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THE SAUDI SECURITIES LAW: REGULATION OF THE TADAWUL STOCK MARKET, ISSUERS, AND SECURITIES PROFESSIONALS UNDER THE SAUDI CAPITAL MARKET LAW OF 2003

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ABSTRACT

On July 31, 2003, the late King Fahd of Saudi Arabia issued Royal Decree number M/3, officially announcing the constitutive law of the securities industry, the Capital Market Law, and leading the Saudi Kingdom into new territory: capital market regulation. For Saudi businessmen, as well as many attorneys, the question “what are securities laws?” is a fair one. Securities laws are the body of rules that regulate certain subjects and issues pertinent to trade in securities, such as the registration and listing of companies in the stock market, securities professionals, the operation of the securities markets, the regulation of investment companies, and public offering of stock. Despite the fact that

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almost nine years have passed since the enactment of the Capital Market Law, not one comprehensive legal paper has been submitted to explain or discuss the law. This Article attempts to do so by outlining the law of securities relating to securities professionals as laid out in the Capital Market Law and other statutes. Professionals' fiduciary duties and other legal obligations imposed, such as their duties to the market and their clients, are extensively discussed. Moreover, this article gives a detailed account of the process of offering stock in the Saudi market.

I. INTRODUCTION TO THE LAW AND THE SYSTEM OF SECURITIES IN THE KINGDOM OF SAUDI ARABIA

In 2003, while the international stock markets were doing well, King Fahd of Saudi Arabia issued Royal Decree number M/3, promulgating the constitutive law of the securities industry, the Capital Market Law¹ (hereinafter CML), and ushering the Saudi's Kingdom into new a area:² securities laws and regulations. Securities regulation scholars have long considered securities law as consumer protection law because it aims to achieve the same goals of other consumer protection statutes. As such, the Capital Market Law is a consumer protection statute. Here, the consumer is the investor or the public at large, while the consumed are the financial products. The Saudi CML is preceded by a few statutes aimed at consumer protection. The most important of these are the Law Against Deception in Trade of 1984,³ the Rules Regulating Advertisements of 1992,⁴ and the Competition Law of 2004.⁵ While the idea of consumer protection is not new to the Saudi Kingdom, the enactment of the Capital Market Law is a big leap into the protection of capital market participants. This article focuses on securities laws in the context of the Saudi stock market exchange, "*Tadawul*." In particular, it explains the law of securities as laid out in the Capital Market Law and its implementing statutes and regulations. More specifically, it outlines

1. The name "Capital Market Law" is commonly used as a generic name for the securities laws. For example, Egypt, Oman, Turkey, Indonesia, and Uruguay use the same name. The Royal Decree promulgating Saudi Arabia's CML is dated July 31, 2003.

2. See Abdulrahman A. Al-Twajjry, *Saudi Stock Market Historical View and Crisis Effect: Graphical and Statistical Analysis*, 1-3, available at <http://www.slideshare.net/Zorro29/saudi-stock-market-historical-view-and-crisis-effect> (giving a brief history of the Saudi stock market and its development and discussing its recent changes. The author also recommends further research on the cultural impact on the stock market).

3. Law Against Deception in Trade, Royal Decree No. M/11, 29/05/1404H (Jan. 3, 1984) (also prohibiting certain fraudulent and deceptive acts, mainly in the context of the sale of goods).

4. Rules Regulating Advertisements, Royal Decree No. M/35, 28/12/1412H (June 28, 1992) (calling for accurate and honest advertisements).

5. Competition Law, Royal Decree No. M/25, 4/5/1425H (June 22, 2004) (requiring the notification of the Board of competition sixty days prior to the offering of any securities). This law is in line with the Capital Market Law, which requires in the Mergers and Acquisition Regulations, Article 16, the compliance of an offer with the rules of the Competition Law.

and discusses the rules regulating the offer of securities, securities professionals, and the securities market. Currently, including the Capital Market Law, there are eleven statutes in this area: Anti-Money Laundering and Counter-Terrorist Financing Rules,⁶ Merger and Acquisition Regulations,⁷ Real Estate Investment Funds Regulations,⁸ Corporate Governance Regulations,⁹ Investment Funds Regulations,¹⁰ Offers of Securities Regulations,¹¹ Listing Rules,¹² Securities Business Regulations,¹³ Authorized Persons Regulations¹⁴ and Market Conduct Regulations.¹⁵ These are also called implementing rules because, in their entirety, they are structured as a framework or a mechanism for the enforcement and the implementation of the constitutive law, the Capital Market Law.

Although the CML regulates the entire securities market in the Kingdom, it is primarily directed at the public offering of securities. The CML requires the full disclosure of all securities when first made publicly available and before offering to the public. Not only that, the Capital Market Authority (hereinafter the “Authority” or “CMA”)¹⁶ conducts a review and demands that applicants make full disclosure prior to approving the listing of a security. The theory behind review and full disclosure is that investors receive accurate information before they make a decision to invest in new securities and that only good securities are offered in the *Tadawul* market. Moreover, the CML requires listed companies to make periodical reports and updates of their financial and managerial developments with the Authority. Disclosure, whether it is initial or continuous, is significant for two reasons. First, for those who want to subscribe to newly offered securities, it gives them the chance to make an informed decision and in the meantime, makes them feel that the Authority is there for them and is guarding them against any unscrupulous business. Further, the Authority is in a position to reject any offering of securities that is risky or meritless. This process, seemingly, assures investors that only good securities are being offered

6. Board of the Capital Market Authority Resolution No. 1-39-2008, 3/12/1429H (Jan. 12, 2008) [hereinafter CMA Board Resolution].

7. *Id.* No. 1-50-2007, 21/9/1428H (Mar. 10, 2007).

8. *Id.* No. 1-193-2006, 19/6/1427H (July 15, 2006).

9. *Id.* No. 1-212-2006, 21/10/1427AH (Dec. 11, 2006) (amended by CMA Board Resolution No. 1-1-2009, 8/1/1430H (May 1, 2009)).

10. *Id.* No. 1-219-2006, 3/12/1427H (Dec. 24, 2006).

11. *Id.* No. 2-11-2004, 20/8/1425H (April 10, 2004) (amended by CMA Board Resolution No. 1-28-2008, 17/8/1429H (Aug. 18, 2008)).

12. CMA Board Resolution, *supra* note 6, No. 2-128-2006, 2/12/1426H (Jan. 22, 2006).

13. *Id.* No. 2-83-2005, 21/05/1426H (June 28, 2005).

14. *Id.* No. 1-83-2005, 21/05/1426H (June 28, 2005).

15. *Id.* No. 1-11-2004, 20/8/1425H (April 10, 2004).

16. The first CMA was appointed by Royal Decree No. M/30, 2/6/1424H (Jan. 2, 2004).

in the *Tadawul* market. Second, for those who have already subscribed to active or listed securities, the periodic reporting requirement functions as an accountability and feedback system, assuring investors that their investments are protected.

Under the CML's listing requirement, the prospective offering company must file an initial disclosure document—known as a “prospectus”—created by a team of professionals consisting of accountants, advisors, the issuer's management, and underwriters.¹⁷ A prospectus is defined as “communication, written or by radio or television, which offers any security for sale or confirms the sale of any security.”¹⁸ The prospectus is posted or distributed to potential investors. Usually, a copy of it is published in a booklet and made handedly available to investors. It is also published at the Capital Market Authority's website. While neither the CML nor the Implementing Regulations, substantively, define the prospectus, the Glossary of Terms defines it as “the document required to offer securities in accordance with the Capital Market Law and Listing Rules.”¹⁹ The prospectus and other statutorily required documents must be filed before any public sale of securities can take place. For potential investors, they must receive the prospectus after approval by the Authority and prior to the sale date.²⁰ If the prospectus is approved, an offer of securities could be made through the prospectus itself, verbally, through an announcement containing a summary of the prospectus or through electronic media.²¹ After filing the prospectus and the required documents, and once the issuer's application is approved, a registration of all securities must take place. Registration is done with the Capital Market Authority.²² There is a waiting period, during which the Authority reviews the filing for completeness. The most significant rule to remember is that if the prospectus has not been approved by the CMA, there is no publication of the prospectus; thus, no offer and consequently no sale of securities can take place.

17. Lawyers act as technicians and consultants in the writing of the prospectus. However, they are not securities professionals under the CML rules.

18. 15 U.S.C. § 77b(a)(10) (2006). The CML does not define prospectus, but a definition-type wording could be gleaned from the provision of Article 40(c).

19. Board of the Capital Market Authority, Glossary Of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, 16, *available at* <http://www.sukuk-compliance.com/u/G2.2%20CMA%20Glossary.pdf> [hereinafter CMA Rules Glossary].

20. Capital Market Law, art. 41 (Saudi Arabia), *available at* <http://www.cma.org.sa/En/AboutCMA/CMALaw/Documents/CAPITAL%20MARKET%20LAW-26-8-009.pdf> [hereinafter CML].

21. CML, *supra* note 20, art. 40(c). Note that electronic and other media offers must be approved in advance by the CMA.

22. The phrases “Authority”, “Capital Market Authority”, and “the Board”, and the abbreviation “CMA” are interchangeably used to mean the Board of the Capital Market Authority.

The Capital Market Law neither allows injured investors to bring civil suits in civil courts against other investors or other subjects regulated by it, nor does it allow disputants to adjudicate their securities cases in the Kingdom's traditional judiciary system. However, the CML contains remedies for injured investors through the CMA's judicial bodies: the Committee for the Resolution of Securities Disputes (CRSD) and its Appeal Panel. The law is clear as to whether the CRSD and the Appeal Panel's decisions are reviewable by ordinary courts or higher judicial authorities—they are not. This means once the case has reached the Appeal Panel from the CRSD, it has exhausted all the available remedies under the Kingdom's system. At this point, the case becomes, more or less, akin to a *res judicata* case in the common law system.

The CML also contains antifraud provisions that bar fraud, manipulation, omissions and misrepresentations in connection with the sale and offering of securities. According to Article 55, issuers, senior officers, and underwriters are strictly liable for material misleadings or false statements appearing in their registration or prospectus.²³ The Authority initiates investigations on its own or by complaint. Thereafter, it decides whether to bring charges in front of the CRSD against alleged violators. Since 2006, the Authority has prosecuted a tremendous amount of cases.²⁴

Under the CML proceedings, all evidence is admissible in any form. Moreover, evidence can be obtained without warrant or an order from a judge or a prosecutor, and all the civil rights granted to criminal suspects under Criminal Procedure law of 24/08/1422H, corresponding to Jan. 24, 2004, Section 3-5 are in jeopardy if a person violates the CML.²⁵

In the event of a dispute between investors, they have to pursue their remedies through the Authority as well. Pursuant to Article 25 of the CML, investors first must file their complaint with the Authority and wait ninety days after the filing.²⁶ After the expiration of the ninety days and prior to the lodging of the complaint, the complainant is given a notice informing him that he is allowed to file the complaint with the CRSD or otherwise.

23. CML, *supra* note 20, art. 55(b).

24. There are no publicly known records for these cases. However, the Annual Reports of 2007-2009 point to the prosecution of more than one thousand cases.

25. Here, a due process question may arise because people can be searched, detained, interrogated and their rights can be violated during these processes.

26. CML, *supra* note 20, art. 25(e).

For all suits or actions arising from violations of the CML transparency or disclosure rules, the statute of limitations for bringing such a suit or an action is no more than five years after the occurrence of the violation.²⁷ The period is the same for actions, the causes of which ensue from breach of the CML prohibition against unfair, manipulative or deceptive practices, or any of the actions prohibited by Articles 49 and 50.²⁸ The statute of limitations for an action the cause of which arises from violations to Article 55, 56, or 57 is one year from the date when the “claimant should reasonably have been aware of facts causing him to believe he had been the victim of a violation”, i.e., the date of discovery.²⁹ Notably, the CML cannot be stalled; in other words, there is no tolling. It does not provide incidents in which the statute of limitations can be extended for more than five years. Moreover, there are no cases on this point.

Tolling is significant in two situations. One, in a *continuous crime*, such as continuous fraud that is perpetrated by an offeror against an investor at some point in time. According to the CML, if the investor/victim does not discover the crime within the five year period, his right to file a suit is forever forfeited. This could happen despite the fact that the crime and its effects are ongoing. Two, in a *sophisticated crime*, the perpetrator is so sophisticated to the degree the victim cannot discover the crime or the transaction that caused the crime soon enough, e.g., a security that matures after more than five years. By default, an investor in an instrument that matures after more than five years will likely not discover the crime within five years if the perpetrator is aware of what he is doing or if he hides the evidence. Moreover, it is not uncommon in stock market business for criminals to cook the books, and as such, they can hide their crime for decades. At least in these two scenarios, the CML should have provided an exception to toll the statute of limitations.

Part I introduced the securities system in the Saudi Kingdom with a brief historical introduction to 20th century legal developments in the area of consumer protection in the Kingdom. It also outlined the legal framework that governs the securities industry in the Saudi Kingdom. Part II discusses the role of the Capital Market Authority, the entity tasked with administering the securities laws in the Kingdom. In Part III, the basic issues pertinent to the law of securities are adequately

27. *Id.* art. 58. The statute of limitations is similar to *Taqadum*/"lapse of time" in Arabic. If the suit is not filed by that date, then the complainant is forever barred from suing.

28. In general, Article 49, among other things, prohibits inside trading, fraudulent transactions, creating false impressions, and misrepresentations that affect the market or the participants thereof.

29. CML, *supra* note 20, art. 58.

discussed: jurisdiction under the Capital Market Law, the definition of ‘securities’ in Saudi Law compared to that of the American Securities Act of 1933, admission into the *Tadawul* market and regulation of public and private offerings of securities in the Kingdom, and the requirements for offering and registering securities. Brief comparison with the American system is conducted throughout this part and the following. Other fundamental legal issues that might arise from the definition of securities are highlighted and further explained. Part IV discusses the regulation of the *Tadawul* Market, issuers, and securities professionals under the Capital Market Law with comparison to the Securities Act of 1933. This part also addresses the transparency rules and violations of said rules. Part V concerns liabilities and remedies for violations of the Capital Market Law in general, and in particular, violations of the transparency rules. Part VI reaches the conclusion: although the CML is a very sophisticated body of law, it has a fundamental problem; that is, the CML was literally copied from the American system with no regard to the realities of the Saudi legal system.

A caveat must be mentioned here; despite the fact that the norms about to be discussed were sophisticatedly enacted, there either has not been any case law or the research for this Article did not yield any case worth discussing. This is due to several factors. First, *stare decisis*—the system of precedence—is not that attractive to the Saudis. Second, the legal profession and the formal judicial system in the Kingdom are still developing. Third, Saudi Arabian judges are given broad discretionary powers, and the use of such powers renders the judges’ need for a statute or precedent of little importance. Even in the area we are about to venture into, one may find that the law, in many instances, leaves the matter that is settled in western jurisprudences and jurisdictions wide open to the decision maker. In some areas, one may get the sense that this “whole thing” of discretion makes the law subject to the whim of the individual who is making the decision. How unfortunate it is, but this is the reality.

