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A second bite of the apple for judgment debtors

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Summary

It has long been held that a Bankruptcy Court has 'undoubted jurisdiction' to go behind a judgment and question whether a debt exists. Yet it is commonly thought that the Court will *only* exercise such discretion in circumstances of fraud, collusion or where there has been a serious miscarriage of justice.[1]

However the High Court of Australia (HCA) in *Ramsay Health Care Australia Pty Ltd v Compton* [2017] HCA 28 has recently confirmed the position that a Bankruptcy Court can, and should, be willing to 'go behind' a judgment and question whether a debt is really owed where a 'genuine dispute' exists between a creditor and debtor.

This decision is a warning to creditors seeking to enforce a judgment that a debtor may now use the opportunity in a bankruptcy proceeding to take a 'second bite of the apple' and re-litigate the existence of a debt.

Background

In 2012, Ramsay Health Care Australia Pty Ltd (Ramsay) alleged that money was owing by Adrian Compton (Compton) pursuant to a guarantee signed for the purposes of a medical product importation and distributions agreement with Compton Fellers Pty Ltd t/a Medichoice.[2]

Before the Supreme Court of New South Wales, Compton argued a *non est* factum defence, contending that although he signed parts of the guarantee, those parts were signed to signify a separate guarantee and one which did not expose him to personal liability. Further, and to his detriment, Compton did not dispute the quantum of the claim.

Ultimately, Hammerschlag J held in favour of Ramsay and judgment was entered in the amount of $9,810,312.

On 4 June 2015, a Creditor's Petition was filed in the Federal Court and in opposition to the Petition, Compton asked the Court to make a separate determination as to whether they should 'go behind' the Supreme Court judgment and question whether the debt was really owing.

However, the Federal Court declined to do so stating that there had been no "miscarriage of justice", and the discretion to investigate whether a debt was owed was not enlivened as Compton had made a forensic decision in the first instance not to dispute the quantum of the claim.

Compton sought leave to appeal to the Full Court of the Federal Court.

Federal Court decision on Appeal

In a unanimous judgment, the Full Federal Court (Siopis, Katzmann and Moshinsky JJ) found in favour of Compton, which was a considerable departure from the primary Judge's findings.

The Full Court found that the Federal Court (Flick J) had wrongly focused on the way in which Compton had conducted his case by not disputing the quantum of his claim instead of focusing on the central issue, being whether a debt was owed to Ramsay.

Ultimately, the Federal Court surmised that a Court *should* go behind a judgment when there are substantial reasons

to question whether, in truth and reality, a debt is due.[3] In determining what formed a 'substantial reason' they stated that 'where the merits of a claim have not been tested in adversarial litigation, a judgment debt will not have the practical guarantee of reliability'.[4] In essence, the Court should be open to 'go behind' a judgment if the debtor produces evidence which raises any uncertainty as to the existence of a debt.

High Court Appeal

Earlier this year Ramsay was granted special leave to the High Court of Australia to appeal the Full Federal Court decision.

A majority of the High Court (Kiefel CJ, Keane, Nettle and Edelman JJ, Gageler J dissenting) dismissed the appeal and upheld the decision of the Full Federal Court.

The majority held that in light of the evidence adduced by Compton, the Full Federal Court was correct to conclude that the Bankruptcy Court should have proceeded to investigate the question of whether the debt relied upon by Ramsay was owing.

Further the Court held that a 'Bankruptcy Court has a statutory duty to be "satisfied" as to the existence of a debt'.[5] The Court referred to the decision of *Wren v Mahoney* [1972] 126 CLR 212 where it was held that if any 'genuine dispute' exists as to the liability of the debtor to the petitioning creditor then that in itself would be sufficient for a Court to question the debt.[6]

Edelman J added that the power to go behind a judgment has long been established in the Court of Chancery, and that history supports the view that the power was not and is not reserved to any specific category.[7]

Implications

A Bankruptcy Court is now obliged to investigate the existence of a judgment debt where there is a 'substantial question' as to whether the debt relied on is owing.[8] The circumstances are not limited to fraud, collusion or a miscarriage of justice, and as demonstrated in this case, it is also not limited to judgments which are obtained after adversarial litigation where both parties are represented.

We expect the decision will cause an increase in the number of judgment debtors relying on the decision to oppose petitions, and cause obfuscation and delay to creditors seeking a petition for their bankruptcy.

[1] Corney v Brien [1951] HCA 31 at [39].
[2] Ramsay Health Care Australia v Compton [2015] NSWSC 163 at [7].
[3] Ibid at [67].
[4] Ibid at [68].
[5] Ramsay Health Care Australia Pty Ltd v Compton [2017] HCA 28 at [54].
[6] Wren v Mahoney [1972] 126 CLR 212.
[7] Above n 5 at [90].
[8] Ramsay Health Care Australia Pty Ltd v Compton [2017] HCA 28 at [72].

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