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Abstract
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Keywords
Theissbacher v MacGregor Garrick and Co, Bankruptcy Act, annulment of bankruptcy

Cover Page Footnote
I am grateful to Lance Bartholomeusz for his assistance in the preparation of this article.

Comments and Notes

THEISSBACHER v MACGREGOR GARRICK & CO, OR, HOW A 'BANKRUPT' CAN GO SCOT FREE

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It recently fell upon the newly created Queensland Court of Appeal in *Theissbacher v MacGregor Garrick & Co*[1] to be the first appellate court to consider the effect of the annulment of a bankruptcy since 1872.

The Court decided by majority that the effect of annulment is that the former bankrupt is, at least in general, treated as never having been made bankrupt. Whilst sub-section 154(2) of the *Bankruptcy Act* preserves from invalidity acts of the trustee which would otherwise be rendered invalid by the annulment, the majority decided that it was not applicable to a trustee's failure to make an election as to whether or not to pursue an action commenced before the bankruptcy - a failure which is given legal effect by sub-section 60(3) of the *Bankruptcy Act*. The majority judgment in *Theissbacher* is clearly in favour of a liberal interpretation of the effect of annulment so that where a bankruptcy has been annulled sub-section 154(2) is to be construed narrowly so as to minimise the effect of the annulled bankruptcy on the erstwhile bankrupt. This approach limits the effect of sub-section 154(2) to protecting the trustee for actions taken bona fide. While the provision dealing with annulment (section 154) was repealed and replaced after the events in question occurred, the current provisions are materially identical to those considered in *Theissbacher*.

The facts of the case were as follows:

In late 1984 the appellants sold their interest in a company to one Kostka. The respondents acted as the appellants' solicitors for the purpose of this sale. In 1989 one of the company's creditors sued the company, and the appellants as guarantors, for money due under a lease agreement. The

* I am grateful to Lance Bartholomeusz for his assistance in the preparation of this article.

1 Unreported 6 October 1992, Appeal No 95 of 1992.

appellants issued a third party notice to the respondents in respect of this claim substantially on the ground that the respondents should have so arranged the sale as to release the appellants from the guarantees. Subsequently the creditor obtained judgment against the appellants. Owing to the judgment a sequestration order was made under the *Bankruptcy Act* with respect to the appellants' estates in September 1991. Soon thereafter the respondents' solicitors gave a notice under sub-section 60(3) of the *Bankruptcy Act* to the trustee of the appellants' estate with respect to the third party proceedings. Sub-sections 60(2) and (3) provide:

(2) An action commenced by a person who subsequently becomes a bankrupt is, upon his becoming a bankrupt, stayed until the trustee makes election, in writing, to prosecute or discontinue the action.

(3) If the trustee does not make such an election within 28 days after notice of the action is served upon him by a defendant or other party to the action, he shall be deemed to have abandoned the action.

The trustee did not respond except by a letter dated 30 September 1991 asking for more information.

The appellants paid all of their unsecured debts by early December 1991 and their bankruptcy was annulled under sub-section 154(1)(b) of the Act by an order of the Federal Court which became effective on 22 February 1992. Section 154 was repealed and replaced after the events in question occurred. Sub-sections 154(1) and (2), as they then stood, provided:

(1) Where the Court is satisfied:

(a) that a sequestration order ought not to have been made or, in the case of a debtor's petition, that the petition ought not to have been presented or ought not to have been accepted by the Registrar; or

(b) that the unsecured debts of the bankrupt, being debts that have been proved in the bankruptcy, have been paid in full or the bankrupt has obtained a legal acquittance of them; the Court may make an order annulling the bankruptcy.

(2) Where a bankruptcy is annulled under this section, all sales and dispositions of property and payments duly made, and all acts done, by the trustee or any person acting under the authority of the trustee or the Court before the annulment shall be deemed to have been validly made or done but, subject to sub-section (3), the property of the bankrupt still vested in the trustee vests in such person as the Court appoints or, in default of such an appointment, reverts to the bankrupt for all his estate or interest in it, on such terms and subject to such conditions, if any, as the Court orders.

