

## **RECKLESS CONDUCT: DISREGARDING STANDARDS OF CARE**

Johannesburg

21 November 2014

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There has hardly been a day that goes by where the media headlines grip the attention of citizens, announcing yet another case of poor governance practices, or a director engaging in reckless business conduct. While this is not only a phenomenon attached to certain brazen directors in South Africa, this irresponsible conduct is also seen across the world. Giving weight to the damage caused through director's reckless conduct, a notable overseas example is BP's *Deepwater Horizon* oil spill disaster in 2010 off the Gulf of Mexico. BP PLC were ordered by the courts to pay billions of dollars in penalties for the horrific incident. The negligence – mostly on the part of BP – destroyed large areas of wildlife, stained large stretches of beaches and polluted fresh water marshes after approximately 666\* million litres of crude oil gushed into the Mexican Gulf. Indeed, whilst the company suffered massive financial losses, estimated at USD42bn\*, one must not forget the eleven rig-workers who died at the scene of this deadly blowout, including the immeasurable environmental damages.

There are many examples of reckless conduct in business, and perhaps they are not all as monumental as the case of BP. Notwithstanding the size of each case, most of them are generally underpinned by individual greed and selfish, business profit-driven motivation. In their quest to maximise their company's return on investments over the shortest possible time, directors who make these reckless decisions flagrantly disregard their standards of care and their fiduciary duties owed to the company and its stakeholders.

Then we have South Africa's most recent case of African Bank who were placed under curatorship by the South African Reserve Bank when it collapsed in August this year. Whilst a 5-month investigation against the African Bank board is currently underway for alleged reckless and negligent trading, there is no doubt that each director will be scrutinised to determine their part in any questionable management practices, or material non-disclosures with the intent of defrauding depositors or other creditors. The holding company of the bank, African Bank Investments Limited (ABIL), announced that it was expecting a loss of R6.4bn\*\* and that it needed to raise a further R8.5bn\*\* to keep the bank afloat. Spectacularly, after this announcement was made, the bank's share price crashed by ninety-eight percent to a thirty-one cent low before it was suspended. As all the facts regarding the extent of the director's conduct is not known at this stage of the investigations, it is reported that at least R10bn has already been written off by the bank's shareholders. Considering the fact that the investigations are still far from complete, there is speculation that the bank may no longer be a viable concern as the bank's estimated debt is calculated at R26bn\*\*\*.

Understandably, the consequences of the board's alleged reckless actions (or inactions) may lead to grave circumstances for not only its shareholders and the economy, but also upon the lives of thousands of people.

*"The concepts of limited liability and separate legal personality of the company give rise to endless opportunities for abuse by the directors and controlling shareholders of a company. Most people would agree that a director should be held accountable when he uses the company as a vehicle to commit fraud.*

*Difficulties arise, however, when the person concerned has acted not fraudulently but recklessly. Entrepreneurial spirit must not be completely curbed. A director is entitled, indeed expected, to take calculated business risks.*

*But where does one draw the line between calculated risks and reckless mismanagement?"*

### ***Extending the Liability of Directors***

***(S. Luiz - (1988) 105 SALJ 788)***



Whilst these are only two examples where the boards of BP PLC and African Bank stand accused of not showing proper concern for the entire well-being of their companies (and their respective stakeholders), there are usually legal consequences that await any company and its directors where it can be proved that reckless conduct has indeed occurred. It is important to note that reckless conduct in business may manifest essentially in two ways; namely the *actual act* itself or the *failure to act* in an appropriate manner in order to protect the company and where harm is brought to the company and its stakeholders.

Notwithstanding the provisions of Section 22 of the Companies Act, 71 of 2008 -- which deals specifically with reckless conduct and must be read with Section 77 -- it is becoming increasingly important for directors and prescribed officers to be vigilant in the performance of their duties. Company officers (this includes similar governmental authorities) are expected to exercise their powers and perform their functions with a standard of care, skill and diligence, also having taken reasonable steps to be fully informed of the matters at hand. As the consequences for reckless conduct can be extremely harsh, it is imperative that companies ensure there are various preventative mechanisms in place to prevent such behaviour. Companies should amongst other; have a proper Corporate Governance Framework® and system of internal controls, ensure that the company's internal policies and practices are adhered to and kept updated, as well as ensure there is proper oversight across all facets of the business.

