The Insolvency Factor in the Avoidance of Antecedent Transactions in Corporate Liquidations

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A INTRODUCTION

Division 2 of Part 5.7B of the *Corporations Law* 1989 (Cth) (hereafter 'the *Law*') provides a regime for the avoidance of certain transactions entered into by companies prior to their winding up (referred to in this article as 'antecedent transactions').[1] The central provision in Division 2 is s 588FE because it articulates what transactions are voidable. Section 588FE provides that there are two general types of transaction which are voidable: unfair loans[2] and insolvent transactions.[3] The former category is defined in s 588FD. 'Insolvent transactions' is a much broader category and is defined in s 588FC. According to s 588FC a transaction is an insolvent transaction if, and only if,

> it is an unfair preference given by the company, or an uncommercial transaction of the company, and:
> (a) any of the following happens at a time when the company is insolvent;
> (i) the transaction is entered into;
> (ii) an act is done, or an omission is made, for the purpose of giving effect to the transaction; or
> (b) the company becomes insolvent because of, or because of matters including:
> (i) entering into the transaction; or
> (ii) a person doing an act, or making an omission, for the purpose of giving effect to the transaction.

The upshot of s 588FC is that the question of insolvency is integral to whether or not a transaction can be regarded as an insolvent transaction. It will be imperative for a liquidator who wishes to have an antecedent transaction set aside on the basis that it is an insolvent transaction to establish that the company was insolvent at the time of the transaction or became insolvent as a result of the entering into of the transaction.[4]

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[1] The Division became operative on 23 June 1993 and applies to transactions entered into after that date. The regime is discussed in detail in J O'Donovan, 'Voidable Dispositions and Undue Preferences: The Transition to the New Regime' (1994) 12 C & S LJ 7; Z Singer, 'Invalidation of Antecedent Transactions Under the Corporate Law Reform Act' (1994) 2 *Insolv LJ* 36; A Keay, 'The Avoidance of Pre-Liquidation Transactions' (1994) 2 *Current Commercial Law* 98.

[2] See s 588FE(6).

[3] See s 588FE(2)-(5).

[4] This is articulated in s 588FA.

This is not a new state of affairs as far as preferences are concerned. It has been incumbent on a liquidator for many years to establish that a company was insolvent when it gave the alleged preference to a creditor if he or she was to be successful in having the preference set aside by a court.[5] Generally speaking it is true to say that proving insolvency has been the most difficult task for liquidators when seeking to set aside a transaction such as a preference. This has been due to a number of factors, not least of which is the fact that there has been some uncertainty in the courts as to what they can take into account in determining whether a company is solvent.

This article examines the relevant issues which pertain to the concept of insolvency as far as Division 2 of Part 5.7B is concerned. Other sections in the *Law* refer to a company being insolvent[6] but they do not create the same uncertainties as are potentially created by the reference to insolvent companies in Division 2. Initially, the article considers, in general, the tests of insolvency which have been employed to determine whether a company is insolvent. This is followed by an examination of the major issues which will confront a court in determining the meaning of insolvency in the context of a claim by a liquidator that an antecedent transaction should be avoided. The definition of 'solvent' in s 95A of the *Law* is examined and substantial reference is made to the cases which have been decided pursuant to s 122 of the *Bankruptcy Act* 1966 (Cth). Finally, the article discusses presumptions of insolvency which were introduced by the *Corporate Law Reform Act* 1992 (Cth) in order, inter alia, to assist liquidators in establishing insolvency when they seek to challenge antecedent transactions.

B THE DEFINITION OF SOLVENCY IN THE CORPORATIONS LAW

Despite the fact that the concept of insolvency is integral to Division 2 of Part 5.7B the Division fails to define 'insolvency' or 'insolvent'. In fact, oddly enough, there is no direct definition of 'insolvency' or 'insolvent' in the *Law*. To understand the meaning of these words in the context of the *Law* one must examine the definition of 'solvent' in s 95A. The section states in subsection (1):

> 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.

[5] See s 565 of the *Law* and s 122(1) of the *Bankruptcy Act* 1966 (Cth). Also see J O'Donovan, *McPhersons's The Law of Company Liquidation* (3rd ed, 1987) 314–20; D Rose, *Lewis' Australian Bankruptcy Law* (10th ed, 1994) 171–2; A Keay, *Bankruptcy Proceedings Handbook* (2nd ed) 112–14.

[6] Chief among these are ss 459A and 459B. They permit a court to order the winding up of a company if it is insolvent. In practice applicants for winding up orders generally rely on one of the presumptions of insolvency established in s 459C(2) and rarely have to consider whether the company is technically insolvent. Paragraph 459C(2)(a) provides that if a statutory demand is served on a company and the company fails to comply with it, the company is presumed to be insolvent, providing that the failure occured within the three months preceding the filing of the application to wind up.

Sub-section (2) then provides that a person who is not solvent is insolvent. Hence, to determine whether a company was insolvent when a transaction was entered into, the test that is to be applied is: could the company pay all of its debts, as and when they became due and payable? If the answer is in the negative and the transaction was an unfair preference or an uncommercial transaction, it can be classified as an insolvent transaction.

The Explanatory Memorandum to the Corporate Law Reform Bill 1992 stated that s 95A would provide 'a clear statement of when a person is or is not solvent'.[7] With respect, it does nothing of the sort. All that it does do is to indicate that a classic cash flow test of insolvency is to be invoked[8] and adopts similar wording to that contained in s 122 of the *Bankruptcy Act* 1966 (Cth). As a consequence it is likely that the case law which has developed in relation to the meaning of insolvency in s 122 will be employed in gauging the meaning and ambit of s 95A.[9] Sub-section 122(1) states, inter alia, that for a transaction to be a preference the person effecting it must be 'unable to pay his debts as they become due from his own money'.

The concern is that the law developed in relation to s 122(1) is not free from uncertainty and this state of affairs is likely to apply to the interpretation of s 95A. Therefore, it cannot be said that the section provides a clear statement of when a company is insolvent.

C TESTS OF INSOLVENCY

1 Cash Flow Test

There are two primary tests which have been employed in determining whether a person or a company is solvent.[10] The cash flow test[11] provides that a company is insolvent when it is unable to pay its debts as they fall due.[12] It is of no consequence, under this test, that assets exceed liabilities.[13] The important point is: can the company pay its way in carrying on its business? The court, in examining whether a company is suffering cash flow insolvency, will consider whether the company is actually paying its debtors.[14]

This type of test is incorporated in s 95A and has been widely applied by

[7] Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 388.
[8] Harmer, 'Avoidance of Antecedent Transactions in Corporate Insolvency Law', unpublished paper presented at the Corporate Insolvency Law Conference at the University of Melbourne on 31 October 1992, 14.
[9] It appears that H Ford and R Austin, *Ford's Principles of Corporations Law* (7th ed, 1995) 765 accept such a view.
[10] R Goode, *Principles of Corporate Insolvency Law* (1990) 26. Statutory provisions may state that other tests apply. For instance, s 459C of the *Law* enumerates a number of circumstances which if fulfilled will deem a company to be insolvent.
[11] Also known as 'practical insolvency': I Fletcher, *The Law of Insolvency* (1990) 5, or 'commercial insolvency': *London and Counties Assets Company Ltd* v *Brighton Grand Concert Hall and Picture Palace Ltd* [1915] 1 KB 493, 501; *Minion* v *Grayson Pty Ltd* [1990] 1 Qd R 157, 161; H Ford and R Austin, *Ford's Principles of Corporations Law* (6th ed, 1992) 813.
[12] *Hymix Concrete Pty Ltd* v *Garritty* (1977) 13 ALR 321, 327.
[13] Goode, op cit (fn 10) 26.
[14] Id 27.

courts in Australia and England. If a company fails the test it means, in effect, that it has insufficient resources available to pay creditors. The test has been in equity jurisprudence for hundreds of years and is a classical concept of civil law.[15]

2 Balance Sheet Test

The second test is known as the 'balance sheet' test.[16] It also has a long history. In *Re European Life Assurance Society*,[17] James V-C accepted that the test ought to be employed in relation to the *Companies Act* 1862 (UK). In a nutshell a company is insolvent, pursuant to this test, if its total liabilities (including the cost of liquidation) outweigh the value of its assets and therefore the company's assets are insufficient to discharge its liabilities.[18] What liabilities are to be taken into account will depend on the relevant statutory provision which is applying the test. An example of the use of the test is s 101(32) of the *Bankruptcy Reform Act* 1978 (US). The sub-section states that 'insolvent' means in relation to an entity that:

> The sum of such entity's debts is greater than all of such entity's property, at a fair valuation [exclusive of certain exempt property].

It is interesting to note that the same sub-section also states that 'insolvent' in relation to a municipality, means, inter alia, 'unable to pay debts as they become due' which is a cash flow method of determining insolvency and very similar to s 95A.

This state of affairs is not unique. In England, the balance sheet test is invoked for determining insolvency in an action brought for wrongful trading under s 214 of the *Insolvency Act* 1986 (UK)[19] yet the cash flow test is to be found in s 123(1)(e) of the same legislation.

3 An Assessment of the Tests

As Goode says in relation to the two tests:

> There is a close link between cash flow insolvency and balance sheet insolvency in that where a company is a going concern and its business can be sold as such with its assets in use in the business, those assets will usually have a substantially higher value than if disposed of on a break-up basis, divorced from their previous business activity. So a company which is commercially solvent has a much greater chance of satisfying the balance sheet test of solvency, than one which is unable to pay its debts as they fall due.
>
> Under some statutory provisions a company is insolvent if either of these two tests is satisfied, whilst under others only one test is specified.[20]

[15] J Honsberger, 'The Failure to Pay One's Debts Generally As They Become Due' (1980) 54 *American Bankruptcy Law Journal* 153, 154.

