SUPREME COURT OF QUEENSLAND

CITATION:	*Re: Cube Footwear Pty Ltd* [2012] QSC 398
PARTIES:	**KARINO EMANOUEL** (applicant) v **CUBE FOOTWEAR PTY LTD ACN 127 584 089** (respondent)
FILE NO:	BS6791/12
DIVISION:	Trial
PROCEEDING:	Application
DELIVERED ON:	14 December 2012
DELIVERED AT:	Brisbane
HEARING DATES:	17 & 25 October 2012
JUDGE:	Jackson J
ORDERS:	**1. The application is dismissed.** **2. The applicant pay the respondent's cost of the proceeding to be assessed.**
CATCHWORDS:	CORPORATIONS – WINDING UP – WINDING UP IN INSOLVENCY – WHAT CONSTITUTES INSOLVENCY – PROOF OF SOLVENCY – where the applicant applies to wind up the company on the ground of insolvency – where the respondent is at hearing date able to pay debts as and when they are falling due and is trading profitably yet its total (current and non-current) liabilities significantly exceed its total assets – where the respondent has two debts to related party creditors which it would be unable to pay if due – where the creditors have agreed to defer the time for payment of the debts when they become payable if necessary – extent debts payable at a future date should be taken into account in assessing solvency under s 95A of the *Corporations Act* 2001 (Cth) – whether the company by the support of its creditors can discharge the onus of proving that it is solvent B*ankruptcy Act* 1924 (Cth), s 95 *Corporations Act* 2001 (Cth), s95A, s 459A, s 459C, s 459D, s 459E, s 459F, s 459G, s 459P, s 459S, s 460, s 461, s462 *Companies Act* 1863 (Qld), s 79, s 78 *Companies Act of* 1931 (Qld), s 173 *Companies Act of* 1961 (Qld), s 364 *Companies (Queensland) Code*, s 364 *Companies Act Amendment Act of 1913* (Qld), s5

Insolvency Act of 1874 (Qld), ss 107-109
Service and Execution Process Act 1992 (Cth)
Life Assurance Companies Act of 1871 (UK), s 21
Companies (Consolidation) Act 1908 (UK), s 130

Australian Securities and Investments Commission v Plymin (No 1) (2003) 46 ACSR 126, referred
Bank of Australasia v Hall (1907) 4 CLR 1514, cited
Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9) (2008) 39 WAR 1, cited
Edwards v Attorney-General (NSW) [2004] NSWCA 272, considered
Emmanuel Management Pty Ltd v Foster's Brewing Group Ltd [2003] QSC 205, referred
Georgiou Building Pty ltd v Perrinepod Pty Ltd [2012] WASC 72, considered
Insurance Commissioner v Associated Dominions Assurance Society Pty Ltd (1953) 89 CLR 78, referred
Leslie v Howship (1997) 15 ACLC 459, considered
Lewis (as liquidator) Doran Constructions Pty Ltd v Doran (2005) 54 ASCR 410, considered
Melbase Corporation Pty Ltd v Segenhoe Ltd (1995) 17 ACSR 187, referred
Mulherin v Bank of Western Australia Ltd [2006] QCA 175, considered
New Cap Re Insurance Ltd (in liq) v Grant (2008) 221 FLR 164, cited
Pereira v Farace 413 F.3d 330, 2005, referred
Quick v Stoland Pty Ltd 29 ACSR 130, considered
Re European Life Assurance Society (1869) LR 9 Eq 122, cited
Re RHD Power Services Pty ltd (in liquidation) (1990) 3 ACSR 261, referred
Re Whitla Holdings Pty Ltd (1982) 7 ACLR 348, cited
Sandell v Porter (1966) 115 CLR 666, cited
Southern Cross Interiors Pty Ltd (in liq) v DCT (2001) 53 NSWLR 213, referred
Taylor v Australia 7 New Zealand Banking Group Ltd (1988) 13 AVLR 780, referred

COUNSEL: A J H Morris QC and V Brennan for the applicant

D B Fraser SC and PA Telford for the respondent

SOLICITORS: Taylor David Lawyers for the applicant

Bruce Thomas Lawyers for the respondent

[1] **Jackson J**: The statutory test of corporate solvency requires that a company is able to pay its debts as they become due and payable. Commonly, on the hearing of a winding up application on the ground of insolvency, the inquiry as to solvency is primarily directed to the short term cash flow position of the respondent company.

In general, it is no answer for a company which is unable to meet current liabilities to say that its assets exceed the liabilities overall. The time aspect of the test of solvency – "as they become due and payable" – will not be satisfied.

[2] What about the reverse situation? The company is trading profitably at present. Yet its total (current and non-current) liabilities significantly exceed total assets and the company survives only by the grace of a couple of creditors who have agreed to defer payment of their debts. There is a question whether the company can, in the foreseeable future, generate profits or raise capital which would repay the deferred debts. Is it insolvent? And should it be wound up on either the insolvency ground or the just and equitable ground?

[3] The applicant (Emanouel) applies to wind up the respondent (Cube Footwear) on the ground of insolvency under s 459A of the *Corporations Act* 2001 (Cth) (CA). Emanouel claims to be a creditor whom may apply to the court for the company to be wound up in insolvency under s 459P.

