Thus, while the approach of Kitto J. in applying the tort of negligence to sport has advantages, it might be best to acknowledge that the playing of contact sports is not amenable to regulation through the criteria of negligence.

HAYDEN OPIE*

KINSELA AND ANOR V RUSSELL KINSELA PTY LTD (IN LIQUIDATION)[1]

In this decision the New South Wales Court of Appeal has given the strongest judicial recognition yet of any British or Australian Court as to the fiduciary duty owed by the directors of a company to its creditors. The Court held that where a company is in a position of marginal commercial solvency the duty owed by directors to the company as a whole extends not only to the interests of the shareholders of that company, but to the interests of its creditors as well. Where the directors act in breach of this fiduciary duty, to the detriment of the company's creditors, the shareholders of the company do not have the power or authority to absolve the directors of their breach.

Members of the Kinsela family as directors of, and shareholders in various family companies carried on a business as funeral directors. These companies were well established, well known and had a reputation of which the family members were proud.

One such company, Russell Kinsela Pty Ltd ('the company') offered, in addition to the provision of funeral services, a form of contributory insurance against the cost of its clients' funerals. Regular payments, of small amounts were received from contributors in return for which they became entitled to cost-free funerals. The company did not structure the scheme properly, failing to make adequate provision for rising costs. In late 1976 the company had begun to incur regular and increasing trading losses and its liabilities greatly exceeded its assets.

During this period, the Funeral Funds Act 1979 (N.S.W.) was enacted. This Act, which came into operation in October 1980, incorporated provisions requiring companies carrying on funeral insurance schemes to disclose their financial position and conferred powers upon a statutory officer to intervene in the affairs of a defaulting company with a view to protecting the interests of creditors.

In this climate Mr. Kinsela, an appellant to the action and a director of the company, devised a scheme by which it was hoped the family business could continue despite the company's imminent collapse and the imposition of the statutory constraints of the Funeral Funds Act.

On 26 January 1981, the directors executed a lease of company premises. The lease was for a period of three years, with an option for a further three years and named Mr and Mrs Kinsela as lessees. The lease was on particularly favourable terms but was unanimously supported by all of the company's shareholders.

In April of the same year proceedings were brought to have the company wound up. The liquidator challenged the lease on three grounds, only one of which the Court found necessary to discuss in any detail. The liquidator argued that the company's power to lease the premises was exercised for a purpose which was not in the best interests of the shareholders as a whole and therefore the lease was voidable at the option of the company. The appellants argued that this submission could not be correct as the execution of the lease was an act of the company with the unanimous knowledge and approval of all the shareholders.

At first instance[2] Powell J. held that while the directors had power to lease company premises under the company's Memorandum of Association, the power had been exercised otherwise than in furtherance of the company's stated objects. Therefore the lease was voidable at the option of the company.[3] While his Honour held reservations as to the correctness of the principle, he

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[1] (1986) 4 A.C.L.C. 215.
[2] *Russell Kinsela Pty Ltd (In liquidation) v. Kinsela and Anor* [1983] 2 N.S.W.L.R. 452.
[3] *Ibid.* 464.

was bound by a previous decision of the New South Wales Court of Appeal in *Winthrop Investments Ltd v. Winns Ltd*[4] to accept that the consequences of a breach of a director's duty may be overcome if at a general meeting of the company to which a full disclosure of all relevant facts is made, including the facts of actual or potential breach of duty, the breach is ratified.[5] However, his Honour found that there had been a lack of informed consent and therefore no ratification had taken place.[6]

On appeal, the New South Wales Court of Appeal did not find it necessary to decide whether full disclosure had taken place as the Court held that the breach was such that the company did not possess power to ratify the breach in general meeting.[7]

The Chief Justice delivered the decision of the Court.[8] His Honour referred to a number of previous decisions, including that of Sir Owen Dixon in *Mills v. Mills*[9], in stating the principle that directors of a company are under a fiduciary duty to exercise their powers for the benefit of the company.[10] In the context of insolvency, his Honour held that this duty exists not only for the benefit of the shareholders of the company, but for the creditors of the company as well.[11]

Street C.J. referred to the decision of Mason J., in *Walker v. Wimborne,*[12] where his Honour stated

> It should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them.[13]

Street C.J. also referred to, and approved of, the recent decision of Cooke J. in the New Zealand case of *Nicholson and Ors v. Permacraft (N.Z.) Ltd (In Liquidation)*[14]. Cooke J. held that the duty owed by the directors of a company may require

> directors to consider inter alia the interests of creditors. For instance, creditors are entitled to consideration in my opinion if the company is insolvent or near insolvent or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency".[15]

Street C.J. refused to formulate a general test as to the degree of financial instability which would impose upon the directors a duty to consider the interest of creditors, but stated that the duty will arise where the company is insolvent in as much as it is the creditors' money which is at risk, rather than the shareholders' proprietary interest.[16] His Honour noted that to some extent the degree of financial instability and the degree of risk to the creditors are inter-related.[17] The plainer it is that the creditors' money is at risk, the lower may be the risk to which the directors can justify exposing the company.