[16] Also known as the 'assets test', see B Jones, 'Insolvency and the Balance Sheet' (1993) 9 *Insolvency Law and Practice* 133.

[17] (1869) LR 9 Eq 122, 127.

[18] Goode, op cit (fn 10) 27.

[19] Also see, s 123(2) of the *Insolvency Act* 1986 (UK).

[20] Goode, op cit (fn 10) 27.

There are drawbacks with both tests. The main difficulty with the cash flow test is that it is vague in meaning.[21] The decision about whether a company, on a particular day, was insolvent is often a difficult and imprecise one.[22] This point is made manifest when one examines the definition given in s 95A. Such an examination is undertaken shortly.

The balance sheet test does not suffer from this deficiency. However, in marginal cases, which tends to be the type of situation where a company is being attacked for non-payment of debts or claims, it may be difficult to assess whether the test is satisfied.[23] The reason for this is that assets have to be valued and the valuation of assets,

> is not an exact science but to a considerable extent a matter of judgment as to the amount a willing buyer would pay in the market when dealing with a willing seller.[24]

It is, undoubtedly, difficult where no market value has been established for some assets to be valued. Even where there are market value factors which may affect the value of an asset, they can vary substantially and influence the amount which can be obtained for the asset. Undoubtedly, it is quite easy to envisage a situation where in applying the balance sheet approach there are two reasonable views given concerning the solvency of the company but they are inconsistent.[25] Of course, the actual amounts which are likely to be received on a realisation of assets if a company is in financial straits could well be far less than what might be obtained if the assets were disposed of in good times and with no pressure brought to bear by creditors. Whether assets are valued on a going concern basis or a break-up basis depends on the circumstances.[26]

Just as the valuation of assets can cause difficulties so can the estimation of liabilities. Those causing special concern are usually unquantified existing liabilities, contingent liabilities and liquidation expenses.[27]

It has been said in relation to the use of the balance sheet test in the United States of America that it has been difficult for the trustee in bankruptcy even to trust the debtor's books and records.[28]

While vague in meaning, the cash flow test has its advantages. The primary one is that with this test one looks at what a company is actually doing and, therefore, it may be more accurate in practice; if a company is not paying its debts as they fall due it is assumed to be insolvent.[29]

21 D Milman, 'Test of Commercial Solvency Rejected' (1983) 4 *Co Law* 231, 232.

22 K Chiah, 'Voidable Preference' (1986) 12 NZULR 1, 6.

23 R Goode, op cit (fn 10) 27; 'Wrongful Trading and the Balance Sheet Test of Insolvency' [1989] JBL 436.

24 Goode, op cit (fn 10) 27.

25 Id 39.

26 Goode maintains that it should be the former if the business will be continued as a going concern. Goode, op cit (fn 10) 41. See B Jones, 'Insolvency and The Balance Sheet' (1993) 9 *Insolvency Law & Practice* 133.

27 Goode, op cit (fn 10) 41.

28 R Levin, 'An Introduction to the Trustee's Avoiding Powers' (1970) 53 *American Bankruptcy Law Journal* 173, 185.

29 Goode, op cit (fn 10) 27.

4 Which Test Applies?

It has been held[30] that the cash flow test, rather than the balance sheet test, was to be used in relation to s 122(1) of the *Bankruptcy Act* 1966 (Cth). Moreover this was the case when s 122(1) was applied to the liquidation of companies by the *Companies Act* 1961 (Vic).[31] Many of the cases which have discussed the meaning of insolvency have done so in the context of analysing s 122(1). Consequently, much of the law which has developed in relation to the meaning of insolvency has come to us through these cases, together with cases decided pursuant to applications for sequestration orders under s 52 of the *Bankruptcy Act* 1966 (Cth). When a creditor applies for the sequestration of a debtor's estate the court may, under s 52(2), if satisfied that the debtor is able to pay his or her debts, dismiss the application.

It is apparent from a study of the cases which have considered s 52(2) that there is some uncertainty as to whether a cash flow or balance sheet is to be employed. Older cases such as *Re Poulson; Ex parte Hempenstall Bros Ltd (No 2)*[32] unequivocally indicate that the latter test should be employed while other cases, most of which are modern, clearly apply a cash flow test.[33] These cases have made substantial references to cases dealing with s 122(1).

It is not only bankruptcy cases which have applied the principles developed in cases which have considered s 122(1). Many company cases have adopted the cash flow test as construed by bankruptcy courts.[34] For instance, in *Expo International Pty Ltd* v *Chant*,[35] Needham J determined that the test of solvency in both the *Bankruptcy Act* 1966 (Cth) and the *Companies Act* 1961 (Cth) was the same. After saying that, his Honour applied the cash flow method. The New South Wales Court of Appeal did the same, in *Dunn* v *Shapowloff*,[36] in relation to a claim under a precursor of s 588G of the *Law*. The Court indicated that the balance sheet test was not appropriate. O'Donovan states that the view that cash flow insolvency is the primary test to be applied in the corporate area, is supported by the weight of authority.[37]

However, some courts have been willing to employ a balance sheet test

30 *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather & Trading Co Pty Ltd* [1970] VR 605, 609.
31 Ibid.
32 (1929) 1 ABC 54, 60; cf *Re E C Smith* (1929) 1 ABC 186, 188.
33 For example, *Re Noye; Ex parte Deputy Federal Commissioner of Taxation* (1956) 18 ABC 77; *Beljajev* v *Diners Club Ltd* (unreported, Federal Court, 15 August 1984, Smithers J); *Trojan Corporation of the Town of Hindmarsh* (1987) 16 FCR 37.
34 For example, Dunn J in *Re Australian Co-Operative Development Society Ltd* v *Qld Credit Union League Ltd* [1977] Qd R 66, 79; (1976) 2 ACLR 207, 218 in considering the meaning of 'solvent' in s 266 of the *Companies Act* 1961 (NSW). Also, see *Pizzey Ltd* v *Classic Toys Ltd* (1975) CLC 28,011, 28,015.
35 [1979] 2 NSWLR 820, 837; (1979–80) CLC 40-608, 34,055.
36 [1978] 2 NSWLR 235, 240. The case went on appeal to the High Court ((1981) 148 CLR 72) but there was nothing in the High Court's judgment which indicated disagreement with the Court of Appeal's view on this point.
37 O'Donovan op cit (fn 5) 54–5. Justice McPherson expressed the same view in his judgment in *Minion* v *Grayson Pty Ltd* [1990] 1 Qd R 157, 161.

when dealing with liquidation issues.[38] It is submitted that courts find it easier to apply a balance sheet approach in attempting to determine whether a company is insolvent when hearing winding up applications because it can be employed in a mechanical fashion. Simply, assets can be compared with liabilities and if one finds a negative amount the company is insolvent.

In sum, both tests are used, but the cash flow test is the one which is applied primarily.[39] In some cases the balance sheet test has been employed as a secondary test in the sense that it is a factor, but not a conclusive one, in assessing a company's position.[40]

D THE MEANING OF INSOLVENCY

This section of the article seeks to examine the likely interpretation given to s 95A by the courts. It is probable that the approach to be adopted will be that propounded previously by the courts when they have been dealing with expressions similar to that found in s 95A, for example, s 122(1) of the *Bankruptcy Act* 1966 (Cth) (and its precursors).

Sub-section 95A(1) provides that:

> 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.

History has taught that the meaning of insolvency, that is, 'unable to pay debts as they become due', has been a vexed and difficult one.[41] The task of the courts is, as Ford and Austin state: to determine whether the company is experiencing a temporary lack of liquidity, in which case it is solvent, or an endemic shortage of working capital, in which case it is insolvent.[42] In fulfilling this task the courts must consider the debtor's position in its entirety.[43]

[38] In *Mine Exc Pty Ltd* v *Henderson Drilling Services Pty Ltd* (1990) 8 ACLC 51, 55 Ipp J considered a company which was the subject of winding up proceedings based on its insolvency; *Recta Pty Ltd* v *ASC* (unreported, Supreme Court of Western Australia, 16 March 1993, Murray J).

[39] See L Maxsted, 'When are there Grounds for Suspecting Insolvency—the Accountant's View' (1994) 6 *Australian Insolvency Bulletin* 16, 17.

[40] In *Re Capital Annuities Ltd* [1978] 3 All ER 704, 714 there was evidence that the company's contingent and prospective liabilities if made the subject of demand, would exceed its assets, but because there was evidence that the 'company had cash at the bank amply sufficient to meet its total liabilities, including uncleared cheques, other than future or contingent liabilities' the company was not insolvent.

[41] J Farmer, *Creditor and Debtor Law* (1986) 253. The expression has a long history in the legislation relating to companies. For instance, s 79(4) of the *Companies Act* 1862 (UK) gave the court the power to wind up any company which was unable to pay its debts.

[42] Ford and Austin, op cit (fn 9) 765.

[43] See *Sandell* v *Porter* (1966) 115 CLR 666, 670; *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather and Trading Co Pty Ltd* [1970] VR 605, 608. In relation to the question of whether a company is insolvent for the purposes of a winding up application see *Re Kerisbeck Pty Ltd* (1992) 10 ACLC 619, 621.

1 Debts As and When They Become Due and Payable

The first question which comes to mind when looking at the definition in s 95A is: what is the meaning of 'debts which are due and payable'? There are three matters which are very important in this context.