The consequences of reckless conduct need not only be restricted to financial penalties imposed upon the company. The extent to which companies and its board of directors could be held accountable for reckless conduct includes the possibility of the entire board, or any individual director being removed. In the case of the latter circumstance, directors can be declared delinquent by a court of law which in most cases implies onerous personal reputational and career limiting restrictions. Understandably, any of these actions will also have dire implications upon the company and / or the directors blamed for reckless conduct and this in turn could result in brand erosion, loss of business and investments, and even in more severe cases, business closure. For companies to avoid reckless conduct, it is important that they recognise the early warning signs which if left unchecked, could cause substantial harm to the company and its stakeholders. There are generally four traits -- as general indicators -- that may indicate a propensity for reckless conduct. They are:

1. *lack of due concern for consequences*

- individuals who 'shrug off' the potential consequences (or cost) resulting from a failed decision are more prone to reckless conduct than those who carefully consider and show due concern for the potential outcome of their decisions

2. *impulsive behaviour*

- individuals who make decisions quickly without doing the necessary research are more prone to recklessness than those who are more disciplined during the decision-making process
- individuals who have a propensity for engaging in reckless conduct are more likely not to follow a plan and will act impulsively without keeping in mind the bigger picture

3. *spirit of denial*

- individuals who make light of the potential for failure (or choose to deny failure) are more prone to reckless conduct
- individuals who make excuses for why a decision did not succeed (instead of facing the reality of their choices) indicates a potential for reckless conduct

4. *sensation-seeking behaviour*

- individuals who engage in sensation-seeking behaviour in their everyday lives and who thrive on high-stakes decision-making and chaotic atmospheres may indicate a propensity for reckless decision-making.



In its most simplistic form, reckless conduct is a rash or careless act that is a gross deviation from the standard of care a reasonable person would exhibit under similar circumstances. Most often the person acting recklessly will selfishly attempt to avoid their own personal losses, as they transfer the associated risks onto other innocent bystanders who then suffer the casualties. The act of *recklessness* -- which is most often intentional behaviour - is treated by the courts in a far more serious light as compared to an act of *negligence*. A person who has acted recklessly would have done so knowingly and they would have taken a risk which could have placed others in danger. In terms of the Business Judgement Rule, the courts will apply an objective test to determine reckless conduct. In order to determine the individual's guilt, it will not matter what the individual was thinking at the time of their reckless conduct. If the person's actions deviate far enough from how a reasonable person would have acted, then the person could be found guilty and/or liable for reckless conduct and face prosecution. In extreme cases of reckless conduct, especially if it involves the loss of life, the person may be faced with not only a criminal lawsuit, but also a civil lawsuit.

Many directors will agree that running a successful business is becoming increasingly difficult in a tough economy, and their differentiators for success are dependent upon good risk taking and mitigation. Indeed, there is a fine line between risk taking and being reckless and directors need to be acutely aware of these differences.

\* Judge: BP's reckless conduct caused Gulf oil spill, 04 September 2014 (<http://news.yahoo.com/judge-bps-reckless-conduct-caused-gulf-oil-spill-154742726.html>)

\*\* Abil's need for R8.5bn alarms big investors, 07 August 2014 (<http://www.bdlive.co.za/business/financial/2014/08/07/abils-need-for-r8.5bn-alarms-big-investors>)

\*\*\* R10bn lifeline for SA bank, 11 August 2014 ([http://www.iol.co.za/dailynews/news/r10bn-lifeline-for-sa-bank-1.1733366#.VG7bb\\_mUfkU](http://www.iol.co.za/dailynews/news/r10bn-lifeline-for-sa-bank-1.1733366#.VG7bb_mUfkU))

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**Words: 1,422**

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