SETTING ASIDE A BANKRUPTCY NOTICE BY GOING BEHIND THE DEBT

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In an article in the *Australian Law Journal*[1] the power of a court exercising jurisdiction under the *Bankruptcy Act* 1966 (Cth.) (the Bankruptcy Court) to examine the judgment of another court was considered. It was pointed out that the Bankruptcy Court has the power to inquire into the consideration for a judgment debt when the judgment debt is relied on by a creditor who presents a creditor's petition, but that it is impossible to lay down any strict or inflexible rules as to when this power will be exercised. The recent unreported decision of Pincus J. of the Federal Court of Australia in *Re V. & J. Removals; Ex p. Earl*[2] sheds some light on the circumstances in which the court's power will be exercised.

The case involved a dispute between two removalists who had an arrangement whereby each would do work for the other although it was by no means clear how each was to be remunerated. From September 1981 to August 1983 the respondent did work for the applicant on a commission basis at a rate that varied between 10 and 20 per cent depending on the size of the order. The respondent claimed that he was not paid the commissions due to him; nor was he reimbursed for certain expenses incurred in carrying out the work. The applicant claimed that he was engaged by the respondent to do work for which he was only partly paid. Accordingly, the applicant issued a plaint claiming the balance alleged to be due to him. The respondent entered an appearance to the plaint, did not admit the allegations contained in it and counter-claimed for the commissions and expenses said to be due to him. The applicant omitted to plead to the counter-claim and the respondent obtained judgment in the District Court in June 1984. It was this District Court judgment which was used by the respondent in bankruptcy proceedings against the applicant.

The applicant had tried unsuccessfully to have the District Court judgment set aside on the ground that not enough time had elapsed between the issue of the judgment summons and the date of the hearing. The District Court Rules provide for the setting of a return date (r.154), but do not provide any minimum time within which the judgment summons must be served on the other party. In this case it was served on the eve of the hearing. The District Court nevertheless refused the application to set the judgment aside.

In the Federal Court proceedings to have the bankruptcy notice set aside, counsel for the respondent took a preliminary point, namely that the question of going behind the debt could not arise until the issue of a creditor's petition. In the absence of any authority supporting that proposition, Pincus J. exercised his discretion in favour of the applicant.

Counsel for the applicant submitted that since the judgment in question was a judgment by default, his client had a *right* to have the default judgment re-opened. In support of this proposition he relied on the dictum of Fullagar J. in *Corney* v. *Brien*[3] that ". . . whenever the judgment in question is a judgment by default . . . the [Bankruptcy] Court will always 'go behind' the judgment if there is what it regards as a bona-fide allegation that no real debt 'lay behind' the judgment. Further support for this test is to be found in the dictum of Gibbs J., as he then was, in *Re Vojnovski; Ex p. Malcolm*[4] that 'Since the judgment obtained by the petitioning creditor was a default judgment, a debtor is entitled to ask this court to go behind it and to enquire whether it is founded on a real debt.'

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1. See 47 A.L.J. 377.
2. 21 June 1985.
3. (1951) 84 C.L.R. 343 at 357.
4. [1970] A.L.R. 355.

This submission was rejected by Pincus J. who held that a Bankruptcy Court need not *always* go behind a default judgment, even if there is a bona-fide allegation of no real debt. In doing so he applied the law as laid down in *Wren* v. *Mahoney*[5] that it is only where substantial reasons are given that the Bankruptcy Court *must* go behind a default judgment. Pincus J. went on to state that this principle applies to all cases, both default judgments and others, although default judgments must be regarded with more suspicion.

Having worked out the test to be applied, Pincus J. then had to decide whether substantial reasons had been shown for going behind the default judgment in question. His Honour gave the following reasons for exercising his discretion in favour of the applicant. In the first place, the issues had never been tried and neither party's version of the facts was more credible than the other. Secondly, the respondent had refrained from making any claim in respect of his alleged debt until the applicant had issued his plaint. Thirdly, the principal part of the respondent's claim was for commission at rates that varied between 10 and 20 per cent. It was arguable that this part of the contract was too vague and that only a *quantum meruit* was allowable. Finally, the application for judgment was made only the day before judgment was given.

The judgment of Pincus J. in *Re V. & J. Removals* is worthy of note because it clarifies the test to be applied by the Bankruptcy Court in exercising its discretion to go behind the judgment of another court. The test in relation to default judgments is more stringent than the one suggested by Fullager J. It is also noteworthy because the discretion was exercised in order to set aside a bankruptcy notice rather than at the hearing of the petition which is more usual.

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5. (1972) 126 C.L.R. 212.