[4] On the morning of the first day of the hearing of the application, Emanouel applied to amend the grounds of the application to raise the just and equitable ground of winding up under s 461(1)(k) of the CA. Leave to amend was granted, but limited to the contention that "assuming… that the respondent company is not at present technically insolvent, the respondent will inevitably become insolvent…".[1]

[5] Emanouel served a demand on Cube Footwear under s 459E(1) of the CA which Cube Footwear did not comply with as required under s 459F(1). Cube Footwear purported to apply for an order setting aside the statutory demand under s 459G(1). The application was defective as not properly served under s 459G(3) because it was not endorsed as required under the *Service and Execution Process Act* 1992 (Cth). In the result, the application for an order setting aside the statutory demand was dismissed.

[6] Accordingly, under s 459C(2) of the CA, the court must presume that Cube Footwear is insolvent and by s 459C(3) the presumption operates "except so far as the contrary is proved for the purposes of the application". The sole factual issue at the hearing was whether Cube Footwear has proved that it is solvent at the time of hearing.

[7] Another consequence of Cube Footwear's failure to comply with the statutory demand is that, without the leave of the court, it may not oppose the application on a ground that it relied on for the purposes of an application by it for the demand to be set aside or that it could have so relied on but did not so rely on: 459S(1). The court is not to grant leave unless it is satisfied that the ground is material to proving that the company is solvent: s 459S(2).

[8] Cube Footwear applied for leave, so as to contest its alleged liability to Emanouel. The parties reached common ground during the hearing that whether or not Emanouel's alleged debt is owed does not affect whether or not Cube Footwear is solvent. That is because the alleged debt would be a current liability and Cube

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1 Exhibit 1

Footwear's current assets exceed its current liabilities, including the amount of Emanouel's alleged debt. The dispute about solvency, as will appear, is confined to the effect on Cube Footwear's position of two non-current liabilities. Thus leave should not be granted. In any event, the parties agreed that this application should be disposed of on the footing that there was a bona fide dispute as to the existence and the amount of Emanouel's debt. There are other proceedings between the parties about whether or not that alleged debt is owed.

[9] Cube Footwear did not contend that Emanouel was not a creditor who had standing to apply for winding up under s 462. Accordingly, it is unnecessary to further consider whether Cube Footwear owes the alleged debt to Emanouel.

[10] Emanouel also conceded that "considered solely at this moment in time, the company is solvent". However, the concession did not extend to solvency within the meaning of s 95A(1) of the CA. The dispute as to solvency was fought on a narrow basis, over the effect of two particular debts that will not be payable before the end of August and mid-September 2013 respectively. It was contended that they were relevant because:

(a) in determining whether the company is solvent the court may take into account "a contingent or prospective liability of the company": s 459D(1); and

(b) as defined by s 95A(1) of the CA, "a person is solvent if and only if the person is able to pay all the person's debts, as and when they become due and payable" which means, *inter alia*, that the assessment of solvency is to be made looking into the future.

[11] The first of those contentions requires no more authority than the text of s 459D(1). However, as a matter of history, a provision in similar terms has been a feature of companies legislation since 1871,[2] when it was first introduced to overcome a court decision that contingent or prospective liabilities, that is debts or possible debts payable at a future date, were not to be taken into account in assessing solvency.[3]

[12] Given the specific authorisation under s 459D(1), and that subsection's progenitors, courts have answered the question posed by the statutory language of insolvency in companies legislation - either "unable to pay its debts"[4] or "[not] able to pay all the person's debts as and when they become due and payable"[5] - having regard to debts which will become payable in the future.[6] A question arises in this case as to how

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2 Initially, by s 21 of the *Life Assurance Companies Act of* 1871 (UK), followed by s 130 of the *Companies (Consolidation) Act* 1908 (UK) and thereafter into Australian companies legislation. For example, in Queensland, it was first introduced in s 79(3) of the *Companies Act* 1863 to 1913 (Qld) as amended by s 5 of the *Companies Act Amendment Act of* 1913 (Qld). It has existed in all companies legislation since that time, currently in s 459D

3 *Re European Life Assurance Society* (1869) LR 9 Eq 122

4 For examples see s 78(4) *Companies Act of* 1863 (Qld), s 173(e) *Companies Act of* 1931 (Qld); s 364(1)(e) *Companies Act of* 1961 (Qld); s 364(1)(e) *Companies (Queensland) Code* and s 460(1) *Corporations Law*. Compare ss 107 – 109 of the *Insolvency Act of* 1874 (Qld); s 95 *Bankruptcy Act* 1924 (Cth)

5 Section 95A(1) *Corporations Act* 2001 (Cth)

6 *Bank of Australasia v Hall* (1907) 4 CLR 1514 at 1528; *Sandell v Porter* (1966) 115 CLR 666 at 670 – 671; *Lewis (as liquidator) Doran Constructions Pty Ltd v Doran* (2005) 54 ASCR 410 at [103];

far into the future it is permissible to look. The cases give no simple answer to that question,[7] which can only form one aspect of the determinative statutory question whether the corporation is solvent within the meaning of s 95A(1), having regard to s 459D(1).

