

Bankruptcy Law- Failure to Set Aside Bankruptcy Notice

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1. Background

The Federal Court of Australia in a recent case, **Katter v Melhem (No 2) [2014] FCA 1176 (6 November 2014)** has refused to look behind a Court Judgment in deciding whether or not to set aside a bankruptcy notice.

2. Fact

Mr Melhem (“M”) sued Mr Joseph and Mrs Katter (“**Applicants**”) in the District Court for \$550,000.00 plus interest, said to be owing under a loan agreement. The Applicants defended the proceedings and argued that no monies were received by them from M. However, the proceedings settled in favour of M. The terms of settlement provided that if certain conditions were not satisfied, M was to have leave to enter Judgment against the Applicants for \$1 million.

Ultimately, Judgment was entered in the sum of \$1million against the Applicants as they failed to comply with the terms of the settlement reached. The Applicants then made an application to set aside the Judgment which was subsequently dismissed. An appeal from that dismissal was then commenced but later discontinued.

After service of a bankruptcy notice on the Applicants by M, which was founded on the Judgment obtained, the Applicants made an application to the Federal Court of Australia seeking orders that the Court exercise its discretion to go behind the Judgment of the District Court and investigate whether there was a valid debt notwithstanding the settlement reached. The issue for the Court was whether the Court should exercise that discretion.

The Applicants argued that the Judgment debt was not enforceable by way of a bankruptcy notice as there was no debt upon which bankruptcy proceedings could be founded.

The grounds relied upon by the Applicants were as follows:

1. no monies were received by them from M or anyone else (lack of consideration);
2. the Judgment of \$1 million exceeds the jurisdictional limit of District Court; and
3. the Judgment was based on terms of settlement that operated as a penalty.

3. Outcome

The Federal Court held that the Applicants had not established that in all the circumstances there were substantial reasons to warrant the exercise of the Court’s discretion to go behind the judgment. Most importantly, the Federal Court found that the Applicants failed to raise any of the arguments they now raised in the District Court Proceeding or later on appeal to the Court of Appeal.

Therefore, the Court concluded that the Applicants were bound by the way the prior proceedings were conducted on their behalf. Ultimately, the Court found that the bankruptcy notice should not be set aside.

4. Implications

Implications arising from this case are as follows:

1. a Court, in deciding whether or not to set aside a Bankruptcy Notice, will rarely reinvestigate the debt unless there are very compelling reasons to do so;
2. generally, a judgment is considered to be satisfactory evidence of debt unless proven otherwise; and
3. the Court generally will not look behind a judgment when deciding whether or not to set aside a Bankruptcy Notice where the judgment is challenged in the following circumstances;
 - a. a debtor has acted on the advice of Counsel and Counsel had full knowledge of all relevant facts, and no suspicion of unfairness;
 - b. a debtor has been pressured by their legal advisers to compromise the claim, despite the merits of their defence;
 - c. a debtor's argument would only support a finding that the amount of debt be reduced; and
 - d. where the debtor raises new arguments which could have been raised in earlier proceedings.