



Inappropriate Application of Breach of Trust and its Impact on the Cambodian Economy¹

Cambodia's current legal system is not considered sufficiently effective to promote strong economic growth. While enacting new laws is important, it is equally crucial that existing regulations are fairly and consistently applied as inappropriate and arbitrary legal enforcement negatively affects the country's overall economy.

One specific issue that the business community has been concerned about for a number of years is the implementation of the breach of trust provision (Article 46) of the Transitional Criminal Law. The inappropriate application of the breach of trust provision to breach of contract cases directly costs Cambodia's business community thousands of dollars and also deprives the economy of millions of dollars in lost investment opportunities and of thousands of jobs per year. The business community has consistently communicated its grievances to the government, and recently, in response to these concerns, the government established an Ad Hoc Sub-committee under the framework of the Government-Private Sector Forum to study the economic impacts of this. The government plans to use the study's insights to mitigate the abuse of the breach of trust provision in order to improve investor confidence which would benefit the overall economy.

This issue of the Bulletin explains what breach of trust is, discusses how it is currently applied in Cambodia, and examines the impact of its use on Cambodia's economy, summarizing key findings of the committee's study entitled "Abusive Breach of Trust Cases and Their Impact on the Economy of Cambodia." ²

What is breach of trust?

Breach of trust is a criminal offense against property that occurs when the accused person, who lawfully possesses property under an agreement with the owner, intentionally and permanently deprives the owner of the property. The agreement between the owner and the accused can be either written or verbal. For example, Mr. A borrows a motorcycle from his friend, Mr. B, in the morning and promises to return it by the end of the day. However, rather than returning it to Mr. B, he sells the motorcycle to Ms. C. In this case, Mr. A has committed a breach of trust offense.

As can be seen from the example above, two main elements are required for a dispute to constitute a breach of trust offense: the **physi-**

¹ Unless otherwise noted, the information provided in this *Bulletin*, including statistics, conclusions and recommendations, is drawn from the forthcoming publication "Abusive Breach of Trust Cases and Their Impacts on the Cambodian Economy," conducted by the Ad Hoc Sub-committee of the Government-Private Sector Forum and supported by the International Finance Corporation's Mekong Private Sector Development Facility (IFC-MPDF).

² Because breach of trust is a sensitive issue, only a few dozen people were willing to be interviewed or provide information to the Ad Hoc Sub-committee's study team. Hence, the findings presented here may not be representative of the situation in the entire country.



The *Business Issues Bulletin* provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Cambodia. Also included are opinions on topic from a number of relevant stakeholders.

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The statements and opinions presented here are only meant to provide additional reference material and do not reflect the official opinion of the Mekong Private Sector Development Facility or of IFC.

cal element and the **mental element**. The physical element relates to the misappropriation of property against the interests of the owner. The mental element refers to the accused person's intent to commit the crime.

The **physical element** of breach of trust violations has three key components:

(i) The property must have been entrusted to the accused person. The property in question must have been given to the accused by the owner: for example, as a loan, as a deposit or as collateral for a contract. Breach of trust does not apply if the accused has acquired the property by illicit means, such as theft or robbery.

(ii) The accused person must have promised to return the property to its owner or to use it for a specific purpose. If the property was simply given or sold to the accused, then breach of trust cannot exist. It only applies in cases when the owner has entrusted property to the accused or the accused has promised to do something specific with the property. Breach of trust is meant to prevent the accused from keeping the property for himself, or from using it for a purpose other than that agreed upon by both parties. For example, if the owner loans property to the accused, then by accepting the loan, the accused is promising to return the property.

(iii) The accused must have disposed of or misappropriated the property. Misappropriation occurs when the owner can no longer recover the property. Common examples of misappropriation include: destroying the property, selling the property to a third person, or keeping it for oneself and refusing to return it.

The most important element of a breach of trust violation, however, is the **mental element**. Unless there is evidence of criminal intent, the accused can not be found guilty of breach of trust, even if she or he has performed the three key physical elements. For example, Monin borrows \$500 from his neighbor to plant corn. He promises to pay back his neighbor in six months, but due to severe drought, all of his corn plants die and he cannot repay his neighbor. In this case, although he has failed his contractual obligation to repay the debt after the agreed-upon period, he has not committed a breach of trust offense because he had no intention to default on the loan.

However, in the previous example where an individual borrows a motorbike from his neighbor for the day but then sells it to a third person it does satisfy the mental element. He has consciously broken his promise to return the motorbike by selling it to someone else. This deliberate commission of a wrongful act

constitutes evidence of criminal intent. Consequently, he has committed a breach of trust.