On 1 May 1992 a District Court judge dismissed the third party notice, with costs, without giving any reasons (a point which did not go unnoticed on appeal). The District Court judge apparently accepted the respondents'

contention that the trustee was deemed to have abandoned the third party proceedings under sub-section 60(3) of the Act and (although the bankruptcy had been annulled) the appellants were bound by that abandonment and accordingly could not continue the action.

The appellants appealed from the order of the District Court judge.

The appeal was heard by a Court consisting of Fitzgerald P, Pincus JA and White J. Pincus JA and White J delivered a joint judgment and Fitzgerald P dissented.

The dissenting judgment of Fitzgerald P states that

> [w]hile the general effect of annulment provided for by sub s 154(1) involves the retrospective annihilation of the sequestration order and its consequences, that is subject to the effect of other sections in the Act which make specific provision to the contrary, including s.154(2).[2]

His Honour proceeded to give effect to sub-section 154(2) such that the action, or more precisely the lack of action, of the trustee was deemed an act by sub-section 60(3) and hence preserved after the annulment of the bankruptcy. The President stated that:[3]

> [s]uch an approach seems to me to provide a more consistent and cohesive relationship between the respective provisions in the Act which are presently material than the opposite view.

The joint judgment of Pincus JA and White J gives full effect to the annulment provision:[4]

> The former bankrupt is, at least in general, treated as never having been made bankrupt; that is the effect of annulment.

The result of this conclusion in the present case was that:[5]

> ...the appellants, being deemed never to have become bankrupt, [were] unaffected by s 60(2), which depends upon their having become bankrupt; in consequence s 60(3) does not affect them either.

With respect to sub-section 154(2) the majority stated that its general effect:[6]

> ...is to preserve from invalidity acts of the trustee which would otherwise be rendered invalid by the annulment. Here, there is no act one can point to of that sort; the contention was, we think, that there is a deemed act under s 60(3).

2 *Theissbacher* n 1 above at 2-13.
3 Ibid at 3.
4 Ibid at 9.
5 Ibid.
6 Ibid.

> Although the argument has substance, in our view it should not succeed. To deem an action to have been abandoned, it is not necessary to treat the trustee as having done anything.

The majority here describe the effect of sub-section 60(3) as deeming an action to have been abandoned, sub-section 60(3) in fact deems the trustee 'to have abandoned the action'. The exact words of sub-section 60(3), more so than the majority's paraphrasing of them, seem to connote some form of deemed act on the trustee's behalf.[7] The majority supported their conclusion that sub-section 154(2) did not save the deemed abandonment from the general effect of annulment on two further bases. Their Honours stated that:[8]

> ...it would be odd if, a sequestration order having been wrongly made [s 154(1) is the appropriate recourse if the sequestration order 'ought not to have been made': see paragraph (1)(a)], after annulment the erstwhile bankrupt should be adversely affected by complete inactivity on the part of the trustee.

They doubted whether the effect of sub-section 154(2) - deeming the failure to make an election 'to have been validly made' - was such as to assist the respondents. In their view,

> the problem is not that the failure to make the election is invalidated by annulment, but rather that after annulment it is not taken to have put an end to the former bankrupt's suit. The question whether the failure is 'validly' made or not is inapposite when what has to be decided is whether, despite the annulment, the trustee's inaction is still deemed to have that destructive effect which it would have had if no annulment order were made.[9]

This reasoning presupposes that there is no deemed act to which sub-section 154(2) could apply; the majority here refer only to 'the failure to make the election' and 'the trustee's inaction' whereas, as adverted to above, it is perhaps arguable that sub-section 60(3) deems an act of abandonment and it is that act towards which sub-section 154(2) would require the court's attention to be focused.[10] Their Honours appear to be adopting an interpretation of sub-section 154(2) which posits that sub-section 154(2) was not really designed to give any additional effect to a bankruptcy beyond what is necessary to protect the trustee from things done bona fide. On Their Honours' interpretation, sub-section 154(2) is an exception to the general effect of annulment designed only to protect the trustee and it could be of no assistance in preventing an erstwhile bankrupt pursuing an action instituted before the bankruptcy commenced.

