Outflanked – High Court of Australia "goes behind" Bankruptcy Court Judgment

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On 17 August 2017, the High Court of Australia delivered its judgment in *Ramsay Health Care Australia Pty Ltd v Compton* [2017] HCA 28 (***Ramsay v Compton***). In this case, the High Court has taken a comprehensive look at the Court's discretion under section 52 of the *Bankruptcy Act* 1966 (**Act**) to "go behind" a judgment and scrutinise a debt that forms the basis of a creditor's petition.

Please note that this article provides an overview only. Bankruptcy Notices and Creditor's Petition proceedings can be complex, and advice needs to be tailored to individual circumstances. This article is not intended as a substitute for independent legal advice. If you have any questions or concerns we suggest that you contact JHK Legal for further information.

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What does "going behind" the judgment mean?

In bankruptcy proceedings, a creditor must establish that a debt of at least $5,000 is owed to it.[1] A final judgment that has not been stayed will, in the usual cases, be good evidence that a liability or debt is owed to it; but it is not determinative.[2]

Importantly, sequestration orders are not granted as of right. The Court has a discretion under section 52 of the Act to dismiss a creditor's petition if, for some other sufficient cause, it sees a sequestration order ought not to be made.[3]

So, if there is evidence that the debt does not in fact exist, section 52 of the Act gives the Court hearing a creditor's petition the discretion to go behind a judgment debt to enquire into its validity and the Court may refuse to make a sequestration order.[4]

The rationale for this position is that the Court is not just dealing with the judgment creditor and debtor, both parties and the Court are interfering with the rights of other creditors if the debtor is made bankrupt.[5]

However, it must be said that going behind a judgment is not done readily, and as we will see, there must be substantial reasons and evidence which warrant the exercise of the discretion, such was the case in *Ramsay v Compton*.[6]

Background facts

On 2 June 2014, Ramsay Health Care Australia Pty Ltd (**Ramsay**) commenced proceedings in the Supreme Court of New South Wales against Mr Compton, claiming money purportedly owing to it by Mr Compton under a guarantee.[7]

Both sides retained solicitors, briefed counsel and filed evidence on the issue of the quantum of the alleged indebtedness. Ramsay's material put in issue the quantum of Mr Compton's indebtedness to Ramsay, however, Mr. Compton's response raised only a defence that he was not liable to pay a debt (referred to as a *"non est factum"* defence).[8]

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[1] See section 44(1) (a) & (b) of the Act;
[2] See section 40(1) (g) of the Act; *Wren v Mahony* (1972) 126 CLR 212 (***Wren v Mahony***); *Ramsay v Compton* at paragraph 42
[3] See section 52 of the Act; see also section 104(2) of the *Federal Circuit Court of Australia Act* 1999 where a party may apply to the Federal Circuit Court of Australia for a review of a Registrar's powers in making a sequestration order.
[4] See *Wren v Mahony*; *Ramsay v Compton* at paragraph 44.
[5] See *Ramsay v Compton* at paragraph 55.
[6] Ibid at paragraph 20.
[7] *Ramsay v Compton* at paragraph 7.
[8] Ibid at paragraph 8.

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At the trial, Mr Compton relied solely on the abovementioned defence, that is: he did not have a liability to pay a debt to Ramsay; he did not seek to dispute the amount of the alleged debt. In other words, Mr. Compton's adopted an "all or nothing" approach to his defence.[9]

Mr Compton's defence failed, and, in the absence of any issues raised by Mr. Compton as to the amount of the debt allegedly owed to Ramsay, judgment was awarded to Ramsay against Mr Compton for $9,810,312.33 (**Judgment**). Mr Compton did not appeal the Judgment and on 29 April 2015, Ramsay served a bankruptcy notice on Mr Compton requiring that he pay the Judgment Debt by 20 May 2015.[10]

The bankruptcy proceedings

Mr. Compton failed to comply with the bankruptcy notice issued by Ramsay and on 4 June 2015 Ramsay presented a creditor's petition. On 7 July 2015, Mr Compton filed a notice stating grounds of opposition contending that no debt was really owed to Ramsay because the Judgment was not founded on a debt that in truth or reality existed.

This position was adopted because Mr Compton's evidence was that after a reconciliation of the debt that was deposed to in evidence, it was Ramsay that owed money to Medichoice (the Company Mr. Compton had guaranteed the debts of), and not the other way around. On that basis, Mr Compton submitted that the court should exercise its discretion to go behind the Judgment upon which the petition was based.[11]

The primary judge dismissed Mr Compton's application and concluded that he did not have the discretion to go behind the Judgment, but even if he did, he could not exercise the discretion for a number of bases.[12]

Some of the bases upon which the primary judge made that decision included (but were not limited to) that Mr. Compton was represented by counsel in the Supreme Court, there was evidence that had been filed in the Supreme Court addressing the amount owed, no explanation was advanced by Mr. Compton as to why the amount of the Judgment was not put in issue before the Supreme Court, and that Ramsay maintained the Judgment was owed to it.[13]

[9] Ibid at paragraphs 9.
[10] Ibid at paragraphs 10 and 11.
[11] Ibid at paragraphs 12 to 15.
[12] *Ramsay v Compton* at paragraphs 17 and 20.
[13] Ibid at paragraphs 21 to 23.