The difference between breach of trust and breach of contract

A breach of contract occurs when the parties involved simply fail to fulfill their contractual obligations. For example, Ms. Bopha promises to sell a silk shirt (with agreed-upon fabric specifications) to Mrs. Rottana for \$50. When Ms. Bopha delivers the shirt with the required specifications, however, Mrs. Rottana refuses to buy the shirt, saying that she no longer needs it. This situation would be considered a breach of contract.

There are two other specific differences between breach of trust and breach of contract. First, breach of trust requires "entrustment," i.e., that one party has lawfully entrusted his or her property to the care of another party. For most breach of contract cases, however, the entrustment of property is not an issue. In the example above, Ms. Bopha did not entrust any property to Mrs. Rottana. Consequently, their transaction cannot be regarded as a breach of trust.

Second, in the case of a breach of trust, the accused must have demonstrated the intent to deprive the owner of his or her property, and this must result in the owner's being unable to recover that property. This requirement is meant to prevent a simple case of bad luck from being considered a full-fledged crime. In our previous example about borrowing money to plant corn, Monin's inability to repay his loan resulted from the drought's destruction of his crop, not from any deliberate act by Monin. The neighbor may be able to bring a civil action against Monin for breach of contract, but Monin has not committed breach of trust because he demonstrated no criminal intent.

Current application of breach of trust in Cambodia

Given that entrustment and criminal intent are key aspects of breach of trust, most breaches of contract should not be prosecuted as breaches of trust. Unfortunately, in Cambodia criminal breach of trust charges are applied in many ways that are inconsistent with the provisions of the law. Businesspeople have reported that the courts ignore the entrustment and criminal intent requirements, treating breach of contract cases as breach of trust offenses.

According to *Doing Business*, in Cambodia it takes an average of 401 days and costs over 123% of the dis-

puted amount to enforce a contract through civil proceedings in the court system.³ Because breach of trust is a criminal offense, the accused may be kept in pre-trial detention for days, weeks or even months while waiting for formal charges to be filed. The use of pre-trial detention puts the person who is charged with the breach of trust under tremendous pressure to do whatever it takes (including paying money) to get out of detention. This is made possible in the form of a “bail” payment. There is little chance that the bail payment can be recovered.

The breach of trust provision has been wrongly used in Cambodia to turn what should be simple civil cases into criminal cases because the courts do not make a distinction between the two. If someone wants to put pressure on someone else to agree to settle a dispute, a breach of trust suit is a preferred way to do it. This may be partly related to the fact that Article 46 on the breach of trust of the Transitional Criminal Law is often misinterpreted.

Mr. Bretton G. Sciaroni,
Co-chairman of Law, Tax and Good
Governance Working Group of the
Government-Private Sector Forum

In Cambodia, there are many cases of defaulting on credit. Enforcing a contract and recovering the money through the courts takes a long time. By suing for breach of trust, a creditor can recover his or her money faster than going through a civil proceeding, because a breach of trust suit can lead to the detention of the accused and hence be used a way to extract money. The breach of trust provision of Article 46 of Cambodia's transitional law has consistently been wrongly interpreted and applied.

Mr. Hem H Naryth,
Managing Partner of B.N.G. Co., Ltd.

I have no direct experience with breach of trust cases, but I have learned about them from lawyers whose clients were sued for that offense. Breach of trust has been misused in Cambodia. What should have been civil cases have been converted into criminal breach of trust partly because judges do not clearly understand the issue. Also, some creditors file breach of trust suits so that debtors who fear pre-trial detention will do whatever he can to make the payment to the creditor, even if he must borrow money from others or sell assets.

Mr. Koy Neam, Lawyer

Disputes often occur in business. For example, two people form a partnership, but unfortunately, the business loses money. One of the partners wants to recoup his investment. If he undertakes civil proceedings, it may take a long time and he might not recover the money at all. One way to get his share back in Cambodia is to sue his partner for breach of trust. In many cases, the accused is put in detention and must pay bail to get out; the bail often costs about the same as the amount of money in dispute. These kinds of disputes should really be settled in a civil proceeding. However, court officials convert them to criminal cases so that they can extract money from the accused.

**Mr. Kong Pisey, Attorney-at-Law and Chief
Technical Advocate,
Cambodian Defenders Project**

Impact of breach of trust on the economy of Cambodia

Breach of trust is a major concern because, according to the business community, it is often applied improperly. The abuse of the breach of trust provision in settling commercial disputes impacts Cambodia's economy in two ways: first, by imposing direct costs (i.e. legal and other related fees) on the accused, and second, by inflicting indirect costs (i.e., lost investment opportunities) on the economy.