The majority based their conclusion as to the full retrospective effect of annulment upon three considerations. First, 'odd' results may ensue if the

7 Ibid at 2 per Fitzgerald P.

8 Ibid at 10.

9 Ibid at 10-11.

10 Section '60(3) reads in part'...[the trustee] shall be deemed to have abandoned the action.

annulment provision is not given full effect. If, for example, the sequestration order ought not to have been made because the debt on which the bankruptcy petition was based had been paid or had not yet fallen due an annulment provision with prospective effect would allow consequences attaching to bankruptcy, such as criminal liabilities dependent on bankruptcy, arising before annulment to survive that order.[11] This first consideration becomes more persuasive when one considers a scenario[12] in which the limitation period has expired (the erstwhile bankrupt's only recourse being to pursue the action already instituted) and the trustee has allowed sub-section 60(3) to take effect. Secondly:

> in the first part of s 154(2) the legislature has taken the trouble to validate the acts of the trustee before annulment. That could not have been necessary if the effects of annulment were wholly prospective.[13]

Thirdly, the majority identified a number of decisions which have treated the effect of annulment as retrospective. The earliest example given, and the only one of an appellate court, was *Bailey v Johnson*.[14] In *Bailey* the Court of Exchequer had to interpret the equivalent of sub-section 154(2).[15] Cockburn CJ stated:

> The effect of s 81 is, subject to any bona fide disposition lawfully made by the trustee prior to the annulling of the bankruptcy, and subject to any condition which the Court annulling the bankruptcy may by its order impose, to remit the party whose banktuptcy is set aside to his original position. Here the Court of Bankruptcy has imposed no conditions; the general provision of this section has therefore its full effect, and that effect is to remit the bankrupt, at the moment the decree annulling his bankruptcy is pronounced, to his original powers and rights in respect of his property.[16]

To give effect to his reasoning Cockburn CJ reconstructed the facts of the case such that money paid by the trustee in bankruptcy was to be looked at 'as though it were money paid in his [the erstwhile bankrupt's] name instead of in the name of [the trustee]'. Blackburn J, whilst coming to the same conclusion as Cockburn CJ, stated:

> Without determining whether the effect of s 81 is in every case to go back to the beginning, and to place the bankrupt in the position of having always owned what is by the section to 'revert' to him - as to which I do not wish to express any dissent from what the Lord Chief Justice has said, but only to abstain from expressing an opinion.[17]

The rest of the Court (Keating, Mellor, Lush, Brett, and Grove JJ)

11 *Theissbacher* n 1 at 5.
12 *Theissbacher* appears to have been such a case.
13 Note 1 above at 6.
14 [1872] LR 7 Ex 263.
15 Section 81 of the *Bankrupt Act* 1869.
16 Note 14 above at 265.
17 Ibid at 265.

appeared to agree with the judgment of Cockburn CJ. *Bailey* was applied in a number of decisions cited by their Honours. In another of the decisions noted[18] the effect of an annulment upon a bankrupt was described as 'he goes scot free and is as though he had never been in the court at all'.[19] Lastly, the majority noted that the effect of annulment had been considered in a number of decisions of the Federal Court. Their Honours noted *Re Oates*[20] and *Re Fitzgerald*[21] which both treated annulment as having retroactive effect. Their Honours did not note the decisions in two other Federal Court cases which have considered this issue.[22] In *Hayes*, Spender J expressed the view[23] that the applicant there continued to be a bankrupt until the date his bankruptcy was annulled under section 154. However, in *Re Fitzgerald* Pincus J (as His Honour then was) noted that the views of the effect of annulment taken in *Re Hayes* and *Director of Public Prosecutions v Ashley*[24] differ from those expressed by Sheppard J in *Re Oates*. Pincus J stated that the view of Sheppard J was in general agreement with *Bailey v Johnson* and the explanation of that case made in successive editions of the standard English work on bankruptcy[25] and he applied the view espoused by Sheppard J in *Re Oates*. In *Oates v Commissioner of Taxation* Hill J stated:[26]