Mr Compton sought leave to appeal from this decision to the Full Court of the Federal Court, and leave was granted.[14]

The Full Court's decision

Ramsay argued that the decision in *Corney v Brien*[15] established a principal that a Court should not go behind a judgment which follows a full investigation at trial and where both parties were represented. Ramsay also argued that *Corney v Brien* stood for the proposition that "*fraud, collusion or miscarriage of justice*" are exhaustive of the circumstances in which a Court may or should go behind a judgment.[16]

The Full Court rejected that argument, and concluded that the judgment in *Corney v Brien*, did not establish that narrow view of the function of a Court. The Full Court applied the approach in *Wren v Mahony* that:

> "*where reason is shown for questioning whether [to go] behind the judgment ... there was in truth and reality a debt due to the petitioning creditor, the Court of Bankruptcy can no longer accept the judgment as such satisfactory proof*… [but rather must],,,*exercise its ... discretion to look at what is behind the judgment*".[17]

The Full Court held that the primary judge erred in concluding that the discretion to go behind the Judgment had not been enlivened and allowed Mr Compton's appeal, ordering that the Bankruptcy Court should go behind the Judgment.[18]

By special leave, Ramsay appealed to the High Court of Australia, arguing that the Full Court erred in setting aside the decision of the primary judge to decline to go behind the Judgment.[19]

Ramsay's submissions

Ramsay maintained that *Corney v Brien* established that the Court's discretion to go behind a judgment after a contested hearing is enlivened only in the event of some fraud, collusion or miscarriage of justice.[20] Although, there was no suggestion of fraud or collusion, Ramsay argued that a miscarriage of justice in this case:

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[14] Ibid at paragraphs 24 and 25.
[15] [1951] HCA 31; 84 CLR 343.
[16] *Ramsay v Compton* at paragraph 26.
[17] Ibid at paragraph 27.
[18] Ibid at paragraph 30.
[19] *Ramsay v Compton* at paragraph 30 to 32.
[20] Ibid at paragraph 33.

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> "*…refers only to circumstances which impeach the judgment such that the judgment should never have been obtained*."[21]

Ramsay argued that in the circumstances, the Full court could not have concluded that the judgment was affected by some miscarriage of justice and that the Full Court took too broad a view of the approach adopted in *Wren v Mahony*, and that these propositions were consistent with the principle of finality in litigation.[22]

Mr. Compton's submissions

Mr Compton submitted that the question for a Bankruptcy Court was whether the judge was persuaded that there was a debt truly owing to the petitioning creditor, and that a Bankruptcy Court should go behind a judgment where sufficient reason is shown for questioning whether, behind the judgment, there is in truth and reality a debt due to the petitioning creditor. He further submitted that sufficient reason was shown in this case.[23]

The High Court's decision

By majority of 4 to 1 (Gageler J dissenting), the High Court held that Ramsay's submissions should be rejected, and Mr Compton's accepted. In doing so, the High Court concluded that:

1. The broad approach in *Wren v Mahony* should be adopted, that is, a judgment debt is on the face of it evidence that a debt is owed, *but* it is not determinative;[24]

2. A court hearing a creditor's petition may go behind a judgment debt to enquire into its validity if there is evidence that the debt does not in fact exist;[25]

3. In this case, there was sufficient evidence available to the primary judge to exercise the discretion to go behind the judgment but this was not done[26];

4. the Full Court was correct to conclude that there was a substantial question as to whether the debt on which Ramsay relied for its bankruptcy proceedings was owing, and for those reasons, the Bankruptcy Court should proceed to investigate this question and to decide whether it was open to it to make a sequestration order;[27] and

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[21] Ibid.
[22] Ibid at paragraph 33 to 35
[23] Ibid at paragraph 37.
[24] Ibid at paragraphs 42 to 43 and 47
[25] *Ramsay v Compton* at paragraph 44.
[26] Ibid at paragraph 70.
[27] Ibid at paragraph 72

5. Ramsay's appeal should be dismissed with an order that Ramsay pay Mr. Compton's costs of the appeal.[28]

JHK Legal observations

While a judgment debt is still good evidence that a debt is owed, the decision in *Ramsay v Compton* has made clear that the narrow view (that is, a judgment debt or money order is determinative that a debt is owed for the purposes of bankruptcy proceedings) should not be preferred.

As noted above, the High Court has taken the view that a broad interpretation of the Court's discretion in section 52 of the Act should be taken should an applicant debtor file sufficient evidence. With that in mind we consider it prudent that creditors continue to keep documents and evidence supporting their position that a debt is owed well after any contested trial, summary judgment and or a default judgement is entered, so that this evidence can be relied upon if necessary at a later date, and especially if bankruptcy proceedings are being contemplated.

If you are considering enforcing your rights with a Bankruptcy Notice or Creditor's Petition, JHK Legal are happy to assist you with this process.

[28] See Orders dated 17 August 2017.