[13] Because it will be necessary on the facts of this case to say something of the effect of an unsecured creditor's agreement to defer the time for payment of a debt, and an expressed intention to grant further indulgence, if necessary, when the time for payment arrives, it is appropriate to specifically mention two cases of high authority decided in the context of analogous bankruptcy legislation: *Bank of Australasia v Hall*[8] and *Sandell v Porter*[9]. In both of those cases, the provision of the bankruptcy legislation in question[10] defined or expressed insolvency as a debtor "unable to pay his debts as they become due from his own moneys". The words "from his own moneys" resulted in the decision that the debtor's "own moneys… extend to moneys which he can procure by realisation by sale or by mortgage or pledge of his assets within a relatively short time".[11] Some thought that had the consequence, in the company law context, that unsecured borrowings including loans from directors were not to be taken into account in assessing whether a company was unable to pay its debts.

[14] However, the words "from his own moneys" have never found their way into the language of the ground of insolvency for winding up in a company statute in this State, or in national legislation.[12]

[15] There was, however, a context where "from his own moneys" did come into play in assessing insolvency in a company liquidation. Where a winding up order had already been made, power was conferred on the liquidator to avoid a voidable preference.[13] The relevant sections operated "in like manner" to s 122(1) of the *Bankruptcy Act* 1966 (Cth) and therefore picked up the bankruptcy legislation's definition or expression of insolvency under s 122(1), including the requirement that the debtor must be able to pay "from his own moneys". Thus a number of company law cases dealing with the subject matter of voidable preferences applied "from his own moneys" to the solvency of a company.[14]

New Cap Re Insurance Ltd (in liq) v Grant (2008) 221 FLR 164 at [77]; and *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1 at [1123] – [1138]

7 There is no magic formula: the relevant period has been as short as one month: *Bank of Australasia v Hall* (1907) 4 CLR 1514. Or as long as two and a half years: *re Whitla Holdings Pty Ltd* (1982) 7 ACLR 348 at 353. And a recent consideration of the question in a particular factual context adopted one year: *The Bell Group Ltd (in liquidation) v Westpac Banking Corporation & ors (No 9)* (2008) 70 ACSR 1 at [1123]-[1128]

8 (1907) 4 CLR 1514 at 1528

9 (1966) 115 CLR 666 at 670

10 Sections 107 – 109 of the *Insolvency Act of* 1874 (Qld) and s 95 of the *Bankruptcy Act* 1924 (Cth)

11 *Sandell* at 670

12 Palmer J's statement in *Lewis v Doran* [2004] NSWSC 608 at [84] that "the predecessors of s 95A defined insolvency as an inability to pay… "from his own monies" does not apply to the provisions in Australia relating to winding up a company on the ground of insolvency

13 For example, by s 293 *Companies Act of* 1961 (Qld) and s 451 of the *Companies (Queensland) Code*

14 For example, *Taylor v Australia 7 New Zealand Banking Group Ltd* (1988) 13 AVLR 780 at 784; cf *re RHD Power Services Pty ltd (in liquidation)* (1990) 3 ACSR 261 at 263-264

[16] When close attention is paid to the differences between the statutory language in the context of inability to pay debts as a ground to wind up a company and statutory the language in the context of personal bankruptcy, it may never have been correct to say that regard should be confined to secured credit as a source of funds to pay debts when assessing insolvency on a winding up application. But whether or not that was so, the question is now answered clearly by s 95A, which does not refer to a person's ability to pay being confined to a payment from "his own moneys" at all. And as Palmer J showed in *Lewis v Doran*,[15] the statutory definition of "solvent" which was introduced for the first time in June 1993 into the *Corporations Law*, by s 95A, did not include those words or any equivalent, notwithstanding that they had been included in the exposure draft of the Bill for the amending Act.

[17] Thus, available unsecured borrowings may be considered as a source of funds to pay debts, debts placed on deferred payment terms may be considered as a source of credit available to the company and the support of directors (or shareholders) by unsecured loans may also be taken into account in that way. These conclusions are directly supported by a decision of the NSW Court of Appeal: *Lewis v Doran.*[16] And they are indirectly supported by a decision of the Queensland Court of Appeal: *Mulherin v Bank of Western Australia Ltd.*[17] Both decisions bind me.

[18] Consistently with that analysis, a recent apt statement summarises matters thus: "The company's ability to borrow is an aspect of the overall facts and commercial reality: see *Lewis v Doran* at [106]-[114]. The ability of [the] company to borrow and the willingness of creditors to continue lending may be significant factors. The likelihood that directors and shareholders will continue to support the company by lending money is relevant: see *Mulherin v Bank of Western Australia Ltd* at [113]-[115]. The terms on which funds are made available are also important…"[18]

[19] As already mentioned, there are two debts of Cube Footwear upon which the evidence and argument at the hearing of the application in this case was focussed. The first is a debt owed to Tung Shing Trading (H.K) Ltd ("Tung Shing") of which King Lau is the managing director and holds three quarters of the ordinary class shares. The other director and shareholder was his deceased nephew. The amount of the debt at the hearing was "more than 6 million"[19] and almost $4 million had been outstanding for over 120 days. Tung Shing is Cube Footwear's sole supplier of trading stock for the latter's business of wholesale footwear sales and distribution carried on in Australia.