> [s]ubject to s 154(2), *Director of Public Prosecutions v Ashley*, and perhaps other exceptions that may arise as in *Re Hayes*, it seems not incorrect to say that the effect of the annulment will be the setting aside of the bankruptcy order. Indeed, as stated in *Halsbury's Law of England* (4th ed) the formal order of annulment made in the United Kingdom includes an order that the petition upon which the bankruptcy order was made should be dismissed.

Hill J went on to adopt,[27] subject to sub-section 154(2), the observation of Sheppard J in *Re Oates* that '...at least in legal theory, he is treated as if he were never a bankrupt'. On one interpretation the statements of Hill J could be seen to support the majority's view. However, Hill J's references to *Ashley* and *Hayes*[28] make His Honour's adoption of the observations of Sheppard J in *Re Oates* somewhat incongruous, hence the understandable absence of any reference to His Honour's views.

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18 *Re Taylor, Ex Parte Taylor* (1898) 8 BC (NSW) 50.

19 Two passages of High Court obiter dicta *Cameron v Cole* (1944) 68 CLR 571 per Latham CJ at 583 and *Marek v Tregenza* (1963) 109 CLR 1 per Kitto and Menzies JJ at 4-5 were also relied upon: Note 1 at 8.

20 (1987) 88 ATC 4038.

21 (1988) 99 ALR 189.

22 *Re Hayes, Ex Parte Hayes* (1984) 59 ALR 219, and *Oates v Commissioner of Taxation* (1990) 27 FCR 289.

23 Note 18 *Hayes* at 224.

24 [1955] Crim LR 565. *Ashley* is authority for the view that bankruptcy offences may be prosecuted after annulment.

25 At that time Williams and Muir Hunter, *The Law and Practice in Bankruptcy*, 19th ed.

26 *Oates* n 18 above at 297.

27 Ibid at 302.

28 The majority in *Theissbacher* doubted the authority of *Ashley*: n 1 at 8.

The majority's second reason for holding that sub-section 154(2) did not apply to this case and their first reason for giving the annulment provision full effect both hinge upon the presence in section 154 of sub-section (1)(a) which is to the effect that a sequestration order ought not to have been made or that the petition ought not to have been presented or ought not to have been accepted by the Registrar. *Theissbacher* was in fact not a sub-section (1)(a) case but a sub-section (1)(b) case. The significance of this is more evident if one considers the decision in *Bailey v Johnson* (which was the cornerstone for a number of the decisions cited by the majority) more closely.

Bailey was concerned with *The Bankruptcy Act* 1869 which contained a provision equivalent to sub-section 154(2) but did not contain a provision equivalent to sub-section 154(1). In *Bailey* the bankruptcy was annulled on appeal because the order adjudicating Johnson a bankrupt ought never to have been made owing to the failure of a Registrar to fix, as he ought to have done, a time and place for the execution of a bond.[29] The bankruptcy was effectively set aside on appeal and the nomenclature which the court employed was that the bankruptcy was 'annulled'. *Baily* was an example of something akin to a paragraph (a) annulment under sub-section 154(1) in that the order ought not to have been made, however the majority have applied it equally to a paragraph (b) annulment.

It is perhaps arguable that this extended application does not follow as a matter of course and it may be that in this light Blackburn J's reservation in *Bailey* acquires more significance. *Director of Public Prosecutions v Ashley* which was criticized by the majority in *Theissbacher*, was a paragraph (b) type case, and the decision in *Ashley* was clearly given on the basis that it was an example of a case in which the original adjudication ought to have been made but that the bankrupt had subsequently paid off all his unsecured debts. In light of the separation into different paragraphs of sub-section 154(1) of the situation where a sequestration order ought not to have been made and the situation where the order ought originally to have been made but the former bankrupt was able to pay off all unsecured debts in full or has obtained a legal acquittance of them it may be that the majority's use of paragraph (a) of sub-section 154(1) in their reasoning is somewhat misguided.[30]