(a) *Are Contingent and Prospective Debts Relevant?*

It is critical that one ascertains which debts can be taken into account when assessing the solvency of a company. Of particular concern are contingent liabilities.

Bank of Australasia v *Hall*[44] is a High Court decision which is a seminal case in relation to what matters are to be considered in determining whether a debtor was solvent. The case was concerned with whether a debtor was insolvent at the time of giving securities which were alleged to be preferences. The relevant provision, s 108 of the *Insolvency Act* 1874 (Qld), included wording, as far as the issue of insolvency was concerned, which was identical to s 122 of the *Bankruptcy Act* 1966 (Cth). The majority gave a wide interpretation to the word 'debts', and held that the debts which were relevant to deciding whether a debtor was insolvent were those which would have been provable if the debtor had been bankrupted at the time of the impugned transaction.[45] As a result, the majority held that a claim against the debtor could be taken into account in determining the issue of solvency.

The claim resulted from the sale of a ship by the debtor to the claimant. The ship was sold for £2500 and the debtor gave a warranty of seaworthiness. Subsequently, the unseaworthiness of the vessel was discovered and the claimant sued for rescission and repayment of £700 already paid, as well as seeking an unliquidated sum for a breach of warranty and misrepresentation.[46] Shortly after giving the alleged preference, a judgment was delivered against the debtor on the unliquidated claim and, as a consequence, Griffith CJ said that the claim could have supported a proof of debt in bankruptcy because the amount would have been ascertained in due course.[47] Justice O'Connor was of the view that as the claim could be proved in a bankruptcy then it could, consequently, be regarded as a debt for determining solvency.[48] On the other hand, Higgins J, in a strong dissenting judgment, said that the claim was a contingent liability and contingent liabilities were not to be taken into account in assessing insolvency for the purposes of s 108.[49]

The majority did not categorise the claim as a contingent debt, as Higgins J had. But, it is submitted that the claim could be regarded as a contingent debt, given the law that has succeeded the case and the statements of the majority judges in the case itself.

[44] (1907) 4 CLR 1514.
[45] Id 1527, 1537.
[46] Id 1534.
[47] Id 1527.
[48] Id 1537.
[49] Id 1555–6.

In *Re William Hockley Ltd*,[50] it was held that a contingent creditor was someone 'towards whom under an existing obligation, the company may or will become subject to present liability on the happening of some future event or at some future date'.[51] Subsequently, Kitto J of the High Court, in *Community Development Pty Ltd* v *Engwirda Construction Company*[52] adopted what was said in *Re William Hockley Ltd*, and indicated that for there to be a contingent creditor one must have an existing obligation out of which a liability on the company's part to pay a sum of money will arise in the future, whether it be an event which must happen or only may happen. Chief Justice Griffith in *Bank of Australasia* v *Hall* talked in similar terms. His Honour said:

> The words 'as they become due' require, as already pointed out, that some consideration shall be given to the immediate future; and, if it appears that the debtor will not be able to pay a debt which will certainly become due in say, a month . . . by reason of an obligation already existing, and which may before that day exhaust all his available resources, how can it be said that he is able to pay his debts 'as they become due' out of his own moneys.[53]

Chief Justice Griffith was of the view that the debtor was subject to an existing obligation, under the contract for the sale of the vessel, to the person who was claiming damages from him. One assumes this was because the contract was not fully executed and obligations remained for both parties to fulfil at the time of the giving of the preferences.

Justice Nicholson of the Supreme Court of Victoria, in *Re Gasbourne Pty Ltd*,[54] went further, and said that he did not regard the statement in *Re William Hockley Pty Ltd* as exhaustive and held that a person with an arguable claim against the company, whether for liquidated damages or otherwise, was a contingent creditor. However, with respect, this seems to be at odds with what Kitto J said above, and which was adopted by both King J of the Supreme Court of Victoria, in *Re International Harvester Australia Ltd*,[55] and Franklyn J of the Supreme Court of Western Australia in *Lyford* v *Carey*,[56] because Nicholson J did not require there to be an existing obligation. In *Lyford* v *Carey* Franklyn J said that an existing obligation was essential.[57]

It has been held by Needham J, in *Expo International Pty Ltd* v *Chant*,[58] that not only contingent liabilities, but prospective liabilities are to be considered in relation to the solvency of a company when determining whether a charge created shortly before liquidation was invalid under s 294 of the *Companies Act* 1961 (Cth) (a forerunner of s 588FJ of the *Law*).[59] Courts appear to have considered the question of solvency under s 294 and its suc-

[50] [1962] 1 WLR 555.
[51] Id 558.
[52] (1969) 120 CLR 455, 459.
[53] (1907) 4 CLR 1514, 1528.
[54] (1984) 2 ACLC 103, 131.
[55] (1983) 1 ACLC 700, 703.
[56] (1985) 3 ACLC 515.
[57] Id 518.
[58] [1979] 2 NSWLR 820.
[59] Id 839.

cessors in the same light as it is considered under s 122 of the *Bankruptcy Act* 1966 (Cth).[60]

Prospective creditors are those creditors who are owed a debt which will certainly become due in the future.[61] Justice Needham made this decision on the basis that s 222 of the *Companies Act* 1961 (NSW) (a precursor of s 459C of the *Law*), allowed a court to take into account contingent and prospective liabilities in deciding whether a company was insolvent for the purposes of a winding up application. His Honour said that it would be strange if a different test was to apply under s 294.[62] It is interesting that s 459D of the *Law* allows a court to have regard for such liabilities when it is determining solvency on a winding up application.

This causes one to ask, why did the legislature state specifically in s 459D that contingent and prospective liabilities are permitted to be considered? Would it not have been better to state expressly in s 95A that such liabilities may be considered in determining insolvency? If this had been done then there would be no doubt that contingent and prospective liabilities are to be taken into account when considering solvency in the context of antecedent transactions as well as in the context of winding up applications. The omission of any reference to contingent and prospective liabilities in s 95A, coupled with the express reference in s 459D, might suggest that contingent and prospective liabilities are to be taken into account in deciding solvency on a winding up application, but not for other questions. However, the answer is probably that the reference to contingent and prospective liabilities is found in s 459D because the sections of the *Companies Code* (s 364(2)) and the *Companies Act* 1966 (Cth), which dealt with the same subject matter included it, and the legislature did not wish to change the law on the matter. It is submitted that there was no intention on the part of the legislature to suggest that the liabilities were to be omitted in a consideration of insolvency in the context of antecedent transactions.

It is, therefore, concluded that contingent and prospective liabilities are relevant to the question of solvency in actions involving Division 2 of Part 5.7B.

(b) *How Far into the Future Does the Court Look?*

It was stated in *Bank of Australasia* v *Hall*[63] that the words 'as they become due', in relation to debts, meant that courts had to engage in some forward looking. In other words, courts were to consider not only debts presently due but were to take into account those due in the future. This begs the question: how far into the future are courts to look?

In *Bank of Australasia* v *Hall*, Griffith CJ said that consideration should be given to the immediate future.[64] This approach was endorsed by Needham J

[60] *Re Glenland Poultry (Rutherglen) Pty Ltd (Receivers and Managers Appointed)* (unreported, Supreme Court of Victoria, 1 October 1983, King J).
[61] *Stonegate Securities Ltd* v *Gregory* [1980] 1 Ch 576, 579.
[62] [1979] 2 NSWLR 820, 839.
[63] (1907) 4 CLR 1514, 1528.
[64] Ibid.

in *Expo International Pty Ltd* v *Chant*,[65] who said that being solvent does not mean that there is 'an absence of creditors knocking at the door'.[66] The implication of his Honour's words is that a company may be insolvent despite the fact that it is at present safe from pressure, because it has substantial debts coming due in the future. The view expressed in *Bank of Australasia* v *Hall* was adopted by Harper J in *Re Kerisbook Pty Ltd*[67] when assessing what debts could be taken into account when deciding whether a company was insolvent and should be wound up.

A slightly different statement on the issue is given by Ford and Austin. They say that debts currently due and those which will become due in the near future are to be considered in determining insolvency.[68]

It seems reasonable for courts to look ahead and see what obligations a company has, as they are required to look ahead when considering what the company has in the way of assets.[69] It would be illogical for there to be forward looking for assets but not for liabilities. This was certainly the view of Needham J in *Expo International Pty Ltd* v *Chant*.[70] His Honour referred extensively to *Sandell* v *Porter*[71] and acknowledged that Barwick CJ, in that case, accepted that in determining insolvency one can take into account, in favour of the debtor, not just the cash resources of the debtor, but also assets which are readily realisable.[72] Justice Needham then said that:

> Of course, it follows that in doing so, one is looking to the future and, in my opinion, if one does so in order to see whether a temporary lack of liquidity can be overcome, one cannot overlook debts which will become payable during the period in which the lack of liquidity is being cured.[73]

In *Kyra Nominees Pty Ltd* v *National Australia Bank Ltd*,[74] Burt CJ indicated the same thought when he said that when considering the capacity of a company to pay its debts in the future, regard must be had to the fact that further debts will be incurred in the meantime.[75]

The problem, however, with the above statements by the courts on the issue of forward looking is that they provide little guidance to parties and courts alike. What is meant by 'the immediate or near future'? Only two judges, both in *Bank of Australasia* v *Hall*,[76] have made any attempt, albeit in vague terms, to quantify the period of consideration. Justice O'Connor mentioned a few weeks,[77] while Griffith CJ referred to a month.[78]

[65] [1979] 2 NSWLR 820.
[66] Id 837.
[67] (1992) 10 ACLC 619.
[68] Ford and Austin, op cit (fn 9) 765.
[69] *Bank of Australasia* v *Hall* (1907) 4 CLR 1514; *Sandell* v *Porter* (1966) 115 CLR 666.
[70] [1979] 2 NSWLR 820.
[71] (1966) 115 CLR 666.
[72] [1979] 2 NSWLR 820, 839.
[73] Ibid.
[74] (1986) 4 ACLC 400.
[75] Id 402.
[76] (1907) 4 CLR 1514.
[77] Id 1538.
[78] Id 1528.