II. THE CAPITAL MARKET AUTHORITY

The Capital Market Authority is similar to the U.S. Securities and Exchange Commission (SEC) in the American Securities system, yet tremendously more powerful. It was established by the CML, and its powers and mandate are found in Section 2 of the law. It is fundamental in administering the securities laws. Looking squarely at the agency’s function, one could safely say this agency is empowered to do almost

anything with respect to the stock exchange market;³⁰ it has police power, oversight power, legislative power and a judicial role as well.³¹ For day-to-day operation of the *Tadawul* market, the CML has created a joint company called Saudi Stock Exchange (SSE).³² SSE is the sole entity in the Kingdom authorized to carry out trading in Securities.³³ Article 20(c) lists the objectives of the exchange, which are essentially the same objectives of the Authority.³⁴

While the CMA could do almost anything with respect to the stock market in the Kingdom (by virtue of Article 4 of the CML), it cannot engage in any of the following activities:

- commercial activities;
- having a special interest in any project intended for profit; and
- lending any funds, acquiring, owning or issuing any Securities.³⁵

Similar to the SEC, the CMA has a five member board,³⁶ called Commissioners.³⁷ The members are appointed by a Royal Decree for a

30. See CML, *supra* note 20, art. 4(a). The text reads “[a]n Authority to be named “The Capital Market Authority” is hereby established in the Kingdom and shall directly report to the President of the Council of Ministers. It shall have a legal personality and financial and administrative autonomy. It shall be vested with all authorities as may be necessary to discharge its responsibilities and functions under this Law. The Authority shall enjoy exemptions and facilities enjoyed by public organizations. Its personnel shall be subject to the Labor Law.”

31. See *id.* art. 2(e). Subsection (e) gives the CMA the power to determine what instruments should be considered securities. Not only that, it gives this broad discretionary power to the CMA to admit or exclude any instrument from the definition if the Board believes it would further the safety of the market (“... any other rights or instruments which the Board determines should be included or treated as Securities if the Board believes that this would further the safety of the market or the protection of investors. The Board can exercise its power to exempt from the definition of Securities rights or instruments that otherwise would be treated as Securities under paragraphs (a, b, c, d) of this Article if it believes that it is not necessary to treat them as Securities, based on the requirements of the safety of the market and the protection of investors”). This section gives the CMA the power to interpret the law; a truly judicial function to determine what falls under the term “securities”. See Part II of this Article for more discussion on this point.

32. The Board of the Exchange consists of nine members: one from the ministry of finance, one from the ministry of commerce and industry, one from the Saudi Arabia Monetary Agency (SAMA), four from licensed brokerage companies, and two from joint stock companies listed on the Exchange. *Id.* art. 22(b).

33. *Id.* art. 20(a).

34. See, e.g., *id.* art. 23(a)(5) (empowering the Exchange to settle disputes between members and between members and their clients). In fact, all the powers exercised by the Exchange in Article 23, by default, are powers originally granted to the CMA by the CML.

35. *Id.* art. 4(b).

36. CML, *supra* note 20, art. 7(a).

37. The sitting CMA Board, as of May 2010, is chaired by Dr. Abdulrahman A. Al-Tuwaijri and four Commissioners, deputy chairman Mr. Abdulrahman Al-Rashed, Mr. Mohammed Al-Shumrani, Mr. Mazin A. AlRomaih, and Dr. Abdulrahman M. AlBarrak. Capital Market Authority, 2008 Annual Report 7, available at <http://www.cma.org.sa/En/Publicationsreports/Reports/CMA2008.pdf> [hereinafter 2008 CMA Annual Report].

five year term, renewable once.³⁸ The Decree specifies from the members who is to be the chairman and who the deputy.³⁹ The CMA Board is headquartered in Riyadh, with five main departments or offices: the chairman's office, legal affairs, the internal audit office, office of the general secretariat, and public relations.⁴⁰ These five main offices are assisted by twenty-eight sub-offices that have various functions: administrative, regulatory, research, supervision of the market, and investigation, i.e., the housekeeping work. Basically, the CMA carries its mandate and exercises its power through these offices and sub-offices. The CMA answers to the prime minister.

Since the CML anticipated amounting administrative responsibilities ensuing from the task of administering it, it established the CMA to be the official agency responsible of administering this law and regulating all aspects of public trading of securities. The CMA's role is carried out in various ways: (a) through a direct regulatory role and rulemaking power; (b) via supervision of trading, disclosure, violations, and investors' complaints (an administrative role); (c) by making sure participants comply with initial and continuous disclosure requirements; and (d) through investor awareness.

A. DIRECT REGULATORY ROLE AND RULEMAKING POWER

The CMA has issued, so far, ten statutes. These statutes cover the entire securities market personnel, transactions, traders, brokers, etc., in the *Tadawul* market.⁴¹ Moreover, besides the brokers and advisors, these regulations cover proxy solicitations, real estate transactions, corporate governance, and purchasers of securities, and they also impose disclosure, reporting, and other duties on publicly-held corporations. This direct regulatory role is one of the CMA's pivotal functions; it enables it to control the entire securities market by making binding rules that affect:

- Listed and perspective companies;
- Authorized persons and securities professionals;
- *Tadawul*; and
- Traders

38. CML, *supra* note 20, art. 7(b).

39. *Id.* art. 7(a).

40. 2008 CMA Annual Report, *supra* note 37, at 18.

41. *See supra* notes 6-15.

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B. SUPERVISION OF TRADING, DISCLOSURE, VIOLATIONS, AND INVESTORS' COMPLAINTS (ADMINISTRATIVE ROLE)

Since the CMA is the *default* administrative agency tasked with enforcing the CML, it basically functions as an administrative court in both proceedings initiated on its own and in proceedings between private parties. Therefore, besides its rule-making power, the CMA does a number of things that achieve the goal of administering the law, such as:

- Receives investors' complaints;
- Follows-up and monitors violations of the CML and its Implementing Regulations and of the decisions and directives issued by the CMA Commissioners;
- Investigates issues referred to it by the competent departments relating to violations of the Capital Market Law or arising from investors' complaints;
- Brings legal proceedings before the Committee for Resolution of Securities Disputes against any party violating the Capital Market Law and its Implementing Regulations;
- Makes daily market activity reports;⁴² and
- Follows-up on the implementation of the decisions and verdicts issued by the CMA board or the CRSD.

Each of the powers to exercise any of the aforementioned functions is either derived directly from Article 5 of the CML or the implementing statutes that were enacted by the CMA itself.

C. MAKING SURE PARTICIPANTS COMPLY WITH INITIAL AND CONTINUOUS DISCLOSURE REQUIREMENTS

1. Initial Disclosure

As mentioned, the CML requires all prospective companies that desire to conduct business in the *Tadawul* market to make available all the relevant information in a prospectus. The contents of the prospectus include sufficient information for investors about the offering company's financial status, its affiliate, directors, securities issued, shareholders, etc. The prospectus has a significant role. Based on the information contained in it, potential investors make a decision to buy the stock of the company or otherwise. Therefore, if the information submitted to them is

42. In 2006-2007, it averaged over ten reports per day. Capital Market Authority, 2007 Annual Report 58, available at http://www.cma.org.sa/En/Publicationsreports/Reports/cma_report_2007.pdf [hereinafter 2007 CMA Annual Report].

misleading or faulty, these investors can be tricked into investing in the company based on bad information and could eventually sustain substantial losses. Accordingly, the accuracy of the information in the prospectus is crucial. The CMA does not review the prospectus to ascertain the accuracy of the information therein; it only reviews it for completeness. However, according to Article 55(a), if the prospectus omitted or misstated information and the CMA approved it, and based on the information an investor bought the stock and sustained damages, he can always invoke Article 55(a) and claim his damages from the parties who wrote or signed the prospectus. No responsibility lies with the CMA despite the fact that it approved the offering of the stock without ascertaining the correctness of the information.⁴³

To what degree may an injured party invoke Article 55? The Article sets the test here: the injured party can claim his damages if the misstated or the omitted information that caused his losses is “*material*” and had the buyer been aware of the mistake or the omitted information, he would have offered a lower price than what he paid.⁴⁴ Indeed, the information would also be considered material had the buyer been aware of it; it would have prevented him from buying the stock.⁴⁵

2. Continuous Disclosure

This type of disclosure is made to ensure compliance of already listed companies in the *Tadawul* market with the CML and other rules. It is called “continuous” because it is an ongoing process; a listed company must file papers with the CMA as long as it is listed in the *Tadawul* market. Pursuant to this requirement, listed companies must disclose their annual and quarterly reports and fiscal statements, any change in capital that might affect the company’s wellbeing, changes of address, changes in the board of directors and senior executives, changes in

43. The CMA does not endorse statements by offerors or investors. In more than one provision, the CMA disclaims responsibility in the event of approving false or misleading information. The main disclaimer, which exonerates the CMA in case of faulty information in the prospectus, is found in CML, *supra* note 20, art. 48(b).

44. CML, *supra* note 20, art. 55(a) (“In case a prospectus, when approved by the Authority, contained incorrect statements of material matters or omitted material facts required to be stated in the prospectus, the person purchasing the Security that was the subject of such prospectus shall be entitled to compensation for the damages incurred by him as a result thereof. A statement or omission shall be considered material for the purposes of this paragraph if it is proven to the Committee that had the investor been aware of the truth when making such purchase it would have affected the purchase price”).

45. For more on the law of disclosure, see Part IV of this Article.

ownership of substantial shares, and changes in the company's by-laws.⁴⁶ Every security listed in the *Tadawul* market must be continuously reported except those which were acquired by private placement.

Violators of the continuous disclosure requirement may be disciplined or even sanctioned. In one case, the CMA fined a bank for failing to comply with the continuous reporting requirement.⁴⁷ The Bank's fault was that it did not inform the CMA as to the change in its management. In another case, the CMA fined a listed company for failing to report the decision to stop a factory operation.⁴⁸

D. INVESTOR AWARENESS

Investor awareness is achieved by developing financial and economic research and studies, preparing the annual and other periodic reports, and issuing periodic awareness pamphlets and statistical and analytical reports on the Saudi *Tadawul* market.⁴⁹ Also, the CMA disseminates information on the CMA website and media, and answers inquiries from concerned persons by phone, fax, email, etc. Despite the fact that one of the major goals of the *Tadawul* market is achieving transparency in transactions, the decisions of the CRSD are nowhere to be found. The CMA and CRSD are not open for independent researchers or inquiries regarding decisions issued by them. So far, the CRSD has disposed of hundreds of cases, but no one outside the circle of litigants or the judges themselves knows how things go inside the judges' chamber. Few know the facts of the cases that come in the media in the form of news releases. This is considered one major flaw of the system because no one knows how the judges think or how they interpret the law, how they reason their decisions or under what section of the law the CMA prosecutes violators of the CML. The CMA and the CRSD decisions and investigation results are not published.⁵⁰

46. See CML, *supra* note 20, art. 45 (mandating continuous disclosure, among other requirements). The reason for this reporting is to keep the listed company's status updated for concerned persons.

47. See Khalil Hanware, *CMA Fines 2 Listed Firms for Violation*, ARAB NEWS, Apr. 5, 2010, available at <http://arabnews.com/economy/article39204.ece> (reporting that the bank was Aljazeera Bank).

48. *Id.* (reporting that the company was Advanced Petrochemical Company).

49. See 2007 CMA Annual Report, *supra* note 42, at 18.

50. The details and deliberations of the CMA and the CRSD decisions are published as news releases in the daily media or on the website. The way they are released is of little to no value for legal academicians. For example, one complete decision revoking the license of a firm issued by the Authority reads: "Under its resolution No. 11-9-2010 and due to several violations of the Capital Market Law and its Implementing Regulations, the CMA Board of Commissioners issued today Sunday 28/3/1431H corresponding to 14/3/2010 its decision to revoke the license granted to Ernst & Young Saudi Arabia Consulting Limited based on the Capital Market Law issued by the Royal

III. JURISDICTION, DEFINITION OF SECURITIES, AND OFFER AND ADMISSION INTO THE TADAWUL MARKET UNDER THE CAPITAL MARKET LAW

A. JURISDICTION UNDER THE CAPITAL MARKET LAW

The Capital Market Law applies to transactions involving securities that are listed or about to be listed in the *Tadawul* market. Thus, the subject matter jurisdiction of the CML is securities and the geographical limit of this law is the boundaries of the Saudi Kingdom. If any violation of the CML occurs within the Kingdom, naturally, the CMA or the Saudi authorities have jurisdiction over the violation. According to Article 20(b), securities listed or traded in a regulated market outside the Kingdom are not subject to the provisions of the CML even if trading in such a market originates within the Kingdom.

However, the CML has an overreaching provision with respect to personal jurisdiction over violations for foreign law that took place in a foreign country. To make this point clear, if a person violates foreign laws and the same person does business in the Kingdom, such a person is subject to the provisions of Article 62(a)(4), according to which the Authority has jurisdiction to suspend the license of such a person or his agent for twelve months, if the Authority has been formally notified by foreign regulators. The provision of Article 62(a)(4) was rather built on an unsound ground because the Authority cannot make the suspension if it has not been “*formally*” notified by a securities regulator in another country that the person or his agent willfully violated the securities laws of a foreign jurisdiction.

The unsoundness comes from the fact that the Authority has to be “*formally*” notified by the foreign authorities in order to effectuate provision 62(a)(4). A question arises as to what the CML means by “*formal*” notice. It is not clear whether a judgment against a violator of a foreign law constitutes a “*formal notice*” for the purposes of the CML. From the face of the statute, the answer is no. If not, the publication of such a judgment in legal reports or the media may still be a notice, but it does not constitute a notice as specified by the statute.

Decree No. (M/30) dated on 02/06/1424H, and the Authorized Persons Regulations issued by CMA Board of Commissioners on their Resolution No. 1-83-2005 dated on 21/5/1426H corresponding to 28/6/2005. The CMA had authorized Ernst & Young Saudi Arabia Consulting Limited to conduct Arranging & Advising activities in the securities business under resolution No. 2-174-2006 dated on 22/4/1427H corresponding 20/5/2006.” *Saudi Capital Market Authority Revokes Ernst & Young License* (Mar. 15, 2010), available at <http://www.complinet.com/global/news/news/article.html?ref=129983>. This one paragraph decision says Ernst & Young violated the law but cites no provision and gives no reasoning.

It is reasonable to think that any credible notice of a violation should be considered a formal notice because the Authority will not get formal notices unless it has reciprocal agreements with foreign authorities. In some countries, even with the existence of reciprocal agreements, formal notices, as required by CML Article 62(a)(4), would be useless because either the country's judicial system does not have a judgment reporting system or the privacy laws prohibit the transmission of information to foreign authorities. In this way, the formal notice requirement makes little sense.