[20] King Lau also holds a quarter of the issued shares in Cube Footwear. He is related to each of the other shareholders of Cube Footwear. He is the brother of Kitty Lau, who is one of two directors of Cube Footwear and who also holds a quarter of the issued shares. Their deceased nephew also held a quarter of the shares. Kitty Lau's husband is Simon Chung, who is the other director of Cube Footwear. The businesses of Tung Shing and Cube Footwear are operated by their "extended

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15 [2004] NSWSC 608 at [85]

16 (2005) 219 ALR 555 at [109]

17 [2006] QCA 175 at [112]-[115]

18 *Georgiou Building Pty ltd v Perrinepod Pty Ltd* [2012] WASC 72 at [41]

19 In oral evidence Mr Lau said more than $6 million: T1-64.20, whereas Mr Chung said about $5.7 million: T1-41.05

family" and there is a close and cooperative relationship between them through the directors of the two companies.

[21] The second debt is owed by Cube Footwear to Tiu Holdings Pty Ltd ("Tiu"), of which Kitty Lau is one of 3 directors and one of 5 members. The amount of the debt is approximately $2.16 million and it has been outstanding for up to 5 years. The debt is owed for the purchase price of the business carried on by Cube Footwear which it acquired from Tiu in September 2007.

[22] There is no dispute that Cube Footwear is presently unable to pay either of those debts. In the face of the present application to wind up, Cube Footwear, by Simon Chung, entered into an agreement with Tung Shing, by King Lau ("Tung Shing agreement"), and an agreement with Tiu, by Kitty Lau ("Tiu agreement"), that those debts shall not be repayable until after 31 August 2013 and 10 September respectively.

[23] It is because of those agreements that Emanouel concedes that, considered solely at this moment in time, Cube Footwear is solvent, but nevertheless still contends that Cube Footwear is insolvent by reference to its inability to pay those debts as and when they become due and payable.

[24] Cube Footwear contends that its exposure to repay those debts after the non-repayment periods expire does not repel the conclusion that it has discharged the onus of showing that it is solvent because:

(a) the earliest dates for repayment of those debts occur too far into the future to inform the answer to the question of solvency;
(b) under each of the relevant agreements the creditor has bound itself to call up only so much of the money owing as Cube Footwear has the ability to pay while remaining solvent; and
(c) it is likely that each of those creditors, controlled by family members, will give further support and grant further indulgence as to repayment after 31 August 2013 or enter into further agreements like those which have deferred the time for repayment of those debts until after 31 August 2013 and 10 September 2013 respectively.

Bare summary of financial position

[25] Before turning to those questions, it is appropriate to set out the circumstance of Cube Footwear in a little more detail, but only to the extent necessary to consider the central dispute over the impact of the Tung Shing debt and the Tiu debt.

[26] At 30 September 2012, according to its management accounts[20] Cube Footwear had assets and liabilities as follows:

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20 Which were not challenged

Current assets	$8,623,759.24
Non-current assets	$380,643.18
Current liabilities	($6,996.462.62)
Non-current liabilities	($2,156,247.59)
Net assets	($148,307.79)

[27] Some of the allocation between current assets and non-current assets requires adjustment. Although the exercise is a little untidy because the calculation below was done in respect of the balance sheet as at 31 August 2012, not 30 September 2012, a representation of the appropriate adjustments as at 31 August 2012 is as follows:

Reported current assets	$8,071,012
Remove: Loan to staff – Karino Emanouel	($791,220)
Remove: Loan to staff – Michael Emanouel	($218,949)
Remove: Loan receivable - Simco	($319,937)
Remove: Loan receivable – Cube Holdings	($1,555,765)
Adjusted current assets	$5,185,141
Reported current liabilities	$6,757,955
Remove: Trade creditor – Tung Shing	($5,711,852)
Adjusted current liabilities	$1,046,103
Adjusted net current assets	$4,139,038

[28] For present purposes, the point to note is that the adjustment of current liabilities in the representation of adjusted net current assets treats the liability for the Tung Shing debt (at 31 August 2012 in the sum of $5,711,852) as non-current.

[29] Similarly, the liability for the Tiu debt (at 30 September 2012 in the sum of $2,156,247) is treated as non-current in the statement of assets and liabilities.

[30] The bases of those treatments are the Tung Shing agreement and the Tiu agreement. It will be necessary to return to them.

[31] As to current and historical trading, again a brief summary is sufficient for present purposes:

Financial year	2009	2010	2011	2012	2 months to 30 Aug 2012
Sales	$14,720,693	$16,893,405	$13,179,560	$13,208,435	$2,602,020
Cost of sales	($10,291,259)	($12,371,581)	($7,285,406)	($8,464,055)	($1,610,397)
Other income	$77,530	$235,023	$405,571	$599,490	$12,917
Expenditure	($4,715,315)	($5,116,899	($6,089,884)	($5,279,640)	($752,238)
Net profit (loss)	($208,353)	($360,052)	$209,841	$64,231	$252,302

[32] The 2012 profit of $64,231 was negatively affected by the write-off of a particular bad debt of $644,015 which was brought to account in that year.