As the majority stated, in a paragraph (a) of sub-section 154(1) situation it could be draconian if the order had an effect after annulment and the same could be said of the annulment or setting aside of a sequestration order on appeal, but in a paragraph (b) situation the necessity for ascribing a full retroactive effect to the annulment provision is not so obvious. It may be that on closer scrutiny *Bailey v Johnson* does not support a full retroactive effect to be ascribed to the annulment provision where it is paragraph (b) of

29 See *Ex Parte Johnson, In Re Johnson* (1870) LR 5 Ch 741.
30 See *Re Hayes* at 223 lines 43-49.

sub-section 154(1) which is being applied, and some of the majority's reasoning in *Theissbacher* may not have been wholly applicable to a paragraph (b) case, such as *Theissbacher* was.

The majority also noted, in obiter dictum, that in their opinion the deemed abandonment under sub-section 60(3) destroys the trustee's right to pursue the action[31] absolutely, and, contrary to the argument of the appellant, does not have some lesser effect.[32] Fitzgerald P stated that the effect of sub-section 60(3) was to prevent the cause of action being asserted in that action except by an order in the District Court which permitted it to be reintroduced.[33] On his Honour's view the cause of action is not lost or destroyed and the District Court's decision whether or not to make such an order might turn upon a variety of factors including the possible expiration of any limitation period. His Honour's view was based upon the use of the 'well recognised' concept of abandonment of a claim incorporated in sub-section 60(3).[34]

An interesting point which did not arise specifically in *Theissbacher* but which was adverted to by the majority was the question whether the District Court judge had any power to dismiss the action or order that the appellants pay the costs of the action, ie in the case of an abandoned action is there anything left to dismiss or make an order with respect to? There appears to be obiter dicta in *Re Kwok, Ex Parte Rummel*[35] to the effect that the court can make an order of some nature[36] with respect to the abandoned action. In *King v The Commercial Bank of Australia Limited*[37] the Victorian Full Court was required to consider a provision materially identical to sub-sections 60(2) and (3).[38]

Each of the three judges in that case considered that if the action was deemed 'abandoned' due to the trustee's failure to make an election then the defendant could obtain an order dismissing the action on the ground of abandonment.[39] Irvine CJ ordered that an action abandoned by the trustee be stayed until further order by the court. His Honour refused to make an order dismissing the action fearing that the dismissal may be pleaded in bar as *res judicata* and may prevent an erstwhile bankrupt 'from continuing this litigation himself should he so desire'.

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31 Vis-a-vis the cause of action: see *Re Kwok, Ex parte Rummel* (1981) 61 FLR 336.

32 *Theissbacher* above n 1 at 11.

33 Ibid at 2.

34 His Honour is here referring to the principle of abandonment applied in pleadings ie, someone who delivers a narrower pleading is deemed to have abandoned what was previously in their wider pleading.

35 (1981) 61 FLR 336 per Rogerson J at 341-343.

36 A stay and a dismissal were the orders Rogerson J was discussing immediately prior to the relevant statement.

37 [1921] VLR 48.

38 *Insolvency Act* 1915 (Vic) s 176.

39 Irvine CJ at 58, Mann and Cussen JJ at 61. In *Millane v President, etc, of Shire of Heidleberg* [1928] VLR 52.

These cases support the dicta of Rogerson J in *Kwok* and are not necessarily contrary to the majority's decision that abandonment destroys the trustee's right to pursue the action absolutely. If this is the law as it stands, then it raises this question: if, before an annulment order is made, the trustee was deemed by sub-section 60(3) to have abandoned the action, and the defendant in the action had applied to the court for some formal court order to dispose of the action, then what happens if the bankruptcy is subsequently annulled? In these circumstances the relevant action for the purpose of sub-section 154(2) is not the action or inaction of the trustee, it is the action of the court in striking out or dismissing the action. A court order is not within the compass of sub-section 154(2) and yet the court order would survive the annulment of the bankruptcy. This would suggest that sub-section 154(1) cannot have the wide operation of going back and ignoring everything that has happened since the bankruptcy except the things specifically referred to in sub-section 154(2).