Though the study may not have been representative of the situation in all of Cambodia, direct costs to the accused were estimated at thousands or even tens of thousands of dollars in each breach of trust case. These figures include lawyers' fees as well as bribes paid by those being sued for breach of trust. Another cost to the accused is the loss resulting from time spent in jail or pre-trial detention, during which the accused cannot work or earn money.

An indirect impact of breach of trust cases is the loss of investment opportunities. Due to their fear of being sued for breach of trust, businesspeople sometimes turn down the chance to participate in what may otherwise be profitable ventures. The study found that a preliminary estimate these lost investment opportunities added up to over \$5 million per year for Cambodia's economy.

The abuse of breach of trust has a negative impact on business. It discourages investors from coming to and investing in Cambodia. Commercial disputes can occur anywhere in the world, but they are generally considered

³ International Finance Corporation and World Bank, *Doing Business 2007 – How to Reform*. Washington DC, September 2006.

civil offenses. When investors learn that simple commercial disputes can be easily criminalized in Cambodia, they stay away and don't invest to avoid the risk of being put in jail. As a result, the country loses as investors turn down opportunities.

Mr. Bretton G. Sciaroni,
Co-chairman of Law, Tax and Good
Governance Working Group of the
Government-Private Sector Forum

If a banker is sued for breach of trust in a dispute over a simple business contract and is detained as a result of that, it will affect the entire bank's reputation. Clients may not trust the bank anymore and the bank will lose customers, especially depositors.

Mr. Prom Visoth, Legal Department Manager
of ACLEDA Bank Plc.

In business, borrowing money for business purposes is important, as it contributes to the expansion of business and the generation of more profits. But in Cambodia, if the business goes bankrupt and defaults on a loan, its owners can end up in jail. This deters businesspeople from borrowing money and, in turn, hurts business growth.

Mr. Koy Neam, Lawyer

Conclusion and recommendations

In a small but significant number of cases, breach of trust charges are filed improperly and the provision is applied inappropriately. The courts ignore the elements that constitute breach of trust, converting simple breaches of contractual obligations into criminal breach of trust offenses, largely so that court officials and the police could extract bribes from the accused.

Inappropriate and unjust implementation of the breach of trust is causing Cambodia's economy to lose millions of dollars a year. If this money were invested in productive ventures, it could create thousands of jobs for Cambodian workers.

The following recommendations are aimed to help prevent further abuse of the breach of trust provision of the Transitional Criminal Law, and thereby encourage investment that creates jobs for new entrants to the labor market.

Focusing on entrustment and criminal intent

Most of the improper breach of trust cases could be eliminated if there was an emphasis on requiring the

accuser to show evidence of both entrustment and criminal intent. There should be formal guidelines that require evidence of these two elements for every breach of trust decision that is rendered.

Publishing all breach of trust decisions

The lack of access to judicial decisions in Cambodia makes it difficult to monitor whether a conviction is based on sufficient evidence for each element of the crime. Once decisions are made by the courts, breach of trust opinions should be published. This would allow for scrutiny of the evidence supporting the ruling and ultimately help all parties focus on the key elements that constitute breach of trust.

The optimum solution is to have developed a new criminal code and to make sure that it is written more carefully than the Transitional Criminal Law. A short-term solution may be to make judicial decisions on breach of trust cases available so that the public can see how they are applied. This may make lawyers and prosecutors more careful about bringing up the issue. Right now, the courts' decisions are not widely known. If everybody had access to those decisions, it could make everybody more careful.

Mr. Bretton G. Sciaroni,
Co-chairman of Law, Tax and Good
Governance Working Group of the
Government-Private Sector Forum

Creating a mechanism for anonymous reporting of court personnel or police who solicit bribes

Anonymous reporting would help establish oversight of clerks, judges, prosecutors, or the police, all of whom may pressure the accused for bribes. These officials would be less likely to solicit money if they knew that the accused could report them to someone who would investigate the allegations. The anonymity of such a mechanism is crucial; only then would people feel safe reporting abuses in breach of trust cases.

Restricting the use of pre-trial detention by issuing formal guidelines that describe when pre-trial detention is appropriate

As indicated, the pre-trial detention is sometimes used as a threat to extract bribes from the accused. Therefore, it should be restricted through clear guidelines that explain to the judiciary which factors it should evaluate to determine whether an accused person is a flight risk. It should also detail when bail is appropriate, how the bail amount should be calculated, and the mechanism by which an accused person can recover the bail payment.