[33] Further, it was said that the profit performance for two months in the 2013 financial year was not necessarily representative of a full year's performance. In oral evidence Mr Chung said that the cash projection for this year was "to make a million dollars"[21] which he thought was a "very safe figure".[22]

Other creditors

[34] Leaving aside Emanouel and other creditors whose debts are disputed (according to Mr Chung on legal advice), trade creditors, apart from Tung Shing, are paid within trading terms. At 31 August 2012, apart from Tung Shing and Tiu, the creditors were said to be:

Trade creditors and suppliers	($99,244)

[21] T 1-51.25
[22] T 1-52.53

Premises lease and motor vehicle lease	($26,165)
Emanouel's claim	($416,788)
Crystal IP Pty Ltd's claim	($47,483)

Other sources of funds

[35] A summary of sources of funds said to be available to Cube Holdings at 31 August 2012 was:

Cash at bank	$591,657
Debtors on average within 60 days	$3,309,628
CBA business line of Credit (Cube Holdings)	$379,000
CBA business line of credit (Newco)	$329,000

[36] The point was made that the Cube Holdings and Newco facilities are not Cube Footwear's facilities but Mr Chung said that they are available to Cube Footwear and there are debts owed to Cube Footwear by each of Cube Holdings and Newco which would ostensibly justify those funds being made available to Cube Footwear by those related companies.

Tung Shing and Tui agreements

[37] Clause 1 of the Tung Shing agreement provides that the parties: "… agree that the Trade Debt Balance or any part thereof is not repayable before 31 August 2012". The "Trade Debt Balance" is defined (as at 27 August 2012) as the balance of the Cube Holdings trading account in the sum of $6,724,625.23 in respect of footwear supplied by Tung Shing to Cube Footwear.

[38] Clause 4 of the Tung Shing agreement provides that: "Tung Shing will only call for payment of any amount owing by cube to Tung Shing to the extent to which Cube [Footwear] has sufficient cash resources to meet such call for payment (Call)."

[39] Clause 7 of the Tung Shing agreement provides that the parties "…agree that Cube [Footwear] will not have sufficient cash resources to meet the Call referred to in clause 4 of this deed if by paying the Call or part thereof Cube [Footwear] is not able to pay all of its debts as and when they become due and payable within the meaning of s 95A of the Corporations Act (Cth)."

[40] There are corresponding provisions in paragraphs (f),[23] (i) and (k) of the Tiu agreement, relating to the sum of $2,162,246.09 described as the "Account Balance".

[41] The effect of the agreements is: first, to defer any obligation to pay until the nominated dates; secondly, to restrict the right to call for any amount after that date to the amount Cube Footwear has sufficient cash resources to meet; and thirdly to limit the amount which can be called in that fashion to an amount that would not make Cube Footwear insolvent.

Other evidence about the arrangements and intentions

[42] There was oral evidence given by Mr Chung, King Lau and Kitty Lau about the arrangements in relation to repayment of the Tung Shing and Tiu debts.

[43] It must be acknowledged that the evidence of each witness was not always internally consistent and the evidence of one was not consistent with any other. Emanouel seeks a finding that the oral evidence of Simon Chung and Kitty Lau was deliberately false in some respects.

[44] Although I had the clear initial impression that some of the evidence was less than satisfactory, I was also conscious that Mr Chung and in particular Kitty Lau gave evidence in English as a second language. Her unresponsiveness in some respects may have been contributed to by her language difficulties. King Lau gave his evidence over the phone and through an interpreter. The capacity for misunderstanding was clear. For those reasons, and as I do not consider that any finding as to particular matters of inconsistency will assist Emanouel's case, I do not propose to make any particular findings as to the subject matters of inconsistency.

[45] For present purposes, it is enough to record three matters. First, as previously stated, the Tung Shing agreement and the Tiu agreement were entered into for the purposes of defending the application made in this case. However, I do not think there is any reason not to regard them as genuine.

[46] Secondly, I accept that both Tung Shing and Tiu have a firm intention to continue to support Cube Footwear. Cube Footwear is one of a number of interrelated companies held among the members of the same extended family. There is no reason to reject even Kitty Lau's continued assertions that the arrangements over the Tung Shing and Tiu debts are, among them, considered to be internal family business and that Cube Footwear is not in need of greater protection from either Tung Shing or Tiu as creditors.

[47] Thirdly, the current attitude of support by both Tung Shing and Tiu is consistent with the past, not just a convenient cloak thrown on to defeat the application to wind up Cube Footwear. The Tui debt has been shown as outstanding in Cube's balance sheet since at least the 2009 financial year.

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[23] The Account Balance or any part thereof is not repayable prior to 10 September 2013

[48] It is not as easy to track the amount of the Tung Shing debt, but trade creditors of Cube Footwear at 30 June 2009 were almost $6.4 million. Given the trading performance over the years from 2009 to the present, as disclosed by the financial accounts and management accounts in evidence, and that Tung Shing over the whole of Cube Footwear's time in business has been Cube Footwear's 100% supplier of stock, it seems more likely than not that a core amount of the Tung Shing debt has been owed for those years.