The fact of the matter is that courts are very wary about specifying any time period because it is impossible to prescribe any precise point in time. Each company's circumstances are going to be different. It is an area where one cannot be technical. Rather, a court must assess each company's overall trading and financial position and ascertain whether the company is able to meet its debts. It must ask, for instance: what sort of transactions has the company entered into? What is the nature of the company's obligations? How far ahead the court looks will depend on the company. In the words of Ford and Austin: 'the extent of projection is a matter of commonsense'.[79]

(c) *Is an Extension of Credit Relevant?*

There appears to have been some divergence of judicial opinion in the past (when considering similar wording in s 122(1) of the *Bankruptcy Act* 1966 (Cth)) as to whether or not debts due included liabilities which would be provable in a liquidation, if the debtor was subject to liquidation at the point of time in question, but were not payable because creditors had granted the debtor extended terms of repayment. For example, if X supplied goods regularly to Y Ltd and the invoice always stated that payment was to be made within 30 days but X allowed Y Ltd 90 days in which to pay, could a court take into account the fact that at the end of the 30 day period X would not enforce his rights?

(i) *Extension of Credit Is Not Pertinent*

In *Re Toowong Trading Pty Ltd*,[80] a case involving a claim for the avoidance of alleged preferences, Ryan J of the Supreme Court of Queensland refused to accept a submission based on the fact that at the date of the granting of alleged preferences the company was solvent, as the debts owed to one of its major creditors were not to be considered because the creditor had extended the time in which the debts had to be paid. His Honour said that the terms of s 122(1) of the *Bankruptcy Act* 1966 (Cth) made the relevant inquiry of the Court one as to when debts became due and not when they became payable under some credit arrangement.[81]

Likewise, in *Re Norfolk Plumbing Supplies Pty Ltd* v *Commonwealth Bank of Australia*,[82] Kearney J of the New South Wales Supreme Court refused to have regard for an arrangement made by the debtor company with creditors whereby the company would attempt to reduce outstanding debts from time to time as funds became available.[83]

His Honour said, in relation to the debts of creditors who were a party to the arrangement, that 'the debts of those creditors were due and payable and their

[79] Ford and Austin, op cit (fn 9) 765.
[80] [1988] 1 Qd R 207.
[81] Id 211. The approach appears to meet with the concurrence of Anderson J in *Sheahan* v *Hertz Australia Pty Ltd* (1994) 14 ACSR 209, 222.
[82] (1992) 6 ACSR 601.
[83] Id 615.

undefined voluntary and temporary forbearance to enforce payment is irrelevant to the question'.[84]

It may be argued that the position taken in these cases is consistent with the approach adopted by the majority in *Bank of Australasia* v *Hall*[85] when the judges said, in relation to an equivalent provision to s 122 of the *Bankruptcy Act* 1966 (Cth),[86] that the debts to be taken into account included any liabilities that would have been provable in insolvency if the debtor had been adjudicated insolvent at the time in question. Certainly, the debts owed in *Re Toowong Trading Pty Ltd*, which were the subject of an extension for payment, would be provable in the company's liquidation.

(ii) *Extension of Credit Is Pertinent*

A contrary position was manifested in *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather & Trading Co Pty Ltd*[87] by Menhennitt J. It was proper, according to his Honour, to take into account any extensions of time granted to the debtor to pay its creditors, and in turn to take into account the dates when it might be reasonably expected that the creditor would receive debts due and owing to it.[88]

This view was adopted in *Re Newark Pty Ltd (in liq)* (also referred to as *Taylor* v *Carroll*)[89] by the Full Court of the Supreme Court of Queensland. Justice Thomas, who delivered the leading judgment, said that to adopt the view expounded by Menhennitt J was to recognise that it was appropriate to take into account the reality of the actual trading position.[90] His Honour went on to say that:

> A debt does not necessarily become 'due' within the meaning of the section upon the date originally stipulated for its payment. It would be erroneous to adopt inability to pay a debt before it became payable as a criterion of the inability to which s 122 of the *Bankruptcy Act* refers. If there is a course of dealing whereunder a debt is not payable and the parties do not expect it to be payable until a future time, it should not be reckoned as 'due' at an earlier time.[91]

Justice Thomas relied on a similar interpretation which was given in both *3M Australia Pty Ltd* v *Kemish*[92] and *Heide (t/as Farmhouse Smallgoods)* v *Lester*.[93] In *3M Australia Pty Ltd* v *Kemish*, Foster J held that a debt did not

[84] Ibid. This view, in effect, has been accepted recently by Lindgren J in *Hall* v *Press Plumbing* (unreported, Federal Court, 24 September 1994).
[85] (1907) 4 CLR 1514.
[86] *Insolvency Act* 1874 (Qld), s 108.
[87] [1970] VR 605.
[88] Id 609.
[89] [1993] 1 Qd R 409; (1991) 6 ACSR 255.
[90] Id 413; 259.
[91] Id 414; 260. This was the view accepted at first instance by Shepherdson J: *Re Newark Pty Ltd* (unreported, No 76 of 1985, Supreme Court of Queensland, 6 April 1990). His Honour took into account the debtor company's course of dealing with creditors and came to the conclusion that the creditors' debts were entitled to be treated as not becoming due at the time of the alleged preference.
[92] (1986) 10 ACLR 371, 378.
[93] (1990) 3 ACSR 159, 165.

necessarily become due upon the date initially specified; it was proper to take into account any arrangements which had been made for extensions of time to pay even where the creditor was not bound to honour the extensions as a matter of contract.[94]

It is important to note that another member of the Full Court in *Re Newark Pty Ltd*,[95] Derrington J, was not so unequivocal as Thomas J. His Honour accepted that it was right in some cases to have regard for creditors' non-enforcement of strict compliance with the terms of credit arrangements.[96] However, his Honour was of the view that:

> In other cases the circumstances might be such that it is not suitable on that occasion to have regard to such indulgence because in practical terms it may, through the insubstantial nature of its existence in that case or some other relevant reason, have no real validity to the issue of insolvency read in the light of the purpose behind it. For example, mere hesitation for commercial purposes alone rather than a willingness to enter into a 'legal agreement' to extend credit if necessary, may well, in circumstances with no other features, prove insufficient.[97]

Justice Derrington went on to say, in effect, that whether one has regard for an extension of credit depends on the position of the company. He observed that it was not possible to state any technical rules.[98]

Earlier McGarvie J of the Supreme Court of Victoria in *Taylor* v *ANZ Banking Group Ltd*[99] had taken the view that, in accordance with the approach in *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather & Trading Co Pty Ltd*, it was appropriate to take into account the terms of credit available to the debtor company 'in the sense of the time available to the debtor to pay debts owed to creditors'.[100] His Honour added that the issue of solvency was not to be resolved by merely examining the accounts or mechanically comparing assets and liabilities.[101]

Chiah has argued[102] that the type of approach taken in *Re Toowong Trading Pty Ltd*, which he believed originated in *Bank of Australasia* v *Hall*, is unnecessarily wide and commercially unrealistic. This argument appears to accord with what Bowen CJ said in *Re Timbatec Pty Ltd*.[103] His Honour, in discussing the operations of the company which had allegedly given a preference, said that:

> It is difficult to be precise as to the amount actually then payable, because of the varying terms of credit on which the company operated with different suppliers. With some it was allowed thirty days; others sixty days; others

[94] (1986) 10 ACLR 371, 378.
[95] [1993] 1 Qd R 409.
[96] Id 421.
[97] Ibid.
[98] Ibid.
[99] (1988) 6 ACLC 808.
[100] Id 812.
[101] Ibid.
[102] Chiah, op cit (fn 22).
[103] (1974) 24 FLR 30.

ninety days, and with others again it made special arrangements to pay.[104]

(iii) *Extensions of Credit are only Pertinent Where There Is Express or Implied Agreement*

In *Carrier Air Conditioning Pty Ltd* v *Kurda,*[105] Debelle J of the Supreme Court of South Australia, when dealing with a claim pursuant to s 556 of the *Companies (SA) Code* (now s 588G of the *Law*) favoured a different approach. His Honour could not agree with the view espoused in *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather and Trading Co Pty Ltd.*[106] His Honour said that there was nothing in the decision in *Sandell* v *Porter*[107] to justify the inclusion of the time extended to a company to pay its creditors as a factor to which regard should be had when deciding the question of solvency.[108] His Honour said that Barwick CJ in *Sandell* v *Porter* was concerned with the extent to which a debtor could gather his or her assets to pay debts and he was not indicating that it was proper to have regard to the failure of creditors to enforce obligations strictly.[109] However, Debelle J stated that he would be willing to take into account extensions of credit where the original agreement between the debtor and the creditor had been varied by agreement or by course of conduct which might be the basis for an estoppel.[110]