The provision should have been constructed to achieve a specific purpose; the apparent purpose of this provision is to bar dishonest persons and dishonest practices to ensure the safety of the *Tadawul* market. If this is the true purpose behind the statute, the Authority should not wait to obtain formal notice. Rather, it should act on any credible information it has or it could obtain by any means. Credible information should have been the test here, regardless of how the Authority obtains it. There is no apparent wisdom in tying the market safety to getting information from foreign jurisdictions. The official Arabic version of the statute also mentions formal notice and ignores credible notice or credible information. In sum, the use of the phrase "*formal*" notice renders the statute a bit narrower and contravenes the objectives of the law.

B. DEFINITION OF SECURITIES

A security is a negotiable instrument representing value in something else; it has no independent intrinsic value.⁵¹ One authority, in a quest to define the term, says "the statutory phrase investment contract captures the generic concept of what a security is, and interpretation of this phrase has provided basic guidelines for defining a security."⁵² Investment contracts are the transactions in which one party commits his money to gain profit and the other lends labor or service. While the definition of investment contract sheds light on the term security, the truth is it does not *define* the term.

Notwithstanding the existence of a proper definition, now all securities laws and regulations have a "statutory definition" which actually does not define the term security, but rather enumerates the types of securities under the law. These statutes were enacted, mainly, to cover three broad

51. BLACK'S LAW DICTIONARY (9th ed. 2009), available at Westlaw BLACKS.

52. THOMAS LEE HAZEN, TREATIES ON THE LAW OF SECURITIES REGULATION 29 (3rd ed. 1995); see also LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATIONS 1013-1016 (5th ed. 2004).

categories of investment contracts or vehicles: (1) equity securities; (2) exchange-traded options; and (3) exchange-traded debt securities. Article 2 of the CML is one such example. It does not define the term security, but it does, non-exhaustively, enumerate the types of securities recognized by the law. It states that “. . . for the purposes of this Law, the term “Securities” shall mean:

- a. convertible and tradeable shares of companies;
- b. Tradeable debt instruments issued by companies, the government, public institutions or public organisations;
- c. investment units issued by investment funds;
- d. any instruments representing profit participation rights, any rights in the distribution of assets; or either of the foregoing;
- e. any other rights or instruments which the Board determines should be included or treated as Securities if the Board believes that this would further the safety of the market or the protection of investors. The Board can exercise its power to exempt from the definition of Securities rights or instruments that otherwise would be treated as Securities under paragraphs (a, b, c, d) of this Article if it believes that it is not necessary to treat them as Securities, based on the requirements of the safety of the market and the protection of investors.⁵³

This may seem like such a long definition, but compared to other foreign statutes it is actually shorter.⁵⁴ By way of example, compared to the U.S. 1933 Securities Act’s definition, it fails to expressly mention several internationally recognized investment vehicles and instruments such as “*put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, receipt for, guarantee of, or right to subscribe to or purchase.*”⁵⁵ While the CML does not expressly mention these instruments in the definition, almost everything is included in the Glossary of Terms; for equity securities there are stocks and convertibles, for puts and calls the law recognizes options, and for derivatives the law recognizes futures. Perhaps it is for this reason the Glossary of Terms⁵⁶ further elaborates on the term security

53. CML, *supra* note 20, art. 2.

54. The CML is based on international standards; among them, the U.S. Securities Laws of 1933 and 1934. *See* Al-Twajjry, *supra* note 2, at 3.

55. Securities Act of 1933 § 2(a)(1), 15 U.S.C. § 77b(a)(1) (2010) (emphasis added).

56. CMA Rules Glossary, *supra* note 19. It is notable that the Glossary of Terms has expanded the definition of security to include transactions that are not typically Shari’a compliant, such as futures and possibly credit swabs and derivatives. This may contravene Article 8 of the Offers of Securities Regulations, which requires the securities offered to be Saudi law compliant.

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and outlines ten instruments, some of which were not mentioned in Article 2. These include:

- (1) shares;
- (2) debt instruments;
- (3) warrants;
- (4) certificates;
- (5) units;
- (6) options;
- (7) futures;
- (8) contracts for differences;
- (9) long term insurance contracts; and
- (10) any right to or interest in anything which is specified by the above.⁵⁷

Accordingly, this definition, ostensibly shorter, is not narrow because of the elaboration in the Glossary and more importantly, because subsection (e) is placed at the end of Article 2 as a “savior clause”. Subsection (e) allows the decision maker to consider any missing instruments and any other remotely related investment contracts as securities if this would further the objectives of the law. The overly broad wording of the clause allows the decision maker ample power to exclude or include what it sees fit in the definition. The clause restricts the exercise of this power to further the common good of the market. The question that begs answering is “how does the Commission, or, for this matter, any other judicial body determine whether a specific instrument is a security or not?” The answer is, based on the research conducted for this Article and the apparent Saudi practice, we do not know.

However, since the CML is derived from international standards, one assumes that it follows these standards or at least is guided by them. One of these international standards that has heavily influenced the CML is the U.S. securities regulations. A U.S. court, in determining whether a specific transaction or instrument is a security or governed by the securities laws, first looks at whether the particular investment or instrument calls for investor protection under the securities laws. It is unclear how the court determines the investment calls for protection. To appreciate this point, we will discuss the leading precedent in defining investment contracts in the American System, *SEC v. W.J. Howey*.⁵⁸ In *Howey*, the promoters sold an optional service agreement to the investors and one of the promoters’ affiliates would manage the trees and their

57. *Id.* at 4-5.

58. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). *See also* HAZEN, *supra* note 52, at 13-14.

fruits. About 85% of the buyers bought the optional service, which was managing the trees. The service agreement gave *Howey's* affiliate a full possession of the plots. Investors were not expected to come to the plots and care for the trees themselves. Actually, it was impossible for an investor to do so; the investors did not have a right to access the plots, and it was not economically feasible to individually manage the plots.⁵⁹ *Howey's* court stated that while the services offered by the promoters are not tied by contract, in reality they create security because they are attached to the property. From this case, a contract is an investment contract if a person:

- (1) invests his money;
- (2) in a common enterprise;
- (3) is led to expect profit; and
- (4) the profit comes “*primarily*” or “*substantially*” from the efforts of others.

In essence, *Howey's* standard is sort of a “*totality of the economic circumstances*” test because the court looks at the economic circumstances surrounding the contract or the investment as a whole and determines whether it should be treated as a security. No single factor is determinative in this test. However, it is clear that *Howey's* test is not about defining security; the test determines whether an instrument is an investment contract, not whether the instrument fits within the examples in the definition of securities. The U.S. Supreme Court, years after it decided *Howey*, paid attention to this point. In the 1985 case *Landreth Timber Co. v. Landreth*, the Court focused on whether the investment contract in question fit within the definition of security. The Court noted that *Howey's* totality of the economic circumstances test is good for defining investment contracts, but not good at defining whether these contracts fit within the examples listed in the statutory definition of security.⁶⁰ One obvious reason for not applying *Howey's* test, as the Court noted, was that it would render the “enumeration of many types of instruments in the definition superfluous.”⁶¹ In *Landreth Timber* the Court focused on the factual circumstances surrounding the investment. The Court emphasized two outcomes: (1) each of the financial instruments listed in the statutory definition of security is susceptible to a

59. HAZEN, *supra* note 52, at 13.

60. LOSS & SELIGMAN, *supra* note 52, at 232.

61. *Id.* at 232-233.

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separate analysis employing separate analytical concepts; and (2) there is no universal or generic test for the term 'security.'⁶²

Going back to the CML's definition, the statute does not define securities; it rather identifies certain schemes or transactions and gives them the statutory label "securities." Thus, what is articulated by statute in Article 2 are the securities that the law recognizes. It is as though the legislator is saying, besides what is listed in Article 2(a)-(d), "we know what a security is when we see it." This, in reality, does not mean a lot for a person sitting on a bench because actually there is no disagreement on all the types of securities listed in these subsections. Rather, the disagreement is on what has not been mentioned. To cover this pitfall the CML gave broad discretionary power to the CMA and the CRSD in subsection (e). Subsection (e) allows the Board to define the term security, and to exclude from, or include in the definition what it sees fit. The problem is that there is no published jurisprudence telling researchers what test is deployed in determining whether an instrument or a transaction falls within the ambit of the definition. Moreover, the statute does not point to any type of test the judge should deploy to make the call. It only sets this vague guidance, at the bottom—in the last sentence—of Article 2(e), which says: "based on the requirements of the safety of the market and the protection of investors the Board has the power to include or exclude from the definition what it believes to be or not to be a security."⁶³ However, if we considered the test for determining whether an instrument is a security as "safety of the market," the totality of the economic or factual circumstances tests, articulated by the American courts, do not apply. The issue still stands, by the safety of the market test, that a judge will not be able to determine whether the instrument in question is a security or not.

If we assume, *arguendo*, that the safety of the market is a test, it seems that the judge would have to exercise broad discretionary, perhaps arbitrary, power to make such a decision based on such a test. And here lies the dilemma, because apparently the *safety of the market* test is just a myth at worst and misconception at best. The CML's "*safety of the market*" test is *per se* vague and normally cannot be seen as a test to make a determination on the nature of the note or the transaction. Furthermore, it appears that the coining of the phrase "safety of the market" is just a misconception because it mixes the end with the means. This is so because a test is a mechanism or a tool deployed to reach an outcome. Safety here is an outcome or a goal. Safety of the market is

62. *Id.* at 232.

63. CML, *supra* note 20, art. (2)(e).

one of the CML's goals, while identifying what constitutes a security is basically a jurisprudential question that must be answered by the court by using a test prior to making a decision. The judge should find a guide in the law or the jurisprudence to make this call. The CML assumes this guide is the safety of the market. The test should have been something similar to the totality of economical or factual circumstances surrounding the transaction or any other normative test.

1. Instruments Not Subject to Securities Regulations

Article 3 of the CML excludes from the definition of securities commercial papers such as checks, bills of exchange, order notes, documentary credits, money transfers, instruments exclusively traded among banks, and insurance policies.⁶⁴ These, regardless of their secure or non-secure status, are statutorily excluded from being treated as securities. Article 3 exempts insurance policies from being treated as securities for the reasons outlined below. However, this provision does not exempt insurance company stock or other securities from such policies. If insurance companies are listed in the *Tadawul* market, they are subject to the provisions of the CML. Their bonds and other securities are regulated by the same provisions that apply to everyone in the *Tadawul* market. They must register, disclose and report like other participants. Therefore, in essence, Article 3 exemption is a transaction exemption, not a securities-type exemption.⁶⁵

The rationale for excluding insurance policies and the other items could be that these do not need the protection of the CML and that they are governed by other systems or regulations. In other words, these are mostly secured transactions and papers. Take checks issued by commercial banks as an example: banks themselves are supposedly insured or guaranteed by the Saudi Central Bank/Saudi Arabian Monetary Agency (SAMA) similarly to the way commercial banks are insured by the Federal Deposit Insurance Corporation (FDIC) in the American System.

Another rationale for excluding some of these items could be that these instruments are usually given in sale transactions or as securities for short term maturity transactions in which a party pays some kind of consideration for the unconditional promise of the other to pay.⁶⁶ For a

64. *Id.* art. 3.

65. See LOSS & SELIGMAN, *supra* note 52, at 234.

66. The CMA defines commercial papers as "a debt instrument creating or acknowledging indebtedness that has a maturity of less than one year from the date of issue." CMA Rules Glossary, *supra* note 19, at 17. It must be noted that this definition is extracted from the American Law.

holder in due course, these bills are as good as money; thus, there is no need to protect these bills by the securities laws. Even if problems arise, the holder's rights can be enforced through civil litigation. Moreover, the overriding rationale for excluding these bills is that they are neither used as stock or commodity nor traded in markets; they are rather used as a means to facilitate daily transactions.

Yet, it is not clear why some of these notes or bills mentioned in Article 3 are not treated as securities. They resemble securities in many ways: they are negotiable, they convey rights or interests, they contain a promise to pay, and they are used, indirectly, to raise capital. Similarly, in the American jurisprudence, this provision is found in Section 3 of the 1933 Securities Act. There is no apparent theory behind the exemption, but it seems that both the Saudi regulator and the American legislator took a positivist approach to the exclusion.

Nevertheless, the important question in practice is how a court of law should make the determination as to whether to exclude an instrument or transaction from the definition based on the theory behind the exemption in Article 3. In Saudi law we do not know, but for an American court there is a certain way to make the determination: an American court would place a paramount importance on the purpose of the note. If the issuer of the note desires to raise money to fund investment schemes or commercial enterprises, then the note is likely a security.⁶⁷ On the other hand, if the note is issued in sale transactions to facilitate the cash flow or the note is issued to advance consumer good, the note is unlikely to be described as security.⁶⁸ It seems that the CML has followed the American positivism in this matter. The article that exempts these papers in the CML uses the very wording of the corresponding American article.

C. OFFER, ADMISSION, AND LISTING IN THE *TADAWUL* MARKET

The sale of securities—also called distribution—is mainly regulated by two regulations of the Implementing Rules of the CML, namely, the Listing Rules and Offers of Securities Regulations. To sell securities, companies have to offer them to buyers. Offering is conducted by one of two ways: primary offering and secondary offering. The primary offering, also known as primary distribution, is the sale of securities by the issuing company to the public, usually through an underwriting

Ironically, the CML's Article that deals with exemptions is Article 3 and the American one is Section 3 of the 1933 Act, as well.

67. See LOSS & SELIGMAN, *supra* note 52, at 234. See also HAZEN, *supra* note 52.

68. See LOSS & SELIGMAN, *supra* note 52, at 234. See also HAZEN, *supra* note 52.

agreement between an issuer and broker or dealer.⁶⁹ This is usually done to raise capital because the proceeds of the sale go to an issuing company. The secondary offering, termed a distribution, is when the seller is not the issuer, but a shareholder or group of shareholders that sell a previously issued stock. The proceeds of the sale are not used to raise capital; they go to the selling shareholder.

1. Offer Under the CML

An offer under the CML is quite different from an offer under contract law theory. It is statutorily defined in the Offers of Securities Regulations (Offers of Sec. Reg.) to mean “issuing securities, inviting the public to subscribe therefore or the direct or indirect marketing thereof; or any statement, announcement or communication that has the effect of selling, issuing or offering securities, but does not include preliminary negotiations or contracts entered into with or among underwriters.”⁷⁰ The securities offer is not just an expression or statement to be bound if accepted by the offeree, it is rather broader than that. It is broad because traditional offers are governed by time and they must be specific. As such, the offeree must decline or accept the offer and what has been offered while the parties are still in the *muglis al-akad*, a vicious place in Islamic jurisprudence where the contract is said to be formed. By contrast, for a securities’ offer, any direct or indirect marketing statement, announcement, or communication that has the effect of selling or issuing would be considered an offer.