[49] There is no reason to doubt that, as the 100% supplier of Cube Footwear's stock, "Tung Shing and [Cube Footwear] co-operate to ensure that the payment by [Cube Footwear] to Tung Shing is undertaken in a way and at a time that is mutually beneficial to them, having regard to the prevailing cash flow requirements of each. That is the way the two companies have operated since Tung Shing has been providing goods to [Cube Footwear] … [and] all payments made… are made at times agreed by them".[24]

Commercial insolvency

[50] Many cases have addressed the question of solvency by reference to a cash flow assessment of the relevant company's situation, paying primary regard to its current assets and current liabilities, sometimes described as commercial solvency or insolvency.[25] Whether the company has an overall net surplus or deficiency of assets over liabilities is treated as a matter of secondary importance. Instead, close attention is paid to the ratio of current assets to current liabilities as an important indicator. An assessment of that kind informs the inquirer as to the company's immediate prospects, having regard to the assets which are available and the liabilities which will be payable within a horizon of so many months taken from the assessment date. However, such a period has no statutory significance and it can't be said that the case law treats it as necessarily determinative.

[51] The last point can be illustrated by reference to the decided cases which in many instances show that the court has had a future period shorter than 12 months in view in assessing solvency. Yet, on the other hand, there are cases in which a longer period than 12 months has been taken into account.

[52] Although there is no particular magic in any specific period of time into the future against which solvency is to be assessed, it will often be more difficult to reach a factual conclusion as to whether a company is able to pay its debts as and when they become due and payable if it is necessary to have regard to a future period of years rather than a few months. Common sense dictates that a court should avoid speculation. Some of the older cases reflect a great reluctance to look forward much at all. Other cases show that at times it both can be done and should be done. The leading writer in this field of discourse expressed it thus:

> "Given a reliable balance sheet and the assistance of expert evidence, there seems to be no reason why it should be beyond the court's powers to arrive

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24 Affidavit King Lau filed 7 September 2012, paragraphs 14 and 15

25 For an admirable analysis see *Melbase Corporation Pty Ltd v Segenhoe Ltd* (1995) 17 ACSR 187; 13 ACLC 823

> at a conclusion that the company is insolvent in this sense without becoming involved in speculation about its future business prospects".[26]

[53] The reliability of any prediction of future cash flows is dependent on the reasonableness of the assumptions which must be made as the basis of the forecast. Necessarily, the confidence of a forecaster as to the reasonableness of a future assumption as to financial performance will decrease as the period increases. In general terms, courts have not formulated detailed cash flow forecasts based on assumptions as a method of assessing present solvency.

[54] However, there are cases where courts have looked years into the future in assessing a company's present solvency. Some of the cases concern insurance companies which were held to be insolvent because they had contingent or prospective liabilities from a long tail of present and future claims and did not have the assets to meet those liabilities in future, even though they could presently meet current liabilities.[27] Another case concerned a company that had borrowed from a related company. The borrower had no real prospect of repaying the debt which would become due after two and a half years.[28]

[55] In the present case, I am quite prepared to accept that it is appropriate to have regard to a period of time which includes the time when the non-payment periods under the Tung Shing agreement and the Tui agreement expire. This is until mid-September 2013.

[56] The approach urged by Emanouel has two basal points. First, his counsel contend that there is no prospect that Cube Footwear will be able to pay either the Tung Shing debt or the Tui debt when they become payable, on any view. Secondly, and more specifically, after the agreed non-payment periods have elapsed, Cube Footwear will be unable to pay those debts and can only survive at the whim of Tung Shing and Tui as creditors.

[57] Cube Footwear disputes both contentions. It does not suggest that it can pay both the Tui debt and the Tung Shing debt at the end of the non-payment periods. There was some argument about whether the Tui debt might be able to be paid by then, that is in mid-September 2013. As previously stated, Mr Chung opined in the witness box that Cube Footwear may generate $1 million profit for the year ending 30 June 2012. It is an unnecessary distraction to focus on whether that is a reasonable forecast.[29] Even if it were to prove true, Cube Footwear would be unable to pay Tung Shing's debt when the non-payment period for that debt expires at end-August 2013, if it then became payable. It is appropriate, therefore, to focus on that debt.

[58] The relevant question is whether Tung Shing's debt will be payable in full when the non-payment period for that debt expires. The parties dispute whether or not that will be so under the agreement between Cube Footwear and Tung Shing. The terms

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26 McPherson, *The Law of Company Liquidation*, 2 ed, at 52

27 *Insurance Commissioner v Associated Dominions Assurance Society Pty Ltd* (1953) 89 CLR 78

28 *Re Whitla Holdings Pty Ltd* (1982) 7 ACLR 348

29 There was a formal cash flow forecast that was consistent with such a result in exhibit SC26 to the affidavit of Simon Chung filed on 7 September 2012

set out previously are not consistent with Tung Shing being entitled to payment in full unless Cube Footwear has sufficient cash resources. But as a matter of commercial reality, the answer to that question is beside the point if it is likely that Tung Shing will give further accommodation to Cube Footwear from the end of the non-payment period.

[59] In my view, the question of fact in this case may be formulated more broadly: whether Cube Footwear has the support of its creditors Tung Shing and Tui in such a way that it discharges the onus of demonstrating that it is solvent?