(iv) *An Assessment*

There appears to be little or no basis for reconciling the two main approaches which have been adopted. No decision has sought to explain either the divergence or why the opposite approach was incorrect. At first instance, in *Re Newark Pty Ltd (in liq) (Taylor* v *Carroll),*[111] Shepherdson J, when referring to the view of Ryan J in *Re Toowong Trading Pty Ltd,* merely said that the remarks by Ryan J were obiter dicta and therefore he felt that he need not follow them. On the other side of the debate, Ryan J in *Re Toowong Trading Pty Ltd,* in dismissing the view espoused by Menhennitt J in *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather & Trading Pty Ltd,* considered that Menhennitt J went beyond anything said in the influential High Court decisions in *Sandell* v *Porter*[112] and *Bank of Australasia* v *Hall,*[113] and his statements were not warranted by the terms of s 122 of the *Bankruptcy Act* 1966 (Cth).[114]

Neither approach appears to be supported by a greater amount of authority; although, leaving aside *Bank of Australasia* v *Hall,* which was decided before

104 Id 35.
105 (1993) 11 ACSR 247.
106 [1970] VR 605.
107 (1966) 115 CLR 666.
108 (1993) 11 ACSR 247.
109 Ibid.
110 (1993) 11 ACSR 247.
111 Unreported, No 76 of 1985, Supreme Court of Queensland, 6 April 1990.
112 (1966) 115 CLR 666.
113 (1907) 4 CLR 1514.
114 [1988], 1 Qd R 207, 211.

the emergence of the debate and involved a different issue, that is, how far in the future can a court look in considering a debtor's liabilities, the approach espoused by Menhennitt J in *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather & Trading Pty Ltd* has been accepted by the only appellate decision (*Re Newark Pty Ltd (in liq) (Taylor* v *Carroll))* which has considered the issue.

One of the central principles involved in a determination of solvency was enunciated by Barwick CJ in *Sandell* v *Porter*,[115] when his Honour said that one had to consider the debtor's position in its entirety in deciding whether a debtor was solvent or not.[116] Does this mean that the company's extended terms of credit should be taken into account in the determination of its insolvency? The proponent of the view espoused in cases such as *Re Toowong Trading Pty Ltd*[117] might well say 'no' because in assessing the debtor's entire situation one ought to consider its future obligations.

However, the supporter of the line of the cases following *Calzaturificio Zenith Pty Ltd (in liq)* v *NSW Leather & Trading Pty Ltd*[118] might argue that it is erroneous not to include a consideration of extended terms of credit because, by the time debts related to these terms become due, the company's financial situation might be totally different. The company may be obtaining increased profits or have been able to recover debts owed to it by recalcitrant trading partners.

Undoubtedly, the latter view is attractive because it accords with commercial realism.[119] It is relevant to note that the courts have clearly decided that in determining solvency, the money of the company which is taken to be available to pay debts which are due not only includes cash resources, but can include money which is able to be procured by realising (by sale or by mortgage) its assets within a relatively short time. This is indicative of commercial realism, that is, companies often do not have sufficient cash resources available to pay all of their due debts.[120] It may be argued that if the courts are willing to consider commercial realism in respect of the money available to companies, why cannot the courts take into account the extended terms of credit which have been given to companies, on the basis that just as a matter of practice companies do not keep by them sufficient cash resources to meet all of their debts, as a matter of practice they are often able to secure extended terms from some of their trading partners.

It may be argued that the fact that a company is able to secure extended terms of credit is indicative of its relatively strong, or at least reasonable, financial standing. On the other hand, it may be said that extensions of credit are often granted informally and haphazardly. This has the potential to create

[115] Unreported, No 76 of 1985, Supreme Court of Queensland, 6 April 1990.
[116] Id 670.
[117] [1979] 2 NSWLR 820; (1979) CLC 40-608.
[118] [1970] VR 605.
[119] Chiah, op cit (fn 22).
[120] This is, in effect, acknowledged by both Isaacs J in *Bank of Australasia* v *Hall* (1907) 4 CLR 1514, 1543, and Barwick CJ in *Rees* v *Bank of New South Wales* (1964) 111 CLR 210, 218.

uncertainty in that often a company cannot say that it will not be required to pay within the period specified in an invoice or contract.

There are minor distinctions in the wording of s 95A compared with s 122(1). Is it likely that the distinctions can be relied on to argue that the law developed under s 122(1) should not apply? For instance, while s 122(1) states that one must consider debts which are due, s 95A states that one must consider debts which are due and payable. The presence of the word 'payable' in s 95A could be seen as acceptance by the legislature of the view that courts will not take into account debts where terms have been extended because technically there is no debt 'payable'. However, most of the decisions which have examined s 122(1) have implied the word 'payable' into the sub-section.[121] Also, in reality where payment of debts has been extended other than pursuant to some agreement or estoppel it is questionable whether the debts are not payable.

It is submitted that the position adopted by Debelle J in *Carrier Air Conditioning Pty Ltd* v *Kurda*[122] has much to commend it. It accepts, by implication, commercial realism and avoids the uncertainty which exists where extensions of credit are given by default rather than the overt actions of creditors. Furthermore, if the time for payment of a debt is extended then the debt is not payable and cannot be taken into account in assessing solvency.

Any given case may well have to be decided solely on its facts rather than under a rigid legal rule. This is the view taken by Gummow J in *Sycotex Pty Ltd* v *Baseler.*[123] For instance, his Honour believed that where a debtor is operating in a field where a code of practice has arisen which permits payment within 60 days, rather than the stated terms of 30 days, the extension may be pertinent.[124] However, if a debtor has a single creditor who granted indulgence once, an extension could not be expected and could not be taken into account in determining the ability of the debtor to pay its debts.[125] Justice Derrington in *Re Newark Pty Ltd*[126] articulated similar thoughts. His Honour said, after expressing his belief that extensions of credit to a company ought to be taken into account in determining insolvency, that:

> In the present case the indulgence granted to the company by its trade creditors was well established over a long period and this was very relevant to the most significant issues. It is not to the point that those trade creditors change their attitude and their requirements as to the debts dramatically

[121] For example, see *Re Timbatec Pty Ltd* (1974) 24 FLR 30, 35; *Re Newark Pty Ltd (in liq) (Taylor* v *Carroll)* [1993] 1 Qd R 409, 414; (1991) 6 ACSR 255, 260; *Norfolk Plumbing Supplies Pty Ltd* v *Commonwealth Bank of Australia Ltd* (1992) 6 ACSR 601, 615. This was also the situation in England as far back as the nineteenth century. See *In re Washington Diamond Mining Company* [1893] 3 Ch 95. In *Carrier Air Conditioning Pty Ltd v Kurda* (1992) 11 ACSR 247, 254 the Full Court of the Supreme Court of South Australia took the same view in relation to the precursor of s 588G.

[122] (1993) 11 ACSR 247.

[123] (1993) 13 ACSR 766, 775.

[124] Ibid.

[125] Ibid.

[126] [1993] 1 Qd R 409, 420–1.

and swiftly in the drastic circumstances which occurred after the relevant date.[127]

2 Ability to Pay

(a) *The Issues*

In considering the solvency of a company under s 95A, it is necessary to determine what can be taken into account when deciding whether the company is able to pay the debts due and payable. It needs to be noted at the outset that a debtor is not regarded as solvent simply because given sufficient time it could realise its assets and pay all creditors in full.[128]

What is at issue is, first, whether a company is limited to cash on hand or whether it is entitled to rely on sales of its assets to establish its solvency. If it is able to rely on sales, is there any time limit placed on the sale? The second issue is whether a company is permitted to rely on loan funds in order to establish its solvency. If it is, is it only able to rely on funds obtained through secured loans or can it rely on funds obtained on unsecured loans? Unlike s 122 of the *Bankruptcy Act* 1966 (Cth) there is no reference in s 95A to an ability to pay 'from his own money'. Therefore, there appears to be no room for arguing that reliance cannot be placed on funds available from other sources. In any event the distinction between s 122(1) and s 95A is of no great import given the fact that courts have construed the words 'from his own money' liberally. In determining the solvency of companies in preference actions under s 122 courts have not restricted companies strictly to their own money.[129]

(b) *Taking Into Account The Sale of Assets*

It has been unequivocally established in Australia for many years that a company is not limited to its own cash at hand in determining whether it has the ability to pay its debts. This has been clearly indicated by courts as they have dealt with the meaning of 'able to pay his debts as they became due from his own money' in s 122 and its predecessors. The test of solvency has not been one of liquidity; cash at hand is relevant but not conclusive of the question.

As early as 1904, Griffith CJ stated in *Bank of Australasia* v *Hall*[130] that a debtor's ability to pay was not limited to cash but included 'any moneys of which the debtor can obtain immediate command by sale or pledge of his assets'.[131] In the same decision Isaacs J went further when he said:

> The Act [the *Insolvency Act*] requires the debtor to be able to pay his debts as they become due. This does not mean that he is always bound to keep by

[127] Id 421.
[128] *Re Attiwill; Official Receiver* v *Braithwaite Bros* (1932) 5 ABC 54; *Re Whitgift Nominees Pty Ltd* (1983) 7 ACLR 680; 1 ACLC 1133.
[129] For example, see *Sandell* v *Porter* (1966) 115 CLR 666.
[130] (1907) 4 CLR 1514.
[131] Id 1528.