The terms “offeror” and “offeree” are also defined by the Offers of Sec. Reg. “Offeror” is defined to include the person soliciting an offer or the person arranging an offer, which would give rise to the sale of securities if accepted.⁷¹ “Offeree” is defined to include the recipient of the offer and/or his authorized agent.⁷²

69. BLACK’S LAW DICTIONARY (9th ed. 2009), available at Westlaw BLACKS.

70. Offers of Securities Regulations, art. 1 (Saudi Arabia), available at <http://www.cma.org.sa/En/Documents/OFFERS-OF-SECURITIES-REGULATION.pdf> [hereinafter Offers of Sec. Reg].

71. Offers of Sec. Reg., *supra* note 70, art. 4.

72. *Id.* art. 5

(a) Types of Offers and the Conditions for Listing

In 2008, the rules regulating offers of securities were amended.⁷³ Prior to the 2008 Amendment, the rules imposed a restriction that securities issued by a company in the Kingdom could not be issued unless the issuing company was a joint stock company. Now, after the amendment, this restriction has been lifted and securities may be offered either through public offer or private placement. This means there are two types of offering: private and public. A private offering, termed 'private placement' in the CML,⁷⁴ is made either to the government, to specified persons, or to a limited number of persons (those who are well acquainted with the affairs of the company such that the company does not need to file a registration statement or make a continuous disclosure to the CMA with respect to the securities it is about to sell).⁷⁵ By contrast, a public offering is made to the public at large and every aspect of it, from advertising to selling, is regulated by the CML and supervised by the CMA.

(b) Definition of Public Offer

Where invitations to buy or sell securities are not directed toward specific persons, but rather open to the public, the offer is said to be a public offer. The Offers of Sec. Reg. does not define public offering, it simply provides that an offer is public if it does not fall under one of the categories of private placement as specified in the statute.⁷⁶

The first time an issuer offers securities by public offering and gets listed in the *Tadawul*, the offeror must meet two sets of conditions and requirements provided for in the Listing Rules.⁷⁷ The first set of requirements is related to the applicant. This set, mainly, is structured to guarantee that the issuer is a scrupulous and stable business. Thus, to offer securities, the issuer must: (i) be a Saudi;⁷⁸ (ii) carry on as its main activity, for at least three financial years under substantially the same

73. CMA Board Resolution, *supra* note 6, No. 1-28-2008, 17/8/1429H (Aug. 18, 2008). For more on the amendment, see Glenn Lovell, *Offering of Securities in the Kingdom of Saudi Arabia*, 36-7, available at http://archive.newsweaver.com/altamimi/newsweaver.ie/altamimi/e_00032146000010324064e4.html.

74. Offers of Sec. Reg., *supra* note 70, art. 6.

75. For more on private placements, see subsection 3, below.

76. Offers of Sec. Reg., *supra* note 70, art 7.

77. *Id.* art. 8.

78. Listing Rules, art. 11(a) (Saudi Arabia), available at <http://www.cma.org.sa/En/Documents/Listing%20rules.pdf> [hereinafter Listing Rules]. While the law provides that the applicant must be a Saudi company, in practice the CMA has indirectly allowed so-called "swap agreements" between non-resident foreign investors and local intermediaries, permitting indirect foreign ownership on the bourse.

management;⁷⁹ (iii) publish audited accounts covering at least the last three financial years;⁸⁰ (iv) have management with appropriate expertise;⁸¹ (v) have sufficient working capital for the 12 months immediately following the date of the publication of the prospectus.⁸²

The second set of requirements or conditions is related to securities. This set is put in place to ensure three things: first, alienability of securities; second, financial competency of the issuer; and third, the legality of the issuance in question. Legality refers to both internal legality, which means the issuer is authorized by his bylaws to make the IPO, and external legality, which means the offer must comply with the law. This set contains seven requirements for securities:

- (i) conform to the statutory conditions in the Kingdom.⁸³
- (ii) be duly authorized according to the requirements of the applicant's by-laws or certificate of incorporation.⁸⁴
- (iii) there must be at least 200 public shareholders.⁸⁵
- (iv) at least 30% of the classes of shares that are the subject of the application are owned by the public.⁸⁶
- (v) be transferable and tradable.⁸⁷
- (vi) The securities must be registered and settled centrally through the Depository Center.⁸⁸
- (vii) Except where securities of the same class are already listed, the expected aggregate market value of all securities to be listed must be at least:
 - (1) SR 100 million for shares; and
 - (2) SR 50 million for debt instruments.⁸⁹

These are straightforward requirements, but one notable thing about the second set of requirements is that paragraph (i) requires that the securities must conform to the laws and regulations of the Saudi Kingdom. According to this rule, securities could not be offered where the company offering them is conducting a business that contravenes with the *Shari'ah* principles. *Shari'ah* principles, generally, prohibit

79. *Id.* art. 11(b).

80. *Id.* art. 11(c).

81. *Id.* art. 11(e).

82. *Id.* art. 11(f).

83. Listing Rules, *supra* note 78, art. 12(a)(1).

84. *Id.* art. 12(a)(2).

85. *Id.* art. 13(a)(1).

86. *Id.* art. 13(a)(2).

87. *Id.* art. 12(b).

88. Listing Rules, *supra* note 78, art. 12(c).

89. *Id.* art. 15(a)-(b).

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dealing in three categories of business: first, usuries business or the taking of interest; second, highly risky business, also called excessive uncertainty; third, industries that are prohibited *per se*, e.g., pork, weapon, alcohol and money exchange.⁹⁰ A Shari'a Advisory Board determines the legality of the transaction from an Islamic perspective. If an applicant fails to confirm to (i) or any of the other five requirements, his application for enlisting in the *Tadawul* is in jeopardy.

(c) Definition of Private Placement

Private placement is a private offer or an offer that is not open to the public. Private offers are not defined, but according to the Offers of Sec. Reg. Article 9(a), an offer is a private placement if it falls under any of the following categories:

- (1) The offeror is the government or a supranational agency recognized by the Authority;
- (2) the offer is restricted to sophisticated investors; or
- (3) the offer is a limited offer.⁹¹

This means an offer to sell government debts or bonds would not be subject to the CML disclosure rules or other offer rules. However, this does not mean private placements are not subject to antifraud provisions. Other statutes not relating to the *Tadawul* market regulations may fill the gap and regulate the offering, distribution or advertising of private placements. Additionally, the CMA retains a discretionary power to consider an offer that is originally not a private one as a private offer. This occurs if the person seeking admission to the market made a request and the CMA granted it. The CMA may impose further conditions in this case.⁹²

It is notable that Article 9 of the Offers of Sec. Reg. provides in subsections (2) and (3) the terms "sophisticated investors" and "limited offer". Articles 10 and 11, respectively, answer these questions. Article 10 provides that:

90. For more discussion on the issues facing the Islamic securities industry, see Dr. Theodore Karasike, et. al., *Islamic Finance in a Global Context: Opportunities and Challenges*, 7 CHI. J. INT'L L 739 (2007); see also Nickolas C. Jensen, *Avoiding Another Subprime Mortgage Bust Through Greater Risk And Profit Sharing And Social Equity In Home Financing: An Analysis Of Islamic Finance And Its Potential As A Successful Alternative To Traditional Mortgages In The United States*, 25 ARIZ. J. OF INT'L & COMP. L. 825 (2008).

91. Offers of Sec. Reg., *supra* note 70, art. 9(a).

92. *Id.* art. 9(b). The regulations do not point to any of the requirements the CMA may impose in case it decides to consider an offer that was originally not a private one.

An offer of securities is restricted to sophisticated investors where the offer is directed at any of the following persons:

- 1) authorized persons acting for their own account;
- 2) Clients of a person authorized by the Authority to conduct managing activities provided that:
 - a. the offer is made through the authorized person and all relevant communications are made through the authorized person; and
 - b. the authorized person has been engaged as an investment manager on terms which enable it to make decisions concerning the acceptance of private offers of securities on the client's behalf without reference to the client;
- 3) the government of the Kingdom, any supranational authority recognized by the Authority, the Exchange and any other stock exchange recognized by the Authority or the Depository Centre;
- 4) Institutions acting for their own account;
- 5) professional investors; or
- 6) any other person prescribed by the Authority.⁹³

According to the Article, the sophisticated investor could be a natural person, either a principal or his agent, but must be authorized to conduct business in the *Tadawul* market, e.g., an advisor, single investor and/or his agents. A sophisticated investor also includes the professional investor which is defined as any natural person who fulfills at least two out of three criteria:

- 1) he has carried out at least 10 transactions per quarter over the previous four quarters of a minimum total amount of Saudi Riyals 40 million on securities markets;
- 2) the size of his securities portfolio exceeds Saudi Riyals 10 million;
- 3) he works or has worked for one or more year in the financial sector in a professional position which requires knowledge of securities investment.⁹⁴

Moreover, a sophisticated investor could be a juridical person, either a public entity such as the Saudi government or any of its agencies, or private investment firms.

93. *Id.* art. 10.

94. CMA Rules Glossary, *supra* note 19, at 14.

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Article 11 of the Offers of Sec. Reg. defines the term 'limited offer'. It determines the circumstances under which an offer may be considered a limited one and sets further requirements for treating an offer as limited. Article 11 provides three situations that are considered limited offers: first, where the offer is directed at no more than 60 offerees, not including sophisticated investors, and the minimum amount payable per offeree is not less than one million SR or an equivalent amount.⁹⁵ Here, there is a combination of two conditions, both of which must be met by the offeror. Second, where the offeree is an employee of the issuer or the employee of an affiliate.⁹⁶ Third, where the offeree is an affiliate of the issuer.⁹⁷ Once securities of the same class are offered as limited, they may not be offered again for twelve months. Indeed, the issuer may offer as much as he wants from different classes of securities. This is exactly what Offers of Sec. Reg. Article 11(b) deals with.⁹⁸

2. Private Placement Notification

Prior to the issuance of the 2008 Amendment to the rules regulating the offer of private securities, the law used to require the issuer to make the private placement through a memorandum, called the Private Placement Memorandum (PPM). After the Amendment of 2006 to the Offers of Sec. Reg., the memorandum requirement was removed and replaced by Private Placement Notification (PPN). According to the new rule, Article 12(a) of the Offers of Sec. Reg., the CMA must be notified ten days prior to the date of offering. There is a specific way to make the ten-day PPN, which is to attach the Annex 1 to the Offers of Sec. Reg. In addition, Article 12(a) requires the private offeror to comply with several requirements and make two additional declarations annexed to the Offers of Sec. Reg. when making private placement. The Declarations attest to the accuracy and the completeness of the PPN and the advertising documents.

In sum, to offer securities by private placement the offeror must submit to the CMA a package of paper work containing:

- (1) PPN;
- (2) two declarations; and
- (3) offering documents used in advertising.⁹⁹

95. Offers of Sec. Reg., *supra* note 70, art. 11(a)(1).

96. *Id.* art. 11(a)(2).

97. *Id.* art. 11(a)(3).

98. *Id.* art. 11(b) ("Securities of the same class may not be offered as a limited offer under . . . this Article more than once in a 12 month period ending with the date of the offer in question").

99. This conclusion is based on the reading of Article 12 of the Offers of Sec. Reg.

3. Restrictions on Privately Acquired Securities

Under the 2008 Amendment, once securities are sold by private placement the offeror is not required to produce or to register with the Authority or the Exchange any document relating to the offer of the securities, or to inform the Authority of any material developments relating to the securities.¹⁰⁰ This means there are no continuous disclosure requirements. However, while there is no continuous disclosure requirement with respect to privately acquired securities, the antifraud provisions of the CML are fully operational. Also, the Offers of Sec. Reg. restricts the way private placements are advertised. They must be advertised to persons to whom a private placement may lawfully be made and through an authorized person.¹⁰¹

Also, Article 17 restricts the secondary market of securities acquired privately. The acquirer may not sell these securities, even for private buyers,¹⁰² except through an authorized person and until meeting one of three conditions imposed by the Article:

- (i) the price to be paid for the securities in any one transaction is equal to or exceeds one million SR or an equivalent amount;
- (ii) the securities are offered or sold to a sophisticated investor;
- or
- (iii) the securities are being offered or sold in such other circumstances as the Authority may prescribe for these purposes.¹⁰³

The smallest consequence of noncompliance with private placement requirements would be disallowing the transaction proposed. Moreover, according to Article 18 of the Offers of Sec. Reg., if the private placer submitted inadequate information, the CML rules against omission or misstatement apply. In addition, the antifraud provisions of Articles 49 and 50 apply, as well.

To avoid leaving privately acquired securities in the shadow, the CML in the Offers of Sec. Reg. Article 17(e) provides a window for these

100. Offers of Sec. Reg., *supra* note 70, art. 16. While there are no continuous disclosure requirements, other rules relating to the safety of the market are still applicable. Material developments include, for example, failure to inform the CMA about managerial changes, and failure to inform the CMA about the decision of the company to stop the operation of a factory for maintenance. In at least two cases, the CMA sanctioned listed companies for failure to give notice; *see* Hanware, *supra* note 47.

101. Offers of Sec. Reg., *supra* note 70, art. 15.

102. *Id.* art. 17(c).

103. *Id.* art. 17(a).

securities and allows them to be listed publicly upon approval by the CMA. Indeed, if they are publicly listed, all the restrictions imposed by Article 17 are notwithstanding. However, prior to listing they must satisfy the requirements of listing, discussed below.

4. Offer of Merger and Acquisition

For a listed company in cases of merger or acquisition, Article 5(a) of the Merger and Acquisition Regulations mandates that the offeror put the offer in the first instance to the board of the offeree company or to its advisors. Moreover, to preserve shareholders' voting rights, if the registered company's securities will face reduction or some of them will be cancelled during the merger process, Article 35(d)(1) of the Merger and Acquisition Regulations requires the offeror to make public disclosure.¹⁰⁴ The disclosure is made pursuant to Article 11 of the Merger and Acquisition Regulations. The Article provides that public disclosure must take place for their own account during an offer period when dealings in relevant securities by the offeror or by the offeree and a person acting in concert with them. However, subsection (b) of Article 11 states that if dealing is going on during the offer period, but not for the offeror or the offerees' account, public disclosure is not required. Instead, disclosure is required to the CMA, which is a simple requirement in that it resembles a notice. According to Article 11(c) of the Merger and Acquisition Regulations, during the offer for taking over or merger, any person who owns 1% or more of the shares of the company has a reportable interest. He must report to the CMA because the CMA has a discretionary power as to whether to make the reportable interest public.¹⁰⁵

5. Admission into the *Tadawul* Market

Prior to the offering of any securities, an applicant must be admitted into the *Tadawul* market. An applicant is admitted if he complies with the pre-filing requirements set out in the Listing Rules. First, an entity seeking admission must file a Formal Letter of Application and a prospectus with the CMA.¹⁰⁶ Here, we discuss the other requirements for admission and official listing.

104. Merger and Acquisition Regulations, art. 11 (Saudi Arabia), available at <http://www.cma.org.sa/En/Documents/Merger%20and%20Acquisition%20Regulations.pdf> [hereinafter Merger and Acquisition Reg.]. Disclosure is made to the public or to the CMA. It is made to the public if the parties are acting for their account, while disclosure is made to the CMA only if the parties are acting for their client's interest.