[60] A number of cases show that the support of major creditors can be a decisive fact in considering solvency.[30] The objective evidence shows that Tui has already supported Cube Footwear for several years. As well, they are related corporations. As Kitty Lau said in evidence, numerous times,[31] as far as she was concerned, the Tui debt was "family" business.

[61] The evidentiary picture of the relationship between Tung Shing and Cube Footwear is painted with similar brush strokes. Tung Shing has been the 100% supplier to Cube Footwear for more than five years. Although Tung Shing has received very significant payments from Cube Footwear over that period (over $19 million) the balance of the debt for stock has been maintained or increased over that time. Cube Footwear is also a related corporation of Tung Shing. King Lau said that Tung Shing was prepared to continue that support after the non-payment period and, if necessary, to "forgive" the debt presently owing.

[62] Although there were some serious inconsistencies in the evidence of Mr Chung, King Lau and Kitty Lau as to the conversations they had had with one another, I formed the view that the objective facts support the inference that Tung Shing and Tui have up to now been supportive of Cube Footwear to the extent of deferring the times for payment of their debts as necessary and that the intention of each of King Lau and Kitty Lau is to continue to do so.

[63] It follows that measured as a matter of cash flow or commercial reality Cube Footwear has shown that it is solvent.

Balance sheet insolvency or financial insolvency

[64] Notwithstanding that conclusion, there may be a residual question about the solvency of Cube Footwear. The point arises because of the comparison between the net assets of Cube Footwear, the amounts of the Tung Shing and Tui debts and the degree of likelihood that Cube Footwear will be able to pay those debts in full. Does the balance sheet insolvency or, as it sometimes called, financial insolvency, of Cube Footwear mean that it is insolvent even though the current trading is profitable and the Tung Shing and Tui debts will not be payable until after the non-

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30 See *Southern Cross Interiors Pty Ltd (in liq) v DCT* (2001) 53 NSWLR 213 per Palmer J at [54]; see also *Georgiou Building Pty Ltd v Perrinepod Pty Ltd* (2012) 86 ACSR 713 at [39]; *Australian Securities and Investments Commission v Plymin (No 1)* (2003) 46 ACSR 126 at [378] per Mandie J; *Emmanuel Management Pty Ltd v Foster's Brewing Group Ltd* [2003] QSC 205 per Chesterman J at [75]

31 Regrettably, in a way that was not responsive to a number of questions about other points

payment periods, and only then in accordance with the Tung Shing agreement and the Tiu agreement? Or is balance sheet insolvency or financial insolvency of this kind a basis for winding up on the just and equitable ground?

[65] The starting point must again be the statute. Section 95A is concerned to define insolvency for the purposes of s 459A which confers the jurisdiction upon the court to order that an insolvent company be wound up in insolvency. Section 95A makes no reference to balance sheet insolvency or financial insolvency.

[66] This may be contrasted with other jurisdictions. Section 123(2) of the *Insolvency Act* 1986 (UK) in the United Kingdom provides that it is a ground of winding up that "the value of the company's assets is less than the amount of its liabilities after taking into account the company's contingent and prospective liabilities". Balance sheet insolvency or financial insolvency is a separate statutory ground for winding up to inability to pay debts as they fall due.

[67] In the United States of America, there are numerous different State laws. But an example which may be of interest is that: "Delaware courts define insolvency in two ways… 'First, a company is insolvent if it is unable to pay its current maturing obligations as they fall due in the usual course of business. Second, a company may be insolvent if it has liabilities in excess of a reasonable market value of assets held."[32]

[68] If Cube Footwear is capable of generating substantial profits, of the order of $1 million per annum as forecast for 2013, the present net deficiency in its assets of $148,307 is not a huge amount by comparison. It would be no more than speculation to conclude that Cube Footwear either would or would not be able to pay the Tung Shing debt from end-August 2013 over a period of following years, but the conclusion that it might generate enough profit to reduce the debt enough to eliminate the net deficiency in assets is by no means as unlikely, on the evidence.[33]

[69] In contrast, *Re Whitla Holdings Pty Ltd*[34] may be explained on the footing that although the creditor's debt was not payable, it was inevitable that when the debt became payable the company would be unable to do so. There are two potential distinguishing features between that case and this case. First, there was no question that the creditor liquidator in that case would not have granted more time when the debt became payable. Secondly, the conclusion that the company would not be able to pay the relevant debt at the agreed future date was itself a factual conclusion.

[70] The conspicuous group of cases which raises analogous factual considerations concerns insurance companies which will be unable to meet future claims. In *Insurance Commissioner v Associated Dominions Assurance Society Pty Ltd*,[35] Fullagar J (sitting as a single Judge of the High Court of Australia) regarded it as "clearly established" that the insurance company was insolvent and should be wound up, notwithstanding that the inability to pay maturing policies was not likely

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32 *Pereira v Farace* 413 F.3d 330, 2005, at 343

33 It may be that the applicant's claim of $416,788 should be added to the deficiency but the point remains

34 (1982) 7 ACLR 348

35 (1953) 89 CLR 78

to come about until 1960, seven years from the date of the hearing.[36] In that context, his Honour regarded the period as the "not very distant future".[37] The reason why it was nonetheless just and equitable to wind the company up in those circumstances was that there was no justifiable reason why policy holders whose claims matured sooner should be given priority in the inevitable division of the company's assets. His Honour expressed it in the following terms:[38]

> "There is, in my opinion, a high degree of probability that, if it is not placed in liquidation, policy holders whose claims mature in the near future will be paid in full at the expense of those whose claims mature in the more distant future. Many, of course, will already have been paid in full, and nothing can be done about that. But such a state of affairs ought not, in my opinion, to be allowed to continue. In a winding up all policy holders will stand on an equal footing, whether their claims are due to mature soon or late."