> him in cash a sum sufficient to meet all his outstanding indebtedness however distant the date of payment may be. If at the time he ... [creates the preference, priority or advantage], the debtor's position is such that he has property either in the form of assets in possession or of debts, which if realised would produce sufficient money to pay all his indebtedness, and if that property is in such a position as to title and otherwise that it could be realized in time to meet the indebtedness as the claims mature, with money thus belonging to the debtor, he cannot be said to be unable to pay his debts as they become due from his own moneys. In other words, if the debtor can, by sale or mortgage of property which he owns at the time of the assignment, change the form of the property into cash wholly or partly but sufficient for the purpose of paying his debts as they become due, that requirement of the section is satisfied.[132]

To require a company to retain sufficient cash on hand at all times in order to cover debts could be 'commercially inhibitive, if not crippling'.[133]

Chief Justice Barwick, in *Sandell* v *Porter*,[134] indicated that the debtor was not limited to his or her own immediate cash resources but he or she could, as the Court in *Bank of Australasia* v *Hall*[135] had said, have recourse to funds available through the sale or mortgaging of assets. His Honour said that a time limit is placed on taking this action and the moneys to be procured from a sale or mortgage must be available within a relatively short time. Chief Justice Barwick (with whom the other members of the High Court[136] concurred) did not specify what a relatively short time is; this is a matter for the court in each case.[137] However, his Honour did mention some criteria by which the time period should be calculated: the nature and amount of debts and the prevailing circumstances, and the nature of the debtor's business. While the decision is the court's, expert evidence could be heard as to the likelihood of any of the assets yielding ready cash in sufficient time to satisfy the debts as they fall due.

In *Sandell* v *Porter* the question was whether the appellant had received an undue preference from her husband's building firm. She had advanced money from time to time to the firm because it needed funds to pay sub-contractors on time and while progress payments were due they were delayed, necessarily, while inspections of the firm's building work were attended to. The firm had, in the particular situation in question, given promissory notes to the appellant in satisfaction of the firm's debt to her. When bankruptcy of the firm occurred the appellant had received payment of some of the promissory notes. The trustee of the bankrupt estates of the members of the firm sought to recover payments made to the appellant and an order that the promissory notes were void as against him. The trustee relied on s 95 of the *Bankruptcy Act* 1924 (Cth), the precursor of the present s 122.

The central issue for decision was whether the firm was insolvent when it

[132] Id 1543.
[133] Chiah, op cit (fn 22).
[134] (1966) 115 CLR 666.
[135] (1907) 4 CLR 1514.
[136] Justices McTiernan and Windeyer.
[137] (1966) 115 CLR 666.

paid the appellant. Importantly for our purposes, it was held by the Court that at the time when a payment was made to the appellant by the firm, the firm was not insolvent because while the firm could not, at that moment, pay its sub-contractors, the firm received a progress payment (an asset) within a short time of the due date for payment of the sub-contractors. Chief Justice Barwick adopted a more liberal approach than that expounded in *Bank of Australasia* v *Hall*. He emphasised the nature of the firm's business which involved a continual time lag between the due date for payment of sub-contractors and the receipt of the progress payment which had been earned and was destined, in part, to pay the sub-contractors.

It is difficult to say what is a relatively short time.[138] The only time period specifically referred to in any case was two to three weeks by Richardson J in *Re Northbridge Properties Ltd.*[139] His Honour said that 'there must be a substantial element of immediacy in the ability to provide cash from non-cash assets'.[140]

With respect, the expression 'short time' is not intended to be definite; and it appears impossible to specify any period within which assets must be sold or mortgaged if the comments of Barwick CJ are to be followed. This is because each business is different in nature and constituted by different assets. It is submitted that this is the reason why no other judgment has seen fit to refer to any particular time. It is contended that the view of the Full Court of the Supreme Court of Queensland in *Re Pacific Projects Pty Ltd (in liq)*[141] is the correct one. In that case the Court had regard to what money could be raised in a reasonable time.[142]

Not all assets of a debtor can be taken into account in considering the issue of insolvency. Again, what assets are excluded will depend upon the nature of the debtor's business and the nature of the assets. In *Rees* v *Bank of New South Wales*,[143] Barwick CJ said that stock-in-trade was not an available asset to be realised to meet current debts except in the ordinary course of business.[144] Further, in *Re Timbatec Pty Ltd*[145] Bowen CJ adverted to the problem confronting debtors in realising some types of assets:

> One of the difficulties of realizing assets is that it may involve the company in terminating that particular part of its business and may even, in some circumstances, involve it in breach of contract. The same applied to the sale

138 *Re D'Onofrio* (1983) 76 FLR 136; 65 ALR 545 is an example of a case where an asset could not be realised in a relatively short time. Fisher J held that real property which was not owned solely by the debtor could not be regarded as an asset which would be realised in a relatively short time because the other owner was opposed to a sale and so a court order directing a sale would need to be obtained.

139 Unreported, High Court of New Zealand, 1977, M.46–49/75 and noted in [1983] NZLJ 44.

140 Id, quoted by Chiah, op cit (fn 22). The point is made by Lindgren J in the recent case of *Gregory Winfield Hall* v *Press Plumbing* (unreported, Federal Court, 20 September 1994) where his Honour said that an unconditional forecast that given time the debtor would pay out all of its creditors in full was not sufficient to establish solvency.

141 [1990] 2 Qd R 541.

142 Id 547, 549.

143 *Rees* v *Bank of New South Wales* (1964) 111 CLR 210, 218.

144 Ibid.

145 (1974) 24 FLR 30.

> of stock, which is on hand to be devoted to the performance of works in progress, and in some circumstances may involve liability for damages for breach of contract. The same applies to office furniture and equipment. This may be sold to realize cash. But it is difficult to visualize a continuing business without tables and chairs on which to conduct its administrative side. In other words, the test as regards ready realization of cash resources has regard, as I understand it, to the debtor who is conducting a business, and is applying his cash resources, and selling or mortgaging assets readily available to inflate these resources, while continuing his business. I do not take it to apply to a situation where the business is brought to a full stop, and either sale or mortgage can produce cash resources if it breaks up its business.[146]

In the situations identified by Bowen CJ the viability of the debtor's business obviously would be highly questionable. If a company has to resort to selling assets which are essential to the continuation of its business, those assets are not to be included in a determination of solvency. In *Link Transport Ltd* v *W J Luff Ltd*,[147] Greig J of the High Court of New Zealand said that a company could not be said to be able to pay its debts if all of its assets had to be realised and as a result it had to go out of business.

This approach was supported by the High Court in *Hymix Concrete Pty Ltd* v *Garrity* where Jacobs J said:

> A temporary lack of liquidity must be distinguished from an endemic shortage of working capital whereby liquidity can only be restored by a successful outcome of business ventures in which the existing working capital has been deployed.[148]

In line with the fact that regard must be had not only for the nature of assets but also for the nature of the debtor's business, the sale of critical assets may be able to be taken into account on occasions. For instance, in *Re Adnot Pty Ltd*[149] the only asset of the company was a shopping centre complex. The aim of the company's business was to purchase land, build the complex and sell the completed premises. At the relevant time there were negotiations proceeding for the sale of the complex. As a consequence, Kearney J permitted the funds which were to be generated by the proposed sale of the complex to be taken into account in determining solvency.[150]

(c) *The Relevance of Loan Funds*

In *Bank of Australasia* v *Hall* and *Sandell* v *Porter* the Courts held that funds obtainable from a pledge or mortgage of company assets could be considered in determining whether a company is solvent.

Is the borrowing ability of a debtor company limited to funds obtained by way of secured loan? Justice Clyne in *Re Armour; Ex parte Official Receiver* v

[146] Id 36–7. Office furniture and equipment was excluded in *Bank of Australasia* v *Hall* (1907) 4 CLR 1514.
[147] Unreported, High Court of New Zealand, 18 May 1981.
[148] (1977) 13 ALR 321, 328.
[149] (1982) 1 ACLC 307.
[150] Id 311.

Commonwealth Trading Bank of Australia[151] stated that a debtor could not include borrowed funds.[152] Given the fact that much earlier the High Court in *Bank of Australasia* v *Hall* said that it would, in certain circumstances, permit money to be obtained by pledging or mortgaging assets to be considered, it is possible to conclude that Clyne J was referring to money obtained on unsecured loans. This is, it is contended, supported by the fact that in his Honour's summary of the evidence he stated that Armour, the bankrupt, had admitted that there was nothing he could pledge or sell to obtain money.[153] Certainly Kearney J, in *Norfolk Plumbing Supplies* v *Commonwealth Bank of Australia*,[154] was of the opinion that Clyne J was referring to unsecured borrowing[155] and his Honour indicated that he concurred with the position he believed was adopted by Clyne J.[156] Specifically, his Honour rejected the argument that moneys available by way of overdraft facilities could be taken into account.[157]

There is a substantial amount of authority to support the view that an ability to obtain funds on unsecured loans is not to be taken into account when determining solvency. Chief Justice Burt, in a decision of the Full Court of the Supreme Court of Western Australia in *Kyra Nominees Pty Ltd (in liq)* v *National Australia Bank Ltd*,[158] clearly stated that the company, in that case, was not solvent merely because it was able to borrow money on an unsecured basis.[159] In *Taylor* v *ANZ Banking Group Ltd*,[160] McGarvie J adopted the same view after citing *Kyra Nominees* and *Re Armour*.[161]

All of the above cases dealt with preferences under s 122 of the *Bankruptcy Act* 1966 (Cth). The reason given by the courts for refusing to take into account unsecured borrowings was that such funds are not to be treated as the debtor's own money for the purposes of s 122.[162]

A practical reason for not permitting unsecured loan funds to be considered was articulated by Fisher J of the Federal Court in *Re Trojan; Ex parte Corporation of the Town of Hindmarsh*,[163] which was not a preference case but one which was decided pursuant to s 52 of the *Bankruptcy Act* 1966 (Cth). His Honour said that in borrowing on an unsecured basis in order to pay creditors, the debtor would be substituting one creditor for another.[164] Of course, when