105. *Id.* art. 11(c)(3).

106. The prospectus and its contents were explained in Part 1, *supra*.

The Letter of Application must satisfy at least eleven of the requirements listed in Article 19 of the Listing Rules¹⁰⁷ and be submitted with six annexes, also called supporting documents. The most important of these are Listing Rules Annexes 1, 2, 3 and 6. The first required annex, Annex 1, is a bit complicated. It must contain information about the shares' ownership, class, total amount paid for issued shares and their value. Also, it includes information about the debt instruments, their class,

107. Listing Rules, *supra* note 78, art. 19 (“a. An issuer seeking registration and admission to listing of its securities must submit an application to the Authority which contains the information required under these Rules and pay the fee set by the Authority. b. The issuer must submit with its application to the Authority an original copy (or certified where appropriate) of the following documents: 1) the letter of appointment for the financial advisor; 2) the letter of appointment for the legal advisor; 3) the authorisation letters or powers of attorney of the representatives of the issuer empowering them to sign the prospectus; 4) a working party list providing the contact details of the persons in charge whom are involved with the application at the issuer, the financial advisor and the legal advisor; 5) a list containing the names and civil registry numbers (or the equivalent to it for non-Saudi nationals) of the directors and their relatives, senior executives and their relatives and shareholders; 6) a formal letter of application to registration and admission to listing signed by a representative of the issuer in the form set out in Annex 1 to these Rules; 7) a declaration by the issuer in the form set out in Annex 2 to these Rules; 8) a declaration and undertaking signed by the directors of the issuer and by each proposed director of the issuer in the form set out in Annex 3 to these Rules; 9) the draft prospectus in Arabic; 10) all underwriting commitment letters; 11) the issuer’s certificate of commercial registration and, where applicable, those of its subsidiaries, or equivalent in the case of a foreign issuer; 12) the issuer’s articles of association and by-laws and all amendments to date (if any) and, where applicable, those of its subsidiaries; 13) the annual report and audited annual financial statements of the issuer and, where applicable, those of its subsidiaries for each of the three financial years immediately preceding submission of the application; 14) the latest interim financial statements produced since the date of the last annual report and the most recent audited financial statements; 15) a report by an external auditor on the working capital of the issuer for the 12 month period following the date of the publication of the prospectus; 16) the legal due diligence report issued by the legal advisor regarding the application; 17) the financial due diligence report regarding the application; 18) a presentation detailing the structure of the issuer and its subsidiaries, along with a detailed description of the most recent restructuring of the issuer (if applicable); 19) the market study detailing industry information and market trends produced for inclusion in the prospectus; 20) the letters of consent from all the advisors on the use of their names, logos and statements in the prospectus; 21) a subscription form; 22) a letter from the financial advisor and the issuer setting out the disclosure requirements under these Rules which are not applicable; 23) a letter from the issuer’s financial advisor in the form set out in Annex 7 to these Rules; 24) a letter from the issuer’s legal advisor in the form set out in Annex 8 to these Rules; 25) in the case of debt instruments or convertible debt instruments, a copy of the debenture agreement or any other document constituting or securing a debt instrument must be included; 26) an electronic copy of all the above mentioned documents (where applicable); and 27) any other documentation as it may be required by the Authority. c. Following the approval of the prospectus by the Authority, the issuer must submit an original copy (or certified where appropriate) of the following documents to the Authority: 1) a prospectus in Arabic signed on every page by the representatives of the issuer whom are appointed as authorised signatories; 2) 15 copies of the published prospectus in Arabic; 3) 15 copies of the English translation of the prospectus; 4) the securities allocation model; 5) the latest reviewed interim financial statements (where applicable); 6) all signed underwriting, sub-underwriting and distribution agreements entered into in connection with the offer; 7) an updated and signed letter in the form set out in Annex 1 to these Rules; and 8) an electronic copy of all of the above mentioned documents (where applicable). d. The issuer must retain copies of all documents required pursuant to this Article for a period not less than five years. e. If the issuer has its securities already listed, paragraphs (c) and (d) of Article 11 of these Rules and sub-paragraphs 5), 11), 12), 13), 14) and 15) of paragraph (b) of this Article shall not apply to the application for registration and admission to listing of debt instruments or convertible debt instruments”).

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number, value, and their redemption value. It shares information with Annex 4 and 5, which concern the prospectus and the information contained therein.

Annex 2 is the Issuer's Declaration. This is a document signed by or on behalf of the issuer. The signatory states on it that the issuer has complied with what is legally required to be listed in the *Tadawul*. Also, the document explains that the issuer has understood his obligations and responsibilities. At the bottom of the document the issuer authorizes the CMA to exchange his information with the relevant agencies.

Annex 3 is the Directors' Declaration. Every director in the company must submit this document. Basically, Annex 3 contains personal information about the director, his expertise, address, etc. Information about the director's character and criminal and civil history is also requested in this document. At the bottom of the document the director declares, but not under the penalty of perjury, that the information contained therein is true. Authorization is given to exchange the director's information with other relevant authorities.

Annex 6 is the Accountant's Report. This is a lengthy document prepared by an independent accountant. It contains information about the company's audited financial statements for the last three years with respect to the following:

1. balance sheet;
2. income statement;
3. cash flow statement;¹⁰⁸

Accountants are required to give personal opinion as to whether this document reflects a "true" and "fair" view of the financial matters set out in it.¹⁰⁹

An applicant who complies with the foregoing requirements can drop his application for admission with the CMA after paying the fees. Once the complete application (Letter of Application, Prospectus and 6 Annexes) is delivered, the CMA reviews it for completeness. The process of reviewing the prospectus takes 45 days.¹¹⁰ The Rules do not address cases where the CMA does not take action within the 45 day period.¹¹¹

108. Listing Rules, *supra* note 78, Annex 6.

109. *Id.*

110. *Id.* art. 22(c).

111. *Id.* art. 22(d).

However, other rules suggest that the applicant just has to wait, even if the waiting period exceeds the statutory 45 days.¹¹² During the review, if it appears to the CMA that the prospectus is incomplete, it may require the applicant to submit more information or ask him to appear before the Authority. Moreover, the Authority may as well initiate its own investigation,¹¹³ which would cause an inevitable delay in the applicant's approval. Provision 14(d)(4) of the Listing Rules allows the Authority to defer the approval of any application as long as delay is necessary. During this period, the applicant may be given a chance to be heard by the Authority, or be asked to explain any ambiguities in the prospectus. In the end, at minimum, the prospectus must comply with Article 42 of the CML to be approved.¹¹⁴

While in the review period, applicants are prohibited, by the CML rules, from advertising, offering or selling of any securities until the prospectus is approved by the CMA. Under CML Article 1, the prohibition against pre-approval communications and activities does not include prohibition against negotiations between an issuer and underwriters and contracts or memorandums of understanding entered into between the issuer and underwriters.¹¹⁵ The rationale behind this is that while pre-approval communication might be bad, the law cannot write a blank prohibition check against all communications and activities, because issuers and underwriters need to work together prior to issuing the stock. But, the law also does not want to have a premature buying interest prior to approval.¹¹⁶ Accordingly, the exclusion of pre-filing communications and negotiations is a matter of striking a balance between these two goals.¹¹⁷

If an applicant is denied admission, he appeals the denial with the Authority to the Committee for the Resolution of Securities Disputes.¹¹⁸ A successful applicant is admitted in the *Tadawul* market; he can make an Initial Public Offering and conduct business as usual. However, even approved offerings may be withdrawn if they do not find market or appropriate demand. For example, the CMA had to withdraw *Al-Tayyar Travel Group* and stop its public offering just hours before the public

112. CML, *supra* note 20, art. 41.

113. *Id.*

114. CML, *supra* note 20, art. 45.

115. See HAZEN, *supra* note 52, at 28; see also ROBERT A. FIPPINGER, TIMING ISSUES UNDER CONTRACT LAW AND SECURITIES LAW FROM PRELIMINARY OFFICIAL STATEMENT TO CLOSING (2006).

116. See HAZEN, *supra* note 52, at 28.

117. *Id.*

118. Listing Rules, *supra* note 78, art. 1(c).

offering announcement because demand was weak and investment firms paid substantially less than what the Group sought.¹¹⁹

(a) Registration of Dealing in Securities

After approval and admission into *Tadawul* market, all securities must be registered with the Securities Depository Center (SDC).¹²⁰ The SDC is tasked with executing the transactions of deposit, transfer, settlement, clearing, and registering ownership of securities traded on the Stock Exchange.¹²¹ Furthermore, liens, claims or encumbrances against securities are also registered with the SDC.¹²² Currently, the SDC is not running, but on a temporary basis the Tadawul Company is doing the SDC's job. In the course of registering securities, the SDC is liable for negligence or misconduct that results in losses to investors.¹²³ However, in cases of contributory negligence or if the error could have been avoided, the SDC could escape responsibility.¹²⁴ Registration is required for all securities issued or traded in the Kingdom.

Registration of the securities neither implies that the Authority has found the information disclosed to be accurate nor that the information filed with the Authority is complete. The CML, as mentioned earlier, has disclaimed responsibility for inaccurate or incomplete information submitted by issuers. This means that registration is significant for several reasons. First, from a positivist point of view, the significance of the registration is that, since the SDC basically functions as a record keeper, what is registered on its files is conclusive evidence of ownership. Second, unless a company files a registration statement that is then approved by the Authority, it cannot legally make the public offering.

As mentioned, registration of securities neither implies that the Authority has approved the issue nor that it has found the registration disclosures to be accurate. However, registration still means that a person filing false or

119. See *Al Tayyar Cancels IPO in Saudi Arabia* (Feb. 21, 2010), available at http://www.menafn.com/qn_news_story_s.asp?StoryId=1093306927 (commentators suggest that the company was cooking the books to get enlisted in the market).

120. CML, *supra* note 20, art. 26. The rules regulating the operations of the SDC are found in CML Section Four.

121. At the time of writing of this article, May 2010, the SDC had not been functioning.

122. CML, *supra* note 20, art. 25(a).

123. *Id.* art. 27(g).

124. By virtue of CML Article 27(h), the SDC could reduce or even escape responsibility if the claimant has contributed to the misconduct or the error committed by the SDC's employees. *Id.* art. 27(h).

incomplete information with the Authority subjects himself to the antifraud provisions and consequently risks fine or criminal prosecution.

(b) Disclosure Requirements Under the Securities Regulations

Transparency and making information available to investors is said to be fundamental to the wellbeing of any securities system.¹²⁵ The CML desires to achieve these goals. In Part I, it was noted that the disclosure rules require that all *material* information be disclosed to the public prior to offering any securities. This is the same rule that prohibits misstating and omitting information from the prospectus. There is certain information that must be disclosed to the Authority, outlined in Article 42 of the CML. It was also concluded that this rule was primarily enacted for the benefit of a bona fide investor. In all likelihood, this rule would not protect an underwriter who relied on statements provided by an issuer. The reason for this could be that, unlike a bona fide investor, an underwriter has a duty to independently ascertain the truthfulness of the information submitted by the issuer.

There are two basic issues that must be discussed with respect to the law of disclosure. But before discussing these two issues, let us submit that what is required to be disclosed in the prospectus and the application is the minimum amount of information an issuer is required to disclose to the CMA and potential investors. Some of the information is required to be submitted by Article 42, which determines the contents of the prospectus. Other information is required in the application and the six annexes we discussed above. But we know this is not all the information the investor needs to know, in order to make a decision to invest. These are the *de minimus* to comply with law. We also know that the prospectus itself is filled with assumptions and predictions or what scholars call “soft information”. The question that arises is whether soft information is required to be disclosed. It could form material information, and if this is the case, then we must answer first what is considered material, and second, to what extent the issuer needs to disclose.

(c) Disclosure of Soft Information

For the purposes of CML Articles 42 and 55, all material information must be disclosed in the prospectus. A statement or the omission of a statement is considered material “if it is proven . . . that had the investor

125. See, e.g., Amr Daoud Marar, *Saudi Arabia: The Duality of the Legal System and the Challenge of Adopting Law to Market Economies*, 19 ARAB L. Q. 91 (2004).

been aware of the truth when making such purchase it would have affected the purchase price.”¹²⁶ This part of Article 55 of the CML captures the essence of the definition of the term *material* in American jurisprudence. American law defines material as “matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.”¹²⁷ According to this definition, one could say that all the information required to be disclosed in the prospectus, listed in Annex 5 of the Listing Rules, could be considered material. Also, all the information required to be reported in the Formal Letter of Application and the other five annexes are material for the purpose of the CML. Certainly the financial information of the company and items required by Article 11 of the Listing Rules are considered material for the investor. Apparently, the omission or misstating of these could be considered “material” under the CML.

Consequently, not only is the financial information counted as material information, but the American court has gone further than that and construed the term material to include professional and personal integrity of management.¹²⁸ This means it is material to state in the prospectus whether the persons involved in the writing of the prospectus are qualified, honest and have no prior criminal record, etc. The CML has no view on this point, but once again it is only logical to think that the CML, if it is necessary, will follow the American lead. In fact, there is a strong presumption that the CML meant to follow American law because it did require the professionals who are involved in writing the prospectus to submit some of their personal information, qualifications, civil liabilities history and criminal history.¹²⁹

Thus, with respect to soft information, in general the CML provisions do not require the issuer to give opinion or make speculations as to the proposed investment. However, in one instance the Listing Rules requires independent accountants to submit their professional opinion with respect to the information they are submitting in the Accountant’s Report in Annex 6.¹³⁰ Here, the CML is asking a professional to give his professional judgment about matters that are not hard fact. Moreover, the prospectus usually contains soft information such as speculation about

126. CML, *supra* note 20, art. 55(a).

127. THOMAS LEE HAZEN, FEDERAL SECURITIES LAW 35 (2d ed. 2003).

128. *Id.* at 36.

129. The supporting documents required with the Letter of Application contain information relating to the professional’s character and qualification. *See, e.g.*, Listing Rules, *supra* note 78, Annexes 1 & 3.

130. Listing Rules require the accountant to state whether the report gives a true and fair view.

risk factors, or future projects of the company, the company's plan of operations and the competitive conditions in the company's industry, etc.¹³¹

With the exception of the Accountants' opinion in Annex 6, the CML, in general, does not require the issuer to give projections or any form of soft information. However, it is highly desirable that investors get them to study their options and make their choices. At the end, the line between fact and soft information is thin. In addition, here comes the controversy. Under the American law, Rule 175, the issuer is under no duty to provide soft information; but if the issuer chooses to do so, the information is presumed non-fraudulent and the burden is on the challenger to show either that there was no reasonable basis for the statement or that it was not made in good faith.¹³² Moreover, the American law requires that management discusses and analyzes known trends and uncertainties that could have a material impact on the company's operations.¹³³ With respect to disclosing soft information, the American jurisprudence could be summarized as such: you do not have to provide soft information, but if you do, it better be good.

