guardian is governed by Federal Circuit Rule 11, the Federal Court provisions are at Rule 9.61 – 9.71, and the Supreme Court is governed by UCPR 7.13 – 7.18