151 (1950) 18 ABC 69.
152 Id 74.
153 Id 72.
154 (1992) 6 ACSR 601.
155 Id 615.
156 Ibid.
157 Ibid.
158 (1986) 4 ACLC 400.
159 Id 405.
160 (1988) 6 ACLC 808; 13 ACLR 780.
161 Id 812; 784. This view was accepted in *Geraldton Building Co Pty Ltd* v *Woodmore* (1992) 8 ACSR 585, 598 in relation to the precursor of s 588G.
162 For instance, see *Re Armour* (1956) 18 ABC 69, 74; *Kyra Nominees Pty Ltd (in liq)* v *National Australia Bank Ltd* (1986) 4 ACLC 400, 405; *Taylor* v *ANZ Banking Group Ltd* (1988) 6 ACLC 808, 812.
163 Unreported, Federal Court, 3 November 1986. On appeal the Full Court did not consider the issue.
164 Ibid.

funds are borrowed against assets, while an extra creditor is acquired the debtor has sufficient equity, except in extreme circumstances such as an horrendous fall in the value of the security, which can be offset against the loan.[165]

However, the view that funds obtained on unsecured loans cannot be relied on in establishing solvency has not always been accepted as true for all occasions. In *Re RHD Power Services Pty Ltd*,[166] McPherson SPJ (as he then was) took issue with the opinion of McGarvie J espoused in *Taylor* v *ANZ Banking Group*. After referring to the statement of McGarvie J, McPherson SPJ said:

> That may not always or necessarily be so because a person's ability to borrow without security may in some circumstances provide compelling evidence of his strong financial standing.[167]

McPherson SPJ applied the statement of McGarvie J because the company in the case before him had been able to trade only by receiving continuing financial assistance from its parent company.[168]

Apart from *Re RHD Power Services Pty Ltd*, all of the cases which have indicated that funds from unsecured loans can be taken into account in determining insolvency have been concerned with issues other than whether a company was solvent when giving an alleged preference. In *3M Australia Pty Ltd* v *Kemish*,[169] Foster J of the New South Wales Supreme Court, in deciding whether a company was solvent for the purposes of s 556 of the *Companies (NSW) Code* (the precursor of the present insolvent trading provision, s 588G), accepted the view of Mahoney JA of the Court of Appeal in *Dunn* v *Shapowloff*,[170] that a court should be willing to take into account loans in determining insolvency.

Justice Kearney in *Re Adnot Pty Ltd*,[171] a case which involved an application for the appointment of a provisional liquidator of a company, X, took into account funds loaned by a related company of X which had a substantial cash flow from other developments, assets and activities, in deciding whether X was insolvent. His Honour was impressed, it would seem, by the fact that the directors of the related company had determined to provide loan funds until the shopping complex, which was the *raison d'être* of the debtor company, was completed and sold.

The state of the law is such that in a case involving a consideration of s 122 of the *Bankruptcy Act* 1966 (Cth), an argument that a company is solvent because it is able to avail itself of unsecured loan funds could not be regarded as strong. However, it is submitted that a defendant to an action initiated by a

[165] For other decisions see, for example, *Re Attiwell* (1932) 5 ABC 54, 57; *Re D'Onofrio* (1983) 76 FLR 136, 137; 65 ALR 545, 546. Also, see R Baxt, 'The Ballard of the Running Account' (1969) 7 MULR 178, 188.

[166] (1991) 9 ACLC 27; 3 ACSR 261.

[167] Id 28; 264. See Goode, op cit (fn 10) 59. Ford and Austin, op cit (fn 9) 813–14 accept the correctness of the statement in *Re RHD Power Services Pty Ltd*.

[168] Ibid.

[169] (1986) 4 ACLC 185.

[170] [1978] 2 NSWLR 235, 244.

[171] (1982) 1 ACLC 307.

liquidator under Division 2 of Part 5.7B who wishes to argue that the company in liquidation was not insolvent at the time of the impugned transaction may have a stronger case.

When the Exposure Draft Bill of the Corporate Law Reform Bill was published in February 1992, the clause which ultimately became s 95A stated that solvency involved a person being able to pay his or her debts as they became due and payable from his or her own money. However, the words 'from his or her own money' were deleted when s 95A became law. The omission of the words may simply mean that the legislature was intending to ensure that the position adopted in the cases, namely that a debtor did not necessarily have to have money to pay for debts due provided there were assets which could be sold or mortgaged within a reasonable time, was confirmed in the legislation. However, it is submitted that this was not necessary because the case law, as indicated in this article, clearly provided that the words 'from his or her own money' neither prohibited a debtor's assets (where they could be sold) nor money raised on secured loans from being taken into account in determining solvency.

It is submitted that there is a strong argument in favour of the proposition that the omission of these words signify the legislature's intention that unsecured loan funds can be taken into account when determining a debtor's solvency, that is, the legislature omitted the words to overcome the cases which refused to consider unsecured borrowings in deciding whether a debtor was solvent at a particular point in time.

This would be consistent with commercial practice. It is submitted that if a company can obtain funds from a lender of some substance then a court should carefully consider the fact that that, in itself, may indicate that the debtor company is not insolvent. It is contended, with respect, that the courts which fail to give any consideration to unsecured borrowing in any circumstances are, effectively, adopting a balance sheet test of insolvency rather than a cash flow test. There is an apparent concern, in these decisions, that there is not sufficient on the credit side of the balance sheet to offset what is being included on the debit side. Yet the cash flow test simply asks: can the company pay its way?[172] Does it matter that it might be replacing one debtor with another? Businesses tend to do that quite frequently. It is acknowledged that in some cases a debtor company may be able to obtain funds because the creditor is deceived as to the company's financial position. Accordingly, the statement of Dunn J in *Re Australian Co-operative Development Society Ltd*[173] that there will be cases where 'evidence of borrowing in order to pay debts will be strong evidence that the borrower is unable to pay his debts'[174] is to be noted.

Finally it is clear that a temporary lack of liquidity is not a reliable indicator of a lack of ability to pay one's creditors.[175] On the other side of the coin, the

[172] Goode, op cit (fn 10).
[173] [1977] Qd R 66.
[174] Id 78–9.
[175] *Sandell* v *Porter* (1966) 115 CLR 666, 670; *Hymix Concrete Pty Ltd* v *Garrity* (1977) 13 ALR 321; 2 ACLR 559.

fact that a company has sufficient liquid assets is not always conclusive of the fact that the company is able to pay its debts.[176]

E THE PRESUMPTIONS OF INSOLVENCY

As we have seen, it is incumbent on a liquidator to establish that a company was insolvent when a pre-liquidation transaction was entered into or became insolvent because of the transaction if the transaction is to be set aside as an insolvent transaction.

As mentioned at the beginning of this article, historically it has been far from easy for liquidators to prove insolvency. It has been accepted generally that, of the conditions which a liquidator had to establish in proving an undue preference under s 565 of the *Law*,[177] the most difficult was that the company gave the alleged preference when it was insolvent.[178] The determination of whether a company was insolvent could not be based solely on an investigation of a balance sheet,[179] that is, demonstrating that the assets were outweighed by the liabilities, although there is authority for the proposition that a reconstructed balance sheet could be admitted into evidence and taken into account.[180] The process of establishing insolvency may be costly[181] and there is no guarantee that a court will accept that a company was insolvent. The decision is the court's ultimately although expert evidence can be heard and may be relied on.[182] A liquidator may be able to give expert evidence about the solvency of the company,[183] yet the court may decide not to rely upon it.

The legislature has recognised the difficulties encountered by the liquidator. The Explanatory Memorandum to the Corporate Law Reform Bill 1992 noted the observation of the Australian Law Reform Commission's *General Insolvency Inquiry* (Report No 45, 1988) (commonly known as 'the Harmer Report'), that a liquidator:

> Being a stranger to the past business operations of a company, is often

[176] *Expo International Pty Ltd* v *Chant* [1980] NSWLR 820, 837; (1979) CLC 40-608, 34,054.
[177] In conjunction with s 122 of the *Bankruptcy Act* 1966 (Cth).
[178] D J Purcell, 'Banks and the Recovery of Voidable Preferences' (1990) 2 *Bond LR* 107. For examples, see *M & R Jones Shopfitting Co Pty Ltd (in liq)* v *National Bank of Australasia Ltd* (1983) 1 ACLC 946, 949–50; *Sheahan* v *Air Con Serve Pty Ltd* (unreported, Supreme Court of South Australia, 25 May 1994, Burley J). The same view has been expressed in England in *Re Kushler Ltd* [1943] Ch 248, 252.
[179] *Calzaturificio Zenith Pty Ltd* v *NSW Leather & Trading Co Pty Ltd* [1970] VR 605, 609; *Re Pacific Projects Pty Ltd (in liq)* [1990] 2 Qd R 541, 544; *Court* v *National Australia Bank* (unreported, Supreme Court of Western Australia, 12 November 1990, Commissioner Kakulas QC). In *Sheahan* v *Vogt* (unreported, Supreme Court of South Australia, 7 May 1993, Bowen-Pain J) it was said that the proof of insolvency must entail more than the mere mechanical examination of financial statements.
[180] *Re Action Waste Collections Pty Ltd* (1980) 5 ACLR 673, 685.
[181] See *Sheahan* v *Air Con Serve Pty Ltd* (unreported, Supreme Court of South Australia, 25 May 1994, Burley J).
[182] *Guthrie* v *Chandler* (1991) 5 ACSR 387, 393.
[183] *Sheahan* v *Hertz Australia Pty Ltd* (1994) 14 ACSR 209, 213.

confronted with considerable difficulty in affirmatively establishing that a company was insolvent at a time prior to the winding up, even though there may be every indication that this was the case.[184]

The *Law*, as a result of the enactment of the *Corporate Law Reform Act* 1992 (Cth), now includes presumptions of insolvency, that is, the company being liquidated will be presumed to have been insolvent at a particular time before liquidation if certain circumstances existed. There are a number of presumptions. They are contained in s 588E(3), (4), (7) and (8). The presumptions apply to 'recovery proceedings'[185] which is a term defined in s 588E(1) and includes an application made by the liquidator to the court pursuant to s 588FF in which an order is sought in relation to a voidable transaction.