As for the CML, it is not clear how much soft information the issuer needs to disclose. The issuer is not required to reveal more than what is statutorily required. In other words, the issuer would need to write a prospectus containing the information required by Article 42 and the information required in the six annexes we discussed above. This is not an easy task. A typical prospectus consists of more than a hundred pages. An Accountant's Report could also consist of more than a hundred pages. These, coupled with the other requirements the applicant would be handling, amount to a tremendous sum of paperwork. Apparently, completing the paperwork in the way it is described in the Listing Rules should satisfy the minimum required amount of information that must be disclosed to all concerned persons.

Think about a hypothetical case, where the issuer included soft information in the prospectus and investors relied on this information and bought the stock. It turns out that the projections were not as accurate. In addition, it turns out that the issuer's company plan of operations is not

131. See, e.g., Sahara Petrochemicals Rights Issue Prospectus (Feb. 17, 2004), available at <http://www.saharapcc.com/English/MediaRelations/Publications/Documents/SAHARA%20RIGHTS%20ISSUE%20PROSPECTUS.pdf>. (More prospectuses are posted at www.cma.org.) Moreover, the CMA Merger and Acquisition Regulations require listed companies to disclose their intention if they are about to merge with or acquire other companies.

132. HAZEN, *supra* note 127, at 36.

133. *Id.*

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achievable. Moreover, the issuer's company, unlike what they predicted, turns out to be uncompetitive. As a result, a few months after listing the company's stock, stock value plunges and investors lose a tremendous amount of money. If the investor relied on the information provided by the issuer, he can claim his losses ... or he might not recover anything. It depends.

First, to recover in an action, the investor must have relied on the information to make his investment decision both under the American law and potentially under the CML, under one condition: that the injured investor proves that there was no good faith basis for the information.¹³⁴ Meaning when the issuer provided the information he had no reasonable basis to make such statements or predictions. Here, a successful plaintiff would argue that the information is material by virtue of Article 55(a) of the CML because he considered or gave them weight in making his investment decision. Moreover, although reliance is relevant by the wording of Article 55(a), the investor does not have to prove it. Accordingly, regardless of whether the information is soft or hard, or whether the investor relied on it or not, the fact that it is material entitles him to recover his losses. This is all that is required to be proved under CML Article 55—materiality. In fact, an injured investor does not have to prove the issuer had *mens rea*, he just has to show that the issuer omitted or misstated material information.

There is another scenario under which an investor might not recover for losses sustained as a result of soft information. It depends on the language the issuer used in the prospectus. If the issuer provided soft information and he warned his investors about the associated risk with clear language, he likely won't be liable under the CML. Claims of fraud will not arise under the circumstances and, as such, no action can be brought against the issuer. But here is one trick: it is arguable that the business of the issuer is highly risky. This is evidenced by the fact that all the issuers' predictions have failed. Highly risky businesses are prohibited *ab initio* in the Saudi Kingdom and apparently they will not be allowed in the *Tadawul* because they are not in conformity with the statutory conditions in the Kingdom.¹³⁵ Assuming that the risky business was approved by the CMA and the case turned out to be as described—failed predictions—the injured investor's remedy will be rescission of the contract *status quo ante*; parties will be brought as far as possible

134. *Id.*

135. Listing Rules, *supra* note 78, art. 12(a)(1) (putting this as a prerequisite to allowing an offering of securities in the Kingdom). Statutory conditions require that the dealing be in conformity with *Shari'a* law, which prohibits high risk and excessive uncertainties.

back to the position in which they were before they entered into the contract.

There are several defenses available to Article 55's defendant. First, a substantive defense available is that the issuer or the person making the statement reasonably believed, at the time of making the statement, that he had reasonable grounds to make such a statement. The standard to determine the reasonableness of the actor's actions here is measured by that of a prudent man in the management of his own property.¹³⁶ Affirmative defenses are also available for the issuer in case of an action based on violation of the disclosure rule. The first available affirmative defense is that the plaintiff knew of the untruthfulness or the omitted information. The second is that the information was not material. Damages recoverable under Article 55 claims are calculated to cover:

the difference between the price actually paid for purchasing the Security (not to exceed the price at which it was offered to the public), (a), and the value thereof as of the date of bringing the legal action or the price which such security could have been disposed of on the Exchange prior to filing the complaint with the Committee,(s) provided that if the defendant proves that any portion in the decline in value of the Security is due to causes which are not related to the omission or the incorrect statement which is the substance of the suit, such portion shall be excluded from the damages for which the defendant is responsible.¹³⁷

In mathematical terms, $a \pm s = \$$, where $\$$ = the amount of compensation, (a) = purchase price, and (s) = sale price.

IV. CML REGULATION OF THE *TADAWUL* MARKET, ISSUERS, AND SECURITIES PROFESSIONALS

The Capital Market Law and the other ten regulations present a comprehensive legal framework for the regulation of the securities market in the Kingdom. The three principal targets of the CML are issuers, exchange or *Tadawul* market, and market professionals. In addition to market and financial regulation, CML regulations impose disclosure and other obligations on issuers of securities. The CML also regulates issuers and distribution of securities. It requires purchasers to register the stock transactions with the SDC. This registration requirement is apart from Article 42's prospectus disclosure, required

136. CML, *supra* note 20, art. 55(d).

137. *Cf.*, *Id.* art. 55(e).

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prior to an IPO. This actually applies to all publicly traded securities in the Kingdom.

The CML also regulates proxy solicitations and insider transactions involving companies that are registered or listed with the exchange. Listing under the CML, as mentioned, triggers periodic reporting requirements. Listed companies are required to submit quarterly and annual reports. These reports mostly contain financial information about the company, managerial changes, if any, and material developments in the company's investment plans.¹³⁸ Moreover, reporting is imposed on any investor who owns 5% or more of any class of voting shares or convertible debt instrument or if the total interest owned by the person would increase or decrease the issuer's shares or debt instrument by 1%.¹³⁹ Similarly, a director or senior executive of the issuer who becomes the owner of any percentage of the shares or debt must report that to the CMA. In all cases, reporting to the CMA must occur at the end of the trading day or the day after.¹⁴⁰

A. ANTIFRAUD STATUTE—ARTICLES 49 AND 50

1. Manipulation—Article 49

Article 49(a) of the CML is a catchall provision outlawing all actions that could possibly affect or manipulate the market or the price of securities. It states that

[a]ny person shall be considered in violation of this Law if he intentionally does any act or engages in any action which creates a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression or thereby inducing third parties to buy, sell or subscribe for such Security or to refrain from doing so or to induce them to exercise, or refrain from exercising, any rights conferred by such Security.¹⁴¹

This prohibition against manipulation includes all exchange-based transactions that give the ostensible impression of active trading, as well as transactions entered into for the purpose of depressing or raising the price of the securities. Additionally, Article 49(b) empowers the

138. CML, *supra* note 20, art. 45. Information disclosed pursuant to Article 45 is confidential by virtue of paragraph (c).

139. Listing Rules, *supra* note 78, art. 45(a)(1)-(2).

140. *Id.* art. 45(a).

141. CML, *supra* note 20, art. 49(a).

Authority to promulgate rules, define the circumstance and procedures aimed at stabilizing the prices of securities offered to the public, and define the manner in which and the period during which these actions must be taken.

The CML has pointed to some of the actions that are considered manipulative in Article 49(c)(1). These actions include: (1) entering into transactions not involving a true transfer of ownership;¹⁴² (2) entering into transactions simultaneously with prior knowledge that another party is about to make a transaction that is substantially the same in terms of size and price;¹⁴³ (3) entering a sale order with prior knowledge that an order, substantially the same, has been or will be entered by the same person or different parties;¹⁴⁴ and (4) taking actions, individually or in concert with others to create actual or apparent active trading for the purpose of inducing third parties to buy or sell securities.¹⁴⁵ Moreover, Article 49(c)(2) prohibits pegging, which the act is entered into, individually or in concert with others, the purpose of which is to stabilize the price of a security.¹⁴⁶

It was mentioned above that Article 49(b) empowers the Authority to promulgate rules to define the circumstances that could possibly constitute manipulation. In fact, the CMA has exercised this power. In 2010, in an undated pamphlet, the CMA determined five circumstances the act of which constitutes manipulation:

1. entering orders by investors for the purchase or sale of a security with the prior knowledge that an orders is of substantially the same size, time and price;
2. entering an order or orders in order to establish a predetermined sale price, ask price or bid price;
3. entering an order or orders in order to effect a high or low closing sale price, ask price or bid price;
4. entering an order or orders in order to maintain the sale price, ask price or bid price within a predetermined range; and
5. entering an order or orders for a security that are not intended to be executed.¹⁴⁷

142. *Id.* art. 49(c)(1)(a).

143. *Id.* art. 49(c)(1)(b).

144. *Id.* art. 49(c)(1)(c).

145. *Id.* art. 49(c)(2).

146. *Id.* art. 49(c)(3).

147. In fact, these acts are not new rules or legislation; they are already implied in the prohibition of manipulation in CML Article 49(c).

It is extremely significant to distinguish Article 55 claims from Article 49 claims. In all likelihood, the defendants under Article 55 are only the persons identified by the Article itself, i.e., potentially all the prospectus' writers or signatories. No investor in his capacity as investor can be a defendant under Article 55, while under Article 49 the potential defendant could be an investor, either buyer or seller, or broker-dealer or a substantial shareholder. Moreover, the substantive difference between claims based on Articles 49 and 55 is that under Article 55, the plaintiff does not have to prove that the defendant has knowledge or intention to publish the faulty statement or omit material information. Instead, the standard is strict liability and the defendant has a narrow window of defense. Under Article 49, proving intent or knowledge is central to the plaintiff's case.

In an Article 49 claim, the plaintiff has to prove that the issuer or the person doing the manipulative activities has done so intentionally. The use of the adverb "*intentionally*" in the Article lays a heavier burden of proof on the plaintiff. If the plaintiff cannot prove that the defendant has violated the prohibition of manipulation with *scienter*, or intent, there is no chance that he could win his case. Proving intention under the CML requires the plaintiff to show that there was *scienter*, intention, on the part of any of Article 49's defendants.

2. Insider Trading—Article 50

According to Black's Law Dictionary, the term "insider trading" means the use of "material, nonpublic information in trading the shares of a company by a corporate insider or other person who owes a fiduciary duty to the company."¹⁴⁸ The U.S. Supreme Court has an expanded definition that includes misappropriation, which is the act of deceiving a person and misusing information that belongs to him from one who owes a fiduciary duty to that person.¹⁴⁹ According to American jurisprudence and the misappropriation theory, it is illegal for a lawyer to trade in securities of a company after learning from his client that the client is about to take over the company, even though the lawyer owes no fiduciary duty to the company.¹⁵⁰

It is no news that insider trading enriches some individuals—those who work for the company and their acquaintances and relatives, because their intimate knowledge of the company gives them an opportunity to

148. BLACK'S LAW DICTIONARY 810 (8th ed. 2004).

149. BLACK'S LAW DICTIONARY (9th ed. 2009), available at Westlaw BLACKS.

150. *Id.*

trade on nonpublic information. As Hazen has noted, the practice of insider trading destroys the integrity of the market and leads people to lose faith in the system.¹⁵¹ That is why it is prohibited. CML Article 50 is the relevant provision that deals with insider trading. Article 50(a) of the CML states that:

Any person who obtains, through family, business or contractual relationship, inside information (hereinafter an “insider”) is prohibited from directly or indirectly trading in the Security related to such information, or to disclose such information to another person with the expectation that such person will trade in such Security. Insider information means information obtained by the insider and which is not available to the general public, has not been disclosed, and such information is of the type that a normal person would realize that in view of the nature and content of this information, its release and availability would have a material effect on the price or value of a Security related to such information, and the insider knows that such information is not generally available and that, if it were available, it would have a material effect on the price or value of such Security.

The CML did not divert from the standard definition of insider trading. However, it uses phrases such as “family, business or contractual relation,” which are not necessarily the only ways by which insider trading could take place.¹⁵² In addition, the CML did not mention in the whole Article that the disclosing person-insider has to be a fiduciary person. This means the duty not to inside-trade is not just imposed on family members or persons who have relation to the insider; it is rather imposed on everyone, even upon persons who have no relation to the company. This is achieved by using the phrase “any person” in the opening of the Article. This is the facial reading of Article 50(a). Article 50(b) prohibits the selling or purchasing of securities acquired by insider means to any person if the seller or the purchaser knows that the disclosing party violated the prohibition of insider trading stated in Article 50(a). Article 50(b) reads:

No person may purchase or sell a Security based on information obtained from an insider while *knowing* that such person, by

151. HAZEN, *supra* note 52, at 126. For empirical research on manipulation, see Rajesh K. Aggarwal and Guojun Wu, *Stock Market Manipulation — Theory and Evidence* (Mar. 11, 2003), available at http://www.afajof.org/pdfs/2004program/UPDF/P306_Asset_Pricing.pdf.

152. However, these relations are meaningful in the Saudi community. In all likelihood, if insider trading were to take place, it would be through these relations.

disclosing such insider information related to the Security, has violated paragraph (a) of this Article.¹⁵³

First, this is an ongoing prohibition, meaning this prohibition applies against the original discloser as well as against persons who later in a chain of transactions buy and sell the security in question. Second, while 50(b) apparently confirms what is stated in 50(a), it uses the gerundive “knowing” for the person who is receiving or obtaining the information. The use of the gerundive means the seller/buyer of the security must have a positive knowledge that the information he is using is leaked by an insider. Third, Article 50(b) prohibits the use of inside information, but it does not sanction the person who obtained the information but did not use it. This is because, as Hazen has noted, insider trading, as a violation, is premised on common law fraud and the existence of some duty to speak honestly. Silence alone is not actionable; there must be a duty to speak.¹⁵⁴ He further notes that under American law, possession of inside information without more does not create the duty to speak or abstain from trading.¹⁵⁵ It is also worth mentioning that common sense says that there is no prohibition of insider trading if the security, the subject matter of the inside trade, is not a tradable security. Article 4(a)(1) of the Market Conduct Regulations codified this principle.¹⁵⁶ With this reading of Article 50(b), if the recipient of the information has no knowledge that the information was leaked by an insider, he is not liable if he trades based on the information. Remember that a violation of Article 55, non-disclosure, entails only monetary damages. As mentioned above, damages are calculated according to the equation: $a \pm s = \$$.

However, sanctions for violating both Article 49 and 50 are monetary damages and criminal penalties against the violator that could result in up to five years imprisonment.¹⁵⁷ Also, if the violator is a security professional-dealer or broker, his license could be revoked or suspended. Moreover, Article 59 of the CML gives the CMA the power to prosecute actions against a violator, or a potential violator of any of the CML provisions. The penalty for charges brought under Article 59 ranges from enjoining the violator by issuing an order to cease and desist from

153. CML, *supra* note 20, art. 50(b) (emphasis added).

154. HAZEN, *supra* note 52, at 128.

155. *Id.*

156. Market Conduct Regulations, art. 4(a)(1) (Saudi Arabia), available at <http://www.cma.org.sa/En/Documents/Market%20Conduct%20Regulation-26-8-009.pdf> [hereinafter Market Conduct Reg.]. The article further elaborates on the term “insider trading” and gives examples of acts that are considered insider-trading.