[71] In addition, his Honour expressed the view that it may be just and equitable to wind up a such company in insolvency even if it is foreseeable that the company could by continuing to trade accumulate assets sufficient to pay the impending future debt when it becomes due. The reasoning for this is that it could only do so by exposing future creditors to unjustifiable risk:[39]

> "Theoretically it might be possible for the company to carry on business vigorously and, by writing a large amount of new business at a low expense rate, build up its funds. But, even if this were a practical possibility - and I do not think it is - to embark on such a course would be, in effect, to invite new policy holders to come to the rescue at considerable risk to themselves."

[72] More recent authority suggests that a company whose total liabilities exceed its total assets may nonetheless be solvent if it can pay its debts as they become due and payable, and it is more probable than not that it will be able to generate profit sufficient to pay the long-term debt when it becomes payable. In *Quick v Stoland Pty Ltd*,[40] Emmett J, with whom Finkelstein and Branson JJ agreed, confirmed that:

> "…a deficiency of total assets to total liabilities is not conclusive as to insolvency. A company could have a deficiency of net assets yet, because of a very strong profit making business, be in a position to pay all its debts as and when they become due and payable. That is to say, even if a net asset deficiency exists reasonable projections may indicate that the company would generate sufficient profit to be able to eliminate that deficiency before the long term debt becomes due and payable. The company would be solvent in those circumstances. Equally, a company which has a surplus of total assets over total liabilities could still be insolvent."

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36 (1953) 89 CLR 78 at 110-111
37 At 111
38 At 111
39 At 112
40 29 ACSR 130 at 139

[73] It also seems that there is no general principle that a company should be wound up in advance of a future debt maturing in order to ensure the distribution of assets pari passu amongst creditors. In *Edwards v Attorney-General (NSW)*,[41] Young CJ in Equity said:

> "I am not convinced that one can glean from *Insurance Commissioner v Associated Dominions Assurance Society Pty Ltd* the proposition that pari passu distribution amongst claimants is a fundamental purpose of the Corporations Act. If one is in the subset insolvent companies or winding up then the pari passu principle is one of the basic norms. However, when one is dealing with a wider picture, the purpose of a corporation in life, not as much emphasis is put on what will happen if future claims overwhelm the company, but rather on its purpose in life and its administration."

[74] *Leslie v Howship*[42] was a case which concerned a company whose solvency depended largely on the resolution of a dispute with the council regarding a large holding of land, which was the principle asset of the company. Sackville J found that the company was in a precarious position and the evidence suggested that it may well fail in the future as a result of the circumstances surrounding that asset. However, his Honour nonetheless reached the conclusion that the company was solvent, because of the speculative nature of an assessment on that basis, saying:[43]

> "…the question is not whether the company will survive for the foreseeable future. It is whether the company has discharged the burden of showing that it can pay all of its debts as and when they become due and payable, having regard to the principles to which I have referred. In my view, the company has discharged that burden."

[75] Having regard to the recent cases, in my view, the contention that even though Cube Holdings is solvent upon the basis specified under s 95A, it may be wound up because its balance sheet insolvency or financial insolvency will continue into the future so as to justify the order, either on the ground of insolvency or on the ground that it is just and equitable to wind the company up, must fail.

[76] That conclusion follows, in my view, from four points: first, the ground of insolvency under the CA is that stated under s 95A and does not contain balance sheet or financial insolvency as a necessary element or separate test; secondly, given that there is a specific ground relating to insolvency in s 459A of the CA it is doubtful that there is scope for a parallel operation of the just and equitable ground in respect of possible future insolvency; and, thirdly, once it is accepted that it is not inevitable that the Tung Shing debt and the Tui debt will be due for repayment in full by mid-September 2013 and that Tung Shing and Tui are likely to grant further accommodation to Cube Footwear to maintain the latter's solvency, not only does the factual basis for the conclusion that Cube Footwear will not be able to pay its debts as and when they fall due fall away, but also the factual basis for the

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41 [2004] NSWCA 272 at [89]

42 (1997) 15 ACLC 459

43 At 476

conclusion that its balance sheet or financial insolvency will continue inevitably into the future falls away.

[77] The ultimate findings that I make, therefore, are that Cube Footwear has proved that it is able to pay its debts as and when they fall due within the meaning of s 95A of the CA, that the present balance sheet insolvency or financial insolvency of Cube Footwear is not a separate ground for winding up in insolvency, that Cube Footwear should not be wound up on the ground of insolvency under s 459A of the CA and that Cube Footwear should not be wound up on the ground that it is just and equitable to do so under s 461(1)(k) of the CA.

[78] It follows that the application should be dismissed. There is no reason why the costs of the proceeding should not follow the event. The applicant should pay the respondent's cost of the proceeding to be assessed.