This view of sub-section 154(1) lends support to Fitzgerald P's interpretation of that provision and is perhaps an example of what His Honour had in mind when he justified his approach as providing 'a more consistent and cohesive relationship between the respective provisions in the Act which are presently material than the opposite view'.[40]

It is also interesting to consider whether the decision of the majority would have differed had the trustee taken the positive step of giving the other party to the action notice in writing that the trustee intended to discontinue the action.[41] The question would be whether sub-section 154(2) would apply and would thereby prevent the action being pursued. The majority's three reasons for concluding that sub-section 154(2) did not allow the effect of the trustee's inactivity to continue after the annulment were as follows: Firstly, there was no act or deemed act to which sub-section 154(2) could apply; secondly, '...it would be odd if, a sequestration order having been wrongly made, after annulment the erstwhile bankrupt should be adversely affected by complete inactivity on the part of the trustee and, or particularly, that he or she should lose a cause of action on that basis'; and thirdly the effect of sub-section 154(2) - deeming the failure to make an election 'to have been validly made' - was not such as to assist the respondents.

With these hypothetical facts it would seem that the first of the majority's reasons becomes inapplicable because there is an act of the trustee to which sub-section 154(2) can apply. The second of Their Honours' reasons is not so easy to counter. The fact that the trustee has done an act might make the loss seem less 'odd', however, a wronged erstwhile bankrupt could still lose the ability to litigate a cause of action (as distinct from merely the particular action) through no fault of their own if the relevant limitation period has expired, clearly an 'odd' result. However, even if such act were deemed to

40 *Theissbacher* above n 1 at 3.
41 See *Bankruptcy Act* 60(2).

have been 'validly' made, if the majority is adopting the interpretation adverted to earlier then it is not the trustee's act which is invalidated by the annulment 'but rather that after annulment it is not taken to have put an end to the former bankrupt's suit', and again the majority's view would seem to be that whether that act was 'validly' made or not is inapposite when what has to be decided is whether, despite the annulment, the trustee's action is still given that 'destructive effect' which it would have had if no annulment order were made.

It may be that the majority's liberal view of the ambit of annulment is such that a written notice of discontinuance, although declared a valid act by sub-section 154(2), would not have the effect of preventing the erstwhile bankrupt reviving the relevant suit in these circumstances (although observations made earlier as to the correctness of these three reasons are equally relevant here).

The immediate implications of the majority judgment in *Theissbacher* for a practitioner acting for a defendant to an action where the plaintiff goes bankrupt after the commencement of proceedings are these:

If the trustee either elects to discontinue the action in writing[42] or fails to make an election[43] then the trustee's right to pursue the action (vis-a-vis the cause of action) is destroyed absolutely.

In these circumstances it seems that a court can make an order disposing of the action and any such order will finally dispose of the action even if the bankruptcy is subsequently annulled. There is no doubt that a trustee or bankrupt can commence fresh proceedings on the same cause of action so long as the relevant limitation period has not expired.

If the bankruptcy is subsequently annulled and the defendant has not obtained a court order disposing of the action, then the trustee's failure to make an election will not prevent the bankrupt reviving the dormant action, sub-section 154(2) will have no application, and it may be that any written election to discontinue the action similarly will not prevent a bankrupt reviving the action.

As has been stated, section 154 of the *Bankruptcy Act* was repealed and replaced by Act No 9 of 1992 after the events in question occurred. However, the decision and the reasons of the majority in *Theissbacher* are equally applicable to the equivalent sections 153A, 153B and 154 of the *Bankruptcy Act*.

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42 See *Bankruptcy Act* s 60(2). I have assumed that the effect of a written election to discontinue is at least as definitive as mere inaction: in support of this see *Cooper v Williams* [1963] 2 QB 567 per Lord Denning MR at 580.

43 *Bankruptcy Act* s 60(3).