157. CML, *supra* note 20, art. 57(c). Several executives have been prosecuted for violating the insider trading law. In all cases the violators were fined, and in two cases jail penalty was attached to the sentencing.

carrying out the act which is the subject of the suit, to a travel ban, or even seizing the property of the violator. According to Article 59(b), the CRSD may also impose a fine not less than SR 10,000 and not exceeding SR 100,000 multiplied by the number of violations committed by the defendant.¹⁵⁸ Indeed, in all violations, whether under Article 49, 50, 55, 56, or 57, the CRSD may order the violator to disgorge any profit made illegally.

Several defenses, not including affirmative ones, are available for manipulators and insiders. According to CML Article 58, these two crimes are not subject to the statute of limitations. Note that this CML statute of limitations is applicable to suits brought under Article 55, 56, and 57. Strictly speaking, this means the provision of Article 58 does not cover manipulation and insider trading; thus, the affirmative defense that the statute of limitations has expired is not available for those two crimes. Therefore, substantive defenses must be considered. The central substantive defense should be focused on negating intent or knowledge because both crimes require either knowledge or intent. A successful defendant would argue that he did not have the intention to violate the antifraud provisions, but this likely won't take him far because the law authorized the CRSD or the CMA to order disgorgement of the profit made from the illegal transaction.

However, for a convicted insider there is still a chance to avoid jail time by requesting to plead Article 64 of the CML. According to Article 64, insiders may bail themselves out to avoid imprisonment if they reach agreement with the CMA to pay treble the profits they have made or treble the losses they have averted by committing the violation.¹⁵⁹ The payment of the treble damages to the CMA does not relieve the defendant from the responsibility to pay compensation to injured investors who were harmed by the insider's violations.¹⁶⁰ It is not clear whether the bargain to plea provided for in Article 64 is available to manipulators. However, the CML does not provide that manipulators may bargain to avoid imprisonment. Reason says that as long as this bargain is available to insiders, it should be available to manipulators as well.

158. While the CML does not expressly provide for punitive damages, the fines imposed by Chapter 10, seemingly, were enacted to play the role of punitive damages. This is so because these fines are huge; they range from 10,000 to 100,000 and they are multiplied by the number of violations. Moreover, if there is more than one violator in the same company, he is severally liable.

159. CML, *supra* note 20, art. 64.

160. *Id.*

B. REGULATION OF SECURITIES PROFESSIONALS

Securities professionals, primarily, means brokers/dealers—also called underwriters—custodians of securities, managers of portfolios, arrangers/financial advisors and investment advisors.¹⁶¹ In order to conduct business in one of these professions, a company or its agent must hold a license from the CMA. The license to practice these professions is available for registered, authorized and exempted persons. According to the Securities Business Regulations, exempted persons are certain government agencies. To be a broker, an entity must be a joint stock company that carries on brokerage activities.¹⁶² The actual individuals who perform the broker's job are the agents of the joint stock company that is licensed to perform brokerage activities. The unauthorized practice of the brokerage profession is sanctioned with a fine between SR 10,000 and 100,000 and/or an imprisonment for a term not exceeding nine months.¹⁶³

Article 34 of the CML requires all brokers and their agents in the *Tadawul* market to observe the Exchange's rules pertaining to the regulation of brokers' businesses. Article 35 empowers the Exchange to investigate any broker or his agent to verify whether that broker or his agent violated, is violating or is about to violate the law. Moreover, underwriters are subject to the rules of disclosure (Articles 40-48) and the antifraud provisions (Articles 49 and 50) discussed above.¹⁶⁴ Accordingly, the CMA may prosecute brokers, and the CRSD may impose disciplinary sanctions on brokers, monetary fines or even suspension of the license for 12 months or permanent revocation.¹⁶⁵ Article 61 of the CML empowers the CRSD to impose similar sanctions for the same types of conduct on all securities professionals, including brokers and their agents. Not only registered brokers are subject to the provisions of Article 61, but also in all likelihood, by virtue of Article 6 of the Authorized Persons Regulations, potential brokers are subject to

161. A dealer is one holding himself out as one engaged in selling and buying securities at a regular place of business; Cf. LOSS & SELIGMAN, *supra* note 52, at 815. In April 2010 the CMA, in an undated circular, issued a new definition for finance professional: "any natural person who fulfills at least two of the following criteria: (1) he has carried out transactions of a significant size on securities markets at an average frequency of at least 10 per quarter over the previous four quarters, (2) the size of his securities portfolio exceeds [Saudi Riyals 5 million]; (3) he works or has worked for at least [one] year in the financial sector in a professional position in relation to a securities investment."

162. CML, *supra* note 20, art. 32(a).

163. *Id.* art. 60(a).

164. *Id.* art. 62.

165. *Id.* art. 59 & 61.

the provision of Article 61 of the CML from the day they submit their applications to the CMA.¹⁶⁶

In addition to imposing sanctions arising out of the CML rules, the law delegated to the Exchange the power to supervise a broker firm's structure and take measures to ensure its solvency. This is, partially, achieved by Article 33, which requires brokers and their agents to meet three operational and financial competency standards. The first standard relates to the broker's professional competency. This means the broker must be a qualified person to conduct brokering business. The requirement is open-ended because there are further other rules that set the minimum requirements to act as an agent or a broker. The second requirement relates to personal integrity, the person's moral character, honesty etc. The third requirement regards financial competency, meaning that a broker must always meet a financial threshold. Until 2010, the required minimum amount that a broker must always keep in his account is 50 million Riyals.

Sophisticated rules regulating brokers' businesses and other authorized persons' duties are laid out in the Authorized Persons Regulations. For example, Article 5 of the Authorized Persons Regulations, which represents a code of professional conduct, makes acting professionally a fundamental obligation for all authorized persons. The Article directs the authorized persons to act with integrity, to exercise due care and due diligence, to act with efficiency and prudence, and to be informative and responsive to their clients.¹⁶⁷ Article 5 of the Authorized Persons Regulations also requires the authorized persons to avoid conflict of interest, or in case there is a conflict, to fairly manage it.¹⁶⁸ Conflict of interest includes conflict among brokers' own clients and conflict between the broker and the client. Additionally, the Authorized Persons Regulations impose various fiduciary and professional duties on securities professionals. The Regulations require authorized persons to form a professional client's relationship in which the authorized person is the fiduciary and thus he must act as one; he must segregate clients' money and act with confidentiality. Article 29 of the Authorized Persons Regulations requires the advisors to hold clients' information in strict confidentiality. Disclosure of clients' information is only allowed in four

166. Authorized Persons Regulations, art. 6(a) (Saudi Arabia), *available at* <http://www.cma.org.sa/En/Documents/AUTHORISED%20PERSON.pdf> [hereinafter Authorized Persons Reg.] ("For the purposes of these Regulations, an applicant for authorization means the person that is applying for authorization to carry on securities business. An applicant for authorization becomes subject to these Regulations from the date of submission of his application").

167. *Id.* art. 5.

168. *Id.*

specific situations determined by the Regulations: (1) if disclosure is required by law; (2) if the client has consented to the disclosure; (3) if disclosure is reasonably necessary to perform a particular service for the client; or (4) where the information is no longer confidential.¹⁶⁹ Advisors are also prohibited from inducing clients or allowing themselves to be induced.¹⁷⁰ Furthermore, Article 30 of the Authorized Persons Regulations requires advisors and managers to establish and maintain internal policies and procedures that keep information confidential and prevent disclosure.¹⁷¹

In the context of mergers and acquisitions, if there is an impending offer for takeover, Article 6 of the Merger and Acquisition Regulations imposes a confidentiality duty on all persons in privy of the sensitive information concerning the offer. One significant customer relation but also a fiduciary duty imposed on brokers is the duty to “know the customer”. This duty requires that a broker knows the client’s objectives and is certain that the client understands the risks of investment.¹⁷² Obviously, this duty, in some circumstances, imposes on the broker or advisor a duty to warn the client that interest is not warranted and that investor might even lose substantial part of his capital or all of it.

1. Selection of Brokers

With the exception of the disclosure and antifraud provisions and a few ethical rules scattered in the Implementing Regulations, the CML does not interfere in the relation of an investor and his broker or advisor. The entire regime of the CML contains no provisions relating to the selection of brokers or advisors. However, it is useful to explore, briefly, how this process plays out in practice.

Prior to investing in any security, a potential investor usually goes to a financial planner or financial advisor to recommend some securities.¹⁷³ If

169. *Id.* art. 29.

170. *Id.* art. 27 (disallowing the taking from or giving of gifts to clients). Authorized persons are also required to observe the Anti Money Laundering Statute and other CMA professional responsibility rules.

171. This is known as a “Chinese wall arrangement”. Chinese wall arrangements may restrict the sharing of documents and information between the operations or may require the destruction of documents.

172. As Hazen explains, this duty “includes, in a discretionary account, that the broker understands the clients’ objectives, e.g., financial security as opposed to speculation.” HAZEN, *supra* note 127, at 137.

173. “Planner” is not synonymous with “advisor”; as the U.S. S.E.C explains, most financial planners are investment advisors, but not all investment advisors are financial planners. Some financial planners assess every aspect of a client’s financial life—including savings, investments, insurance, taxes, retirement, and estate planning—and help to develop a detailed strategy or financial plan for meeting financial goals. While others call themselves financial planners, they may only be

the investor decides to invest, an “advisory contract” between the two parties is initiated. As Clifford Kirsch explains, the advisory contract typically specifies whether the advisor or the client will be responsible for selecting the broker. Where the client retains that responsibility—according to Clifford Kirsch, a situation often referred to as “directed brokerage”—and trades, it must naturally be executed by the broker selected by the client.¹⁷⁴ Kirsch goes on to note that in those cases, the contract generally specifies the broker selected by the client (e.g., “the client has directed the advisor to direct all brokerage transactions to Broker ABC”).¹⁷⁵ An advisor is required to disclose any potentially adverse consequences that may arise with respect to directed brokerage.¹⁷⁶ Such consequences would occur, for example, if the advisor would be in a better position to negotiate brokerage commissions on behalf of the client if the client had not chosen the broker.¹⁷⁷

If the advisor assumes responsibility for selecting a broker, the advisory contract typically does not specify the particular broker that will be used.¹⁷⁸ The advisor makes selections throughout the course of the client's investment period. In this case, the advisor has the discretion to choose different brokers for different transactions.

V. LIABILITIES AND REMEDIES

Under the CML, violations of the disclosure rules (Articles 40-48) and the antifraud provisions (Article 49-50) may entail administrative action by the CMA, civil liability, and criminal sanction.

A. CMA ADMINISTRATIVE REMEDIES

Article 42 represents the minimum items required in a complete prospectus. Any prospectus that falls short of complying with Article 42 is deficient and the CMA may reject any deficient prospectus. Moreover, if the prospectus is misleading or incorrect, or if the applicant did not pay the fees, the CMA may reject the prospectus as well. When taking such an action, the CMA acts as an administrative court and, in accordance

able to recommend investments in a narrow range of products, and sometimes products that aren't securities. See U.S. Securities and Exchange Commission, Investment Advisers: What You Need To Know Before Choosing One (Aug. 20, 2010), available at <http://www.sec.gov/investor/pubs/invadvisers.htm>.

174. CLIFFORD E. KIRSCH, INVESTMENT ADVISER REGULATION: A STEP-BY-STEP GUIDE TO COMPLIANCE AND THE LAW (2005).

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

with the CML, due process should be observed. If the CMA is faced with an incomplete prospectus, it may request the applicant to submit extra information or documents.¹⁷⁹ Under such circumstances, the CMA is not bound by the statutory 45-day review period. The CMA may take as long as necessary to review the prospectus. Alternatively, when faced with a materially deficient prospectus, the CMA may flatly reject it. Prior to the Board's rejection of the prospectus, an applicant may be given a chance to be heard. The CMA decisions relating to rejection of a prospectus can be appealed to the CRSD.¹⁸⁰ For listed securities, in addition to proceedings conducted by the CMA under the Listing Rules, Article 59 of the CML gives the CMA the power to issue cease and desist orders and other injunctive relief or suspend the trading of the security in question.

Besides the administrative powers granted to the CMA in Articles 42 and 59, Article 62 of the CML empowers the CMA to make administrative decisions that affect registered and potential brokers and their agents. These decisions may include reprimanding the violator or temporarily suspending his license or even revoking it. Article 62(a) calls upon the CMA to observe due process when taking administrative measures against brokers and dealers, except in urgent cases where the Board may suspend the broker's license without due process for sixty days.¹⁸¹

B. CIVIL REMEDIES OR PRIVATE ACTIONS

The CML contains two Articles, 55 and 56, prohibiting misstatements and omissions, and two Articles, 49 and 50, prohibiting fraud. All four articles create a private right of action, and proceedings brought under these articles are initiated at the CMA by either private parties or the CMA itself. When the action is lodged by a private party, the plaintiff is allowed to bring his meritorious claim in front of the CRSD within ninety days of submitting his claim.

For actions brought under Article 55 for material deficiencies in the prospectus, the plaintiff has to claim that the defendant violated any article between 40 and 48, which call for an accurate and complete prospectus. Article 55, on the other hand, imposes express liability on issuers, preparers and signatories of materially misleading prospectuses. According to Article 55(a), if the prospectus omitted or misstated information and the CMA has approved it, and based on the information

179. Listing Rules, *supra* note 78, art. 22(d).

180. *Id.* art. 1(c).

181. CML, *supra* note 20, art. 62(c).

an investor bought the stock and sustained damages, he can always invoke Article 55(a) and claim his damages from the parties who wrote or signed the prospectus. No responsibility lies with the CMA, despite the fact that it approved the offering of the stock without ascertaining the correctness of the information.¹⁸²

The test for invoking Article 55(a) is the materiality of the information; the injured party can claim his damages if the misstated or the omitted information that caused his losses was “*material*” and, had the buyer been aware of the mistake or the omitted information, he would have offered a lower price than what he paid.¹⁸³ Indeed, the information would also have been considered material had the buyer been aware of it; it would have prevented him from buying the stock.

The key phrase in Article 55 is the term “material.” It is not clear what constitutes a material statement or material omission. Article 55 suggests that this is a question of fact, and if proven that the issuer misstated or otherwise omitted material statements, then the buyer is entitled to damages because he was unaware, misled or somehow deceived into buying the stock. The logic here resembles the logic prohibiting *ghubn* transactions, dealings prohibited in *Shari‘a* law.