The presumptions, on which a liquidator can rely in a claim that a transaction is an insolvent transaction, are:

- if a company is proved to be insolvent, or it is presumed to be insolvent because it either breached s 289(1) by failing to keep adequate accounting records, or it was proved to be insolvent in another recovery proceeding at a point of time within the 12 months immediately preceding the relation-back day (normally this would be the day on which the application to wind up was filed), then the company is presumed to be insolvent from that point of time until the relation-back day;[186]
- if a company has breached s 289(1) by failing to keep adequate accounting records, or it has breached s 289(2) by failing to retain such records for a period of seven years, it is presumed to be insolvent for the period to which the inadequacy or absence of the records relates;[187]
- if a company has been proved to be insolvent in other recovery proceedings under Part 5.7B, it is presumed to be insolvent.[188]

The first of these presumptions provides for a continuing presumption in that if the necessary facts exist it must be presumed that the company was insolvent throughout the period commencing on the day specified, such as the day it was proved to be insolvent, and ending on the relation-back day.

The second presumption as contained in s 588E(4)(a) does not apply where there are minor or technical breaches of s 289(1).[189] Furthermore, the presumption does not apply in so far as it would prejudice a right or interest of a person where the accounting records of the company were destroyed, concealed or removed and the person was not knowingly or recklessly involved in such action.[190]

Importantly, the second presumption can only be employed in an action for

[184] Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 1020.
[185] s 588E(2).
[186] s 588E(3).
[187] s 588E(4).
[188] s 588E(8).
[189] s 588E(5).
[190] s 588E(6).

the recovery of an unfair preference if the creditor who received the benefit of the alleged voidable transaction is a related entity of the company.[191]

Any of the presumptions can be rebutted if the contrary is proved.[192] Clearly the presumptions 'do not exclude proof of insolvency according to the principles established in the case law'.[193]

The introduction of the presumptions means, in effect, that where a presumption applies the time from which a company is presumed to be insolvent will constitute an act of bankruptcy and the period from that date until the commencement of winding up is a relation-back period.

It is submitted that the presumptions do not advance the position of the liquidator very far. For the most part liquidators will still be required to prove insolvency. The legislature's expression of understanding the plight of the liquidator appears to be hollow. There is no real assistance to help the liquidator overcome the great disadvantage he or she experiences in coming fresh to a company whose affairs have usually been poorly administered and where books and records may well be totally inadequate or non-existent.[194]

It is respectfully contended that the recommendation of the Harmer Report, which advocated the introduction of a rebuttable presumption that the company was insolvent during the 90 day period immediately preceding what is now referred to as the relation-back day,[195] has much to commend it. Interestingly, according to the Report, there was no criticism of this approach in submissions made to the Commission.[196] If the legislature had incorporated the Harmer Committee's recommendation creditors would have had, as a safeguard, the right to rebut the presumption. With a company which went into liquidation within 90 days it is contended that it is more likely than not that it was insolvent during that period.

The legislature did not implement this recommendation on the basis that the potential benefit which it offered did not 'justify the element of retrospective liability which it involves'.[197] With respect, this should not be a relevant factor. All of the provisions dealing with voidable transactions involve an element of retrospectivity. In bankruptcy law a trustee in bankruptcy can recover a disposition which occurred during the relation-back period (up to six months before the date of the presentation of the petition) without proving anything, save for the date of the disposition. That is an extreme case of retrospective liability yet it remains part of the *Bankruptcy Act* 1966 (Cth).[198]

Admittedly, the establishment of a 90 day set period is arbitrary, but it is

[191] s 588E(7).
[192] s 588E(9).
[193] J O'Donovan, 'Voidable Dispositions and Undue Preferences: The Transition to the New Regime' (1994) 12 C & S LJ 7, 15.
[194] See Wilde, 'Preference Actions: The Practical Problems of Trying to Prove', unpublished paper delivered at an insolvency seminar conducted by the Queensland Law Society and the Institute of Chartered Accountants of Australia at Brisbane on 27 October 1989.
[195] Para 635.
[196] Id para 640.
[197] Supra fn 184, para 1019.
[198] s 115.

difficult to envisage any other method of relieving the substantial burden which is imposed on liquidators; the presumptions in s 588E do not appear capable of assisting liquidators in all but a few cases. The United States of America has wrestled with this issue and determined that it is necessary to establish a set period before liquidation during which the debtor is presumed to be insolvent.[199]

Commentators in the United States have indicated that the introduction of the presumption of insolvency for the 90 day period preceding bankruptcy has been a boon to efficiency and has produced a reduction in the expense of bankruptcy administration.[200] As in Australia, it would appear that the issue of insolvency had previously occupied substantial amounts of court time.[201]

F CONCLUSION

When 'insolvency' or 'insolvent' is mentioned in Division 2 of Part 5.7B it is necessary to refer to s 95A and the definition of 'solvency'. This section encapsulates a cash flow test of insolvency, which means that a court is not to weigh a company's debts against its assets but to determine if the company can pay its way as it carries on business.

In determining what insolvency actually means in Division 2 it is likely that the courts will have recourse to the judicial interpretation of s 122(1) of the *Bankruptcy Act* 1966 (Cth). That sub-section contains a cash flow test of insolvency which is very similar to s 95A.

The problem for the courts is that there have been divergent approaches adopted in interpreting the meaning of 'unable to pay his debts as they become due from his own money' which is the explanation given to 'insolvency' in s 122(1). The cases appear to be evenly balanced as to whether or not 'debts due' includes liabilities which would be provable in a liquidation, if the company was liquidated at the time of the transaction under challenge, but which were not strictly payable because creditors had extended the debtor further time in which to pay. It has been submitted that a preferable view is that the only extensions which should be considered are those which are given pursuant to an agreement or estoppel.

While it is clear that debtor companies can require courts to have regard to funds which are able to be procured from a sale or mortgage of its assets, there is some uncertainty as to whether or not a court should take into account money which can be obtained pursuant to an unsecured loan. The preponderance of authority is against courts taking into account such funds, but, it is submitted, there is substance in the argument that in some circumstances the

[199] *Bankruptcy Reform Act* 1978 (US), s 547(f) and see *In re Bennet* (1984) 35 BR 357; *In re World Financial Services Center Inc* (1987) 78 BR 239. The period is 90 days in the United States.

[200] R Aaron, 'The Bankruptcy Reform Act of 1978: The Full-Employment-For-Lawyers Bill' (1980) 19 *Utah Law Review* 19, 43.

[201] Ibid. Aaron refers to *Re Olympic Construction Co* 1 Bankr Ct Dec 1380 (1975).

fact that an unsecured loan can be obtained is highly suggestive of the company's solvency; in fact in some situations it may indicate the company's relatively strong financial standing.[202]

Liquidators are obliged to establish the insolvency of a company if they are to succeed in having a transaction classified as an insolvent transaction. The legislature has introduced presumptions to assist the liquidator to prove insolvency. It is submitted that these presumptions will not be of assistance in many cases which liquidators encounter. It is submitted that the legislature should have provided that a company is to be presumed to be insolvent for a set period of 90 days preceding the relation-back day, which will, for most compulsory liquidations, mean the day on which the application to wind up is filed. Such a provision would enable liquidators to concentrate on the other elements which need to be proved in order to establish that a pre-liquidation transaction represented a transaction which should be avoided under Division 2 of Part 5.7B. If this type of provision was enacted it is likely that the costs incurred in mounting a case would decrease appreciably.

The present state of the law as it applies to the concept of insolvency is not satisfactory. The insolvency factor is critical to Division 2 of Part 5.7B, primarily because the majority of voidable transactions will have to satisfy the meaning of 'insolvent transaction', yet there are unresolved issues concerning a number of matters which will determine whether a company is insolvent. Until there is a resolution of these issues liquidators often will be hesitant to commence proceedings under Division 2 for fear of not being able to satisfy the court that the company was insolvent at the time of the entering into of the transaction under challenge. Consequently, it is hoped that the issues might be resolved in the near future by the courts as they are called upon to determine the insolvency of companies when hearing actions initiated under Division 2 of Part 5.7B. Furthermore, it is hoped that in any amendment of the *Law's* insolvency provisions[203] the legislature will introduce a provision to the effect that companies are presumed to be insolvent during the 90 days preceding the relation-back day.

202 *RHD Power Services Pty Ltd* (1991) 9 ACLC 27; 3 ACSR 261.

203 This may be sooner rather than later given the number of concerns expressed in respect of certain parts of the legislation which were introduced by the *Corporate Law Reform Act* 1992 (Cth), for example the statutory demand code in Part 5.4 (see, the judgment of Young J in *John Holland Construction and Engineering Pty Ltd* v *Kilpatrick Green Pty Ltd* (1994) 12 ACLC 716, 717).