His Honour found that at the time of the making of the lease, the company was in severe economic difficulties, bordering upon liquidation. Under these circumstances, the directors were under a fiduciary duty to the creditors of the company and this duty had been breached by the execution of the lease as its intended effect was to place one of the company's assets beyond the immediate reach of the company's creditors.[18]

[4] [1975] 2 N.S.W.L.R. 666.
[5] [1983] 2 N.S.W.L.R. 452, 464.
[6] *Ibid.* 465.
[7] (1986) 4 A.C.L.C. 215, 223-224.
[8] The Court was constituted by Street C.J., Hope J.A. and McHugh J.A.
[9] (1938) 60 C.L.R. 150.
[10] (1986) 4 A.C.L.C. 215, 220.
[11] *Ibid.* 223.
[12] (1976) 137 C.L.R. 1.
[13] *Ibid.* 7.
[14] (1985) 3 A.C.L.C. 453 (Court of Appeal New Zealand).
[15] *Ibid.* 459.
[16] (1986) 4 A.C.L.C. 215, 223.
[17] *Ibid.*
[18] *Ibid.* 223-224.

Street C.J. proceeded to hold that such a breach could not be authorised by the shareholders of the company. His Honour stated

> It is, to my mind, legally and logically acceptable to recognise that, where directors are involved in a breach of their duty to the company affecting the interests of shareholders, then shareholders can either authorise that breach in prospect or ratify it in retrospect. Where, however, the interests at risk are those of the creditors I see no reason in law or in logic to recognise that shareholders can authorise the breach.[19]

This is because

> [W]here a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company are under the management of the directors, pending either liquidation, return to solvency or the imposition of some alterative administration.[20]

His Honour therefore concluded that while the lease was not ultra vires and void as exceeding the capacity of the company[21], it was entered into by the directors in breach of their duty to the company, to the detriment of the company's creditors at a time of insolvency and therefore could not be affirmed by the company's shareholders. It was accordingly a voidable transaction and the company was entitled to avoid it.[22]

While some text book authors[23] and individual members of the judiciary[24] have noted that directors must take into account the interests of creditors in discharging their fiduciary duty this case provides the first authoritative statement of the existence, extent and scope of the duty owed to company creditors. The Court's finding that in certain circumstances the duty owed by directors of a company extends beyond the interests of the company's shareholders is of interest given the increasing demand for and expectations of greater corporate social responsibility.[25] While the most significant developments in this area have occurred in the United States,[26] rather than the United Kingdom or Australia, the concept of corporate responsibility is nevertheless prevalent in Australia. Both the Trade Practices Act 1974 (Cth.) and the consumer protection legislation of the various States would appear to be, at least in part, legislative recognition of the desire to make corporations more accountable to the public for their operation.

In *Parke v. Daily News,*[27] a case decided in 1961, Plowman J. dismissed an argument that directors owe a duty to company employees in addition to the duty owed to shareholders. However, in the light of the *Kinsela* decision and the trend toward greater corporate responsibility the potential for director's duties to be extended to employees, customers or even to society generally becomes apparent.

Should the courts extend the duty owed by directors of companies beyond the traditional bounds, complex problems of competing interests will need to be faced. While it may be true to say[28]

[19] *Ibid.* 223.
[20] *Ibid.* 221.
[21] The doctrine of ultra vires has since been abolished in its application to companies: ss 66C, 67, 68 Companies (Victoria) Code.
[22] (1986) 4 A.C.L.C. 215, 224.
[23] For example, Ford, H.A.J., *Principles of Company Law* (4th ed. 1986) 390; Gower, L.C.B., *Principles of Modern Company Law* (4th ed. 1979) 578.
[24] Mason J., *supra* n.12, Cooke J., *supra* n.14. Slade L.J., *Rolled Steel Ltd v. British Steel Corporation* [1985] 2 W.L.R. 908, 947-948.
[25] A point noted by Lord Wedderburn of Charlton, Southey Memorial Lecture 1984: 'The Social Responsibility of Companies' (1985) 15 M.U.L.R. 4.
[26] *Ibid.* 5.
[27] [1961] 1 W.L.R. 493 (Chancery Division).
[28] As Mason J. did in *Walker v. Wimborne,* supra n.13.

that directors should take into account the interests of creditors in considering what is for the benefit of the company as a whole, once a duty to creditors is recognised a real possibility exists that the duty may conflict with the duty owed by the directors to the shareholders and others associated with the company. It is not hard to imagine the potential difficulties that would be faced by the courts in attempting to find solutions to the problems caused by these competing and conflicting duties.

Although the Court of Appeal did break new ground in the *Kinsela* decision it would be wrong to overstate the implications of a basically conservative judgment. As noted above, the concept that directors of a company owe a duty to company creditors, at least in some circumstances, had previously received recognition. Moreover, the circumstances in which the Court stated that such a duty arises have been drawn very narrowly.

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