Contrarily, between issuers and underwriters, things are different. If the underwriter omitted material statements or supplied faulty information to the issuer, or the other way around, and in turn these omissions injured an investor, the American law has a different standard. In one American case between an underwriter and an issuer, the underwriter argued that he relied on the information provided by the issuer appearing in the registration statement and was therefore justified in relying on the issuer's statement.¹⁸⁴ The underwriter argued that he even went further

182. The CMA does not endorse statements by offerors or investors. In more than one provision, the CMA disclaims responsibility for approving false or misleading information. The main disclaimer for what is provided in the prospectus is found in CML Article 48(b).

183. CML, *supra* note 20, art. 55(a) (“In case a prospectus, when approved by the Authority, contained incorrect statements of material matters or omitted material facts required to be stated in the prospectus, the person purchasing the Security that was the subject of such prospectus shall be entitled to compensation for the damages incurred by him as a result thereof. A statement or omission shall be considered material for the purposes of this paragraph if it is proven to the Committee that had the investor been aware of the truth when making such purchase it would have affected the purchase price”).

184. *Escott v. BarChris Const. Corp.*, 283 F. Supp. 643, 685 (S.D.N.Y. 1968). This case was extensively analyzed by scholars; *see, e.g.*, Ernest L. Folk, III, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case Part 1—Section 11 of Securities Act of 1933*, 55 VA. L. REV. 1 (1969). *See also* Ernest L. Folk, III, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case Part 2—The Broader Implications*, 55 VA. L. REV. 199 (1969); Jennifer O’Hare, *Institutional Investors, Registration Rights, And The Specter of Liability Under Section 11 of The Securities Act of 1933*, 1996 WIS. L. REV. 217 (1996).

and verbally asked the issuer and the issuer answered him.¹⁸⁵ The underwriter claimed that based on the verbal affirmation he got from the issuer he acted. The court rejected this argument. The court said that the underwriter must make reasonable attempts to verify, “*independently*”, the information contained in the registration statement.¹⁸⁶ Consequently, the takeaway from this case is that the rule requiring the disclosure of all material information would not protect an underwriter; it is enacted to protect bona fide investors.

Furthermore, compared to the antifraud provisions, Article 55 imposes broader liability on all persons who signed or prepared the prospectus, because the complainant/buyer need only show that he bought the security and there was a material misrepresentation in the prospectus. There is no requirement under Article 55 that the buyer shows that he relied on the information. It is noted that Article 55 corresponds to Section 11 of the U.S. 1933 Securities Act. As Hazen has noted, with respect to the American law under Section 11, there are two standards of liability imposed. The first is on the issuer, who generally is strictly liable once the claimant has proved that he bought the stock and that there was a material misstatement in the prospectus. The second standard of liability under Article 55(b) applies to non-issuers, brokers/underwriters, boards of directors, advisors, accountants, etc. Similarly, with CML Article 55(b), there are two standards of liabilities. First, under 55(b)(1), an issuer is liable irrespective of whether it had acted reasonably, or whether it was aware of the incorrect statements in connection with material matters, or of the omission of material facts that should have been disclosed in the prospectus.¹⁸⁷ Article 55(b)(1) seems iron clad, structured to make the issuer strictly liable. The issuer cannot relieve himself except by using affirmative defenses. There are three of these defenses available to the issuer:

- (1) buyer knew of the untruthfulness or omission in the prospectus at the time of purchase;
- (2) immateriality of the information; or
- (3) *Taqadum*, expiration of the limitations period.

The second standard of liability under Article 55(b) applies to non-issuers, those persons identified in Subparagraphs (2)-(5) of Article 55(b). These persons may raise defenses not available to issuers; two

185. Jennifer O'Hare, *Institutional Investors, Registration Rights, And The Specter of Liability Under Section 11 of The Securities Act of 1933*, 1996 WIS. L. REV. 217 (1996).

186. *Id.* at 218.

187. CML, *supra* note 20, art. 55(b)(1).

additional possible affirmative defenses are provided for in Article 55(c)(1)(2). The first defense relates to someone who, after reasonable investigation and on the basis of reasonable grounds, is convinced that part of the prospectus was not in violation of the disclosure rules.¹⁸⁸ The second affirmative defense available to non-issuers relates to someone who had no reasonable ground at that time to believe that the part of the prospectus in question contained what could be deemed a violation of the disclosure rules.¹⁸⁹ “Reasonable ground” is understood according to Article 55(d), which establishes the appropriate standard of reasonable care: the standard required of a prudent man in the management of his own property.¹⁹⁰ Note that this does not mean the three affirmative defenses available to an issuer are not available to non-issuers.

There could be the third affirmative defense available to principals and investors, but also this provision might apply to issuers as well. According to Article 20 of the Market Conduct Regulations, in the event that an investor or any person acting as his agent, broker, or dealer violates the antifraud and the disclosure provisions, that person—not the actor—is liable unless (1) he takes reasonable steps to prevent the violation and (2) he did not authorize the acts in question.¹⁹¹

In suits for damages brought under Article 55(a), compensation depends on whether the security is sold prior to the date of the judgment. The significant dates are the dates of sale (if the security has been sold prior to the lawsuit), the date the lawsuit is filed, and the date of the judgment.¹⁹² If the security is sold before the filing of the suit, damages are calculated to cover the purchase price minus the price for which it is sold. If the security is sold between the date the suit is filed and the date of judgment, the plaintiff is entitled to either (1) the amount paid minus the price for which the security sold, or (2) the amount paid minus the value of the security at the time the suit was filed, whichever is less. If the security is held until the date of the judgment, the plaintiff is entitled

188. *Id.* art. 55(c)(1)

189. *Id.* art. 55(c)(2)

190. *Id.* art. 55(d) (“In determining that investigation shall be deemed reasonable or what shall constitute reasonable ground for belief for the purposes of paragraph (c) of this Article, the standard of reasonableness for the purpose of this Article shall be that of the prudent man in the management of his property”). Hazen calls this the “due diligence duty”. HAZEN, *supra* note 127.

191. Market Conduct Reg., *supra* note 156, art. 20. While the Market Conduct Regulations seem to be a code of professional conduct, mostly, they are as binding as the CML because most of their provisions are explanation, reinstatement, and elaboration of the CML provisions.

192. *Cf.*, HAZEN, *supra* note 127, at 63.

to the amount paid less the value of the security at the time the suit was filed.¹⁹³

It is notable that CML Article 55 and other statutes impose due diligence on non-issuers, but they are not actually pointing to any factors to be considered in determining whether or not the conduct of a person constitutes a reasonable investigation or a reasonable ground for belief meeting the standard set forth in Article 55(d) of the CML, which requires the actor to act with due diligence. The American jurisprudence has dealt with this aspect. It points to several factors that must be considered in determining the due diligence required. Some of these factors are to be found in the SEC Rule 176, which include:

- (1) the type of issuer;
- (2) the type of security;
- (3) the type of person;
- (4) the office held when the person is an officer;
- (5) the presence or absence of another relationship to the issuer when the person is a director or proposed director;
- (6) reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the issuer and the filing);
- (7) when the person is an underwriter, the type of underwriting arrangement, the role of the particular person as an underwriter, and the availability of information with respect to the registrant; and
- (8) whether, with respect to a fact or document incorporated by reference, the particular person had any responsibility for the fact or document at the time of the filing from which it was incorporated.¹⁹⁴

Nevertheless, as Hazen points out, these are not the only determinative factors; other factors may also be considered,¹⁹⁵ such as special expertise the person in question might have. This means SEC Rule 176 is not conclusive; it is only a guideline to make the call. Hazen further notes that courts emphasize that this matter is to be resolved on a case-by-case basis.¹⁹⁶

193. *Id.* at 64.

194. *Id.*

195. *Id.*

196. *Id.*

C. LIABILITY UNDER ARTICLES 55 & 56

Article 55 applies in cases where securities are sold by means of prospectus. This means the statement that was omitted or untruthfully stated is in writing, i.e., statute of frauds. In such a case, liability is joint and several on all the signatories of the prospectus. Moreover, the Article seems to suggest that there must be privity of contract between the injured person and the defendant. The plaintiff in such a suit is likely an investor or advisor who has sustained losses because of omissions or the untruthfulness of a statement in the prospectus. The defendant in this suit is “all” or any of the persons identified in Article 55(b). However, underwriters of the public offering are not liable under Article 55(b) beyond the proportionate amount of securities they have underwritten or the amount of securities they have distributed, whichever amount is greater.¹⁹⁷

Article 56 applies when securities are sold and the omitted or false statement is made orally or in writing. The Article is broader than Article 55 because it covers oral communications and it does not require privity of contract between the defendant and the plaintiff, but the plaintiff must prove that: (1) he was not aware that the statement was omitted or untrue;¹⁹⁸ (2) either he would not have purchased or sold the security in question had he known that information was omitted or untrue, or he would not have purchased or sold such security at the price at which such security was purchased or sold;¹⁹⁹ and (3) defendant had knowledge of the fallacy of the information or was aware that more likely than not the information disclosed, omitted, or misstated a material fact.²⁰⁰ Damages under Article 56 are the same damages awarded according to the prescription of Article 55(e) discussed above.

D. CRIMINAL LIABILITY UNDER ARTICLES 49 & 50

Articles 49 and 50, known as the antifraud provisions, impose criminal sanctions on any person who fraudulently violates the CML. Article 49 outlaws manipulative acts. Manipulative acts are identified by the Article as acts that are intentionally done to create a false or misleading impression as to the market, the prices, or the value of any security for the purpose of creating that impression or thereby inducing third parties to sell, buy or refrain from exercising any rights conferred by the security in question. From Article 49, it seems that the CML meant to categorize

197. CML, *supra* note 20, art. 55(b)(4). Damages under Article 55 were covered in Part III.

198. *Id.* art. 56(a)(1).

199. *Id.* art. 56(a)(2).

200. *Id.* art. 56(a)(3).

all manipulative acts in three broad groups: (1) acts designed to create false or misleading impressions of existing active trading; (2) acts designed to create actual or apparent active trading to induce third parties to buy or sell or to refrain from doing so; and (3) interfering with the market by pegging or making an order to sell securities with prior knowledge that a substantially similar order has been made, in terms of size, price and time. The prohibition of these three main categories is mainly against trade-based manipulations, meaning these prohibitions are mostly valid for listed securities while they are actively traded. In all likelihood, any act, even if not mentioned in the Article, constitutes manipulation if it falls under any of these categories. Several activities, the commissions of which constitute manipulation, are outlined in the Article.²⁰¹ Further, the Article sanctions manipulative activities whether they are done by a single actor or done in collaboration with others.

Unlike Article 50, the CML did not provide that the jail penalty imposed by Article 49 can be avoided by paying treble the profit made or treble the losses averted. In practice, the Authority has not shown that it is keen on criminal prosecution under Article 49. Few cases were filed against violators. As of April 2010, only one or two persons were imprisoned and no one had ever been sentenced to the five years' imprisonment penalty provided for in Article 57(c).

On account of Article 50, insider-trading works against the seller and the buyer on the condition that the person using the inside information knew that the information he used to trade had been obtained through an insider.²⁰² The prohibition of insider trading is not just confined to the immediate seller and the immediate buyer; it applies to successors if they know that the information has been obtained through inside means. Moreover, Article 50 prohibits the disclosure of the inside information to another person if the person disclosing the information expects that the person might trade on securities based on the information he obtains. This means that for a person to avoid violating the inside trading rule, the insider has to know the people around him, for whom they work for, and to whom they might reveal the inside information.

A question arises as to how the recipient of the inside information would know that the information is illegally obtained. The test for knowing what constitutes inside information is provided in Article 50(a); it is the reasonable man standard. A reasonable man, given the nature and the content of the information, would realize that this information is not

201. *Id.* art. 49(c). These acts were discussed in Part III.

202. *Id.* art. 50.

available to the public and if it were available, it would have a material effect on the price or value of the securities.

From the standard set by the Article, it seems that the law anticipated the user of the inside information to be quite knowledgeable about the rule against insider trading. But in reality, what will happen in a chain of transactions originated by acquiring inside information? For example, in a typical case of insider trading A, an insider, disclosed information to B, an investor. B may not use the information to trade or else he would be violating Article 50. If B discloses the information to C, assuming that C knew that B received the information illegally from A, C cannot use this information. This means there does not have to be a relation between the original discloser/insider and the person using the information. As long as C knew that the information was originally obtained by an insider, he cannot use it. Likewise D, E, etc., down the chain of users are prohibited from dealing based on this information.

Victims of violations of Article 50 may sue at the CRSD through the CMA. Damages awarded are similar to those of Article 49 damages. In addition to heavy monetary fines, which resemble punitive damages, jail time may also be added to the sanctions of Article 49 violators.²⁰³ However, by reaching a settlement with the CMA for the payment of treble the benefit realized or the losses averted, violators may avoid jail time.²⁰⁴

VI. CONCLUSION

The Capital Market Law and its implementing statutes are a very sophisticated body of rules. They are much needed in the Kingdom's rapidly growing economy. The Saudis wealth is estimated to be well over 55 Billion Riyals in 2009, which is about 15 trillion US dollars. With the ability to regulate this wealth, the Saudi capital market was ranked just behind Germany and ahead of Taiwan in 2009. These are extraordinary achievements given the fact that this law kicked-in only in 2003 and still some of the CMA offices are not fully functional. That being said, with the exception of the rules that prohibit certain non-Islamic dealing, one must note that the CML, almost in its entirety, transplanted from the American system. The provisions are identical; the language is the same

203. In August of 2009, it was reported that for the first time, the CRSD imprisoned an investor for violating the rule against insider trading; *see Saudi Bishah Chairman Sentenced to Three Months Jail For Insider Trading*, SECURITIES DOCKET, Aug. 18, 2009, available at <http://www.securitiesdocket.com/2009/08/18/saudi-bishah-chairman-sentenced-to-three-months-jail-for-insider-trading>.

204. CML, *supra* note 20, art. 64.

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and the bureaucratic structure is the same. And while the American system has evolved in the last nine decades, the CML leaves behind a wealth of jurisprudence and scholarship that guides judges and decision makers in regulation of the market, and it is still evolving.

More importantly, the American system itself is still developing because of the *stare decisis* system. On the other hand, in the Saudi system, the prospect for natural development is bleak despite its novelty. The Saudis have no written jurisprudence in this area. Moreover, even in other commercial and business law areas, there is no meaningful jurisprudence. Judges have to rely on antiquated *fiqh* books.²⁰⁵ It would have been a good opportunity to make the CML dispute subject to the jurisdiction of ordinary civil courts in the Kingdom. This way, hopefully after a few years, the law would develop and grow. Now that disputes concerning the CML are only adjudicated at the CMA, one tends to think that the CML makers deprived it from naturally developing. Therefore, the only path left for the CML to develop is through the CMA decisions which were rendered by bureaucrats and appointed officials, some of whom have no knowledge on the science of law. Even the CMA path seems bleak because the CMA decisions are not reasoned, not grounded in jurisprudence or logic. They were rendered in a sentence or two and not published as precedent and—if they are even published—they have no precedential value according to the Saudi legal system.

205. Books that contain ancient Islamic jurisprudence.